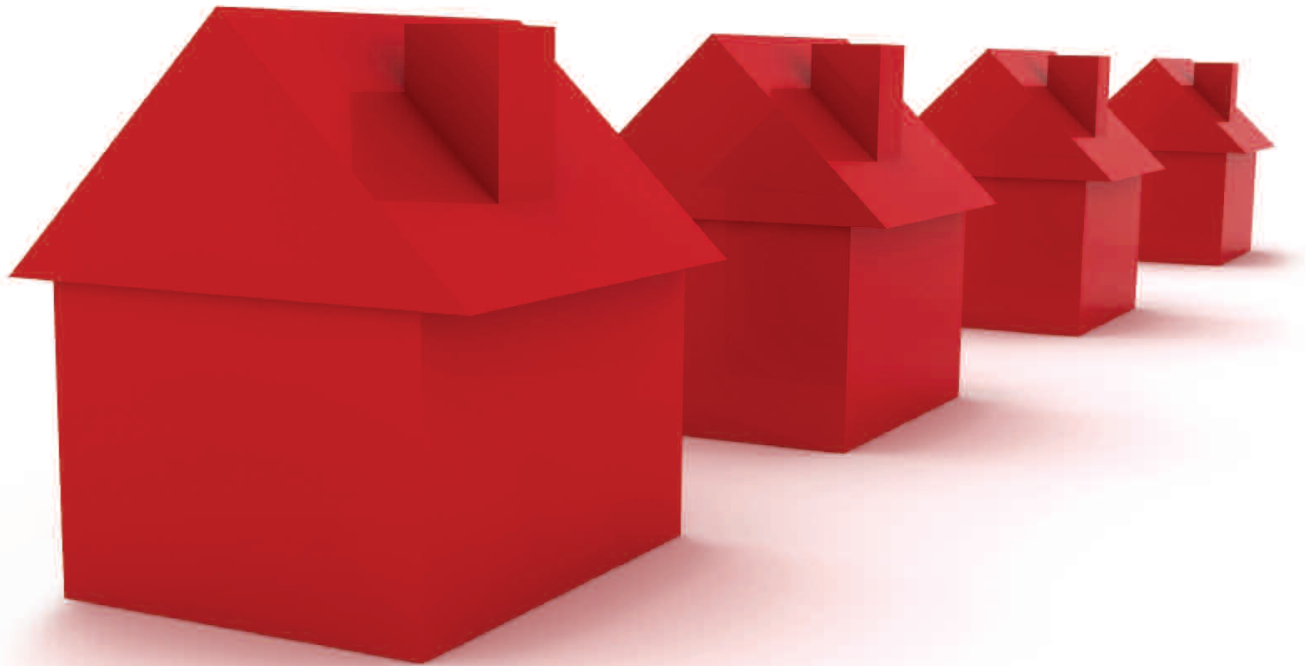


HOUSE PRICE EXPECTATIONS:

An insight into how people think about property purchase



Executive Summary

House prices have more than tripled in the last decade, but by summer 2007 the rate of growth appears to be slowing as five increases in interest rates by the Bank of England begin to take some of the heat out of the market.

Research by Ipsos MORI for the BSA into how people think about house purchase and how they form their expectations of future movements in house prices shows that the buyer's decision is influenced by a wide variety of factors. As such, it is not easy to categorise buyers into different groups, but some general trends can be identified:

- A fall in house prices would not lead to mass withdrawals from property ownership by home owners or, in particular, investors, other things remaining equal. In fact, a significant proportion would be spurred to buy more if prices fell.
- Most of those buying or considering buying property are aware that property prices could fall.
- For most homeowners, the non-pecuniary value derived from actually owning a house is more important than the prospect of a financial return.
- Recent and long-term trends in house prices are both important factors in forming expectations of house prices.
- Unsurprisingly, first-time-buyers rely more on external advice than other buyers. Experience of property purchase is a crucial determinant of how expectations are formed.
- However, the role of the media in influencing expectations about the housing market is often over-emphasised.



