

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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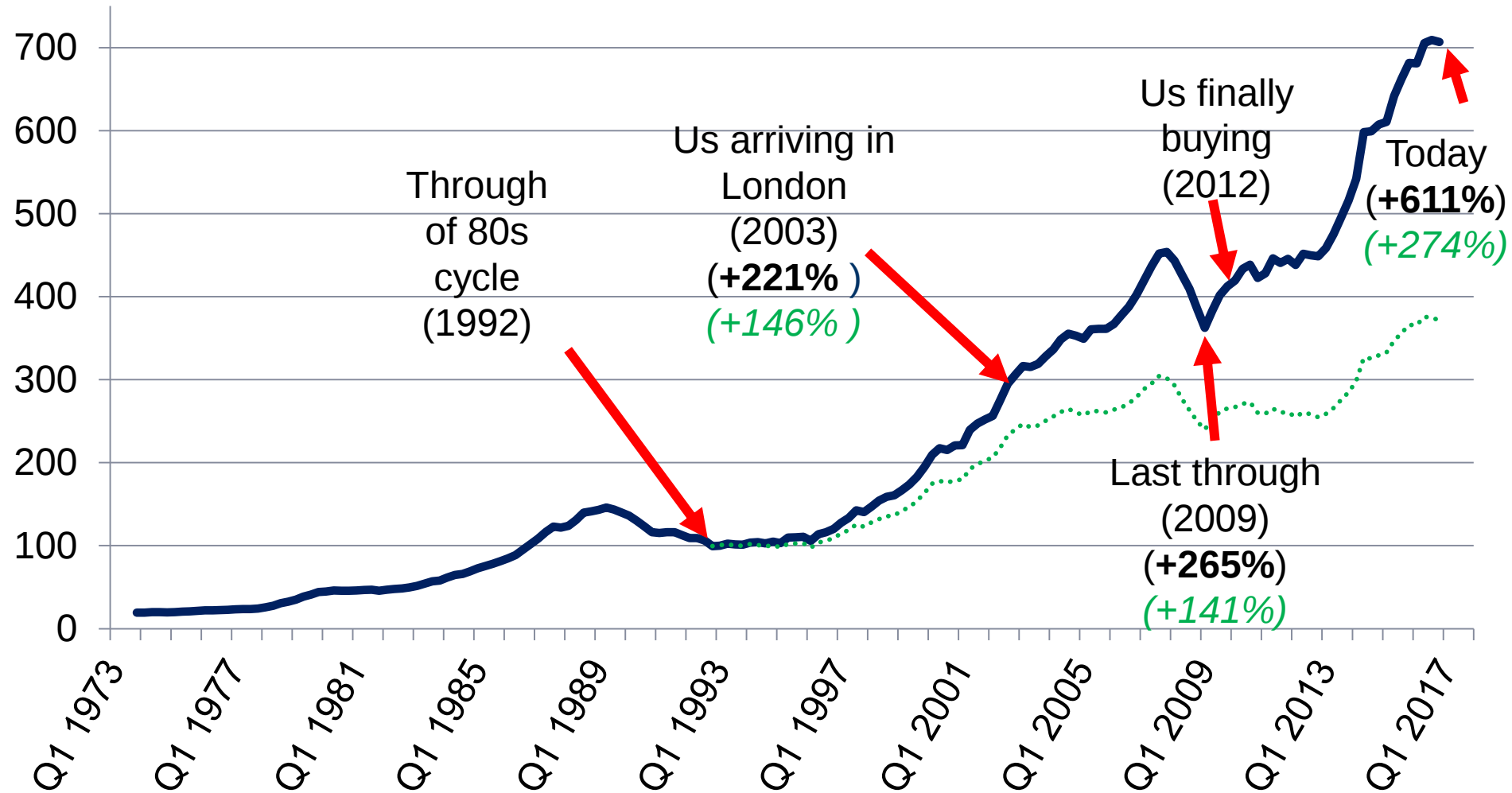
Inaugural Lecture

21 March 2017

Hong Kong Theatre, Clement House, LSE

On a personal note
(that relates to the topic)

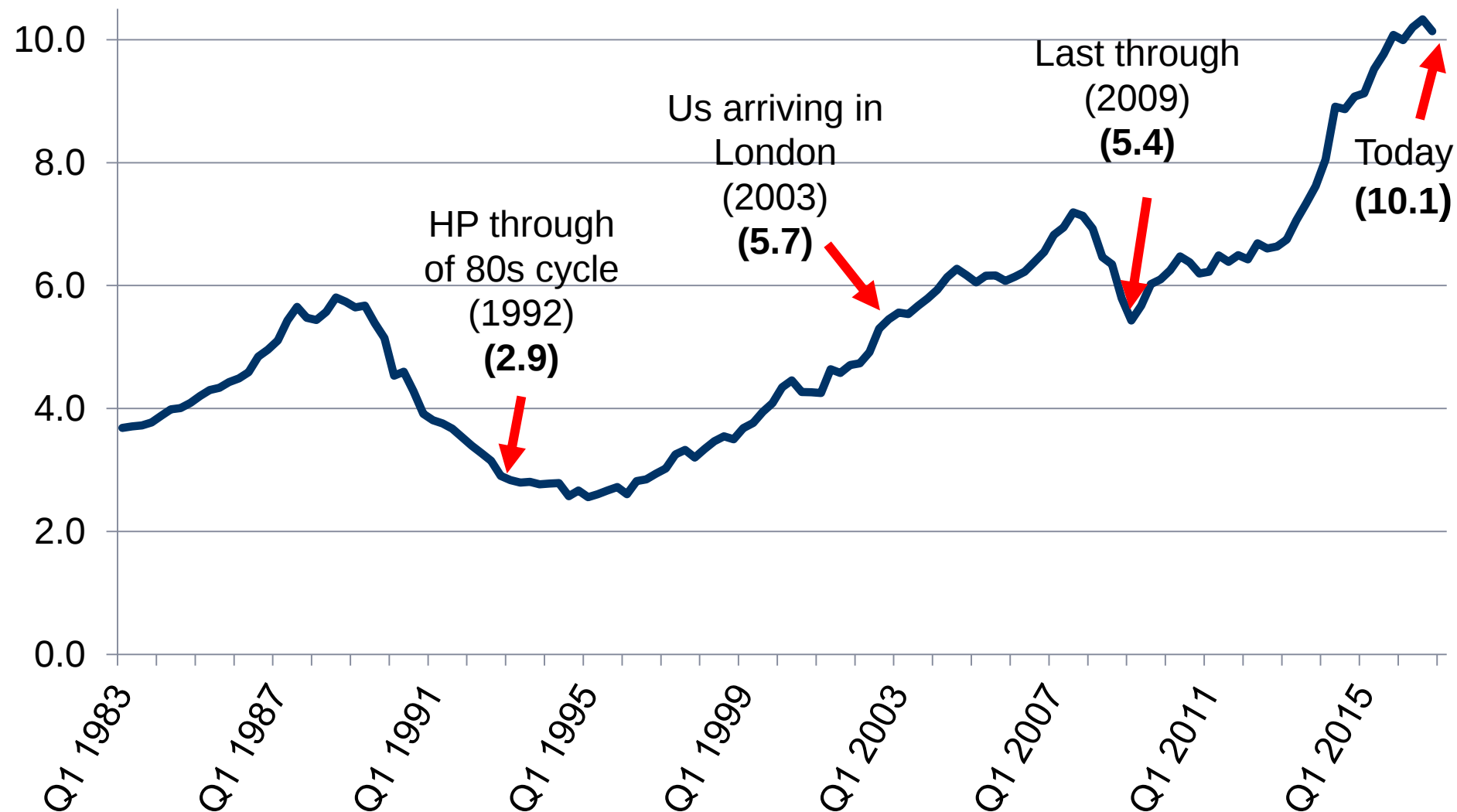
House price index for London



Source: Nationwide, price growth adj. for retail prices (base 1992q4)

What about house prices relative to earnings?

