



*Home Information Packs  
Housing Market Analysis*

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## **ADDENDUM**

Subsequent to the finalisation of the analysis in the main body of this report on 31 July 2007, in November 2007 we were asked by Communities and Local Government to prepare an addendum to reflect upon the changes in the UK housing market and the effect these have upon our conclusions. This addendum was prepared jointly with Dr Peter Williams. It is presented at Appendix 3. As will be seen there, our central conclusions remain unchanged by recent events.

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## Executive summary

### Home Information Packs

- 1 Europe Economics (hereafter in this document “we” or “us”) has been commissioned by Communities and Local Government to carry out a study investigating the impact of Home Information Packs (HIPs) on the housing market in England and Wales, in particular what the impacts on house listings might be.
- 2 HIPs will be compulsory for houses with four or more bedrooms from 1 August 2007, with the requirement being extended to other properties in due course. The timing of this phasing-in of HIPs will depend, at least in part, upon the availability of Home Inspectors and Domestic Energy Assessors required to conduct energy efficiency audits. Communities and Local Government believes that about 3,000 Home Inspectors and Domestic Energy Assessors will be required to cover the whole market.<sup>1</sup> Any property on the market before 1 August 2007 will not need to produce a HIP.
- 3 HIPs will make available to prospective purchasers of a house various legal documents (such as title information), searches and an Energy Performance Certificate. The aim of HIPs are to improve the house buying and selling process and encourage greater energy efficiency to promote a reduction in carbon emissions from homes.
- 4 There have been a number of reports and media commentaries claiming that the introduction of HIPs will have an adverse impact on the housing market. Taking as given the analysis of the Impact Assessment (IA) as to the general merits of the scheme, our aim in this report is to quantify the impact on the market, focusing on the period of transition.

### The current situation

- 5 In order to provide a baseline from which to analyse the impacts of HIPs, we have conducted a review of the current situation in the housing market in England and Wales. The main findings from this review are:
  - (a) **Transactions:** since the early 1990s there is a well-established trend for transactions to be increasing.
  - (b) **Listings:** unsurprisingly house listings display a degree of seasonality. The number of new listings coming onto the market falls during the winter months, with a corresponding increase in time on market. However, there is some ambiguity in the data of total listings due to issues of multiple listings.
  - (c) **Time on market:** there was a noticeable rise in the average length of time on market during the period 2002–2004. However, subsequently, average lengths in time on market have remained constant in recent years.

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<sup>1</sup> HIPs Implementation Update, 11 June 2007.

- (d) Housing supply:** around 10 per cent of active housing supply is new housing. After a slump in new house construction after 1990, the annualised rate of new house construction has recovered to levels similar to those at the start of the 1990s.
- (e) Housing demand:** while supply in the housing market has been increasing, it remains below demand. The latest official projections for new households in England and Wales point to annual growth of 235,000 between 2004 and 2026.
- (f) House prices:** the raw data points to a familiar story of an increase in prices throughout the 1980s culminating in a relatively brief spike and correction, followed by a sustained period of near stagnation and strong growth in recent years.
- (g) Affordability:** this can be measured along a number of dimensions. Comparing house price movements versus earnings, one notes that house prices relative to earnings have increased by about 80 per cent since 1999. Relative to rents, since Q2 2000, house prices have risen by 40 per cent.

The time series comparing asking prices versus actual sales prices appears to show increased divergence over the past eighteen months. If it is accepted that there is some stickiness in vendor expectations, this result would appear consistent with either a slight softening of the housing market over this time frame or increased over-optimism among vendors.

We also note that there are other measures of affordability, such as the Daily Telegraph/Lombard Street Research Housing Affordability Index, which has recently dropped to its lowest register since Q3 1991.

## Modelling the impacts of HIPs

- 6 Building on an estimate of housing listings in the absence of HIPs and a combination of fundamental and pragmatic analysis, we have developed a number of scenarios to examine the impact of HIPs. Our main variable of interest is the number of new listings on a month by month basis. We model how this is driven by vendor behaviour. The results of this model are then used to assess the impact on transactions and any wider macroeconomic impacts.
- 7 We have modelled three scenarios for a phased introduction of HIPs:
- In the first scenario (which we term Scenario I), HIPs are introduced for houses with four and more bedrooms on 1 August 2007, for three bedroom houses on 1 September 2007 and extended to all houses on 1 October 2007.
  - In the second scenario (Scenario II), HIPs are introduced for houses with four and more bedrooms on 1 August 2007 and then extended across the whole market from 1 September. This scenario can be characterised as one in which the number of assessors available becomes sufficient to cover the whole market most rapidly, ie the most optimistic scenario that we have considered.

- Finally, we look at a case where HIPs are introduced for houses with four and more bedrooms on 1 August 2007, for three bedroom houses on 1 October 2007 and extended to all houses on 1 December 2007 (Scenario III). It follows that this is a more pessimistic take on the availability of assessors.

- 8 We note that there has been some debate about possible difficulties in implementing an effective definition of what constitutes a bedroom. However, this should be mitigated by the price differential between properties with different number of bedrooms (in particular between four and three bedroom properties) and the provisions of the Property Misdescriptions Act and so we have not incorporated such gaming into our model.
- 9 Our modelled scenarios are based on research that suggests that the majority of vendors choose to sell their house for personal or work related reasons. That is to say, for these vendors, the decision to market and sell their property is unlikely to be sensitive to policy changes, such as the introduction of HIPs. The category in which one would expect there to be change is the ‘speculative or tentative’ sellers – those sellers that have not made a firm decision to sell and may in principle be swayed to move their decision to sell or not sell at all.<sup>2</sup> Though research shows that the number of those not fully committed to moving could represent as much as 35 per cent of the total market, we argue that only a portion of these are likely to have their behaviour affected by HIPs.
- 10 We have considered two main potential impacts that could occur to house listings with the introduction of HIPs: a portion of vendors choose to shift the date of listing their house for sale forward and a portion of vendors, specifically those speculative or tentative sellers, will defer their decision to sell due to the introduction of HIPs. Where vendors bring the decision to list forward, we believe that such acceleration of listing would be limited to a matter of weeks because of rising house prices. There appears to have been an uplift in the May new property listings, which is likely to have been at least partially motivated by the imminent arrival of HIPs on 1 June (the original date at which HIPs would become compulsory for the whole market).<sup>3</sup>
- 11 Our baseline case incorporates both of these effects. It assumes that a significant proportion of speculative or tentative sellers change their behaviour, with the introduction of HIPs leading to a change in behaviour equivalent to 20 per cent of all vendors, whereby they choose to delay the listing of their property until after they have had an offer accepted for the property into which they wish to move.<sup>4</sup> These properties are not ‘lost’ however, and come back onto the market in the following months.
- 12 The baseline also acknowledges that some listings may be moved forward. A statistical (but not a fundamental behavioural) allowance is made for some vendors, at the margin, bringing their decision to list forward by a few weeks, perhaps

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2 This categorisation is based on that used in research by Countrywide Estate Agents.

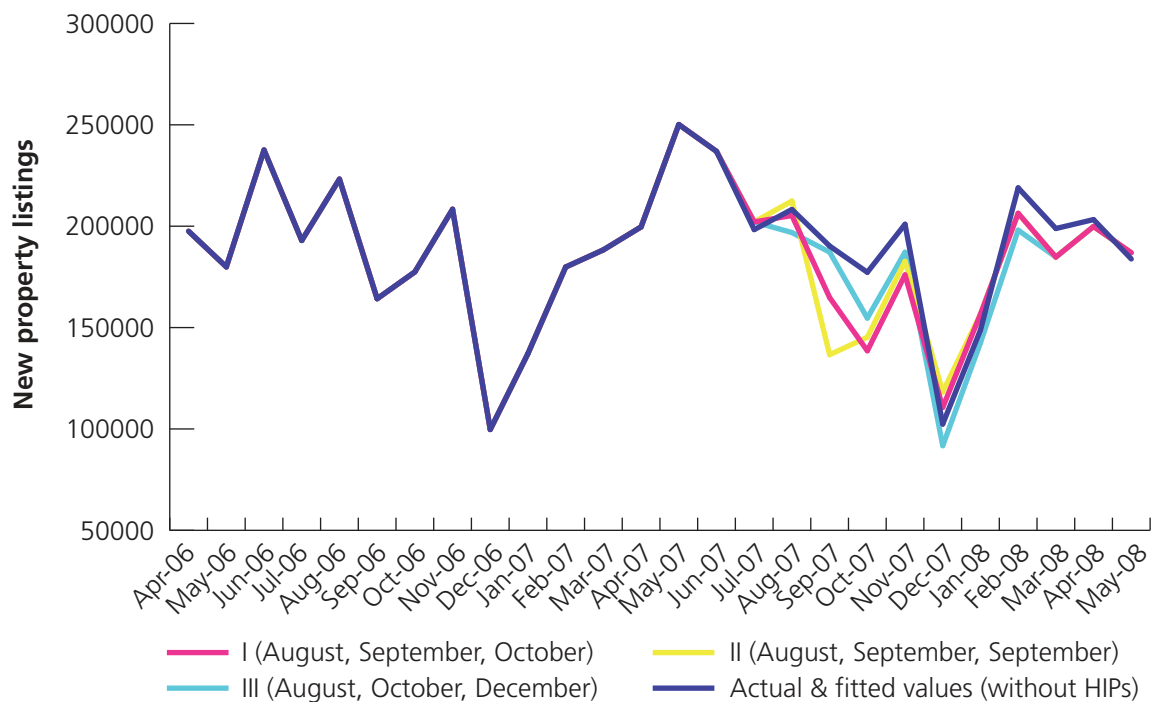
3 We also note that it was reported in The Daily Telegraph on 2 May 2007 (*Housing supply overtakes demand*), that a survey by Hometrack showed that new listing in April 2007 grew by 5.7 per cent compared to March 2007 – the prime reason offered being HIPs. Since demand also rose 4.4 per cent, it appears that the portion of this 5.7 per cent that can truly be attributed to HIPs must be very small, and that normal seasonal fluctuations and wider demand factors are more plausible explanations at this stage for this movement.

4 This figure represents a little less than two thirds of all speculative and tentative sellers.

because they have been persuaded by the collective efforts of estate agents. In our expected case model, this is taken at 10 per cent of vendors.

- 13 Our combined baseline assumes that the introduction of HIPs does not cause any change in transaction times. We believe that there will be a transitional phase in which the credibility issues and consumer confusion around the introduction of HIPs will counterbalance any efficiency improvements. This is not to deny future reductions in transaction times caused by HIPs, but rather to assume that this benefit is unlikely to be felt immediately.

Figure 1: Overall scenarios for number of new listings per month (10 per cent brought forward, 20 per cent delayed and time on market unchanged)



- 14 In this, our baseline case, the variance from the counterfactual caused by the implementation of HIPs is in line with the normal fluctuations exhibited by the new property listings, and which have historically been absorbed by the housing market.
- 15 However, the magnitude and timing of these variations from the baseline do vary according to the exact timing of the implementation of HIPs across the property market, as one would expect. In particular, we note that the impact of a significant proportion of sellers deferring their decision to list means that there is a drop in listings volume compared to baseline ahead of the normal winter decline. This is most marked in Scenario II, which accelerates the application of HIPs to the whole market.
- 16 On the basis of the above model, Scenario III appears to create smaller perturbations, at least through to the end of 2007, due to the slower phase-in that underlies that option. On the other hand, Scenario III, unlike the other two scenarios, deepens the winter drop off in listings for the same reason.

- 17 By April 2008, our model suggests there will be a convergence between the scenarios and that would have been expected without the introduction of HIPs. This indicates that whilst HIPs may have a short term impact on the number of properties listed (the magnitude of which could be regarded as not unusual in the context of normal listing fluctuations), the long term consequences of that transitional impact would appear to be small.

## Conclusion

- 18 In this report we consider the potential impact of HIPs, particularly on the numbers of properties listed and on time on market, investigating the plausibility of suggestions that the introduction of HIPs may lead to significant disruption.
- 19 Our models suggest that there may be an effect of HIPs on the behaviour of vendors whereby those not fully committed to selling wait until they have had an offer accepted on the house they wish to move into before placing their own property on the market or bring forward the listing of their property (by a few weeks but not more) in order to avoid the cost and inconvenience of HIPs.
- 20 Under our expected scenarios for the impacts of HIPs (with at 20 per cent delay in marketing, 10 per cent forwarding of marketing, and no change in time on market), the predicted behavioural changes will not be so dramatic as to be outside the normal market variation, except in one or two isolated months, found within the number of new listings and which is already well tolerated by the housing market.
- 21 Our overall conclusion is that, although prices may rise (or fall) during the next twelve months, as in other markets this will be overwhelmingly driven by the fundamental drivers of supply and demand, including the changing interest rate environment. Fears that HIPs will be the main or key determinant are, in our view, unfounded.

### **ADDENDUM**

Subsequent to the finalisation of the analysis in the main body of this report on 31 July 2007, in November 2007 we were asked by Communities and Local Government to prepare an addendum to reflect upon the changes in the UK housing market and the effect these have upon our conclusions. This addendum was prepared jointly with Dr Peter Williams. It is presented at Appendix 3. As will be seen there, our central conclusions remain unchanged by recent events.

# 1 Introduction

## Scope of report

- 1.1 The Government is introducing Home Information Packs (HIPs) in England and Wales from 1 August 2007. The aim is to address concerns about the house buying and selling process, particularly the time it takes and the cost and the uncertainties involved. HIPs are also part of wider Government reforms to reduce carbon emissions from homes via the inclusion of Energy Performance Certificates (EPCs).
- 1.2 However, the introduction of HIPs is not without controversy. In addition to criticisms of the whole basis of the scheme (which do not fall within the scope of this study), a number of press commentaries have alleged that the requirement for sellers to provide HIPs to prospective buyers, allied with other developing features in the housing market, will lead to significant upheavals.<sup>5</sup>
- 1.3 In this report we analyse the current state of the housing market, aiming to quantify the short-term transitional and longer-term impacts of HIPs.
- 1.4 Specifically, there are three areas on which we shall focus our analysis:
  - (a) a high-level overview of the current state of the housing market (house prices, level of overall activity, demand, and supply), including commentary on recent market developments;
  - (b) an assessment of likely trends in the number of houses offered for sale over the next 12 months, drawing out the impact of HIPs on this; and
  - (c) an assessment of the medium-term economic impact of any short-term deviation from trend housing market behaviour beginning around 1 August 2007 arising from the introduction of HIPs.

## Home Information Packs

- 1.5 Home Information Packs (HIPs) are being introduced in England and Wales on 1 August 2007, a requirement under the Housing Act of 2004. As noted in the Regulatory Impact Assessment for HIPs, these packs are regarded as having two key roles:
  - (a) improving the home buying and selling process for consumers; namely in the areas of time taken, cost and uncertainty;<sup>6</sup> and
  - (b) encouraging greater energy efficiency to reduce the 27 per cent of carbon emissions that originate from homes.

<sup>5</sup> Perhaps the most important of these was the Council of Mortgage Lender's *How disruptive will HIPS be?* February 2006. But even in the period of writing this report, picking at random from the many press articles, we might consider the Daily Mail 2 April 2007 *Property may slump next year*, or the Evening Standard 3 April 2007 *Double whammy could send house prices plunging*.

<sup>6</sup> The Council of Mortgage Lenders (CML) quotes the Government commissioned research which showed that around 28 per cent of house sales fall during the period between acceptances of the offer and exchange of contracts. Only 2 per cent of sales transactions involve gazumping. (CML – *Background note on the development of home information packs*)

- 1.6 HIPs only apply in England and Wales. Scotland is introducing parallel reforms, and Northern Ireland may also do so in the future.
- 1.7 The packs will be compiled by, or on behalf, of the property seller and will contain various legal documents (such as title information, sale statement, and leasehold documents, where appropriate), searches and the Energy Performance Certificate (EPC). In addition, sellers may voluntarily offer a Home Condition Report (HCR) in the pack.<sup>7</sup> This information will seek to address the instances of market failure identified: information asymmetry, principal-agent issues, externalities (chain failure), and coordination failures.
- 1.8 The energy efficiency aim will be tackled through the inclusion of EPCs in the HIPs. The introduction of EPCs in HIPs is part of wider strategy to reduce building emissions alongside the strengthening of Part L of the Building Regulations and the introduction of the Code for Sustainable Homes.
- 1.9 The direct benefits identified in the Impact Assessment (IA) published by Communities and Local Government as arising from HIPs are as follows:
  - (a) reduced rate and cost of transaction failure;
  - (b) reduced transaction times;
  - (c) reduced cost of property searches; and
  - (d) reduced wasted costs from speculative sellers.
- 1.10 HIPs are not expected to work in isolation. They will form part of a wider strategy to improve the house buying and selling process, alongside other initiatives such as e-conveyancing.
- 1.11 In the HIPs Impact Assessment (IA), it is calculated that the net financial benefit of introducing HIPs (without a compulsory HCR) would be £70 per successful transaction (with expected benefits of £408 per successfully concluded transaction, against costs of £338).<sup>8</sup> In addition to the financial benefit, non-monetary benefits of HIPs include a saving in time and a reduction in stress associated with the house transaction process.
- 1.12 Despite the conclusions of the IA, and previously of the Regulatory Impact Assessment, about the net financial benefits arising from the introduction of HIPs, there have been a number of reports and media commentaries claiming that the introduction of HIPs will have an adverse impact on the housing market. In this report, our aim is to quantify the impact on the market, focusing mainly on the period of transition, taking as given the analysis of the IA as to the general merits of the scheme.
- 1.13 HIPs were originally intended to be introduced upon 1 June and to apply to the whole housing market from that date. However, the Royal Institute of Chartered Surveyors (RICS) lodged an application for a judicial review of Energy Performance

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<sup>7</sup> In the RIA the compulsory inclusion of the HCR is estimated to add one per cent to existing costs of successful transactions and is, therefore, rejected.

<sup>8</sup> See: [www.homeinformationpack.gov.uk/pdf/HIPImpactAssessment.pdf](http://www.homeinformationpack.gov.uk/pdf/HIPImpactAssessment.pdf)

Certificates (EPCs) being included within HIPs which led to a judge issuing an order on 16 May preventing EPCs being included from 1 June. In addition, the number of fully accredited energy assessors was below that which the Government believed necessary to support a 1 June implementation date. These factors led Ruth Kelly, Communities Secretary, to announce on 22 May a deferral of the introduction of HIPs to 1 August. The HIPs would include EPCs at this date, but would initially apply only to houses with four or more bedrooms in order to ease the burden upon the energy assessors available at that date. HIPs would then be phased in to cover the rest of the market. A number of transitional arrangements were also announced at this date in order to ease acceptance of HIPs.

## **This report**

1.14 Later sections of this report are structured as follows:

- (a) Section 2 presents an analysis of the current state of the housing market.
- (b) Section 3 reviews previous research on HIPs, and in particular considers to what extent valid analogies can be drawn between the plausible impacts of HIPs and the impacts of previous initiatives which directly impacted on the housing market.
- (c) Section 4 presents our counterfactual, considering how the number of properties offered for sale and the time on market might have evolved if HIPs were not being introduced. This is not in itself a forecast, but is rather a reference point from which we can present our own forecast of the impact of HIPs.
- (d) Section 5 moves on to present our view of the likely scenarios for the impact of HIPs on the numbers of properties offered and on the time on market.
- (e) Section 6 presents our overall conclusions.

## 2 Current state of the housing market

### Introduction

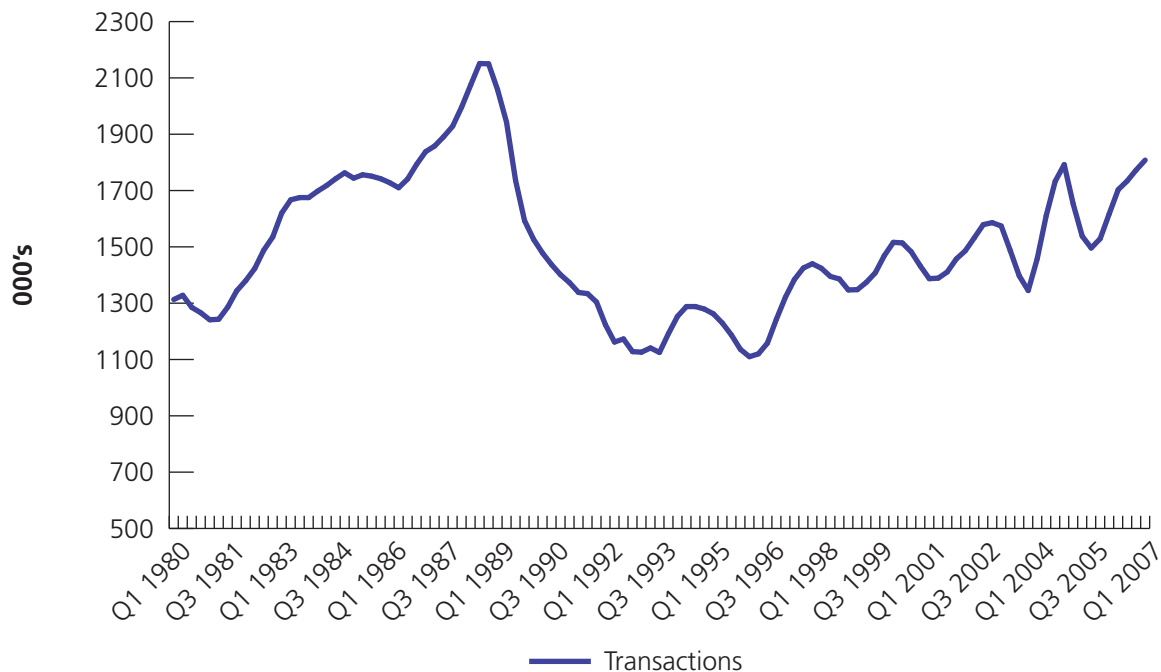
- 2.1 In this section we review the current state of the housing market as at June 2007, focusing on trends in the volume of transactions, listings and time on market, but also considering briefly certain factors related to (and potentially affecting) these, including new housebuilding, and demand factors such as need, pricing and affordability. Where possible the analysis focuses upon England and Wales rather than the United Kingdom.
- 2.2 We emphasize that the analysis in this section is not intended to be a comprehensive overview of all aspects of the current state of the housing market. In particular, we do not offer any detailed analysis or conclusions in certain current areas of ongoing interest, such as whether house prices are more likely to rise or fall over the next couple of years, independent of the introduction of HIPs – in this area we merely summarise a number of recent predictions of interest without necessarily endorsing any one in particular. Our purpose is to provide sufficient context and insight to inform our later analysis of the introduction of HIPs, rather than to make predictions about volumes or prices *per se*.

### Transactions, listings and time on market

#### Transactions

- 2.3 The number of transactions in the market rose to a peak in the late 1980s prior to the fall in house prices in 1990 and the associated drop in the volume of residential property transactions. There is a well-established, ongoing trend towards increased volumes from the early 1990s until the present.

Figure 2.1: Rolling annual number of housing market transactions in England and Wales, 1980-2007



Source: Land Registry/Communities and Local Government

- 2.4 Loan approvals do not exactly track transaction numbers, but the most recent Council of Mortgage Lenders (CML) data shows that year-on-year mortgage approvals for house purchases (ie excluding re-mortgages) were still above prior year levels. However, in December through to February, this increase was much reduced from the previous three months and reversed in March. The Royal Institute of Chartered Surveyors reports that new buyer enquiries stabilised in May 2007, after declining for five consecutive months.<sup>9</sup>

## Listings

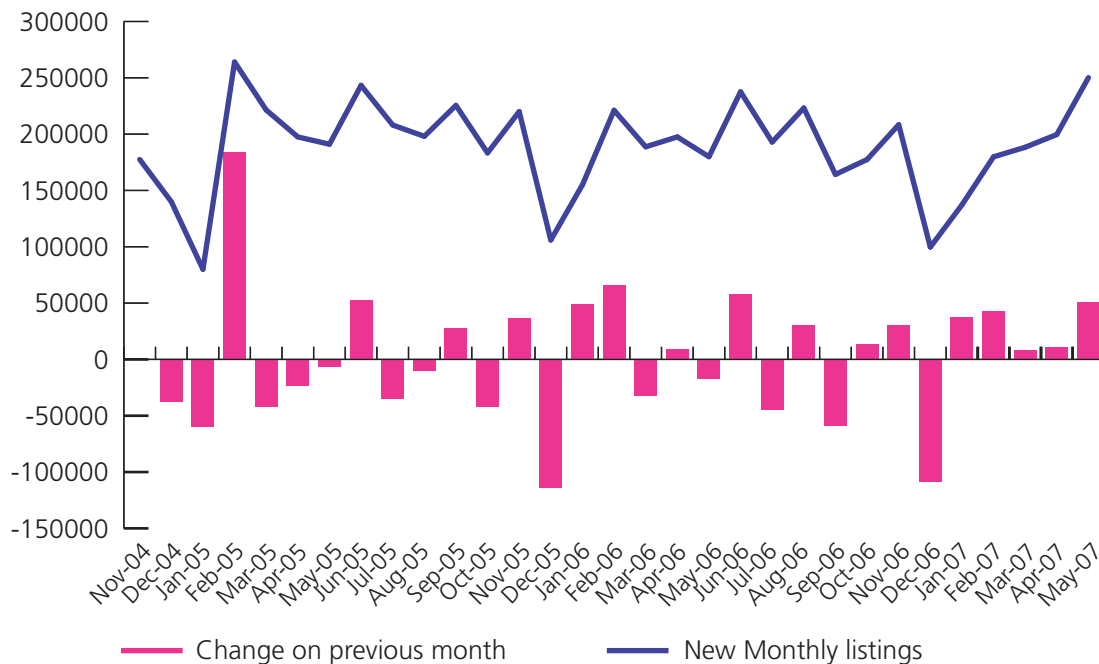
- 2.5 As at March 2007 (the latest available information at the time of writing), Rightmove, (which acts as a consolidator of internet listings for estate agents, letting agents and property developers) states that its database contains 635,000 properties for sale, which it believes constitutes over 80 per cent of all homes for sale via estate agents.<sup>10</sup>
- 2.6 Each month Rightmove produces a House Price Index report, which includes estimates for the numbers of new listings in Rightmove's database and for their market share. Combining these gives Rightmove's implicit estimates of the total number of new listings.<sup>11</sup>

<sup>9</sup> RICS UK Housing Market Survey, published 14 June 2007.

<sup>10</sup> House Price Index report for March 2007: [www.rightmove.co.uk/pdf/p/hpi/HousePriceIndex19thMarch2007.pdf](http://www.rightmove.co.uk/pdf/p/hpi/HousePriceIndex19thMarch2007.pdf)

<sup>11</sup> eg for May 2007, Rightmove quotes 200,115 for the number of new listings used in the calculation of its asking price index, and a market share of 80 per cent, implying that it estimates the total number of new listings at 250,140.