Introduction

By mid-way through 2007, house prices are more than three times the level they were a decade earlier, according to figures from Nationwide Building Society. While the level of prices may be explained by a number of factors that have boosted demand, such as lower interest rates and strong employment in combination with a limited response in the supply of housing, it is possible that an element of speculation has added to the rate of growth. The BSA commissioned some research to try to determine how sustainable house prices are by examining how those who have recently bought or considered buying property approach their decision, and how important their expectations of price rises are to their behaviour and ultimately, to their decision to buy and sell property.



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The results suggest that the housing market could exhibit considerable resilience to a fall in property prices – that is, a fall in property prices would not necessarily presage further falls in prices. Most of those participating in the market acknowledge that house prices could fall, as has occurred in the past. Even if prices did fall, most owners would do nothing, and only the minority would look to sell immediately. Furthermore, a significant number would be more eager to buy if prices fell. However, these stated reactions are likely to rely on the assumption that other factors, such as levels of employment and income growth, remain resilient.

Homeownership itself was the most important factor for those buying their house, more important than financial motivations. This again suggests that a fall in house prices, in itself, would not lead to a large number of properties being vacated. As long as households' confidence in their ability to keep their home is not seriously disrupted by a radical change such as unemployment, or by break-up of the household (which could be made more likely by financial distress), people are unlikely to have to sell. A wider economic shock would be necessary to cause a significant change in property owners' behaviour.

Can the level of house prices be explained?

A number of factors could explain why house prices have risen so much since the mid 1990s. Firstly, short term interest rates are relatively low compared to the past. In a relatively low inflation environment, as the UK has been over the past decade or more, low nominal interest rates mean that mortgage payments are more affordable at the start of a loan. This reduces the so-called “front-end loading” problem where, in times of high inflation, high nominal interest rates mean the percentage of income required to meet mortgage interest payments at the start of the loan is elevated, restricting house purchase for many.

Furthermore, long run interest rates have been low over the past decade, assisted by the credibility of the Bank of England’s inflation targeting regime. This has reduced the actual and expected future cost of borrowing over the long term.

Add to this stable economic growth, and in particular growth in real personal disposable incomes, and relatively high employment over the period, as well as shifts in demographic factors such as immigration and higher divorce rates that have caused the number of household units to increase, the level of demand for property has remained strong. This is set off against housing supply that has been stubbornly slow to respond. As such, the level of house prices could well be supported by fundamental factors.

However, given the sustained rise in prices since the mid 1990s, some commentators suggest that speculation has also put upward pressure on property prices. A model by David Miles* published in 2006 assumed that people’s expectations of house prices were partly based on recent house price changes. Furthermore, this assumed that the expectation of price rises led to further price rises, because the anticipation of a capital gain from higher property prices makes the prospect of owning property even more appealing. As such, rising house prices fuel demand for house purchase. The implication of the model was that speculative demand explained a large part of the rise in house prices over the previous decade.



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* “UK Housing: How did we get here?” Miles. D, Morgan Stanley Reserch, 2006

The BSA commissioned Ipsos MORI to ask people who had either bought a property or considered buying a property in the last year a number of questions to try to understand how they, as homebuyers and investors, thought about the housing market, and whether this thinking had any impact on the buying decision itself. The results are outlined below.

Why buy a home?

Most of the respondents (77%) were buying a home to live in, and the primary motivations for these people were that they wanted to own (88% of homebuyers agreed) and that rent payments were seen as wasted money (77% in agreement). Making money from property purchase was important to less than half (45%). Needing to purchase a property, because of relocation or having to move to a larger property, was relevant to only around 40% of buyers or prospective buyers.

Why invest in property?

Those who were buying for investment mostly believed that in the long run house prices can only go up (89% agreed) and that property is a good investment for their pension (89%), and a better investment than other assets (88%).