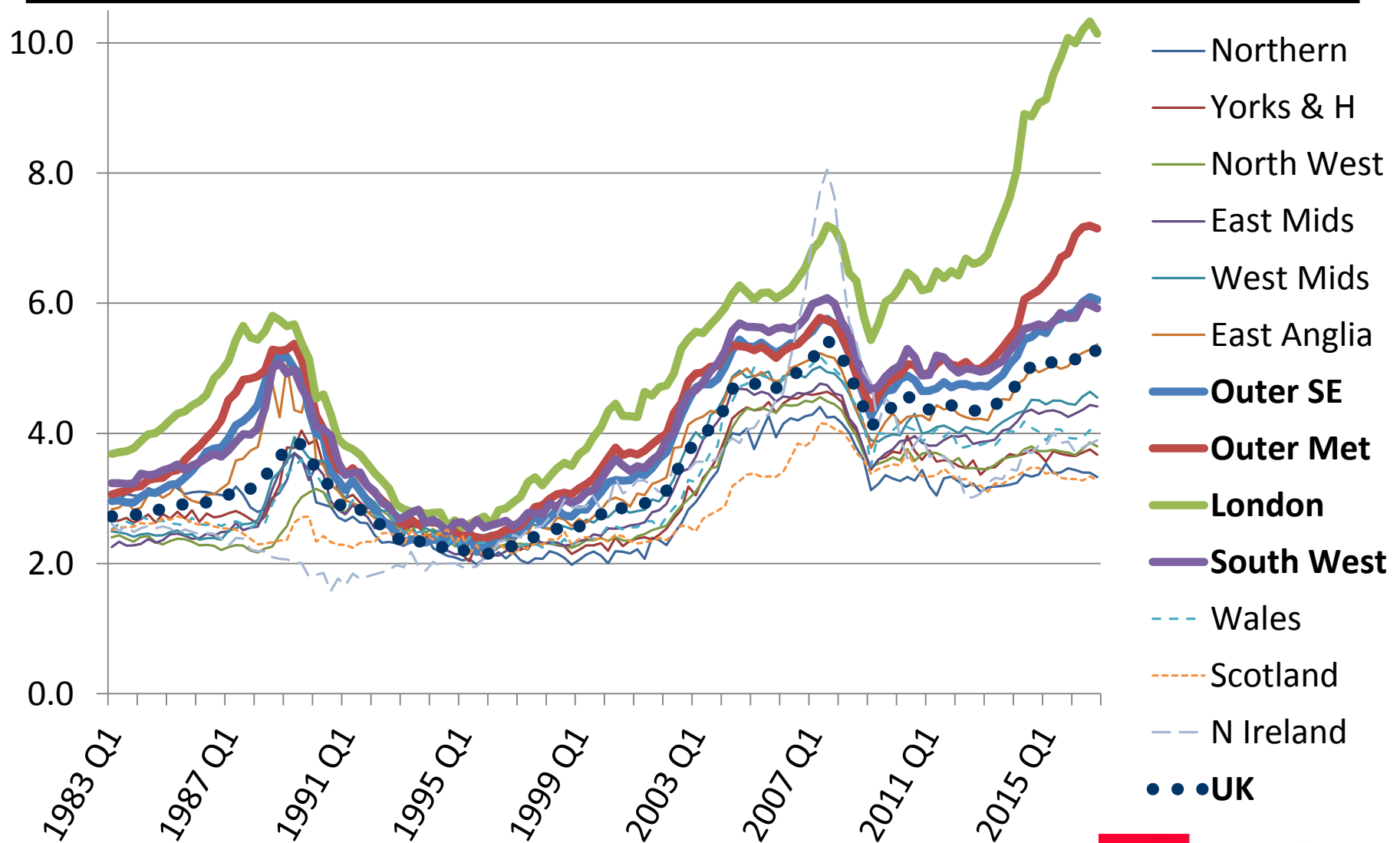
House price to earnings ratio for London



Source: Nationwide

Not just a London phenomenon...

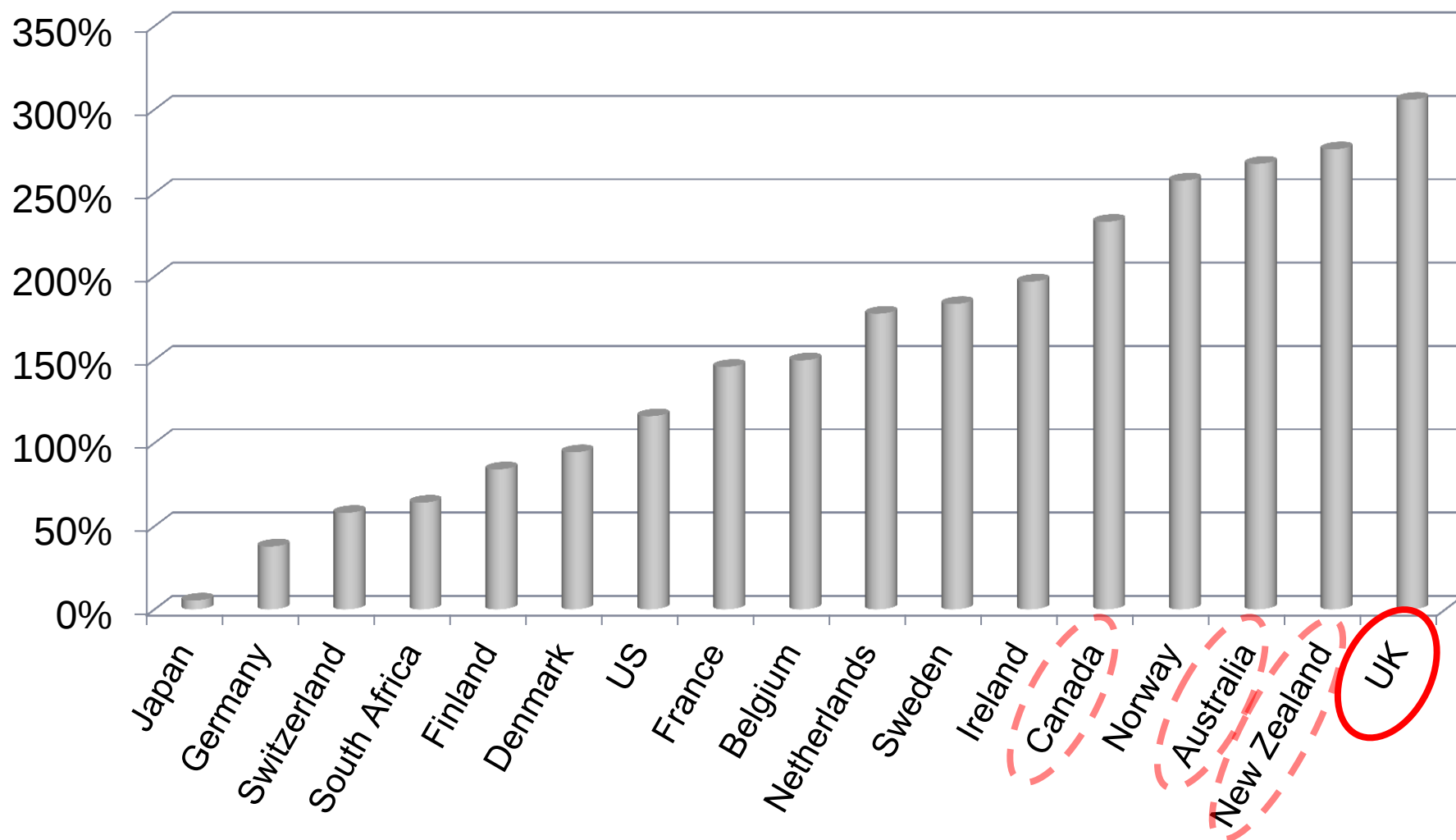
House price to earnings ratio, UK regions



Source: Nationwide

And in an international comparison?

(Real HP growth 1970-2015, selected OECD countries)

