

CREATING THE CONDITIONS FOR GROWTH

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EXECUTIVE SUMMARY

- House building activity is beginning to pick up, especially in London and the South East. However, the period since the financial crisis has been disastrous for investment, worsening the longer-term shortages of both market and affordable housing.
- This essay draws some lessons from the last few years about how to support expansion and bring about a step change in housing investment to meet longer term requirements.
- There are three strong arguments in favour of increasing housing output as quickly and sustainably as possible: first, housing is a core contributor to economic growth; second, the housing requirements of a rapidly growing population must be met; and third, the capital in particular needs far more affordable housing to provide for Londoners across the income scale.
- The decline in housing investment since the mid- 2000s has been a particular drag on the economy, leaving unused resources which could readily be employed to expand output and generate multiplier and spillover effects that would benefit the whole country.
- In 2012, The Berkeley Group commissioned Ernst & Young to analyse its economic impact from the start of the financial crisis in 2008 to 2012.
- That report identified that, despite the wider economic problems within the UK, Berkeley had expanded its economic activity to some £2.6 billion in 2012, delivering 13,000 new homes over the previous five years. This represented an increase in the number of new homes built annually by 13% against a 35% reduction in the number of new homes built in the UK as a whole. At the same time, this output sustained over 16,000 jobs in 2012.
- While some of this economic contribution could fairly be attributed to Berkeley's strategy and knowledge of the market, much relates to the conditions which allowed Berkeley to invest and grow. In particular, the attractiveness of the UK's world position and longer term stability created a demand particularly from international buyers which provided confidence underpinned by forward sales to commit large housing developments to construction.

- Without international forward sales, many of these developments would have stalled. The fact that they went ahead meant new dwellings, both market and affordable, were added to the housing stock; employment and the economy grew more than they otherwise would have done; and high quality new homes were provided in the private rented sector.
- The benefits of international investment to the economy are well understood and new housing investment both private and affordable is an important and integral element of that investment. International buyers develop a commitment to Britain and contribute to making London a dynamic city. Actively discouraging international investment would not only reduce economic growth but also cause long-term damage to London's reputation as a world city.
- The biggest threat to a sustained recovery in house building is uncertainty. This includes uncertainty about the economy (although this now appears to be stabilising); uncertainty about potential changes to the tax system and uncertainty about whether enough large development sites will be available in future.
- Currently, the most pressing of these issues surrounds property taxation. This is a highly sensitive area with continuing political debate on a mansion tax, council tax, and the impact of stamp duty on the housing market. Property taxation needs coherent reform. But over the last few years, government has instead made frequent, partial modifications, responding to immediate pressures. These have done more to increase uncertainty than to improve the tax take. Change is required to create a stable and predictable regime. But it should be made in a transparent and coherent fashion which treats all those involved fairly and consistently.
- This report first reviews the extent of the housing problem especially in London. It then examines some of the factors that have made it possible for Berkeley to grow in this difficult environment, particularly forward sales into the international market. We then look at evidence about which factors would help maintain both domestic and international demand and which might hinder expansion. Finally, we make some recommendations about what policies could better ensure the stable environment necessary to foster confidence among both consumers and developers.

THIS IS A HIGHLY SENSITIVE AREA WITH POLITICAL DEBATE SURROUNDING A MANSION TAX, COUNCIL TAX AND THE IMPACT OF STAMP DUTY ON THE HOUSING MARKET.

PROPERTY TAXATION NEEDS COHERENT REFORM.



SECTION 1
THE CONTEXT

Increasing housing construction activity is widely accepted as a particularly important element in kick-starting and maintaining impetus in the national economy. Housing construction accounted for 1.8% of GDP in 2007, fell by around 40% over the following two years and is still more than 20% below the levels it attained in the mid-2000s.

If economic growth is to be sustained, construction activity and house building in particular must play a core role. This has been recognised by some of the Chancellor's initiatives in this year's budget and in the spending reviews, as well as by the IMF, which argues that growth in the UK is likely to be led by the housing market. Indeed, even the current rather sluggish forecasts assume 10% plus increases in new housing construction each year. But new homes will not actually be built unless there is both demand and industry confidence to expand capacity and output.

Apart from its contribution to economic recovery, vital as that is, there are other important reasons for increasing housing output. Much larger-scale and continuing investment in housing is absolutely necessary if the growing population of Britain is to be adequately housed over the coming decades. Household projections published in April suggest that the number of households in England will grow by over 220,000 per annum in coming years – some 60% higher than the number of new homes now being built. As a result we are going backwards in terms of housing availability, especially in London, where the level of output of new homes is currently well below half that required to meet projected household numbers.

WE NEED A STABLE ENVIRONMENT WHICH SUPPORTS ROBUST GROWTH IN BOTH DEMAND AND CONSTRUCTION ACTIVITY.

Opposite: Edenbrook, a new development with 40% affordable housing and a 60 acre country park.

As Mark Prisk, the housing minister, said to the HBF's annual conference this March: 'for 15 to 20 years or more, we have been building half the homes we need – both freehold and rented. Indeed, we've seen the rate of house building drop to its lowest peacetime level since the 1920s. As a result, supply and demand was completely out of kilter.'

But just building more housing is not enough. There is a particular shortage of homes for lower-income employed households who need accommodation near sources of employment if the health of the economy is to be maintained. Again this problem is concentrated in London, where private rents are more than twice the national average.

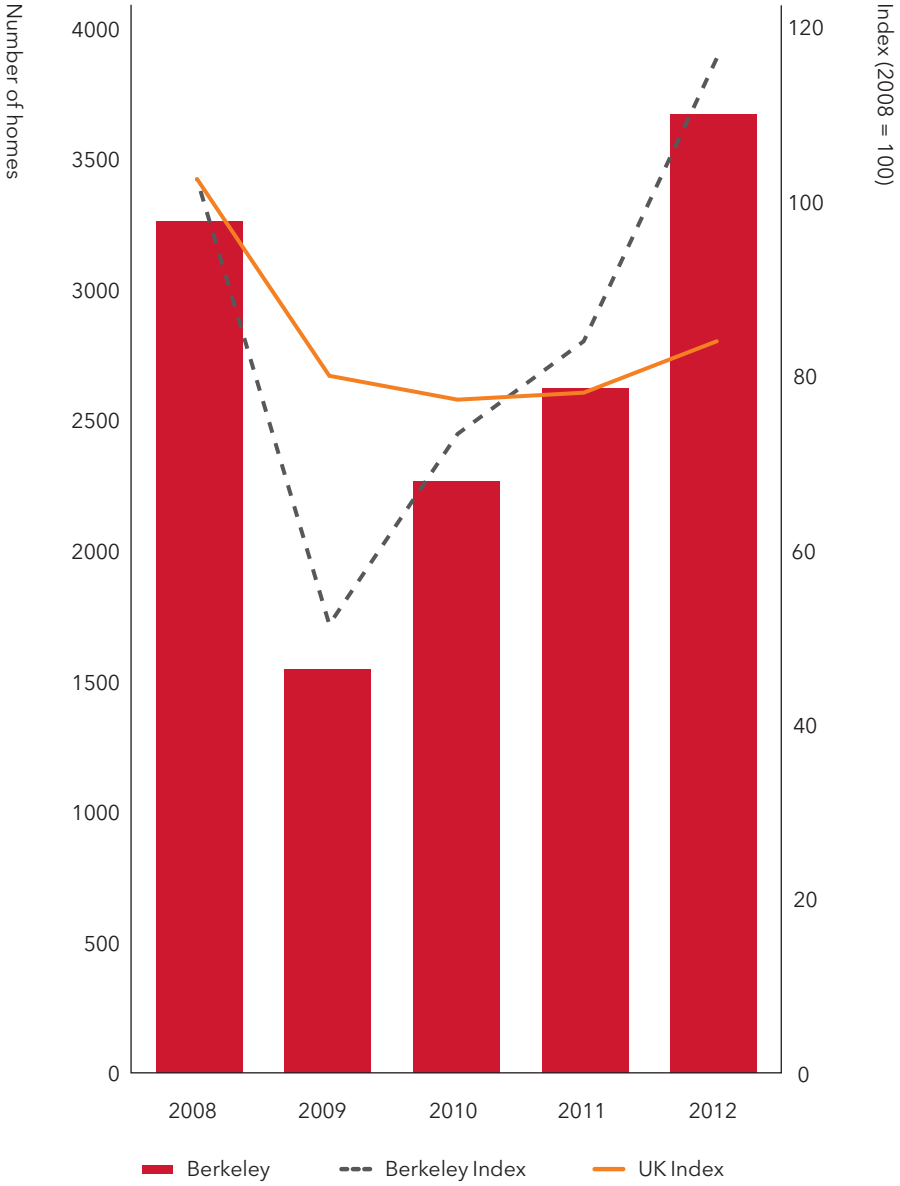
So increased house building brings three distinct benefits: more investment and jobs in residential construction and related industries; more homes; and more affordable homes. To achieve these, we need a stable environment which supports robust growth in both demand and construction activity.

