Peter Kenway

Getting ready to meet the wolf? The looming crisis in housing

Peter Kenway explores a new threat to people's lives - that of repossession of their home. He argues that there are good reasons to believe that a housing crisis is on the way, and outlines some radical ideas for averting its worst effects. The consequences for politicians, as well as individuals and communities, could be dramatic.

The apparent truth of Labour's claim to have 'brought an end to boom and bust' has had a profound effect on how we automatically think about almost every aspect of social policy.

Whether it is poverty, education, employment or health, the basic motif is now that of 'progress'. Rarely pausing to dwell on where the problems actually originated - the 'legacy of an out-of-date past' serves well enough for that - we are now constantly pre-occupied with how to make progress, how much progress has been made and what scope there is to make more progress in future.

In this climate, the gravest charge that can be hurled at government, whether in Cardiff or London, is that it has 'failed to reach its target'.

It is possible, however - not yet likely, but certainly possible - that within the course of a year or so, politicians may find themselves in the dock not just for the self-inflicted misdemeanour of missing targets but rather for the altogether more real and serious offence of failing to act with speed and firmness to prevent many peoples' lives from taking a rapid turn for the worse.

The source of this threat lies in a possible housing slump.

On average, Welsh house prices are now two and half times what they were in 2000. While there is variation across the country, it is notable that

Affordable housing under construction in Merthyr Tydfil Image courtesy: Peter Slater

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somewhere like Merthyr has moved roughly in line with that average over the period. If there has been a concern, it has been to do with young adults' ability to buy their first home.

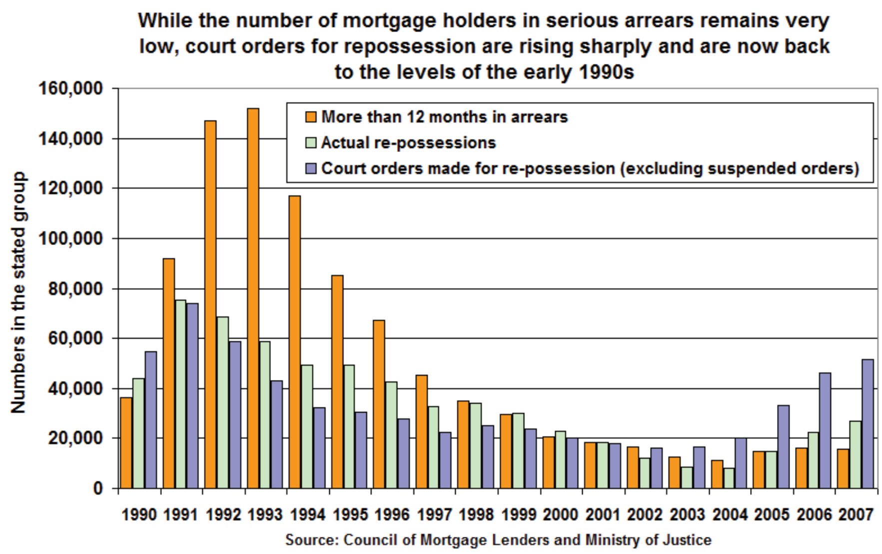
The new threat is repossession, both forced and voluntary.

The costs of repossession hit three parties. First is the family who were living in a house as owner occupiers with a mortgage. Second is the mortgage company. Repossession is costly and, except in a strongly rising market, the eventual sale is bound to be at a discount. Even if such losses are nominally the responsibility of the original borrower, how many are likely to have the assets to make good the deficit? Third is the local neighbourhood. Even if the average semi in Merthyr does now go for a £100,000, yours won't fetch that if next door is boarded up. Two or three boarded-up spells trouble for the whole street.

So how big is the threat? As the graph shows, some 27,000 properties were repossessed in England and Wales last year. While that is a threefold rise compared with 2003, it is still only one third of the peak level in 1991. The rate of long-term arrears, meanwhile, is but a small fraction of its level in the early 1990s.

The trouble with this, though, is that arrears is a backward looking indicator. During a rising market, it is in a lender's interest to act swiftly against anyone in arrears: hence the low level of arrears in 2007. The real build up in arrears takes place during a slump, when rapid repossession and re-sale can be a very bad option for the lender. As the graph for the early 1990s shows, long-term arrears actually peaked two years after repossessions, and at a much higher level.