Figure 2.2: Rightmove implicit estimates of numbers of new listings



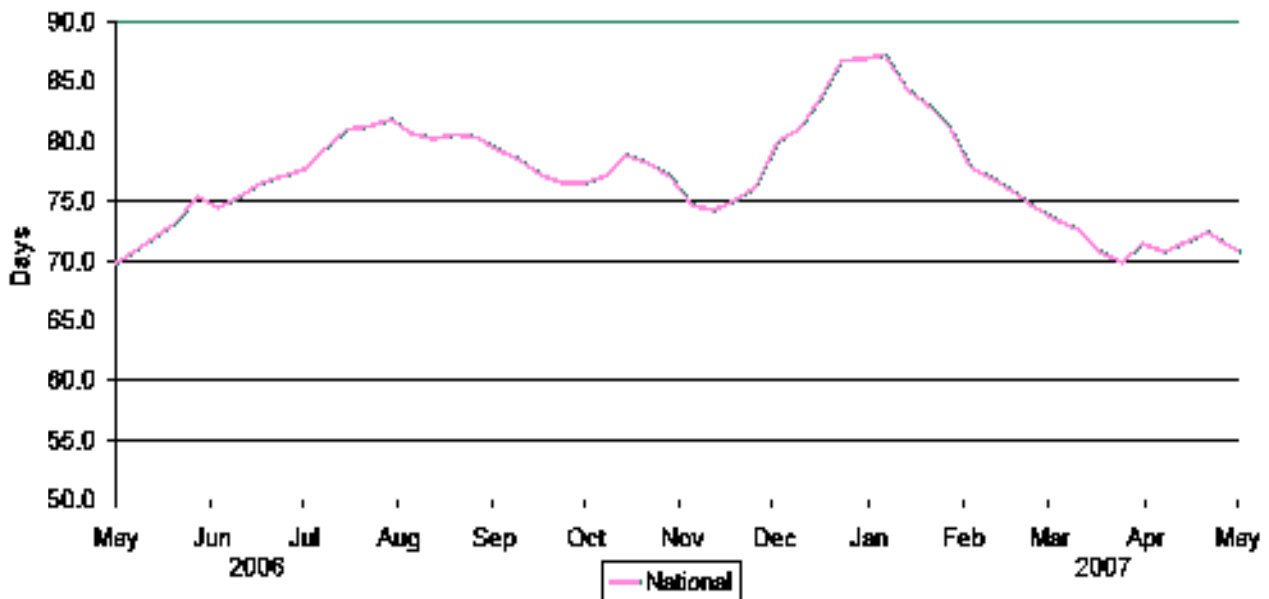
Source: Rightmove monthly House Price Index reports

### Time on market

2.7 Rightmove also publishes ‘time on market’ statistics, which typically show some seasonality with houses typically on the market longer over the winter and correspondingly low new listings in the winter. For instance, the time on market as at May 2007 was just above 70 days (similar to the level in May 2006) – see Figure 2.3. This is below the recent winter peak of slightly in excess of 85 days in January 2007. The Communities and Local Government Baseline shows a mean 108 days for marketing to offer, with a median of 55 days.<sup>12</sup>

12 This is based on work by the Building Research Establishment and Ipsos MORI.

Figure 2.3: Time on market



Source: Rightmove May 2007 House Price Index, [www.rightmove.co.uk/pdf/p/hpi/HousePriceIndex21stMay2007.pdf](http://www.rightmove.co.uk/pdf/p/hpi/HousePriceIndex21stMay2007.pdf)

2.8 Inspection of past Rightmove house price reports indicates that there was a noticeable rise in the average length in time on market during the period 2002-2004. However, subsequently, average lengths in time on market have stabilised.

## Related factors

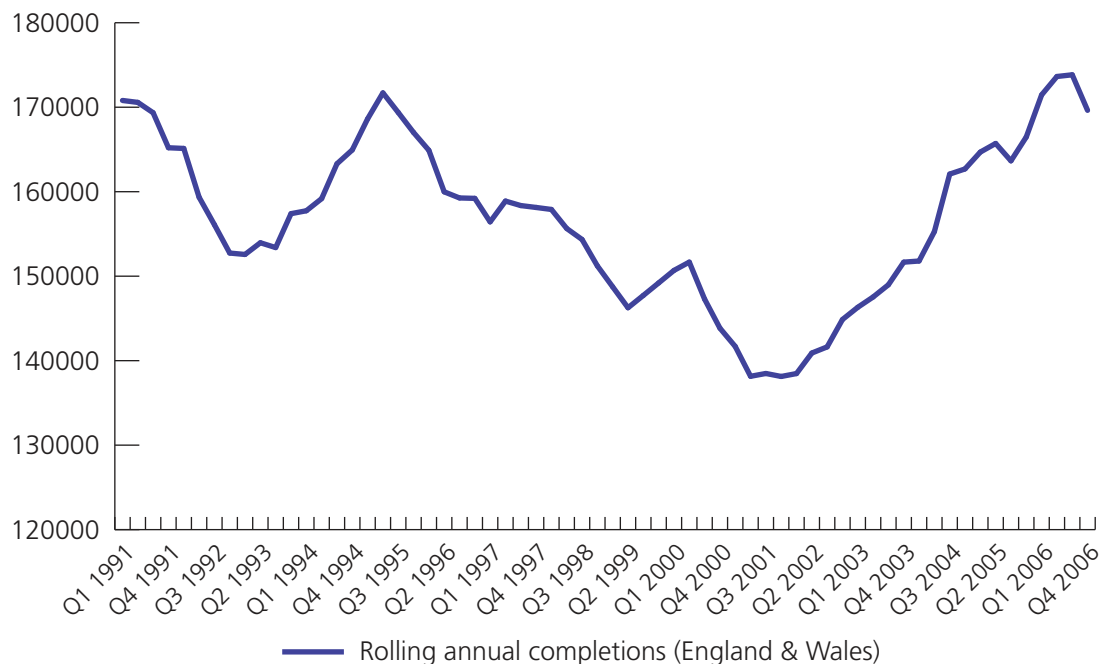
### Supply of new housing

2.9 Around 10 per cent of housing supply on the market at any one time is new housing (or about one per cent of the total stock).<sup>13</sup> The number of new homes built had a marked downward trend after the crash in house prices in 1990, which continued until about 2001. Since that date, completions have recovered to the 1990 level, with an annualised rate of about 170,000 in England and Wales at Q4 2006.<sup>14</sup> This represents the highest annual level since the start of the 1990s.

<sup>13</sup> Using rolling annual data for Q4 2006, in England and Wales.

<sup>14</sup> The last available information for Wales is from Q3 2006. Therefore (and considering that its share of the total is just six per cent), those figures were kept constant for the last quarter.

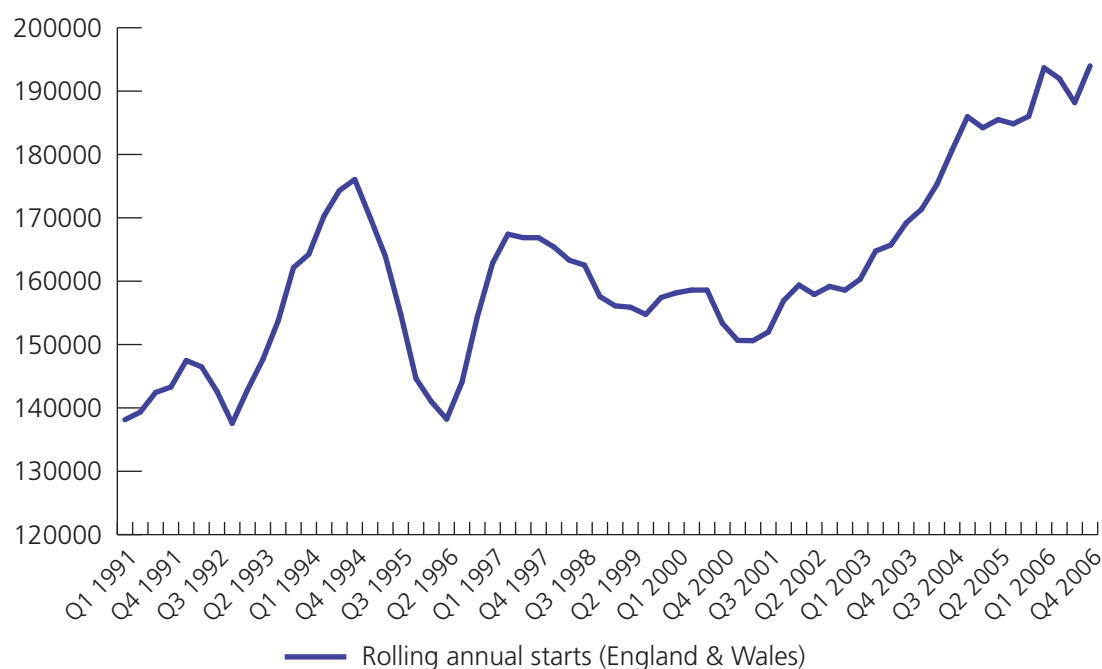
Figure 2.4: Rolling completions of new housing in England and Wales (on an annual basis), 1990-2006



Data: NHBC, Communities and Local Government

2.10 The data on starts, shown below, present a broadly similar picture, subject to the inherent lag involved in the construction process. Whilst not all starts will actually be completed, and so form part of the housing market, this series implies that the rate of housing completions in England and Wales is likely to be running at, or even a little above, current levels over 2007 and early 2008. Despite dropping in the end of 2006, the level of starts remained at a high compared to any time post-1980s. However, it is noted that the data on starts and completions (sourced from local authorities) may have some shortcomings, eg under-reporting of completions.

Figure 2.5: Rolling of new housing starts in England and Wales (on an annual basis), 1990-2006



Data: NHBC, *Communities and Local Government*

2.11 The overall stock of properties within England and Wales has grown from 18.9 million homes in 1980 to 23.1 million in 2005 (*Communities and Local Government*) an increase of about 22 per cent.

### Additional demand for housing

2.12 Although new housing supply has risen to the highest level since 1990, the 175,000 new houses built should be understood in the context of more rapid growth than this in household formation. The latest official projections for new households in England and Wales are for growth of 235,000 per year between 2004 and 2026.

2.13 Since the above is driven principally by household fission, there may be some tendency over time for the conversion of existing housing stock into smaller units (eg by making one two-storey house into two one-floor apartments), but it still seems plausible to suppose that the difference between the number of new homes and the number of new households will, over time, lead to some fall in the surplus of dwellings over households, reversing the trend in the 1990s.<sup>15</sup>

2.14 Although, given that new housing supply represents such a small proportion of the total stock, any recent reduction in the surplus of dwellings over households is

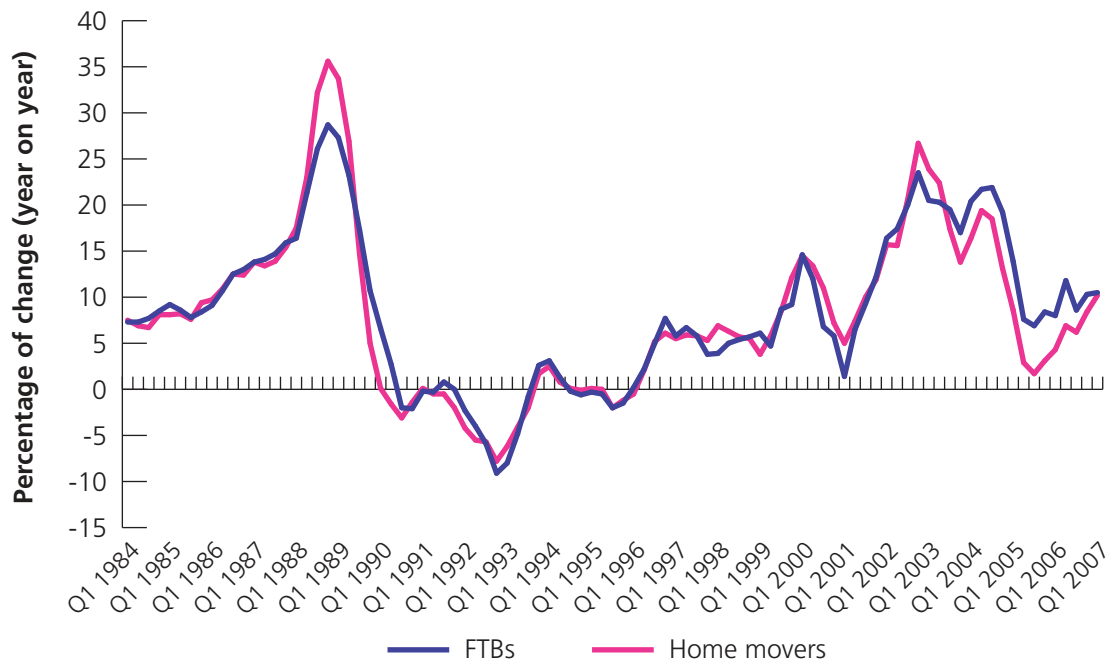
15 In the 2001 Census, across England and Wales, there were 3.8 per cent (about 800,000) more dwellings than households, with this surplus having increased from 2.6 per cent at the time of the 1991 Census. The measured surplus also increased in every individual region of England and Wales except for London, where it was unchanged. (See *Barker Review Interim Report*, Table 3.3.) It should perhaps be noted that there were significant methodological differences between the 1991 and 2001 census surveys, with the consequence that the 1991 census may have underestimated the population at that time – thus the increase in surplus during the 1990s may be larger than that indicated here. There are also well-known debates concerning to what extent the Census figures and later estimates based upon them properly capture the number of households – eg see [www.lse.ac.uk/collections/BSPS/pdfs/Holman\\_jan07.pdf](http://www.lse.ac.uk/collections/BSPS/pdfs/Holman_jan07.pdf).

most unlikely to have been a factor in house price rises since the late 1990s<sup>16</sup>, over a longer timescale (say, out to the forecast period, 2026), a fall in the surplus of dwellings over households might be expected to raise the trend rate of house price growth.<sup>17</sup>

## House prices

2.15 The raw data on house price inflation paint a now familiar story of a rise during the 1980s culminating in a relatively brief spike and correction, followed by a sustained period of near stagnation followed by strong price growth in the past several years. This is illustrated below where year-on-year price inflation is tracked.

Figure 2.6: Year on year nominal house price inflation, 1984-2007



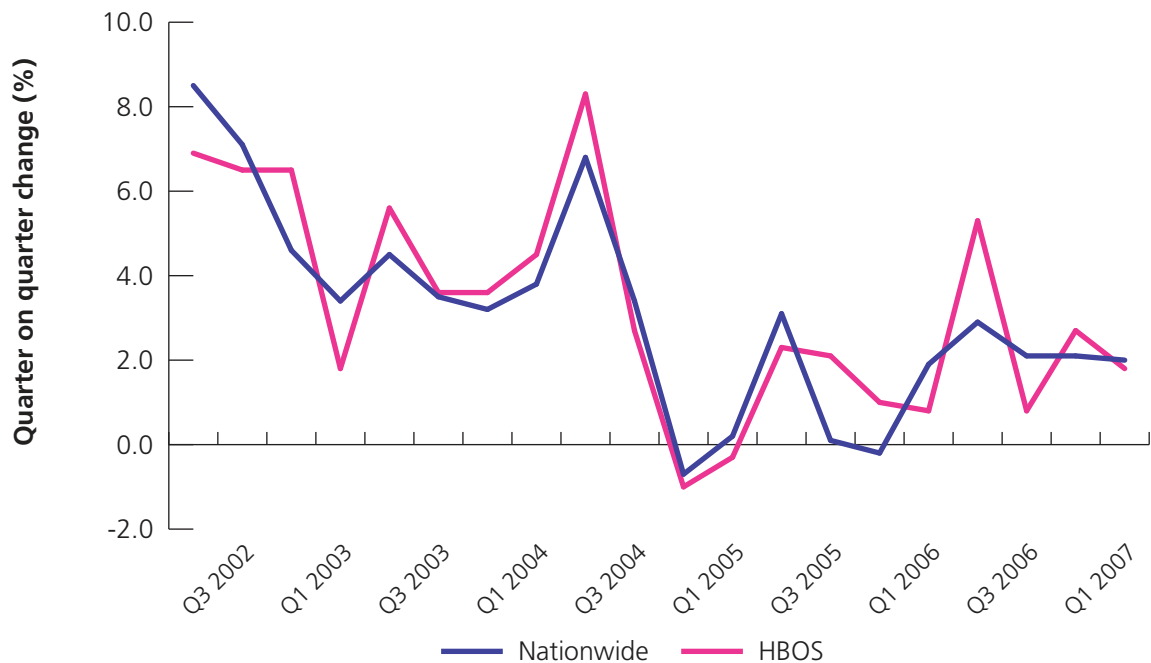
Source: HBOS NB UK data

2.16 Although there is some disagreement in terms of month by month reports on house price movements, on a quarterly basis there is strong agreement between the Nationwide and HBOS series as illustrated below.

16 More plausible factors include: expected increases in working life (thereby increasing lifetime wealth), reduced fear of unemployment, reduced real interest rates, increased availability of mortgage credit, and reduced attractiveness of alternative investments.

17 This point is discussed in further detail in *Barker Review Interim Report*.

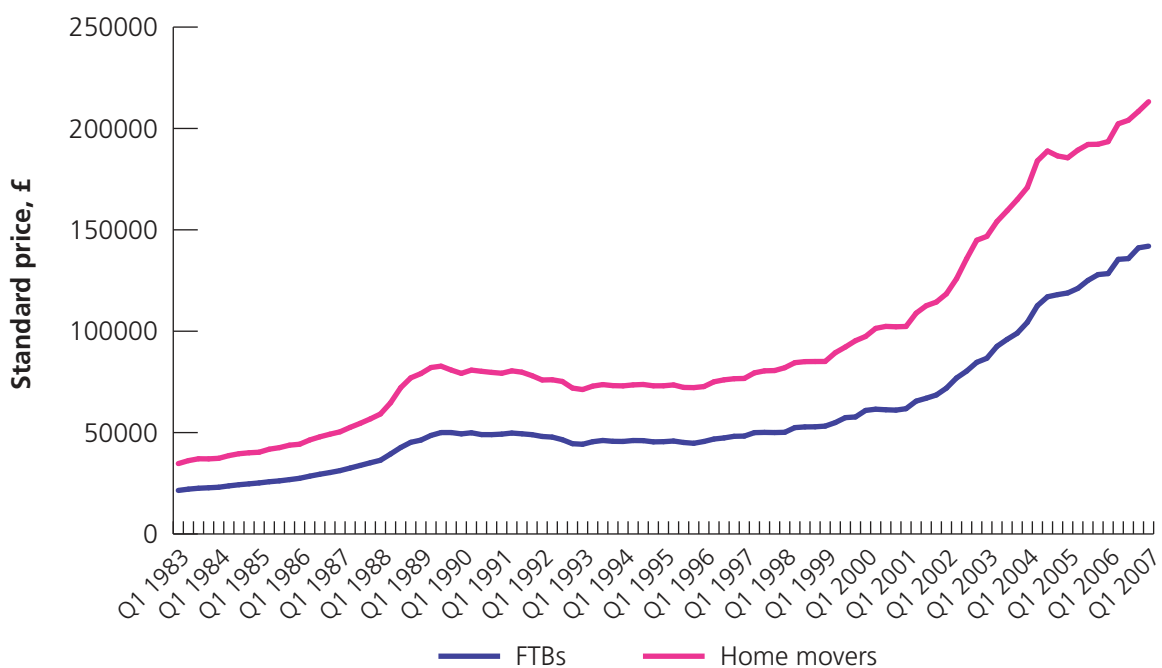
Figure 2.7: Quarterly nominal house price inflation, 2003-2007 (non seasonally adjusted series)



Source: Nationwide, HBOS NB UK data

2.17 The average house price in England and Wales in Q1 2007 was about £223,000 (on Communities and Local Government's figures), and for the UK at the end of Q1 2007 was about £190,000 (on HBOS non-seasonally adjusted data).<sup>18</sup>

Figure 2.8: Nominal house prices, 1983-2007

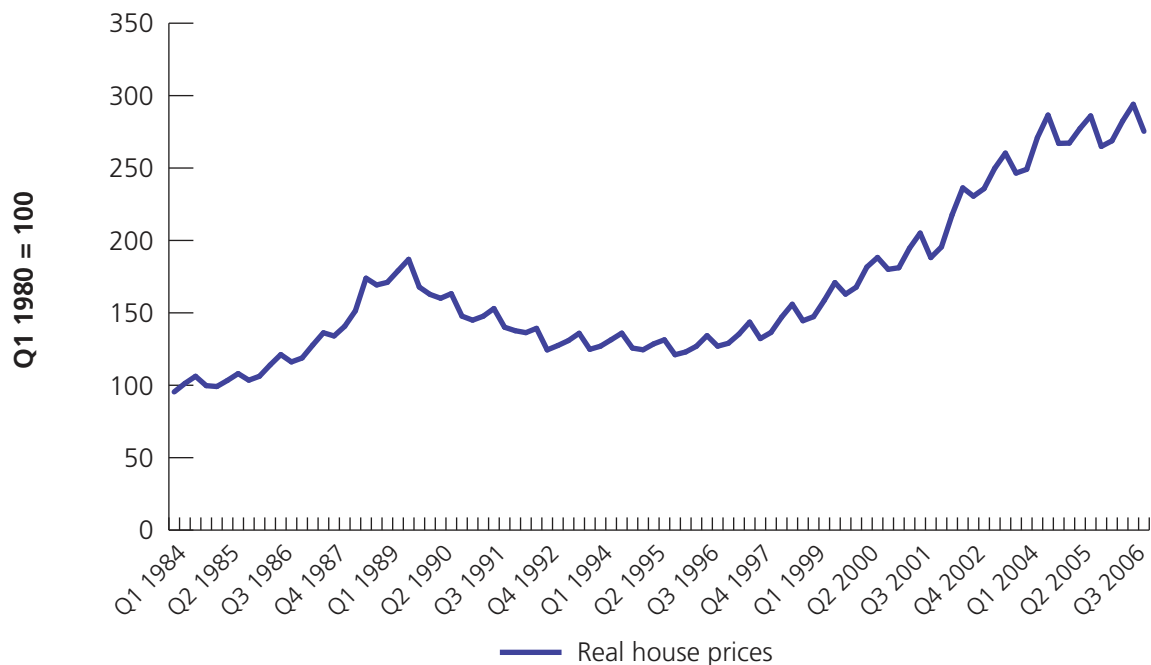


Source: HBOS NB: UK data

<sup>18</sup> On same series, but seasonally adjusted, it is about £192,000 and for the HBOS standardised house, £194,000.

- 2.18 A number of parties report some limited cooling in the market in early 2007. Nationwide notes that the rate of growth in the first quarter of 2007 was 2.2 per cent, against 3.2 per cent in the previous quarter. Nationwide reports the monthly rate of inflation for May 2007 as 0.6 per cent (although year on year change remained narrowly above ten per cent). Similarly, HBOS reports a 0.3 per cent rise in nominal prices in May, the smallest monthly increase since August 2006, and the third consecutive slowing in monthly growth rate. RICS reported that 28.9 per cent more chartered surveyors reported a rise than a fall in house prices in April 2007.<sup>19</sup> This represented an increase from the previous month, but a notable decline from November 2006 (when gap was 45.9 per cent).
- 2.19 On a combined basis, adjusting nominal prices for the RPI, the rate of growth in house prices remains significant.

Figure 2.9: Real house prices, 1984-2007



Source: Nationwide NB: UK data

- 2.20 If the current rate of year-on-year price inflation is taken as 10 per cent (ie monthly price inflation of just under 0.8 per cent), and average house value as £190,000, a one month delay has a nominal cost of about £1,515. Even at an annualised rate of increase of five per cent, one month would see a £774 increase in the average nominal house price – ie above even fairly high estimates of the anticipated cost of a HIP including a Home Condition Report (say, £650 plus VAT being £765). The Communities and Local Government IA estimates the cost of a HIP without a Home Condition Report as £350 (or about £410 including VAT).<sup>20</sup>
- 2.21 A corollary of the current rate of price inflation is that significantly accelerating sale decisions (eg to avoid incurring HIP cost) for vendors who are selling a second property or those in a chain and ‘trading down’ is made markedly less attractive. Similarly, purchase-deferring by potential buyers (eg to benefit from a reduced

<sup>19</sup> RICS UK Housing Market Survey for April 2007, published 15 May 2007.

<sup>20</sup> In addition, as discussed further below, it should be noted that the ‘cost’ of a HIP is principally a cash-flow effect rather than a cost addition – in most cases only the EPC is a truly new cost requirement (~£100).

transaction cost by having a HIP) is made markedly less attractive for first time buyers and those ‘trading up’. Where a vendor is ‘trading up’, then there is already an incentive to accelerate the process. It is not clear that the cost of a HIP would add materially to that.

- 2.22 It is noted, however, that the above analysis does not preclude some switching in initial listing (as opposed to sale) around a specific date – say moving forward the decision by a seller to commence marketing from immediately after the proposed implementation date to a few days before it – in order to avoid the cost of a HIP.

## Affordability

- 2.23 Affordability of houses has a number of dimensions, including the relationship between the price of houses-to-own and lifetime wealth, the willingness to pay to own rather than to rent, and cash-flow issues such as the ability to pay the deposit and the ongoing ability to service the mortgage commitments made.

### House prices versus earnings

- 2.24 As a first proxy of affordability, we chart below the relative movement of house prices (HBOS non-seasonally adjusted series) and the average earnings index (non-seasonally adjusted, and including bonuses). This is indexed to 100 at January 1990 and compared to the published Halifax Price Earnings Ratio.<sup>21</sup> The latter compares nominal house prices to the earnings of full-time male employees.

Figure 2.10: Index of house prices and average earnings, 1983-2007

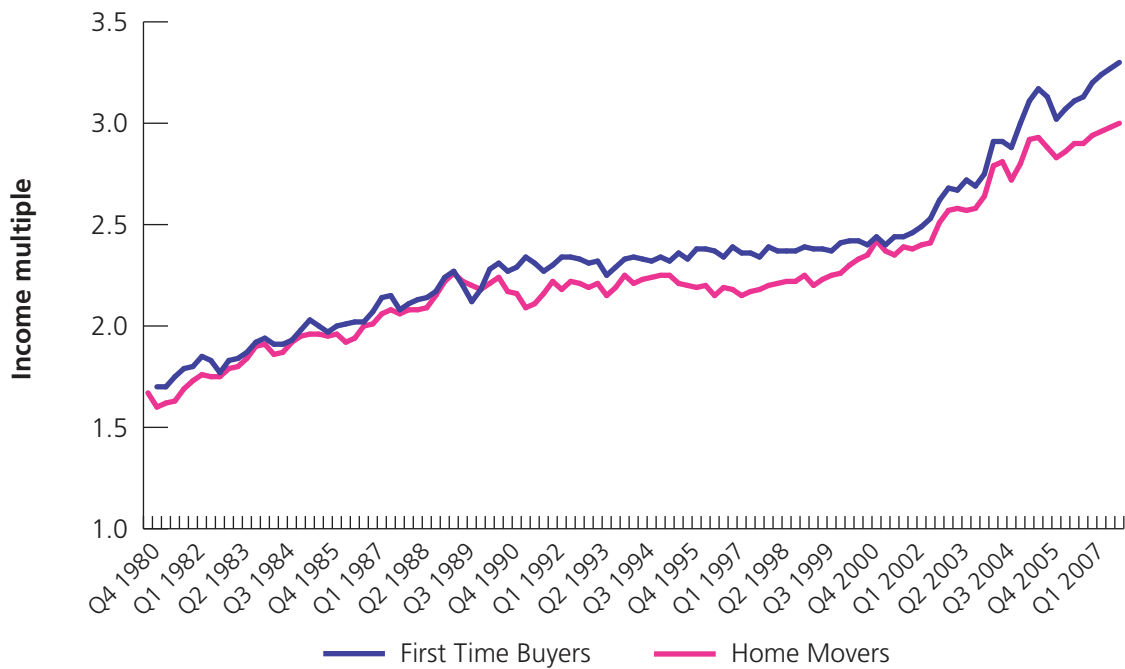


Source: ONS/HBOS/EE calculations.

Note: \*Available only from 1990.

2.25 Looking at either series, the previous several years have seen a steep increase in house prices relative to average earnings – increasing by 77 to 79 per cent since January 1999. The Halifax Price Earnings Ratio reached its highest level in March 2007, whereas the alternative measure is slightly below the peak reached in November 2006 (7.2 per cent below). There is a corresponding, albeit lesser, growth in the level of house prices against median incomes for first time buyers and home movers, illustrated in Figure 2.11.