Statistics suggest the Berkeley Group has played an important role in maintaining house building activity since the crisis, particularly in London. They have bucked the UK trend by consistently delivering more homes each year (chart 1).

As a result, the number of new homes contributed by Berkeley over the last five years has increased by 13% compared to a 35% drop for UK housebuilders in aggregate. The company's significant contribution to the wider UK economy in terms of economic activity, GDP, employment and tax paid, as well as benefits to local communities, is detailed in the report by Ernst and Young published late last year.

This study moves on from the Ernst and Young report to address the broader question of how to create and maintain an environment in which house building can contribute most effectively to economic growth particularly in London and the South East and in so doing can support the necessary increases in investment in both market and affordable homes.

Chart 1: Homes delivered by Berkeley





SECTION 2
WHY IS MORE HOUSING INVESTMENT REQUIRED?

As we move slowly out of recession, far more housing investment is needed almost everywhere in the UK, and particularly in London, for two main reasons: first, because there are enormous housing shortages and consequently pressure on house prices and affordability; and second, because housing investment provides a particularly effective stimulus to the local and national economy.

(i) The need for more housing

The extent to which housing demand and supply are out of kilter is a well-known story, but the statistics are worth repeating.

The population of London grew by 12% from 2001 to 2011 – a third more rapidly than in any other region – but the number of households went up much more slowly. This was almost certainly in part because of housing shortages. There were 3.27 million London households enumerated in the 2011 census, an increase of 250,000, or around 8%, over the previous decade.

In London, average household size increased from 2.35 to 2.47 persons over the decade, while remaining constant in the country as a whole. This is an unprecedented reversal of a long-term trend towards smaller households and its costs are reflected in the fact that almost 12% of London households live in overcrowded conditions (defined as having at least one bedroom too few to meet bedroom standard requirements), three times the rate in other regions.

The projected rate of increase in the number of London households based on 2008 figures was 36,000 per annum to 2031. But even though the 2011 census found that population growth had been much higher than projected, the 2011-based household estimates, which take account of the impact of the financial crisis and the housing shortage, turned out some 10% lower than

Opposite: Kidbrooke Village, a new community in the Royal Borough of Greenwich, south London, and currently one of the largest regeneration projects in the UK.

MASSIVE EXPANSION IN INVESTMENT WILL BE REQUIRED JUST TO STOP THE POSITION WORSENING.

the 2008-based ones. This reflects the impact of the housing shortage, especially on poorer households, but still suggests that maybe up to 40,000 units per annum will be required over the next two decades to meet additional requirements.

Of course, what actually happens to household numbers will depend in part on how many homes are built. On past experience, output levels will be far below what is needed to accommodate projected increases. Moreover this shortfall is particularly concentrated in London, as shown by the very large reduction (nearly 15%) in vacant dwellings in London over the decade. This contrasts with an increase of 1.5% in the country as a whole. All the evidence suggests therefore that housing requirements will rise most rapidly in London, where there are already clear indications of increasing pressure. Massive expansion in investment will thus be required just to stop the position worsening.

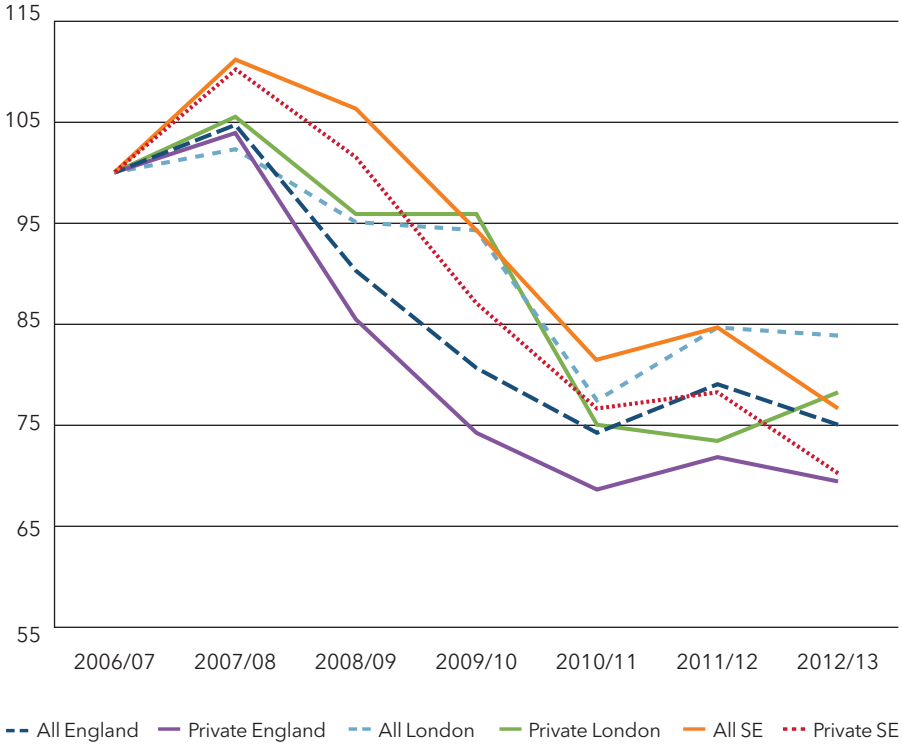
This tension has been reflected in increasing house prices and rents as well as reduced affordability. The position has been far worse in London than anywhere else in England. According to the Land Registry, while prices of new dwellings fell slightly faster in London than in the rest of the country between 2007 and 2009, in the wake of the worsening financial crisis, they also picked up more quickly, growing by 17% in the two years from 2009 to 2011 as compared to 11% in England as a whole. This year prices in London have already risen by a further 4.7%, while in England as a whole they have risen by less than 1%. Given these figures it is not surprising that average price-to-income ratios have worsened in London since 2009 and stood at over 8.5 times mean earnings in 2012 as compared to 6.6 across England.

At the same time, median private rents in London have risen consistently, while elsewhere in England they have remained fairly constant. As a result London rents are more than twice those in England overall (source: Shelter Databank). With more than one in four London households living in the private rented sector (as compared to perhaps 17% in the country as a whole) these figures reflect enormous differential pressure. This in turn adversely affects both household and government budgets – the latter in particular through housing benefit. This is increasingly paid to working households because of the high cost of rented housing and is more and more concentrated in London.

One obvious reason for these worsening conditions is the low level of house building everywhere in the country and particularly in London. We have already noted that output levels nationally have been running at about 50% of demographic requirements over the longer term. Chart 2 shows how this situation worsened in response to the crisis. The steep decline in completions in England that started in 2007 only began to improve in 2010/11. The chart also shows that private-sector output fell more rapidly than output of affordable homes, as government tried to offset the worst effects of the crisis. New residential construction in London fell at much the same time as in the rest of the country but somewhat more slowly. It stabilised at around 90% of 2007 levels for a while, then fell off a cliff.

It was only in 2011/12 that there was significant improvement in private sector output in London. Investment was initially concentrated in central and

Chart 2: Housing completions in England and London, 2006/07 – 2011/12 (number of dwellings)



inner London. Outer London and the South East took rather longer to recover but by 2012/13 they were overtaking central and inner London as domestic demand increased and more traditional forms of output started to dominate (chart 3).