Relatively few investors (19%) were investing purely for rental payments as opposed to capital growth. The influence of media was not important for the majority of investors (only 30% agreed) nor was herd behaviour (with just 17% agreeing that they were investing because others were too).



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Perspectives on the housing market

Across all buyers or prospective buyers, the health of the general economy is considered to be a vitally important determinant to the future of property prices (79% of all respondents agreed to some extent). However, there appear to be high levels of awareness that property prices *could* fall: 71% agreed strongly or slightly that house prices had fallen before and could do so again. Less than 1 in 10 disagreed to some extent, and just 0.7% of respondents disagreed strongly.

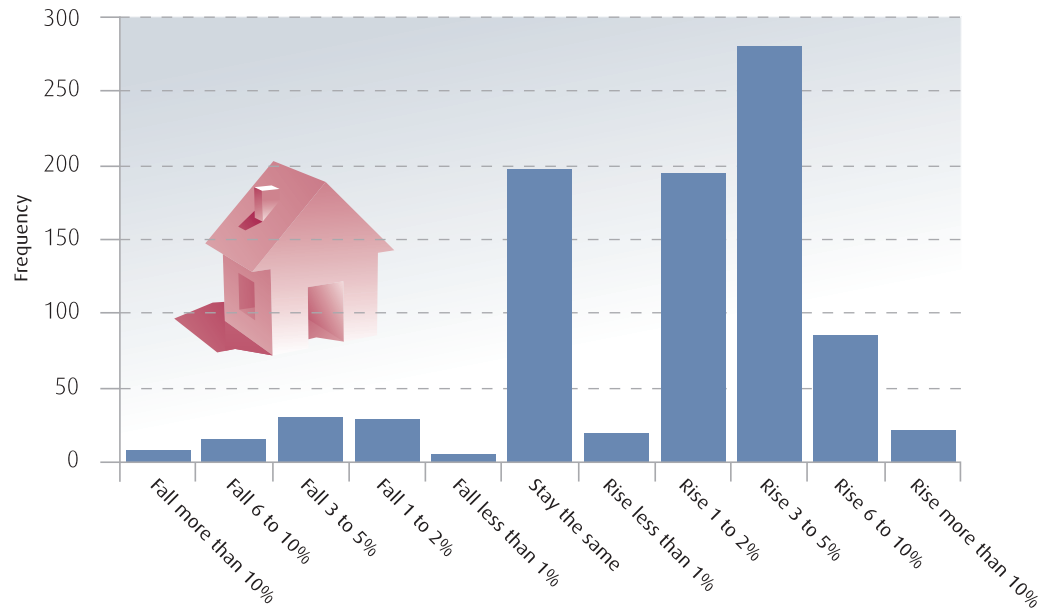
Long run trends in prices are important to expectations of future house prices (61% agreed), but so are more recent trends over the last couple of years (59% agreed). Media or television hype is not important for the majority (only 31% agreed that such things increase their desire to buy). The advice of friends and families on house prices is little valued (27%). Just under half (49%) agreed that they carefully consider the timing of their purchase.



Price predictions

Around two thirds (65%) of respondents thought that property prices would rise in the twelve months following the survey (that is, by the end of May 2008), with most predicting a rise of 3% to 5%. However, just 9% of our sample expected house prices to fall in the next 12 months, with most of these expecting a fall of 1% to 5%. Almost one in five (20%) expected them to stay the same. There was little difference between the predictions of those buying for investment and those buying a home.

House price inflation predictions



Change in prices in the 12 months to end May 2008
Based on 1000 online responses between 15th May - 23 May 2007

Source: Ipsos MORI

Reactions to a fall in price

If property prices had fallen in the last year, less than a quarter (24%) of respondents agreed to some extent that they would have held back on their property purchase. Only 7% agreed strongly that they would have held back.

