How disruptive will HIPs be?

- From 1 June 2007 home sellers or their agents will require a home information pack (HIP) before marketing their property. A HIP will consist of all the legal documentation necessary for the transaction, plus a report on the condition of the property – a home condition report (HCR).
- This will be a major change in the way houses are bought and sold in England and Wales. Evidence from previous government interventions in the housing market, such as the removal of double mortgage interest tax relief in 1988 and the stamp duty 'holiday' in 1991/92 suggest that such interventions can have a significant impact on supply and demand.
- It is difficult to predict the impact of HIPs on the level and pattern of housing market activity, but they could pose unintended risks in the short- and longer-term.
- The likelihood is for disruption during the transitional period immediately before and after 1 June 2007. We see a combined effect of sellers listing before 1 June 2007 to avoid the cost of a HIP and buyers, particularly first-time buyers, waiting until after 1 June 2007 to benefit from the greater certainty and lower transaction costs associated with buying a property with a HIP. This is likely to lead to an oversupply of properties in the first half of 2007, and a rapid unwinding of that position after HIPs come in.
- In the longer term, HIPs have the potential to reduce the number of speculative sellers and thus also the number of transactions and overall market liquidity. Although the market is likely to find ways to mitigate or defer the estimated £600-£1,000 cost of a HIP until a sale has completed, the potential cost to the seller if a property does not sell may deter speculative listings.
- It is essential that the Government carries out work to explore these possible market impacts and ramifications for stakeholders, particularly consumers, before HIPs become mandatory in England and Wales next year.

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Introduction

Over the years there has been a good deal of criticism of the house buying and selling process in England and Wales. Indeed, government research in 1998 found that fewer than half of buyers and sellers were satisfied with the process, and 28% of the offers made by buyers which were accepted by sellers failed to proceed to completion (DETR, 1998). On the basis of this research, the government concluded that HIPs would help to reduce the delays and uncertainties in the process.

Although there was a considerable delay in implementing legislation, the Housing Act 2004 finally introduced a new requirement for the seller of a property or their agent to prepare a HIP prior to marketing the property. In November 2005 the government announced that HIPs would become compulsory from 1 June 2007. A background note setting out the history of the development of HIPs can be found on the CML website. A HIP will consist of all the information needed for the property transaction, including legal searches and title deeds, together with the HCR - an independent report on the condition of the property.

The principle behind the change is relatively simple – to provide at the outset information which is currently not available until after an offer is made. By requiring the seller to have a HIP prior to marketing it is hoped that the period between an offer being accepted and contracts being exchanged will shorten. It is also hoped that this will reduce failed sales, when an offer is accepted but the transaction does not proceed to sale. Scotland is introducing its own Purchasers' Information Pack although the contents of the pack will be somewhat different.

While it is by no means clear that the aims of the changes across the UK will be achieved, this article focuses on the possible market impact of introducing HIPs. We concentrate on potential impacts in England and Wales. Our key conclusion is that this reform is likely to have an uncertain but potentially significant effect on housing market dynamics and stakeholders.