All the evidence therefore points to a shortage of housing across most of the country, as output has not kept up even with household formation over the longer term and has fallen further behind since the financial crisis. The situation in London is most acute because the shortfall is larger, the numbers of people and households have grown more rapidly, and the housing supply response has been poor. When the economy finally resumes something like trend growth, demand will undoubtedly rise faster than supply can adjust, resulting in even higher prices and worsening affordability. The more homes that can be built now – and the bigger the pipeline – the better.

(ii) The particular value of housing construction for the economy

Investment in new housing has positive effects on the wider economy. Such investment is strongly cyclical – in the USA, the standard deviation of residential investment is more than twice that for non-residential investment – and changes in residential investment lead the business cycle (Leung 2004).

Economists have tried to quantify the effects of residential construction (and all construction) on the wider economy (Lean 2001). Many have applied Leontief's input-output analysis to identify the linkages between the construction sector and other parts of the economy, using huge matrices of statistics that quantify the inputs needed from each sector of the economy to produce outputs in another sector. This essentially static exercise identifies the knock-on effects at a single point in time. The construction of new housing requires purchases of a range of goods (e.g. timber, kitchen appliances); these are termed direct effects. The suppliers of such goods in turn make their own purchases; these are known as supply-chain or indirect effects. In addition, those who are employed by construction companies or their suppliers spend their wages to purchase goods and services, which is known as the induced effect. The sum of direct, indirect and induced effects is the total economic impact.

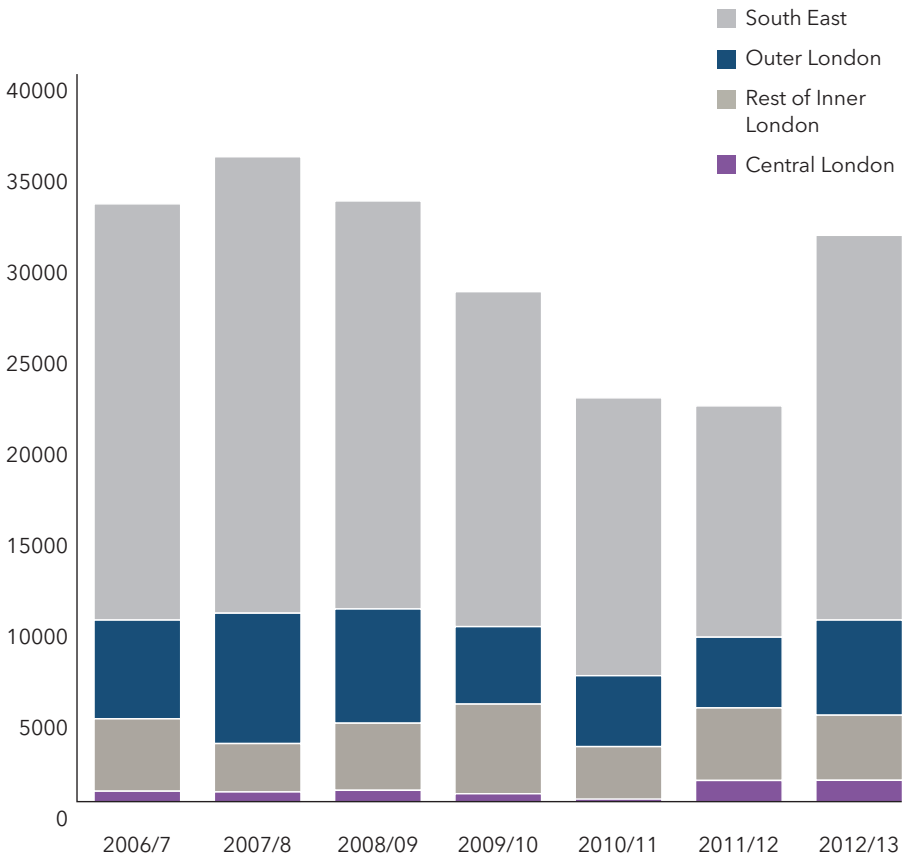
The 'multiplier' is the relationship between expenditure in one sector and the total economic impact. For the construction industry overall[1] , the multiplier is currently estimated at 2.6 – suggesting that an investment of £1m in construction will generate an overall increase of £2.6m in the economy as a whole (Regeneris Consulting 2010). This is higher than the multiplier for most other industries because construction requires fewer imported goods. Some analysts suggest that

[1] UK input-output tables, most recently updated in 1995, are not disaggregated enough to permit identification of the effects of residential construction alone.

residential construction may have an even higher multiplier, since housing uses fewer imported materials than other sectors of the construction industry. The one offsetting factor is that the construction industry in the UK is heavily dependent on foreign labour, so there is leakage out of the UK economy in the form of remittances – but again this may be less in housing.

In addition to the multiplier effects there are also 'spill-over' benefits to an active investment market. In particular the number of transactions in the existing housing market also rise, increasing expenditure on renovation, white goods and other services associated with mobility.

Chart 3: Housing completions, South East England and London



One recent study found that the sluggish expansion in residential investment between 1999 and 2007 contributed very little to overall economic growth during that period, so Britain has been losing out for a long time because of low supply elasticities. At the peak of the housing market in 2007/08 about 170,000 new homes were built, which (taking account of net change of use) was still perhaps 20% below the desirable level to improve affordability. That number fell to fewer than 120,000 completions in 2009. The *decline* in residential investment after 2007 accounted for more than one-quarter of the overall fall in GDP between 2007 and 2009 (Regeneris Consulting 2010).

These analyses of the impact of housing investment make it clear that:

(i) longer-term supply inelasticity has been extremely damaging to the British economy. Ensuring greater supply responsiveness in future would contribute directly to higher employment and economic growth

(ii) housing investment not only directly increases activity and growth but also has a disproportionately positive effect on jobs and overall output because of its high multiplier and spillover effects; and

(iii) although many of these multiplier benefits are local, as the Ernst and Young report quantifies, the supply chain for housing is nationwide – so significant benefits are felt across the whole country. The unquantified benefits to business and consumer confidence as house building and housing-market transactions pick up should also be noted.

Most importantly, at present there are unused (and therefore wasted) resources in the economy, so large-scale growth in housing output would not only help to take pressure off house prices but would also increase employment, the level of demand in the economy and economic growth. Moreover, because house building uses relatively few imports it puts less pressure on the balance of payments than rapid expansion in other parts of the economy.

The case for increasing housing investment is therefore very strong. But it remains important not to see this solely as a cyclical issue – however crucial it is to maintain the upward trend. The evidence from the decade of growth from the mid-1990s to the mid-2000s shows clearly that Britain has been losing out because of structural difficulties in expanding housing supply. Overcoming these more fundamental constraints would not only ensure a step change in housing output levels into the longer term, but would also contribute towards higher levels of sustainable economic growth.

IT REMAINS IMPORTANT NOT TO SEE THIS SOLELY AS A CYCLICAL ISSUE. THE EVIDENCE FROM THE DECADE OF GROWTH FROM THE MID-1990S TO THE MID-2000S SHOWS CLEARLY THAT BRITAIN HAS BEEN LOSING OUT BECAUSE OF STRUCTURAL DIFFICULTIES IN EXPANDING HOUSING SUPPLY.


Berkeley
Berkeley
Kidbrooke
Village
SE3
Berkeley
2020

SECTION 3
LOOKING BACK

The experience of the Berkeley Group provides a good example of the impact of the financial crisis, and its successful response to that crisis offers lessons about the requirements for longer-term sustainable growth. Since about 2004, Berkeley has concentrated its operations in London and the South-East, working mainly on large-scale regeneration projects that involve long lead times, infrastructure investment and wider place-based planning. These in turn generate very considerable cash-flow requirements and, consequently, are high risk.

Since the financial crisis, Berkeley has bucked the trend and expanded output. This has generated relatively stable operating profits compared to other similar developers (chart 4), putting the firm in a strong position to maintain momentum. Indeed, Berkeley has moved up to fourth place among housebuilders as measured by turnover, and first in terms of profits.