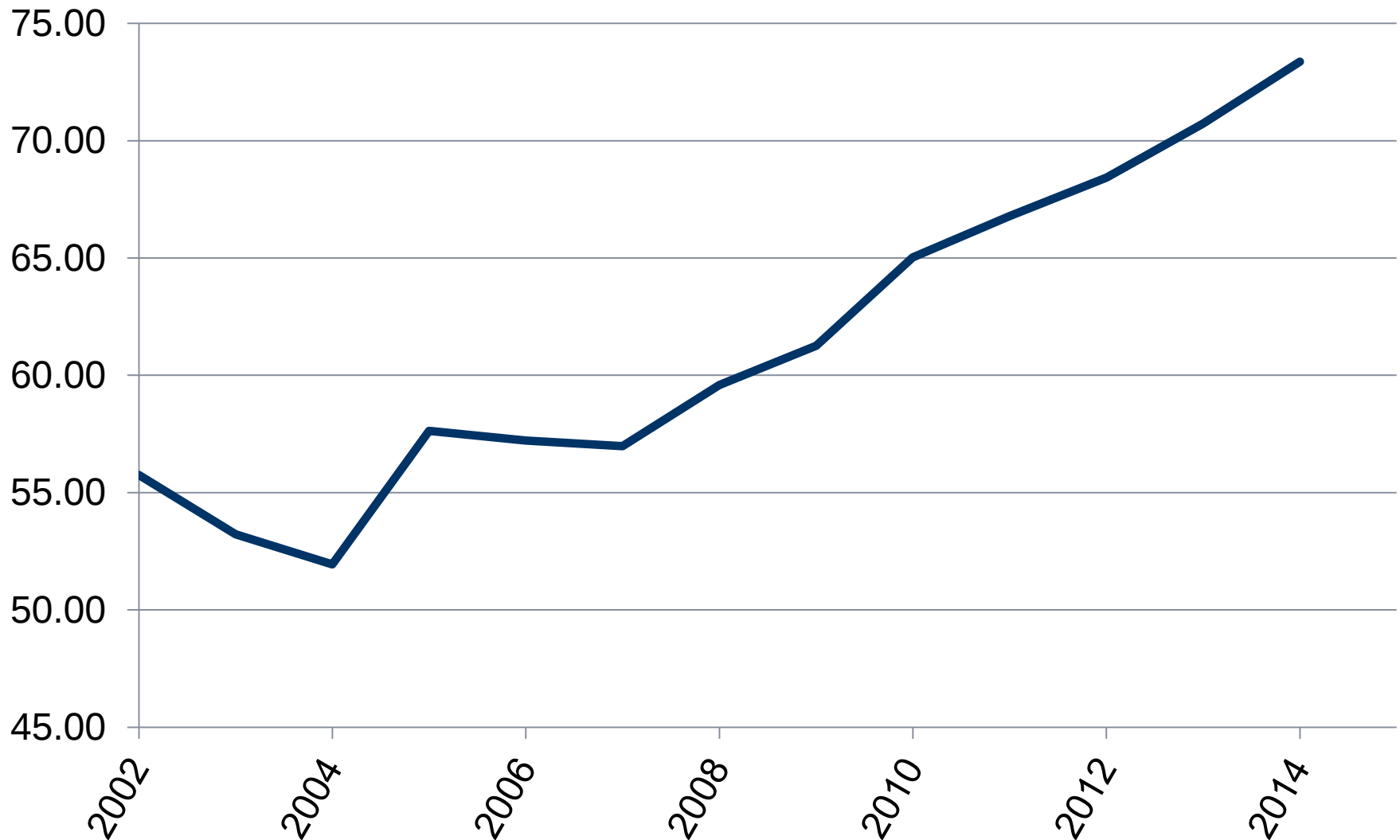


Sources: BIS, World Bank, Bank of England

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 10th percentile weekly pay, England



Sources: ONS and DCLG

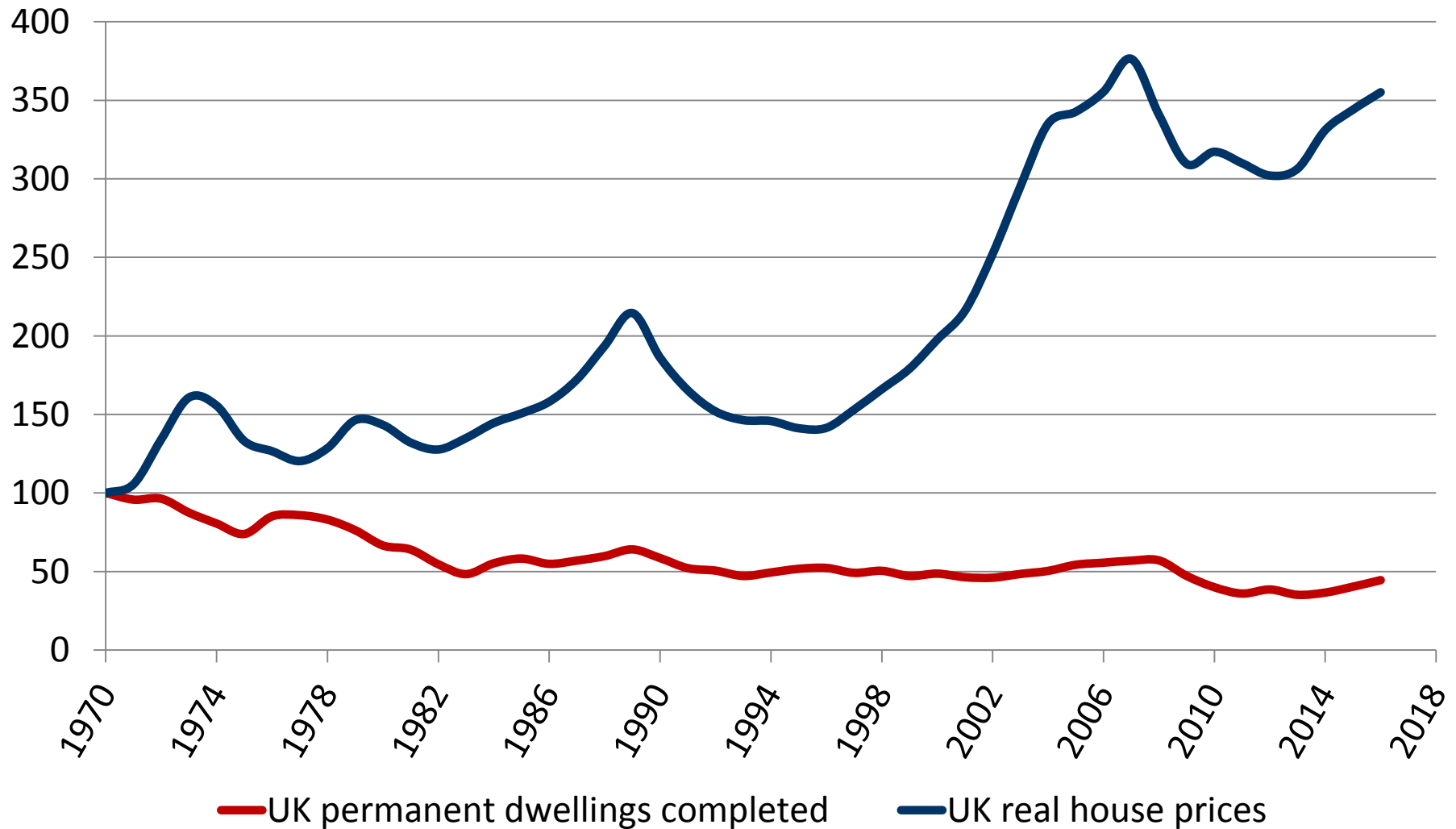
Opinion polls

- ⇒ **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)

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?

