The UK's Broken Housing Market

Causes, Consequences and Cures

The Second Part of Policy Exchange's *Policy Programme for Prosperity*

Roger Bootle and James Vitali
With assistance from data researcher, Ben Sweetman
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Foreword

Rt Hon Ruth Kelly
Former Secretary of State for Communities and Local Government

In the first paper in Policy Exchange's Policy Programme for Prosperity series, Bootle and Vitali considered eight historical case studies of economic transformation to conclude that achieving economic transformation was just as much a political enterprise, as it was a purely economic one.

In this, the second paper of the series, Policy Exchange rightly argues that unlocking the housing market is the most important step in turning around Britain's economic fortunes and driving broad based prosperity. Solving the chronic undersupply of housing will benefit not just for the economy, but deliver health, environmental and social outcomes too . It is also one of the most important means of reducing the cost of living for low and middle earners.

Policy Exchange's paper could not be more timely, as the new Labour Government embarks on an ambitious set of reforms to get Britain building again. Policy Exchange's report offers a roadmap to the new Government on how to overcome the thorny political issues that many previous Governments have foundered on – with practical proposals on planning reform, tripling the New Homes Bonus to give local authorities an incentive to build, reforming Council Tax and Stamp Duty, and releasing public land on which to build homes.

One area of particular interest to our new Prime Minister will be the supply of genuinely affordable housing for those most in need. The recommendations in this paper could help in two important regards. Firstly, when it comes to private housing for rent or ownership, a move towards a less discretionary planning system, yielding a more abundant supply of housing, could help to deliver a sustainable increase in the delivery of new housing, and so in the longer term enable median earnings to close the gap with median house prices. Secondly, the authors' proposal for a new public land for housing programme would help expedite the building of new homes for social rent. Greater attention to beauty and design, as the report argues, could help guarantee that new social housing is integrated properly and attains the support of local communities.

The report also proposes thought-provoking changes to Council Tax and Stamp Duty., which could potentially be of interest to a Labour Government. The addition of two new Council Tax bands at the upper end – and one at the bottom – could, alongside updating the existing bands (currently based on 1991 values), make one of the UK's least equitable taxes more progressive. The paper also proposes two possible ways of tweaking Stamp Duty to encourage older people to downsize, with the aim for freeing up additional housing stock for families.

Policy Exchange has long been a leader in the field of housing and planning policy. It has been the incubator of innovative policies to free up the planning system, and has proved pivotal in moving aesthetics and beauty up the policy agenda. In this latest report, Policy Exchange shows why house-building must be front and centre in the new Government's plans for growth, and offers a credible plan to how it could be achieved. I trust that the Labour leadership will read its contents carefully.

Executive Summary

- The poor provision of housing in Britain is the result of the greatest failure of policy-making in the post-war period.
- This finds expression in recently low rates of owner-occupation (by British standards) and the struggles of the younger generation to be able to own their own homes. But it is also seen in the sky-high rents that people have to pay.
- The reason behind these problems is the inadequate rate of housebuilding. The main cause of this is the current planning and land use system which was put in place immediately after the Second World War. Reflecting the time of its inception, this planning regime is driven by "needs" as perceived by the planners, with scant regard to the message given by market prices. We would not accept such an approach in any other aspect of our economic lives. It should be abandoned.
- At base, our problem concerns the scarcity of land available for development, which is a direct consequence of our planning system. From this all things flow, including deteriorating affordability, our highly consolidated and uncompetitive housebuilding sector, and even the low design standards of much new housing development. Tinkering around the edges without dealing with the fundamental source of housing market dysfunction will see such distortions perpetuate.
- Not only has the consequent shortage of housing blighted millions of peoples' lives but it has also been a leading factor holding back the British economy.
- Major reform of the planning system that would both permit more housing to be built and enable more commercial and infrastructure development could add significantly to the UK's annual growth rate.
- These powerful truths have often before been grasped by many people, only for the message to disappear behind a smokescreen created by the interaction between widely held misconceptions and powerful vested interests.
- The most damaging of these misconceptions is the idea that house price inflation is a creator of national wealth. It is nothing of the sort. Rather, it is a massive redistributor of wealth and the peculiar workings of the housing market are probably the single greatest source of inequality in the country.

- The most powerful vested interests lie with the millions of home-owners who view their properties as their primary source of security and often their largest, or second largest, investment.
- The way out of this is a root and branch reform of the planning system. Outside protected areas, in a reformed, rules-based system there should be a presumption in favour of development. Much of the gain from development should be returned to the local communities that host it. This is the way to transform the default position of most local communities from opposition to new development into support for it.
- As far as possible, a reformed planning system should enable the development of brownfield land. But there also needs to be the release of under-used land owned by the public sector and some green belt land. Over the last fifty years, the amount of green belt land has more than doubled.
- Even privately owned property is not solely a private good. The appearance of property has a major bearing on other people in the community. It is important that an expanded programme of housebuilding upholds and enhances the aesthetic appearance of housing and that new builds fit in with the character and heritage of established communities. There does not need to be a conflict between building more and building beautiful.
- A key feature of the building scene over the last forty years has been the collapse of building by local authorities. It isn't necessary for these to re-enter the construction business in a big way but there is a need for more social housing. The finance for this should come from the extraction of the development gain from more land being approved for development, and local authorities should focus on land assembly to deliver new social housing. The delivery of new social housing should be expedited by local authorities by the strategic disposal of land, rather than loading increasing obligations onto private developers.
- Reforming the planning system in order to permit and encourage the construction of more homes is not an easy task politically as millions of home-owners would viscerally oppose it. Yet a properly crafted and managed process of reform and encouragement of more building would not undermine these peoples' wealth.
- But it would end the system under which this wealth perpetually increases, seemingly without limit, while poorer and younger members of society are left behind, forking out a huge part of their incomes in rent.
- This latter group constitutes a powerful constituency in favour of more housebuilding. Moreover, even the "haves" of the housing market are increasingly appalled by the way that the housing crisis blights the lives of the younger generation, often including their own children and grandchildren.
- It is high time that the housing market money-go-round came to a halt.

Policy Recommendations

In this paper we advocate that the government aims to make housing more affordable by gradually increasing supply so that the House Price to Earnings (HPE) ratio returns to approximately where it was in the years 1970 to 2000, when it averaged 4, compared to the current level of about 7. Thereafter, the aim should be to keep supply rising in line with demand so that housing affordability remains roughly constant at this lower level of the HPE. Once the market has settled at this lower level of the HPE, this implies house prices rising roughly in line with average earnings.

There is no silver bullet for achieving this objective. Rather, a suite of policy measures is required, which are sustained over a prolonged period of time. Nevertheless, increasing the abundance of developable land is the pre-requisite for solving dysfunction in the housing market, which is why we discuss planning reform first:

Planning Reform

1. In an ideal system, land use would be regulated, but not planned at all. As a result, land would be highly abundant, and usage would be dictated by market forces. Supply would be more elastic and respond efficiently to demand, and there would be far greater competition in the housebuilding sector due to lower entry barriers. This would be a profound alteration to planning this country, and so we believe a commission should be launched into the feasibility of implementing such a system. And in the here and now, there are other additional measures that ought to be taken to increase the abundance of land.
2. The Government should scrap the 1947 Town and Country Planning Act, introduce a new Planning Act, and redraft the National Planning Policy Framework (NPPF) to shift the UK to a new, rules-based planning system based on zoning with appropriate stipulations for mixed-use areas, conservation areas, and urban densities. All detailed planning should be stripped out of the system.
3. A pilot for these changes should be implemented via a Special Development Order (SDO) within city limits and their immediate environs, where housing demand is most acute. *This would amount to a scrapping of the 1947 regime on a limited basis in areas where the economic benefits would be most pronounced.*

