

UK HOUSING: SETTING OUT THE CHALLENGE

Output of a joint ESRC/ British Academy Conference

29 October 2014



Introduction

Housing affects everything. It is interwoven into the wider economy, the financial system and the wellbeing of citizens. The quality, tenure, type, price and location of homes have implications for outcomes in areas such as shelter, wealth, tax revenues, health and education.

The Economic and Social Research Council and the British Academy jointly organised a forum on the challenges posed by housing. The event brought together senior figures from the housing and planning professions, think tanks, housing charities, and central and local government with leading academics in housing research from a range of disciplines.

The forum event aimed to raise the profile of housing as an issue of policy relevance by highlighting key evidence structured around three topics:

- The Economics of Housing: the relationship between demand and supply; macroeconomics of sector stability and volatility; and models of credit and equity of access.
- Planning and Regulation: the role of housing in the urban infrastructure; urban design and sustainability; and planning law.
- Distribution and Inequality: distributional issues; generational cohorts and the life course; and taxation of housing.

This report summarises the evidence and discussion that took place at the event in order to continue to inform the growing debate on housing policy and research across the UK.

The Economics of Housing

The impact of the recession and financial crisis highlighted the threat that a build-up of debt based on lending against real estate poses to financial stability in the UK and other advanced economies. Understanding trends in the housing market is therefore fundamental to financial and macroeconomic stability.

Housing is an important part of the economy, both because of its direct input into growth but also through the role it plays in welfare, household debt and labour mobility.

Supply and demand

Rising house prices have negative consequences. The lack of responsiveness of supply to changes in demand have made mortgage and housing crises more likely as prices rise to unsustainable levels. When prices then fall sharply, this leads to reductions in demand for housing and in capital of financial firms, which together lead to lower GDP than would otherwise have been the case with more stable price

‘Understanding what’s going on in housing is fundamental to financial stability issues and macroeconomic stability issues’ - Lord Adair Turner

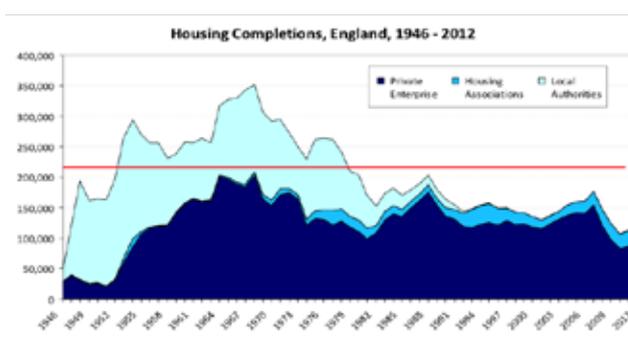
growth. Large rises in house prices have tended to lead to an appreciation in the exchange rate, which will hit the export-focused productive sector. On the social policy side high house prices have led to the emergence of a “lost generation” unable to buy their homes and increasing social exclusion as housing becomes unaffordable.

Since 1980 the rise in real house prices can be explained by the rise in average incomes and the decline in the available housing stock. Other factors have also played a role including the liberalisation of credit, on-going urbanisation and increased demand from overseas investors.

Housing supply has not kept pace with the formation of new households recently. While the Government projects that 221,000 households will be formed on average every year, the three years from 2010 to 2012 have seen completions at around half that rate. There has not been in excess of 221,000 new homes built in a single year since 1978.

This does not necessarily mean that supply is failing to meet demand, which is a market-driven concept and related to the type and number of homes households will choose based on their preferences and ability to pay. Another measure is housing need, which is a measure of the number of households that do not have access to accommodation that meets certain standards – a deficit that has in the past been met by social housing. When the government stopped building social housing in the early 1980s, there was no compensatory rise in private sector homes being built in England as Figure 1 shows.

Figure 1. Decline in housebuilding in England since WWII - source: DCLG



While there is no direct correlation between household formation and housing demand and need – which are sometimes combined under the term “housing requirement” - the number of households in England is projected to grow and more housing will need to be constructed in order to accommodate this growth.