Percentage

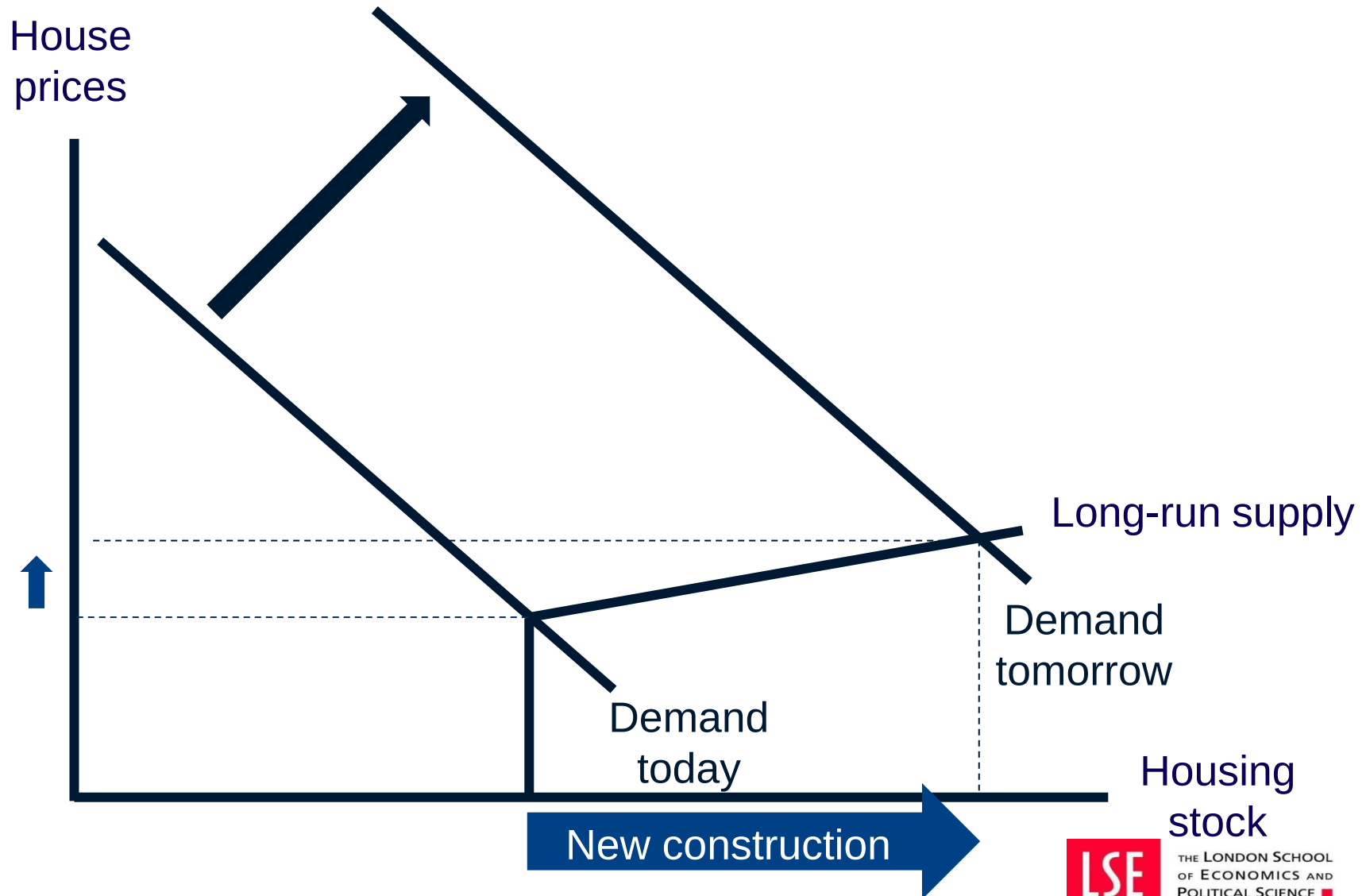


Source: The Guardian, 30 April 2016; Observer Graphic/Opinium Research

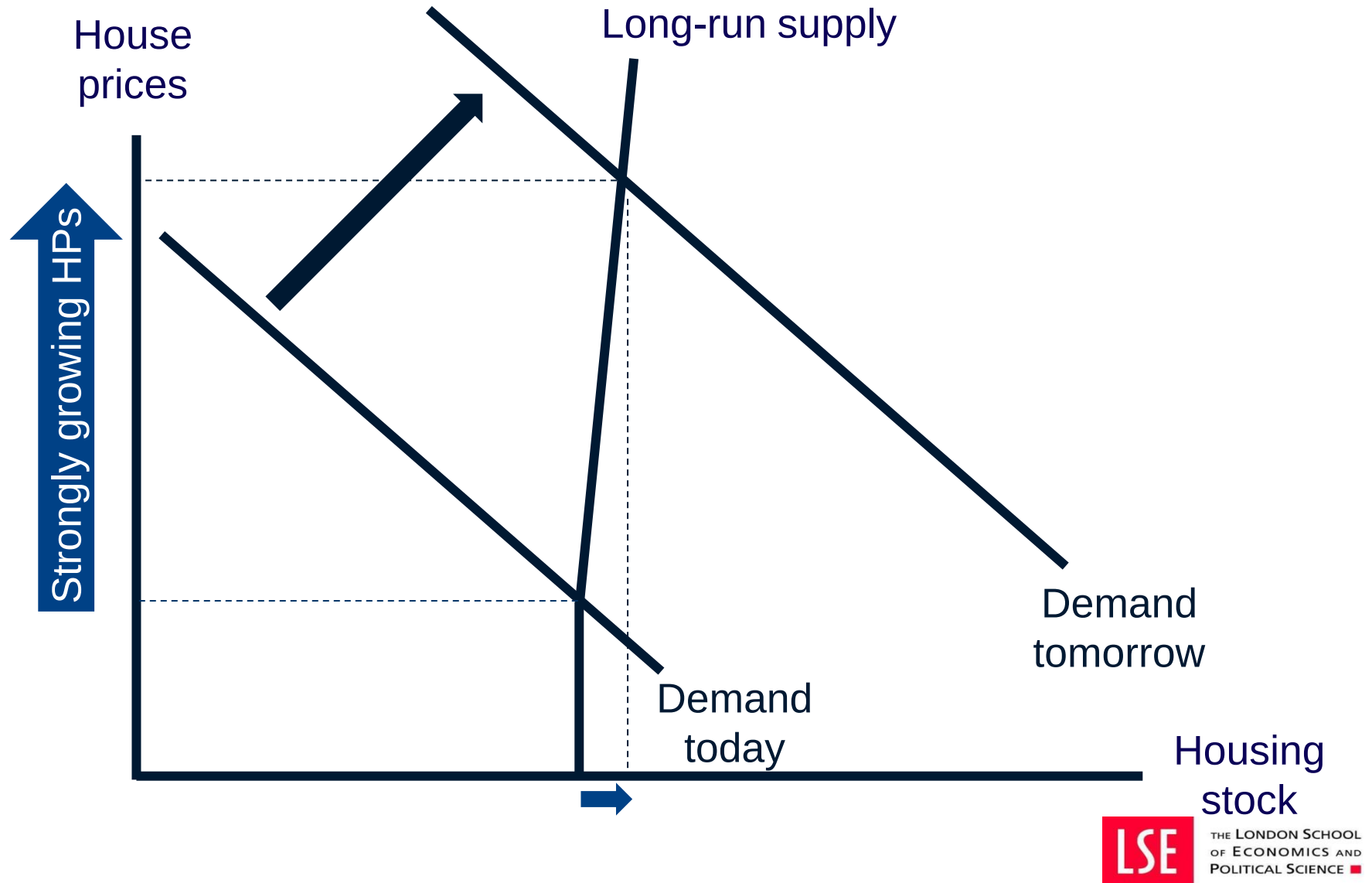
A proposition

- 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...**

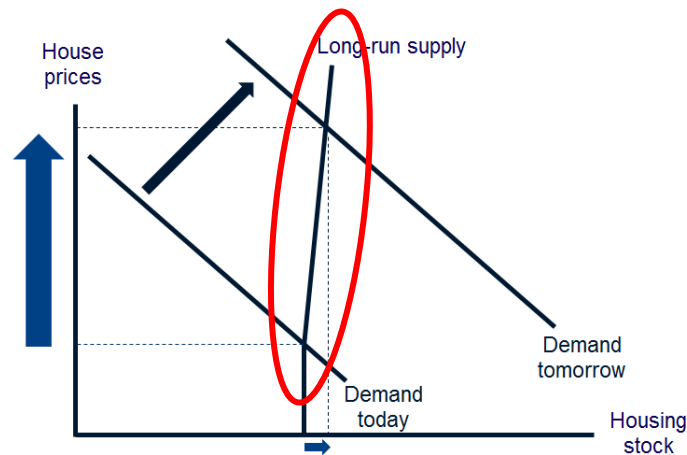
Economics 101: If long-run supply is responsive...



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'

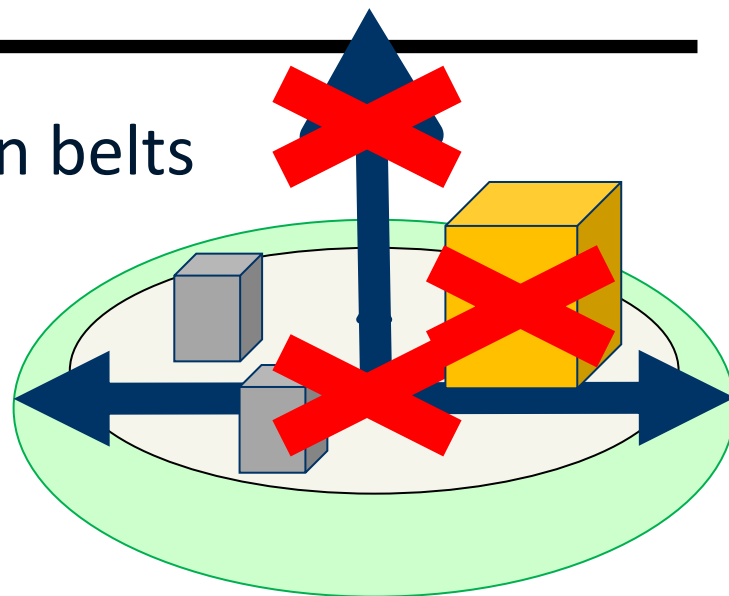
Regulatory constraints (*cont.*)

