REFLECTING ON THE BROKEN HOUSING MARKET: AN INTRODUCTION

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"*The poorest man may in his cottage bid defiance to all the forces of the Crown. It may be frail – its roof may shake – the wind may blow through it – the storm may enter – the rain may enter – but the King of England cannot enter! – all his force dares not cross the threshold of the ruined tenement!*"

William Pitt the elder, Earl of Chatham, 1763

Introduction

The housing market is a source of much comment and tension in the UK. Many commentators and policymakers have got into the habit of describing the market as 'broken', indeed we take our title from the White Paper issued by the then Department for Communities and Local Government in 2017. In our commentary in February 2018, we outlined a number of critical issues when assessing the housing market; see Chadha (2018), as a precursor to the June conference. We question whether the market is actually broken, in which case traded prices would neither reflect the overall cost to society nor the benefits to the individual household of being a homeowner. To the extent that there is a market failure there is a case for government policy to counteract distortions but some of those are themselves the results of government policy. We must be careful not to stack distortion on distortion. What we noted in February is that the large fall in housing affordability in the UK over the past two decades seems to be well explained by national preferences for owning homes, the increased availability of loanable funds for housing purchase and limited housing completions. Given that preferences are hard to shift and that much policy since the establishment of the Financial Policy Committee in 2011 has been directed at reducing excesses in lending practices, the remaining degree of freedom seems to be in encouraging housing development.

Opening session

Matthew Howell (Royal Institute of Chartered Surveyors, RICS) underscored the importance of collaboration when seeking solutions to fix the 'broken' housing market. He argued that evidence-informed policymaking is critical but bridging the technical knowledge base to a non-technical audience continues to be a challenge. As the professional body to the industry, RICS contributes by gathering timely market intelligence and communicating its views on policy formation in coordination with research centres such as NIESR and CaCHE. The multidisciplinary nature of housing requires the cross-fertilisation of ideas with other sectors in areas such as architecture, urban planning, transportation and technology as well. Identifying gaps in knowledge is equally crucial, as is the need to consider a mix of tenures in addressing society's housing requirements.

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Housing and consumption

In the first session of the day the focus was placed on questions surrounding housing and consumption patterns and implications for macro-prudential tools. To kick off, Luisa Corrado (Tor Vergata) presented work by Chadha *et al*. (2018) that explores the links between house prices, borrower consumption, loan-to-value-ratios (LTVs) and the lending rate. They show that, while the level of house prices does not drive net wealth, fluctuations can be related to aggregate consumption in an economy. However, the key finding of their study is that macro-prudential instruments can generate welfare gains for borrowers, as they can decrease the correlation between house prices and consumption.

The second paper by David Miles and James Sefton (2018) (both Imperial College) analyses how housing wealth and housing costs evolved since the nineteenth century and how this might project into the future. By using a two-sector Ramsey model they show that changes in transport technology are crucial in determining the price of houses and patterns of residential development. Furthermore, it matters to what degree land and structure can be substituted to generate housing services, and the relation between housing and other consumption goods as a source of utility. The authors conclude that it is quite plausible that in many countries the ratio of house prices to income will increase over time.

The final paper of this session was presented by Peter Levell (IFS). His joint work with Thomas Crossley (Essex) and Hamish Low (Cambridge) (2018) demonstrates that UK households see housing as a financial asset. Their empirical analysis shows that households re-leverage in response to an increase in house prices. From a theoretical perspective this can be underpinned by the idea of 'portfolio rebalancing' to optimise the risk and return (as the loan-to-value ratio decreases). Since this makes households potentially more vulnerable to future housing price shocks, the authors highlight a potential role for macro-prudential interventions that limit re-leveraging.

Housing affordability

The second session dealt with issues around the affordability of housing. Philippe Bracke (Bank of England) presented a working paper that analyses data on equity loans issued to individuals in England as part of the Help-To-Buy Equity Loan scheme (Benetton *et al*., 2018). The scrutinised policy is restricted to new builds and academic studies have long argued in favour of such equity sharing schemes, due to their potential to decrease risks of a household's exposure to house prices. In contrast to this conjecture, the authors show that in fact these loans were predominately used by households to buy properties otherwise not affordable to them and so may not have acted to improve the balance sheet of borrowers and their risk exposure.