4. Zones would be set out by Local Authorities in Local Plans, which would also be accompanied by a design code, devised by architects in consultation with local residents. So long as proposed development conformed to the Local Plan, the urban density stipulations, the design code and so on, it should not require further permissions.
5. The production of Local Plans should be incentivised by retaining the presumption in favour of sustainable development when an up-to-date plan is not in place, in addition to the financial incentives set out below.
6. Within this broad framework, the Government should encourage the maximum degree of flexibility and innovation at the local level in the delivery of new housing, so long as it is plan led. In areas zoned for development, communities should be encouraged to produce Neighbourhood Plans which will set the parameters of any new housebuilding. Community Land Auctions should be piloted by interested Local Authorities.
7. The Government should establish Development Corporations, particularly in strategically important urban centres. But the principle of a rules-based system, in which a higher degree of certainty is available for market participants than under the current regime, must undergird all of these potential delivery strategies.
8. For non-residential planning applications, the Government should introduce a new pathway for community ownership or benefit schemes in energy infrastructure like windfarms and solar farms. Developers willing to make a community ownership or benefit offer should be able to access a fast-tracked planning process based on a local referendum. Hospitals and prisons should be added to the list of projects eligible for the Nationally Significant Infrastructure Projects (NSIP) regime. New National Policy Statements (NPSs) on energy, prison and hospital infrastructure should be published to help safeguard legitimate planning applications from legal challenge.
9. The Government should complete the review into statutory consultees within the planning system initiated in December 2023. The NPPF should specify that a proportionate approach be taken when it comes to offsetting the impact of new homes. Nutrient Neutrality requirements, for example, ought to be amended so that Local Authorities can better take mitigation measures into account, such as upgrades for waste water treatment or schemes to reduce agricultural run-off in the area.

"Right to Build"

10. The Government should reform the 'Right to Build' register, requiring that local authorities supply enough serviced plots to meet self-build home applications within two years.
11. Custom and self-build homes could be made a material consideration in the NPPF, and they would be eligible for the New Homes Bonus discussed below.

Financial Incentives for Local Authorities

12. The New Homes Bonus should be augmented. For every £1 of new council tax revenue, the government should provide a £3 bonus. On top of this, there ought to be an extra £1 bonus if the new development conforms with an up-to-date local plan, as this will incentivise Local Authorities to put these in place and positively support the type of strategic development that can command legitimacy amongst local communities.

Developer Contributions

13. The current system of developer contributions should be replaced with a single, flat rate, locally set infrastructure levy, which would be levied on the final value of the completed development, rather than at the point of permission. It should be mandatory, and with very limited opt outs for social or affordable housing, self or custom builds, or home improvements. The Home Building Fund Infrastructure Loans, instead of being directed towards developers, should be targeted at local authorities, who apply for the funding. Local authorities should also be able to borrow against their infrastructure levy receipts in order to forward fund infrastructure in the future. Developer contribution receipts should be ring-fenced for infrastructure development and resourcing local planning departments.

Help to Buy

14. The Government should reallocate Help to Buy funding towards boosting housing supply. In particular, it should shift that funding towards resourcing local planning departments, so that Local Authorities are sufficiently well staffed – and that their staff have the requisite skills and training – to execute their role in the planning system expeditiously.

Public Land for Housing Programme

15. A new Public Land for Housing Programme should be launched, which requires government departments to transfer land to Homes England for new housing.
16. The programme should have a duty to maximise the delivery of new homes and should be assessed against three performance indicators: the total number of housing completions it supports; the housing capacity of the land unlocked; and the receipts generated by the disposals.
17. The Government should make it explicit in relevant strategic asset management plans that the programme should prioritise the delivery of new homes over receipts.

Green Belt

18. Green belt designations in the United Kingdom should be overhauled. Land of genuine environmental value within them could be categorised and protected as Areas of Outstanding Natural Beauty. Areas which do not meet this standard, and which are within a certain radius of existing transport infrastructure, could then be zoned as land for permitted development.

Tax Reform

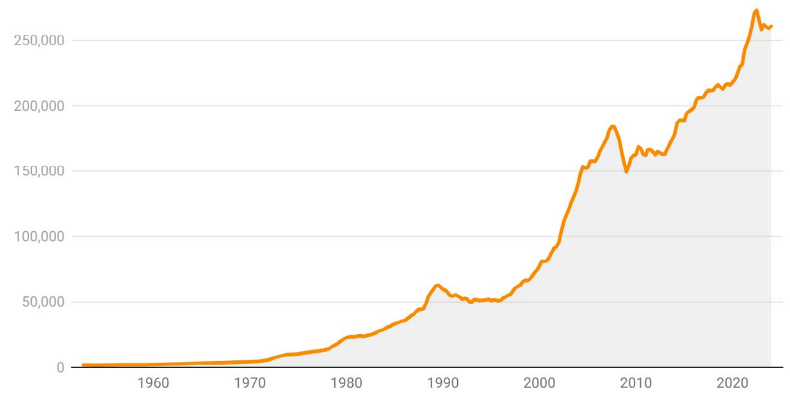
19. The nettle of Council Tax reform must be grasped. Two additional bands should be introduced at the top of the property value scale, and one should be introduced at the bottom, and a system of regularised property value assessments should be introduced. The rates of tax in the top bands should be increased.
20. Following the Government's decision to remove the Council Tax exemption on empty homes, the single person exemption should also be removed.
21. Some of the increased revenue could be retained by local authorities to fund local services, and a portion of it should be remitted to central government and used to finance targeted tax reductions on earned income, which we believe would be highly beneficial for economic incentives.
22. The Government's recent move to allow councils to levy double council tax on long-term empty properties should be retained.
23. A Stamp Duty exemption for last time buyers should be introduced. If people who benefited from this concession subsequently bought another property, then they would have to pay full duty on not only their new purchase but also the previous one which had carried the Stamp Duty concession.
24. Alternatively, an exemption from Stamp Duty could be introduced when a new primary residence costs no more than 80% of the amount realised by the sale of the old one.
25. To eliminate the tax disincentive for downsizing arising from the fact that money released from downsizing would be subject to Capital Gains Tax on new assets purchased whereas capital left in owner-occupied housing is not, a new tax wrapper should be introduced exempting assets acquired with money released by downsizing from the tax.
26. The income tax allowance on the "Rent a Room Scheme" should be increased from £7,500 to £10,000.

Introduction

1. Housing and wealth

For many British people, the housing market, and their stake in it as owner-occupiers, has been one of the few things about the British economy that has been unambiguously successful. After all, average house prices have risen pretty much relentlessly throughout their lives. Since 1952, on data from Nationwide, they have risen by almost 14,000%, giving an annual average increase of 7.5%. (See Chart 1.)

Chart 1: Average House Prices in the UK (£), 1952 - 2024

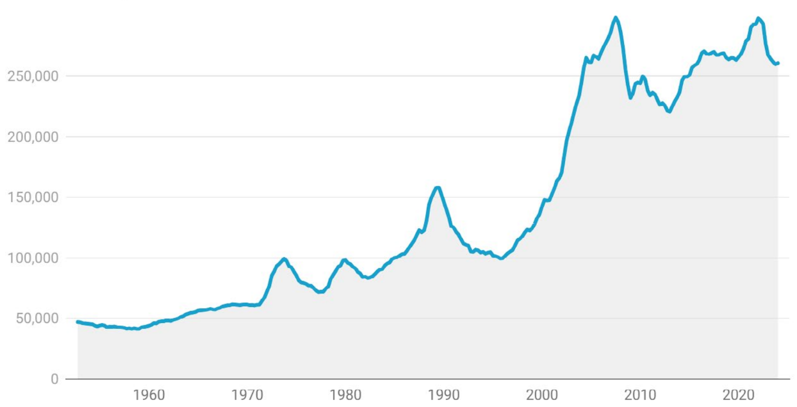


Source: Nationwide: 'UK House Prices Since 1952'.

Admittedly, much of this enormous increase reflects inflation. In real terms the increase has been just over 450%, giving an average annual increase of "only" 2.8%. (See Chart 2.) Even so, this average increase is pretty large.