There appear to be three main – interlinked – reasons for this success, apart from good management and planning: the extent of forward (off-plan) sales, the role of international buyers in filling the gap left by the reduction in domestic demand after the crisis, and the company's emphasis on place-making.

First, off-plan sales: unless developers can secure significant forward sales it is extremely risky to go ahead with large mixed-use developments. These need a high quality environment, public realm and amenities to attract new purchasers, and developers require strong cash flow to support the full range of investment required. Forward sales have increased consistently over the period since the crisis and this has allowed Berkeley to maintain and indeed expand building activity.

It has been widely reported that London developers have benefitted from the

willingness of international buyers to commit at an early stage to buying off plan. Without their purchases, Berkeley would have had to put projects on hold as domestic buyers, constrained by access to capital, disappeared and cash flow declined. Indeed, on sites with few such sales (mainly in outer London), shovel-ready projects were delayed until domestic demand started to recover. In inner and particularly in central London, forward sales have been buoyant – and building has followed rapidly.

Second, this international market has expanded since the financial crisis. Demand from these buyers has increased consistently and Berkeley has benefited. International buyers have therefore filled the gap in domestic demand and generated the forward sales that have provided funding and reduced risks. This is reflected in chart 3 in the rapid expansion in completions from an extraordinary low level, in central London. A market without international buyers would have generated much lower levels of activity by house builders – not only Berkeley but also other large developers with operations in central and inner London.

Commentators suggest that a majority of sales in central areas since the crisis have been to international buyers (Savills, 2013) and the evidence is equally strong that domestic purchasers would simply not have filled this gap. There are examples of sites where domestic demand was maintained and development proceeded. But without international buyers, whose demand is particularly strongly concentrated in new-build apartments, investment would have been much less buoyant. Berkeley invested within a challenging market and the resulting strengthening of their financial position places them in a good position to expand as domestic demand increases.

Thirdly, Berkeley is involved predominantly in large-scale developments where they provide a range of environmental and retail services to create a functional community in which both owners and occupiers are committed to maintaining standards. Investors in this market expect a high-quality product and management designed to ensure long-term sustainability, not just a quick profit. This in turn generates high demand from good-quality tenants as well as significant benefits for the surrounding areas.

One particularly important benefit of these developments is their contribution to mixed communities. The strength of demand for Berkeley's market housing has enabled the construction of a significant number of affordable homes for both lower-income working households able to afford intermediate housing and those in need of social housing. Ernst & Young's report highlights that over the last five years Berkeley has committed to deliver some 7,000 new affordable homes via the planning process which are currently in the course of construction where these have not already been delivered. These affordable homes are provided on the

Chart 4: The Profitability of Berkeley and its Peer Group

Total Profits before tax							
Year End	Company	2007	2008	2009	2010	2011	2012
		£m	£m	£m	£m	£m	£m
30 Apr	Berkeley	188	194	120	110	136	215
31 Dec	Persimmon	583	(780)	78	154	147	222
31 Dec	Bovis	124	(79)	5	19	32	54
31 Jul	Bellway	235	35	(37)	44	67	105
30 Jun	Redrow	121	(194)	(141)	1	25	43
30 Jun	Barratt	451	393	(679)	(163)	(12)	100
31 Dec	Taylor Wimpey	(15)	(1,953)	(668)	(155)	79	208
The Relative Impact of Berkeley Homes							
	Average Profits before tax	241	(341)	(189)	2	68	135
	Average Profits before tax (excluding Berkeley)	250	(430)	(240)	(17)	56	122

back of market homes; and without the growth of international demand since the crisis most would not have been built.

Consequences

As the discussion above makes clear, in order to maintain this level of output and expand investment, Berkeley and other developers require a stable flow of demand and, in particular, upfront sales. This reduces the risks of starting and completing a large-scale project in a reasonable time and to an acceptable standard for all the purchasers.

One of the most important benefits of maintaining and expanding output is that it allows affordable housing to be provided and to be available more quickly. Almost all large-scale projects in London have affordable housing both social and intermediate on site. As these are part of the S106 agreement they are 'pre-sold' and are often completed during the earlier stages of the project. This enables immediate letting and more effective use of the infrastructure which, in large projects, is put in place before households move in. The result is mixed tenure development with high quality management.

INTERNATIONAL INVESTORS GENERATE ADDITIONAL HOUSE BUILDING WHICH RELIEVES RATHER THAN EXACERBATES THE PRESSURE ON HOUSING SUPPLY.

Immediately after the financial crisis much of the private demand coming forward was from international buyers – who mainly bought off plan and paid in cash.

The latest assessment of the role of international investment comes from Knight Frank (2013.) This shows that international investors channelled £2.2bn into the new build sector in central London in 2012, up from £1.8bn in 2011. This investment accounted for over 70% of new build sales in central London. However, across even prime London locations nearly 60% of all residential purchases were by domestic buyers, showing the relative importance of international investors to the new build market. This has undoubtedly been the most important factor in enabling residential investment in central London to increase rapidly. This in turn has helped build confidence in inner and outer London and now the South East where domestic purchasers dominate.

This in turn has now led to an upturn in domestic demand, resulting in increased building activity across the whole of London and the South East.

There has been considerable negative press coverage of the role of international buyers in the London housing market because they are seen as excluding domestic purchasers, putting up prices and leaving property vacant.

First, international investment is often the difference that makes it possible for a project to go ahead. It supports cash flow and underpins the provision of public amenities. As a result, London has had more employment, more tax revenue and more potential for economic growth than it would have without this investment. The impact has been concentrated in central London, notably in prime locations, but demand has also spread outward (not least as a result of the Olympics), supporting development and economic activity more widely across the city.

Second, international buyers are usually looking for new-build apartment accommodation. This channels demand directly into new investment and increases the supply response as compared to purchases of existing housing. These buyers are usually

ONE OF THE MOST IMPORTANT EFFECTS OF INVESTMENT IN MARKET HOUSING IS THAT IT ALLOWS AFFORDABLE HOMES TO BE PROVIDED.

looking for high-density housing in inner urban areas, a form of development which is consistent with London's longer-term planning goals and the recent emphasis on place-making. This is also the type of investment needed to expand the provision of new build-for-rent housing – which both the government and the Mayor of London support.

Third, all the direct multiplier benefits of new construction accrue to the local and national economies – no matter who the property buyer is. In addition, international investors are likely to increase their consumption, trade and investment in the UK – and not just in property – as they become more committed to London. So, as long as they do not crowd out other investment, such purchases are highly desirable, especially given continuing low levels of residential construction activity.

Importantly, a large proportion of buyers (estimated at 85% by Jones Lang LaSalle, 2013) are looking for returns in the form of both capital growth and rental income, and therefore rent out their new properties once they are complete. These buyers add to the private rented stock and help to increase the availability of a wide range of properties. Yes, they may let to international tenants, but such tenants would be in the market anyway; London is a world city and the 2011 census showed that over 40% of the population have been born outside the UK.

In short, international investors generate additional house building which relieves rather than exacerbates the pressure on housing supply.

The larger the investment, the larger the gain to ordinary Londoners who benefit from better homes in the form of either shared ownership/equity or social and affordable rented property. Without new market housing, there would be no new affordable housing, and no improved infrastructure through planning obligations. Resources from both Section 106 and the Community Infrastructure Levy (CIL) would be reduced – now and into the future. In an environment where government subsidy is increasingly limited, these sources of funds are absolutely necessary to support local communities.

While international investors have enabled a large proportion of new build that has occurred in central London they account for only a small proportion of total demand. Across the capital as a whole, only around 6.5% of sales by value were to international investors.

Moreover 80% of all sales were financed by UK mortgages – and of the other 20%, the majority were overwhelmingly domestic cash sales. International buyers are probably particularly obvious because they concentrate in Central London and on new properties – but this means that they add to supply more

effectively than domestic purchasers. Of course there may be issues relating to unoccupied overseas-owned homes just as there are to other vacant units. But they clearly are not squeezing out other investment, whether residential or commercial. As long as all potential buyers have equal access to available properties, the particular benefits of international investment are clearcut and can be effectively realised.

