Can government policy on the UK property market damage the economy?

By Godwin Okri

It has long been a settled argument amongst free-market economists that a liberated market is a flourishing market. This is why some economists wince each time they read about Government policies affecting the UK property market.

I believe in safe, low risk ways help people enter the housing sector and build financial security for themselves and their family. There is no asset class as strong as property and I'm driven by my heritage, experience and passion for successful property investments. However, recent policy initiatives by the Government are set to undermine the platform for individuals to enter the property market and may have other, more far reaching negative impacts on the UK economy as a whole.

The Buy-To-Let (BTL) market (also referred to as the Private Rental Sector) has grown in size since the inception of the BTL mortgage in 1996. There are now about 2 million BTL landlords controlling assets worth about £2 trillion. The growth of the private rental sector has helped to mitigate the effect of the growing number of people on council waiting lists, which now stands at about 1.9 million. Commercial real estate investment in the UK has also grown significantly.

Rather than applaud the strides made by this sector, the current Government has instead blamed the Private Rental Sector (PRS) for the escalating property prices in the UK. As a result, the Government introduced a plethora of policies as panacea to cure the alleged problem, which are summarised below.

1. The Prudential Regulation Authority (PRA), which is part of the Bank of England, has instructed that lenders must not lend to BTL investors if the property in question produces rent below an Interest Coverage Ratio (ICR) of 145%. The borrower must also be able to afford the mortgage with a hypothetical interest rate of 5.5%. Portfolio landlords (i.e landlord with more than 4 properties) must also show a robust yield.

2. The Government announced that anyone buying a second home must pay a 3% surcharge to HMRC.

3. BTL landlords must check the ID of potential tenants before execution of the agreement.

4. The Government introduced Section 4 of the Finance Act (No.2) 2014 which prevents landlords from offsetting the full value of their mortgage interest payments against their rental income when calculating their profit. From April 2020, the tax relief they can claim will be limited to the basic rate of 20%.

5. Since April 2016 the 10% of the rental income which landlords (who let furnished properties) were able to claim as notional wear and tear when preparing their tax returns has now been discontinued. Now, landlords can only claim the actual cost of 'replacement' of furniture, but not the initial cost of purchase.

6. As a final straw, the amendment made to the provisions of Section 21 of the Housing Act 1988. The Deregulation Act 2015 (which introduced the amendment) is seen as the final dagger piercing the BTL heart. The 2015 Act now makes it a lot harder for BTL landlords to evict their recalcitrant tenants, even during a period of

persistent none payment of rents. The Act introduces a new Form 6A, which cannot be served earlier than 4 months into the tenancy; if the tenant raises a complaint, he cannot be evicted until certain conditions are met, etc.

The cold breeze blowing from the camp of the government is cooling the market. The rules introduced by the PRA are making it difficult for buyers to get a mortgage. Stamp Duty surcharge is also adding more upfront costs to transactions, making it even harder for purchasers. Investors looking to sell would now be forced to reduce their prices, because of these draconian policies. London and the South East are already experiencing a drop in prices. This sustained attack by Government on the Private Rental Sector could be costly. But could it be costly enough to affect the whole UK economy? Could this possibly affect investment, consumer confidence, consumption, the mortgage market, or international trade?

Economists have long identified that there is a correlation between consumer confidence and spending. An investor who feels that the value of his property has dropped, would react by cutting back on his spending because of the economic uncertainty. Industries suffer when consumers cut their spending. This could lead to unemployment. It puts the economy in reverse, which affects the gross domestic product (GDP). John Maynard Keynes refers to this as the 'multiplier effect'.

The banking and financial sector could also be affected: a stagnated property market affects banks looking to lend. As at 2015, the total value of mortgage lending was in the region of £152 billion. This included banks' profit. A fall in the mortgage market would affect this margin, which may lead to a reduction of activity in the financial services sector.

Furthermore, many pension funds and investment bonds generate income from the UK property market. A loss of income as a result of a contracting property market would be damaging for these organisations.

Lastly, a failing UK property market could even affect our international trade. The balance of payments from international trade has two main sections: Current Account and Capital & Financial Account. The Current Account records payments for purchase and sale of goods and services. The Capital & Financial Account records flows of money relating to investments, savings or speculation. The 'foreign direct payment' is part of the Financial Account, which shows funds coming into the country from abroad to finance investments.

Although Britain has a history of trade deficit, it has benefited from the billions of pounds of inward foreign direct investments brought into the UK for property investments, which has helped us balance the books from international trade. The Bank of England even acknowledges that overseas investors account for about half of all commercial real estate transactions since 2013.

An international investor who believes that the value of his investment is likely to fall would readily sell up and move on. This could affect the inflow of investment, which would in turn worsen our international trade account.

It is therefore clear that a falling property market would have a macro-economic effect on our economy and the GDP. The Government should rethink its policy and act decisively by reversing or amending the policies set out above. Attacking the issues from the demand side will not solve the problem. The Institute of Public Policy Research said that England is facing a growing housing crisis and estimated a shortfall of 750,000 units by 2025. Thus, the Government could approach this from the supply side: releasing more land for development; allowing local authorities to borrow in the

open market to fund programs of house building; relaxing the planning procedures; restricting the excessive use of Article 4 Direction, etc.

The PRS should be allowed to flourish in a free market without interruption. Free markets police their own integrity and solve problem areas by default because it is logical to do so. Maintaining the investment policies that have significantly enhanced a free property market would certainly be the fuel we need to guarantee the "greatest happiness to the greatest number".

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