Court-orders, on the other hand, are a forward-looking indicator of repossessions. Court orders reached 50,000 in 2007, close to the level in 1990. Even in 2007, therefore, the warning signs were already there.



What about 2008? In its *2008 Financial Risk Outlook*, the Financial Services Authority has analysed mortgages taken out between 2005 and 2007 to see how many exhibit one or more of three risk factors, namely, a term of more than 25 years, a loan-to-value ratio of more than 90% or a loan-to-income ratio of more than 3.5.

Mortgages showing at least one of these risk factors account for almost a third of all mortgages written in the period but the FSA indicates that concern is really only in order for those borrowers with two, or even all three, risk factors simultaneously, that is, one million borrowers and 150,000 borrowers respectively. These figures dwarf the historical numbers on repossessions. The FSA also estimates that 1.4 million fixed rate mortgages are due to mature in the next twelve months, pushing average borrowing costs up by some £200 a month if borrowers switch to the variable rate. In practice, some will do better than this, but it is still a potentially big hit for an awful lot of borrowers.

So is that the worst that might happen - or is there more? To be more precise, might the sort of thing that has been happening in US housing markets happen here too?

Since the credit crunch blew up in 2007, mainstream economists have been widely at odds with one-another about how bad things are going to end up being. These are not ideological divisions but rather differences of judgement about what the near future holds. If nothing else, this underlines the huge degree of uncertainty in the present situation.

Average US house prices have already fallen 10% from their peak in early 2006. Falls of another 10 percent seem to be widely expected, and some experts foresee 20 percent. In some states and localities, falls of up to 50 percent have even been mentioned. Between 10 and 15 million households are estimated as likely ending up in negative equity territory. This may be the worst housing bust in US history.

Could it happen here? Again, opinion is divided. One City bank foresees falls in UK house prices of 10 percent, even while noting that UK prices had actually risen faster than US ones in the last decade. UK households' debt to income ratio is also worse than their US counterparts. On the other hand, the US has had a long house-building boom (which the UK has not), leaving a huge overhang of unsold new homes. So things are different here - but not always better.

Latest figures from the Nationwide show seasonally-adjusted average house prices two percent lower in February 2008 than four months earlier. A few months' data can fit with a lot of stories but - while fully acknowledging the double negative - they are not inconsistent with the US story taking off over here too. In the end, what matters is that it is possible.

So what should be done? Clearly, it is too soon to think about exactly *what* should be done since the problem itself is still so indistinct. But here are seven suggestions intended to shape *how* we should go about thinking about it.

1. Start looking at it now. Unlike Northern Rock, which came as great surprise even to those in charge of the financial system, this one is signalled well in advance. Don't be deterred by industry spokesmen who pooh-pooh the threat: they have a vested interest. Watch the early warning indicators like court-repossessions.

2. Recognise that a large number of borrowers defaulting on their mortgages represents a different kind of situation from the norm in which a mere series of individuals default. Established procedures for dealing with default and repossession in normal times no longer apply.

3. Be clear about the goal: to minimise the number of people who lose their homes (though not to prevent house prices from falling, at least gradually).

4. Insist on the principle that the costs of avoiding widespread default and repossession should be borne by lenders as well as borrowers. This is crucial. Beside the moral arguments for this (irresponsible lending is part of the problem), there are sound economic ones too. The yardstick for lenders is no longer full repayment on the original terms but what they would get back if there is widespread default. Resist strenuously any assertion that to expect lenders to lose money is anti-business. The rates they charge already reflect the risk the run.

Image courtesy: Joanne Sheldon Evans

5. Seek general rules to be applied administratively to vary the terms and conditions of certain well-defined classes of mortgages. Borrowers who would have coped under the original terms gain from this approach too but the alternative, of court-based settlements only for those in difficulties, is not practicable when the numbers involved are large.

6. Recognise that lenders have been right to keep the arrears situation under control - and that they should continue to do so after the rules have been reset. The aim is to minimise repossessions among owner occupiers, not ban them.

7. Be slow to offer public money or public guarantees. Lenders were happy to take their profits when times were good so they should take their losses when times are bad. To do otherwise is just bankers' socialism.

Peter Kenway is Director of the New Policy Institute, and writes extensively on poverty and income issues.