Professor Paul Cheshire at the London School of Economics (LSE) has estimated that in the 20 years to 2012 1.6-2.3m too few homes were built in England and Wales. Since 2003 the share of owner-occupation in the housing market has fallen in both absolute and proportional terms. Meanwhile private renting has overtaken social housing for the first time. Many of the 1.5 million new households formed since 2005 went into private renting, sharing with other households or staying under parents' roofs.

‘Tinkering’ at edges

‘Since 2008 renting in terms of housing expenditure has gone through the roof, as opposed to owner occupation, as interest rates have fallen’ - Professor Christine Whitehead, LSE

Solving the problems in the housing market is a major challenge. Affordability will remain a constraint with prices forecast to grow at least 4% year, while house prices in London and the South East are now at least 10 times the average salary in the local area. Eventual

rises in official interest rates will increase mortgage costs. That may pose problems for people who have taken out mortgages with rates at the historic low of 0.5%.

Further cuts in state spending will mean funding by the Government, which is a major investor in the housing market both directly and indirectly via infrastructure and welfare payments, will fall. There is an urgent need to improve levels of productivity and innovation within the housing sector to increase the UK's ability to build more homes more quickly.

One contributor pointed out all players in the housing market had “skin in the game”, that it was in their interest to keep house prices rising: the public had bought into the idea of buying a home as a financial asset to provide long-term savings; banks' balance sheet were heavily weighted towards real estate lending; landowners knew they could hold out for the highest prices; and politicians had an interest in rising prices both because of the positive impact on consumer confidence, GDP and voting intentions but also because of its position as an investor via Help to Buy.

‘The greatest potential is changing the forms of rental contracts to a more German style where tenants and landlords have a long-term stake in the relationship’ - Professor John Muellbauer FBA

View from Government: Overcoming barriers

In the wake of the 2008 financial crash there were sharp falls in housing transactions, completions and lending to first time buyers. Terrie Alafat, Director of Housing Growth and Affordable Housing at the Department for Communities and Local Government, said the crisis led to changes in supply and demand.

One was a fall in demand, particularly from first-time buyers (FTB) who need an average of £21,000 for a 10% deposit. A second challenge is a shortage of land with permission to build where people want to buy coupled with the burden of high upfront infrastructure costs for larger sites. Another challenge to improving supply is the domination of the housing development industry by a small number of large firms, which has become more concentrated since the crisis. Meanwhile small developers have found problems getting access to finance. Finally the long-awaited inflow of institutional investment into the rental sector has not so far arrived.

The Government has taken a number of initiatives and Ms Alafat said there are positive signs. Permissions granted on new sites had increased substantially. Since the end of 2009 the rolling annual average of permissions has granted on all sites in England has risen from around 150,000 to over 230,000 by June 2014. Developers have reported falling delays in the planning process. There has been an increase in housing starts, which commentators say is caused in part by the Government's Help to Buy equity loans. Access to finance is improving for larger firms. There has been an estimated £1.3bn of institutional investment in the private rented sector since 2012.

Learning from other countries

Britain should look to other countries for lessons on meeting the challenges, according to Professor John Muellbauer FBA of Oxford University. South Korea was discussed as an example of effective supply and demand management. The Korean Land guarantees a steady supply of land to the private sector and allows most of the planning gain to accrue to the nation, solving both supply and funding problems. On the demand side it deployed macroprudential regulation to impose loan-to-value and debt-to-income control ratios. However the discussion highlighted that a small number of large housing companies tend to dominate the South Korean market, and that some of the housing built would not be of acceptable quality in the UK. Meanwhile in Germany, consistent growth on new homes had led to income relative to the housing stock trending down since 1980 - the opposite of UK experience.

Muellbauer argued having a land bank would be a major benefit to the UK. Other countries had done much better in making land supply meet business plans and so deliver houses in the right places.

**‘We need radical reform of the planning system because anything short of radical reform will not solve the problem. The question is whether we can do it in time’
- Professor Paul Cheshire**

As a result, the current proposals for reform were little more than “tinkering around the edges”.