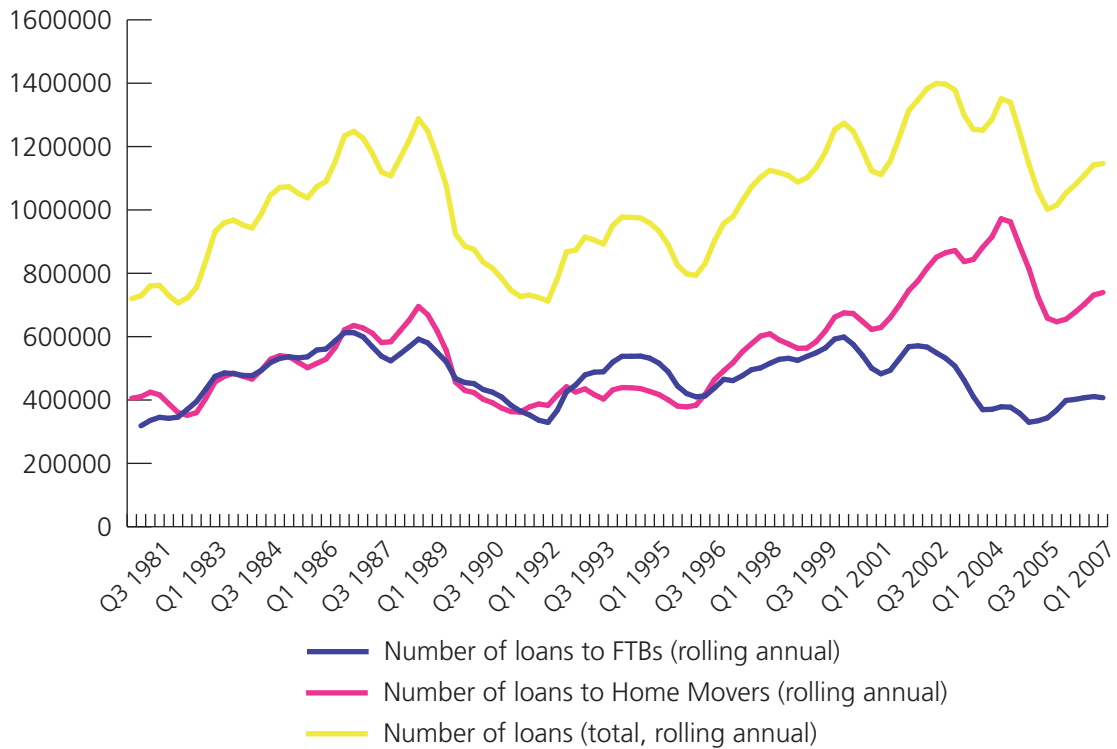
Figure 2.11: Income multiples of house buyers, 1980-2007



Source: CML NB UK data

2.26 The changed balance in the market between first time buyers and house movers can be seen in CML/Bank of England data on mortgage approvals, shown in Figure 2.12. It is clear from this data series that the housing market since 2000 has increasingly been driven by existing home owners.

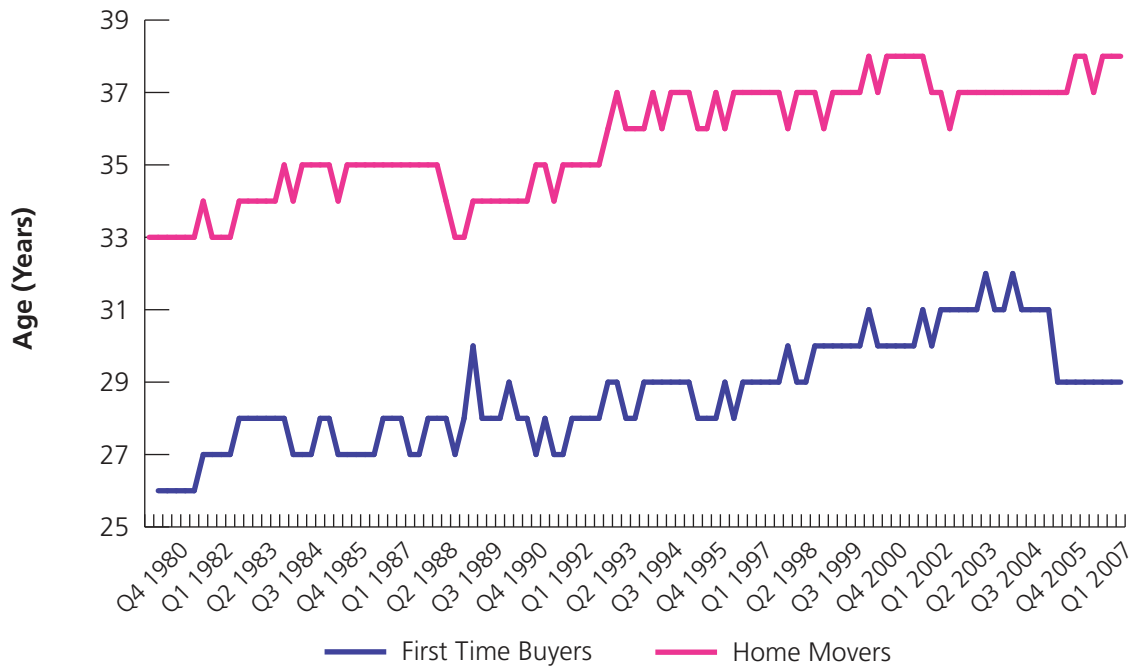
Figure 2.12: Rolling annual number of housing loan approvals, 1980-2007



Source: CML/Bank of England

- 2.27 Communities and Local Government data on household formation indicates an increase in the number of households in England and Wales of about 26 per cent over the whole period from 1980 up to 2006 (using Communities and Local Government's projected 2006 figure). It is noted that loans to First Time Buyers (FTBs) have consistently exceeded net new household formation – ie this group incorporates a substantial element of existing households previously in the rental market.
- 2.28 Another relevant aspect is the average age of the individual drawing down a mortgage. A clear trend is for these ages to have risen over the last 25 years. This may reflect societal changes (ie later age of first steady job, marriage/cohabitation; and children coming later in life). The peaking of the average age of first time buyers at the end of the 1980s immediately preceded a sharp price drop. The current average ages of first time mortgagees are somewhat below peak levels. This is illustrated below.

Figure 2.13: Average age of first time buyers and home movers

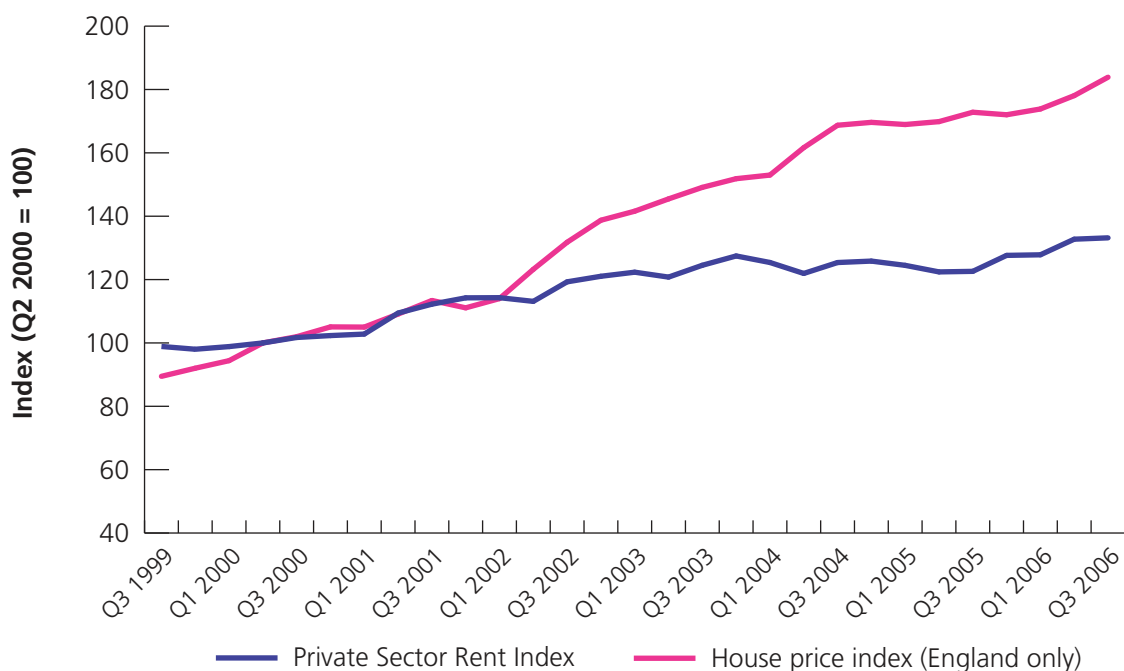


Source: CML NB UK data

### House prices versus rents

2.29 Another key aspect is the cost of the next best alternative, in other words the rental market. Data on the private rental market is scarce, although Communities and Local Government has an ‘experimental’ index on private sector rents in England, based upon household survey data. This is compared to house prices, and mortgage rates, below.

Figure 2.14: Comparison of private rent and house price indices, 1999-2006



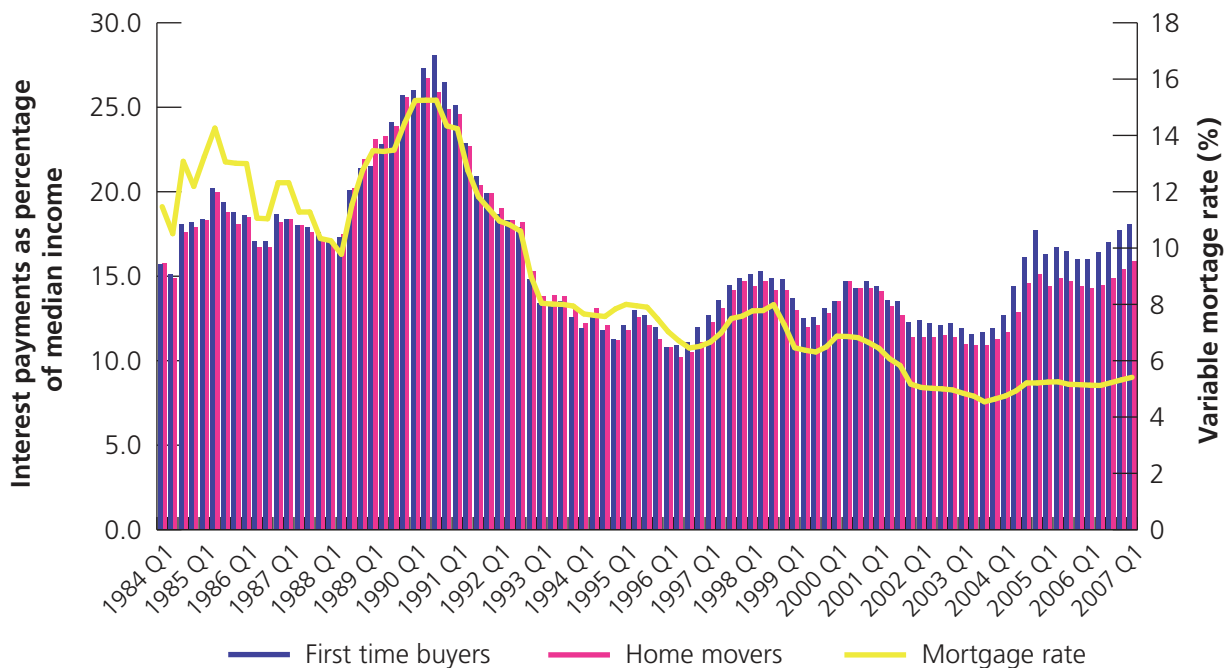
Source: Communities and Local Government /Bank of England

2.30 Since Q2 2000 private sector rents have risen broadly in line with average earnings, whilst house prices have risen by 40 per cent relative to this.

### Cash-flow impacts: the burden of mortgage interest payments

2.31 Figure 2.15 below illustrates the slice of income represented by mortgage commitments for the median borrower.

Figure 2.15: Interest payments as percentage of median income, 1984-2007



Source: CML (NB UK data)/ONS (average Building Society rates)

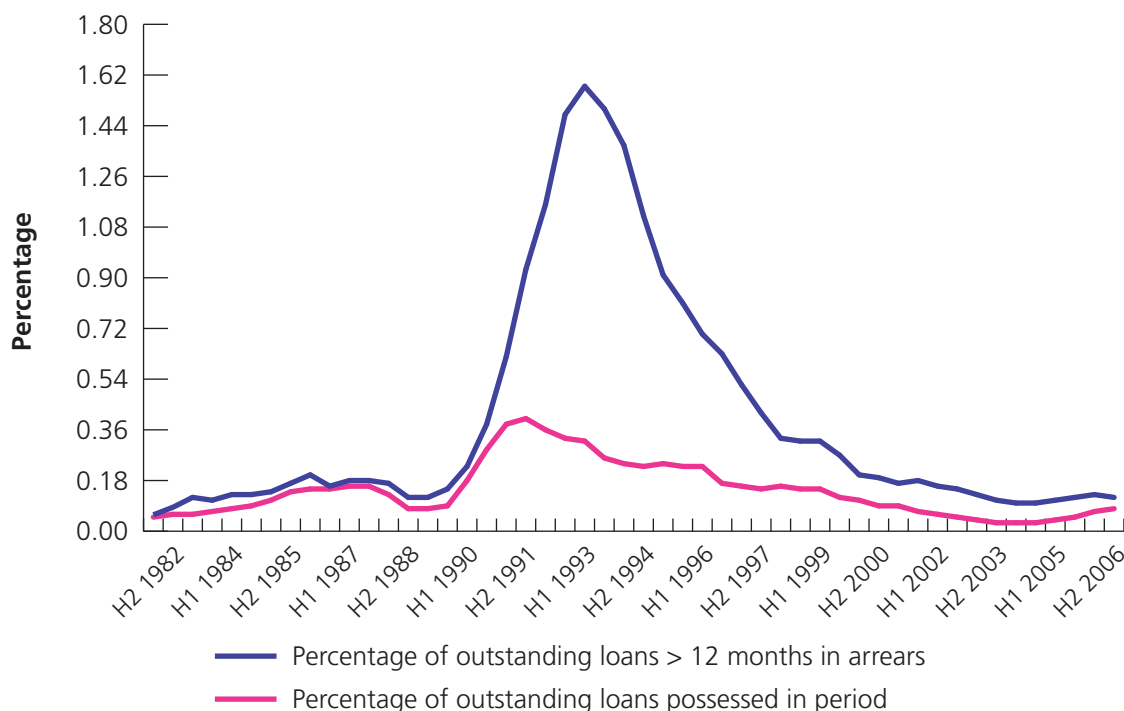
2.32 Despite the sustained growth in house prices from the mid 1990s onwards, which has been markedly more rapid than in incomes as discussed above, interest rates have fallen sufficiently to keep the rise in the cash-flow burden of keeping up interest payments relatively modest. Of course, given low inflation, even modest rises in the percentage impact per period represent a significantly increased burden over the lifetime of the mortgage.<sup>22</sup> It is noted that the current trend in mortgage rates since August 2006 is up and so this measure of affordability is likely to deteriorate in the short term.

2.33 We note that a differential between first time buyers and home movers has appeared over last two years. At this stage it is unclear what the implications of this might be.

2.34 Increased cash-flow challenges of servicing mortgage payments might be expected to lead to increased arrears and possessions. Data on these is shown below. Whilst neither series is particularly high in an historic context, it is worth remembering that both series had barely begun to spike when house price deflation started in 1990.

<sup>22</sup> For a more detailed discussion of this point, see Harley, E. and Davies, S., *Low inflation – implications for the FSA*, April 2001.

Figure 2.16: Arrears and possessions, 1982-2006



Source: CML NB UK data

### Other measures of affordability

2.35 We note that other measures of affordability exist. The Daily Telegraph/Lombard Street Research Housing Affordability Index has recently dropped to 89.14 in March 2007, its lowest register since 1991 and a 7 per cent drop on the year before. However, this index went below 60 immediately prior to the 1990 house price crash.

### Asking prices versus sales prices

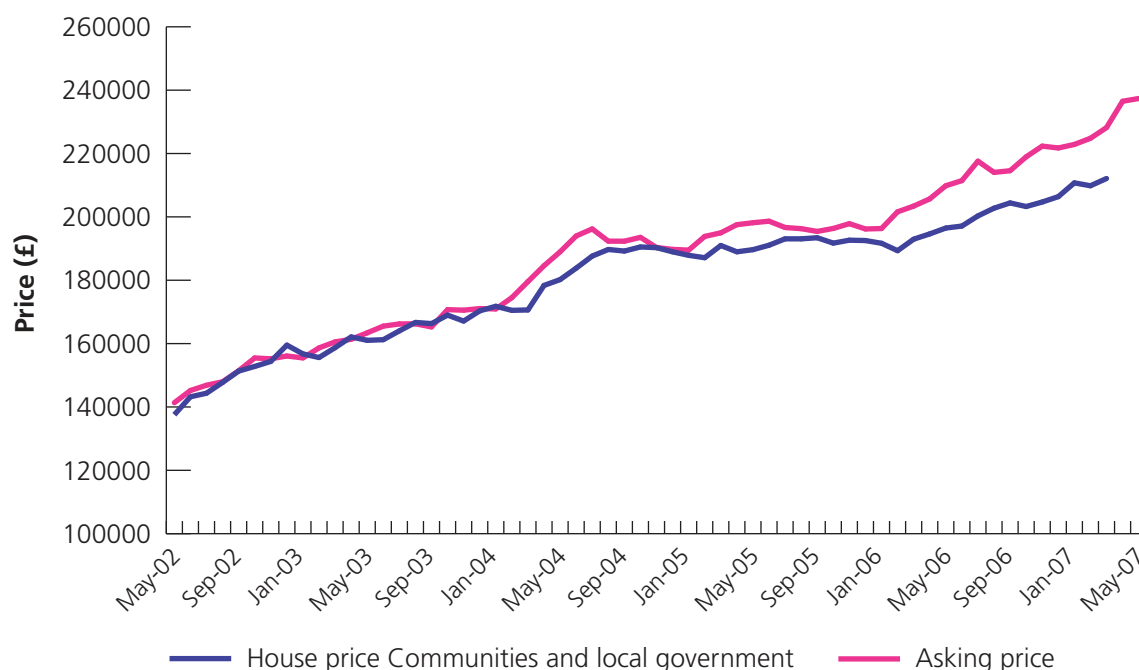
2.36 Asking prices and in reported sales data are illustrated below. Whilst caveats are required given potential timing and collection differences between these data sets – sourced from public domain Rightmove data and Communities and Local Government respectively – these time series appear to show increased divergence over the past eighteen or so months. If it is accepted that there is some stickiness in vendor expectations, this result would be consistent with either a slight softening of the housing market over this time frame or increased over-optimism among vendors.

- (a) Rightmove reported the smallest gain of the year in asking prices in May 2007 (0.4 per cent)<sup>23</sup> and suggested that this slowdown could be due to the effect of higher interest rates on seller's pricing decisions. It also argues that sellers were motivated to come to the market before 1 June in order to avoid HIP costs, leading to an increase in supply in May.<sup>24</sup>

<sup>23</sup> House Price Index, May Edition (May 2007): [www.rightmove.co.uk/pdf/p/hpi/HousePriceIndex21stMay2007.pdf](http://www.rightmove.co.uk/pdf/p/hpi/HousePriceIndex21stMay2007.pdf)

<sup>24</sup> As previously shown in Figure 2.2, new listings increased to 250,000 in May from 200,000 in the previous month. Whilst part of this increase is likely to be due to other market factors or issues arising from the way in which the series has been generated, it is reasonable to believe that some parts of this increase was caused by the impact of HIPs. This point is investigated further below.

Figure 2.17: Comparison of house sale prices and asking prices in England and Wales, 2002-2007



Source: Rightmove/ Communities and Local Government

## Debate about the future direction of house prices – Valuation of housing stock

2.37 There is a long-running debate as to whether the UK housing stock is currently over-valued or not. A few of the more authoritative contributions from both sides include:

- (a) An IMF study in 2004<sup>25</sup> identified the UK housing market as being out of line with fundamentals (such as real income growth which drives purchasing power and the ability to borrow), ie prima facie overvalued, by as much as 20 per cent.
- (b) The OECD<sup>26</sup> also analysed the current 'boom' in house prices from an international perspective and considered it to be both longer and stronger than in previous cycles such that the growth in real house prices was increasingly out of step with the business cycle. The OECD study viewed United Kingdom house prices to be overvalued against a number of measures – over 30 per cent overvalued in 2004 against OECD's calculation of the fundamental price-to-rent ratio.
- (c) As an explicit rejoinder to the OECD work, Cameron, Muellbauer and Murphy<sup>27</sup> found no significant evidence for an asset bubble from a dynamic panel data model of British regional house prices, 1972–2003. Their conclusion was that the evolution in house prices between 1996 and 2003 can be explained by strong income growth, higher population growth (partly from immigration), lower interest rates and low levels of house-building. This paper's base forecast for 2004–2010 anticipated continued real, and so also nominal, house price rises, based on 'business as usual' for the UK economy (eg no stock market crash).

<sup>25</sup> IMF World Economic Outlook, *Global House Price Boom*.

<sup>26</sup> OECD Economic Outlook 78 (2005), *Recent House Price Developments: Role of Fundamentals*.

<sup>27</sup> Cameron, Muellbauer and Murphy (2005), *Was there a British House Prices Bubble? Evidence from a Regional Panel*, [www.cepr.org/pubs/dps/DP5619.asp](http://www.cepr.org/pubs/dps/DP5619.asp).

- (d) Kate Barker in evidence to the Treasury Select Committee on 27 March 2007 stated that:

*“the combination of lower long-term rates and the relationship between supply and demand provide pretty good reasons for most of the rise we have had. It is possible that on top of that there is a small, slightly more speculative element in buy-to-let, but I would certainly hesitate to say that house prices were overvalued.”*<sup>28</sup>

2.38 From 2002 to 2004 there were a number of high-profile predictions that house prices would fall substantially in nominal terms:

- (a) In November 2002, Professor Andrew Oswald of Warwick University penned *The Great 2003-2005 Crash in Britain’s Housing Market*.<sup>29</sup>
- (b) In December 2002 Capital Economics predicted that house prices would (after rising rapidly during 2003), fall 20 per cent peak-to-trough beginning in 2004, with a larger fall of 30 per cent possible.
- (c) During 2004, Dye Asset Management and Invesco Perpetual made predictions of crashes of 30 per cent and 30-40 per cent, which were to occur within four to five years of the forecast being made.

2.39 Since the time of these predictions, house prices have risen further, and, although bearish press articles still appear from time to time, authoritative negative predictions have largely ceased.<sup>30</sup> It is probably most natural to attribute this not to an increased sense of bullishness about house prices amongst these authors, but rather to a loss of confidence in either the accounts offered for why prices had become too high, the mechanisms proposed for falls or the devices used to predict the timing of falls.

## Current forecasts for evolution of house prices

2.40 We summarise here a number of recent predictions for house prices, without endorsing any one in particular. Most current forecasts anticipate a continuation of upward movement in house prices in 2007:

- (a) Lombard Street Research predicts house price growth of 10 to 15 per cent in 2007, although noting that double digit growth in 2007 could see an asset bubble develop in 2008. This prediction was linked to a base rate of five per cent.
- (b) Rightmove predicts an average national increase in house prices of six per cent, with regional variation driven by the extent of the local under-supply of housing stock. This would translate to faster growth in London and the south of England.
- (c) HBOS sees a shortage of both new and second hand properties available for sale pushing house prices, particularly in London, but asserts that house price inflation will slow significantly during the second half of 2007, due to higher interest rates and rising house prices.

28 [www.publications.parliament.uk/pa/cm200607/cmselect/cmtreasy/414/7032703.htm](http://www.publications.parliament.uk/pa/cm200607/cmselect/cmtreasy/414/7032703.htm)

29 [www2.warwick.ac.uk/fac/soc/economics/staff/faculty/oswald/housingaccountancynov2002.pdf](http://www2.warwick.ac.uk/fac/soc/economics/staff/faculty/oswald/housingaccountancynov2002.pdf)

30 This phenomenon is discussed further in: [www.ft.com/cms/s/c85003f2-25a9-11da-a4a7-00000e2511c8.html](http://www.ft.com/cms/s/c85003f2-25a9-11da-a4a7-00000e2511c8.html)

(d) CML forecasts a seven per cent rise in 2007, slowing to five per cent in 2008. This is due to “the strength of demand relative to supply” continuing to be “a structural feature of the housing market for the foreseeable future”. Reduced affordability is expected to result in lower levels of transactions.

(e) RICS is predicting a rise of 7 per cent in house prices in 2007. RICS anticipates that strong employment conditions and a robust economy will continue to shield the market from any dip. RICS recognises that affordability and accessibility for first time buyers will continue to worsen, in part due to the changing interest rate environment.

2.41 For this study we have done no new analysis of whether housing is over- or under-priced and whether in the future prices should be expected to rise or fall. But we note that there is certainly no current consensus among major forecasters that the housing market is at a peak and on the verge of a significant downturn.

## 3 Existing research on HIPs

- 3.1 In this section we consider previous research on HIPs, focusing in particular on the results of the Area Trials, and on an interesting and provocative report from the CML in early 2006.

### Home Information Packs – Area Trials

- 3.2 Prior to the full rollout of HIPs, Communities and Local Government is undertaking trials of HIPs across England and Wales, in partnership with the Association of Home Information Pack Providers (AHIPP). The first six trials commenced on 6 November 2006 in the following postcode areas:<sup>31</sup>
- (a) Newcastle (NE1 – 13, NE27 – 36 and NE98)
  - (b) Northampton (NN1 – 5, NN8 and NN9)
  - (c) Huddersfield (HD1 – 9)
  - (d) Southampton (SO14 – 19)
  - (e) Cambridge (CB1 – 5)
  - (f) Bath (BA1 – 3, BS31, BS39 and BS40).
- 3.3 A second wave of trials began in February 2007 in North West Wales and Southwark.
- 3.4 These trials are voluntary and consist of an estate agent or vendor agreeing to provide HIPs to potential buyers. Participation in the trials has been incentivised, with the cost of the HIP being wholly or partly paid for by Communities and Local Government.
- 3.5 The trials seek to test whether or not the presence of HIPs improved the home buying and selling process, whether the take-up of HCRs could be maximised to accelerate benefits associated with HIPs, and provide an understanding on how to maximise the impact of EPCs. For the purposes of writing this report, we have been provided with an interim report on the research findings.<sup>32</sup> We summarise the most relevant findings below:
- (a) Awareness and satisfaction with HIPs is relatively high.
  - (b) The view of estate agents was that the use of HIPs would speed up sales transactions in only a small percentage of cases. In particular, estate agents felt that since most delays are caused by chains and people changing their mind about selling, so HIPs would not have a significant impact in this area.

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31 As listed on the website of the Association of Home Information Pack Providers: [www.hipassociation.co.uk/rollout.aspx](http://www.hipassociation.co.uk/rollout.aspx). We note that the Association has itself carried out further roll-outs in certain areas.

32 Research carried out by Ipsos MORI and BRE on behalf of Communities and Local Government.

- 3.6 The remit of the research does not include analysis of how the decision to market a house for sale might be affected by the introduction of HIPs. However, it is interesting to note the following responses to the question of whether sellers felt that HIPs would make a difference to the sale of their property.

Table 3.1: Effects on the HIP on sale of the property – perceptions

	Percentage Agree	Percentage Disagree
	Average	Average
Having the HIP will speed up the sale of my property	50	37.5
The HIP will have no effect on the sale of my property	40	49
I am confident that HIP will help sell my property	50.5	32.5

Source: Ipsos MORI and BRE and EE calculations

- 3.7 The issue of perceptions is important. If vendors perceive that there may a negative consequence of HIPs they may make an adjustment in behaviour, even if their perceptions are misguided.
- 3.8 In the above Table 3.1, one sees that, on average, vendors feel that the introduction of HIPs will have an impact on the sale of their property – 49 per cent. Reading across the other rows one can see that this impact is perceived to be positive – in terms of speed and possibility of sale.
- 3.9 These data are interesting because they represent the only large scale data gathered measuring the actual impact of HIPs.<sup>33</sup> While one should not place too much weight on these trials (especially since the cost of the HIPs is not borne by either the selling or the buying party), the survey results appear to suggest an overall favourable attitude from vendors to HIPs.

## The CML report: *How disruptive will HIPs be?*

- 3.10 As discussed in the introduction, there has been much media comment on the potential impact on HIPs. One study of note is that of the Council of Mortgage Lenders (CML) titled *How disruptive will HIPs be?*<sup>34</sup> This report draws on two previous Government policy changes in the area of housing to draw analogies to the introduction of HIPs, as well as presenting some forecasts of the number of house listings.
- 3.11 At the time of writing, CML anticipated that the plan was for HIPs to include a compulsory HCR. The switch to this element being a voluntary component in the HIP has meant that by late 2006 the CML accepted that likely affects would be more restricted than those it argued for in early 2006. Thus, by December 2006 the CML reported: “If all goes smoothly, [the introduction of HIPs in June 2007] should not have a significant impact on the market. There is no longer a requirement for sellers to purchase a home condition report so the cost of pulling together a pack will

<sup>33</sup> We are aware that a small scale pilot ran in Bristol in 2000.