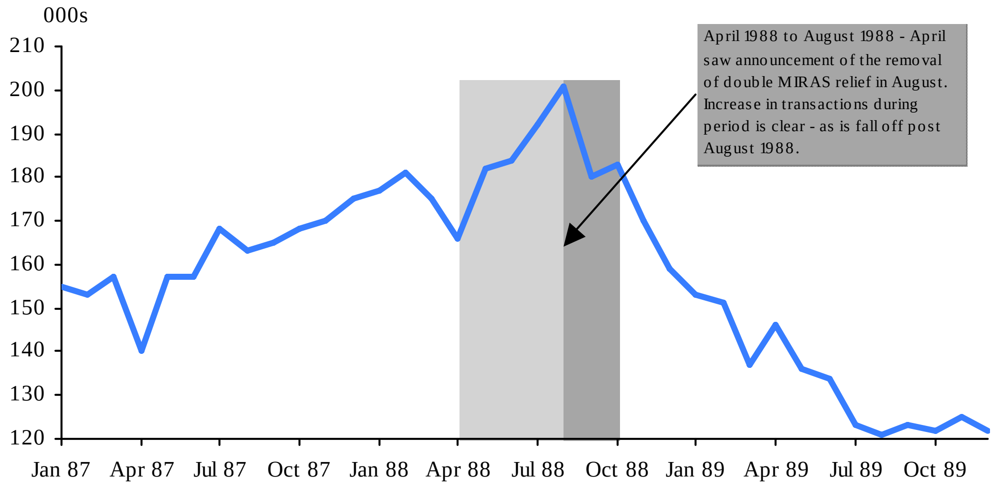
Market impacts

There remains considerable uncertainty as to the likely market impact of HIPs. There is probably no directly comparable policy against which we can fully gauge likely effects. However, we know that changes to government policy can have a significant impact on transaction levels in the period between a policy announcement and implementation, during the life of the policy or in the period after the policy's withdrawal. Understanding and accepting this may be vital to preparing for and mitigating against the risk of HIPs triggering imbalances in supply and demand, with potential knock-on effects for house prices and housing liquidity. In the following sections of this paper, we look separately at the possible transitional and longer-term impacts of HIPs.

Short term market impacts

When considering the initial impact of the introduction of HIPs on the housing market, one example to draw upon is the impact of the removal of double mortgage interest relief at source (MIRAS) in August 1988. In effect, this 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. The policy was not retrospective and, importantly, was announced in April 1988 but did not come into effect until August 1988. This meant that co-habitees who managed to buy between April 1988 and August 1988 were eligible for the more favourable relief for the life of the MIRAS regime. As Stephens *et al*[1] commented, this was "a textbook example of how not to implement change".

Chart 1: Transaction numbers (000s) and removal of double MIRAS



Source: HM Revenue & Customs

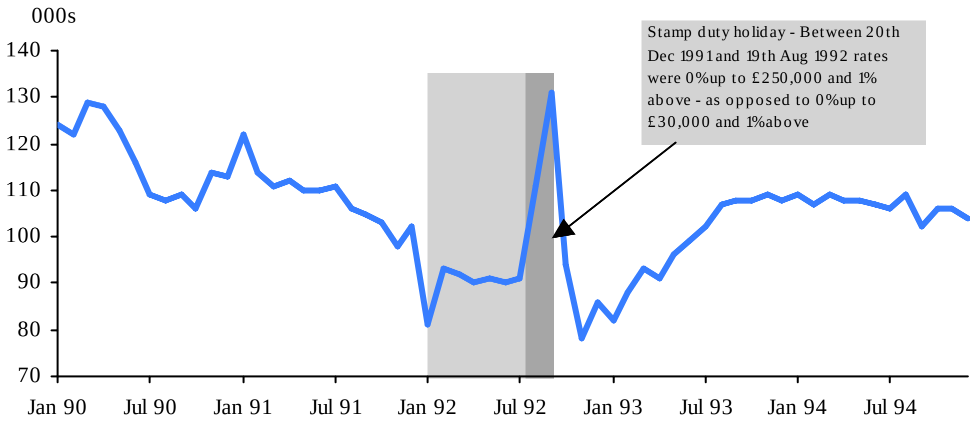
Chart 1 shows the number of property transactions recorded in England and Wales by HM Revenue & Customs[2]. The period April to August 1988 (shaded light grey) reflects the period between the announcement that double MIRAS was going to end and it actually ending. The period August to October 1988 (shaded dark grey) reflects the fact that HM Revenue & Customs do not record transactions data straight away.

In practice, there is an average lag of roughly one month between the transaction date and the date it is recorded. Irrespective of the complexities introduced by lags in data recording, there was a clear increase in the number of housing transactions resulting from the removal of double MIRAS. People sought to buy a property before the August 1988 deadline and therefore benefit from double MIRAS relief – a clear example of government policy impacting upon activity in the housing market.

It could be suggested that the removal of double MIRAS cannot be used to predict the impact of HIPs because the tax relief on mortgage repayments was worth a significant amount of money – well in excess of the market's estimate of £600-1,000 cost of a HIP to a seller. However, a second example of the impact of a change in government policy that does not suffer from this criticism was the increase in the zero rate stamp duty threshold between 20 December 1991 and 19 August 1992.