Even if there was a sudden, significant decline in property prices of 15%, only 1.7% would sell immediately. Most (63%) would simply hold their property, with a further 11% holding with a view to selling when prices recover. Interestingly, though, 17% of the sample would look to buy more property. In particular, this applied to those who were just considering purchasing property, where over a fifth (21%) said they would buy property following a 15% fall in price. This an indication of the strength of demand, with a considerable number of people priced out of the market. Therefore if prices were to fall, this demand may provide some fillip to prices. Even out of the small number that said they would sell their properties if prices fell by 15%, nearly four fifths (79%) said they would buy another property shortly afterwards.

The stated reactions are probably based on the assumption that property prices fall in isolation. However, if prices do fall, this is likely to be as a result of some factor beyond the housing market itself, such as significantly higher unemployment. If this were to occur, people's reactions to a fall in house prices may well be very different.



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Formation of house price expectations

For the majority who predicted a rise in property prices, recent trends in prices were influential to many more (54%) compared to those predicting a drop in prices (where only 24% stated this factor as important). However, in those predicting a rise, a long term trend of rising prices was important to 42% of respondents as well, and this was correlated to those that asserted that recent price trends were important. This therefore broadly supports the assumption in David Miles' model that price expectations are based on a combination of long term price movements, and an element that adapts to more recent changes in price. Those influenced by recent trends in prices also tended to be more open to advice and information from the media and television, or from estate agents or vendors, although these were relatively not as important. However, 40% of those predicting price rises relied on their own analysis for their price prediction.

Advice from friends or family or estate agents was quite unimportant for most (about 9% of respondents stating each as a factor).

Those predicting a fall in price tended to be particularly independent in thought – the factor important to the greatest proportion (52% of those predicting a fall) was their own analysis of the housing market and 41% also relied on gut feeling. In particular, these individuals were unlikely to take advice from friends and family, nor from estate agents. Often those anticipating a fall stated that long terms trends in house prices are important to their prediction, chosen by 38% of these respondents. This is likely to indicate that they expect some reversion to the long term trend in house price growth.

However, long term trends in house prices were also important to many predicting a rise in price, as mentioned above. This backs up the proposition in David Miles' paper that historical house price rises can both support expectations of future house price growth, but also lessen predictions for house price inflation for those who think that prices are due to revert towards a more stable, trend level of growth.



First-time-buyers versus previous owners

Nearly a third (33%) of respondents who had bought a property in the last 12 months were first-time-buyers, in the true sense of the term – this was the first property that they had bought. Nearly a quarter (24%) of those considering purchasing a property were doing so for the first time.

Unsurprisingly, the vast majority (87%) of first-time-buyers or those considering buying for the first time were doing so with the intention of buying a home. Indeed, the desire to own was a motivating factor for 97% of people buying or considering buying for the first time.

First-time-buyers and, in particular, considerers were particularly conscious of not being left behind by rising house prices. While 28% of those who had bought property previously said that if they didn't buy now they wouldn't be able to afford it, 63% of those participating in the market for the first time were motivated by the prospect of being priced out of the market. This was much stronger an influence than merely copying others who were buying, which although relatively more important for first-time-buyers (16%) than previous owners (4%), still constituted quite a minor factor. The fear of being left behind is likely to reflect the fact that raising a deposit is often the biggest barrier to house purchase for first-time-buyers given the doubling of real house prices in the last decade.

The differences in first-time-buyers' consideration of the market compared to previous owners were most marked regarding their acceptance of or reliance on advice. Whereas 43% of first-timers agreed that advice from friends and family was important to them, just over 20% of previous owners thought likewise. Furthermore, 42% of those approaching the market for the first time stated that media reports or television programmes about rising house prices fuelled their desire for property purchase, but only 25% of prior owners were similarly influenced.