<sup>34</sup> J. Bennett and R. Thomas in CML Housing Finance 02/2006

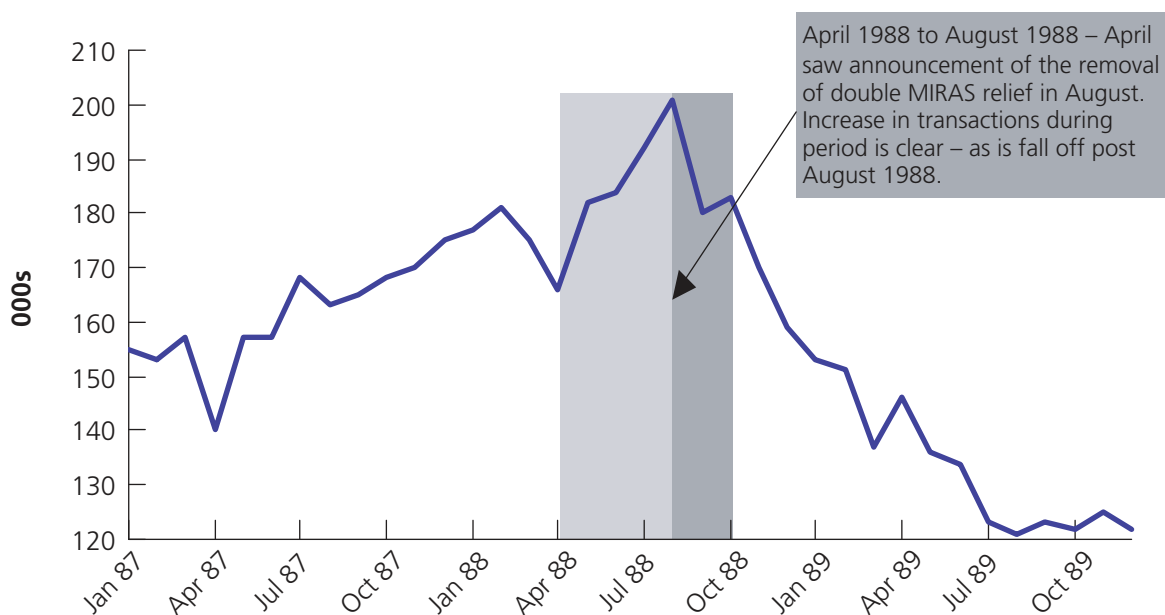
be lower than originally thought. But there is still some risk of a modest drag on transactions from reduced numbers of speculative sellers marketing their properties. The bigger risk is that there will not be enough inspectors in place to satisfy the legal requirement for the production of energy performance certificates. If this remains the case, there is some potential for major disruption. We will not be able to assess this risk fully until next spring.”<sup>35</sup>

3.12 Nonetheless, we still consider the original 2006 paper analyzed here both of sufficient interest in itself, and of sufficient continuing influence on press reporting about the likely impact of HIPs, to be worth detailed critique.

### Removal of double Mortgage Interest Relief at Source (MIRAS)

3.13 The first comparator the authors use for the short term impact of HIPs is the the removal of double MIRAS in August 1998. This change shifted eligibility for tax relief from individuals to properties, meaning that it was no longer possible for co-habiting couples to each seek the maximum relief. This is seen as analogous to HIPs in the sense that the abolition of relief was not retrospective and was announced in advance of its implementation (April 1988 before being implemented in August 1988). This gap in implementation opened a window for co-habitees to buy and remain eligible for the interest relief. The Figure below reproduced from the study shows the impact on transaction numbers.

Figure 3.1: Transaction numbers (000s) and impact of removal of double MIRAS



Source: HM Revenue and Customs, reproduced from CML

3.14 The CML authors observed that, irrespective of any complexities introduced through lags, there was a clear increase in the number of housing transactions resulting from the removal of double MIRAS.

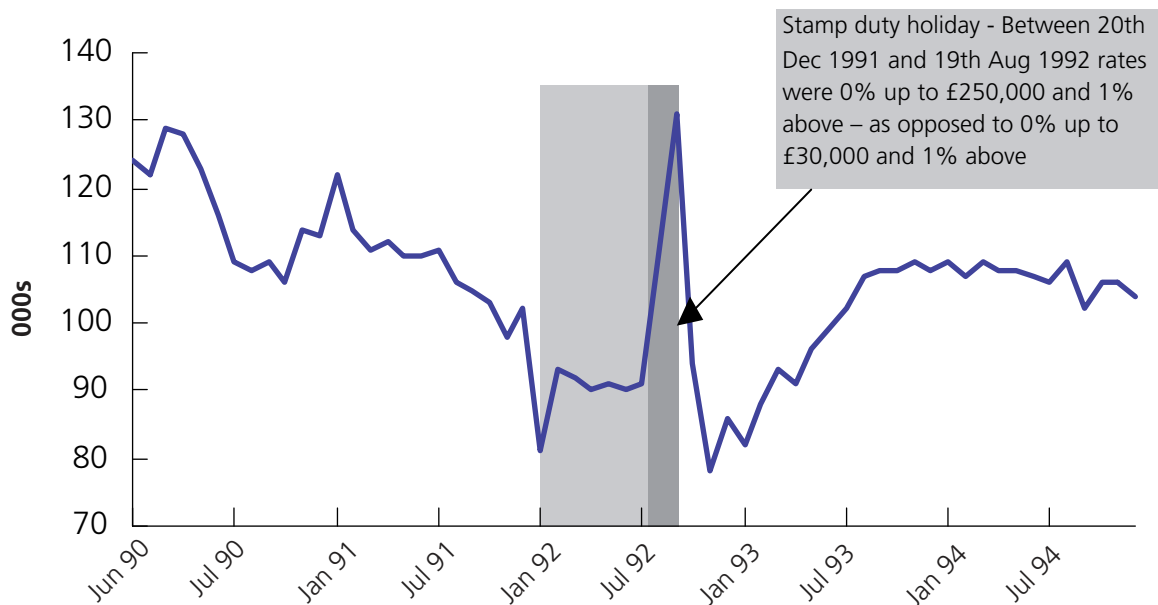
35 [www.cml.org.uk/cml/filegrab/ForecastsDec2006.pdf?ref=5154](http://www.cml.org.uk/cml/filegrab/ForecastsDec2006.pdf?ref=5154)

- 3.15 Nonetheless, while not stating actual monetary values, the CML authors themselves noted that the size of the change involved in the removal of double MIRAS was significantly greater than the predicted cost of HIPs, and thus that quantitative implications should not be drawn from this case alone.

#### Increase in zero rate stamp duty threshold

- 3.16 A second analogy proposed by CML was the increase in the zero rate stamp duty threshold between 20 December 1991 and 18 August 1992. On 19 December 1991, it was announced that the zero rate threshold for stamp duty would rise from £30,000 to £250,000 for a period of eight months, in an effort to stimulate the housing market. At the time of the announcement a rate of one per cent applied for transactions over £30,000. Using average house price data from that period, the authors calculated that purchasers of an average priced house would have benefited to the tune of approximately £660 – comparable to the cost of a HIP with a Home Condition Report.<sup>36</sup> The Table below charts the change in transaction numbers.

Figure 3.2: Transaction numbers (000s) and stamp duty holiday



Source: HM Revenue and Customs, reproduced from CML

- 3.17 The CML authors argued that the data show the impact of the government policy to be massive as buyers rushed to complete their transactions during the stamp duty holiday period.
- 3.18 The paper concluded that both policies (stamp duty and MIRAS) induced significant increases in transaction levels, which suggests that even a small financial cost or benefit could have a material impact on home buyer and seller behaviour.

<sup>36</sup> However, we note that the CML data appears to be in nominal terms. If this is the case, the stamp duty reduction in 1991/2 is worth much more than the cost of HIPs in 2007.

## Commentary on analogues

- 3.19 While we do not disagree with the statement that, under particular circumstances, a small financial cost or benefit could have a material impact on home buyer and seller behaviour, we believe the case studies offered by CML are poor analogues for HIPs.<sup>37</sup>
- 3.20 In the first instance, in both of the CML case studies there was unambiguous advantage to be had from relocating one's purchasing/selling decisions in time (to take advantage of tax relief). In contrast, in the case of HIPs it is not clear that one is always better to commence selling before HIPs are introduced (eg a house marketed without a HIP might sell for less), so whilst some agents may choose to advance their sales offers, others may choose to delay (or at least delay agreeing a sale) until after HIPs is introduced.
- 3.21 The context of each analogue is also important. The removal of double MIRAS occurred during a period of rising prices and was clearly a positive stimulant, and in the case of the stamp duty relief this was introduced during a situation of stagnating (or in some cases falling) prices and again was clearly a positive stimulant. In contrast, HIPs is being introduced during a rising market and it is not clear that their introduction is either a positive or a negative stimulant to prices. If, say, its effect on prices were negative in a rising market, then what lessons would we learn from these other cases? One should also note that unlike the stamp duty analogue, HIPs is not designed or intended to boost the housing market.
- 3.22 Further, one should note that HIPs are primarily a supply side device affecting the vendors of houses and increasing the information provided to potential buyers. While changes in MIRAS and stamp duty may influence sellers, they are primarily devices to encourage demand and assist buyers.

## CML forecasts

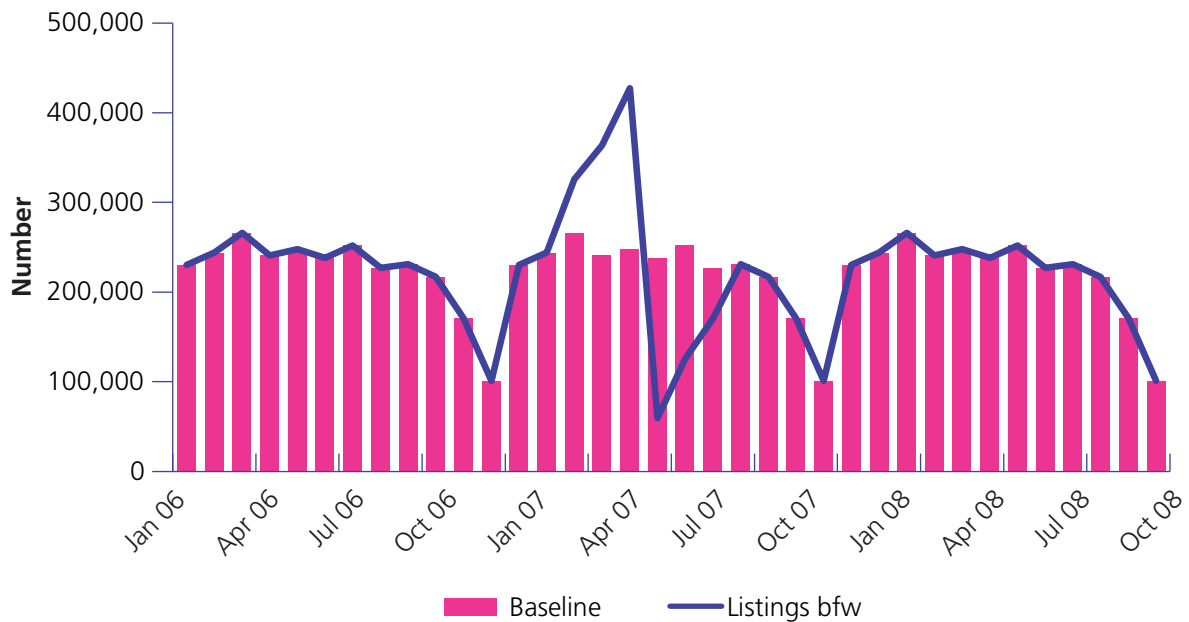
- 3.23 The CML study also contained short-term forecasts on house listings until October 2008. The forecasts were self-consciously crude and represent the entire UK market (of which only England and Wales are required to have HIPs). The forecasts were derived by assuming that vendors would react to the planned introduction of HIPs by bringing forward listings by as much as three months to avoid the cost of the mandatory pack. This movement in listing would have created a shortfall, CML argued, that would have been at a maximum in the month following the introduction of HIPs before falling to normal levels from the fourth month following introduction.

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<sup>37</sup> This is not any criticism of the CML authors. We are not suggesting that any *better* analogues are available.

3.24 The forecasts are reproduced below.

Figure 3.3: CML forecasts for listings before and after HIPs<sup>38</sup>



Source: CML and Rightmove

3.25 The CML argued that in the short term, there would be a temporary excess supply of properties in the months preceding HIPs and a reduction in demand as buyers wait to receive HIPs – implicitly accepting that buyers would perceive there to be value in a HIP. These effects were said to combine to create poor market liquidity, difficulties in completing chains and fewer transactions in the immediate months post-HIPs introduction.

3.26 In the long term, the CML authors argued that their research pointed to a potential reduction of 400,000 transactions per year in the housing market as a result of HIPs, with further consequences for market liquidity.<sup>39</sup>

3.27 We defer our analysis of these forecasts until later sections where we present our own forecasts and analysis. However, one should note that these forecasts were based on a different, more expensive HIP from that to be launched in 2007 (ie CML considered a HIP with a HCR) and were run in early 2006 (with the 1 June 2007 implementation date).

<sup>38</sup> Note that we consider a scenario of this nature ourselves at Paragraph 5.35ff, but argue that this form of behavioural response is less plausible than the others we consider.

<sup>39</sup> This appears to be based on the assumption that 31 per cent of sellers are testing the market, and that all of these might not (ever) offer their houses for sale after the introduction of HIPs. We produce our own analysis of the likely scope for and nature of impacts in Section 5.

## 4 How the housing market might have evolved if HIPs were not being introduced

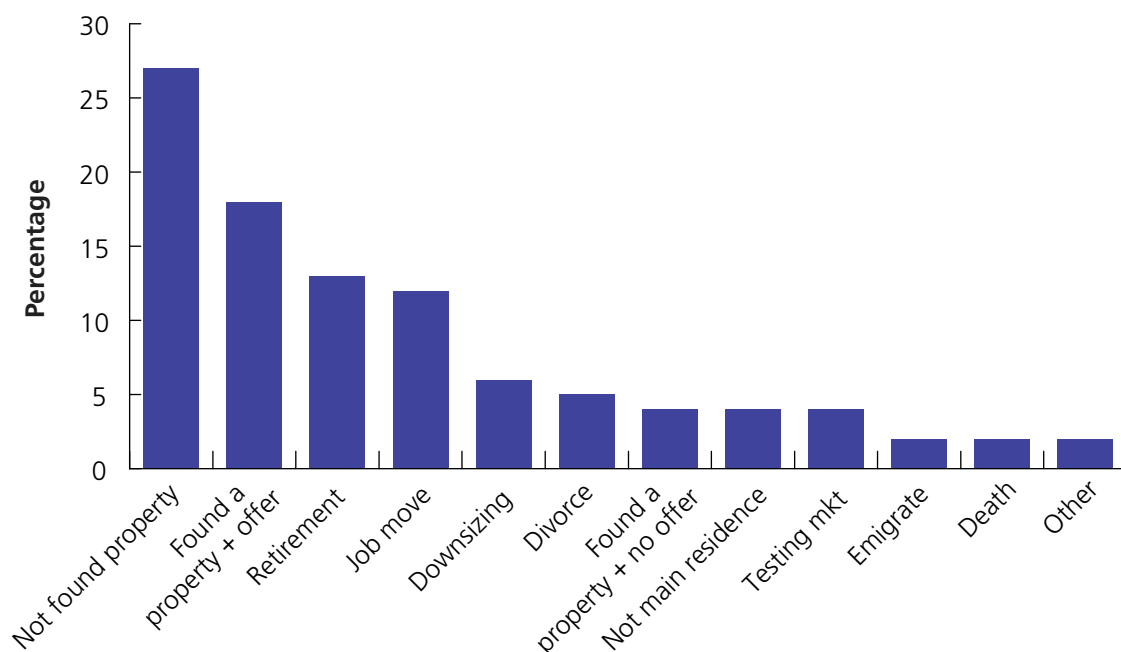
4.1 In this section we construct our ‘counterfactual’ case – ie our estimate of how the number of house listings might have evolved in the absence of HIPs. We begin by examining why people place their house on the market. We then move to discuss our data set and modelling framework. Finally, our forecasts are presented, along with analysis.

### Why people put their house on the market

4.2 The decision to sell one’s house and move home can be based on a range of reasons, from changed personal circumstances (eg a larger family or divorce) to work-related drivers (eg emigration overseas or a change in job). Allied to these factors are wider macroeconomic influences such as prevailing house prices, interest rates, likelihood of unemployment and so forth. Factors also change at different points in one’s lifecycle. It is important to have an understanding of these factors in order to forecast future listings and any long-term impacts HIPs may have.

4.3 As quoted in CML Housing Finance 02/2006, Countrywide Estate Agents sent surveys to 12,501 of their customers to seek motivations for listing homes, and how these motivations may change in light of HIPs. The results are shown below:

Figure 4.1: Listing by reason



Source: CML and Countrywide Estate Agents

- 4.4 From the above motivations for listing, we can categorise different types of vendor as:
- (a) **not found a property:** these are listings made before one has placed an offer for another property (27 per cent of the market);
  - (b) **found a property and made an offer:** these are listings done after one has put in a successful offer for a new property, and now there is a need to sell their own to finance the transaction. In such circumstances, it is unlikely that the vendor will change his decision to sell (approximately 18 per cent of the market);
  - (c) **lifestyle changes creating quasi-forced move:** these are listings caused by changes in one's personal circumstances which force one to sell (approximately 41 per cent of the market);
  - (d) **found a property but not made an offer:** these are listings done after one has found a desirable property, but not yet made an offer (four per cent of the market);
  - (e) **purely financial motivations:** listings done to realise a financial gain from a property, eg perhaps the property is not a main residence and high house prices make it attractive to sell, or simply to test the market (eight per cent of the market); and
  - (f) **other** (approximately two per cent of the market).
- 4.5 Under the category of quasi-forced moves (c) are those moves caused by personal changes such as retirement, divorce, downsizing and upsizing, job moves, emigration and death. In the category of purely financial motivations (e) are those individuals selling houses that are not their main residence and those simply testing the market.
- 4.6 These different categories are critical in our discussion of the impact of HIPs. This is because different vendor categories will react differently to the introduction of HIPs, both in the short term and in the long term. Given that that membership of these categories is fluid, some categories may shrink in size, whereas others grow, depending on vendor behaviour.
- 4.7 In particular, from the above categorisation, one would assume that at most, 35 per cent of the market (categories (a) and (e)) might potentially change their behaviour in response to HIPs, as their decision to list is the least firm. In contrast, categories (b) and (c) are much firmer in their intention to move. Thus, any change in house listings directly caused by HIPs, will be driven by, this 35 per cent of the market.
- 4.8 Although we do not have a break down this 35 per cent by size of dwelling (eg four- and three-bedroom), we attempt below such an analysis based upon the motivations for sale and then debate the usefulness of reflecting such a break-down within the modelling process.
- 4.9 For motivations such as retirement and downsizing, it is quite reasonable to assume that those listing are selling larger properties (three-bedroom and above) and seeking to buy smaller properties. In contrast, one can argue that for motivations such as

emigration and ‘not main residence’, the vendors are selling smaller properties. Emigrants are typically younger adults and second residences are often small city residences or weekend cottages. One might argue that listings due to divorce might involve larger houses, but this presupposes children and a number of other factors – the overall position is, we believe, ambiguous.

- 4.10 Taking the percentages from the CML data, one can see that broadly speaking the categories of emigration and “not main residence” (ie smaller properties) is broadly equivalent with downsizing. This leaves those selling their house due to retirement (at 13 per cent), which we take to be mostly larger properties.
- 4.11 Given that the 13 per cent of retiring vendors are likely to be concentrated among three bedroom houses and above, there would be a case for assuming different proportions of flexible vendors (ie vendors for which the timing of their listing decisions might have the potential for behavioural change to a HIPs-like measure) amongst smaller properties from large properties. For example, perhaps 40.2 per cent<sup>40</sup> of vendors of one- and two-bedroom properties might be more flexible (instead of the 35 per cent overall) compared with only 32.4 per cent of those with larger properties (three bedrooms and above).
- 4.12 However, our forecasts below are not so precise, and the above discussion so robust, that it would be useful to model this difference, and for our purposes we shall assume a flat 35 per cent of flexible vendors.
- 4.13 We discuss the impact of HIPs in detail in the next section.

## Modelling framework

### Introduction

- 4.14 Our later models will focus on the impact of HIPs on the number of new listings, and thence on transactions and wider impacts on the market. First we construct a baseline for how many new listings there would have been in the period around the introduction of HIPs, had HIPs not been being introduced. We have focused on new listings as our main variable of interest as it is on listings that were alleged by CML and others to be where the main impact of HIPs would fall.
- 4.15 It is quite possible that the number of new listings would be affected by other changes than HIPs, such as interest rates. But we are not aware of a mechanism whereby the impact of HIPs on new listings would be changed by changes in interest rates etc; thus, though we by no means deny that these wider factors are crucial to making any accurate estimate of listings, transactions and house prices, we abstract from them for the purposes of the discussion that follows. Our aim is merely to develop a model to assess the impact of HIPs, not to produce forecasts for their own sake.
- 4.16 The volume of new listings is subject to some seasonal fluctuation. The spring and summer are relatively more stable than autumn and winter. Indeed, the relative stability of the market in the late spring and summer is one of the reasons HIPs was being introduced in June. In that sense, the later launch from 1 August 2007 and the

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<sup>40</sup> Being  $35/(100 - 13)$  expressed as a percentage.

gradual phasing-in of HIPs thereafter means that the transitional effects flowing from implementation, whilst spreading the impact, are also likely to cut across the winter slowdown. The effects of this are discussed below in our review of the various scenarios that we have modelled.

## Data review

4.17 Our econometric regressions have used historical trends to predict future levels of housing coming to market. As noted in Section 2, we have interpolated a data series on new listings in the England and Wales property market from data in the public domain. Whilst we have no specific reason to doubt the quality of this information, we note that it was not put in the public domain with a view to its being used for the purposes to which we have used it. In particular, one point to note is that it comes solely from Rightmove publications and therefore will only capture properties listed with Rightmove. In addition, this series contains a relatively small number of observations – the combination of these factors must serve as caveats upon the forecasts drawn from it.

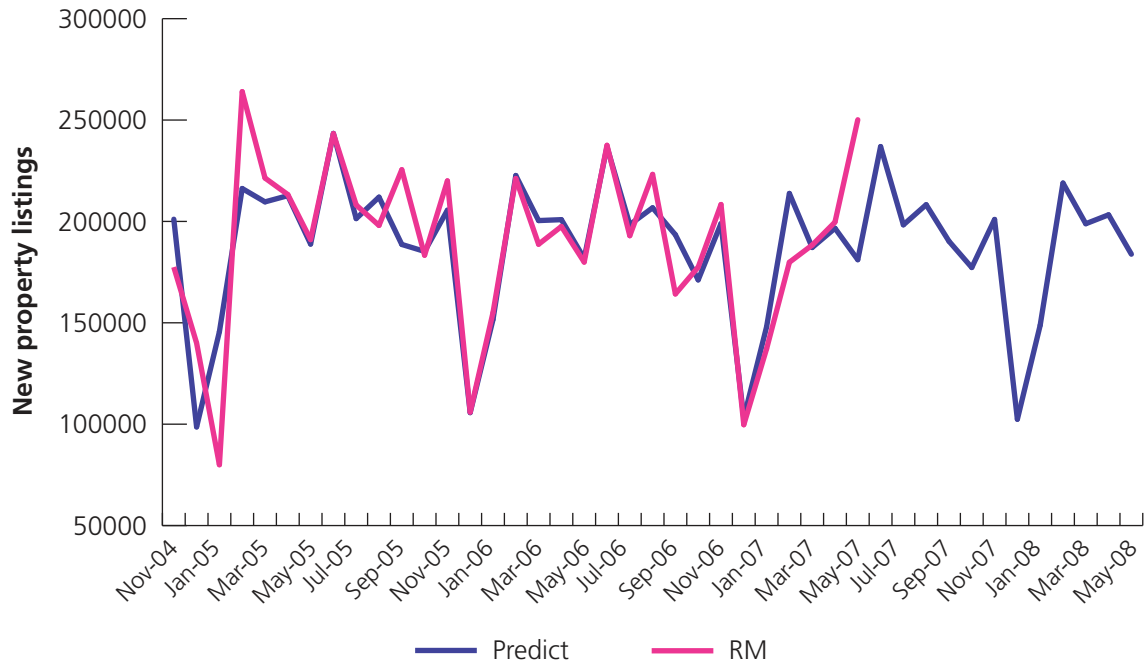
## Number of new listings

4.18 Appendix 1 to this report sets out the technical derivation of our model of how property listings might have evolved had HIPs not been being introduced. We note that this model is constructed for the purpose of assessing the impact of HIPs, and should not be interpreted as best-predictions about how new listings will evolve *per se*. The models in this report are constructed for the purpose of assessing the impact of HIPs, and should not be interpreted as best-predictions about how new listings or time on market will evolve *per se*, not least because other factors are likely to be involved in affecting the number of new listings.

4.19 Our model uses standard econometric techniques and in essence argues that the number of new listings in any given month is dependent upon two main factors: the number of listings in the last month and the time of the year. The latter reflects the impact of seasonality, in particular, the low listings in December. Past data is used to estimate relationships between new listings and these explanatory factors, and these statistical relationships are then used to build forecasts out to April 2008.

4.20 A comparison of the fitted and forecast values to the implicit, historic new listings (see also 2.5 and 2.6 above) is presented below.

Figure 4.2: Comparison between implicit new listings and fitted values



4.21 The above graph includes the number of listings for May 2007. However, this data point has been excluded from our time series model. This is due to it being unusual high compared to previous years (the spike typically occurs in June). Without further data for subsequent months one cannot tell whether this is an anomaly. This may be caused by the uncertainty around HIPs or for other reasons or the beginning of a new trend, or the bringing forward of listings in order to avoid paying for a HIP. Including in an econometric forecast would therefore risk the results being distorted and we have accordingly not used it.

4.22 Table 4.1 identifies the forecast values for new property listings in England and Wales for the period May 2007 through to April 2008.

Table 4.1: Forecast of new properties to be listed in England and Wales (May 2007– May 2008)

Month	Forecast
June 2007	236,907
July 2007	198,309
August 2007	208,248
September 2007	190,225
October 2007	177,261
November 2007	200,971
December 2007	102,418
January 2008	148,768
February 2008	218,923
March 2008	198,852
April 2008	203,261
May 2008	183,835

*Note: not all results shown*

## The total stock of listings

4.23 The Rightmove House Price Index report for March 2007<sup>41</sup> states “Rightmove’s database [contains] 635,000 properties currently advertised on the site (representing over 80per cent of all properties for sale)”. 635,000 divided by 80 per cent equals 793,750. We therefore take 800,000 as our estimate of the total stock.

## Time on market

4.24 Time on market refers to the length of time between listing your house for sale and an offer being accepted. It is the length of time taken to sell one’s house, and we shall later employ it as a proxy for time taken to buy a house.<sup>42</sup>

4.25 As will be discussed in more detail in Section 5, we use our figure for the time on market in order to calculate how changes in house listings caused by HIPs might be displaced across time, ie how long the effect remains in the system.

4.26 Time on market exhibits some seasonality, as illustrated in the The Rightmove House Price Index report for May 2007 (see Figure 2.3).

4.27 In the 12-month period ranging from June 2006 to May 2007, Figure 2.3 suggests that time on market varied from just under 70 to just over 80 days. As our no-HIPs

<sup>41</sup> Last available information. [www.rightmove.co.uk/pdf/p/hpi/HousePriceIndex19thMarch2007.pdf](http://www.rightmove.co.uk/pdf/p/hpi/HousePriceIndex19thMarch2007.pdf)

<sup>42</sup> The two concepts are not equivalent, and one could envisage theoretical circumstances in which they were wildly different – for example, if every current home owner were selling so as to move into the rental sector, and put their houses on the market at once, with no-one buying for 80 days, then on the 80<sup>th</sup> day every house were bought by a first-time buyer, the time-to-sell would be 80 days, but the time to buy would be just one day. Nonetheless, under ordinary circumstances in which most people are moving from one owned home to another, it seems unlikely to be materially wrong for our purposes here if we take it that the time-to-sell and the time-to-buy will be similar.

baseline we assume 75 days. In Section 5 we shall discuss how HIPs might affect the time on market.

