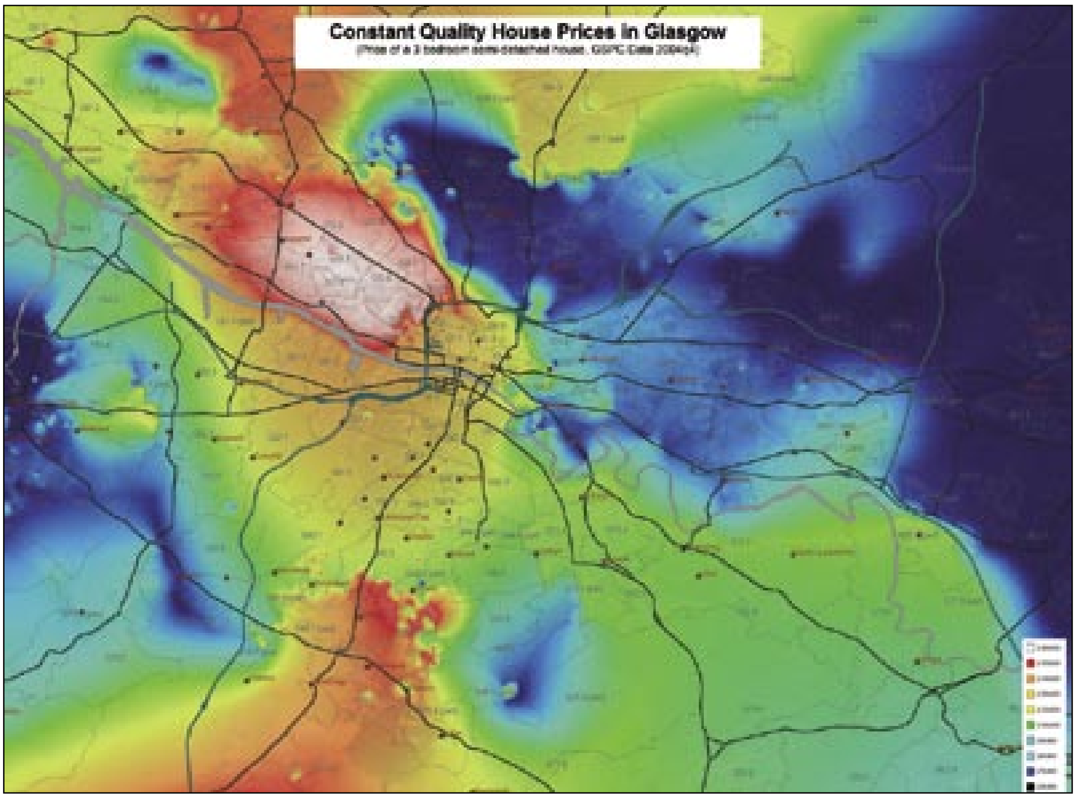
Can We Trust UK House Price Indices?

A detox programme for the index-addicted

Dr Gwilym Pryce, Urban Studies



Multiple-Fractional-Polynomial modelling techniques are used here for variations in property type and to estimate a "constant quality" house price surface for Glasgow (price of 3 bedroom semi-detached house, GSPC data 2004). But are the results distorted by transactions bias?

The weather faces a new contender for the title of Premier British Obsession: house prices. Although housing reports are yet to be issued with the frequency of Met Office missives, they certainly seem to be heading that way. Time was when the providers of house price indices were but a select few (ODPM, Nationwide, Halifax) and their press releases were issued no more frequently than visits from Santa Claus. But times have changed. The growth of home-ownership, and the impact of potentially life-changing fluctuations in property values, have fuelled our appetite for all things housing. Price-index providers, purveyors and pundits have sprung up everywhere. Indices are no longer limited to an annual summary for the whole country: they are available just about anywhere, anytime. You can even find out how much your neighbour's house sold for.

We eyeball house price graphs with the hypnotic fascination formerly reserved for TV weather maps – we don't quite know what they mean, and we certainly don't know what causes the numbers to fluctuate. And if you ask ten different experts what it implies for the long-term outlook, you'll get eleven different answers. But house price bulletins have become as irresistible as tabloid headlines, particularly if we think that the news report means that our home has doubled – or halved – in value (and that's just in the time taken to turn up the volume on your TV).

So, is there a cure for the pandemic of index-addiction? The best medicine, say the experts, is a healthy dose of scepticism…

A good starting point in our much-needed detox programme is to ask, what is a house price? That might sound as banal as asking why the chicken crossed the road (to find out how much the shed opposite sold for, of course). But think about it. Every house is different. Every neighbourhood is different. And so every house price means something different. You can't weigh-up house values the way you compare petrol prices. Simply taking the average price of houses sold in any given month doesn't solve your problem. If the local mansion happens to come onto the market, then the average for your area will be inflated – the index will say that house prices have risen, when the reverse may be true. Mix adjustment – as it is sometimes called – varies greatly in sophistication, partly due to the variation in information recorded between the different datasets. House price junkies beware!

A second question is whether the data used to compute the index is truly representative of all houses sold. This is not a problem with Land Registry data (which includes all transactions), but the same is not true of lenders and estate agents. Different lenders represent different sectors of the market and, since not everyone needs a mortgage to buy a house, some transactions will be excluded altogether.

Third, we must ask whether those properties which have sold are representative of the total housing stock. All major house price indices are transactions-based. In other words, they rely entirely on information reported at the point of sale. But what about properties that have not sold? If your house isn't typical of those used to calculate a particular index, then movements in that index may not be typical of changes to the value of your house.

Surprisingly, although this is the most fundamental of the three questions, it is the least researched. Work on transactions bias currently underway in the Department of Urban Studies is, to our knowledge, the first of its kind in the UK. Yet, it might fundamentally alter our understanding of the meaning of house prices and their policy implications. Consider, for example, the current ODPM policy to expand the housing stock in order to mitigate house price inflation. If new properties are of the type/location that are frequently traded, they will enter house price indices more often, and since they are increasing the supply of that type/location of house they may well stabilise prices in that submarket. The result? Apparent policy success. But what of the impact of those new properties on the remaining housing stock? Perhaps, the true impact of new properties will be to widen the gulf in wealth accumulation (between occupiers of small, low-quality, frequently-traded properties and owners of large, luxurious houses that are seldom sold).

What's the mix adjustment? Where did the sample come from? What about properties that have not sold recently? Ask yourself these questions once a day before breakfast and you'll be well on your way to kicking the house-price habit. Trust me... I'm a doctor.