First-time-buyers were relatively more likely to be influenced by the notion that rent payments were wasted money, with 87% finding this was an important factor compared to 73% in people who had owned property previously. Necessity, whether for a new location or a larger house were less important for first timers than other market participants.



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Those participating in the market for the first time were a little more optimistic overall about the housing market than people who had bought property before. In their predictions for property prices in the next year, a slightly greater proportion of first-time-buyers thought that house prices would rise in the next year than previous owners (69% versus 64%), but first-time-buyers’ predictions for the magnitude of the rise tended to be more conservative.

In the thinking behind these predictions, two thirds (66%) of first-time-buyers agreed that recent prices seen in the last two to three years would probably be repeated, compared to just over half (56%) of previous owners. Only 63% of first-time purchasers conceded that house prices could fall, as they have done in the past, whereas almost three quarters (74%) of those that had owned previously acknowledged this. Rather surprisingly, given the fact that first-time-buyers are more likely to have the flexibility of rental markets to fall back on than those already owning a home, they were not particularly more likely than previous owners to hold back on their house purchase if prices fell. While 27% of first-time-buyers agreed to some extent that they would delay (and 40% disagreed), 22% of previous owners also agreed (and 41% disagreed).

Again, first-time-buyers’ expectations of house prices were more influenced by media and television, and advice from friends and family, or estate agents, rather than their own analysis, which was relatively more important for previous owners. Those who had participated in the market before also attached more weight to long term trends, possibly because they were, on average, more than 12 years older than first-time-buyers, so perhaps can draw on more experience. There is little difference in how those owning their first property would react to a fall in price to those who have owned previously.

The above results suggest that the *experience* of previously owning property is an exceedingly important influence on how people think about the housing market, and the factors and sources that they draw upon. Once the house buying and selling process has been experienced, this then provides a significant basis for subsequent decisions and opinions.

Investors versus homebuyers

Over 19% of respondents have bought or considered buying property for investment in the last 12 months.

Widely held views in the investor group show that property investment is often engaged in with a long term outlook. The majority of investing respondents (89%) agreed with the statement that property is a sound investment, because in the long run house prices can only go up. 89% also thought that property was a good investment for their pension and the tangible nature of property was also appealing to 61% of investors. Furthermore, 88% believed that property was a better investment than other assets. Unsurprisingly, it was often the same respondents that agreed with these statements. Relatively few agreed that television or media had influenced their decision (30%), nor were offers from property investment companies persuasive.

There appears to be a rough dichotomy of investors – the majority seem to have considered their investment decision fairly broadly. A minority, however, may not have given as much thought to their decision.

There is a significant section that can perhaps be marked out by those who identified with the statement that “everyone else was buying, so I felt I should too”. Of all investors, 17% agreed with this statement. These respondents were much more likely than other investors to agree that television programmes and media reports promoting buy to let as a lucrative investment were influential on their decision to invest, or in their formation of house price expectations. They were also more likely to be influenced by a property investment company. In addition, they were more likely than other investors to agree that the property they had chosen was one of the few that they could afford.

When choosing the particular property in which to invest, 80% of all investors considered the particular purchase they had made or were considering to achieve the best return out of all their options. Just under three quarters (74%) chose the specific property because it was convenient for them geographically. 71% thought that the void time (time when the property is not rented out) on



the type of property was low, so they would make more rental income. However, investors were mostly motivated by the combined financial draw of both capital growth and rental payments, with 45% stating joint aims. A further 37% said they were motivated by capital growth only, and just 19% were solely motivated by rental payments.

53% of investors or potential investors admitted the particular property that they invested in or considered was one of the few they could afford. This may simply be a reflection of high house prices, but it may also indicate that some investors are stretching their finances. Almost half of investors (47%) anticipated that the area or type of property they had invested in or considered would yield relatively higher rents.

