MASKELLS RESEARCH: The UBS Global Bubble Index **–** The Devil is in the Detail.

Is the UBS report accurate?

UBS have recently published their "UBS Global Real Estate Bubble Index" which concludes that the London housing market is in "bubble-risk" territory. We examine the components they have used and ask if they have got it right. After all, the devil is in the detail:

UBS data conflicts with GLA Data.

GLA PI Data suggests London cheaper than Paris or Singapore

In their report UBS maintain that the London price income ratio is 14 years and define it as "*the number of years a skilled service worker needs to work to be able to buy a 60M2 dwelling near the city centre*". We thought that this was a very subjective starting point for a City as large and diverse as London where house prices can vary from one street to the next let alone one borough to the next. Also, why 60M2 and not 50M2 or 70M2? The Mayor of London in the report "Housing Space Standards" (Aug. 2006) reports that the NHF's Guide to Standards & Quality call for a 22.2M2 dwelling for up to 2 people with no distinction between 1 and 2 person dwellings – so where does 60M2 come from? Unsurprisingly, the UBS analysts' findings (who both are based in Switzerland) are different to those produced by the Greater London Authority (a source used by UBS in their report p.15) who, in their Ratio of House Price to Earnings by Borough (Feb. 15) conclude that the median PI ratio for Central London is 12.15 years. If the GLA is accurate, this makes London cheaper than Paris and Singapore and on par with New York per the UBS rankings. In fact there are parts of London, such as Tower Hamlets, where the PI ratio is as low at 7.88 which is less than Vancouver, Sydney or Amsterdam. There are also some areas which are very high such as Westminster (23.57) and Kensington & Chelsea (39.85) – but that's what makes London so attractive – it appeals to a range of budgets. We wonder which part of London UBS were looking at when coming to their conclusion or is this 14 years simply an average bearing no real relevance to day to day living?

Average wage used by UBS 16.5% lower than experienced in London.

One website used only has 662 property entries.

We were also concerned with some of the data used by UBS. The skilled service worker (the entry in UBS' Price & Earnings Survey 2015 is a "*Bank Credit Clerk earning £29,587.50"*) is at odds with the annual wage for people working in inner London which the ONS data (Dec 2014) reports as £34,473 - 16.5% higher than the UBS figure. What impact does this 16.5% increase have on their Price Income Ratio? Clearly a higher salary makes property more attainable. We were also surprised to see a website called Numbeo.com (P. 15 UBS report) in their list of data contributors. When accessing the property prices page for London on the site, it asks "*Do you live in London? We need your help – Add data for London!"* and a notice that the data comes from "*662 entries*". To put this into context, there were 76,426 sales in London from November 2014 to July 2015 according to Land Registry. UBS also rely on the EUKLEMS which has not been updated since 2008.

Price to Rent Ratio misses considerations notably effect of inflation on debt.

UBS also look at the price to rent ratio (defined as "*how expensive owner occupied homes are relative to rental apartments. The higher the ratios, the more expensive buying becomes*") where London has a lower ratio than Zurich, Vancouver, Hong Kong, Geneva, Singapore and Paris. The conclusion they drew is that "*the expense of buying a flat* (in London*) is comparable to renting it for 30 years*". We are not sure that this is a sensible conclusion as it does not take into account a number of important considerations:

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Factors to be considered include rent inflation and fixed mortgages may be less than rental payments..

1) After 30 years of rental you will have no property assets to pass to your heirs.
2) Rental contracts over 1 year have a 3-8% inflation uplift built-in regardless of what the CPI does.
3) Homeowners with mortgages can often defease some of the liability through time – CPI may be flat but core inflation is still at 1% which is significant over 30 years in eroding the balance of value (as opposed to the nominal amount) of the mortgage which has not been reduced via monthly payments.
4) Repaying a mortgage is almost always cheaper than paying rent particularly in a low interest rate environment where mortgages as long as 40 years have been recently underwritten by Halifax and Nationwide (Independent, money section, Sept 15)

UBS may have been better placed considering a deposit to Income ratio – how long it takes to save up for a deposit - as a key metric to affordability, particularly as Halifax are now offering 5% deposits (95% LTV) on properties up to £600,000 (terms apply).

Household saving down but also household borrowing – homeowners starting to pay off household debt

The UBS report also looks at mortgage balance vs GDP, which has been increasing. An interesting metric but it does not take into account other household loans. A more interesting perspective is provided by an ONS publication entitled "*The Savings Ratio – how is it affected by the households and non-profit institutions serving households' income and expenditure*" – July 2015. In this publication, the author determines that household savings are down to approx. 4.9% of income but that higher salaries and higher employment are visible in the period 2009-2015, meaning people are saving less than they use to. Household debt (net acquisition of loans by household and NPISH Quarter 1 (Jan- Mar) 1997 to 2015 show a marked slow down in new loans being taken out from 2009 to 2015 vs 1997 to 2007 with the implication that households, whilst saving less, are reducing (repaying) their outstanding loan balances. This is further re-enforced by the publication *"Debt and (not much) deleveraging"* by McKinsey Global Institute (Feb 2015) which shows that the UK Household real economy debt vs GDP has reduced by 8% from 2007 to 2014 (one of only 5 countries where household debt has decreased by more than 5% against GDP). We are not suggesting that the UK does not have a significant debt burden, in fact the opposite is true, but it would appear that whilst mortgage debt as a component of household debt in increasing, overall there is a downward trend in household debt The McKinsey report however does suggest that a careful watch should be maintained as otherwise debt levels will increase again.

Conclusions:

Hypothesis that London is in "bubble-risk" territory not proven.

We do not have the mathematical equation that UBS use to calculate the 1.88 they have allocated to the London Real Estate Market in order to claim we are in "Bubble-Risk" territory, but certainly some of the points and figures we have highlighted do raise the question – have they got it right? A claim that a major international city is heading towards a housing bubble must be made in a cautious, careful and considered manner where subjectivity should never take over from objective analysis. Is the London property market a bubble risk? It may be, but UBS' 1 page report on the London property market does not prove it.

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