- 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

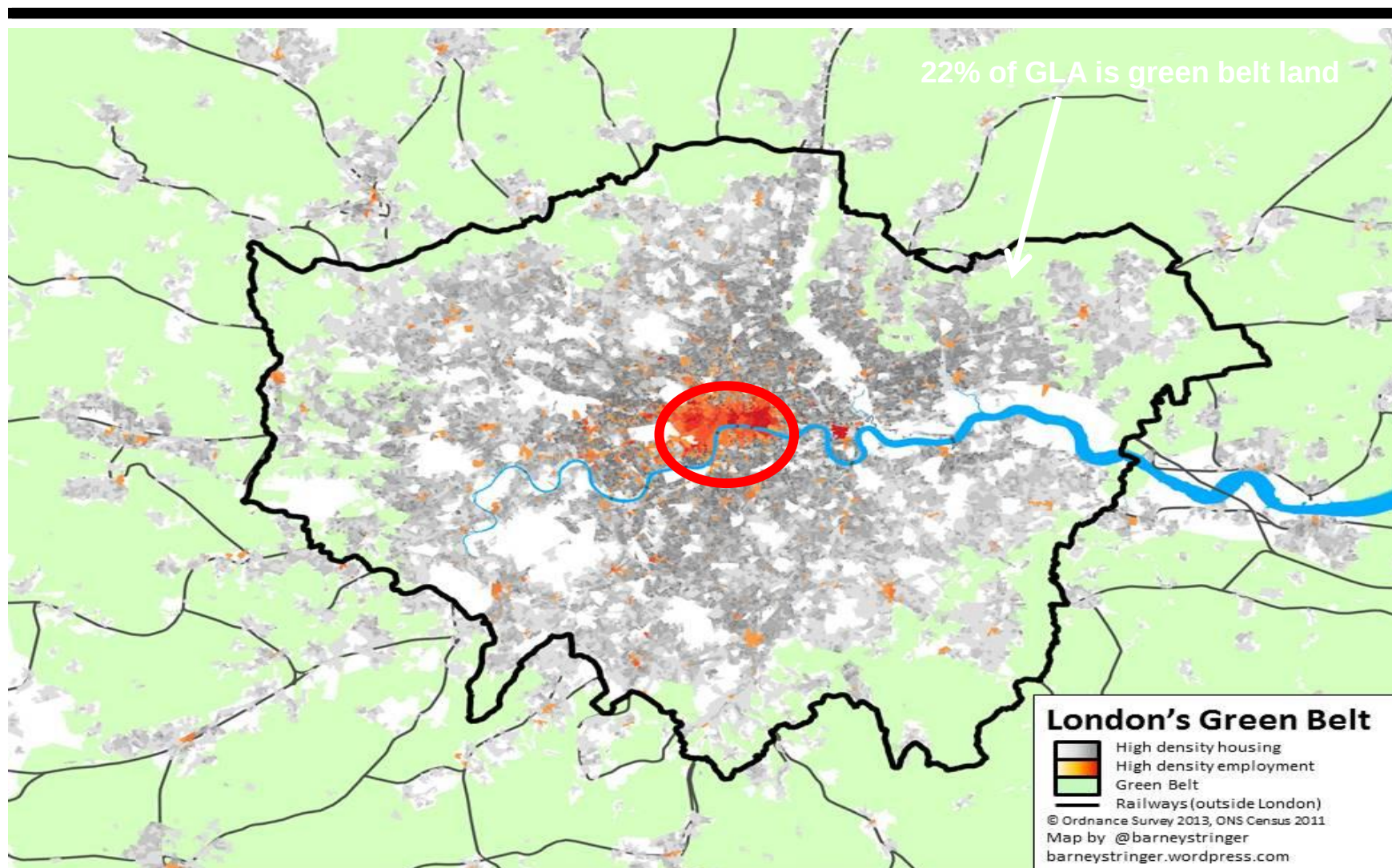


Types of regulatory constraints

- ‘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)



Source: Barney Stringer (Barney's blog)

Height restrictions, preservation policies & protected vistas



Source: Cheshire and Derricks (2014)

Some views absolutely worth protecting...

View from Assessment Point
13A.1 Millennium Bridge



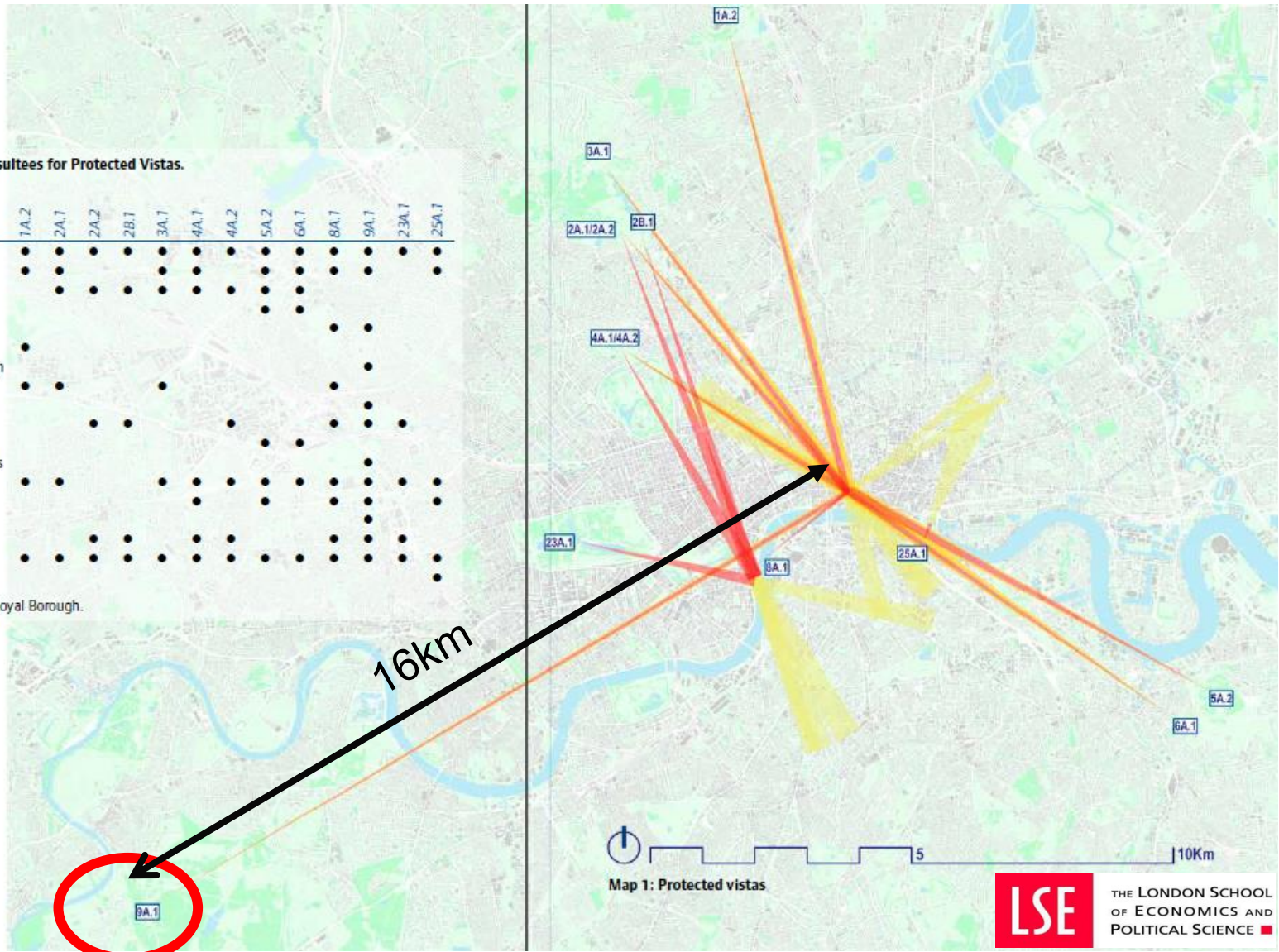
⇒ Huge benefits of view and (opportunity) costs are not very high...

Protected view from King Henry VIII' Mound (Richmond Park)

Table 2 – Statutory Consultees for Protected Vistas.

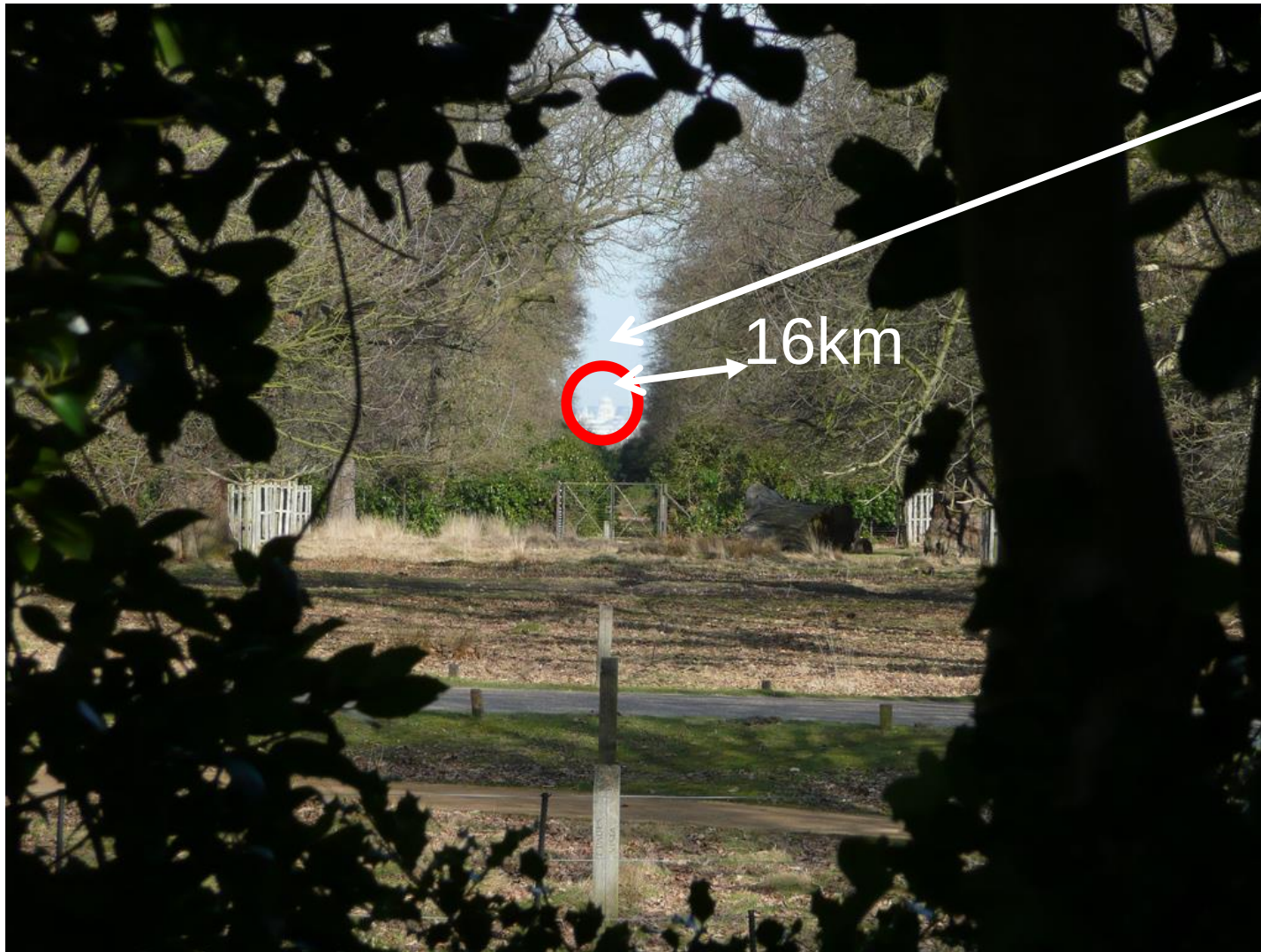
Viewing Location	1A.2	2A.1	2A.2	2B.1	3A.1	4A.1	4A.2	5A.2	6A.1	8A.1	9A.1	23A.1	25A.1
GLA	•	•	•	•	•	•	•	•	•	•	•	•	•
City of London	•	•	•	•	•	•	•	•	•	•	•	•	•
LB Camden		•	•	•	•	•	•	•	•				
LB Greenwich								•	•				
LB Hackney										•	•		
LB Haringey	•												
LB Hammersmith & Fulham											•		
LB Islington	•	•			•					•			
RB Kensington & Chelsea											•	•	
LB Lambeth			•	•			•					•	
LB Lewisham								•	•				
LB Richmond upon Thames												•	
LB Southwark	•	•				•	•	•	•			•	•
LB Tower Hamlets						•							•
LB Wandsworth													
City of Westminster	•	•	•	•	•	•	•	•	•	•	•	•	•
English Heritage	•	•	•	•	•	•	•	•	•	•	•	•	•
Historic Royal Palaces													•