As might be expected, those buying for investment purposes tended to give greater consideration (59% agreed strongly or slightly) to the timing of their purchase than home buyers (47% of whom agreed to some extent that this was important). Again unsurprisingly perhaps, investors would be slightly more likely to hold back on their property purchase if prices fell than home buyers would be (30% compared to 23%). Investors agree that media reports about rising prices increase their desire to buy more than is the case for home buyers (41% compared to 27%).

As further evidence that those investing in property were doing so over the long term, 54% agreed that long term price trends were important to their predictions of future prices, compared to just 33% of homebuyers that thought likewise.

However, if property prices did drop by 15%, those who had bought for investment purposes were not only very unlikely to sell immediately, with only 1% of investors stating that they would respond in this way, but over a quarter of investors (27%) claimed they would buy more property (compared to 13% of homebuyers). As a result, half of investors (51%) would do nothing, compared to two thirds (67%) of homeowners. This suggests that demand is very strong for investment properties, or that a significant portion of investors believe houses are currently over-valued and would not be prepared to pay the current market price.



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Implications

House prices have generally risen since the mid-1990s. This itself may have added to the desire for home ownership remaining buoyant. In addition, low inflation and low interest rates, together with relatively secure employment prospects and, until recently, robust earnings growth, as well as a competitive mortgage market, have created an environment where potential borrowers are comfortable to borrow and readily take on debt. This is particularly applicable at the individual household level, where financial confidence has been crucial in determining the appeal of borrowing.

Overall, the research shows that, for most, the primary motivation for buying is the utility derived from owning a property, rather than speculation on rising prices. While financial motivations appear to be of secondary importance to buyers, the results may also partly reflect the psychology of respondents who were not willing to admit that they were buying for anything as vulgar as a monetary return. The online nature of the questionnaire should have helped reduce this bias, though.

The above results show that the majority of buyers have put considerable thought into their purchase, and enter the housing market with their eyes open. A significant number of people, particularly investors, would be ready to enter the market if prices started to fall, while the majority of owners would try to sit out any downturn. These findings suggest that households' confidence in the market is robust. House price falls do not themselves cause a further decline in prices; instead there needs to be some cause, such as a significant increase in unemployment or interest rates that makes ownership unaffordable and forces owners to sell.

It is worth noting that an important aspect that this research does not uncover is the amount of uncertainty about future prices following a price fall. If prices continued to be uncertain, potentially falling again, individual's anticipated behaviour may be different to that they reported. The results shown here are likely to be representative of participants' current views of the prospects for the housing market, and based against a background of significant price rises since the mid 1990s.

There was also evidence in our research that the majority of investors bought for the long term, and have considered the various investment options available to them. A small proportion do not appear



These findings suggest that households' confidence in the market is robust



to have given full consideration to their buying decision, so could be under greater pressure should the market cool and they have stretched their finances and have not contemplated how they would cope in less benign conditions.

Financial difficulties including arrears and possessions are particularly correlated with new periods of unemployment and relationship breakdown. Financial distress is likely to exacerbate, and be aggravated by, such events. As long as employment remains robust and interest rates relatively low (see charts below), households are likely to be able to resist selling their homes. Although having risen recently, mortgage interest repayments are still some way off the levels seen in the early 1990s. Furthermore, households are likely to try to make adjustments to other areas of their finances to cope with higher interest payments. It is possible that owners could release some of the equity that has accumulated in their property as a result of the strong growth in houses prices to help them cope with additional calls on their finances.*