## Phasing of introduction of HIPs

4.28 We have considered three scenarios for a phased introduction of HIPs.

- (a) In the first scenario, HIPs are introduced for houses with four and more bedrooms on 1 August 2007, for three bedroom houses on 1 September 2007 and extended to all houses on 1 October 2007 (we have termed this Scenario I).
- (b) In the second scenario, HIPs are introduced for houses with four and more bedrooms on 1 August 2007 and then extended across the whole market from 1 September (Scenario II).
- (c) Finally, we look at a case where HIPs are introduced for houses with four and more bedrooms on 1 August 2007, for three bedroom houses on 1 October 2007 and extended to all houses on 1 December 2007 (Scenario III).

4.29 The HIPs Implementation Update issued by Communities and Local Government on 11 June 2007 states that the phasing in of HIPs will be dependent upon the number of energy assessors available, the regional distribution of such assessors and any lessons learned from the actual operation of HIPs. Communities and Local Government believes that about 3,000 Home Inspectors and Domestic Energy Assessors will be required for coverage of the whole market. It follows that Scenario II represents the most optimistic view of this, whereas Scenario III is more pessimistic and Scenario I represents an intermediate case. Given the late deferral of the implementation of HIPs in May 2007, one might argue that the training of such assessors will be slowed by a loss of credibility as to whether HIPs will be implemented at all. On the other hand, the publicity around HIPs – albeit largely adverse to date – may have made any shortfall in such assessors more visible than was previously the case and so be of assistance in attracting people to this role.

4.30 There is an additional prospective transitional measure whereby marketing may commence once a HIP has been commissioned as opposed to completed. To the extent that the existence of these transitional arrangements is communicated to the market place, these should have a dampening effect upon behavioural changes due to the imposition of HIPs.

4.31 Table 4.2 shows an appropriate split of properties according to the number of bedrooms that they have.

Table 4.2: Analysis of houses by bedroom number

Number of bed-rooms	Percentage of total
1 bed	7
2 bed	31
3 bed	44
4 bed	14
5 bed	3
6+ bed	1

Source: *Communities and Local Government*

- 4.32 We understand that Communities and Local Government has based these figures upon a comparison of the frequency of one bed, two bed etc transactions in the Regulated Mortgage Survey (2005) for each dwelling type and the dwelling type transaction count from HM Land Registry.

## Definition issues around bedrooms

- 4.33 At present, the statistical information available on the number of four (or more) bedroom houses is quite limited – data on variances in listings, time on market between differing sizes of property, and so on, do not appear to be publicly available.
- 4.34 There has been speculation that there may be some play around the definition of a bedroom for marketing purposes in order to avoid the cost of a HIP. Given the substantial price differentials between three- and four-bedroom houses (about £120,000), the use of code words by estate agents to differentiate between genuine three bedroom houses and “three *plus x*” houses (that are really four bedroom properties) would need to be convincing to be attractive to a rational seller.<sup>43</sup> The provisions of the Property Misdescriptions Act may also have a mitigating effect on this.

<sup>43</sup> The differential between three- and two-bedroom homes is rather less in absolute terms (at £30,000) and proportionately (at 16 per cent of the value of a three bedroom home against the £120,000 difference being 39 per cent of the average value of four bedroom house). This is based upon Communities and Local Government data for England and Wales.

## 5 The impact of HIPs on the housing market

5.1 Having developed estimates for the number of house listings and time on market in the absence of HIPs, we now turn our attention to the impact of HIPs. We use a combination of fundamental and pragmatic analysis to assess the likely impact on house listings. In the first instance we discuss how vendor and buyer behaviour might change in response to HIPs. We then move to providing estimates, relative to our forecast baseline, given the introduction of HIPs. Lastly, we consider some possible impacts on house prices.

### Vendor and buyer behaviour

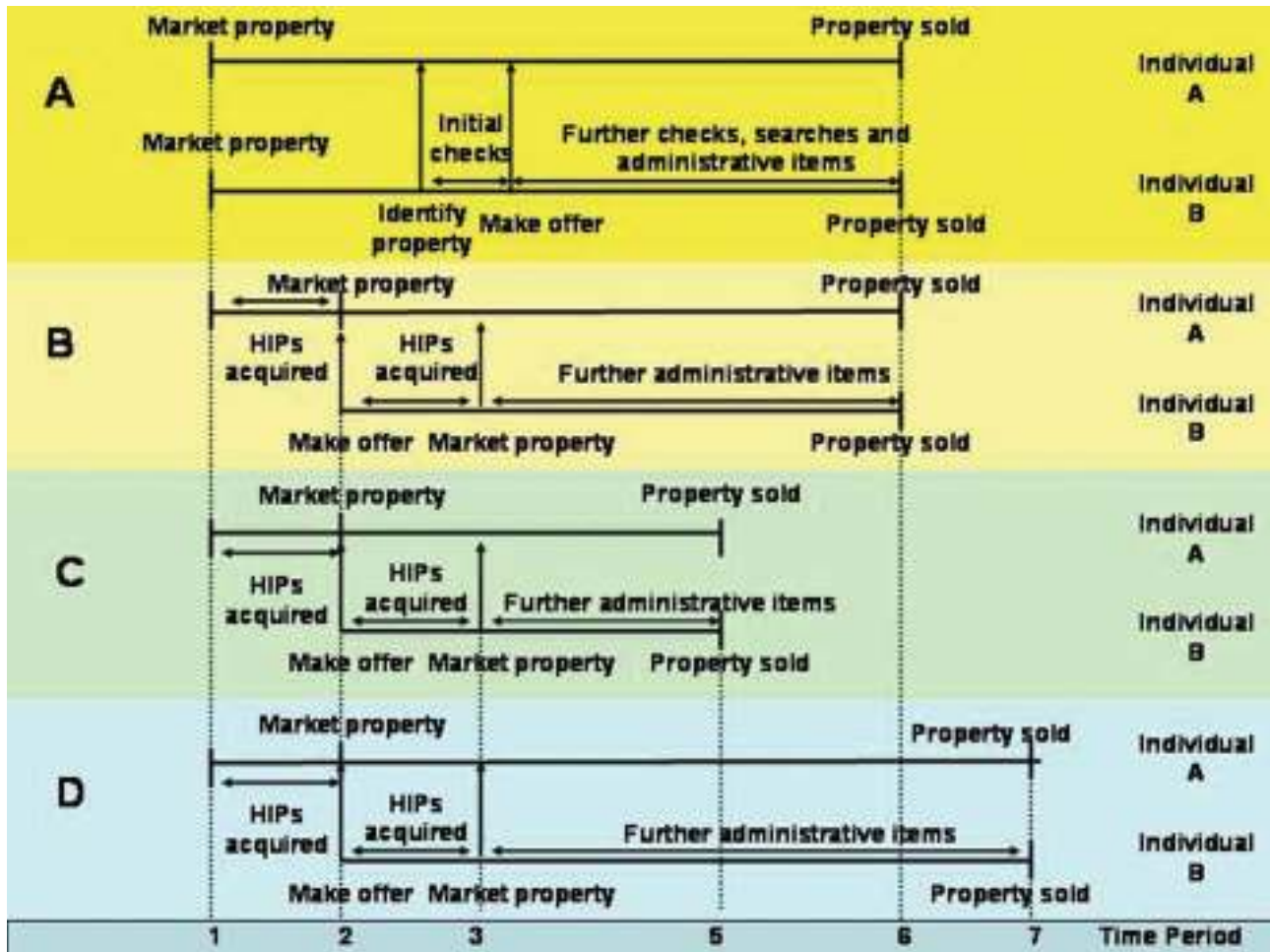
- 5.2 As discussed in the preceding section, using the Countrywide Estate Agents' (CEA) survey, one can distinguish between two main types of vendors: those that have to sell their house, and those that do not. The majority of vendors choose to market and sell their house for personal or work related reasons, eg a change in domestic circumstances, retiring, job change and so forth. What this means is that for this category of vendor, the decision to market and sell their property seems unlikely to be particularly sensitive to policy changes of the nature of HIPs, as these vendors have little choice in selling.<sup>44</sup>
- 5.3 However, where one would expect there to be a change in behaviour (defined by the decision to sell or not to sell) is in the category of speculative or tentative sellers. This category is made up of three groups identified in the CEA survey: 'not found a property' (27 per cent), 'testing the market' (4 per cent) and 'purely financial motives' (4 per cent). Changes in the behaviour of these vendors will be the driver of any changes in house listings brought about by the introduction of HIPs.
- 5.4 To recap, the 'not found a property' category refers to vendors who have placed their house for sale without already having made an offer on another property. Some vendors in this category are likely to actually be vendors selling for reasons such as retirement, job move and so forth. However, in contrast to those specific categories, vendors in this category may not have made a firm decision to move. They may be swayed to remain in the existing home or delay the decision to sell, for example by a policy change. Thus, this category may hide different degrees of vendor tentativeness thus meaning that the figure of 27 per cent is very much an upper level estimate.
- 5.5 Vendors testing the market wish to get a sense of their property value and gauge interest in it. They are not fully committed to selling and are unlikely to accept offers that do not meet or exceed their *a priori* expectations.
- 5.6 Vendors selling for purely financial motives are selling properties that are not their primary residence.

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<sup>44</sup> The Countrywide research further asked vendors what they would have done with regard to listing their property, had they had to provide a HIP. The results, though, indicate that for the majority of vendors the requirement to market a property with a HIP would make no difference to their decision – 73 per cent of respondents.

- 5.7 Collectively, the CEA survey suggests that speculative or tentative sellers represent 35 per cent of the housing market. This figure is best regarded as an upper estimate. Our purpose in identifying them is that it is vendors in this category whose behaviour is most likely to change as a result of HIPs, because they are not in the situation of those in other categories that they are committed to selling their house.
- 5.8 How their behaviour might change is shown graphically in Figure 5.1 below which sets out the current situation (without HIPs), the situation immediately post-HIPs, and a longer term scenario. The timescales given are merely illustrative. We use this framework as the basis for constructing our HIPs scenarios that follow.
- 5.9 In the existing framework (shown in panel A), the house selling and buying process is shown to run in parallel. Individual A places his house on the market in a given area. Independently, individual B also places his house for sale. After some time individual B identifies individual A's house and privately makes a decision to place an offer. However, before he formally makes any offer he may arrange for some initial checks and searches of the property. Once he is satisfied then a formal offer is made. From this point onwards, in the current system, further checks, searches and administrative items are carried out, including information that would have been contained in HIPs.
- 5.10 All the while individual B is purchasing individual A's house, he is also conducting the sale of his own house, hence the parallel nature of the system. The entire process takes six time periods (which are not necessarily equal) for each of the two vendors in our illustrative example. Since the buying and selling process involves a chain, the transaction cannot be completed if either of the individuals has not completed his own house sale/purchase.

Figure 5.1: Changes in behaviour due to HIPs



Source: Europe Economics

5.11 With the introduction of HIPs, the processes and behaviour of vendors may alter (light yellow, panel B). If we assume that individual A has had an offer accepted for a property (perhaps before HIPs was introduced), he now must acquire a HIP before he markets his property.<sup>45</sup> Acquiring a HIP before first marketing might be a very rapid process – perhaps taking as little as 48 hours. In our illustrative example we shall term this one time period. With this acquired, his house can be placed for sale. After some time individual B views the property and makes an offer but he does not need to spend the same time as previously making the initial checks, because he has the HIP to refer to. However, we assume that individual B is a tentative seller, and has chosen not to bear the cost of acquiring a HIP until he was sure he would move. As a consequence he had not listed his own house for sale at the point at which he made the offer for A’s property. By placing an offer for individual A’s house he signals his commitment and then begins the process of marketing his own property. In the above diagram, the introduction of HIPs has also shortened the transaction process to four periods for individual B, and the net effect of HIPs across the whole transaction period for A is neutral.

5.12 The next panel of the diagram (green) depicts the best case scenario for the HIPs system, once it has achieved maturity. In this case the shorter transaction time is

<sup>45</sup> For the purposes of this illustration, we ignore the transitional arrangements whereby an individual could begin marketing a property having commissioned a HIP but without actually being in possession of one.

enjoyed by both vendors A and B. As short as three time periods in one case. The house buying and selling process has moved from being parallel to becoming more sequential in nature, but has been squeezed so that A sells his house more quickly than before.

- 5.13 The final panel (light blue) shows a more pessimistic scenario for the introduction of HIPs. HIPs may introduce complications in the transaction process either prior to marketing, or post-offer, eg complications achieving acceptance by mortgage lenders or the buyer's solicitors who repeat the process (eg of the title search required within HIPs), or simply because the enhanced efficiency of the transaction process does not fully compensate for the increase tendency towards sequential marketing, as set out above. In this case, the entire transaction process time increases. The transitional arrangements, which are designed to facilitate first day marketing, should militate against this. These arrangements run through to the end of 2007.
- 5.14 In terms of the transitional period during which HIPs is phased in across all properties, the achievement of efficiency gains appears unlikely due to the likely existence, at least in part, of the factors identified in Paragraph 5.13 during this time and possible confusion within the property market about the revised process. In other words, the best case – in the short term – for HIPs may be to maintain marketing times at current levels. A less optimistic scenario is that after HIPs are introduced, transaction times will increase for a transition period, before falling back once the new requirement becomes properly established and the efficiency benefits of HIPs are realised in full. Communities and Local Government's view is that the most appropriate assumption is no change in time on market, and we take this as our baseline case.
- 5.15 This discussion has considered scenarios in which some vendors who, in the current situation would market their house without having already placed an offer for another house, will change their behaviour to delay marketing their house until they have had an offer accepted for a new house. During periods in which the housing market is particularly 'hot', such a delay may face some resistance from other vendors – through an increased risk of being gazumped on the property that they wish to buy, or possibly even from estate agents favouring buyers who are already marketing their properties – and so perhaps be reduced.
- 5.16 In the case of the true market testers (estimated at four per cent of the market), in the short run they may be dissuaded from marketing altogether. However, it should be noted that in a market with rising house prices (rising each month far in excess of the cost of HIPs) there are advantages to sellers not in a chain in delaying nonetheless.

### Incidence of HIPs costs

- 5.17 One interesting point to note is on whom the incidence of cost of HIPs will fall. While HIPs will be compiled by authorised agents, it seems likely that, once the market settles, most vendors will typically purchase them through their estate agent. Estate agents may be inclined to pay for these HIPs as part of their services to avoid the up-front cost for vendors.<sup>46</sup> In this case vendors will be faced with a decision either to pay for the HIP or receive it free from their estate agent. The decision is

<sup>46</sup> We note on 2 May 2007, Hamptons International announced they would offer clients Home Information Packs for free, following the expected June 1 implementation date.

complicated by the fact that estate agents are likely to demand exclusivity from the vendor (ie the property can only be marketed through its channels).

- 5.18 Different types of vendors may see this trade-off differently. For example, market testers may be more inclined to sign up for exclusivity as they incur no costs and can get a sense of the market. In contrast, those buyers who have placed an offer and are eager to sell quickly may be more willing to pay for a HIPs directly and then market with the widest possible number of estate agents.

## Scenarios

- 5.19 We now move to present our scenarios for the impact of HIPs. These scenarios are those identified in Section 4 relating to the possible phasing in of HIPs. Within each we begin by considering vendors changing their behaviour only in one direction by either bringing the decision to list forward or delaying it. The models are constructed on the basis of our baseline estimates of the counterfactual and our fundamental and pragmatic analysis. Within each scenario we posit possible ranges and what the impact might be if HIPs alter the length of listing time for properties.
- 5.20 Building on these individual scenarios, we present our overall expected scenario which combines what we consider to be the most plausible behaviour of different vendors.
- 5.21 As discussed above, Communities and Local Government's view is that the most appropriate assumption is that time on market initially shows no change, and we take this as our baseline case. The phasing in of HIPs makes expectation of immediate efficiency gains in time less likely due to the existence of chains where some vendors will have HIPs whilst others will not. It is more plausible to think that a reduction in transaction time is a medium term effect of HIPs, which would occur outside the forecast period.
- 5.22 We also present a sensitivity to Communities and Local Government's expected scenario in which the impact of chains identified above and potential confusion in the market around HIPs leads to a temporarily increase in transaction times after the introduction of HIPs.
- 5.23 Whilst we have not sought to model the longer term impact of HIPs in detail, we have no reason to doubt that there will be a reduction in time on market in due course once HIPs are fully incorporated into the market processes.

## Caveat

- 5.24 The models presented here (as in Section 4) are intended as forecasts of the impact of HIPs, rather than as forecasts of the levels of transactions or of time on market. For example, they contain no explicit modelling or other prediction of the future path of short-term interest rates. We consider it appropriate to abstract from these other issues, so that the impact of HIPs introduction can be seen more clearly, without being obscured by other factors not central to our purposes in this report.

## Scenario I

- 5.25 In the first scenario, HIPs are introduced for houses with four and more bedrooms on 1 August 2007, for three bedroom houses on 1 September 2007 and extended to all houses on 1 October 2007.
- 5.26 There has been some speculation around the phased introduction of HIPs that there might be some play within the market surrounding the categorisation of houses as having four bedrooms and so on, until complete market coverage is achieved on 1 October when this will cease to be possible. Given the financial differential between four and three bed homes and, again, between two and three bedroom properties, the incentives for gaming appear low relative to the cost of a HIP. The Property Misdescriptions Act should also act as a deterrent. On this basis, the potential gaming effect has not been reflected in the model presented in this report.<sup>47</sup>

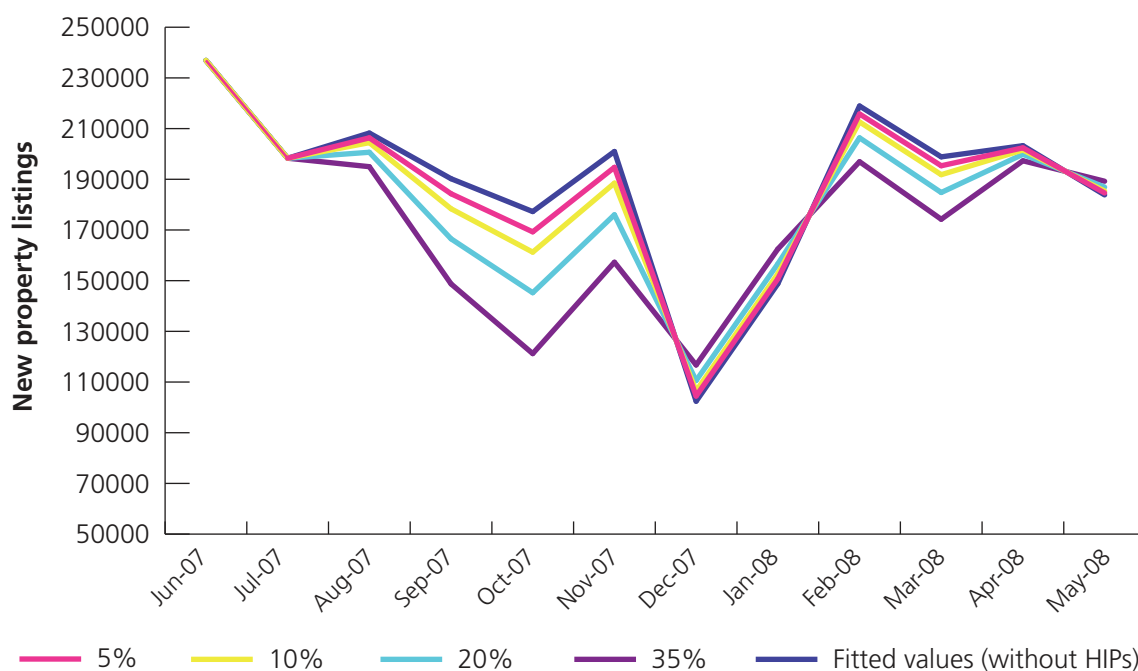
### Listings moved back

- 5.27 We first examine the case where a proportion of those vendors thinking of listing and selling their house delay their decision once HIPs have been implemented (see Paragraphs 5.9ff). As should be made clear, in the context of rising house prices, the decision to delay for vendors can be relatively attractive, dependent in part upon personal circumstances, even if they have to pay for a HIP themselves.
- 5.28 These scenarios match the analysis of the previous section (panels B, C and D of the diagram), ie the change in numbers listed is driven by the segment of the market that has not fully committed to selling. Dependent upon what proportion of speculative or tentative sellers decide to move their decision to list back, this is pro-rated to a per cent of the total market (based on CML statistics). We examine a range of possibilities, from one in which only five per cent of listings are affected, mainly the true market testers up to most or all of the tentative or speculative sellers make a decision to defer (meaning that 35 per cent of new listings were affected).
- 5.29 In our model, the nature of the transaction becomes more sequential (see panel C of Figure 5.1). Because some vendors have delayed their decision to list, other vendors who would have listed after placing an offer for another property, also delay their decision. This causes a complete rightward displacement along the time axis for all listings, ie the introduction of HIPs causes a fundamental shift in the market. The decision to delay listing does not just occur in August (or September or October), but occurs in every subsequent month. Below we chart the difference between these scenarios and the counterfactual without HIPs.

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<sup>47</sup> For completeness, we did model such 'play', and the results were not significantly different from those presented in this report. For instance, about 18 per cent of the market is estimated to have four or more bedrooms. We assumed that only those houses with four bedrooms (14 per cent) would be capable of such re-classification, and that 10 per cent of four bedroom houses would exploit this loophole, or 1.4 per cent of total listings for the relevant period. The same methodology was between three and two bedroom properties, where the effect is slightly larger (such 'play' would obviously discontinue once full market coverage was achieved). Naturally, the magnitude of the resulting variation from the results presented in this report is dependent upon the scenario examined, but is of the order of 1,000 to 2,000 listings per month.

Figure 5.2: Scenario I compared to the counterfactual (listings delayed and time on market unchanged)



- 5.30 As one can see there is an initial fall in the number of properties being listed under all of the variations modelled of our scenario compared to the counterfactual of no HIPs. This is due to the relevant portion (5, 10, 20 or 35 per cent) of the relevant market segment (ie four and more bedroom properties in August) choosing to delay their marketing. As discussed above, it should be stressed that these properties are not lost; rather they come back on to the market at a later date. The delay in listing is set by the average time on market. There is no permanent drop in speculative listings.
- 5.31 Whilst HIPs have an impact during the transitional phase, the long term consequences are relatively minor – the apparent divergence in Spring 2008 is due to the differential between December listings (and to a lesser extent those in January) and the neighbouring months, ie if there were no variation in month to month listings there would be no divergence at this point.
- 5.32 The impact of HIPs during the transitional phase, under these modelling assumptions, is substantial under the more extreme scenarios adopted (such as the case where 35 per cent of sellers accelerate their listing) and the seasonality towards the end of 2007 is affected. The market has shown itself capable of absorbing the normal winter variation which in the year to May 2007 was 148,000. This cumulative shortfall is about 127,000 in our forecast baseline.<sup>48</sup>
- 5.33 In the scenario as presented in the chart above, this cumulative shortfall varies from 132,000 (in the five per cent case), ie 5,000 above that in our forecast baseline, to 166,000 (in the 35 per cent case), ie 39,000 above our forecast baseline. In other words, in our most extreme scenario, the forecast cumulative winter shortfall is about 31 per cent greater than in the forecast baseline and 13 per cent higher than the historic one recorded with respect to the year to May 2007.

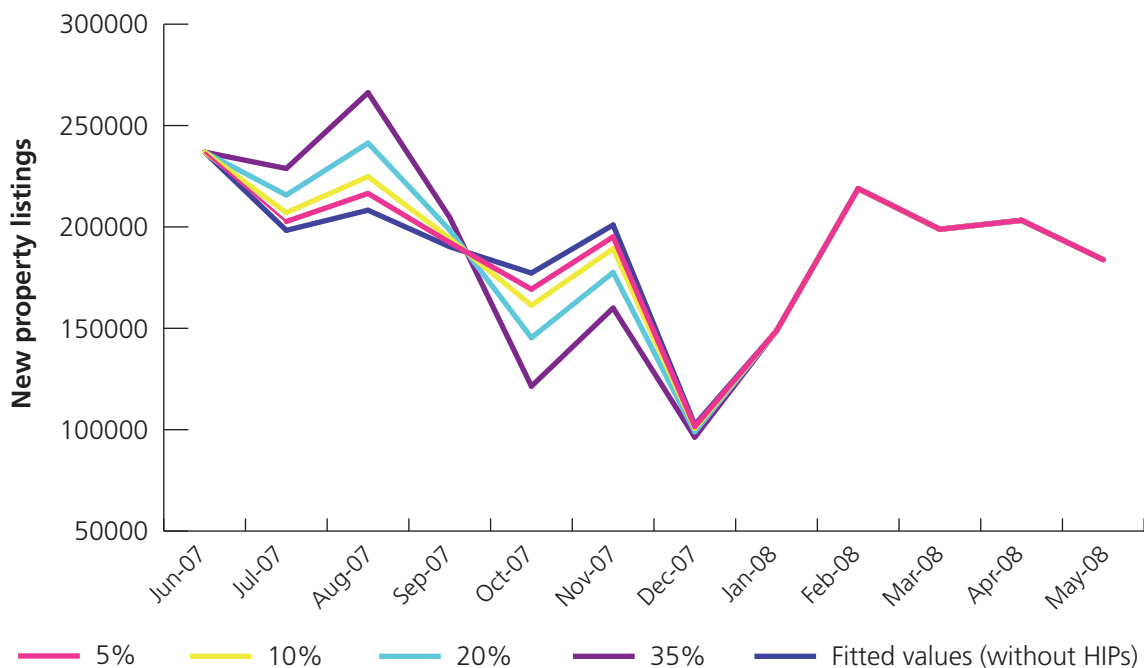
<sup>48</sup> This is calculated with reference to the average monthly listings in the forecast. Each month *below* that average contributes to the cumulative shortfall, until the winter downturn reverses.

- 5.34 It is also noted that as deferred listings come back onto the market, the normal winter drop in new listings is reduced somewhat and by the end of the forecast all the variations on the theme of Scenario I have broadly converged.

### Listings accelerated

- 5.35 We also consider the case where vendors decide to move the decision to list their house forward, ie before the introduction of HIPs. It is important to emphasise that in this situation, the decision to list early has economic significance. Those who list earlier will sell earlier, all other things being equal.

Figure 5.3: Scenario I compared to the counterfactual (listings accelerated and time on market unchanged)



- 5.36 In the forecast, listings are brought forward from a period defined by the time on market (ie 75 days). There is a sharp increase in listings forecast in July and August, and a more muted one in September followed by substantial reductions in the number of new listings until the system rebalances at the end of 2007. The peak is particularly sharp in August, an effect driven by the relative importance of three bedroom properties by comparison to larger ones. The visible effect in September is reduced because of the extent to which listings have been brought forward from this month to July and August.
- 5.37 In the variation where all of the tentative and speculative sellers bring forward their listings (the 35 per cent case), the listings peak in August. These are 29,000 higher than that forecast for June, 38,000 higher than that forecast for July, movements which are within normal month to month fluctuations. In the context of the total stock of properties on the market at one time, 800,000, a movement of 38,000 would represent 4.75 per cent).
- 5.38 It is perhaps also worth noting that there is some tension between the thought that one potential problem of HIPs might be that the need to have one will deter listing by people who want to list their houses on the day they decide to sell, and the idea

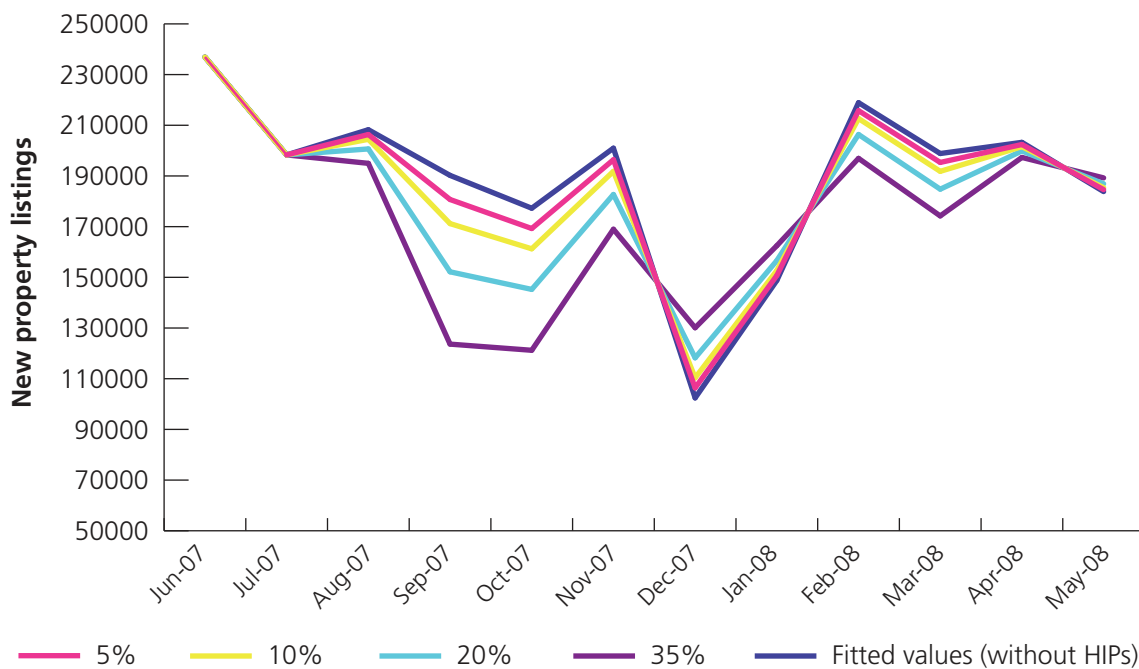
implicit in the bringing listings forward models being that people know months in advance that they are intending to sell their house and would choose to list early.