Planning and regulation

There is evidence that the planning system is one of the most important factors in the lack of supply. Solutions must therefore focus on unlocking barriers to supply. It has been found planning constraints play a causal role in:

- Rising real house prices;
- Greater house price volatility;
- Causing price differentials across geographies; and
- Higher cost of retail and office space;

Greenbelt tightens

Land space for development has been rationed for six decades. The rules governing land use have remained largely unchanged since the 1947 Town and Country Planning Act, which was reinforced by the introduction of greenbelts in 1955. Other restrictions include the preference for building on brownfield sites, limits on building heights in areas of high demand and lack of compensation schemes for existing homeowners afraid they might lose out from development.

These policies, and greenbelts in particular, have led to people being priced out of the urban areas where they work and “leapfrogging” the greenbelts as they search for housing and garden space. The greenbelt means that workers in big cities, especially the higher skilled and richer ones, have longer daily commutes. In towns such as Norwich and Bournemouth, a significant proportion of the most highly skilled working residents commuted to central London. The restrictive policy on new developments means housing supply has become almost totally unresponsive to changes in house prices.

Making room in the greenbelts

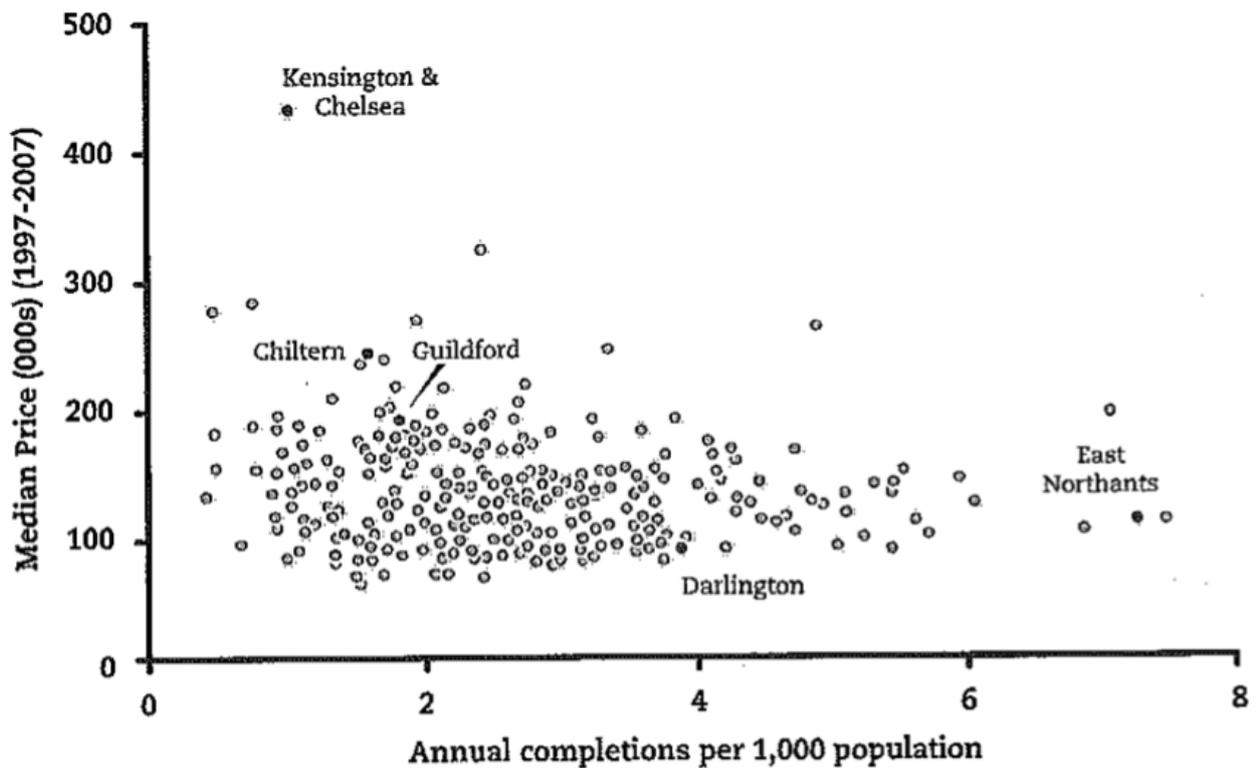
Britain is not running out of land, but has simply manufactured a shortage, according to Professor Paul Cheshire. Greenbelts cover 1.6m hectares, nearly half again as much land as all urban areas. London’s greenbelt is more than three times the size of the city. Much of it is devoted to intensive arable use, and most is private which means it does not have the access rights or amenity value intended when the greenbelt policy was set up.