Looking to the future, it is important to ensure that as domestic demand grows it will be met by increased output with commensurate increases in affordable housing provision. At this moment there is no shortage of resources to meet such demand as long as there is a continued pipeline of appropriate sites.

Implications

Residential investment was badly hit by the credit crunch and the financial crisis. Both affordable housing and international buyers have played crucial roles in maintaining and increasing house building activity ensuring that capacity which would otherwise have been lost could be employed – and more Londoners could be housed. The Berkeley Group have been at the forefront of this expansion.

International investment of all kinds helps to support the UK economy, boosting employment levels and the confidence to undertake future investment for growth. Investment in housing is no different to other types of investment, as long as supply can be expanded. The evidence is that without international investment in housing, and particularly in new apartments, the decline in housing output after the financial crisis would have been far greater – especially in London. London is a global city which needs international commitment. International purchases of new homes support economic activity which is undoubtedly to be welcomed.

As the domestic market begins to pick up, it will increasingly be possible to expand output not only in London but also on major suburban sites and across the South East. The housing built on these sites will involve a mix of tenures and both market and affordable homes; and the construction will support economic growth both locally and nationally.

As long as a reasonable supply of sites and forward sales can be achieved, this type of large-scale development – which is essential to ensure an adequate supply of private rented accommodation and to create sustainable communities – can become a larger and more stable part of the economy. But that positive scenario will only occur if the policy regime remains positive and constraints on supply are reduced.

ACROSS THE CAPITAL ONLY AROUND 6.5% OF ALL HOUSING TRANSACTIONS BY VALUE WENT TO INTERNATIONAL INVESTORS.



SECTION 4
LOOKING FORWARD

The financial crisis showed how rapidly demand could disappear in the face of external crises and uncertainty. Demand is now beginning to build again, but maintaining and increasing that demand requires a more stable environment than in the past. People need to be able to make decisions on the basis of reasonable expectations about the future, and any threats to these reasonable expectations could easily set back recovery.

We can identify seven fundamental elements that make up the stable and robust environment in which demand and investment can thrive.

(i) A clear legal framework for the purchase, sale and holding of housing;

(ii) A stable and competitive tax regime;

(iii) A migration policy that favours those who contribute to the UK economy, notably through participation in higher education and inward investment;

(iv) A competitive exchange rate;

(v) A steady supply of attractive new housing;

(vi) Maintaining London's reputation as a city that welcomes new households and investors and, following on from and encompassing all the above,

(vii) Reasonable certainty, especially about policy. Any policy changes should be transparent, robust and directed at well-defined goals.

Five of these seven elements are as important in maintaining and expanding domestic demand as they are in supporting international demand. The two that directly affect only international buyers are migration policy and a competitive exchange rate, although they still indirectly affect general demand and the health of the economy.

Opposite: A view across the square to a family home at Highwood, a new development in Hampshire.

(i) The legal system

The basics of the UK's legal system and property law have been in place for centuries and its stability is undoubtedly attractive to investors. Property can be bought, sold and held with certainty. Property rights are well defined. This contrasts with the situation in some of the more obvious competitor countries, where conditions may change suddenly and unpredictably. The fundamentals are undoubtedly among the best in the world.

Within this general area it is not just the specifics of ownership and transfer of land and property that matter, but also the framework in which financing can be made available and property can be used to provide a reasonable return on investment. In terms of finance there are some uncertainties with respect to regulation, which have been affecting the capacity of domestic purchasers to obtain mortgages. However the Financial Conduct Authority is currently moving to resolve these. There have also recently been moves towards simplifying the regulatory framework for private renting. The objective is not to limit rental returns but rather to provide a better environment for institutional investment, both domestic and overseas, in private renting (Montague, 2012).

Sudden changes in the legal environment are unlikely. They would be out of line with mainstream political thinking, which clearly recognises the need for transparency, stability, access to funding and a sustainable private rented sector. Hopefully all the likely changes will aim to maintain and improve this position.

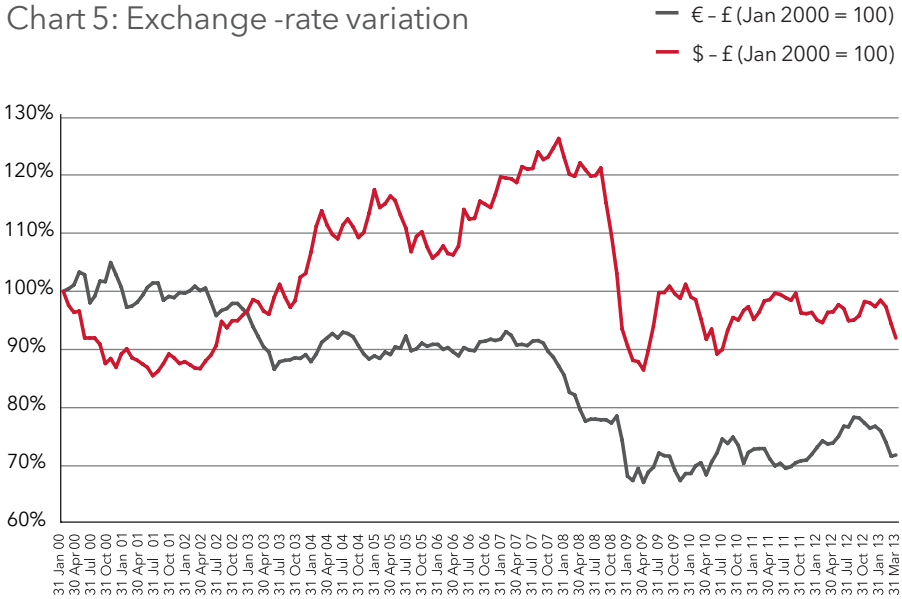
(ii) The tax regime

Tax is currently the most important area of concern for both domestic purchasers and international buyers, especially at the upper end of the housing market. It is not just the short-term question as to whether a 'mansion tax' might be introduced at some future point but also the fact that governments, through a mixture of reactive policy changes and conscious inaction, have failed to address the more fundamental issues of property tax and the need for a more predictable and progressive system. There are good reasons to propose changes to the taxation of domestic property, but such reform should not be piecemeal or (as often in recent years) ill-directed. Rather, any change should provide a coherent and long-lasting approach to the taxation of real property. We discuss this issue in detail in the next section.

(iii) Migration controls

Immigration has in recent years become a contentious topic of political debate. Successive UK governments have taken steps to reduce net international migration from outside the European Union. The current government is committed to reducing overall net migration to the 'tens of thousands' even though European Union migration cannot be controlled. While there has been publicity about problematic immigration barriers affecting highly-skilled migrants there is as yet no shortage of such visas and there is no political discussion about tightening requirements for Tier 1 investor or

Chart 5: Exchange -rate variation



entrepreneur visas which aim to support both inward investment and innovation.

The most immediate concern is in relation to tightened requirements for student visas, although there is no evidence currently that those who have secured places in UK universities and already have English-language skills will face barriers. The worry is thus not so much that good students will be rejected, but that they could be deterred from applying. Any further tightening, as well as bad publicity about the scheme, could affect international demand for property in the capital– as estate agents who specialise in selling homes to Asian investors say that many purchase the properties for their children to live in while studying at London universities.

For students already in the country there is now stricter enforcement of visa conditions with respect to attendance and examination success as well as new limitations on post-graduation employment: applicants can only stay if they secure a job with a minimum annual salary of well over £20,000 based on Tier 2 requirements. However, as noted above, Tier 2 visa quotas are nowhere near fully used, so the concern is more that people will be put off applying than that they will be refused.

More generally there is a perception that border control procedures, even for those visiting for short periods, are too onerous. Such procedures can be off putting to visitors or potential migrants, but may be no worse than those employed by many other countries.

INCREASING INVESTMENT DEPENDS ON AN IDENTIFIED LAND SUPPLY, THE AVAILABILITY OF FUNDING, AND AN EFFECTIVE PLANNING SYSTEM.