LB London Borough; RB Royal Borough.



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)

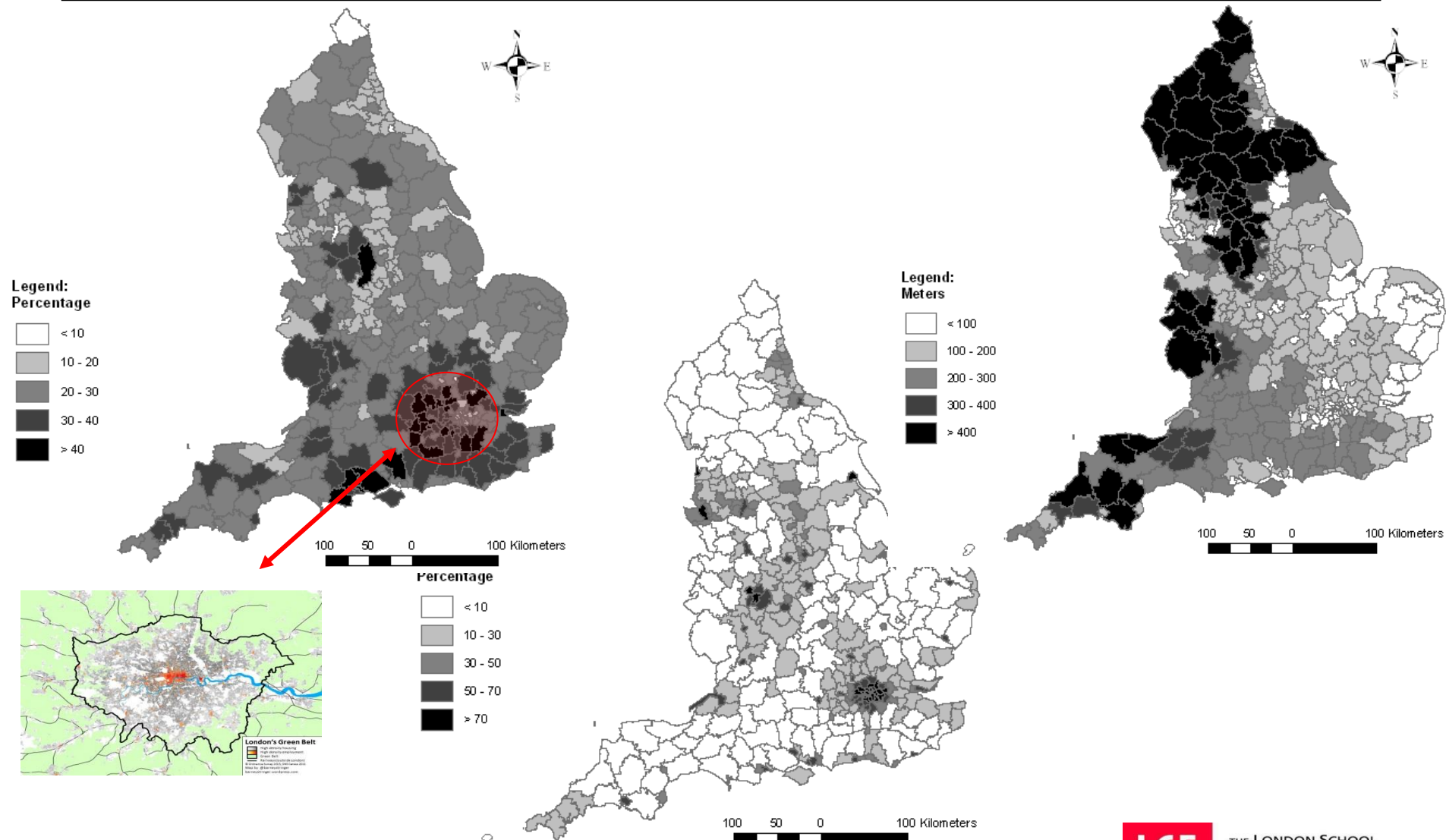
How to test in practice?

- 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



Source: Hilber and Vermeulen (2016)