Large parts of the greenbelts have little amenity or environmental value and would provide homes that would be close to jobs. He pointed to analysis by Barney Stringer of the consultancy Quod, which identified areas of greenbelt land around London that had no amenity value but were within 800 metres of a train station, as Figure 2 shows. Even at current densities of 50 homes per hectare, using 20,000 hectares out of 515,000 hectares of greenbelt land would create 1 million new homes.

Figure 2: Sites in London's greenbelt within 800m of rail station - source: Quod



Figure 3: Prices and new home construction by LA district 1999/00 – 2006/07 - source: Centre for Cities



As incomes continue to rise over the longer term and the supply of land remains rigid, the challenge of unaffordable housing will increase until a crisis forces change. One speaker described greenbelts as a policy that generates “no benefits other than to a small number of extremely wealthy homeowners living there”.

Urban design

As Figure 3 shows there is little relationship between rises in prices and where new homes are built, which

would indicate there is little supply response to signs of rising demand.

There is nothing to encourage landowners to sell for less than what one speaker called “phenomenal” prices. These transactions leave little money for building the infrastructure needed to make the site sustainable such as roads, local transport, schools, hospitals and health centres. Yet it is often lack of infrastructure that makes land unviable. Meanwhile the year-by-year funding by local and central government means it is not possible to

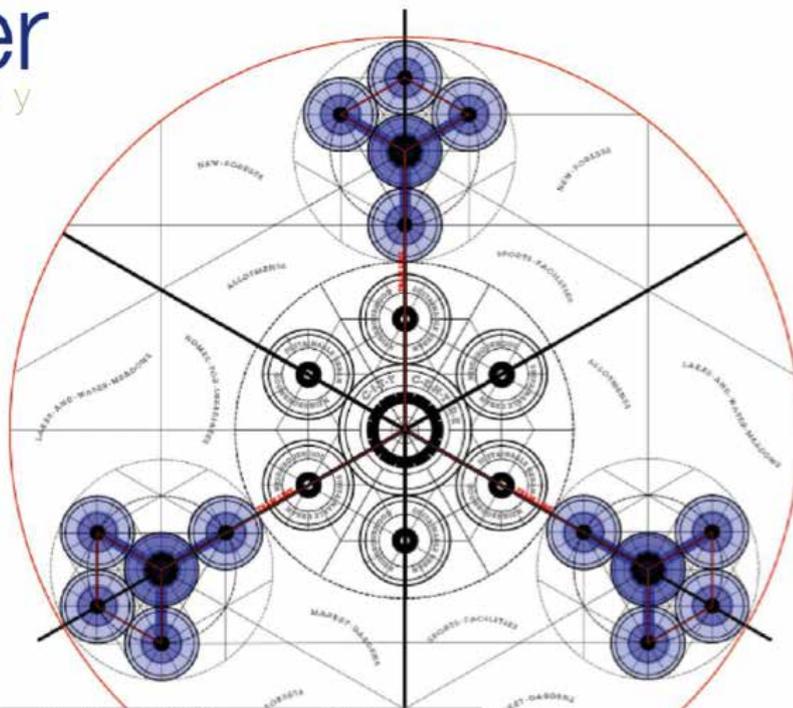
Planning a solution? The snowflake design

Faced with these challenges and constraints, what should the response be? Richard Blyth, Head of Policy and Practice at the Royal Town Planning Institute, pointed to the proposal that won the 2014 Wolfson Prize for answering: “How would you deliver a new garden city which is visionary, economically viable, and popular?”

The winning submission by URBED showed how a typical historic British city of 200,000 residents could be expanded by adding three urban extensions, each housing around 50,000 people. He said the advantage of the idea, called Uxcester Garden City, was to put homes where they were needed – near fast-growing cities with strong demand for workers. This “snowflake” design, shown in Figure 4 ensures new settlements are well-connected to the centre by satellite transport links. It would have an overarching 40-year vision that would ensure the existing community was engaged in how each stage of the development was rolled out. The authors identified 40 cities, creating the potential for 8 million new homes.