Mulheirn and Gooroochurn (both Oxford Economics) (2018) presented an empirical examination of the relation between house prices and home ownership. In contrast to much of the literature and policy debate, they conclude that the rise in house prices and recent fall in ownership rates is not a result of constrained supply of housing. Rather, their analysis suggests that escalating incomes and decreasing cost of capital were behind the real increase in house prices (of 150 per cent) in the period 1996 to 2016. In addition, before the financial crisis the decreasing home ownership rates were driven by increasing prices, while in the post-crisis years the main factors were relatively higher cost of credit for first-time buyers (i.e. decreased availability). The authors conclude that there is a trilemma for policymakers, as they can only choose two of the following: high homeownership rates, fiscal neutrality regarding housing tenure and financial stability.

The next contribution by Kieran McQuinn (ESRI) and co-authors provided evidence based on the Irish case. Their aim was to understand what constitutes 'affordability' in the Irish market, which shares some similarities with the UK. He discussed the '30/40 rule', which highlights affordability issues for households in the bottom 40 percentiles of the income distribution, that spend more than 30 per cent of their disposable income on their mortgage. However, by examining levels of incomes at different ranges of the distribution the authors conclude that the 30/40 rule significantly understates the actual scale of the affordability issue. They call for policymakers to consider a much broader range of incomes in the distribution.

The final presentation of the session was delivered by Richard Donnell (Hometrack), who provided a 'market perspective' on the issue of housing affordability. First, he highlighted the importance of adopting a cross-tenure view when analysing and assessing affordability. The rental market is more liquid than the sales market with more transactions every year. His second point was that it is crucial to look beyond the demand/price relation to include the structure of supply and liquidity of housing. Finally, he presented a granular view of how the house price cycle is unfolding at a postcode area level (e.g. CB, SE). This analysis highlighted how there are strong regional variations when it comes to the affordability of housing. For example, while the price-to-earnings ratio has increased in most cities in the UK it has been markedly stronger in London, Cambridge and Oxford, as well as Bristol. Yet there are many markets where house prices remain below 2007 levels in nominal terms. The conclusion was that the housing market can be said to be 'broken' to different degrees and by different underlying drivers/causes. In the end he raised the question of whether localised approaches are most successful in tackling any breaks in the housing market.

Reflections on housing policy since 2004

The keynote address by Dame Kate Barker (Taylor Wimpey) reflected on developments since 2004 when the Barker Review of UK housing supply was published (DCLG, 2017). In her view it led to much policy change, albeit not continuously. The introduction of the National Policy Planning Framework (NPPF) improved the planning framework, but this was not used to make up for any shortfall in housing supply following the financial crisis (due to prolonged disputes over local plans, and the loss of many small- and medium-sized housebuilders). While the introduction of 'Mayoral spatial plans' is a move in the right direction, fast-growing areas struggle to provide the infrastructure they need. A number of current issues were also discussed, including the increasing number of families found in the private rented sector. It was of concern that the rented housing stock is in a relatively poor condition because standards are not regulated well, and there has also been a rush to office conversions often found to be of a poor standard. Other pressing issues concern how utilities respond to housing plans, and about funding transport and social infrastructure; an inadequate supply of affordable homes (especially for social rent); the green belt and its rigid borders (though an important designation it e.g. prevents cities such as Oxford and Cambridge from growing); and a lack of government courage to tackle tax anomalies (including council tax and capital gains tax). The conclusion was that the 'supply' argument has certainly been accepted – but perhaps too much so – with ever bigger targets for new supply but there may have been a failure to look at other sources of problems.

In a brief commentary (published in this issue), Stephen Aldridge from the Ministry of Housing, Communities and Local Government presented a number of observations on the UK housing market. He also sees the issue of affordability rooted in the subdued supply side and notes that affordability issues are highest in London and the South East, where housing supply has been particularly constrained. His key argument is that sustained increases in the supply of houses in the right places can increase affordability of housing by lowering prices. This observation is driven by expectations as people today also plan with future prices in mind. For policymakers the main challenge in his view is to ensure that sufficient homes are planned in the right places. To do so they need better information on where land is available, referring to the example of the 'Brownfield Land Register' but also the availability of public sector land. Other suggestions include speeding up the pace of development (e.g. by supporting small builders to enter the market) and a potential role for reforming taxes.