Chart 2: Real Average House Prices in the UK (£), 1952 - 2024

Constant 2024 prices



Sources: Nationwide: 'UK House Prices Since 1952', ONS: 'CPI INDEX 00: ALL ITEMS 2015=100', Bank of England: 'A millennium of macroeconomic data'. Prices have been deflated using the Consumer Price Index.

Moreover, for owner-occupiers, neither the income return nor the capital gain has been taxed. The income return is the right to live in the property and enjoy its services. By contrast, you cannot live in an equity and there is no other comparable non-pecuniary reward that share-ownership confers.

Yet do these rewards enjoyed by owner-occupiers correspond to wealth creation for the country as a whole? When we learn that the real value of the average dwelling has doubled, for instance, does that mean that there has been a corresponding enrichment of the country?

It does not. The increase in real value is partly an illusion and partly a redistribution within society from those who do not own property to those who do.

To see this clearly, you have to look through the values expressed in money and delve into what is really going on. When a house price has doubled in real terms has there been a doubling in the quantity or quality of the services that this house provides? The answer is almost always "no".

Home improvements

Admittedly, over the years, there has been some improvement in the housing stock. Many properties have been extended, thereby increasing the number of rooms or increasing room size. Equally, the quality and sometimes the quantity of toilets, bathrooms and kitchens has been improved and more properties have benefited from the installation of double-glazing, central heating and, more recently, in a few cases, air conditioning or air cooling. To the extent that rising property prices reflect such improvements, then the increased value of housing does correspond to an underlying real improvement in wealth and welfare.

Mind you, changes in the size of properties have not been all in one direction. In order to squeeze more properties into a given amount of land, the average size of new build properties has been falling. Moreover, although over the last twenty odd years there has been a move to reunify many older houses that had been subdivided into flats, there have also been frequent moves in the opposite direction. (The house price indices do try to take account of changes in the amount of floor space but not the quality and quantity of housing services provided by a given house.)

Overall, it is difficult to believe that improvements in the quality and quantity of the services provided by the average property can justify more than a relatively minor increase in average real values, probably amounting to much less than 1% per annum.

Nor can the increase in real house prices be explained by an increase in the real cost of construction. There must be some other explanation.

Scarcity

It is not difficult to find that other explanation. Housing has become more expensive because of scarcity – demand exceeding supply. This is not to imply that there are fewer dwellings than there used to be. Very far from it. From 1983 to 2021, the net increase in the number of dwellings in the UK was over 34%.[1]

But this has not been enough in relation to increased demand. (We assess the relative role of increased demand versus inadequate supply in the following section.)

So, herein lies the illusion. Putting aside home improvements, rising real house prices confer no benefits for people in general. The same services are provided in the same quantity. It is just that the capital value of the asset that provides these services is higher because this asset is scarce in relation to the demand for it. That is not to deny, though, that some people are being made richer by the increase in house prices. We will come to that in a moment when we discuss inequality. But first we need to clarify the nature of the problem.

The dual nature of the housing problem

There are two distinct aspects to the problem of the UK housing market:

i. How expensive housing is per sq. ft, whether properties are owner-occupied or rented;
ii. The fall-off in owner-occupation and the concomitant increase in renting.

Failure no. (i) should make it clear that the failings of the UK housing market affect both owner-occupiers and renters. Putting things at their pithiest, there is an unsatisfied demand for living accommodation full stop. This is the primary failing of the housing market. As explained in later sections, this has had a profoundly adverse effect on the quality of people's lives.

We should be clear that most of the ill-effects resulting from (i) derive from the shortage of housing space itself. The high price of housing is the expression of this shortage rather than a fundamental factor in and of itself.

This distinction can be of great importance. After all, it would be possible to imagine measures to reduce the average price of property, for instance by imposing higher property taxes, that did not relieve the fundamental problem of housing shortage. (Admittedly, such measures might encourage more efficient use of space and they would have some other benefits in regard to the issues of inequality that we discuss below.)

Nevertheless, factors (i) and (ii) are related. The fact that housing is so expensive has forced many people into the rented sector. That is just as expensive and, on some measures, more expensive than buying with a mortgage.

You can see how expensive renting is by looking at the share of average disposable income taken up by rent. This has risen from under 34% in 2009 to about 40% now. The long-term average back to 1975 is just below 37%.

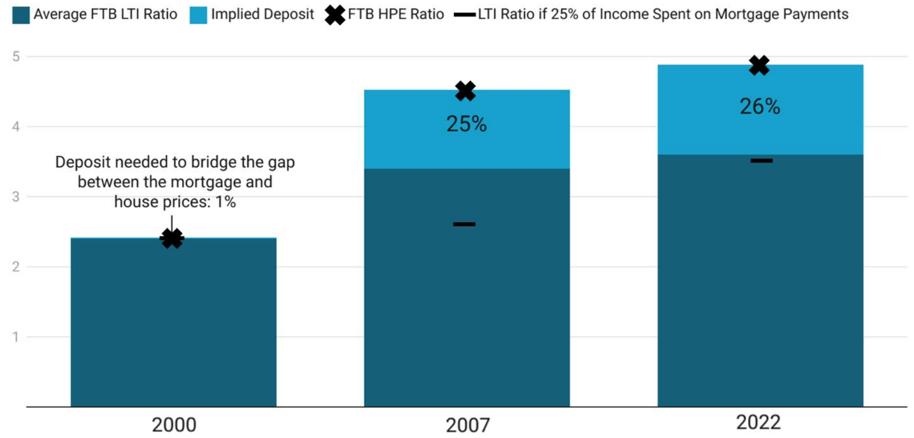
1. European Mortgage Federation, 'EUROPE'S MORTGAGE AND HOUSING MARKETS', 2023.

According to Paul Cheshire and Christian Hilber: "The average private rent in London is significantly more than half of the median gross earnings for full-time workers in the capital."[2]

At equal cost for renting and buying with a mortgage, given access to mortgage credit and the requisite deposit, most people would clearly prefer to buy and borrow as this gives the prospect of capital accumulation and eventual ownership of their home, plus greater security and control over their living arrangements.

But buying requires the ability to persuade a mortgage lender to lend to you and that requires a credit history/demonstrably stable incomes and reasonable prospects. It also requires access to a sizeable sum of money to serve as a deposit. Chart 3 shows how the size of a deposit required by the typical First Time Buyer has ballooned since 2000.

Chart 3: Deposits and Mortgages for First Time Buyers in 2000, 2007 and 2022



Sources: CML/UK Finance, ONS, Capital Economics. LTI ratio: Loan-to-income ratio. HPE ratio: House price-to-earnings ratio. FTB: first time buyer.

Assuming that they save a tenth of their gross income, in the early 1990s, First Time Buyers (FTBs) needed to save for just four years to amass a sufficient deposit to buy an average FTB home. In 2023 the equivalent figure was almost ten years.

Lower rates of owner-occupation

Compared to the primary failing, the falling rate of owner-occupation is of much less importance. Indeed, some people would say that the fall-off in rates of owner-occupation matters hardly at all. After all, Germany and Switzerland are both successful economies and they have always had a comparatively low rate of owner-occupation. In fact, you don't need to go back very far to find property ownership at very low levels in the UK. In 1918, three quarters of people in England and Wales rented their homes.[3] It was only after the Second World War that owner-occupation really took off. Why should we assume that now property ownership should be the norm?

As societies become richer, it is normal for them to have more assets in relation to income. In very poor societies, the only "asset" people have is their ability to earn income through selling their labour. So, it is

2. Cheshire and Hilber, 'Housing and planning', Centre for Economic Performance, p2, 2024.
3. Schroders, 'What 175 years of data tell us about house price affordability in the UK', 2023.

perfectly reasonable to see rates of home-ownership increasing as society has become richer.