Overall the threats lie more in the possibility that potential investors and qualified workers will be put off by uncertainties surrounding how immigration controls operate. Thus it is not seen as a topic of immediate concern to purchasers but it is important that unintentional negative impacts do not occur.

(iv) Variations in the exchange rate

The volatility of sterling can have contradictory effects. In the short term, if the pound falls in value in relation to other currencies, property in London becomes more attractive to overseas buyers. But if sterling is expected to depreciate in the medium to long term, potential buyers will find it difficult to evaluate the likely return on investment and may fear that their homes would lose value as compared with investments in competitor cities. This affects not just international demand but also confidence in the economy more widely and thus domestic demand for property – especially if currency volatility impacts on interest rates and mortgage availability. As with the tax regime and the wider business investment climate, predictability and stability should be the objectives.

As chart 5 makes clear, there was a sharp decline in the value of the pound sterling against the Euro and the US dollar at the time of the financial crisis. This reduced the costs of house purchase for foreign buyers and undoubtedly supported the growth in international demand for property which helped generate house building activity. Britain was seen as a safe haven for investment which was now cheaper than alternative locations – and prices here were expected to rise in the long term. However, future exchange-rate declines might be more likely to injure both international and domestic demand as they would reflect a continuing lack of competitiveness and a level of growth inadequate to ensure the health of the economy.

(v) A pipeline of new properties

Domestic buyers, international purchasers living in London, and those buying off-plan from abroad all need a

choice of new properties. Overseas buyers, especially those from the Far East, generally prefer new-build for reasons of style, low maintenance costs and security. UK purchasers looking for properties to rent will often want similar attributes. Both types of demand therefore help to encourage additional investment.

The land-use planning system is often seen as a major constraint on new development – although it also protects many of the elements that make the UK and London particularly so attractive. Government has been trying to address a number of these constraints through a simplified National Planning Policy Framework, streamlining planning guidance, making change-of-use easier and many other initiatives. Large complex projects which inherently take many years to complete face particular uncertainties. However, the core requirement for a steady flow of new housing remains suitable land: sites identified well in advance, with scope to collaborate and negotiate before an application is made. It is worrying that the slowdown in construction activity and the cutbacks in local government finance have affected local authority skills and capacity to play a proactive part in this process.

Currently, the rate of sale on new developments is accelerating and this is helping to ensure an adequate pipeline from existing permissions in inner London. Demand is also improving in outer London and the South East, where the majority of purchasers are domestic and there are sites available. But these sites are limited, so increasing investment depends on speeding up the pipeline of sites with planning permission, an identified land supply, and increasing the availability of funding. Once again, predictability is crucial.

It is worth adding that there is no evidence that increased residential property construction has led commercial activity in central London to decline. On the contrary, Transport for London's annual count of people entering central London in the morning peak hours shows a gradual, modest increase in recent years.

(vi) London's reputation and quality of life

London's reputation is key to both domestic and international demand. All purchasers are looking for a safe and secure environment as well as high-quality public services and a well-operating transport system. Both domestic and international buyers want to live in a world city that also provides an environment for comfortable living.

The willingness of overseas investors to buy London residential property depends on culture, personal safety, educational facilities and healthcare, alongside the quality and availability of housing. All these factors affect such buyers' perceptions of London as compared to other cities where they might instead choose to buy, including New York, Paris and emerging centres.

Many wealthy international purchasers, who could afford to buy anywhere, see

London as offering a uniquely attractive blend of characteristics, including safety, educational opportunities, shopping and accessibility. London is safe not only in comparison with cities in developing countries and Eastern Europe but also compared to other western cities. The homicide rate in London, for instance, was 2.1 per 100,000 population in 2009, as compared to 4.6 in Moscow and 5.6 in New York.

London offers outstanding educational opportunities from nursery age to university. Children who attend London schools become fluent in English, and international high-net-worth individuals increasingly choose to educate their children in the UK. Of the Financial Times' top 50 secondary schools in 2012, 15 are in London (and several more in the commuter belt); of the top 100 universities by reputation, as compiled by Times Higher Education, four are in London. Boston, with three, is the only other city that comes close.

London's retail sector attracts shoppers from all over the world, who can choose between traditional venues such as the West End and megamalls like Westfield. There is a high concentration of suppliers of luxury goods and bespoke products. London's retail offer continues to evolve; according to retail analyst King Sturge, retail sales growth in inner London is forecast to be 40% between 2010 and 2020—one of the highest growth rates in Western Europe (King Sturge 2010). London and Paris share the distinction of having the highest density of international luxury retailers in the world (Jones Lang LaSalle 2011).

Finally, London is one of the world's most accessible cities. Its six airports are together the busiest in the world in terms of passenger numbers. According to a 2011 study, London's airports had 1113 departure flights to key business destinations overseas, compared with Paris's 499, Frankfurt's 443, and Amsterdam's 282 (Stewart & Baines 2011).

These factors also support domestic demand from those who want to live and work in London. The biggest concerns here have been in the context of safety and state education – both of which are seen to be improving consistently, even though there are obvious constraints.

The critical problem remains the increasing cost of housing and the need to ensure that there is an adequate supply of affordable housing for the lower-income workers who support London's services, both public and private. New construction, especially on larger sites, is one of the few mechanisms through which the stock of affordable housing can be increased. The policy that provides for this is accepted by developers and government alike and helps to generate the types of mixed community for which London remains justly famous.

The lack of affordable housing remains perhaps the most obdurate problem for the long-term health of the London economy. It must therefore be of concern that the Community Infrastructure Levy could reduce the quantity of affordable housing provided as well as generate greater uncertainty as to the rate of

RETROSPECTIVE OR UNPREDICTABLE TAXATION IN WHATEVER AREA IS LIKELY TO UNDERMINE CONFIDENCE AND INVESTMENT POTENTIAL.

'taxations' especially on large sites. Because CIL is non-negotiable, especially if the rates are set too high and threaten the viability of development, we will see less affordable housing because it becomes the balancing factor and the only significant cost to negotiate.

(vii) Certainty

Discussions about the need for certainty and predictability have focused on taxation. We discuss this in greater detail in section 5. In addition, there is some uncertainty with respect to future regulation of finance and private renting, although policy in both cases appears to be moving towards greater clarity and a more stable environment. The other big uncertainty is whether there will be an adequate and consistent pipeline of appropriate development sites as demand picks up. This is essential given the long lead times for large-scale residential and regeneration projects.

Implications

London in the main is providing a good environment for inward investment – especially as compared to countries such as France where taxation changes are discouraging investors. Yet it is clear that uncertainties are growing, especially around property taxation. This is potentially problematic, given that a stable and transparent tax and regulatory framework is seen as the most important requirement for continuing strength in the market.

In the long term, investment in most areas of London, in the South East and in the rest of the country must depend mainly on the domestic market. Local buyers are put off as easily as international ones by sudden and ill-focused changes in taxation. Homes are desperately needed for the growing number of UK households and to reduce the backlog of unmet need that has worsened as a result of the financial crisis. So the policy emphasis should not be just on improving access to finance for domestic purchasers (whether owners or landlords) but more fundamentally on building confidence.

The strength of the economy and the stability of the tax regime will undoubtedly have the greatest effects on new housing investment. The government's macroeconomic policies are clearly of fundamental importance – but so also are the threats, inconsistencies and uncertainties building around the property tax regime.



SECTION 5
THE IMMEDIATE ISSUE: PROPERTY TAXATION

Taxation – and especially property taxation – is currently the most important area where there seem to be real issues that could stop the market in its tracks. Uncertainty and erratic changes to the property-tax system could have the unintended effect of undermining the market and threatening the scale of construction. Compared to other taxes, such as income tax, there have been a great number of changes to the taxation of property. Such changes, generally designed to increase the amount of taxation paid by owners of homes with the highest values as well as by non-domestic buyers, were introduced in response to the public mood and to perceptions that high-value property, and in some cases non-domestic owners, were under-taxed.

The taxation of domestic property in England has become both complex and, especially for high-value homes, unpredictable. Because of a failure to keep council tax up-to-date, successive chancellors have decided to impose new or higher taxes on high-value property and on property transactions. The introduction of these new taxes and tax rates has been arbitrary and may have unintended consequences.