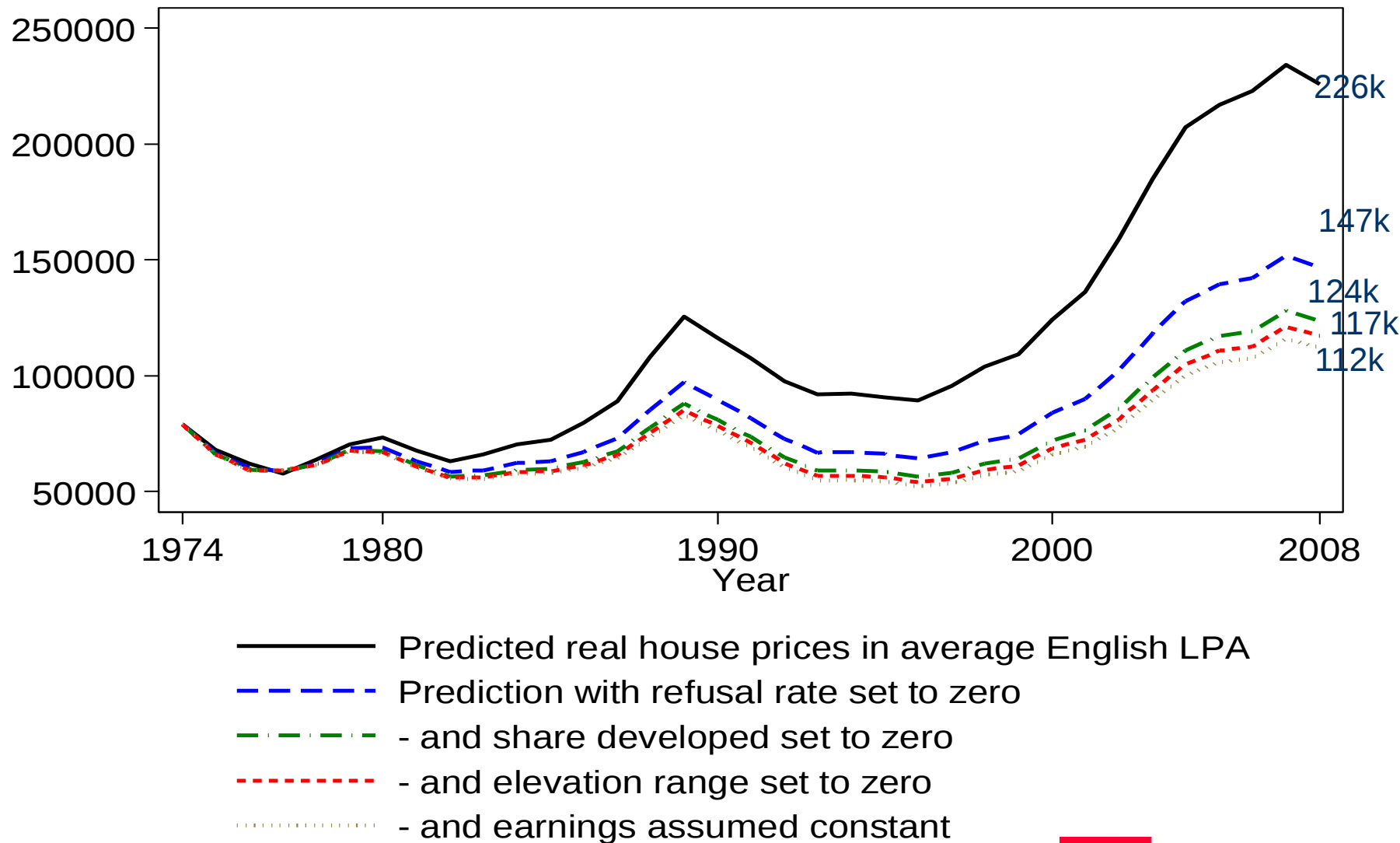
Main findings

- **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

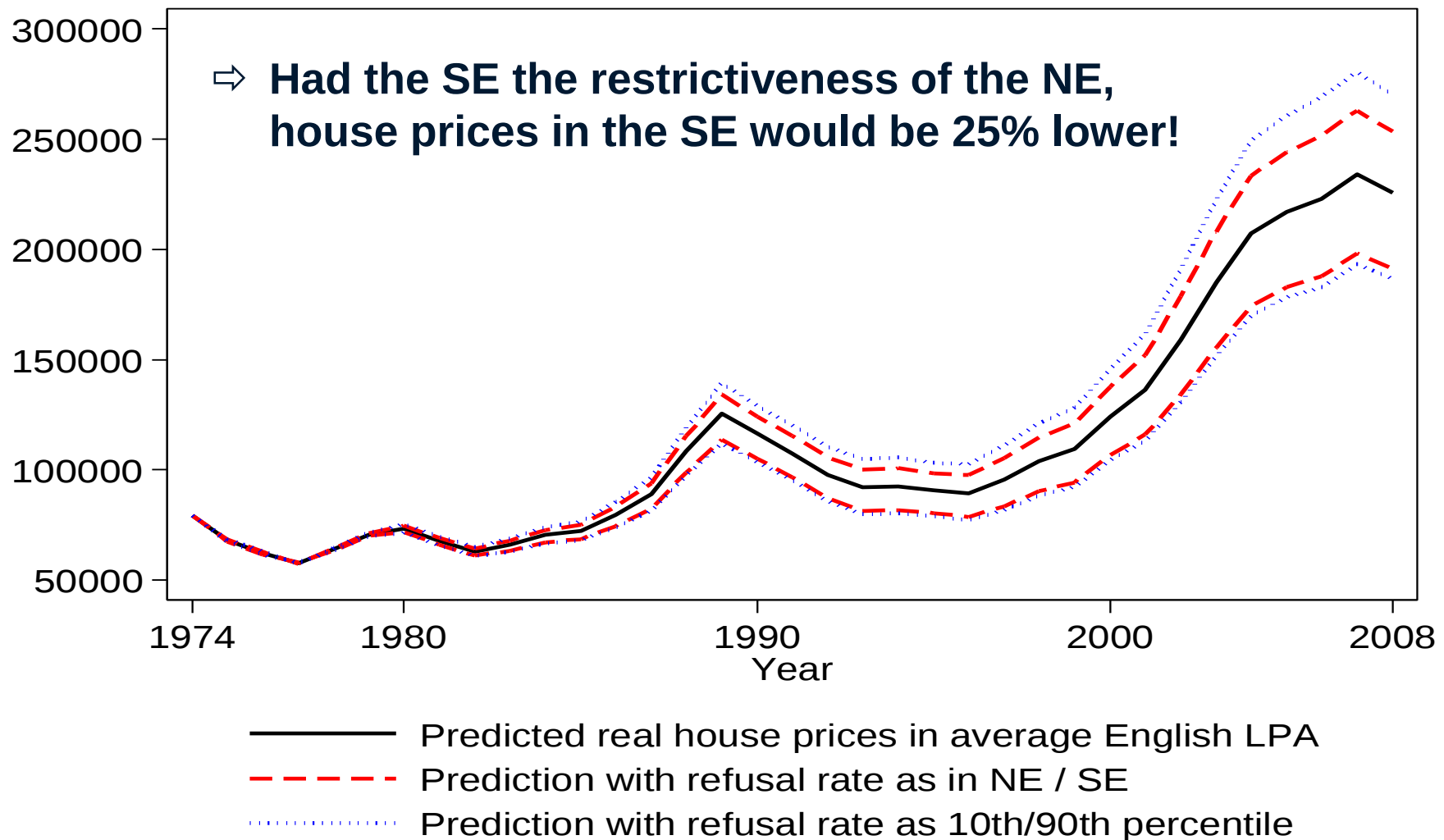
- If planning were completely relaxed in *av. LPA*:
 - ▶ House prices in *average LPA*: **-35%**
- *and* developable land were abundant:
 - ▶ House prices in *average LPA*: **another -10%**
- *and* *av. LPA* were completely flat:
 - ▶ House prices in *average LPA*: **another -3%**

What would house prices in average English LPA be if...



Source: Hilber and Vermeulen (2016)

North East vs. South East & 90th vs. 10th percentile



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

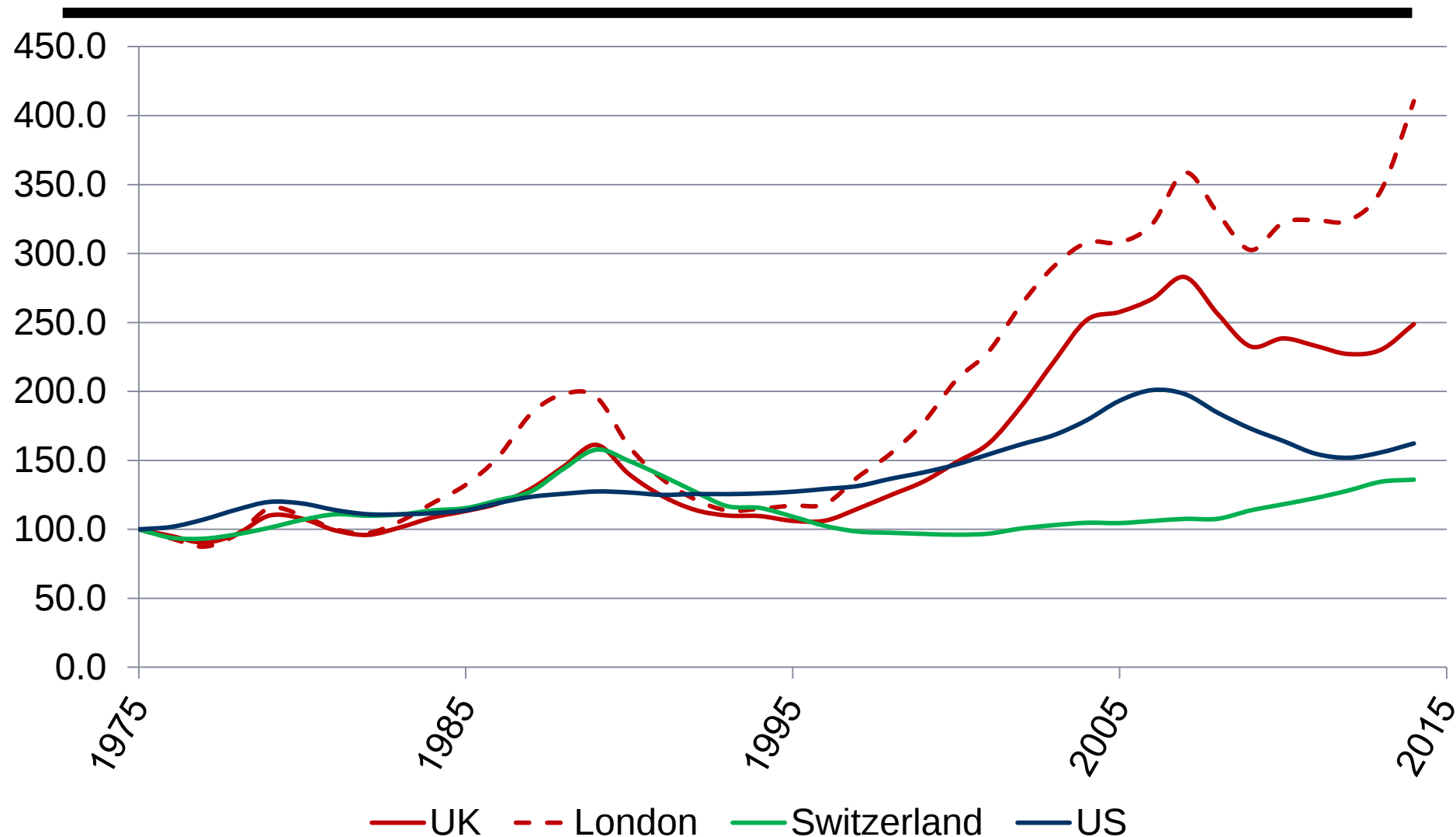
- Local authorities in UK have virtually **no fiscal incentives** to permit development
 - ▶ **Face** infrastructure & service **costs** + congestion, but **reap** very **little revenue**
 - ▶ Any additional revenue equalised away in medium-term through central government grant system
 - ▶ Strong incentives 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