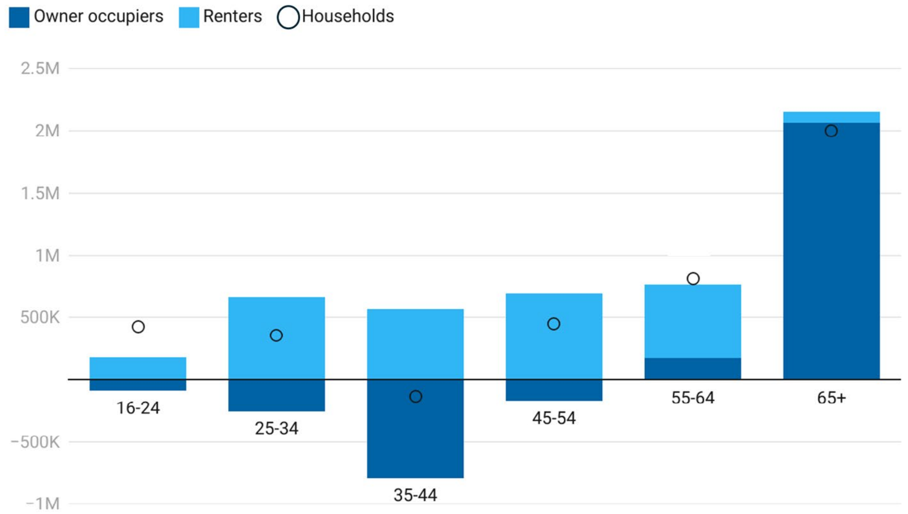
Moreover, other things equal, it is generally in society's best interests that this should happen. Owning their own home gives citizens a greater sense of security and belonging – a real stake in the economy and wider society. Indeed, some writers see widespread home-ownership as central to the effective working of democracy – and even to its very survival. [4]

Furthermore, given the financial structure and the history of the British economy, buying a property with a mortgage has been an attractive form of wealth accumulation. With repayment mortgages (which currently account for the majority of outstanding mortgages), this is a form of forced saving.

In addition, as we have just noted, housing assets have risen substantially in value in real terms and, for owner-occupiers, this increase has not been taxed (save, partially, for Stamp Duty Land Tax.) And housing is just about the only asset against which it is possible for the average person to borrow large amounts of money, thereby "gearing up" their initial capital investment.

There is a major generational aspect to falling rates of home ownership. The fall-off has been particularly acute among younger age groups. (See Chart 4.) This has had a major impact on family formation and the birth rate, as discussed in section 10 below.

Chart 4: The Increase in Owner-Occupiers and Renters from 2003 to 2022



Sources: ONS: population projections, DLUHC: English Housing Survey, Capital Economics calculations.

It is unsurprising, therefore, that opinion surveys regularly report that about 80% of people want to own their own home. This does not necessarily mean, however, that the government should expect, let alone target, an 80% rate of owner-occupation. There are stages of a person's life when owner-occupation is not an attractive or sensible option and when renting, if only for a period, makes more sense.

4. Vitali, 'The Property Owning Democracy', Policy Exchange, 2023a.

While accepting that a low rate of owner-occupation is itself a problem, we must not fall into the trap of believing that it is the only problem with the housing market. It would be perfectly possible to imagine public policy measures that address the second failing – namely low rates of owner-occupation – without doing anything about the first. The re-introduction of tax deductibility of mortgage interest payments for owner-occupiers would be one such measure. But not only would this have damaging side-effects and reinforce the tendency towards rising property prices, but it would do nothing to address the first failing.

Equally, it is possible to imagine a policy regime that resulted in more living accommodation per capita but which did not involve a higher rate of owner-occupation.

So, it is important to address both aspects of the housing market's failure. They are connected through the huge rise in real house prices. What's more, as we argue in the concluding part of this report, they are amenable to the same solution, namely increased housing supply, leading to more affordable accommodation for both owner-occupiers and renters alike.

What explains the huge rise in house prices is a subject of some controversy – which we confront head on in the next section. First, though, we must establish the facts about the UK's housing market and how it compares with markets abroad.

2. Getting the measure of the housing market

House prices

The UK's spectacular increase in real house prices over the last six decades is not unique, but the UK comes out very near the top of a table of developed countries. Between 1970 and 2023, real house prices in the UK increased by 412%. This was behind New Zealand on 461%. The next two countries were also part of the Anglo-sphere – Canada on 368% and Australia on 353%. Interestingly, these three Commonwealth countries all have planning systems modelled on the UK, with extensive green belts. [5]

The United States experienced a much lower rate of increase – some 173%. France was a bit lower at 171%. Below that there are some really strikingly low figures: Switzerland on 93%, Italy on 48%, and Germany on 15%.

It is a similar picture over a more recent time period. Over the last 25 years, some European countries have experienced very low rates of real house price growth. Whereas the average annual figure for the UK is 3.8%, the figure for Finland was 0.8%, with Germany at 0.7% and Italy at 0.3%.[6]

Germany is especially interesting because it underwent a dramatic change when the country was reunified in 1990. The average annual change in real house prices in West Germany from 1970 to 1989 was minus 0.1%. After reunification, for Germany as a whole the figure for 1990 to 2023 was higher – 0.5%.

Over the last 25 years, the Asian city states of Hong Kong and Singapore have experienced increases in the real price of residential property not too

5. OECD, 'Land-use Planning Systems in the OECD', 2017.
6. OECD, 'Analytical house prices indicators', 2024.

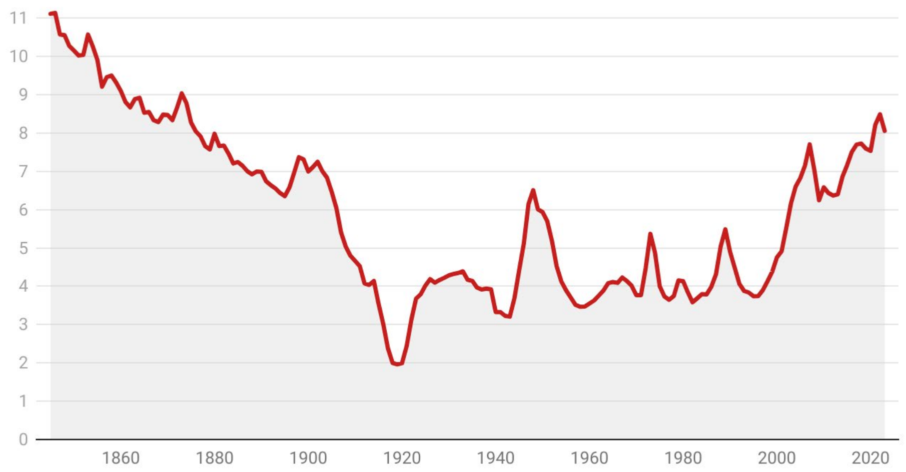
dissimilar from the UK's experience – average annual increases of 2.7% in Singapore and 4.1% in Hong Kong.

Rapid growth of house prices in the UK is a post Second World War phenomenon. We have data back to 1845.[7] From this start date to 1910, the change in average nominal house prices was -21.6%. From 1845 to 1940, nominal prices increased by a cumulative 61.2% but this still equates to an average annual rate of increase of only 0.6%.

Recent rapid growth of house prices in the UK has made housing less affordable. One of the best gauges of this is the ratio of average house prices to average earnings, the HPE ratio. Chart 5 shows a measure of this ratio going back to 1845. Three points stand out:

- The HPE ratio recently reached the highest level since the beginning of the twentieth century.
- Housing was even more expensive in the second half of the 19th century. The HPE ratio was over 11 in 1845.
- There was a dramatic fall in the HPE ratio over the second half of that century thanks to a doubling in the stock of houses, a reduction in the average size of houses and a sharp increase in average earnings.

