Peter Williams and Troy Martin of Acadametrics explore the range of issues surrounding the use of house price indices and underline the importance of knowing what is really happening in the housing market

Homing in on the true measure of house price inflation in UK

While affordability pressures tighten across the UK, while more lenders adopt affordability models and move towards risk-based pricing and while government becomes ever more concerned with the housing market and its own supply and demand targets, so the reporting of house prices becomes ever more central to individuals, to organisations and to the Labour administration.

The British might be pre-occupied with reality TV shows and motor insurance, but home ownership and house prices would surely come top of any obsession list. This is not because UK home ownership levels are particularly high. Indeed, they are around the EU average. A number of other countries, such as Spain and Ireland, have home ownership levels of well over 80%.

However, our obsessive interest in house prices is evident in the volume of printed articles and in the subject's intrusion into daily conversation. At least eight indices report house prices monthly – which are often contradictory – and the results are published as information. The result is noise and confusion and, some might say, a form of house price madness!

Measuring the market

Much commentary in the media and on the street takes any house price reporting largely at face value. Commentary typically notes the average price trends reported by each index. How these reported trends may be affected by the coverage of any particular index, by the point in the purchase process at which the reported prices are gathered or, indeed, by any technical adjustment is rarely commented upon.

While each of the different house price indices provides a legitimate result and reflects a slice of reality, the indices do not necessarily reflect the same reality. This is potentially quite dangerous for those who don't understand the differences.

The alternative house price indices cover variously:

- asking prices – the price which sellers would like to get for their home;
- approval prices – the price notified to the lender and against which the mortgage loan is approved;
- completion prices – the price agreed when the approved loan is actually processed through to completion; and
- registration prices – the price used to calculate the stamp duty, being the price which is then registered.

In addition to reporting the price at different points in the purchase process, the indices also vary by coverage and technical adjustment. This means that:

- some cover England and Wales only (or Scotland or Northern Ireland). Others cover the UK;
- almost all are based upon a sample, rather than upon 100%, of eligible properties. Most of these are quite small. Significantly some lack cash transactions;
- some report a price based upon a simple average of all the homes sold. Others adjust for the very different mix of properties being sold in any month and some are adjusted to reflect the characteristics of the homes or seasonal variation in the number of transactions – for example, the low number in December and the higher number in April; and
- some report prices at a regional and local authority level – small samples used at national level become very small at lower levels and some report these only quarterly.

Taken together what we have are very different indices or measures of house prices. Table 1 outlines the features of the different indices.

A true measure?

It is a surprise to note that a test for a true measure has not been previously examined, despite the fact that, as far back as 1998, Mervyn King called for a "true measure of house price inflation" and pointed to a "puzzling and unfortunate divergence of the lender indices".

Research-based consultancy Acadametrics has taken on the challenge in its recent website publication A True Measure of House Inflation? (see references). Acadametrics chose, as the foundation for a true measure, the final paid prices reported when a property transaction is registered with the Land Registry. Not only are these the factual prices but the transactions represent the universe rather than a sample of data. Importantly, these data are similarly reported to land ownership registration agencies in a number of different countries.

The problem with using the registration price for England and Wales is that its reporting can be quite delayed. As a measure of what is happening in the market today, Land Registry data are not very useful. Not until two to three months have elapsed does the Land Registry report the bulk of the transactions that took place in any given month. Such a lagging measure does not really help buyers or sellers or their agents to establish what they should be asking for or be prepared to pay today.

To overcome this problem Acadametrics first commissioned development of an "index of indices" model at the University of Cambridge to allow Land Registry transaction data to be indexed and reported on the same basis as other indices. The result was the FT House Price Index which has been published monthly since September 2003.

Comparison of indices

A variety of timely index data is now available on a monthly basis. Chart 1 gives a snapshot of how the monthly change results reported by the indices compare. What it shows is considerable monthly volatility in some price indices and greater stability in others. Clearly this volatility can be smoothed in a number of ways. ▶