Opposite: Two of the residents at Empire Square, a mixed use development of 567 homes in south London.

The Exchequer presumably wishes to sustain or increase the overall yield of all domestic property taxes as well as to make the system more progressive. It is thus important that property buyers know at the point of purchase what the ongoing property tax regime will be. Certainty would allow rational investment and decision-making.

Other taxes also need to be predictable if inward investment (of all kinds, not only into residential property) is to be sustained and encouraged. Retrospective or unpredictable taxation

in whatever area is likely to undermine confidence and investment potential.

(i) A short history of domestic property taxation

Domestic property in Britain is taxed in a number of ways. By far the largest of these taxes is council tax, which was introduced in 1993 following the short-lived 'community charge' or poll tax. Until 1989 – 90, homes were subject to domestic rates, a tax which had its origin in the 17th century. The key difference between domestic rates and council tax is that the former was based on rental values across the full range of value, whereas the latter places properties in one of eight bands (A to H), based on their capital values. Current valuations are based on historic 1991 selling prices and thus do not reflect the growing differentials in house prices which have emerged over the last decade.

Domestic rates were very low on properties which had very small rental (and thus, often, capital) values, while there was no upper limit on the potential rate bill on expensive homes. In some parts of London, rates bills were up to £8,000 to £10,000 per annum in the last years of the domestic rates regime. Council tax, on the other hand, operates in such a way that there is a ratio of 1:3 between the bills paid in Band A and Band H, with fixed steps in between. Councils have some freedom to set the local rate of tax but when they do so, the ratio between the total paid from band to band remains fixed.

As a consequence of the 1993 reform, owners of the most valuable properties in England pay significantly less in local domestic tax in 2013–14 than they did in 1989–90. For more modestly-valued domestic properties, on the other hand, bills are significantly higher today than they were in the late 1980s. In addition there have been big increases in house-price differentials, especially between homes in the top five per cent of value and those at the average, further increasing concerns about the equity of the system.

Put simply, if domestic rates had not been abolished and if there had been regular revaluations (which to be fair was not the case in the post-war period), the annual bills paid by owners of the most valuable homes would have risen to more than £50,000 today. As it is, the annual council tax for a Band H property worth over £50 million in central London boroughs can be less than £1,400. Equally, someone living in a council house in a poor area will often be paying nearly as much as someone living in a large house in a conservation area in the same central London borough.

Successive government have proved unwilling to revalue domestic properties for fear that the resulting changes in banding would produce many 'losers'. It is certain that such a revaluation would indeed leave many London properties in higher bands than their relative value suggested in 1991. In addition governments have required councils to limit council tax rises. This has been done by threats of capping and, more recently, by a series of one-off grants

to fund a freeze in the tax level. So both changes in average levels and the lack of change in differentials have favoured those in higher valued dwellings, especially in London.

There is no appetite in central government to reform council tax, or, indeed to revalue the tax base. The poll tax reform experience convinced national politicians that changes to local taxation are toxic and thus cannot be introduced. But in parallel with this political reality, chancellors in the 2005–10 and 2010–2015 governments decided that high-value domestic properties should face higher taxes.

In Labour's 2010 Budget, Alistair Darling introduced a new 5% rate of Stamp Duty Land Tax on properties worth over £1 million. In 2011, new rules were introduced to stop the abuse of Stamp Duty Land Tax. Subsequently, George Osborne set a new 7% rate for homes valued at over £2 million in his 2012 Budget. In 2013–14, a new Annual Tax on Enveloped Properties will be levied, in bands, on company-owned high-value domestic properties. There will also, from 2013, be a new 'capital gains property disposal tax' (table 1 summarises actual changes). Both of these are seen as impacting particularly on high-end non-domestic owners. Latterly, the Liberal Democrats and Labour have publicly stated their support for a 'mansion tax' which, as currently designed, would impose a 1% levy in the form of additional domestic property taxation on homes valued above £2 million.

Table 1: Domestic property taxes in England and their year of introduction

Tax	Year introduced
Council tax	1993, though domestic rates existed till 1990
Stamp Duty Land Tax	2003, though Stamp Duty had existed for centuries. Maximum rate of 1% until 1997; many subsequent changes. Now, six rates with a top rate is 7%
Annual Tax on Enveloped Dwellings	2013
Capital gains property disposal tax	2013
'Mansion tax'	?

THE 'MANSION TAX' IS ANOTHER EXAMPLE OF A POLITICAL RESPONSE RATHER THAN A COHERENT APPROACH TO ADDRESSING A PROBLEM.

The current position

The limitations of council tax and the apparent impossibility of reforming it have generated a cross-party interest in finding new ways of taxing high-value residential property. Had council tax worked in the way domestic rates previously operated, taxation on valuable properties would have increased gradually over time in line with increased capital values.

There is a dynamic in this new desire to make tax 'fairer' which has led to three years or more of new efforts to introduce changes. The problem with this new approach to property tax reform is that it is random and unpredictable. Unlike the operation of council tax (or, indeed, of property taxation in many other major cities internationally), these constant changes make it impossible to predict how the tax regime will work from one year to the next.

The 'mansion tax' is another example of a political response rather than a coherent approach to addressing a problem. This tax proposal remains a policy objective for many leading national politicians and would, if introduced, add a further annual tax on homes worth more than a sum to be determined (although probably £2 million).

The discussion of possible reform itself generates further uncertainties, since the details of its operation have not been specified. There are varying suggestions about how much money it is intended to raise – a mainstream estimate is perhaps £2 billion per annum. It is seen by some as simply an extension of the Enveloped Dwelling tax. Others view it as a slab tax affecting the whole value of the dwelling, although the current political discussion centres on a tax rate of 1% on that part of the value over £2 million (which would be inconsistent with raising £2 billion per annum). Additional complications include the possible exemption of pensioners and farmers and the suggestion that it could fund an introduction of a 10p band of income taxation.

Arguably, the uncertainties are worse than the tax itself for investors; and if the

tax were to be imposed but generated only a limited amount of revenue, there would be likely to be continued pressure to increase rates.

The impact of this kind of uncertainty will be felt most profoundly in those areas with the largest number of high-value properties, such as west and central London. Most of the tax taken from recently-introduced taxes will have been paid by property owners in these locations (approximately 20 per cent of all 'Band H' properties in England are in South Westminster, Kensington and Chelsea). Uncertainty and/or a high tax rate could lead to a fall in sales and prices, reducing the overall yield.

Uncertainty would also extend to future development. If London were to be seen as a city where property tax was unpredictable and might soon become higher overall than in competitor cities, demand would surely ebb away. The problem is less the size of the property tax bills than the difficulty of predicting what might happen next.

Section 106 and CIL levies can also be classified as types of property taxation. The Community Infrastructure Levy was introduced by the Planning Act 2008 and came into force on 6 April 2010. Development of most kinds will be liable for a charge under CIL if a local planning authority has chosen to set a charge in its area. Importantly for large-scale projects, the level of CIL can change even within the planning and development period, creating further uncertainty.

In addition, developers may also still have to make a Section 106 payment.

THE TAXATION OF DOMESTIC PROPERTY NEEDS TO BE SEEN AS A PROGRESSIVE SYSTEM OF TAXES AND LEVIES.

The existence of CIL, however, reduces the capacity to negotiate large-scale affordable housing contributions. This has two important implications for increasing residential investment: it provides another level of uncertainty, and it reduces the proportion of affordable homes provided – even though there is a desperate need for such homes.

These levies, alongside the various domestic and non-domestic property taxes, constitute different ways of extracting resources from development and land values. In a city such as London, with a fixed amount of land, restrictions on the use of the Green Belt, heritage considerations and many other constraints, it is perhaps inevitable that government will seek to exploit the high values which result from scarcity and constraint. However, the accretion of new ways of taxing land and property risks produces distortions and unpredictable outcomes.

Capital Gains Tax on all homes, that is including first homes, might be thought to be another way of reforming property taxation. However, there would be a risk that new forms of tax avoidance would be encouraged. Moreover, it might be hard to change the rules about first homes for people who bought their home many years ago: there is a risk this

would be seen as retrospective and would treat existing home-owners differently from new ones.