Chart 5: UK house prices as a multiple of average earnings, 1845 - 2023



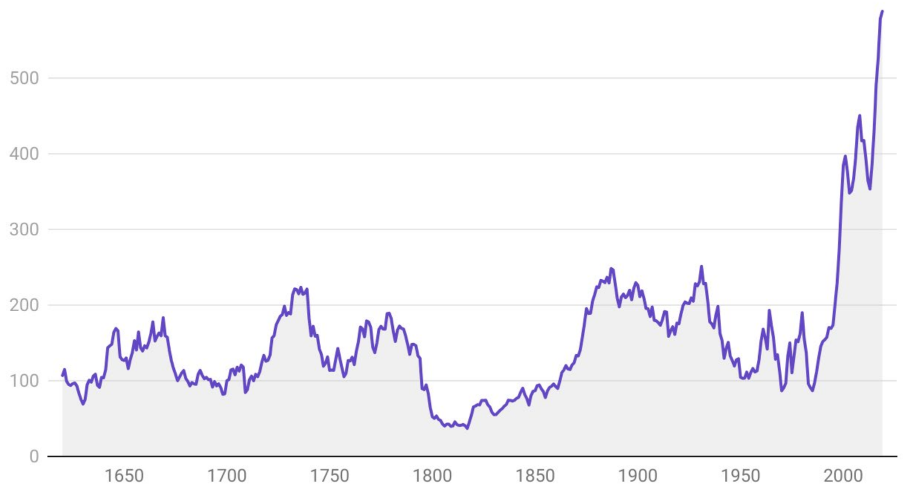
Sources: Bank of England: 'A millennium of macroeconomic data', Land Registry: 'UK House Price Index', ONS: 'Annual Survey of Hours and Earnings time series of selected estimates'.

For anyone tempted to think that substantial increases in real house prices are inevitable, there is a fascinating series on house prices in Amsterdam going back to 1620. Chart 6 shows that the level of real house prices was about the same in 1950 as it had been in 1620 and was again back to this level or a little lower as late as 1986.[8]

7. Bank of England, 'A millennium of macroeconomic data', 2016.
8. Korevaar, Eichholtz and Francke, 'Dure Huizen Maar Geen Zeepbel in Amsterdam', Economisch Statistische Berichten 106 (4793), 32-34, 2021.

Chart 6: Real House Prices in Amsterdam, 1620-2019

Base year 1700



Source: Korevaar, M., Eichholtz, P., & Francke, M. (2021), Dure Huizen Maar Geen Zeepbel in Amsterdam. Economisch Statistische Berichten 106 (4793), 32-34.

Land prices, property size and housing density.

The huge rise in property prices in the UK has been exceeded by some spectacular increases in the price of land. Getting accurate data on land prices is difficult but there is enough information for us to be able to draw a clear picture of the salient features. In the 1930s, the cost of land accounted for less than 5% of the cost of houses. In the 1960s the figure was about 10%; in the 1970s about 20%; and in the late 1990s about 40%. [9]A paper published by Policy Exchange in 2013 estimated that the figure had increased to 55%.[10]

Reflecting the high price of land, British homes are among the most expensive in the world. The average price of a British home is £351 per square foot. This compares with £236 in Germany, £218 in Canada, £212 in France, £208 in Australia, £141 in Spain and £126 in the United States. So, on these figures, UK housing is about three times the price of housing in the US.[11]

Unsurprisingly, the soaring cost of land has had implications for the size of properties built in the UK. According to analysis commissioned by property technology firm Moverly, on average, new UK homes are some of the smallest in the world. Of the 20 countries surveyed, only China (646 square feet), Russia (614), India (504) and Hong Kong (484) were smaller. [12]

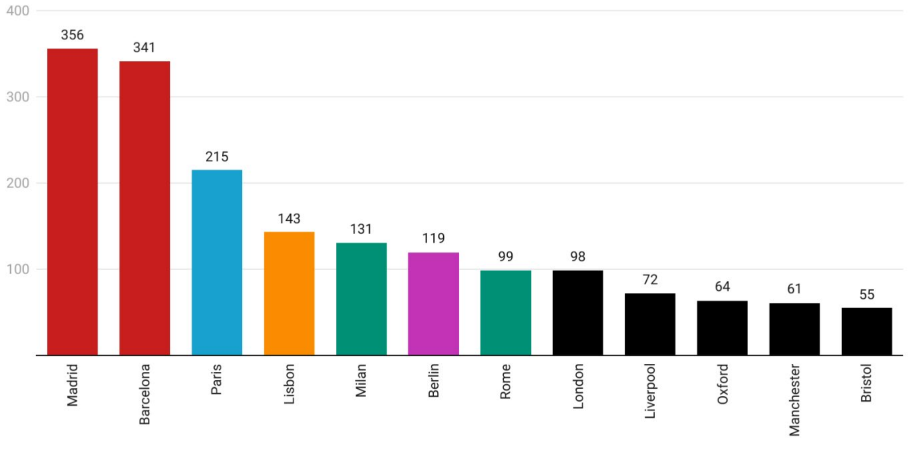
The top of the table was Australia with an average new home size of 2,303 square feet, almost three times the UK figure. New Zealand came in at 2,174, the US at 2,164 and Canada at 1,948. Among the European countries covered by Moverly, Denmark was top with 1,475 feet followed by Greece (1,356) and Belgium (1,293).

It seems surprising, therefore, that housing density in the UK is very low by international standards. (See Chart 7.) According to this data from

9. Lund, 'Housing politics in the United Kingdom', Policy Press, 2016.
10. Policy Exchange, 'Taxing issues? Reducing housing demand or increasing housing supply', 2013.
11. Norwood, 'Size Matters - UK homes amongst world's smallest but most expensive', Estate Agent Today, 2023.
12. Wilson, 'How Big is a House? Average House Size by Country – 2024', Shrink That Footprint, 2024.

the European Commission, in 2010, London's number of inhabitants per hectare was less than a third of the number in Madrid and less than a half of the number in Paris. (Other major UK urban centres shown in the chart have even lower densities than London.)

Chart 7: Population density in selected cities in 2010 (inhabitants per hectare)



Source: Lavalle, Carlo; Aurambout, Jean-Philippe (2015): UI - Population weighted density (LUISA Platform REF2014). European Commission, Joint Research Centre (JRC). Population weighted density refers to a metric which measures the density at which the average citizen lives. It is calculated by taking weighted average of the density of all parcels of land that make up a city, with each parcel weighted by its population.

We suppose this is explained by the different style of property built in the UK, with a proliferation of small houses, usually with gardens, rather than the tall apartment blocks of 6-8 storeys, typical in most continental cities. Building more densely does not necessarily imply the building of skyscraper tower blocks which are immensely unpopular with the public. Interestingly, in Georgian Britain, townhouses were typically built with five storeys, and in terraces, as opposed to the height of only two stories in the typical British semi-detached house of the 20th and 21st centuries.

Housebuilding

In historical perspective, the current rate of housebuilding is strikingly low. The number of homes in England and Wales built by the private sector increased from 133,000 in 1931/2 to 293,000 in 1934/5. In 1953 total housebuilding (private and public sectors combined) breached the 300,000 mark and, under Harold Wilson's Labour Government, it passed 425,000 in a single calendar year. [13]

During the 1980s, the total UK housing stock grew by just 1% a year, compared with average EU growth of 1.4%. Over the following decade the figures were 0.7%, compared with 1.7% for the EU average. [14] Professor Paul Cheshire of the LSE says that between 1994 and 2012 we built about 2.3 million too few homes.[15] Together with his co-author Christian Hilber, he has recently said that "In the 30 years from 1989, 3 million fewer houses were built than in the previous 30 years, despite a strong increase in demand".[16]

Between 1983 and 2021, France built 13.5 million new homes, a 56% expansion of the French housing stock, while over the same period, Britain built 7.3 million, an increase in the stock of only 34%. It is unsurprising,

13. Crafts, 'Returning to Growth: Policy Lessons from History', Fiscal Studies, vol 34 (2), pp. 255-82, 2013.
14. Hilbers et al., 'House Price Developments in Europe: a comparison', IMF Working Paper WP/08/211, 2008.
15. Cheshire, 'Turning houses into gold: the failure of British planning', Centrepiece, 2014.
16. Cheshire and Hilber, op. cit., 2024.

therefore, that over this period real house prices in France increased by 152% compared with 311% in the UK.