FTB Mortgage interest payments as % of income

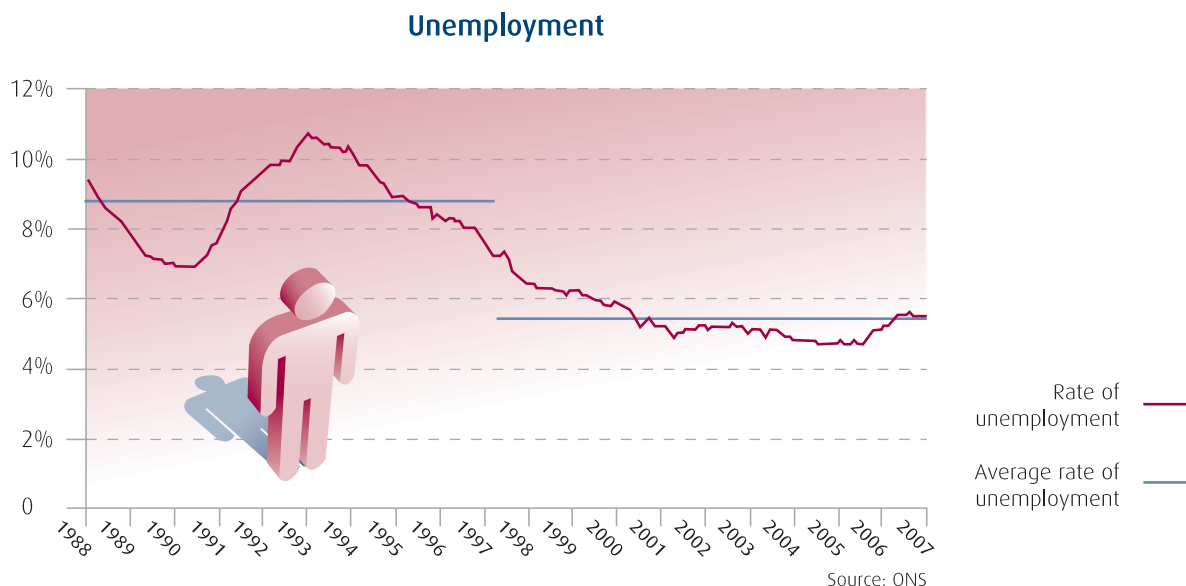


Source: CML

* See "Housing equity as a buffer: evidence from UK households" Benito, A, Bank of England Working Paper no. 324, May 2007

It is therefore really the risk of disruption to income that could shake a household's confidence in its ability to pay the mortgage. However, substantial rises in unemployment are not forecast in the near future as the UK economy is expected to grow near to trend in the next few years. Some shock to the economy would be needed as a precursor to sudden, large falls in house prices.

The research shows that a significant fall in price would not lead to mass withdrawals from the market, and as the majority would stay in their homes, it may lead to supply of homes coming onto the market being even more constrained.



Conclusions

Overall, the above results point to stability of the market if house price inflation reduces, or even if prices fall. There would need to be some shock to the wider economy, affecting employment prospects in particular, for households' confidence in their ability to hold on to their property to be shaken, which could then have more lasting repercussions. As long as there was not considerable uncertainty about house price rises in the medium to long term, investors would generally not exit either. In fact, a sudden fall in prices may activate an element of latent demand into entering the housing market to add support to prices.

The results also show that buyers of property tend to consider their purchase deeply, with most acknowledging that house prices could fall. First-time-buyers draw more on external sources of information due to their lack of useful experience.

Who's who in the housing market:

Aspirant fledglings:

They possess a strong desire to have a home they can call their own, and put an end to "wasting" money on rent. They are generally optimistic about the market and house prices, but because of their inexperience they are more likely to seek out advice from friends and family, not to mention estate agents, the media and television. Many are concerned that they might be left behind if they don't buy, and that their dream home might escape their reach.

Been around the block:

Experience counts for these homebuyers. They are more likely to rely on their own analysis of the market than media reports, drawing on the know-how they have accumulated in previous house moves. Most accept that house prices could fall. The value they derive from owning their home is more important to them than the prospect of a financial return. However, already having a foot on the ladder reduces the fear of being left behind by rising house prices.

