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The *Financial Times*: Real-Estate Booms and Busts

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Introduction

The *Financial Times Historical Archive* provides a rich resource for research and projects at every level on a vast variety of social, political and cultural matters.

Banking and finance can sometimes seem abstract and baffling, but everyone can grasp real estate homes, offices and shops. House prices are of special interest in Britain and America where some 70 per cent of households are owner-occupiers with a vital financial interest in the matter. To serve this interest of readers, in 2005 the *FT* began publication of its own UK housing index, 'a new and improved guide to the latest trends... closer to the perfect index.' See 1 August 2005 for the publication announcement.

British house prices 1945-1979

In the 1950s and 1960s, UK house price rises outstripped the rate of inflation, reflecting increasing prosperity and an imbalance between supply and demand. 'New house prices doubled in past decade,' the *FT* reported on 7 January 1970. But that was just a taster for the housing market mania of 1971-74. 'House prices have left the realm of reality,' the paper declared as early as 19 June 1972. 'The subject of housing - "shortage, scandal, disgrace, supply and demand, market forces, gazumping, profiteering, slums, fair rents, break-ups, etc. etc.," has almost joined politics and religion in the list of subjects not to be discussed in pubs. It is a subject that is certain to evoke strong argument and possibly a fight... In today's market it is enough fuel to feed the argument of anyone from any social, political or financial standpoint.'

By October soaring house prices were leading to 'bitter exchanges' in the House of Commons. 'What has really happened,' declared Conservative Housing minister Julian Amery, 'is that there has been an increase in the money in people's pockets and an increase in the credit facilities available to them. This Government far from being ashamed, should take credit.' But Labour members greeted his words with cries of 'absolute rubbish.'

The house price boom peaked at 40 per cent a year in early 1973, the growth rate slowing sharply thereafter, discussed in an article 'A pause in house prices' on 18 April 1974. 'Housing market in a state of severe shock,' ran an *FT* headline on 24 June 1974. 'The idea once held as sacrosanct, that property is a good hedge against inflation now has a somewhat hollow ring to it,' observed property correspondent Joe Rennison. 'This is a total reverse from the situation a year ago when the property market was reaching the end of a boom which marked an inflation in prices far above that of any other sector of the economy.'

British commercial property 1945-1979

Commercial property was also in dire trouble in the early 1970s. Britain's first postwar property boom got underway in 1954 following the abolition of a wartime requirement for building licences for commercial real estate development. Announcing the move, which was welcomed by the *FT*, the Minister of Works derided the licence system for delay and cost, stating that the government would save £150,000 a year, see 3 November 1954. The resulting development boom

lasted a decade, petering out in 1964 because of over-supply.

A second commercial property boom got underway at the end of the 1960s fuelled by easy credit from the banks and the perception of property as a hedge against rising inflation. It reached a peak in 1973, accompanied by mounting public resentment at the allegedly grotesque profits being reaped by a handful of developers. In December 1973, in response to voters' anger, the Chancellor announced new taxes, describing 'large windfall profits' from development gains as 'offensive.' See 18 December 1973. The timing of the tax hike proved inopportune, since it coincided with the quadrupling of oil prices that resulted in an economic downturn, which triggered a slump in commercial property prices and the value of property companies. This threatened the financial stability of banks that had lent heavily to the property sector, necessitating rescue by the Bank of England in December 1973, an episode known as the 'secondary banking crisis. (The reliance of the lenders on funding in the wholesale money market was uncannily echoed in the 2008 collapse of Northern Rock.)' Property shares,' reported the *FT* on 26 April 1974, 'are down, on average, to less than half their peak since the start of last year, because of the drab state of the property market and of surrounding problems.'

British real estate 1980-2000

Deregulation of the mortgage market in 1980 made home loans more widely available than hitherto, while the Thatcher government's sale of council houses to tenants significantly extended owner-occupation during

the 1980s; by 1990 66 per cent of British households were owner-occupiers, higher than the US, 64 per cent, and well ahead of France, 51 per cent and Germany, 42 per cent. 'The belief that house prices in Britain can only go upwards has exceptionally strong psychological roots,' declared an *FT* editorial in October 1986 as another bout of housing market exuberance got underway. 'Cash buyers form queues down the M4,' ran a headline on 18 September 1987 reporting a property frenzy in the South West. At the peak in early 1989 annual UK house price inflation was running at 32 per cent per annum, way ahead of earnings growth and inflation.

'House prices - the year the roof fell in,' heralded the headline to an article on 7 July 1990 by the *FT*'s John Plender who pronounced that 'the 'property bubble has burst - perhaps for good.' The five years of falling house prices, from 1990 to 1995, were unprecedented in the British post-war housing market and an unimagined nightmare for heavily-borrowed home owners. 'With the collapse of the housing market, prices dropped by about 14 per cent on average between mid-1989 and early 1993 - and by double that in some areas,' reported the *FT* on 5 March 1994. 'Almost 2m people found themselves living in homes worth less than their mortgage - trapped by negative equity... But the long-awaited recovery is now underway.' By 2000 house prices had recovered to the level of 1990, taking account of inflation.