5.39 Even in the case where a vendor is part of a chain and is trading up (and so might have a pre-existing incentive to move early), the incremental effect of HIPs does not appear likely to affect such individuals much more than a month in advance. As a thought experiment to illustrate this, if the “trading up” involved a differential of £60,000, the current rate of nominal house price inflation would be broadly equivalent to the high end estimates of a cost of a HIP inside a month.

### Scenario II

5.40 In the second scenario, HIPs are introduced for houses with four and more bedrooms on 1 August 2007 and then extended across the whole market from 1 September. This is, therefore, the most optimistic scenario with regard to the availability of environmental assessors. We show below the same variations as for Scenario I.

Figure 5.4: Scenario II compared to the counterfactual (listings delayed and time on market unchanged)



5.41 This is somewhat similar to the results under Scenario I. The acceleration in application of HIPs to the whole market leads to a related acceleration in the divergence from baseline. From December onwards, the variation from the baseline is driven by variation in the forecast monthly listings rather than the phasing in of HIPs itself, as the model assumes that the deferral of listing has a continuing knock-on effect. In other words, if the monthly listings were absolutely flat, there would be no variance from the baseline from December 2007 onwards. The same is true for Scenario I (from January 2008 onwards) and for Scenario III (from March 2008 onwards).

Figure 5.5: Scenario II compared to the counterfactual (listings accelerated and time on market unchanged)

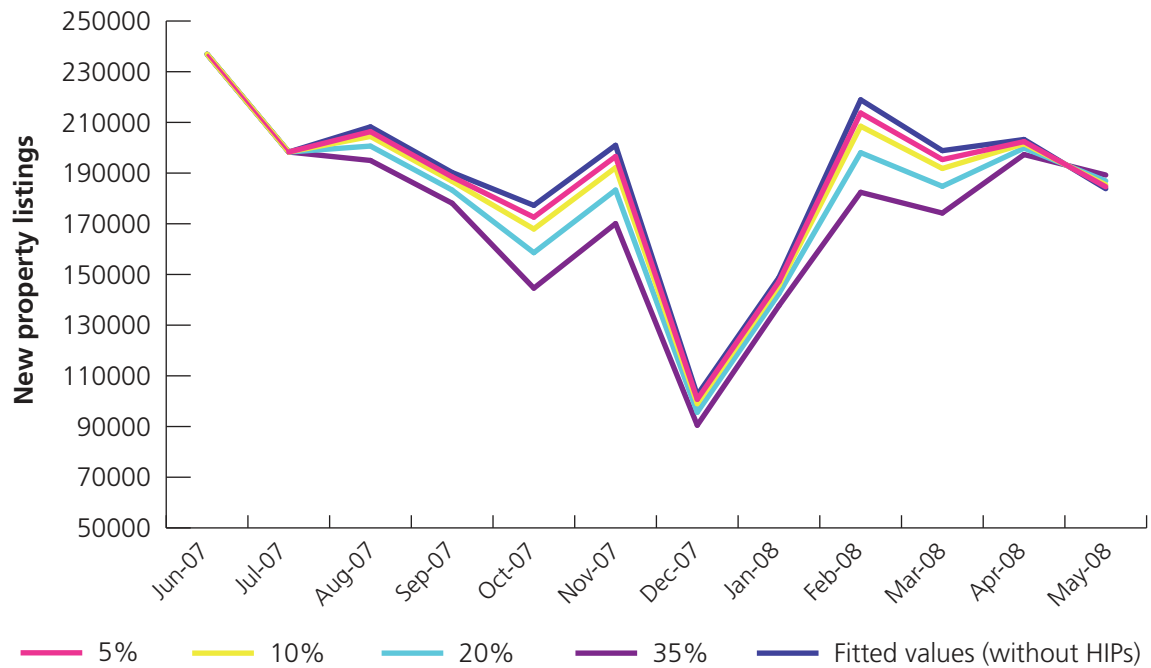


5.42 Again, this is broadly similar to the results presented for Scenario I and we have not repeated the analysis here in full. However, it is noted that the acceleration of the decision to extend coverage to the whole market creates an even more marked spike in new listings in August 2007 in the model considering listings being brought forward in isolation than under Scenario I (comparing Figure 5.5 with Figure 5.3). The increase in listings over base case in July, which is driven by properties with four and more bedrooms, is of course unchanged from that under Scenario I.

### Scenario III

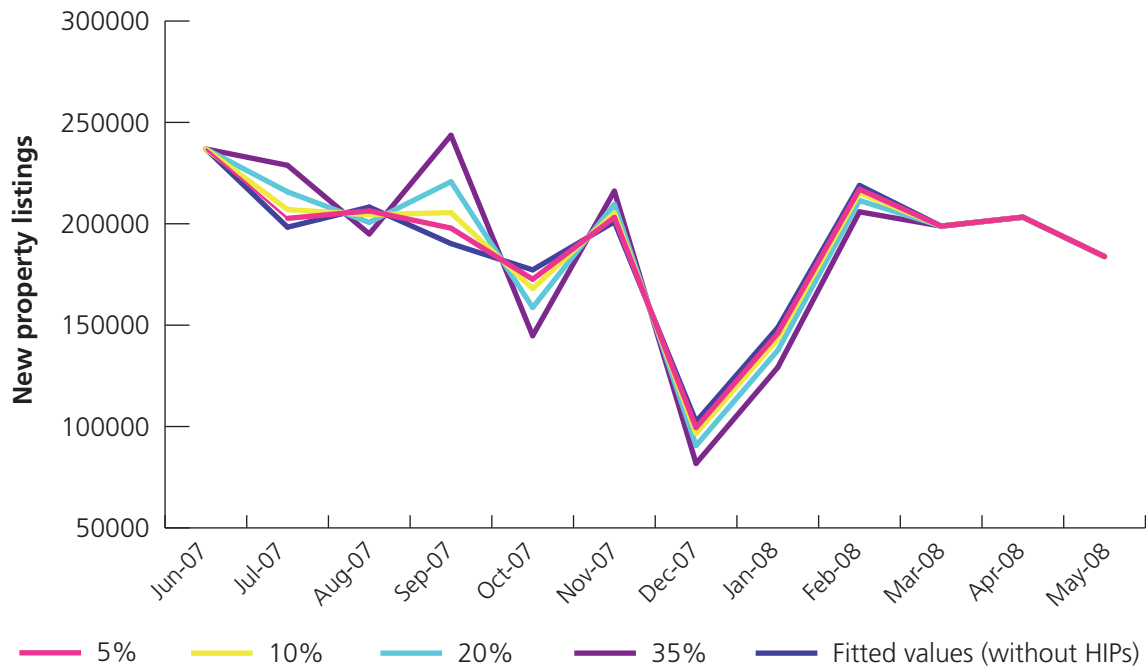
5.43 Finally, we look at a case where HIPs are introduced for houses with four and more bedrooms on 1 August 2007, for three bedroom houses on 1 October 2007 and extended to all houses on 1 December 2007.

Figure 5.6: Scenario III compared to the counterfactual (listings delayed and time on market unchanged)



5.44 This scenario mirrors the counterfactual closely in overall shape albeit at consistently lower levels. This is largely driven by the slower phasing in of HIPs, over four months, so that listings delayed from say August are coming back to the market *before* HIPs is fully implemented. Again, it is worth noting that the divergence from the counterfactual in March and April 2008 is driven by the monthly variation in the new listings rather than a continuing impact of the implementation of HIPs.

Figure 5.7: Scenario III compared to the counterfactual (listings accelerated and time on market unchanged)



5.45 In this scenario the volatility of new listings is increased with new spikes in July, September and November immediately ahead of the relevant HIPs schedule and with the associated dips in the other months until towards the end of the transitional phase where convergence is achieved.

#### Not listing at all versus new choices to list

- 5.46 As set out in Paragraph 4.4 above, some four per cent of listings are from true market testers that have no intention of selling. Whilst some such listings that would have occurred in August, say, may be displaced, once the period of transition is over it is possible that such non-serious listings may be deterred altogether. Indeed, deterring such listings is one of the potential benefits of HIPs.
- 5.47 On the other hand, at present, as discussed in Paragraph 1.9, transaction chains sometimes collapse when information from surveys is discovered. One of the aims of the HIP is to reduce the proportion of such chain collapses. Though we lack precise data, it is plausible that, at present, people involved in chain collapses sometimes give up on the house-selling process altogether, disappearing from the listings stock. Similarly, the risk that chains will collapse may, at the margin, deter other potential vendors from choosing to list at all. These factors might tend to mean that the introduction of HIPs should be expected to be associated with an increase in net new listings.
- 5.48 We have no precise basis for assessing how these two effects (non-serious listings deterred versus new listings encouraged) might net out, but it seems reasonable to suggest that the overall impact in either direction will be small.

## Expected scenarios

- 5.49 In this section we present our overall expected scenarios for the impact of HIPs. This builds on the baseline case of 20 per cent of vendors delaying their decision to list, but also makes an allowance for some vendors simultaneously moving forward their decision to list. However, in these scenarios we assume that these latter individuals would only adjust their listing decision by one month rather than by the time on market, for reasons rehearsed already in the preceding paragraphs.
- 5.50 We do not have a strong basis for assuming an effect as large as 20 per cent as opposed to a still-significant-but-more-modest 10 per cent of delayers. However, given the uncertainties surrounding the introduction of the scheme we consider this an appropriately conservative assumption to make. We consider a more optimistic 10 per cent scenario as a sensitivity below.
- 5.51 The introduction of HIPs appears to have created a focal point for the collective marketing efforts on behalf of many estate agents to persuade vendors to move listings forward (though not all, for example, Hamptons International has, in contrast, responded by offering to provide HIPs for free). It seems reasonable to assume that such a marketing effort may have some effect at the margin, so that in addition to some vendors delaying, some portion of the market will move their decision to list from the first two weeks after HIPs is applied to their category of property to two weeks (or so) beforehand.
- 5.52 There might be a question of whether this coordinated effort will be repeated when HIPs are phased in. However, be that as it may, we regard such movement of listing date as a statistical artefact of little true economic significance – in contrast to the scenario analysed earlier, listing early in this case does not imply selling early. For example, if someone moves his first listing from, say 2 August 2007 to 30 July 2007, statistically he will show up as moving from the August to the July figures, but there seems little reason to consider such a shift economically significant, especially since we would expect such people to be in less of a hurry to sell from their initial listing date. We assume that they should still be expected to agree a sale at the same date.
- 5.53 Our expected scenario assumes that 20 per cent of those vendors that would have listed in the no-HIPs scenario decide to shift back (delay) their date of first listing (as in the scenario in Paragraph 5.27ff), and 10 per cent of vendors at the same time shift forward (advance) their date of first listing by one month.<sup>49</sup>
- 5.54 As discussed above, although it is possible that some listings might be deterred altogether (as opposed to shifted in time) whilst other new listings might be encouraged, our overall scenario does not assume any net change of this sort.
- 5.55 Table 5.1 and sets out our modelled expected scenarios.

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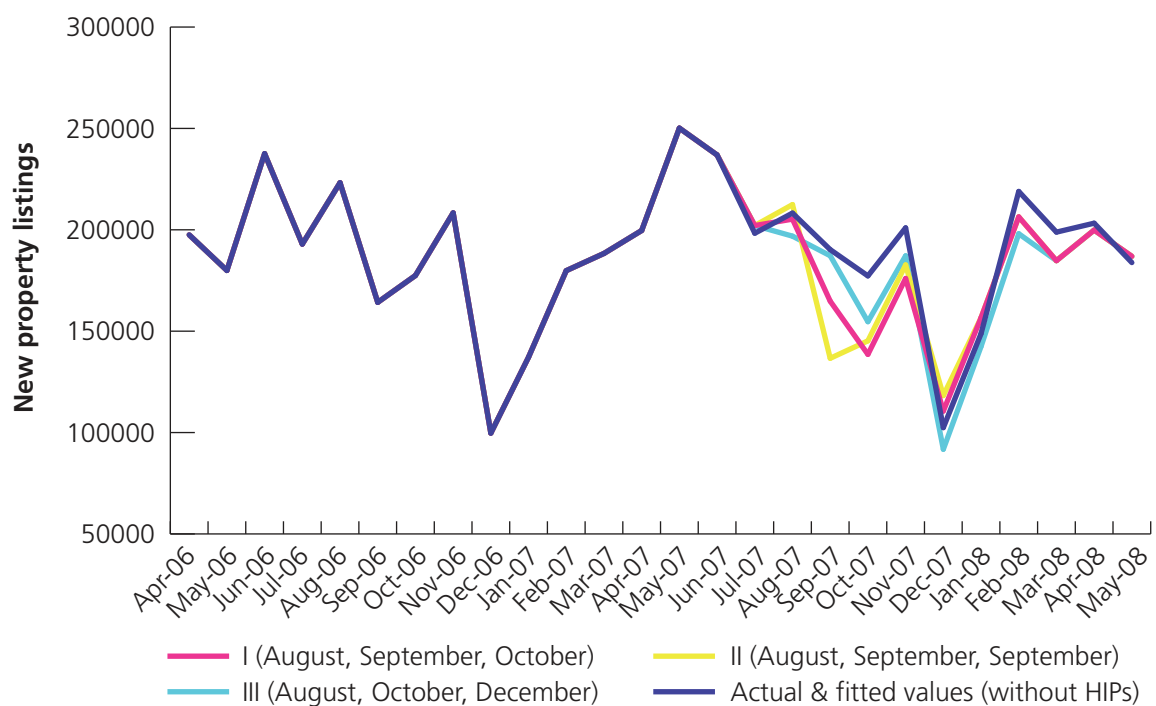
<sup>49</sup> Many vendors will list their property within a few days of making the decision to sell – there is no implementation lag (indeed, undermining the ability to list from Day One is one of the common criticisms of HIPs, albeit one that the transitional arrangements are designed to combat). Allowing for some residual ignorance of HIPs (for instance, a survey by PropertyFinder, that preceded the decision to delay implementation, found only 27 per cent awareness of HIPs: [news.hotproperty.co.uk/Brits\\_ignorance\\_of\\_Hips\\_astonishing\\_18135729.html](http://news.hotproperty.co.uk/Brits_ignorance_of_Hips_astonishing_18135729.html)) and noting that the transitional arrangements reduce the motivation for this behaviour (for those aware of HIPs), we have adopted 10 per cent of the market as the number bringing listings forward in our expected scenario.

Table 5.1: Expected scenarios for impact of HIPs

Month	Baseline (no HIPs)	20% of market delay marketing, 10% shift forward by one month, time on market unchanged		
		Scenario I	Scenario II	Scenario III
Jun 07	236,907	236,907	236,907	236,907
Jul 07	198,309	202,101	202,101	202,101
Aug 07	208,248	205,263	212,430	196,871
Sep 07	190,225	164,799	136,622	187,207
Oct 07	177,261	138,556	145,234	154,680
Nov 07	200,971	176,002	182,691	187,170
Dec 07	102,418	110,592	118,236	91,750
Jan 08	148,768	156,608	156,608	142,445
Feb 08	218,923	206,363	206,363	198,059
Mar 08	198,852	184,780	184,780	184,780
Apr 08	203,261	199,858	199,858	199,858
May 08	183,835	186,921	186,921	186,921

5.56 Figure 5.8 below illustrates the expected scenarios under the phasing options I, II and III, and provides some additional context by also showing the actual listings from the twelve months prior to the forecast period.

Figure 5.8: Overall scenarios for new listings (10 per cent forward, 20 per cent delayed, time on market unchanged)

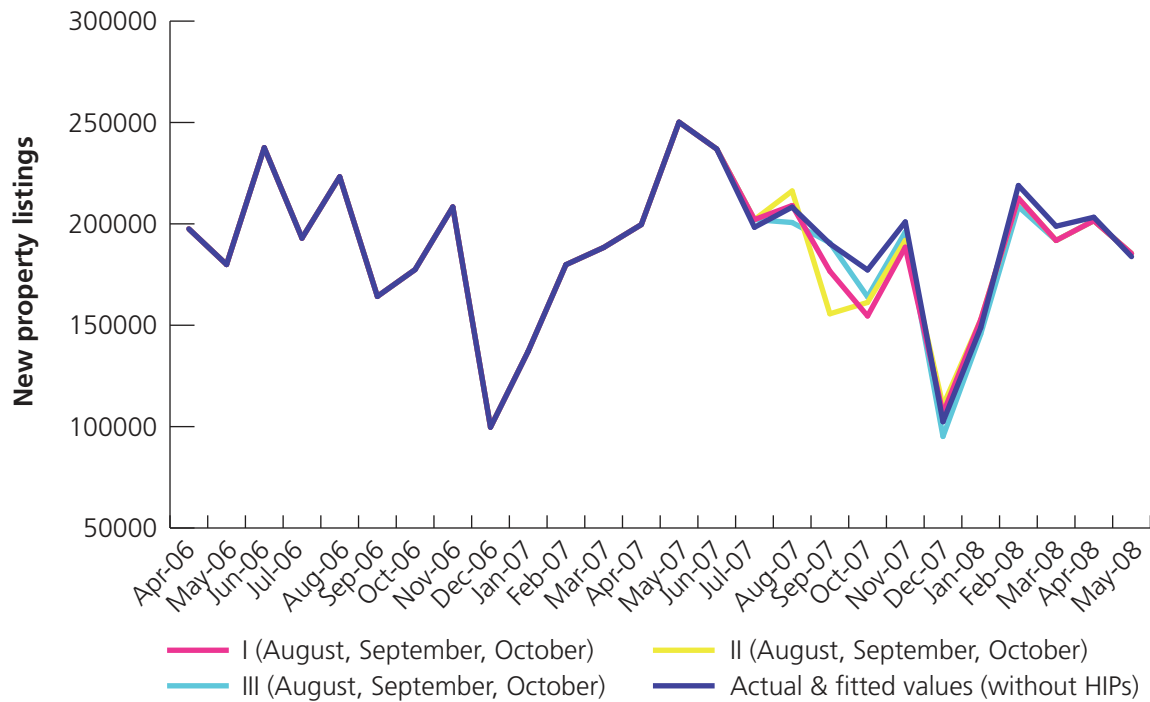


- 5.57 In this case, the range of variation is within the scale and nature of existing volatility within new property listings. In other words, HIPs would appear likely to be drowned out by the noise already existing in marketplace and which have historically been absorbed by the housing market, so there seems little reason to suggest that the implementation of HIPs would cause anything beyond relatively minor temporary disruption. This is particularly the case in respect of the slower phase in of HIPs (from 1 August to 1 December 2007).
- 5.58 However, the magnitude and timing of these variations from the baseline do vary according to the exact timing of the implementation of HIPs across the property market, as one would expect. In particular, we note that the impact of a significant proportion of sellers deferring their decision to list means that there is a drop in listings volume compared to baseline ahead of the normal winter decline. This is particularly marked in Scenario II, which accelerates the application of HIPs to the whole market.
- 5.59 On the basis of the above model, Scenario III appears to create smaller perturbations, at least through to the end of 2007, due to the slower phase-in that underlies that option. This means there is greater scope for the number of listings to recover (eg from sellers who previously deferred coming to market) prior to the next extension of HIPs coverage. On the other hand, Scenario III, unlike the other two scenarios, deepens the winter drop off in listings for the same reason.
- 5.60 By April 2008, our model suggests there will be a convergence between the scenarios and that would have been expected without the introduction of HIPs. This indicates that whilst HIPs may have a short term impact on the number of properties listed (the magnitude of which could be regarded as not unusual in the context of normal listing fluctuations), the long term consequences of that transitional impact would appear to be small.
- 5.61 It is noted that the number of new listings for May 2007 was just over 250,000, representing an increase of about 50,000 on the previous month (see Figure 2.2). We have already noted our concerns about the quality of this data series, but let us for the moment accept that this 50,000 represented an approximate guide to the number of individuals bringing their listing forward in response to the original implementation date of 1 June. This would be from the whole spectrum of properties – homes with four and more bedrooms represent about 18 per cent of the housing stock, giving a rough estimate of 9,000 homes to be brought forward from August to July (being 18 per cent of 50,000).
- 5.62 Our expected scenario gives a figure of just over 4,000 that would be brought forward from August to July. This lower level of response in our model against what was experienced in May nevertheless appears reasonable to us, given first our concerns about the data and more importantly the likely impact of the transitional arrangements put in place. These will allow listing having commissioned a HIP, but without necessarily having a HIP actually being in place. This should lead to a marked reduction in the motivation for bringing forward listings in this way.

## Sensitivities

5.63 We varied our expected scenario such that only 10 per cent of properties are delayed in response to the rolling implementation of HIPs, with the result presented at Figure 5.9.

Figure 5.9: Overall scenarios for new listings (10 per cent forward, 10 per cent delayed, time on market unchanged)

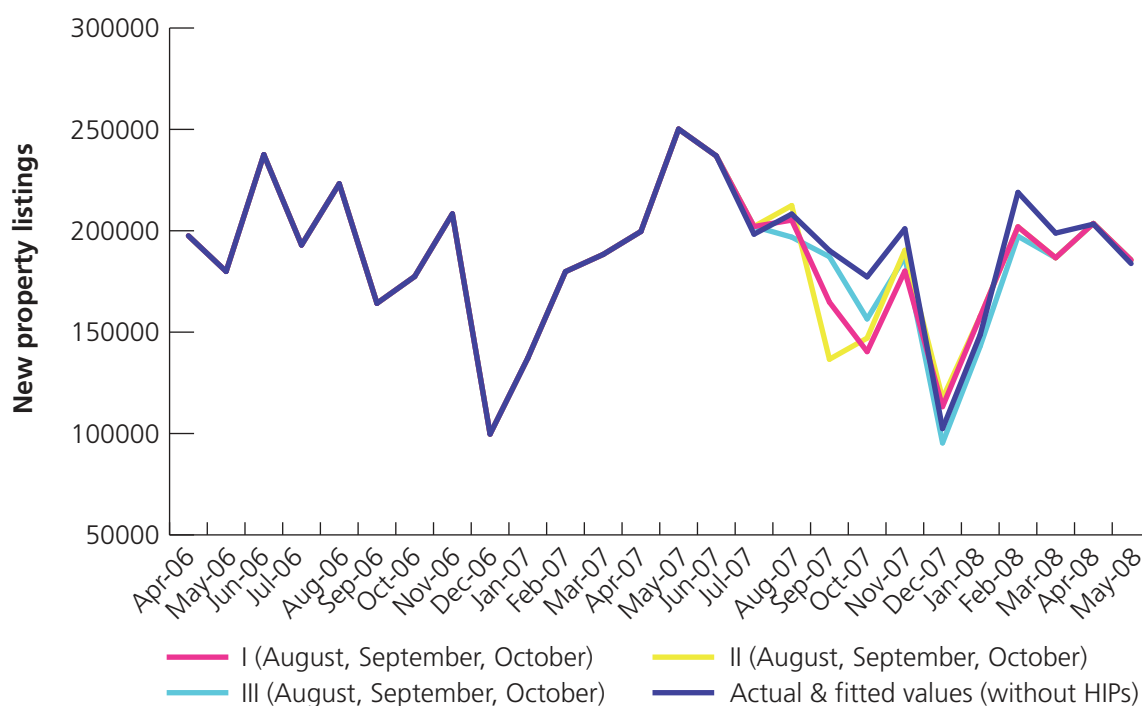


5.64 Naturally, the variation is of lesser magnitude in this case and the conclusion that the volatility is within that already tolerated by the market remains the same.

## Time on market

5.65 We also consider the possibility that time on market increases from current levels, by 10 per cent to around 82.5 days, during the implementation phase of HIPs. We present this below as a variation on our expected scenario. Such an increase in time on market does not produce a significant effect upon the quantum of listings within our model.

Figure 5.10: Overall scenarios (10 per cent forward, 20 per cent delayed, 10 per cent increase in time on market)



## Impacts on house prices

5.66 It is outside the scope of this report to provide detailed predictions for the future path of house prices. However, given that we have forecast above that the introduction of HIPs may cause some limited change in listings behaviour (raising the number of properties listed in one month then reducing by rather more or less in the next month) it is reasonable to consider what sort of impact this might have on prices.

### Might prices fall?

5.67 It has been argued that the introduction of HIPs will lead to a price fall. One mechanism suggested for this was that people would race to place their properties onto the market in advance of the HIPs introduction, so as to avoid bearing the up-front cost. As set out above, we do not consider this a particularly plausible scenario except at the margins (ie moving the listing decision by a matter of weeks). Further, it is far from clear why such a race-to-list would be expected to lead to price falls. In a rational, well-functioning market, purchasers and vendors would understand that the increase in listings was only temporary, and did not represent some change in fundamentals, and so the effect on prices should be expected to be very limited.

5.68 Probably the thought is something like the following: the housing market is very delicately balanced at extreme over-pricing, so that any disturbance to the process whatever (whether a positive or a negative regulatory change) might lead people to re-assess their willingness to pay and upon re-assessing revise downwards.

5.69 In response to this we would make the following points. First, as the section on the prospects for the housing market noted, there is no consensus that the market

is at such an unstable peak. Indeed, those models that predicted falls have been so wrong for so long that they must surely now require material revision. Many commentators have now returned to expecting house prices to continue to rise.

- 5.70 Second, we have not been able to identify any convincing reason to explain how a possible small change in properties listed could feed through to a significant lasting impact on house prices. The small change in listings that we estimate might occur is well within the range of typical monthly fluctuations and should be well within the ability of the market to absorb without a lasting impact on prices. If the market really were as unstable as this argument implies, recent interest rate rises (and expected rises to come), just to take one example market factor, would surely be much more likely to have an impact than would HIPs.
- 5.71 A more plausible mechanism for HIPs inducing price falls assumes that they improve the efficiency of the housing market. As has been noted, house sale transactions can fail due to some new piece of information arising which alters the buyer's decision. What this means is that there is some information asymmetry between the buyer and seller. The cost of searches and other information-gathering may also be higher at present than it would be in a well-functioning market (indeed, reducing such costs is one of the goals of HIPs). If HIPs leads to improved efficiency in the general housing transaction process then one might expect to see a new equilibrium with a slightly lower price than would otherwise have been the case. This would, of course, be a good thing since the lower prices involved would reflect greater transaction efficiency. But the orders of magnitude should be relatively small in the context of alleged housing market over-pricing – something of the order of the cost of the HIPs itself along with add-on cost of time and trouble and non-HIPs information-gathering (collectively summing to something less than £1000) compared with widely-discussed estimates of housing market over-pricing as high as 30 per cent (or nearly £60,000).<sup>50</sup> Thus even if increased efficiency of transactions might (desirably) lead to some fall in prices relative to their otherwise trend, again we believe that it would be extravagant to ascribe any high probability of prices falling materially to this mechanism.

### Might prices rise?

- 5.72 On the other hand there is an argument which says that the introduction of HIPs will cause house prices to rise. The argument is that for a short period prior to HIPs those vendors who would have marketed their houses in the absence of HIPs decide to delay their listing until either they have had an offer accepted or until they feel the new HIPs regime has settled down. This would represent a temporary supply shift in the number of houses available to buy. (Although one must recall that this category of vendor represents only a small proportion of all house listings). This supply shift could have a consequence of pushing up prices.
- 5.73 Although some effect is possible (we note that the effect would surely be relatively small – our base case model, for example, predicts an impact on the stock of houses available for sale of about 60,000 by the end of 2007), we do not find this story a convincing basis to project any significant or sustained impact. There remains an ambiguity as to the advantage of marketing with HIPs. Some vendors may feel this will help them sell their property.