Savvy long-haulers:

They make up the majority of investors. They are investing for the long-term, having considered other investment options available to them. Often, their investment is to provide for them in retirement. They tend to give greater consideration to the timing of their purchase than homebuyers do. Media and television reports are pretty unpersuasive to them, as are the proclamations from property investment companies. Long-term trends are more important to their price predictions than is the case for homebuyers. Could be a wallflower (see below).

Bandwagoneers:

These investors have entered the property market because they had seen other investors doing so. They are much more likely than other investors to be influenced by television programmes and media reports about how lucrative buy to let can be and the future of house prices. Property investment companies are also relatively more persuasive to them. They make up the minority of investors, however.

Wallflowers:

These participants may well fall into one of the above groups as well, and are likely to be investors. Currently standing on the sidelines, they carefully consider the timing of their purchase and are ready to enter the market if they see prices fall. Falls in price represent a buying opportunity, possibly because they consider that property is currently over-priced. Although they still expect prices to rise, a greater proportion than other participants expect, or perhaps hope, that prices will fall in the next year.



Research Methodology

The survey was conducted using the Ipsos MORI Access Panel. This is a panel of pre-recruited respondents who have said they are willing to complete surveys online. The note below provides a general description of how the panel operates and how it is maintained.

In the case of this survey, it was not possible to identify the precise target group for the survey, i.e. people who have bought or considered buying a property in the last year, are currently in the process of buying, or are considering buying a property in the next year or so. Therefore, the target group had to be identified by appropriate screening questions. Only those who answered yes to either question 1 or question 2 were able to complete the full questionnaire.

In order to achieve 1,000 completed responses, e-mails were sent to 16,500 potential respondents. In order to make the sample as representative as possible, the sample profile invited to enter the survey was carefully balanced on age, gender, region, SEG and other demographic indicators. No respondent was made aware of the subject of the interview before completion and all respondents were members of Ipsos MORI proprietary consumer panel. Membership of this panel is by invitation only, effectively eliminating any possibility of any 'professional' respondents entering the sample. It should be noted, however, that this approach is not guaranteed to produce representative samples, as respondents are self-selecting. Furthermore, as we do not know the profile of the target audience, we are not able to ascertain how representative the sample is.

Fieldwork took place between 15th May and 23rd May 2007.

General note on the Ipsos MORI Access Panel

Access Panels provide an efficient way of selecting very precise representative samples for conducting research, ensuring strong confidence in the accuracy and timing of results.

Specifically, an online access panel is a representative group of respondents who have been pre-recruited and have agreed to take part in research. Since they have already provided details about the demographics of all individuals in the household as well as a range of other information such as household income, and online related details such as frequency of using the Internet and activities on Internet, we can target the surveys sent to them very precisely. The following is a summary of our approach to Access Panel recruitment, management and survey execution:

Panel recruitment

Panellists must be invited to join; self-selection is not possible. Blacklists are maintained and panellists are screened at sign up.

Panel management

Frequency and quality of response is monitored, and panellists are removed if this is not up to required standards. There are strict rules on panellist usage to ensure respondents do not become overloaded or perceived as "professional" respondents:

- A panellist can receive a maximum of 6 survey invitations a month
- A panellist can complete a maximum of 1 survey per week
- Panellists completing a survey in a given category are ineligible for surveys in the same category for 1 month
- Panellists completing a product test in a given category are ineligible for surveys in the same category for 3 months
- Regular updates are undertaken of the demographic and lifestyle information held on panellists.

Survey administration

Study participation is controlled via a survey PIN number and accessed via a unique panel number (assigned at sign-up) and the study PIN number. All online data collection is via a website. Panellists receive an email with a link to the questionnaire and the unique password. All concepts and multi-media inserts can be secured within surveys to prevent them being saved as images

Incentivisation

Ipsos MORI use a points based system for their online panellists. Points are allocated for each survey and are communicated to the respondent when an invitation for a survey is issued. Respondents accrue points for completed surveys, which can then be redeemed for vouchers. Panellists can track their own points level through the 'Gift Area' of the panellists website.



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