Britain - into the new millennium

The early years of the new millennium saw yet another upsurge in house prices, running at around 20 per cent

a year from 2002 to 2004. 'King warns on house prices,' reported the *FT* on 15 June 2004, reporting a speech by the Governor of the Bank of England, Mervyn King. 'After the hectic pace of price rises over the past year it is clear that the chances of falls in house prices are greater than they were, he said... At five times earnings house prices are high compared with the long-term average over 50 years of about 3.5 times.' King's pronouncement accompanied yet another rise in interest rates by the Bank, which contributed to a pronounced 'wobble' in the market. See 30 August 2005. Yet a year later, the OECD was warning that UK house prices remained 'significantly overvalued,' in common with real estate prices in other developed countries as discussed on the front page on 30 November 2005. Subsequently the rate of house price inflation fell and then stabilised at a modest level, underpinned by the low interest rate adopted in response to the international banking crisis that began in 2007 and the resulting economic downturn.

The postwar United States housing market

The post-war US housing market has been less prone to price bubbles than the UK because of the abundance of land, though this does not apply to the downtown areas of major cities such as New York, Boston or San Francisco. An early exception was the boom of the late 1940s driven by pent up demand outstripping limited supply because of wartime controls. But then in the 1950s and 1960s mass suburbanisation, based on the automobile, resulted in stable home prices in real terms. The late 1970s and late 1980s both saw home price spikes and falls, but by the mid-1990s US house prices had reverted to the long-term norm.

Savings and Loans

Traditionally, mortgage lending in the US was the business of Savings and Loan (S&L) associations, the American equivalent of Britain's building societies. The S&L's were highly regulated, so much so that in the early 1980s they found themselves so hemmed-in that they had become unprofitable and unable to do their job. The government responded with deregulation measures in 1980 and 1982 that allowed them wide freedom on both the deposit-taking and lending sides of their business, of which a number promptly took reckless or unscrupulous advantage. They took big risks chasing big returns, but instead garnered big losses. 'A wave of anger is sweeping over the US political system about the savings and loan collapse and rescue - the largest in financial history,' wrote the *FT*'s Peter Riddell on 4 August 1990. 'The savings and loan story has now moved from the front pages of newspapers to the top of the main television news programmes every evening. This is partly because of the admission by the Bush Administration that the originally estimated cost to US taxpayers of \$50bn was far too low, and much more - anywhere from \$130bn to \$200bn might eventually be needed.' By the final resolution of the mess in 1995, 500 S&Ls had collapsed and a further 500 had disappeared through merger at a cost to taxpayers of \$150 billion, at the time a record financial sector bailout.

The US home price boom and bust 1997-2006

The US house price boom that began in 1997 was unprecedented in its scale and longevity. 'Mortgage rates in the US have sunk to their lowest level in at least three decades,' observed the *FT* on 9 November

2001, 'explaining much of the resilience of the nation's housing market.' On 30 June 2004 the paper reported that 'since 1995, house prices in the US - after inflation - have climbed by 36 per cent, roughly double the increase of previous housing booms in the late 1970s and 1980s.' Despite 'no shortage of economists warning that boom would eventually turn to bust,' the boom was by no means over. 'US home prices soar,' announced an *FT* headline on 26 August 2005, quoting the president of the National Association of Realtors who explained that 'the rate of price growth reflected supply and demand' and predicted, bullish as always, that 'we expect home price appreciation to remain above normal over the next year.'

'The speed of the slowdown in US house price inflation as taken many observers by surprise,' noted the *FT* on 9 September 2006 reporting the first drop in US house prices for a decade the previous month. It attributed the 'very significant' cooling to the series of rises that had taken US interest rates from 1 per cent to 5.25 per cent and noted anxieties about the threat that the substantial stock of unsold homes posed to house prices. The housing party was over and a painful hangover was on the way.

Subprime mortgage lending

A notable feature of the US home price boom of the 2000s was the spurt of 'subprime' mortgage lending to borrowers with poor credit histories, often from ethnic minorities. Between 2002 and 2007, an additional 3 million minority households became home-owners thanks substantially to subprime mortgages. Characteristically, subprime mortgages had adjustable

interest rates that varied with lending rates. They featured an introductory 'teaser' period with an artificially low rate that jumped after two years, at which point the loan might be unaffordable. By 26 July 2004 the *FT* was reporting 'a potential financial "time bomb" because of the strong interest of low income consumers in adjustable-rate mortgages at a time of rising interest rates...The percentage of adjustable mortgages taken out has more than doubled over the past year, rising to 36 per cent of all loans.' 'There are some borrowers who are selecting these products not out of desire but out of necessity and it may come back to haunt them,' a housing analyst told the *FT*'s reporter. 'Some of the products that are being originated today will turn into the foreclosures of tomorrow.'

'Securitisation' and the international banking crisis 2007

With the downturn in the US housing market from August 2006, a crisis in the subprime mortgage sector became a certainty as financially weak borrowers defaulted on loans they couldn't afford to finance assets that were plummeting in value. 'Hedge funds home in on housing,' ran an *FT* headline on 28 September 2006, above a report that 'growing numbers of hedge funds have placed bets on a slump in the US housing sector in recent weeks...We've seen macro hedge funds become increasingly negative on the US housing market,' commented a trader. 'It seems to be the one trade that they can all agree on.' And for those speculators it paid off spectacularly.

By the 2000s it was common practice for mortgage and other loans to be packaged as bonds (a process known

as securitisation) and sold to banks as investments. As subprime and other mortgages that comprised constituent elements of such securitised bonds defaulted, the bonds themselves were impaired and they became unmarketable and effectively worthless as liquid assets. Unsure of their own liquidity, and suspicious of the ability of other banks to repay inter-bank loans, in summer 2007 banks suddenly refused to lend to each other. The US subprime mortgage crisis was the trigger for the onset of the most serious international banking crisis since the 1930s.

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