Figure 4. ‘Snowflake’ design for three garden city extensions - source: URBED

Uxcester
garden city



The Snowflake plan

| Housing | Density (u/ha) | Mix | Numbers | Land take (ha) | Infill | Extensions |
|---------|----------------|--------|---------|----------------|----------|--------------|
| 20 | 20% | 17,200 | 860 | 0 | 860ha | 17,200 units |
| 30 | 40% | 34,400 | 1,147 | 150 ha, | 997ha | 29,900 units |
| 45 | 30% | 25,800 | 573 | 200 ha, | 373ha | 16,800 units |
| 65 | 10% | 8,600 | 132 | 46 ha, | 86ha | 5,600 units |
| | 100% | 86,000 | 2,412 | 396 ha, | 2,316 ha | 69,500 units |
| | | | | 16,500units | | |

‘There is a Faustian pact between the developers and the planning institutions, which provide an incentive and a forum for ever higher conflict and transactions costs’ - Richard Blyth

set out a 20-year vision of how many school places or hospital beds, for example, will be needed and where.

Planning reform

One solution could be to inject more competition into the market for land by introducing prices into the planning process. If, for example, the price of land with housing is more than £1m per hectare compared with the price of agricultural use, there should be a presumption that permission is granted unless it can be shown the amenity value is worth that £1m surplus. Allied to that would be a shift to a continental-style rules-based system rather than the UK system of applications being decided by individual planning committees made up of local residents and politicians who may have conflicting interests in restricting development. A rule-based system would make it easier for landowners, developers and local residents to predict when and for what permission would be

‘People are behaving very rationally in what is a fundamentally imperfect system...which is giving us incentives and signals that are not leading to the kind of society we want to live in’ - Rachel Fisher, Head of Policy at the National Housing Federation

granted. Currently the system is unpredictable and open to what economists call “gaming”, where the different parties hold out for the best possible deal.

However an alternative view was that the way to unlock land and make it available for building was by investing in public transport links. This then created differences in accessibility of land, which then affected the price of the land. In Germany the government prepares the land for development and then puts in a competitive process at that point for private sector bidders to develop the site.

Distributions and Inequality

The distribution of housing wealth in the UK is massively unequal, creating a gap between homeowners and those excluded from the market. This means a growing number of people lack the opportunity to build up equity and safety for retirement. They will also be less mobile and able to seek new labour market and social opportunities. Meanwhile growth in the number of private tenancies could eventually lead to a situation where a significant proportion of people retire without the housing wealth. This may create tensions between that generation and the previous two generations, which were part of the transformation in tenure that saw the share of homeowners increase. Homeownership in England became the majority tenure in 1971 and peaked at 70% in 2002. Since then it has fallen to 64% in 2012. Over that latter period renting has risen from 10% to 29%.

There is growing concern over the number of people with no housing asset wealth and with significant debts who are cutting back on food, heating and light in order to meet rising rental and utility bills.

Welfare switching: raising questions

The idea that housing wealth is being used to fund welfare costs raises a host of important challenges, according to Professor Susan Smith FBA of Cambridge University. These include:

- Does this ‘welfare switching’ work in terms of providing the quantity and duration of funds that people will need?
- Does it add to, or detract from, overall wellbeing?
- To what extent is it undermined as a policy by the unequal distribution of housing wealth?
- What level of house price appreciation does equity borrowing presume?
- What are the intergenerational consequences?
- Can households tolerate added exposure to the risks of price falls in housing markets?

But the concept of housing-based asset, that can have a major impact on people's decisions in spending and debt, is a relatively recent development. Researchers are getting to grips with the implications of the use of housing wealth as a source of welfare. This is particularly relevant for older people who increasingly look to trade down to a smaller home and cash in the differences to pay for old age care.

However it has become a choice for an increasing number of working age people who have used mortgage equity withdrawal (MEW) to crystallise some of the rise in their home value to fund living expenses.

There is a danger this is being used by those who can least afford it were the housing market to turn against them.

