Hosted by Department of Geography and Environment

Britain's Housing Crisis: causes and cures

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Britain’s Housing Crisis: causes and cures

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Inaugural Lecture

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Hong Kong Theatre, Clement House, LSE
On a personal note
(that relates to the topic)
House price index for London

Source: Nationwide, price growth adj. for retail prices (base 1992q4)
What about house prices relative to earnings?
House price to earnings ratio for London

Source: Nationwide

- HP through of 80s cycle (1992) (2.9)
- Us arriving in London (2003) (5.7)
- Last through (2009) (5.4)
- Today (2015) (10.1)

Source: Nationwide
Not just a London phenomenon...
House price to earnings ratio, UK regions

Source: Nationwide
And in an international comparison?
(Real HP growth 1970-2015, selected OECD countries)

Sources: BIS, World Bank, Bank of England
What about rents?

- **Rental** cost increased less since 1990s than house prices
- Still, affordability for renters—even for social renters—has deteriorated...
Average weekly social rent as % of 10\textsuperscript{th} percentile weekly pay, England

Sources: ONS and DCLG
Opinion polls

⇒ **Evidence** suggests we are facing *unprecedented housing affordability crisis* and **80% of British public agrees**

- In 2015 Londoners said housing is **#1 issue facing capital** (ahead of transport & economy)

Source: Ipsos MORI survey for London Councils (10/15) and UK survey (2/13)
What about new supply of housing (construction)?
UK construction and real house price indices
(Base year = 1970)

Sources: DCLG, Nationwide, ONS
Causes of crisis

(public perception, a proposition, theory and evidence)
Public perception

Which, if any, of the following do you think has had a significant impact on Britain’s housing crisis?

Source: The Guardian, 30 April 2016; Observer Graphic/Opinium Research
A proposition

- Strong house price growth (especially in London and SE) implies **strong demand**

- If demand and house prices grow strongly over long period of time, but construction falls markedly, this must imply **binding long-run supply constraints**...
Economics 101: If long-run supply is responsive...

House prices

Long-run supply

Demand today

Demand tomorrow

New construction

Housing stock
Economics 101: If long-run supply is unresponsive...
What factors **constrain** long-run supply of housing?
Candidate #1: Regulatory constraints

- Constraints imposed by planning system
- Today’s planning system established in 1947 through Town and Country Planning Act
- Key features
  - Development rights of land owners expropriated
  - TCPA designated ‘use’ classes, whereas any change of ‘use’ requires development control permission (granted at local level on case by case basis)
  - Aim is ‘development control’ or ‘containment’
Regulatory constraints (cont.)

- Planning system widely viewed as complex and inflexible

- One issue: development control decisions made at local level
  - Subject to consultation process that caters to local NIMBY pressures & strong vested interests
  - Difficult and time consuming to obtain planning permission
Types of regulatory constraints

- ‘Horizontal’ constraints: green belts
- ‘Vertical’ constraints
  - Height restrictions
  - Protected vistas
- Preservation policies: Conservation Areas & Listed Buildings

⇒ Problematic is combination of constraints: makes supply extremely unresponsive!
London’s green belt (516,000 hectares, 3.3 x GLA)

22% of GLA is green belt land

Source: Barney Stringer (Barney’s blog)
Height restrictions, preservation policies & protected vistas

Source: Cheshire and Derricks (2014)
Some views absolutely worth protecting...

- Huge benefits of view and (opportunity) costs are not very high...
Protected view from King Henry VIII’ Mound (Richmond Park)

Table 2 – Statutory Consultees for Protected Vistas.

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**Source:**
London View Management Framework (2012)
Protected view from King Henry VIII’ Mound (Richmond Park)

Also ‘protects’ backdrop:
- Liverpool St. Station area
- Stratford

⇒ Huge (opportunity) costs, benefiting few…
Candidate #2: Physical constraints

- Two types
  - **Scarcity of open developable land** (the scarcer, the higher the opportunity costs)
  - **Topography** (steep slopes make it difficult + costly to build)
How to test in practice?

- Hilber and Vermeulen (2016, *EJ*)
  - Use data from 353 LPAs & from 1974 to 2008
  - Exploit spatial variation in three different types of supply constraints: *regulatory, scarcity of developable land and topography*
  - Interact local supply constraints with demand shifters (local earnings; measure of labour demand shock)
  - Use econometric techniques to identify *causal effects* of local supply constraint measures on house prices
Average refusal rate (major residential projects) 1979-2008

Share developable land developed, 1990

Elevation range

Legend: Percentage
- <10
- 10 - 20
- 20 - 30
- 30 - 40
- > 40

Legend: Meters
- < 100
- 100 - 200
- 200 - 300
- 300 - 400
- > 400

Source: Hilber and Vermeulen (2016)
Main findings

- **Tight local planning constraints** in parts of England (in conjunction with strong demand) are to a large extent responsible for extraordinarily high house prices.

- **Local scarcity of developable land** matters too but quantitatively only important in most urbanized places.

- **Topography** matters in statistical sense but very little in quantitative sense.
Quantitative effects

- If planning were completely relaxed in av. LPA:
  - House prices in average LPA: -35%

- and developable land were abundant:
  - House prices in average LPA: another -10%

- and av. LPA were completely flat:
  - House prices in average LPA: another -3%
What would house prices in average English LPA be if…

Source: Hilber and Vermeulen (2016)
North East vs. South East & 90th vs. 10th percentile

Had the SE the restrictiveness of the NE, house prices in the SE would be 25% lower!

Source: Hilber and Vermeulen (2016)
Preliminary conclusions

- **Tight local planning constraints** (in conjunction with strong demand) are to large extent responsible for housing affordability crisis.