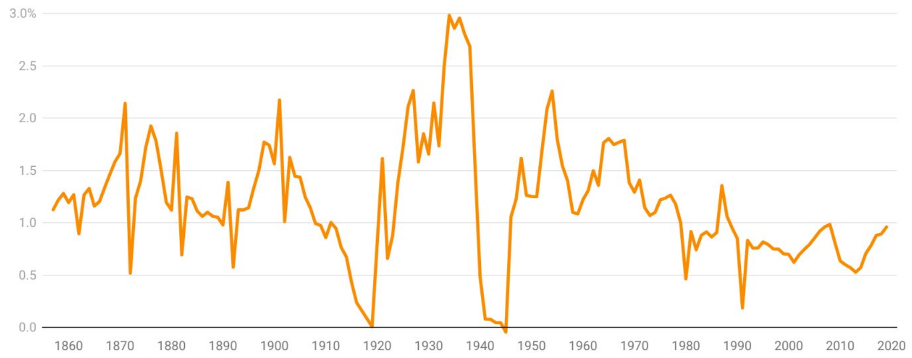
The figures for other European countries are equally telling. The increase in the dwelling stock was almost 57% in the Netherlands and over 64% in Germany and Spain. In Ireland the increase was a staggering 135%.[17]

A recent review from the Competition and Markets Authority stated: "Looking back at the history of this market, it is notable that housebuilding has only reached the desired levels in periods where (sic) significant supply was provided by local authority building". [18] And there appears to be strong evidence to support that view. UK house building has been falling over time, and that fall appears to have coincided with a steep drop in the number of homes delivered by councils. In 1970, local authorities built nearly 180,000 dwellings. By 2000, the number was virtually zero. In 1950 local authorities accounted for 84% of all new homes. By 2023 that share had fallen to 2%.[19]

But Chart 8 below suggests a different story. Net additional dwellings as a measure of housing supply factors in annual demolitions as well as completions. Particularly in the periods of high council housebuilding post 1945, new public housing was being built to replace existing stock that was either damaged in the war or in exceptionally poor condition. So, while the gross number of new social housing might have been high, the net figure was considerably lower.

Chart 8, accordingly, identifies the most successful period of UK housebuilding as the 1930s, when the private sector delivered the overwhelming majority of new permanent dwellings. And it also identifies a steep downward trend in net additional dwellings since the Second World War and the introduction of the Town and Country Planning Act of 1947.

Chart 8: Net housing additions as a share of existing stock in England and Wales (%), 1857 - 2019



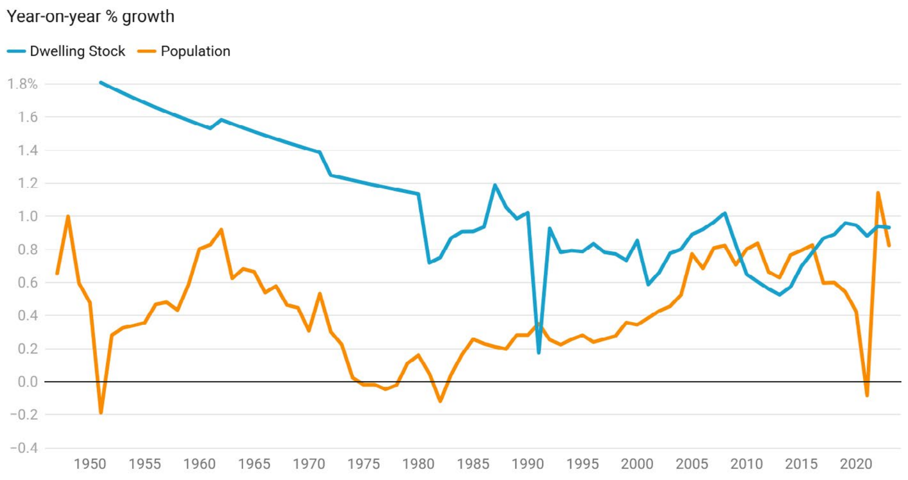
Source: Watling and Breach (2023): 'The housebuilding crisis: The UK's 4 million missing homes', Centre for Cities. 1917 and 1918 are interpolated due to missing data.

It is often argued that the rate of housebuilding in the UK has not kept pace with the increase in the population, recently driven largely by substantial net immigration. But Chart 9 shows that this is not true. For most of the post-war period the UK dwelling stock rose faster than the population. Only in the last few years has the rate of increase of the

17. European Mortgage Federation, op. cit., 2023.
18. Competition and Markets Authority, 'Housebuilding market study: Final report', p23, 2024.
19. ONS, 'House building, UK: permanent dwellings started and completed by country', 2024 and Barton et al., 'Tackling the under-supply of housing in England', House of Commons Library, 2023.

population exceeded the rate of increase of the housing. Mind you, the gap between the two rates of increase has narrowed very considerably.

Chart 9: The dwelling stock and population growth in the UK, 1947 - 2023

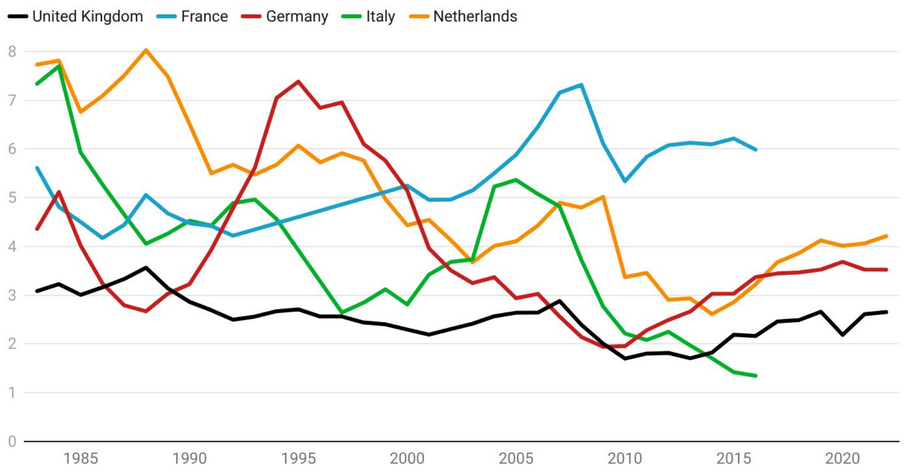


Sources: DLUHC, ONS.

Demand for housing is not related only to the number of people in the country but also to their aspiration to live in bigger and better-appointed homes and not to have different households or age groups squeezed together. In that regard we can say that there has not been enough housebuilding to meet demand – resulting in much higher prices.

A perhaps more telling measure of the UK's rate of underbuilding is the number of housing completions per thousand of the population. As Chart 10 shows, among large European economies, the UK's rate of home-building per 1000 of the population has consistently been either the lowest or the second lowest. In 2015, the French rate of home-building was about four times the UK's rate.

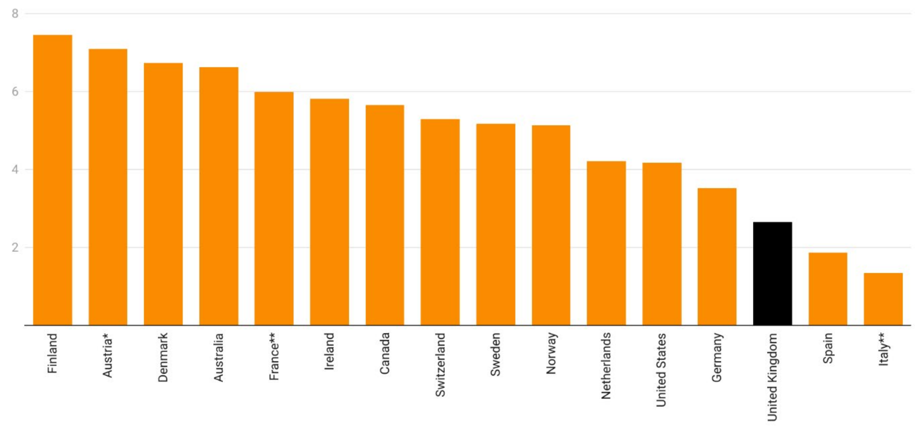
Chart 10: Housebuilding completions per 1000 of population in selected countries, 1983 - 2022



Sources: European Mortgage Federation: 'Europe's Mortgage and Housing Markets', World Bank: 'World Development Indicators'.