On 19 December 1991 the then Chancellor, Norman Lamont, announced that the zero rate threshold for stamp duty would rise from £30,000 to £250,000 for an eight month period in an attempt to stimulate a recovery in the housing market. At the time, stamp duty rates were 1% for transactions over £30,000. Hence, the maximum value of the stamp duty holiday for an individual buyer was £2,500. However, with average house prices of £66,000 (ODPM House Price Index) purchasers of an average priced house would have benefited by £660.

Chart 2: Transaction numbers (000s) and stamp duty holiday[2]



Source: HM Revenue & Customs

Chart 2 shows the period in which the increased zero rate of stamp duty applied, in light grey, and the period during which the HM Revenue and Customs lag in recording the transaction may be relevant, in dark grey. This shows that the government's policy had a massive impact on the level of activity in the housing market as buyers rushed to complete transactions during the stamp duty holiday period.

Even though the monetary value of stamp duty relief was well below that of double MIRAS, both policies induced significant increases in transaction levels. This suggests that even a relatively small financial cost or benefit could have a material impact on home buyer and seller behaviour.

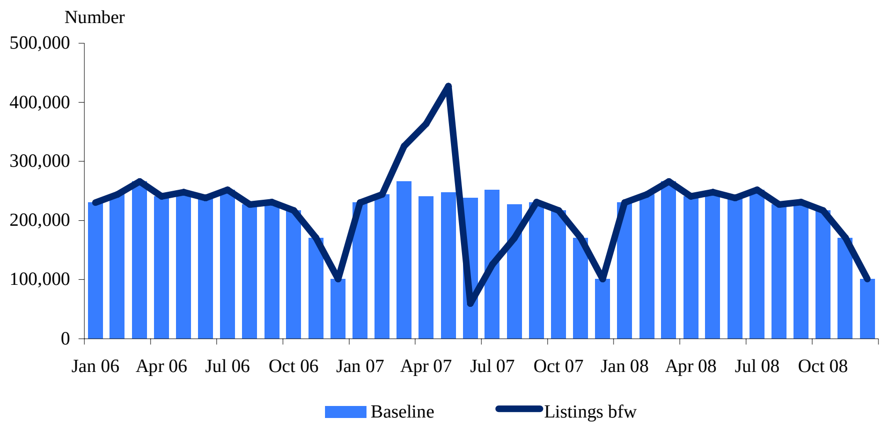
Assessing impact on the market cycle

These two examples suggest that we cannot discount the possibility that the actual or perceived increase in costs to sellers resulting from HIPs could change their behaviour and therefore the flow of properties to the market during 2007. While the increase in the zero rate of stamp duty was intended to stimulate activity in the housing market, the removal of double MIRAS was not. There is historic evidence that government policy can have unintended effects on the market.

For illustrative purposes, Chart 3 shows the result of a fairly crude simulation of housing market listings over the 2006-2008 period and the possible impact of a mandatory HIPs regime starting in June 2007. The monthly listings data are from Rightmove, extrapolated to represent the UK market as a whole.

We have assumed that sellers will react to the planned introduction of the new regime by bringing forward listings by as much as three months before implementation to avoid the cost of the mandatory pack. If we are right, this will cause an increase in listings in these months. Bringing forward listings means there will be a "shortfall" in the period following introduction. We have assumed this will be at a maximum in the month following introduction before returning to "normal" levels from the fourth month following introduction.

Chart 3: Assessment of HIP implementation on listings – implementation date June 2007



Source: CML and Rightmove

While the supply of properties coming onto the market might rise in the months preceding the introduction of HIPs, prospective buyers, particularly first-time buyers, might be tempted to wait for the extra information contained in the HIP. The combined effect of this could be a temporary excess supply of properties, poor market liquidity, difficulties in completing chains and fewer transactions in the months preceding HIP introduction.

After 1 June, there may be pressure on existing sellers without a HIP to provide one even there is no legal requirement to do so. There may also be confusion for consumers who will not know how to compare properties with a HIP to one without. Buyer behaviour may also change if in the post HIP environment moving owner-occupiers decide to look for a property before putting their own on the market. All of this could lead to a period after June of low supply relative to demand until the market settles down.