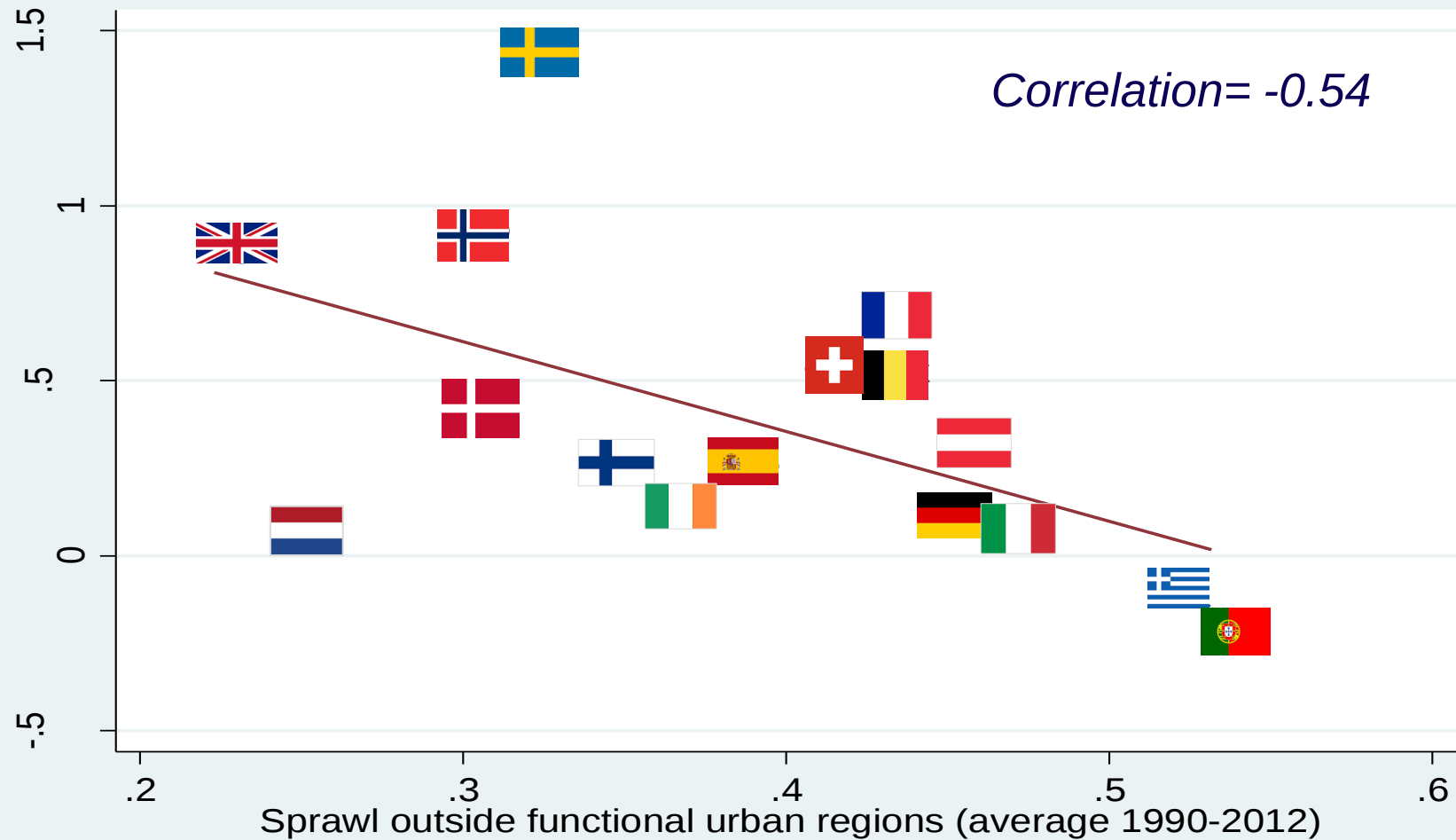
(Price indices; base year: 1975 = 100)



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)



Sources: Corine and OECD

Source: Ehrlich, Hilber and Schöni (2017)

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



Link to **rising** inequality

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**

News › London

Couples put off starting a family because they can't afford homes

It found that eight out of 10 are stuck in the rental sector because they cannot raise the huge deposits being demanded by banks – an

Source: Evening Standard, 18 October 2012

2. Liquidity constraints

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

🏠 > Money > Banking > Mortgages

I've got a £95,000 deposit at age 24, but can't buy a home

“Matthew and Ellie are in a very fortunate position with such a large deposit, however the challenge they are faced with, like so many first time buyers, is that their salary multiples and affordability aren't strong enough to buy properties in many areas in London.”

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

I wish you well at the polls ...

- 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

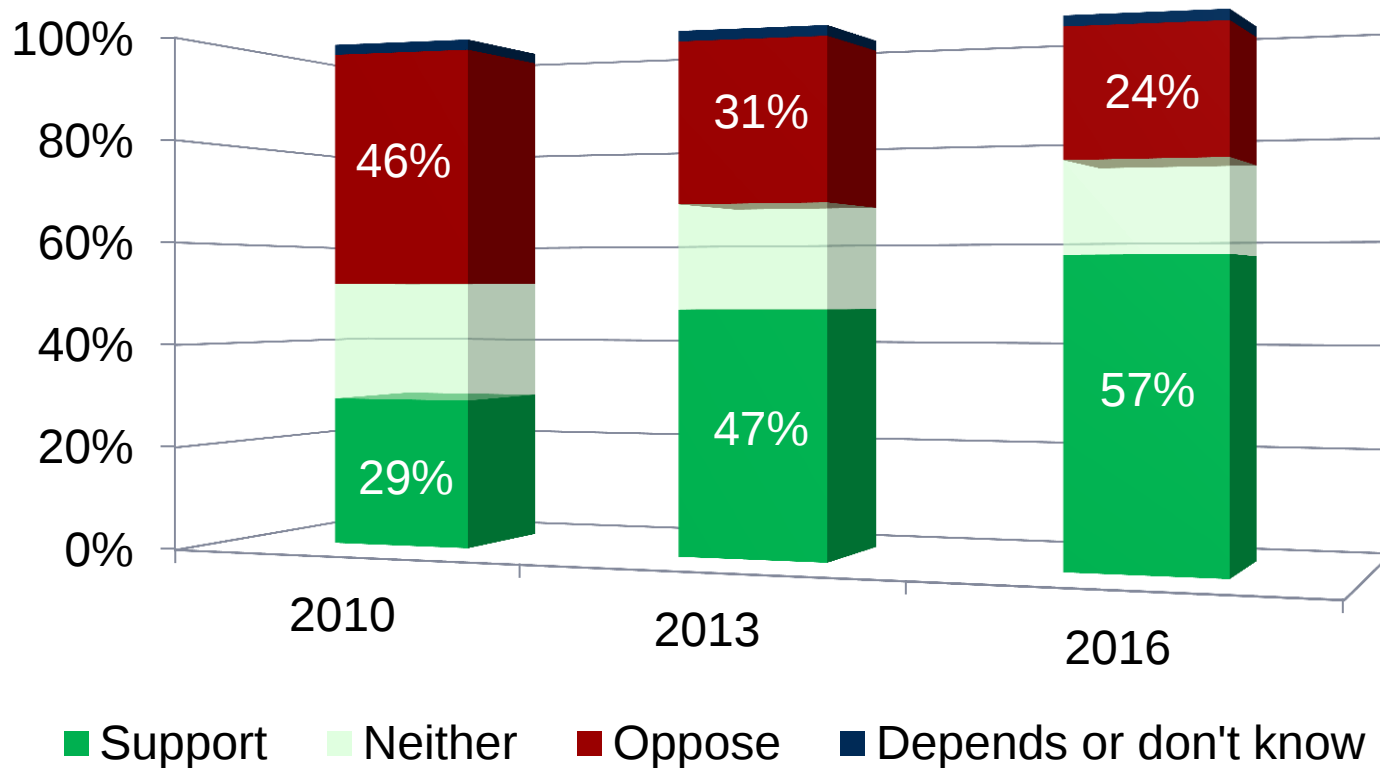


A glimmer of hope...

- 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

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