For a variety of European countries, plus Australia, Canada and the United States, Chart 11 shows the number of housing completions per 1000 of the population in 2022. The UK is the third lowest after Spain and Italy. (Spain's recently low rate of completions reflects the fact that in earlier years there was a massive housebuilding boom. This was decidedly not the case in the UK.) It is striking that the UK's rate of construction was well below the level in the supposedly space-constrained Netherlands, not to mention Austria, Denmark, Finland, Sweden and Switzerland.

Chart 11: Housebuilding completions per 1000 of population in selected countries, 2022



*Sources: European Mortgage Federation: 'Europe's Mortgage and Housing Markets', World Bank: 'World Development Indicators'. *Data for Austria is taken from 2021. **Data for France and Italy is taken from 2016.*

The low rate of housebuilding was clearly identified as at the root of the UK's housing crisis in the Barker Report, as long ago as 2004.[20] Things haven't improved since.

The low rate of housebuilding is closely connected with the deficiencies of the planning system, which are discussed below. The Final Report of The Competition and Markets Authority into housebuilding noted:

"the number of new permissions has at no point been significantly above 300,000, indicating that insufficient new permissions are being granted to support the provision of 300,000 new homes per year."[21]

It is sometimes argued that for the UK the "under-building" argument is weakened by the presence of a large number of empty properties. But the order of magnitude is completely different. In 2010 there were 300,000 "long term vacant dwellings" in England, amounting to 1.3% of the stock. In 2022 the figure was down to just under 250,000, or 1% of the housing stock.[22]

Second homes are another possible source of "surplus housing". The available data on second homes are not very good but, according to the 2021 Census, in England there were 154,970 second homes, representing 0.62% of England's total dwelling stock. According to the English Housing Survey, however, in 2021/22, second homeownership, where the property was not let out, ran at about four times this rate, representing about 2.8% of the total housing stock.

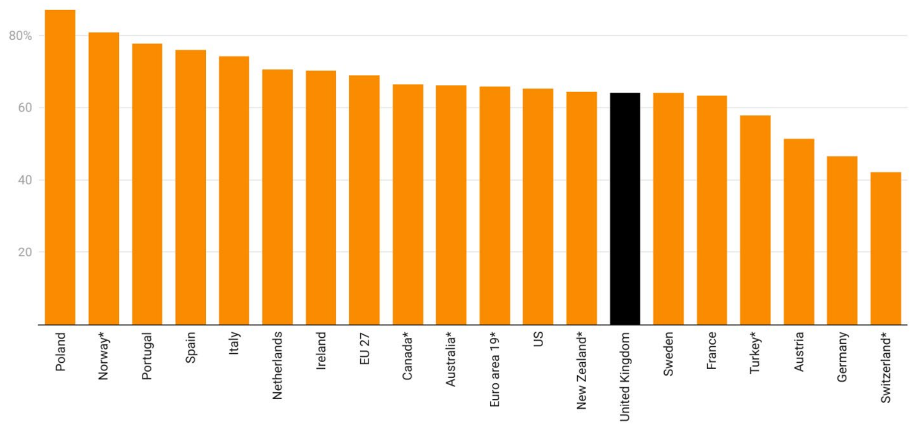
20. Barker, 'Review of Housing Supply – Delivering Stability: Securing our Future Housing Needs', HM Treasury, 2004.
21. Competition and Markets Authority, op. cit., 2024.
22. The Department for Levelling Up, Housing and Communities, 'Live tables on dwelling stock (including vacants)', 2024.

The rate of home ownership

International comparisons of rates of home-ownership come up with some surprising results. As Chart 12 shows, the UK is close to the average. At 64% on the latest available figures (for 2022) the UK's rate of home-ownership was roughly the same as the rates in France and Sweden, although lower than the EU average of just under 70%. Spain, Portugal and Poland all had much higher rates at 76%, 77.8% and 87.2%, respectively. Germany and Austria had much lower rates at 46.7% and 51.4%, respectively. Switzerland is in a category of its own with a rate of home-ownership of only 43.3% (in 2020.)

Outside Europe, the rate of owner-occupation stands at 65.4% in the US, 66.3% in Australia, 64.5% in New Zealand (in 2020) and 66.5% in Canada.

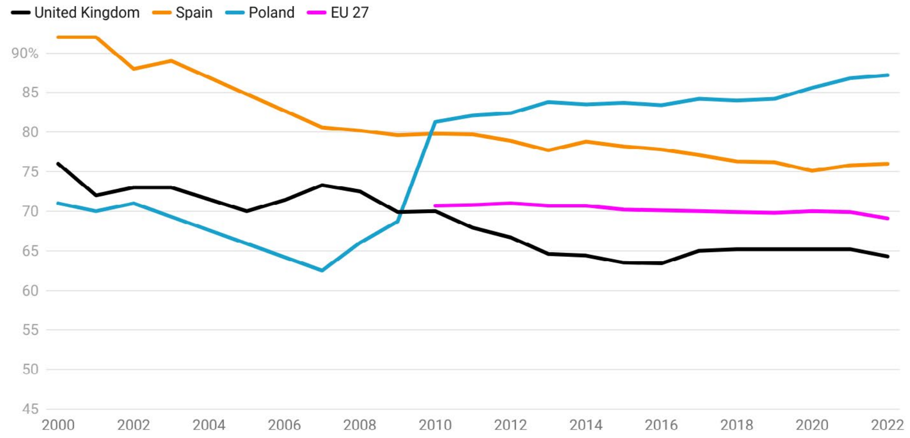
Chart 12: Owner occupancy rate in selected regions, 2022



*Sources: European Mortgage Federation: 'Europe's Mortgage and Housing Markets', U.S. Census Bureau (retrieved from FRED, Federal Reserve Bank of St. Louis), Stats NZ, Statistics Canada. *Data for these countries is from 2020, apart from for New Zealand (2018) and Canada (2021).*

The UK's rate of home ownership has fallen from a high of 73% of households in 2007 to 64% in 2022. A number of other countries have also experienced falling rates of homeownership. This applies to Austria, Germany, France, Ireland, Italy, Spain, Sweden and Australia. Nevertheless, since some other countries, notably Poland, the Netherlands and Italy, experienced increasing rates of owner-occupation, the rate for the EU27 has remained pretty much stable since 2010. (See Chart 13.) Outside Europe, home ownership rates have fallen slightly in the US, Australia and New Zealand.

Chart 13: Owner occupancy rates in selected countries, 2000 - 2022



Source: European Mortgage Federation: 'Europe's Mortgage and Housing Markets'. Values have been interpolated where data is missing.

The UK versus Germany

On many of the housing market variables we have discussed, the UK and Germany are at opposite ends of the spectrum. Table 1 illustrates this by bringing these variables together into a straight comparison between the two countries.