<sup>50</sup> For example, see OECD Economic Outlook No. 78, December 2005 – [www.oecd.org/dataoecd/41/56/35756053.pdf](http://www.oecd.org/dataoecd/41/56/35756053.pdf)

- 5.74 Further, as noted above, if all market participants are well-informed, they will know that the supply shift is not permanent and instead represents a shift in the point of marketing – so prices should not rise due to HIPs.
- 5.75 Thus, overall, our view is that, although prices may rise (or fall) during the next twelve months, as in other markets this will be overwhelmingly driven by the fundamental drivers of supply and demand. Fears that HIPs will be the main or key determinant are, in our view, unfounded.

## 6 Conclusions

- 6.1 In this report we have considered the potential impact of HIPs, particularly on the numbers of properties listed and on time to market, investigating the plausibility of suggestions that the introduction of HIPs may lead to significant disruption.
- 6.2 Our models suggest that there may be an effect of HIPs on the behaviour of vendors whereby those not fully committed to selling, wait until they have had an offer accepted on the house they wish to move into before placing their own property on the market or bring forward the listing of their property (by a few weeks but not more) in order to avoid the cost and inconvenience of HIPs.
- 6.3 Under our expected scenarios for the impacts of HIPs (a 20 per cent delay in marketing, 10 per cent forwarding of marketing, and no change in time on market), the predicted changes in listing are not so dramatic as to be outside the normal noise found within the number of new listings and which is already well tolerated by the housing market.
- 6.4 For example, under our baseline of no HIPs, in May 2008 there are 183,835 new houses listed on the market. This is compared to about 186,000 under the various expected scenarios modelled. The biggest difference in the number of listings occurs under Scenario II in September 2007 – around 28 per cent. However, this is very much a one-off occurrence, and the average fluctuation across all scenarios compared to the baseline of no HIPs is typically less than 10 per cent. We conclude that these behavioural changes will not create effects beyond the normal noise, except in one or two isolated months, and that even in these isolated cases we expect the impacts of such shifts to be fairly rapidly absorbed.
- 6.5 Our overall view is that, although prices may rise (or fall) during the next twelve months, as in other markets this will be overwhelmingly driven by the fundamental drivers of supply and demand, eg the changing interest rate environment. Fears that HIPs will be the main or key determinant are, in our view, unfounded.

# Appendix 1: Forecasting model

A1.1 This Appendix sets out our forecasting models and methodologies.

## New properties coming on to the market in England and Wales

A1.2 Before estimating a statistical relationship in a time series setting, it is necessary to evaluate the stationarity properties of the variable used in the estimation.<sup>51</sup> In our case, we want to forecast the variable ‘new property listings’ for which we have 31 monthly observations. We therefore need to analyse whether or not the variable properties listed can be regarded as a stationary variable.

A1.3 For ease of writing, we label the variable “new property listings” as  $Y$ . As is common practice, we consider the natural log of  $Y$ , which we denote in lower case:  $y$ .

A1.4 In order to verify whether or not  $y$  follows a unit root process, we run a series of appropriate unit root tests.<sup>52</sup>

A1.5 The most common is the Dickey-Fuller (DF) test. The most general form of it consists in running the following regression:

**Equation 1:**  $\Delta y_t = \alpha + \gamma y_{t-1} + e_t$

A1.6 A trend variable can also be appropriate in cases when the dependent variable grows over time.

A1.7 The appropriate test to ascertain whether  $y$  has a unit root or not (and is therefore a non-stationary series) is to test simultaneously for  $\gamma = \beta = 0$  with an F-test, bearing in mind that the value of the F test should not be compared with the standard ones: in practice, the results should be compared with appropriate statistical tables which report the distribution of the test statistics.

A1.8 Alternatively, researchers often test only for  $\gamma = 0$ , assuming that is  $\beta = 0$  as well (see Verbeek, 2004). The DF test is strictly valid only if the error term can be considered white noise. If this is not the case, the DF test can be made robust to serial correlation by inserting enough lags of the dependent variable ( $\Delta y_{t-p}$ , with  $p$  = number of lags) running what is known as an Augmented Dickey-Fuller (ADF) test, which is the main test we have used in this work.

A1.9 Other tests that can be used for comparison with the ADF test are the Phillips-Perron (PP) test and the ADF-GLS test, which are described in Davidson and MacKinnon (2004).

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51 Where stationarity refers to there being a constant mean and variance and autocorrelation throughout time. Thus a stationary process can be defined as a random process whose underlying statistical properties do not change with time.

52 A unit root is an attribute of a statistical model of a time series whose autoregressive parameter is one. It is equivalent to the time series having a stochastic trend and its presence, if not corrected for, invalidates the ARIMA approach. A unit root test is a statistical test for the proposition that in an autoregressive statistical model of a time series, the autoregressive parameter is one.

- A1.10 Our test results show that the ADF test does not accept the null hypothesis that  $y$  has a unit root (the value of the ADF test is -3.168, against a critical value of -3 at 5 per cent and -2.63 at 10 per cent, and with a p-value of 0.0219) if Equation 1 is run with five lags (this is the number of lags suggested by Greene (2002) for a sample of this size) and without a trend. The number of lags is not critical to this result.
- A1.11 The PP test strongly rejects the null (with a p-value of 0.0001). However, the ADF-GLS test does not allow rejection of the null hypothesis of a unit root.
- A1.12 Thus, there some ambiguity as to whether  $y$  has a unit root – on balance, supported by careful observation of the apparent mean reversion properties of the time series, we have rejected the hypothesis that  $y$  has a unit root and the analysis that follows is conducted on the basis that, at least as first approximation, the natural logarithm of  $Y$  is a stationary series.
- A1.13 Given the small sample size, we have decided to run a very parsimonious model that is nevertheless found to fit quite well the behaviour of many univariate time series, the ARMA (1,1) model. (An alternative would be to estimate several models, such as AR(1), AR(2),MA(1), etc, and then try to select the best model according to some statistical Model Selection Criterion, such as the AIC.)
- A1.14 An ARMA(1,1) model can be written as follows:

**Equation 2:**  $\Delta y_t = X_t \beta + u_t$

**Equation 3:**  $u_t = \zeta u_{t-1} + \theta \varepsilon_{t-1} + \varepsilon_t$

- A1.15 The error term in Equation 2 has an ARMA(1,1) structure, as it incorporates both an autoregressive and a moving average structure. To be more correct, the Model in Equation 2 and Equation 3 is said to have an ARMAX structure, given the inclusion of the controls  $X_t \beta$ .
- A1.16 The  $X_t \beta$  term in fact accounts for control variables – as well as the constant – that might influence apart from the error dynamics specified in Equation 3. In our case, we have just introduced monthly dummy variables<sup>53</sup>, to account for possible seasonal effects in the behaviour of the variable of interest.
- A1.17 Combining Equation 2 and Equation 3 and using the knowledge that  $u_{t-1} = X_{t-1} \beta - \Delta y_{t-1}$  it can be shown that the model specified in Equation 2-3 is equivalent to the following model:

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<sup>53</sup> It should be noted that this model displays some evidence that even with the general dynamic structure, the residual is not purely random noise, according to the Portmanteau test for white noise. The most likely cause of this is omission of a relevant explanatory variable from the model – the only variation beyond the dynamic structure allowed are the monthly dummy variables. The results of this model should therefore be viewed with caution.

**Equation 4:**  $\Delta y_t = X_t \beta + \zeta(\Delta y_{t-1} - X_{t-1} \beta) + \theta \varepsilon_{t-1} + \varepsilon_t$

### Omission of observations

A1.18 As discussed in Section 2, our data set has been interpolated from publicly available information and as such we are using the data for purposes other than those originally intended. In particular:

- (a) The interpolated observations for December 2004 and January 2005 have been omitted from the forecasting exercise as these appear out of step with the known seasonality relating to listings within the property market, whereby there is a downturn in listings towards the end of the old year, with a subsequent pick-up in the new. Given the small number of observations overall, the omission of these two data points enhanced the apparent robustness overall.
- (b) May 2007 was omitted. As noted elsewhere in the report, there was a marked uplift in listings in this month. Possible explanations include general market trends and the inferior quality of the data set, but it appears reasonable to conclude that part of this uplift related to the imminent arrival of HIPs and vendors bringing forward listings in order to avoid incurring the associated cost. There is insufficient information available to robustly isolate the scale of this shift, and therefore this observation has been prudentially omitted from the series overall.

A1.19 It is highlighted that, given the use of monthly dummies and the small scale of the data set to begin with, the omission of these observations adds an extra cautionary note to the quality of the forecasts summarised below.

### Results and Forecasts

A1.20 Our results for the number of new properties coming on market are reported below

Table A1.6.1: Results for number of properties coming on the market

ARIMA regression	
Sample: 1 to 30	Number of obs = 28
	Wald chi <sup>2</sup> (13) = 4295.77
Log pseudolikelihood = 31.29096	Prob > chi <sup>2</sup> = 0.0000

Semi robust						
	Coefficient	Standard error	z	P> z	95% confidence interval	
Lny						
January	0.37	0.06	5.8	0.0	0.25	0.50
February	0.76	0.10	7.8	0.0	0.57	0.95
March	0.66	0.05	13.3	0.0	0.57	0.76
April	0.69	0.04	18.7	0.0	0.61	0.76
May	0.58	0.05	12.7	0.0	0.50	0.67
June	0.85	0.04	19.8	0.0	0.76	0.93
July	0.67	0.05	14.7	0.0	0.58	0.75
August	0.71	0.06	11.3	0.0	0.58	0.84
September	0.62	0.12	5.4	0.0	0.40	0.85
October	0.55	0.04	14.4	0.0	0.47	0.62
November	0.67	0.04	15.6	0.0	0.59	0.76
Constant	11.54	0.03	380.0	0.0	11.48	11.60
ARMA						
AR						
L1	0.57	0.58	0.99	0.32	-0.56	1.71
MA						
L1	-0.30	0.80	-0.38	0.71	-1.86	1.26
Sigma	0.08	0.01	6.03	0.00	0.05	0.10

*Note: the monthly dummy variables are relevant to December and hence pick up the December slump in listings*

A1.21 We have then computed the dynamic forecast for for the remaining part of 2007 and the first four months of 2008 and converted the logarithmic forecasts back into actual numbers. The subsequent Table contains our forecasts of the number of properties to be listed in England and Wales between May 2007 and April 2008.

Table A1.6.2: Forecast of new properties to be listed in England and Wales (May 2007– April 2008)

<b>Month</b>	<b>Forecast</b>
June 2007	236,907
July 2007	198,309
August 2007	208,248
September 2007	190,225
October 2007	177,261
November 2007	200,971
December 2007	102,418
January 2008	148,768
February 2008	218,923
March 2008	198,852
April 2008	203,261
May 2008	183,835

*Note: not all results shown*

## Remarks

A1.22 In this Appendix we have forecast expected listings for England and Wales for the twelve month period May 2007 to April 2008. These forecasts form our counterfactual when we come to construct our scenarios for a world with HIPs.

A1.23 The model used was univariate in nature. They do not include control variables for factors such interest rates or GDP trends as we were not able to build these significantly more complicated models under the project timescale. One area for further analysis could therefore be more detailed forecast models with longer and richer data.

# Appendix 2: References

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# Appendix 3: Addendum, 20 November 2007

*This annex has been co-authored by Europe Economics and Dr Peter Williams.*

## Introduction

- A3.1 The Main Report above, completed at 31 July 2007, considered the potential impact on house listings and how this might impact the housing market more generally.
- A3.2 In summary, we established a model of vendor behaviour whereby those not fully committed to selling delay listing until they have had an offer accepted on the house they wish to move into or bring forward the listing of their property (by a few weeks but not more) in order to avoid the cost and inconvenience of HIPs. Under our expected scenarios we concluded that:
- The predicted behavioural changes were not so dramatic as to be outside the normal noise, except in one or two isolated months. Such fluctuations in the number of new listings are already well tolerated by the housing market.
  - Although prices may rise (or fall) during the next twelve months, as in other markets, such changes will be driven overwhelmingly by the fundamental drivers of supply and demand, including the changing interest rate environment. In other words fears that HIPs will be the main or key determinant were, in our view, unfounded.
- A3.3 As at 20 November 2007 we have been invited to review our findings in the context of the key market developments in the last few months in order to establish whether it is appropriate to continue to stand by the conclusions of the main report. We have also had our findings subject to review by a senior market practitioner, Dr Peter Williams. This Addendum reflects our current position and that of Dr Williams.

## Key Issues for Consideration

- A3.4 The key issues that we have identified for consideration are as follows:
- The interest rate environment (i.e. the cost of credit)
  - The “credit crunch”, particularly as manifested in the reduced availability of sub-prime mortgages (i.e. factors potentially affecting the availability of credit).<sup>1</sup>
  - Any more general economic slowdown or a reversal in the housing market in particular (whether as a result of the above factors or for other wider reasons).

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<sup>1</sup> We note that around 20 per cent of housing transactions do not involve mortgages and so would not be directly affected, but such transactions are nonetheless affected by developments in the wider market.

- A3.5 The main question is whether and to what extent these are contributing to the continued softening of the housing market, along with pre-existing factors such as continued affordability pressures and the impact of HIPs.
- A3.6 For instance, the RICS Housing Market Survey (October 2007) reported that weak demand, despite robust economic fundamentals, was driving the weakening of the housing market.
- A3.7 In particular, RICS' headline measure had reached its lowest point since July 2005.<sup>2</sup>This (based on a survey of chartered surveyors) reports the difference between the proportion of surveyors reporting a price decrease and those reporting an increase. At October 2007, the proportion reporting a decline in prices exceeded the proportion reporting an increase by 22.2 per cent. This balance had been declining since April 2007. Bearing in mind the surveyors are asked for their opinions based upon the past three month period, this suggests a softening of sentiment that started earlier in the year.
- A3.8 The key price indices have not strongly evidenced this weakening so far albeit all are now forecasting rates of house price inflation in 2008 that are relatively low by the standards of recent years. The limited evidence to date may part reflect the volatility of monthly data but we note most are now showing typically-reducing annualised rates of growth. Given that the indices vary in terms of whether based on asking or completion prices and that it takes time to get a clear view of market direction, this evidence is widely regarded as a sign that the market is at or even just past its real-terms peak. The latest data from the main prices indices are (all relate to October to November 2007 unless otherwise stated):
- HBOS reports an annual rate of house price growth of 8.9 per cent, with a 0.5 per cent fall in the most recent month
  - The FT index reports a reduced annual rate of house price growth price of 8.9 per cent, but monthly increase of 0.7 per cent in October
  - Nationwide reports an annual rate of price of 9.7 per cent, with a 1.1 per cent increase in the most recent month
  - The CLG index reports an annual rate of price of 11.5 per cent for the year to Q3 2007
  - RICS reports a 7.9 per cent annual rise, with a 0.7 per cent fall in the most recent month.

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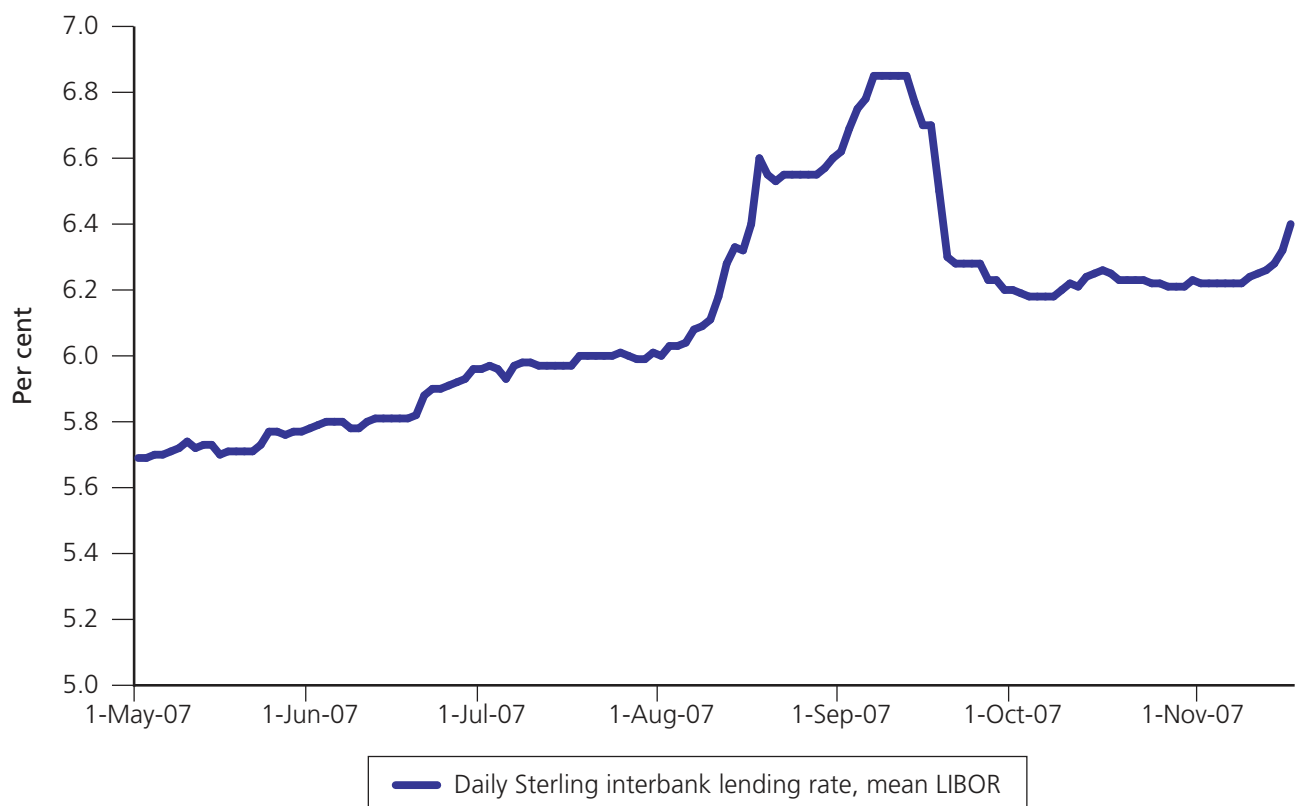
<sup>2</sup> Seasonally adjusted.

## Interest rates

A3.9 Since August 2006, the Bank of England has increased the Bank Rate from 4.5 per cent to 5.75 per cent in a series of five quarter point rises. The most recent of these was in July 2007.

A3.10 These changes in the Bank of England bank rate have affected mortgage rates. However, movements in the interest rates that affect mortgages have not, in recent months, been fully determined by actual or expected Bank Rate movements. Figure 1 below sets out movements in the three-month LIBOR, clearly illustrating a significant hump in the LIBOR that was unrelated to any Bank Rate changes.<sup>3</sup>

Figure 1: LIBOR and the credit crunch



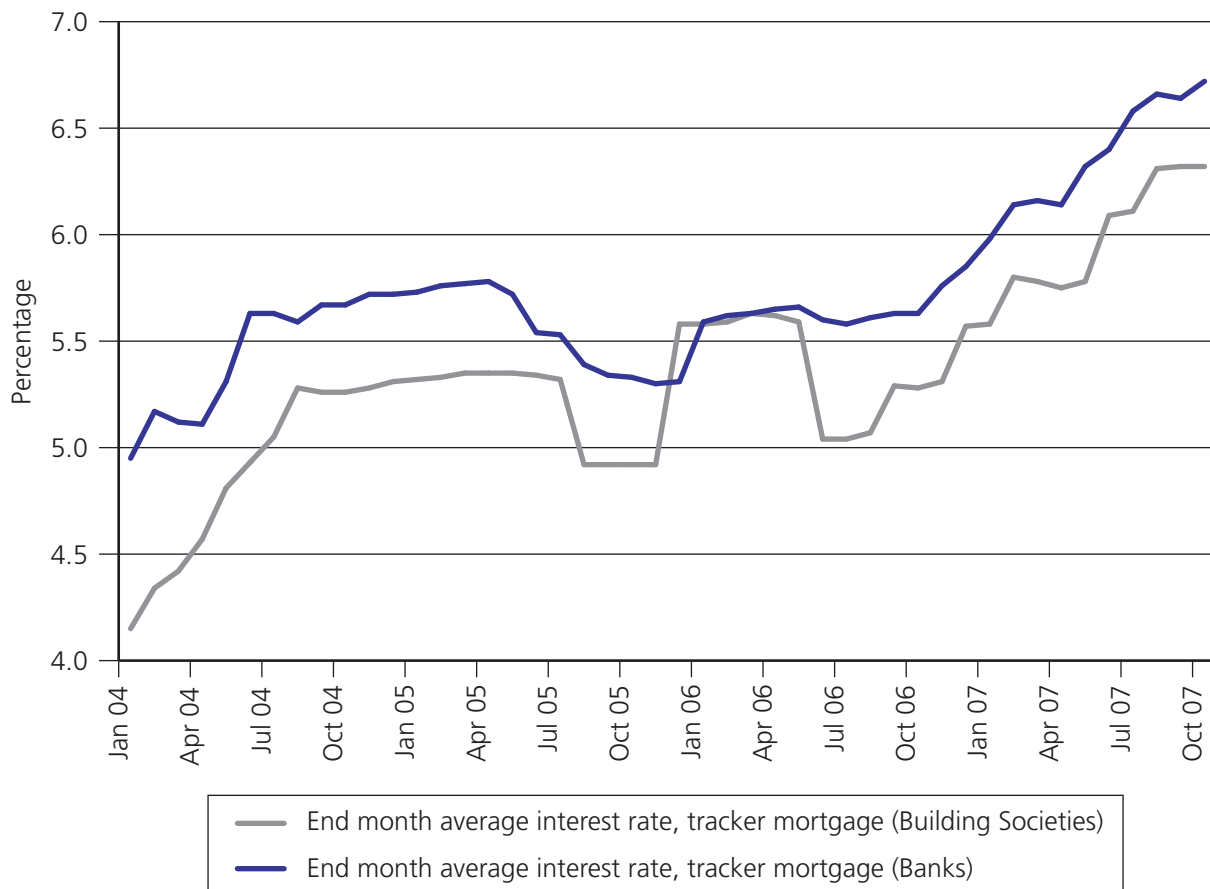
Source: Bank of England

A3.11 This has a cash flow consequence for those borrowers without fixed rate mortgages and whose mortgages are priced off LIBOR. Further, as discussed later, there has been a general tightening across the entire market in terms of loan to value ratios, product availability and prices. In other words, the affordability of housing has been adversely affected and this effect is likely to strengthen as existing borrowers come off their existing fixed rate mortgages.

<sup>3</sup> We note that another hump may be developing from mid-November.

A3.12 The changing rate of tracker mortgages (based on a 95 per cent loan to value ratio) is shown at Figure 2 below. These are the highest rates faced since early 2001.

Figure 2: Evolution of bank and building society mortgage rates



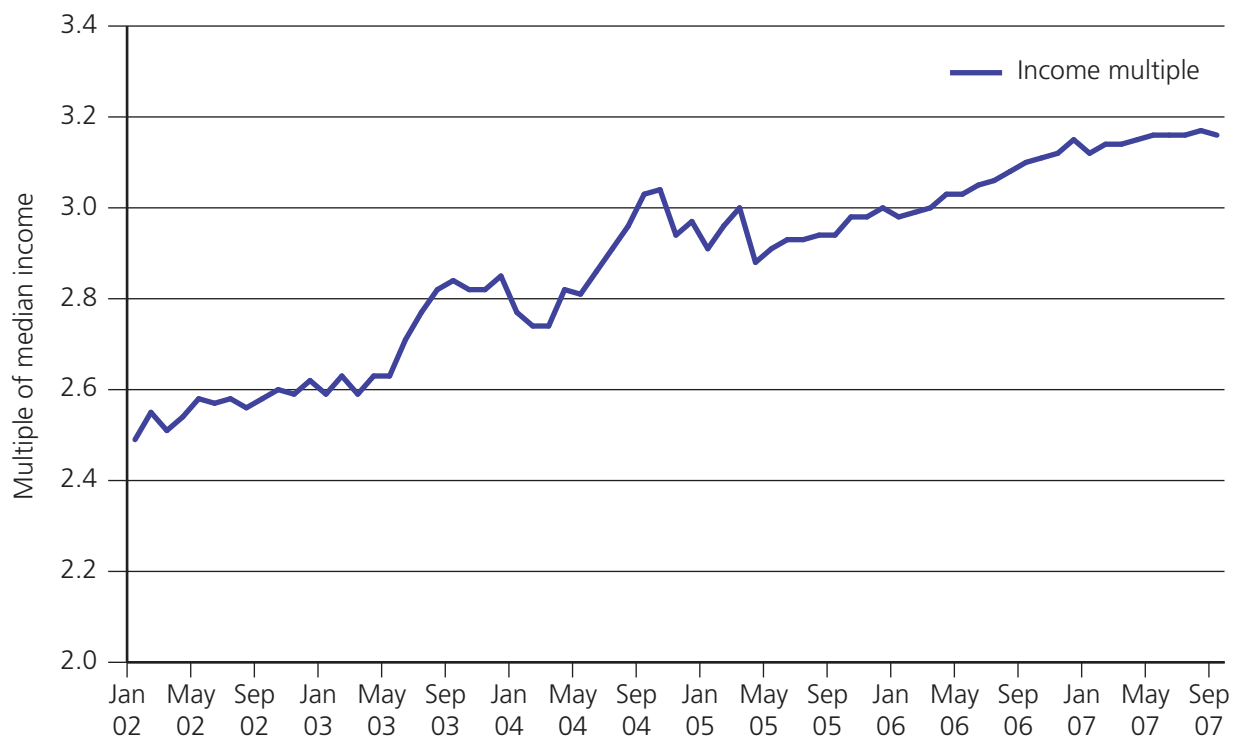
Source: Bank of England

A3.13 The current outlook for interest rates is, of course, intimately related to the outlook for inflation and GDP growth – and consequently for wages and employment. This outlook remains unclear, and we have not been asked to consider this question as part of this study. However, we note that the Bank of England inflation report published on 14 November indicates that the global credit crunch is expected to reduce UK GDP growth in 2008. This has been interpreted by some commentators as a signal that interest rates may be reduced by the Bank of England in early 2008.<sup>4</sup>

A3.14 Employment and wages so far remain robust, so income multiples have not changed materially from July.

<sup>4</sup> For instance, the Financial Times of 15 November 2007 predicts two interest rate cuts.

Figure 3: Average mortgages as a multiple of income



Source: CML

## The availability of credit

A3.15 The phrase “sub-prime” in relation to mortgages (sometimes also referred to as “non conforming mortgages” or “adverse credit mortgages”) relates to those mortgages targeted at consumers with impaired or low credit ratings or limited employment/salary histories who may find it difficult to obtain finance from traditional sources.

A3.16 The sub-prime component within the UK mortgage market has grown from an almost non-existent base since the 1990s. Although the sub-prime mortgage market is difficult to estimate, an FSA official estimated it at “8 per cent or more”<sup>5</sup> in 2007, in 2006 Oxera estimated it at 7 per cent.<sup>6</sup>

A3.17 This is well below the levels in the USA.<sup>7</sup> However, changing sentiment in the USA housing market during 2006-7 and its related impact upon the USA mortgage industry – particularly the sub-prime element within it – have adversely impacted upon investor demand for credit in the USA and beyond.

A3.18 The dearth of credit appetite in global money markets has been most visible in a UK context in respect to the well-publicised troubles of the Northern Rock. However, since this entered the public consciousness only in September 2007, its impact upon sentiment and behaviour is not yet fully apparent in the data available.

<sup>5</sup> Speech by Clive Briault, Managing Director, Retail Markets, FSA to the Council of Mortgage Lenders Annual Lunch 20 April 2007.

<sup>6</sup> Oxera, “UK Mortgage Underwriting”, April 2006, p10.

<sup>7</sup> There may, however, be difficulties in comparison because of differing definitions of “sub-prime” in the US as opposed to UK context.