This raises the issue of whether the wealth inherent in the current housing stock is able to meet these social policy needs. At its heart is whether there is enough of a "welfare premium" in the value of homes to fund the general living expenses of retirees and the future costs of coping with ill health. This equation will depend on the age of the homeowners, how much value they have built up and where they live. The spatial mismatch between housing assets and

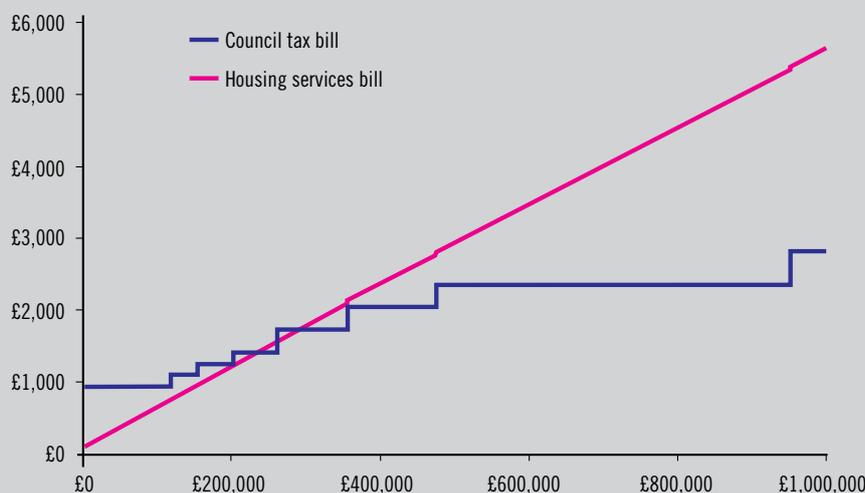
Taxing issues: getting the right levies on housing

Since housing is both something people consume, by living within a property, and also an asset, it is important that the tax system treats it appropriately from both perspectives. Stuart Adam of the Institute for Fiscal Studies argued that the current system of Stamp Duty was not part of a rational tax system. Since it becomes liable at the point of sale it is effectively a tax on transactions, which has a negative impact on labour mobility.

A more sensible alternative would be to tax the annual consumption value of housing – the value of services the property produces each year. It would be akin to the current council tax but based on up-to-date valuations rather than 1991 values currently used.

A 'housing services tax'

Note: Rough guide only – see *Tax by Design* for details



Current property value - source: IFS

Another flaw in the current system is that rental properties face income and capital gains taxes but owner-occupied homes do not – however enormous the capital gains that have been made. One solution would be to impose full labour income tax rates above an allowance based on a "normal" risk-free return on the purchase cost of the asset with the "excess" profits above that taxed in line with normal labour income tax rates and bands. In normal times the normal rate can be approximated by the interest rate on government bonds.

welfare will need to be monitored and managed. The other side of the coin is that the housing stock can be run down as an asset through lack of repair or if homeowners extract much of the value through MEW throughout their lives. This will have implications for subsequent generations.

Conclusion

The evidence presented and the subsequent debates showed how the housing market influences most areas of economic and social policy.

Main findings

A number of challenges were articulated throughout the day, and from the final concluding session:

The Economics of Housing

1. Levels of affordability in rural areas and in smaller British cities as well as in London are becoming a major challenge. High prices make it hard for people to find housing near their work. This has knock-on negative effects on levels of economic growth and labour mobility and productivity.
2. A key contributor to high prices is the shortage of supply of new housing. The finding that 1.5-2.3 million too few homes were built over the last two decades shows the scale of the shortfall. However the low level of existing stock and forecasts of rising populations means it will take a sustained programme of building to close the gap, rather than just narrow it.
3. The financial system affects the funding of housing but can also be affected by changes in the housing market as was seen in the recent financial crisis.

Planning & Regulation

4. The planning system was widely blamed for the lack of housing supply. There was a call for better incentives to ensure local communities capture the benefits of developments to help overcome opposition. There was support for replacing locally-based planning permissions that create perverse incentives with a rules-based system.
5. The role greenbelts play in constraining house-building near areas of growth emerged as a key challenge. The fact greenbelts are something politicians do not want to touch raises serious challenges. The idea that well-designed extensions to 40 historic English cities could create 8 million homes shows the potential for loosening the greenbelts.