Instead, the taxation of domestic property in all its forms needs to be seen as a system of taxes and levies that is progressive, that effectively raises revenue from a major asset, and that can be adjusted to changing circumstances.

One possible approach to a more structured set of changes is that put forward by the London Finance Commision, which suggested that it would be possible to reintroduce a much stronger measure of certainty to the taxation of high-value domestic property by reforming the council tax so that it raised substantially more resources from such homes. In effect, this would move England back towards the structure of domestic rates before 1990.

Properties with a capital value above a particular level would be assigned new council tax bands, above the current Band H. There could be great freedom in deciding on the number of bands, since there are very large differentials between high-value homes even though these are concentrated in London. For example, two or more additional bands ('I' and 'J') might be added, with a ratio of tax to Band D that ensured that the top bands paid perhaps four or five times the Band D figure. The Valuation Office Agency could be given the responsibility of linking the new and existing council tax systems. This adjustment is comparatively easy to introduce, should be politically acceptable, and would provide the greater certainty that investors in higher-valued homes are looking for.

IF COUNCIL TAX WERE REFORMED, IT WOULD BECOME A PREDICTABLE ELEMENT IN DECISIONS ABOUT PROPERTY.

The amount of council tax paid by owners of residential properties in these new higher bands could be determined by the government so as to achieve a 'fair' level of payment. As with the original decision to set a 1:3 ratio between the bottom and top council tax band payments, it would be possible to determine an appropriate payment on properties worth say £1 million, £2 million, £5 million, £10 million and £50 million+.

At the same time, Stamp Duty Land Tax should be restructured so that it does not generate inefficient slabs (by which houses sold for £1 over a threshold incur the higher tax on the whole value) which adversely impact on mobility. The current very high levels of this tax inhibit sales and damage the market. It is not in the Treasury's interest to operate the tax system in such a way as to risk undermining longer-term revenue.

If council tax and Stamp Duty Land Tax were reformed in the ways outlined here, they would become predictable elements in decisions about property purchase and investment. So long as the burden of property tax were not excessive, it is reasonable to believe that

the Treasury, developers and purchasers could all have long-term security. Under this scenario, Stamp Duty Land Tax would continue. Other, new, taxes on high-value properties (including any mansion tax) could then be removed, as long as it was ensured that all owners of residential properties, including companies, paid the new, extended, council tax. For the first time, the full suite of residential property taxes would be made consistent and would operate in a way that ensured longer-term security.

It would not necessarily be the case that the overall tax yield would increase, but the burden could be more fairly spread and, as a consequence, the search for unsettling reforms could stop. It has not been possible to undertake such modelling in the absence of decisions about reform. Once the political parties had decided exactly how they were going to modify property taxation, it would be possible to model the consequences of changes to the system. Importantly, the market could then operate with certainty.



SECTION 6
CONCLUSIONS

Public debate and policy have tended to conflate a number of topical issues. Thus, the taxation of residential property, a shortage of housing, the purchases of new properties by overseas buyers, tax avoidance/evasion, the treatment of an internationally-mobile super-rich population and the redevelopment of prime central London properties have all become entangled in public and political perception. It is important that efforts to do one thing – e.g. tax rich foreigners and domestic owners of high-valued housing fairly and consistently – do not accidentally do another, in this case undermine the delivery of new homes.

Housing priorities

The construction of new homes not only enhances housing availability and increases economic activity, employment and growth but also provides resources for social and community investment including affordable housing. Policy interventions which had the effect of reducing domestic or international demand for such housing would have two impacts beyond the direct consequence of reducing the number of homes built. First, construction industry activity (a major contributor to both economic growth and to its volatility) would be reduced and, second, there would be fewer CIL and Section 106 resources available. The scale of market demand and provision of new property will thus directly affect the number of affordable housing.

This applies as much or more to international buyers as to domestic ones, because international purchasers concentrate on new homes and buy off-plan. It is thus unfair to demonise international property buyers, as bad for London's housing and economy. Certainly over the last few years they have been the opposite. They have allowed the development industry to maintain and increase output, and in so

doing have enabled the construction of large numbers of affordable homes as well as putting demand into the economy more generally.

These benefits will continue into the future as long as we do not face an overheated economy – which does not seem likely over the next few years. An increase in international buyers also generates benefits in the form of increased consumption; enhanced trading and investment relationships; and their contribution to the continued vibrancy of the London scene. They are also showing the way for domestic investment in new private renting, an important goal of current policy.

For these benefits to continue, the UK policy environment must remain welcoming to incomers and those who want to invest in the UK, as well as to domestic purchasers. This means ensuring that the visa process is fair and transparent and the experience of obtaining a visa and going through border controls is well organised.

It means making sure that London's attractiveness is not undermined particularly by poor transport links or safety and security problems. These issues affect the local population as much as incoming domestic purchasers and international buyers. It also means maintaining a flow of suitable properties by ensuring an appropriate pipeline – which will also help to generate significant numbers of affordable homes. Expanding new supply benefits the market as a whole – and helps to generate economic growth through its multiplier effects – not just in London but in the country as a whole.

Most importantly, British public policy needs to avoid surprises and to ensure that the legal and tax regime is as stable as is consistent with good government. This does not mean that higher-value homes or higher-income households should not be taxed; rather it means that particular groups should not be discriminated against because of who they are. Any changes that are made should be aimed at producing a well operating and fair legal and tax framework. The biggest problem at the present time is that the current system of property taxation does not achieve these goals. It needs to be changed in a sustainable and considered way.

Taxation priorities

If stability, predictability and fairness are to be a feature of the London property market, the government needs to reform domestic property taxation so potential buyers can easily understand and predict the tax regime they will face. In recent years, new Exchequer taxes have been added to the existing council tax on residential properties in an attempt to deliver a fairer system with additional revenues for the government. These new taxes have been introduced without proper warning and as the result of domestic political demands. They provide a partial and poorly focused approach to the more fundamental requirement for effective and equitable taxation of property values. Meanwhile, the 'mansion tax' debate continues.

The key challenge for the government in operating the system of property taxation is to avoid making sudden changes that risk accidentally damaging the market's ability to deliver new homes. As and when the government takes action it is important that changes do not have unintended consequences. Public and political opinion is rightly in favour of higher taxation on higher valued property. Some changes must be made – but they should be coherent, consistent and work well whatever the state of the housing market. Ideally they should also be acceptable to both Treasury and across political parties.

One approach to changing the property tax system in line with these criteria is set out in section 5. Others, for taxing wealth more generally or focusing on lifetime capital gains, for example – could also be developed. The objectives of a change in tax regime should be to create simplicity, coherence and transparency – as well as an adequate revenue stream. It would be in developers' interests to work with other stakeholders help to bring about a comprehensive review of property taxation to introduce a system that was clear and progressive – and which could be accepted by all political parties so that it could survive into the longer term. Perhaps there is a window of opportunity as parties draw up their manifestos for the next election?

A final overview

The London property market has proved resilient in the years since 2008, to a significant extent because of overseas buyers. In the short term, this buoyancy has been good for the economy and for the construction industry. But there are also challenges to be faced, mostly because there is a perception that foreign buyers push up rents and house prices.

It is very unlikely that there would be as much economic activity without purchases of property by overseas buyers even in the current environment. In the longer term there is no reason to see these purchasers as competing directly with domestic buyers for construction resources. London needs to ensure it remains an attractive place for inward investment if it is to continue to benefit from the economic boosts generated by such spending.

Fundamentally, longer-term stability must be based on expanding domestic demand and providing housing across all tenures and for all income groups. The government will need to take positive action on land supply, regulation and on many other fronts. The key to delivering continuing and growing investment in property is a stable and predictable legal, economic and tax environment.

In order to deliver the degree of policy security and consistency discussed in this report, the government should instigate a review of domestic property taxation. In doing so, it should be made clear that the purpose of such a review is to deliver security for occupiers, potential buyers, investors and developers. If sensitively undertaken, the government might even be able, in the longer term, to raise the tax yield. A fine balance needs to be achieved.

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