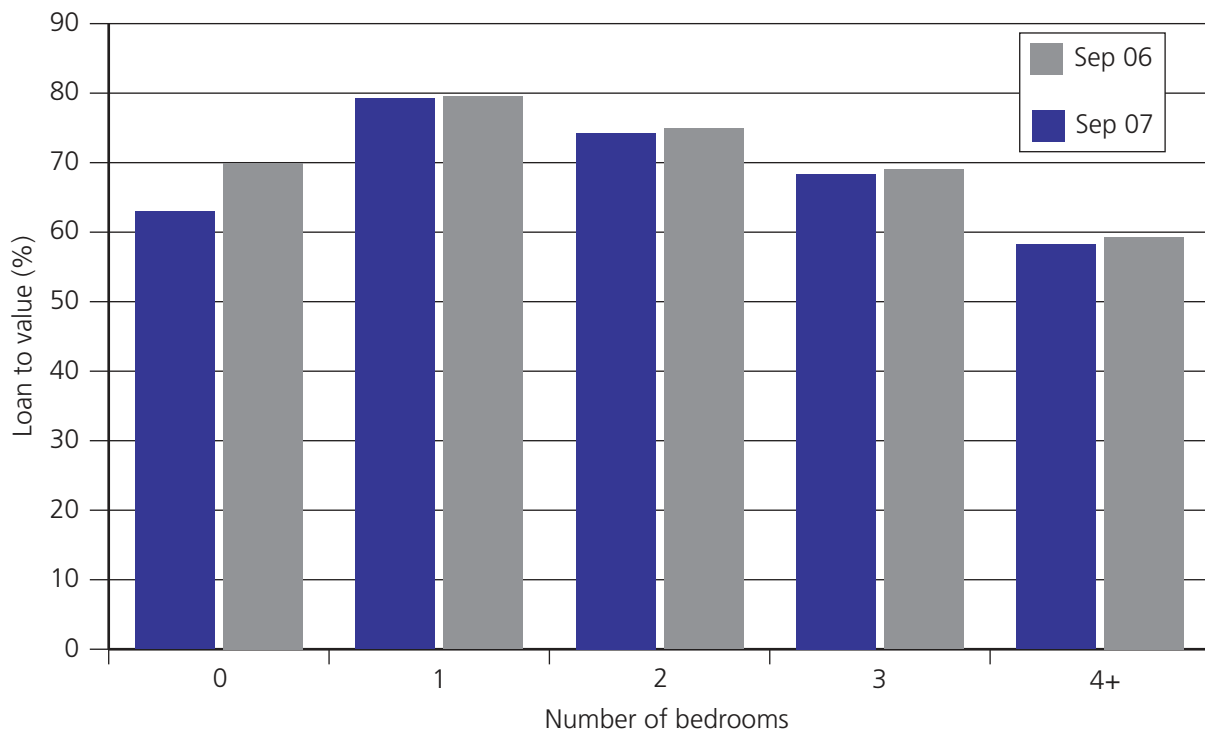
*Mortgage product availability*

- A3.19 There has been a significant reduction in the number of mortgage offers available in the housing market. Moneyfacts.co.uk reported in October 2007 an overall 40 per cent reduction in the number of mortgage products available over the three month period from July. This reduction was particularly marked in sub-prime (a 57 per cent reduction) and in buy-to-let mortgage products aimed at credit impaired borrowers (a reduction of 72 per cent), but was not limited to these areas. The mainstream mortgage market has itself experienced a 16 per cent reduction in available offers: this was described by Moneyfacts.co.uk as “unusual”.
- A3.20 This is likely to reduce the level of effective demand for housing, particularly amongst those with adverse credit histories. Indeed, the Council of Mortgage Lenders (CML) report a 24 per cent fall in the underlying value of loans from “other specialist lenders” from mid-year to September 2007. There is no data as to the correlation of such credit-impaired individuals with property size.

*Loan to value ratios*

- A3.21 Figure Error! No text of specified style in document..4 indicates a relationship between property size and credit exposure. Buyers of the larger properties (ignoring the zero bedroom category, which is assumed by CLG to relate to studio flats) – whether or not first time buyers – tend to have a lower loan to value ratio (probably mainly reflecting equity built up from previous transactions).
- A3.22 First time buyers of 1 to 3 bed properties (inclusive) had an average loan to value ratio of about 82 per cent in September 2007 against 71 per cent for first time buyers of 4+ bed properties. The highest loan to value ratio for existing owner occupiers was 73 per cent (one bed properties) dropping to 57 per cent for 4+ bed properties.
- A3.23 The chart suggests that there has been a slight retrenching of loan to value ratios over the last twelve months. There is insufficient data here to conclude whether this is driven by buyers, lenders or a combination of the two. However, given the analysis above, it is likely that this trend towards reducing loan to value ratios will continue at least in the short term.

Figure 4: Average loan to value ratios

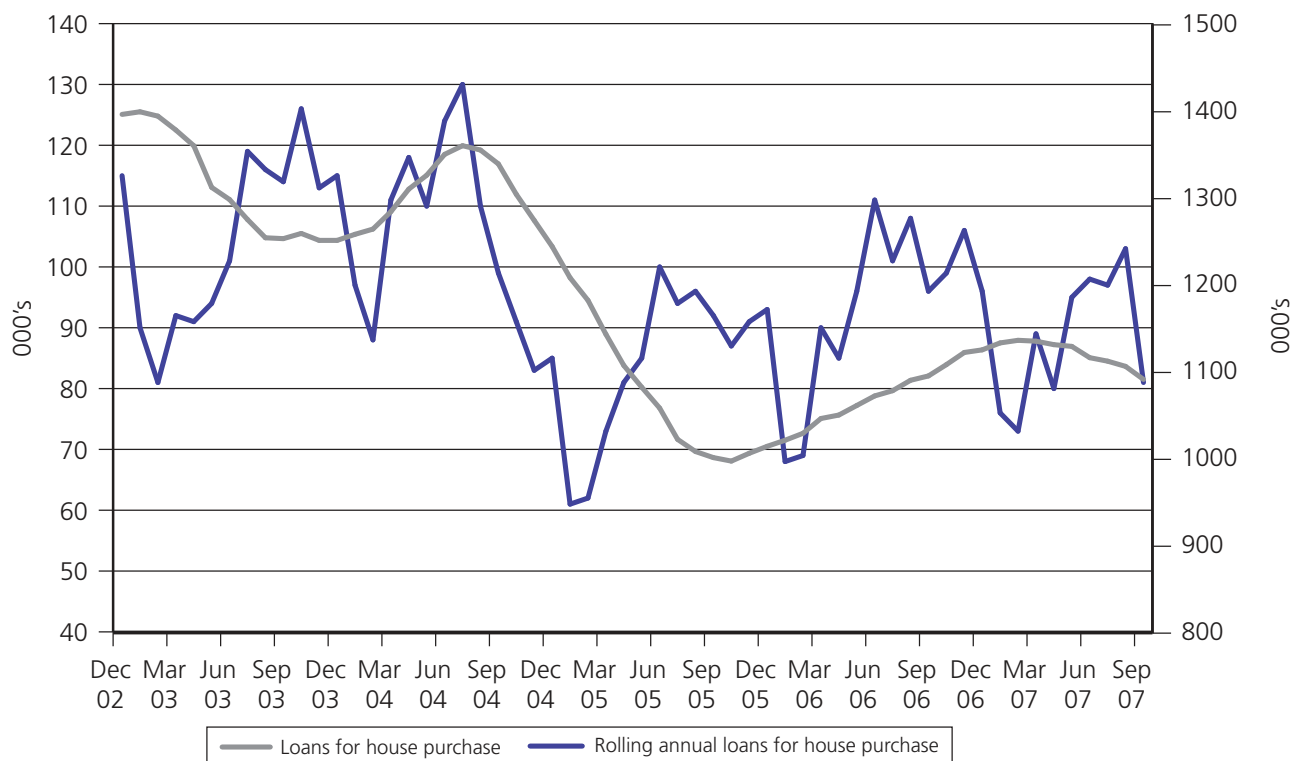


Source: CLG/Regulated Mortgage Survey. Note: Data applies to all UK

### *Mortgage volumes*

A3.24 Looking at mortgages for house purchase only (i.e. excluding, for instance, re-mortgages), it is apparent from Figure 5 below that whilst there was a sharpish reduction in loans made in September 2007, that was well within the volatility bounds of recent years, during which there has been a trend towards lower mortgage volumes dating from March 2007, which in its turn has reflected a longer-term downwards shift since 2003. Even March 2007, let alone 2003, is comfortably prior to any effect that could be persuasively attributed to the implementation of HIPs.

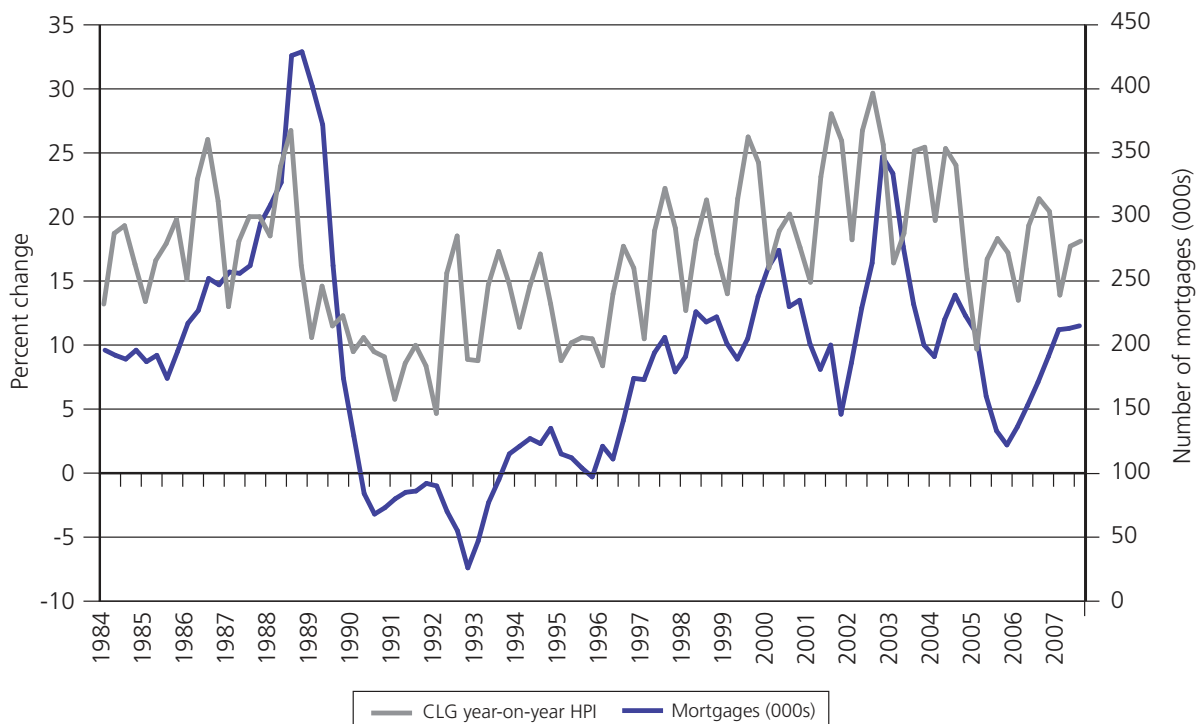
Figure 5: Number of mortgage loans for house purchase



Source: CML

A3.25 The relatively weak correlation between the number of mortgages taken out compared to (non-seasonally adjusted) house price inflation is shown below.

Figure 6: Mortgages and house price inflation, 1984-2007 Q3

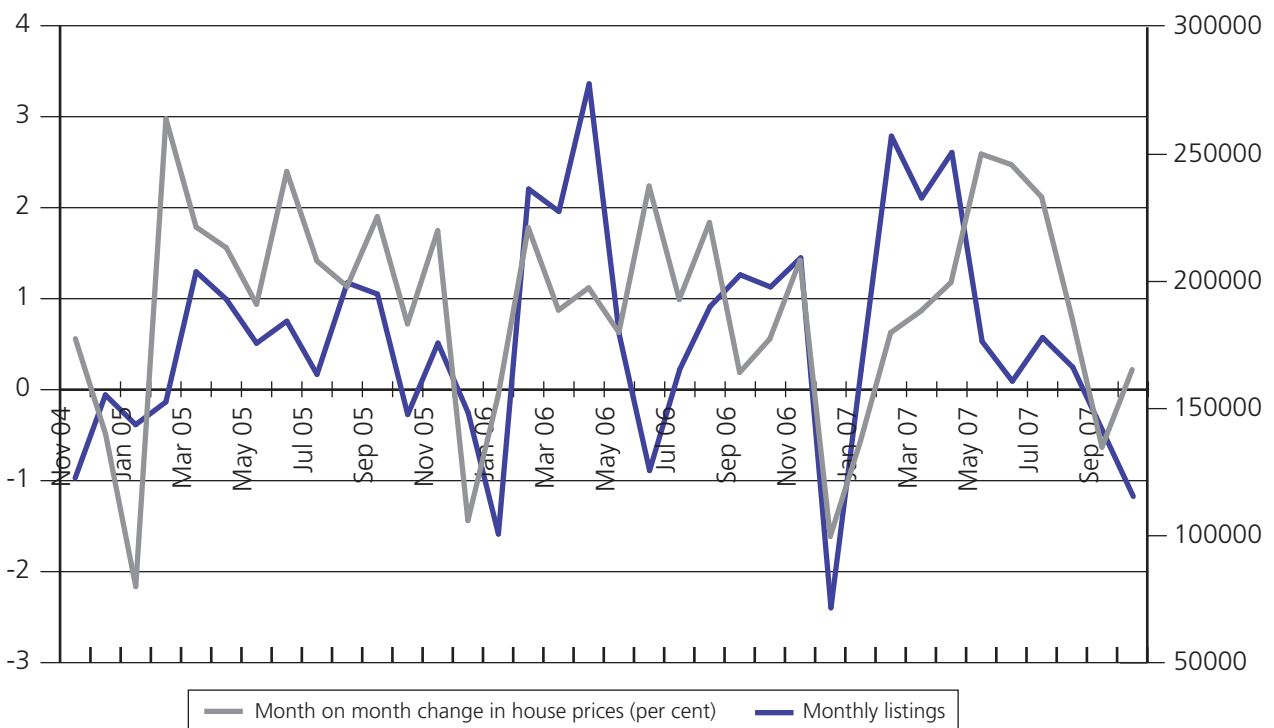


Source: CLG and CML

A3.26 Bearing in mind that this is quarterly data, with the most recent quarter being the third quarter of 2007, there is little to say directly about the implementation of HIPs itself, although it is hard to argue from the above that it has been a major de-stabilising experience upon either the trend of prices or upon transaction numbers (as proxied by mortgages). Indeed, a not-unreasonable interpretation of these data might be that (at least during the period of the house price boom, and on a month-to-month, as opposed to year-to-year basis) causation runs mainly from prices to listings, rather than from listings to prices – that is to say, when house prices rise (for example) people react by being more inclined to put their houses onto the market.

A3.27 Mortgages are taken at the end of the home purchase process. A comparison of house prices (the HBOS monthly series) and the listings data derived from publicly available Rightmove data is shown at Figure 7. To emphasise the linkage, the prices data are non-seasonally adjusted and show the month by month percentage change in prices.

Figure 7: Listings and house price inflation, 2004-2007



Source: HBOS, Rightmove<sup>8</sup> and Europe Economics calculations

A3.28 Whilst the seasonality of the market is well illustrated, the correlation between the two series outside of the winter slowdown is less clear cut.<sup>9</sup> What this does indicate is that the pace of house price inflation in the HBOS series has been weakening since the third quarter of 2006.

8 We have adopted the same methodology with respect to the published Rightmove figures as in our Main Report, and the same health warning applies.

9 The correlation coefficient between these two series is about 35 per cent.

*Other factors*

A3.29 We have already noted that the Bank of England anticipates that the global credit crunch will have an adverse impact on the UK economy in 2008. It is also likely to have an adverse impact on remuneration and employment within the financial services sector, particularly in London. This would seem likely to reduce demand for housing and so reduce upward price pressure.

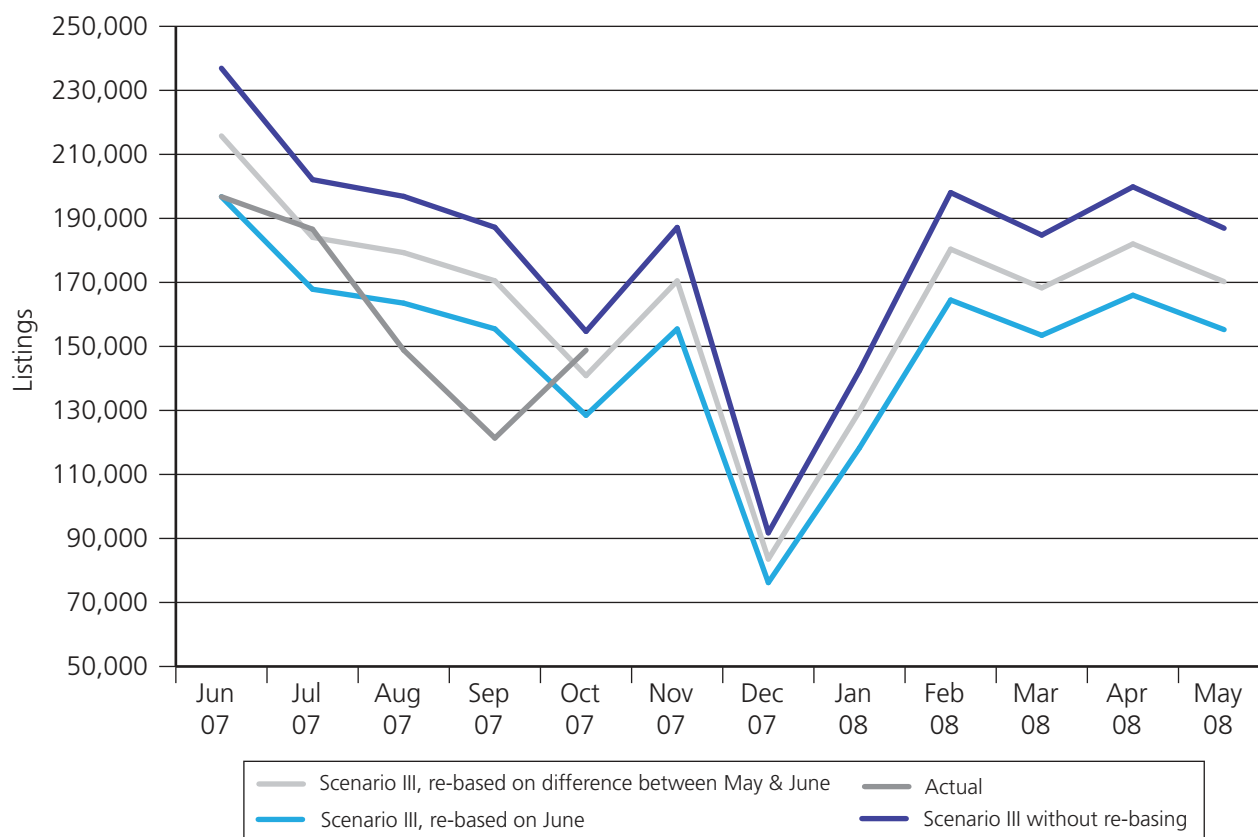
## **Outturns vs Modelled Scenarios**

A3.30 At present, HIPs coverage of the market remains incomplete, with properties with two bedrooms or less not yet covered and the date of that extension to full coverage of the market not yet decided. The closest scenario we modelled to the actually-chosen rollout path was Scenario III of the Main Report, a scenario in which HIPs rollouts occurred on 1 August, 1 October and 1 December. This is not a precise match to the actual phasing in that HIPs were extended to three bed properties on 10 September. This difference would imply that if our underlying behavioural model were completely right, Scenario III might have over-predicted the HIP effect for August (the reduction in listings modelled would be reduced by vendors bringing forward listings from September – though this is slightly unclear in that we argued in the Main report that the bringing forward of listings would probably only be a matter of less than two weeks, and so might plausibly not appear in the August data at all), and under-predicted the HIP effect for September (listings would have fallen by more in September than under Scenario III, since under Scenario III vendors were bringing forward October sales into September in order to avoid HIPs).

A3.31 We also emphasize again that Scenario III was an attempt to isolate a HIP effect – the percentage reductions/increases in listings, during the transitional period, that could be attributed to HIPs. It was not a prediction about wider market trends.

A3.32 Figure 8 below compares Scenario III from Figure 5.8 with the actual data as inferred from data publicly reported by Rightmove (using the same methodology as in our report). The actual data are all materially below those from Scenario III in Figure 5.8. However, this was already the case for the June 2007 figures, as can be illustrated if we re-base Scenario III so that we begin with the actual June 2007 figures, and then take the percentage changes predicted by Scenario III.

Figure 8: New listings



Source: Europe Economics

A3.33 However, the original implementation of HIPs due on 1 June 2007 was only pulled on 22 May. Therefore, it is plausible (based on our own behavioural model of vendors bringing forward listings as a response to the onset of HIPs) that there was some increase in listings towards the end of that month, which would have been followed by a dip in the subsequent month. The key question of the success or otherwise (so far) of the model comes down to whether the fall in listings to June can be convincingly attributed to HIPs or whether it is much more plausible that this is principally a matter of wider market factors.

A3.34 May listings were 19,000 properties, or 10.5 per cent, up on our expected value. On the other hand, June was 40,000, or about 17 per cent, down. If one ignores all other causes of market noise that could affect the level of listings, it would appear that just under half of the June drop could be attributed to the aborted introduction of HIPs resulting in listings being brought forward from June to May. Re-basing Scenario III on this basis is also shown in Figure 8 (labelled as “Scenario III, re-based on difference between May & June”). In addition, part of the discrepancy is likely to be that predicted by the deviation of Scenario III from the actual roll-out dates – namely that Scenario III gives figures that under-predict the fall in listings for September.

- A3.35 It seems likely that reduced mortgage availability and increasing uncertainty amongst both buyers and vendors have had an effect on the number of recorded listings. The dip in listings in September in particular may be seen as a reaction by vendors to increased uncertainty in the housing market, followed by a subsequent correction.<sup>10</sup>
- A3.36 In addition, the HIPs regime may also have reduced the extent of multiple listings for properties with three or more bedrooms. This may be causing some reduction in the level of listings overall.
- A3.37 So, our model of the effect on listings appears, so far, broadly endorsed provided that one accepts that market forces beyond HIPs have had a material impact upon listings. Looking beyond the impact of HIPs on listings it is far from evident that HIPs has caused any deviation from the pre-existing trend in prices or mortgages (see for instance, Figure 6 and Figure 7 above).
- A3.38 Although our model appears so far to have predicted quite well the HIP effect on listings in the transitional period, it does not of course automatically follow that our model will be equally successful in its predictions of how the transitional impact might die away. A critic might still reasonably assert the view that HIPs will have led to material falls in the number of listings and that this fall will be permanent, rather than the market returning broadly to its previous path (normalised for wider market impacts, such as interest rate changes or the credit crunch) by April next year as predicted by our model.

#### *Time on market*

- A3.39 In the Main Report we noted that efficiency gains (if any) that HIPs produce for the home buying and selling process would probably not be apparent for at least six months, and this does seem to be the case so far.
- A3.40 In our report we discuss the potential impact of HIPs on time on market, both in the short and longer term. The chart below clearly illustrates that time on market has increased in recent weeks. However, the timing of this increase makes it appear more likely to be linked to the credit crunch and the slow softening of prices with the market moving in favour of buyers than HIPs lengthening the process. Whatever the balance of causation, increased time on market does impact upon listings in our model as presented in our main report, albeit not significantly.

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<sup>10</sup> It is interesting to note that this closely corresponds with the key period of the credit crunch as illustrated in Figure 1 above.

Figure 9: Time on market



Source: Rightmove

Extract from Rightmove press release

### *The transitional arrangements*

- A3.41 The transitional arrangements are due to drop away at the end of 2007. These arrangements have allowed, in theory, for the purchase of HIPs to be deferred, as long as a HIP has been ordered prior to the property being marketed. If it is assumed that these arrangements have worked, then they should have acted as a partial brake upon one aspect of the behavioural changes that we incorporated into our model. This is because, simplistically, if you do not need to have a HIP prior to marketing you should be less likely to bring forward your plans in order to avoid it.
- A3.42 However, the removal of the transitional arrangements, provided that it lags behind the final implementation of the HIPs scheme to cover the entire market and the necessary agents to provide HIPs are in place to cover new cases and any back log, should not be of great consequence in itself.
- A3.43 It seems likely that the transitional period, and perhaps some uncertainties created by the complexities that have arisen in the policy process and timing, have tended to delay the market's adaptation in terms of providing market-based "solutions" to HIPs. For instance, once the HIP is established as a feature of the market, then practitioners can focus upon delivering it more efficiently and/ or cheaply.

## Updated Conclusions

- A3.44 As noted in the Main Report, there were already signs of a softening in the housing market that preceded the events of summer and autumn 2007. That said, the housing market is in a more clearly vulnerable state now than was the case in July for the reasons rehearsed above.
- A3.45 HIPs currently apply to approximately 60 per cent of the housing market in England and Wales. Its implementation to date has been against a backdrop of an already weakening housing market and new factors the full impact of which are not yet fully apparent.
- A3.46 It seems likely that what we observe is a market that had begun to slow in 2007 and upon which HIPs may have had an additional modest-but-material effect on listings activity but no discernable impact on transactions, mortgages, or prices. However, at this stage it is still too early to be definitive about what the scale of impact has been (indeed, even on the Europe Economics model the transitional effects – let alone any longer-term impact – are still under way).
- A3.47 Even with a longer-term view, the sort of data available and limits to the academic/practitioner understanding of the functioning of the housing market mean that in reality it will be very difficult to ascribe with any precision how significant an impact HIPs will have had on prices, mortgages and transactions. The likelihood is that it has been and will be much smaller than the uncertainties of measurement surrounding much more material factors such as interest rates, and employment and wage expectations. Going forward, with further potentially even more significant factors adding to pressures upon the market – such as the unwinding of fixed rate mortgages, the credit crunch and a slowing economy, the effect of HIPs (if any) on prices, mortgages and transactions is likely to be an even more limited proportion of the total impact, and even less possible in practice to measure separately – it will just be too small to notice amongst the noise of the wider issues.
- A3.48 Notwithstanding this, we still expect the effect on *listings* due to the implementation of HIPs to have largely washed through within three to six months of its introduction – so if, for example, smaller properties were to have a HIP requirement from 1 December 2007, the market would be back to a path that reflected wider market developments, and in which there was no longer a material transitional HIP element, by April 2008. There would be a residual impact in that we expect HIPs to deter a small proportion of sellers (those testing the market without little real intent to pursue a transaction through, or about 4 per cent of the total) from seeking a listing. By definition, since those listing that fell into this category had no intention of actually selling, this latter effect is unlikely to have a measurable impact on actual transactions.
- A3.49 Standing back from this specific evaluation of the potential effect of HIPs and taking a wider market based view, the position appears to be this:

- (a) The UK housing market has been growing strongly for a number of years and affordability pressures have been building up. A combination of these and interest rate increases resulted in an almost inevitable slowing in 2007 and this process was added to later in the year by the effects of the ‘credit crunch’. Although HIPs have surely had some impact on new listings, it is striking that few analysts have identified HIPs with either the start of the wider market slowdown or with much lower rates of house price growth in 2008. There is a widespread view that it is very difficult to identify a specific HIP effect on price trends (as distinct from listings).
- (b) In a softening market reduced listings might most naturally be argued to lead to limits on any tendency for prices to fall, since with buyers would have fewer properties to choose from. With 60 per cent of the market already covered by HIPs and with a degree of uncertainty regarding future house price trends there are strong arguments for putting the whole market under the same regime, particularly in the context of more testing and uncertain market conditions. From a market perspective closing off uncertainty regarding the HIP regime is likely to be seen as a positive step forward given the range of other pressures coming through. Indeed, were the HIPs rollout not now to be completed, it is possible that that might be interpreted as a negative signal for the future of the housing market – as if the government “knew something nasty” about the outlook for housing.

A3.50 We repeat, as in the Main Report: Although prices may fall (or rise) during the next twelve months, as in other markets this will be overwhelmingly driven by the fundamental drivers of supply and demand, rather than by HIPs. The idea that HIPs would be the main or key determinant of the direction of the housing market remains, in our view, unfounded. In other words, although the world has changed, our view of the likely impact of HIPs has not.