Policy lessons for a 'broken' housing market

During the final session of the day speakers were invited to discuss specific policy implications based on their own research experience and what had been discussed during the day. The following three papers are also published in the current issue.

The first paper by Paul Cheshire (LSE) subsumes some of the recent evidence on the impact of the British planning system on housing supply in the UK. He makes an important distinction between planning that restricts development to mitigate market failures, and 'absolute' restrictions on the supply of housing. While the former is important to guarantee the ability of cities to develop in the future, the latter merely leads to a hike in prices. He identifies four factors that have made the British system inherently restrictive, leading to 'systematic undersupply'.

The paper by John Muellbauer (Oxford) takes a comparative approach between housing markets in the UK and Germany in discussing 'A Tale of Two Countries'. His starting point is the stark contrast in affordability and volatility of housing, rooted in historical, institutional and policy differences. In Germany the supply of residential housing has increased much more strongly, where the private rented sector is now about twice as large as in the UK. Moreover, sensible regulations and stable house prices have resulted in an average rental duration of around eleven years as compared to 2.5 years in the UK. The failure to adopt the right policies has adverse implications for the British public not only in terms of inequality and social mobility, but also productivity and economic growth. To tackle these issues policymakers should look beyond the remit of the MHCLG. Specific policies to tackle (and reform) are the council tax, stamp duty and a potential taxation of foreign-owned trophy homes.

Christine Whitehead (LSE) drew attention to housing policy in the light of a changing tenure mix in the

UK. While the focus of policymakers has traditionally been owner-occupation some policies had unintended consequences. For example, there was a large increase in the private rented sector, where the number of units grew from 2.5 to 4.8 million between 2003 and 2017 (12 to 20 per cent of total housing stock). One of the policies she identifies to contribute to this is the 'Right-to-Buy' scheme and she reports estimates that around 40 per cent of homes built under this scheme are in fact privately rented. Another key issue for policy is the fact that taxes are controlled by HMT, while housing policy is technically in the hands of the MHCLG, implying the possibility of a co-ordination failure.

Finally, Liam Halligan (Telegraph) highlighted five areas for policy intervention to bring about change in the UK housing market. The first is the growing gap between granted planning permissions and actual completions of new housing units (two-thirds of permissions 'lapse' in the UK). Secondly, Help-to-Buy apparently raised sales prices and hence profits of the top housebuilders that build around half of the houses under this scheme. Thirdly, the concentration of market share among the 'volume builders' almost doubled between 2008 and 2015, reaching 59 per cent. Fourthly, Housing Development Corporations should be used to sell land below market price to SME builders. This, together with local reinvestment of the 'planning gain', can raise the popularity of local housebuilding. The fifth point was that while net additional dwellings went up in recent years, shortages for certain groups and places are real. However, high house prices might represent the vested interest of large developers, banks and homeowners.

Concluding session

Ken Gibb concluded and reflected on the role of the ESRC and JRF funded UK Collaborative Centre for Housing Evidence (CaCHE) to tackle some of the issues raised. He welcomed earlier remarks by Kate Barker that the new centre should seize the opportunity not only to provide evidence but also to build conceptually, as this is the core mission of the centre. On the private rented sector, he noted that it is a 'complex mosaic' of largely independent but well-defined segments on either side of the market. He concluded by noting that research on housing needs to make full use of the literature on policy analysis to scrutinise the policymaking process in housing itself. To do so the centre is embarking on a 'policy transfer exemplar project'.

Concluding remarks

The broad range of issues tackled on the question of housing (from local planning regulations on S106 to the impact of quantitative easing) not only signifies the difficulty of finding better answers but also the way in which so many policy problems are not only reflected in the housing market but may also be amplified by its failures. We have avoided extensive discussion of housing and property taxes but will return to these particular issues later in the year. Of course, various proposals have been made for tax reform, for example, including: changes to inheritance tax, which is a lumpy way of getting at the increases in wealth; reform or abolition of stamp duty, which may reduce distortions if it involved a fiscally neutral shift away from taxes on transactions to taxes on wealth; and reform of the Council Tax system so it more closely resembles a land value tax (see Lenoel *et al*., forthcoming 2018). Perhaps we should simply say that perhaps "even if it ain't broke do fix it".

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