- Physical constraints and macro-variables (at aggregate level) matter too, but are not main drivers.
Another important cause: Lack of local fiscal incentives

- Local authorities in UK have virtually **no fiscal incentives** to permit development
  - **Face** infrastructure & service **costs** + congestion, but **reap** very **little revenue**
  - Any additional revenue equalised away in medium-term through central government grant system
  - Strong incentives to refuse, delay or impose/maintain other forms of regulatory constraints...
The role of fiscal incentives (cont.)

- Countries differ vastly in local fiscal incentives to permit housing development
  - **UK**: Local planning authorities have **virtually no fiscal incentives** to permit residential development
  - **US**: local property tax system provides meaningful fiscal incentives at local level
  - **Switzerland**: local income taxes provide **extremely strong incentives** to permit development

⇒ Do these differences affect **house price growth** and **residential development**?
Real house prices: UK vs. US vs. Switzerland
(Price indices; base year: 1975 = 100)

Source: Hilber and Schöni (2017);
Data sources: ONS, Nationwide, SNB, St. Louis Fed
Physical containment policies are no ‘free lunch’ (Real HP growth vs. sprawl, European countries with av. data)

![Graph showing relationship between real house price growth and sprawl outside functional urban regions.]

**Correlation** = -0.54

Source: Ehrlich, Hilber and Schöni (2017)

Sources: Corine and OECD
Implications for inequality
Who benefits from status quo?

- Long-term homeowners who have benefited from past capital gains...particularly if sell & move abroad!

- Offspring of (wealthy) long-term homeowners
Who loses out?

- Young (of non-wealthy parents) & low income HHs
  - Particularly in London and South East
  - Housing – both owned and rental – increasingly unaffordable
  - End up living with parents or in cramped spaces
Could argue: everybody is free to own, but problem...

- Most young and low income households in UK face three constraints that prevent them from accessing owner-occupied housing ladder...
1. Downpayment constraints

- Young (of non-wealthy parents) and low income households struggle to save deposit

Source: Evening Standard, 18 October 2012
2. Liquidity constraints

- Young and low income HHs struggle to make monthly mortgage payments

Source: The Telegraph, 6 April 2015
3. Cannot diversify investment risk

- For young/low wealth HHs buying with mortgage is extremely risky investment
  - Risk that housing bust wipes out all wealth
  - Cannot diversify away this risk

Matthew is also concerned that property prices seem very high in London at the moment. He’s worried about investing at the top of the market, as it might not turn out to be such a good investment. He describes his attitude to risk this early stage of his life and career as “cautious”.

Source: The Telegraph, 6 April 2015
Shouldn’t ‘Help to Buy’ help to buy?

- Helps with downpayment constraints
- But also pushes up demand, and in setting with unresponsive supply, **pushes up house prices further**
  - Raises debt levels, makes it more difficult to make monthly payments and increases investment risk
- Plus **creates systemic risks** for central government (and ultimately tax payers) who in end assume default risks in case of a severe price bust
Some proposals for reform
A guiding principle

- Reforms should **focus on tackling causes** of crisis – not symptoms
  - **Symptoms:** Young are no longer able to afford deposit, few large house builders, developers hoarding land
  - **Causes:** Broken planning system + lack of fiscal incentives at local level to permit residential development
1. Reform of planning system

- **Introduce rule based zoning system**
  - Focus on correcting market failures (e.g. protect areas of natural beauty & ensure provision of public parks)
  - In areas that are not protected, designate zones with presumption for development as long as rules are followed

- Implication: **Move away from current development control system**, which gives too much weight to NIMBYs & creates massive uncertainty in development process
2. Reform of tax system

- **Introduce proper local fiscal incentives to develop**
  - Replace Council Tax with **local tax on property value** (or land value) with automatic annual revaluation
  - Phase out Stamp Duty and correspondingly **increase weight** of local Property Value Tax (PVT)

- **Advantages**
  - SD extremely inefficient: hampers mobility + functioning of labour & housing markets
  - Local PVT provides incentives to approve housing development + reduces empty plots and houses
2. Reform of tax system (cont.)

- If politically intolerable, could consider **local tax on a developer’s finished scheme**

- Idea: Reform tax system to **align fiscal incentives to develop**: Local authorities/residents who bear costs also ought to reap benefits of development
Political challenges
Political resistance

- Chairman of Treasury Committee comment on my policy proposals in 2016...

- Possible reasons why might not be popular?
  - Around 63% are ‘homevoters’ who want to protect asset values + landlords also like status quo
  - People like ‘avoidable’ taxes but hate salient ones
  - Central government seems unwilling to give significant fiscal power to local government
A glimmer of hope...

- Crisis increasingly serious
  - Homeownership rate falling since 2002 & **private rental share** growing quickly ⇒ Pro-reform group growing stronger
  - ‘Pro-development’ & ‘pro-reform’ movements have started to emerge: **YIMBY-movement** now spreading across UK!

- Many perceived ‘winners’ of status quo are actually ‘losers’: Young expanding families who recently bought (tiny) homes *(i.e. us in 2012!)*
More glimmers of hope...

- “Would you support or oppose more homes being built in your area?”

Sources: British Social Attitude Survey (2010, 2013, 2016)
Conclusions
1. Planning serves important purpose: can improve welfare through correcting market failure

2. But British planning and tax systems have serious “design flaws” – these are largely responsible for affordability crisis

3. Existing policies (such as HtB) do not tackle causes of crisis – they are ineffective or counterproductive

4. Bold reforms are politically challenging but the only real hope to solve housing crisis
Thank you

*Presentation with references & hyperlinks will be downloadable from:*

http://personal.lse.ac.uk/hilber/
References and related readings


Readings (cont.)


Readings (cont.)


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