Distributions & Inequality

6. There was concern over the widening gap between those with housing-based assets and those without and the impact on society of that divide. The use of housing wealth as a supplement or replacement for welfare payments raised important questions about the sustainability of housing as a form of social insurance.
7. The changing nature of housing tenure raised many questions. The share of owner-occupation is falling while private renting increases. Social housing has increased more slowly but not by levels that offset the end of council house-building. There was a plea for more focus on housing as enabling access better health outcomes and life choices, and on the role social housing can play.

Future research

The challenges posed by the housing market will be a major issue in the General Election in May 2015. But meeting them will take years or perhaps decades to resolve even once policymakers begin to address them head on. There is therefore a major opportunity for researchers to address the issues highlighted in the seminar. Key areas for future research included:

The Economics of Housing

- A. The major role that housing-related debt played in the last financial crisis raises fundamental issues about the way housing finance should be regulated. Understanding these trends is central to ensuring greater macro-economic and financial stability.
- B. There is a need for better understanding of the total cost of housing that goes beyond the purchase price and interest payments or rental costs and includes areas such as heating and electricity that disproportionately affect poorer people. Many speakers said there had not been as much research into the social as the economic issues.
- C. In all of these areas, speakers said there was a need for more research into the lessons from other countries that had delivered higher levels of house-building, slower rates of house price growth and greater stability. There was a desire for a greater focus on the sharing of data.

Planning & Regulation

- D. What specific objectives should housing policy aim to achieve:
 - i. Should its aim be to deal with the issue of worsening affordability for new homebuyers or should it be tenure neutral?

- ii. Should taxation be used to favour particular forms of tenure or behaviour; and what? Or should taxation policy be moved closer to a level market approach and away from the current arrangement?
 - iii. To what extent has the attempt to implement a free market approach to housing provision stalled, what are the outcomes of these moves and how have they contributed to the problems we currently face? Should policy move further towards the free market or revise existing planning and regulatory regimes, and how?
- E. Increasing supply is critical but raises many issues:
- i. How can one identify locations where new homebuilding will have the largest positive impact?
 - ii. How much extra supply would actually make a difference: is it enough to get back to the levels that are forecast to match supply and demand?
 - iii. How can we ensure that houses are built in the right places and not repeat the mistakes of the past of building in unsustainable locations?
 - iv. What are likely social and economic impacts if supply were not increased? For how long can the parties involved in housing adapt to supply shortages before a crisis point is reached?
 - v. How should policymakers manage the transition as current price changes take account of expectations of future declines as supply rises?
- F. What role can planned devolution to the countries, regions and cities of the UK play in ensuring policies are better tailored to meet specific characteristics of local areas? Would it be possible to remove the divide between tenures to allow renters to invest in housing as part of an equity package?

Distribution & Inequality

- G. There is potential for identifying evidence-based reforms of the planning system. For example, how can one design a system to reduce resistance from existing homeowners to new developments by, for example, strengthening incentives for them to support projects?
- H. Since the end of council house-building as a policy it is unclear what role social housing is intended to play. To what extent should social housing be seen as delivering a public good and as a way for people to access the labour market and better health outcomes? Who should be given access to a good that is in very short supply?
- I. There is great potential for further research into housing as a social welfare asset. How does the accumulation of housing wealth affect investment in

other asset classes? If housing wealth is likely to be used to meet welfare costs how can that value be made more accessible?

Issue-wide recommendations

- J. What lessons does Britain's history contain? For example, is there potential to revive the house-building carried out by employers and philanthropists particularly in the Victorian era?
- K. One area that has not been explored fully is the application of behavioural economics to understand decisions in the housing sector.
- L. Finally, there was a consensus that housing must not be considered in isolation and research should be carried out on a multidisciplinary basis. Housing is an area that will benefit from interdisciplinary research co-produced with involvement from a number of stakeholders. ■

This document is a summary of the views expressed by the speakers and attendees at the event and does not represent the established position of either the ESRC or the British Academy.

Economic and Social Research Council
Polaris House
North Star Avenue
Swindon SN2 1UJ
Tel: +44 (0)1793 413000
Fax: +44 (0)1793 413001
www.esrc.ac.uk