Clearly, we have made a number of assumptions in modelling seller behaviour in the period before and after the introduction of HIPs. The reality may be different. However, our judgement is that there will inevitably be some impact on listing numbers in the short term as a result of the introduction of HIPs, and associated confusion in the market place. This was why we indicated in our reaction to the announcement of the implementation date that it would have been better to choose a time when the market is quieter and more able to cope.

Now that a date has been announced the challenge is to understand the potential drivers that may cause disruption and develop strategies that minimise their impact. It is important that the various parties involved in house buying and selling, primarily estate agents, surveyors, solicitors and lenders, are aware of the potential impacts and can cope with them.

Relationships between buyers, sellers and the various property professionals involved with the process will need to adjust and new marketing and sales models are likely to emerge. The behaviour of HIP providers in the lead up to introduction may also have an impact. Pack providers will be seeking to secure market share and their pricing and marketing strategies will influence consumer behaviour and their perception of packs. This suggests that there needs to be an open debate about these issues so that the opportunity for unintended consequences, and the possibility of consumer detriment, is reduced.

Longer term market impacts

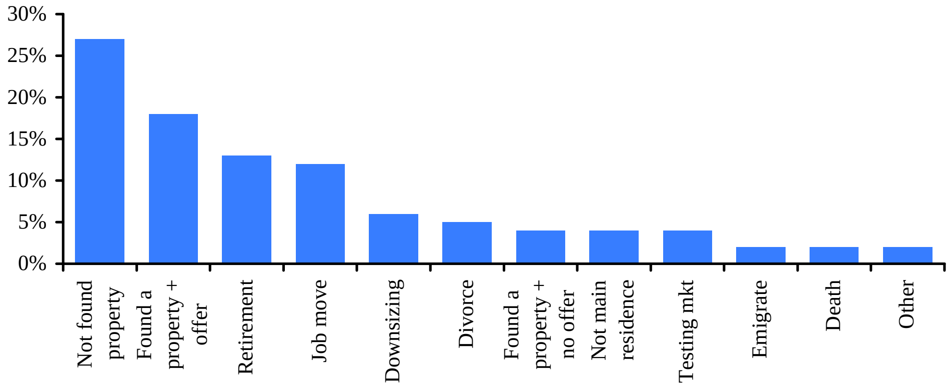
As well as considerable uncertainty about the transitional effects that HIPs may have, there is also uncertainty about the longer-term impacts. The requirement for sellers to have a HIP might be felt mainly in an on-going reduction in the number of "speculative sellers", as the cost of compiling a HIP may deter them from listing their properties. By speculative sellers we mean those who put their house on the market without being fully committed to moving.

Although it is likely that the market will find ways of deferring the cost of preparing a HIP until a sale is completed, as is the case with estate agency fees now, if a potential seller has to withdraw his property from the market, for example, because he cannot find a buyer, he is likely to have to pay for the HIP. This could deter many speculative sellers.

There is little reliable evidence as to what proportion of sellers can be considered to be speculative and therefore may be put off by the need to have a HIP. However, in 2001 Countrywide Estate Agents sent surveys to 12,501 of their customers (receiving 2,493 replies) seeking information on what motivated them to place their home on the market and how their decision-making may have changed had they needed to provide a HIP.

Chart 4 presents the results of Countrywide's research. Only 4% of respondents actually define their motivation as "testing the market" – a group that can clearly be defined as "speculative". This is a small component of the market but a number of other reasons given could also suggest an element of speculation. For example, many of those who have not found somewhere to move to (27% of total) may also not have firm intentions to move. Adding this group to that of "testing the market" gives 31% of the market.

Chart 4: Listings by reason

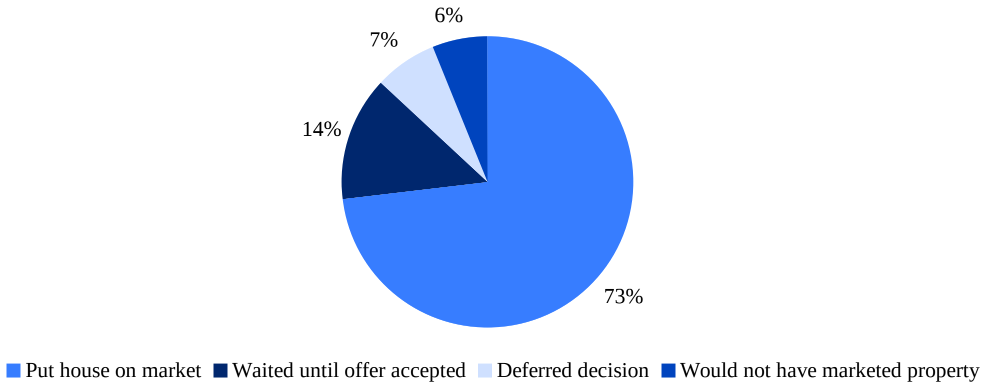


Source: Countrywide Estate Agents:

