

30th January 2009

Boom & Bust!

You know we have been here before!

Relocating for work in 2002 we moved from the Midlands to the South East of England. We hadn't arrived a day before three locals told us about the strength of the local housing market. Our first 'dinner' party a week later saw the price of houses as the central topic of conversation and, although not on the grand scale of our new neighbours, we could understand the euphoria a little, as our own house in Birmingham was starting to rise in value. Apparently there was a new dynamic feel to the UK economy, it was a new era, a time when constant stable growth was the order of the day. Property was hugely in demand, desperately short in supply, and was destined to outperform other asset classes.

You know it's incredibly difficult to argue over dinner that, actually, there never really is a new era, especially when it comes to western economies (and in the fullness of time probably eastern economies to). More so when the dinner party was being held in the midst of one of the greatest property bull markets in UK history.

The problem was that all the UK property market experienced from 1996 to 2007 was an enormous speculative bull market. And you know it's really scary because for many homeowners or investors, it involved enormous leveraged (debt supported) gambles.

If I suggested to you that it would be a good idea to invest £250,000 in the FTSE 100 and loan the money to do it, how would you feel? It would be a risky gamble at any time, but then how about if I suggested you pick one sector of the FTSE 100 or even just one stock and put £250,000 of loaned money in? Even riskier eh? But that is what punters are doing when buying one house, in one sector, in one market place.

Many have borrowed enormous amounts of money to buy one single asset and therefore become exposed to what can only amount to a breathtaking gamble on the price of this asset class, property.

The boom, fuelled by cheap credit, from the west and the east, supporting a host of homeowners and buy-to-let investors, has driven average house prices to levels so far in excess of incomes that our esteemed banks and building societies started to offer 120% mortgages and 5 or 6 times income multiples when calculating our allowable mortgage.

Apparently the downturn in any sector is foretold by dinner parties around the UK, or so it seems in hairdressers, pubs, trains or on the front page of the Daily Mail. When anyone and everyone is telling you how wonder a particular investment is, it's gone to the mania phase and it's time to get out.

So now the nations gamblers (who for the most part I'm sure never saw themselves as such), must implement a strict protocol to ensure they survive the next few property bust years. Here is my personal emergency bullet point guide:

1. Don't look at the front pages of the tabloids - those same papers that inspired with 'house prices up by 25%' will shock you with the exact opposite this year;
2. Remain convinced your home is just that a home (it helps because most of us will be staying where we are for some time);
3. Try not to get too angry with the government (generally speaking they have no idea what they are doing and probably can't be blamed for their actions) this boom and bust cycle is more normal than you might think. Remember one of our relatively recent Chancellors said 'there are two types of Chancellor, the failures, and those that get out in time';
4. Don't get too upset with our German friends who see home ownership as quite unusual and much prefer to rent (thereby avoiding the crippling impact of a house price crash in the process);
5. Revisit history, this crash will give way to another phase of rising prices. As with any overvalued market the reality is that a sharp correction in prices is probably best (why should we expect sharply rising prices as we have experienced will be replaced by steady growth or even steady declines). The market hit mania phase and needs to pull back sharply to clear the way for recovery;
6. Develop the patience of Job! This crash needs to work through the system and the true effects may not become entirely apparent until after the next general election when the temporary economic props begin to, or are allowed to, collapse.

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