Further Countrywide research asked customers what they would have done with regard to listing their property had they needed to provide a HIP. Chart 5 summarises the results. These results can only be seen as indicative as the question posed was hypothetical and no information was given as to whether a seller would have to pay for a pack if the property was not sold.

But they clearly show that a significant number of those listing their property suggested that would change their behaviour if they needed to provide a HIP prior to being able to market their property. 73% of respondents said that, in a HIP environment, they would still place their property on the market. 6% said they would not have placed their property on the market, while the other 21% suggested they would hold back from marketing for some reason.

Chart 5: Reaction to provide HIP



Source: Countrywide Estate Agents

Taking these two pieces of research together suggests that up to a third of sellers can be considered as 'speculative' or more tentative sellers. If these are listings that are lost to the market this could mean a reduction of up to 400,000 transactions a year. This would have a knock-on impact on the liquidity of the housing market. This also suggests that the market needs to consider ways of funding HIPs that does not deter speculative sellers.

Another possible long-term effect of HIPs relates to the HCR and the impact this might have on how buyers assess the quality of the property they are buying. The HCR will provide the buyer with more information on aspects of the property's condition, including a numerical rating. This rating has the potential to increase the price differential between properties with a good HCR rating and those with a poor one, particularly if there are a smaller number of properties on the market. It may lead to increased competition for highly rated properties and a much more fragmented or polarised housing market differentiated by quality and property type. It could even facilitate the return of gazumping – an issue which the original proposals on HIPs were designed to overcome. One positive effect of HCRs may be an increase in the overall condition of properties if sellers put any faults right before marketing the property.

Conclusions

The introduction of HIPs is designed to have a significant impact on the house buying/selling process in England and Wales. We cannot be sure of the precise impacts, but we have outlined a number of plausible outcomes, drawing on past policy changes and survey evidence. Some of these outcomes may have unwanted and unintended consequences for consumers and the wider housing market alike.

We will only know the true outcomes once the scheme is implemented. However, it is very disappointing that to date government has done little to explore the potential impacts of such a major change, or to consider potential coping strategies with stakeholders . At the time when the implementation date was announced, we expressed concern that introduction in the early summer risks creating disproportionate disruption during the busiest period of the housing market.

In addition, we have serious concerns about a number of implementation issues that have not yet been addressed that suggests that June 2007 is a challenging timetable. We have sent an open submission to the ODPM today outlining our concerns.

A combination of a challenging practical timetable and seemingly little appetite to explore or acknowledge potential market impacts means that the risks of poorly implemented policy with consequent unrealised outcomes are increasing. It is essential that the government carries out work to explore these possible market impacts and ramifications for stakeholders, before HIPs become mandatory in England and Wales next year.

References

Department of the Environment, Transport and the Regions (1998) *The key to easier home buying and selling*, DETR, London

[1] Stephens, Whitehead and Munro (2005), *Lessons from the past, challenges for the future for housing policy*, ODPM

[2] Figures are based on the number of particulars delivered forms processed by the Stamp Office of District Land Registry. These relate to the transfer or sale of any freehold interest in land or property, or the grant or transfer of a lease of at least seven years, and therefore include some non-residential transactions.

Further information on Housing Finance

Housing Finance is an authoritative online journal which provides in-depth articles on a wide range of mortgage related issues. For free online access to other recent articles and research reports see http://www.cml.org.uk/cml/publications/research. A range of statistics that complement Housing Finance online is free to members and associates or can be subscribed to by non-members (for details see http://www.cml.org.uk/cml/statistics). For further information on Housing Finance articles contact the editor Bob Pannell at Bob.Pannell@cml.org.uk.

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