Table 1: A comparison between housing markets in the UK and Germany

Variable	UK	Germany
Average multiple of earnings required to purchase apartment in large city*	7.7	6.5
Owner-occupancy rate (%)	64%	47%
Average size of new properties (square metres)	76	109
Residential floor space per person (square metres)	38	46
Proportion of average renters' income taken up by rent (%)**	32%	28%
Number of dwellings per 1000 of population	445	514
Housebuilding completions per 1000 of population	2.7	3.5
Average rate of increase of nominal house prices (%), 2000-2022	5.5%	3.1%
Average rate of increase of real house prices (%), 2000-2022	3.5%	1.5%
Average household savings rate (%), 2000-2022	3.3%	10.8%

*Sources: Various international and domestic sources, latest data where possible. *refers to 70 square metre apartments.**The UK figure refers to data from the English Housing Survey.*

Causes

3. What is behind the imbalance between supply and demand?

There are five main sources of the increased demand for housing. First, the UK population has increased dramatically recently thanks to substantial levels of net immigration. (Mind you, in the period from 1951 to 2023, the population has increased by 36% whereas over the same period the number of dwellings increased by 115%.)

Second, property has a relatively high positive elasticity of demand. What this means is that as people get better off they wish to spend more of their income on property. So much so, indeed, that the *proportion* of their income that they wish to spend on property may well rise as they become better off.

The increase in the demand for property appears in several forms. Most importantly, people want to have more space in their homes: more rooms and bigger rooms, extra space devoted to different activities and bigger gardens. The lockdown experience undoubtedly increased the demand for properties with separate living and work space.

Relatedly, as people become better off they are willing to pay a higher premium for the locational quality of property, such as access to a good school, proximity to green space or a shorter commute.

And, as people get better off, many people want to live in separate households rather than being forced to share with parents, siblings, spouses or friends. In addition, as they become richer, some people wish to have a second, holiday, home.

Third, there can be increased investment demand from owner-occupiers. This may itself be a direct consequence of lower real interest rates, as discussed below, but it may occur independently of this influence, not least as the past record of substantial real price rises leads to the expectation that there will be similar capital gains in the future. This investment demand may show itself in a desire to buy larger and more expensive homes than the purchasers would otherwise want for straightforward purposes of accommodation, and/or in the purchase of second homes, as referred to above.

The fourth source of increased demand for property has been the emergence of investment demand for property by non-owner-occupiers. The development of the Buy-to-Let industry has had a major impact on the housing market. It emerged because of certain changes in the law and

in relation to the undoubted investment attractions of residential property. Low interest rates and easy money produced significant capital gains. It took time for investors to realise what a good deal was on offer.

Table 2 shows the extent of the switchover between owner-occupiers and people renting over recent years.

Table 2: The number of First Time Buyers (FTBs) against the number of private renters in the UK

Change in number of homes (average per annum)	1986 - 2000	2001 - 2015	Difference
Private rental	27,000	211,000	184,000
FTBs	496,000	320,000	-176,000
Total stock	199,000	197,000	-2,000

Sources: UK Finance, DLUHC and Capital Economics calculations.

Fifth, lower real interest rates will normally boost the demand for housing as the capital value to be placed on future income streams (including the non-pecuniary benefits of living in a property) rise, the return on competing assets falls and mortgage affordability improves. This has undoubtedly been a factor behind the third and fourth drivers of property demand mentioned above.

A recent Bank of England working paper thought that the fifth factor, lower interest rates, was overwhelmingly important. It concluded that nearly all of the increase in average house prices relative to incomes between 1985 and 2018 was the result of "a sustained, dramatic, and consistently unexpected, decline in real interest rates as measured by the yield on medium-term index-linked gilts."

This conclusion is certainly consistent with the fact that house prices rose rapidly across a broad range of countries for the decline in real interest rates was an international phenomenon.

Does this explanation suggest that the "shortage of houses" is merely a financial artefact? No, it doesn't. As pointed out in the introduction, the concern with real house prices is not with the prices themselves but rather with the underlying state of supply and demand. If interest rates rose dramatically that would undoubtedly depress real house prices but so what? It would not make housing any more affordable because, although the house prices and hence the necessary mortgage levels would be lower, borrowers would have to pay more to service their mortgages. Equally, it would do nothing to increase the amount of housing in the country or the average size of houses.

At the opposite end of the spectrum to the interest rate explanation lies the first of our five factors - population. This is a real (as opposed to a financial) factor, if ever there was one. It is often put into a separate category from the others although, as we will argue in a moment, it shouldn't be. In particular, the increased number of people is often compared with the number of new homes built as a measure of whether there is a shortage of housing. This may seem straightforward but in fact it is a subject of some controversy.

Homes and households

There is a view that there has been no under-supply of homes and that the causes of large increases in real house prices lie with various factors which have boosted demand. The leading exponent of this view is Ian Mulheirn.[23] He argues that a shortage of housing did not contribute to the growth of house prices since 1996.

(The Redfern Review, based on modelling work done by Oxford Economics and with input from Ian Mulheirn, also argued that there is no housing shortage as such.[24])

Mulheirn says that the housing stock has grown about 14% faster than the number of households. So, the number of dwellings in excess of households has increased by 70% from 1996 to March 2018. He says that between 1996 and 2017, the English population grew by 14.6%. Meanwhile, the residential property floor area increased by 25.7%. Similarly, the number of bedrooms per dwelling increased by 19.5%.

Mulheirn argues that plummeting real mortgage rates are the real explanation for what happened to house prices. A 2-year 75% LTV loan down from 4% real in 1996 to -1% real in 2017/18. And a five-year loan down from 8% real to 2% real. Meanwhile, he says that differences in institutions and regulations explain different international experience – especially the comparison with Germany.

And he says that falling rates of home-ownership are caused by tighter lending conditions for FTBs after the financial crisis. The Redfern Review, to which he was a contributor, also says that this was the largest causal factor behind the fall in homeownership rates up to 2014. But it put the rise in real house prices as the second most important factor, followed by the decline in the incomes of people in the 28-40 age bracket compared to older people.

It said that boosting housing supply would not necessarily increase the rate of home-ownership because, even though it would eventually reduce house prices, it would also tend to reduce rents. (This is true but if one of the real constraints on people being able to "get on the housing ladder" is the difficulty of amassing a deposit, then lower real house prices and lower real rents should help to relieve this constraint.)

Moreover, Mulheirn argues that much higher rates of house building sustained over a generation would not reduce prices to anything close to the levels prevailing 20 years ago in real terms. He says that various studies suggest that a 1% increase in housing stock would reduce real prices (and rents) by between 1.5% and 2%. Therefore, an additional 300,000 units would reduce real house prices by 0.8%, implying a reduction of 7-13% over 20 years if this rate of extra building were to be sustained. [25]

Mind you, not everyone agrees with this conclusion. Christian Hilber and Wouter Vermeulen argued that real house prices in 2008 could have been 35% lower if building had kept pace with latent housing demand. [26]

The Redfern Review said that if the number of households grew at 200,000 per year, new supply of 300,000 homes a year would reduce house prices at the end of a decade by about 5%. This might not sound much but everything depends upon time horizons. The Review stated that "boosting housing supply will have a material impact on house prices but only if sustained over a long period". [27]

The counter-attack

Mulheirn is right on the bare facts about the increased number of households versus rates of new building. But this by no means clinches the argument. The number of households formed does not equate to demand. A four-person family living in a one-bedroom flat is housed – after a fashion.

The main argument against Mulheirn is that there is a large number of "hidden households" where people are being forced to stay living with their parents or sharing with friends. From 2008 to 2023, the percentage of 20–34 year-olds living with their parents rose from 22% to 28%, an estimated 3.6 million adults.[28]

In addition to adult children living with their parents, there has been a huge increase in other "concealed households". Government estimates suggest that the number of concealed households has risen by 50% from 2006 to 2016, to a figure of some 2.5 million. In London the increase was greater, about 80%.[29]

But Mulheirn argues that increases in the number of so-called hidden households are explained by a shift in the distribution of incomes against young people, plus the increased proportion of immigrants in the population. (He says that many of these people are culturally accustomed to living in multi-generational households.)

Lindsay Judge of the Resolution Foundation calculated that in 2016, whereas there were 1.045 homes for each 1,000 registered households, there were only 825 homes for every 1,000 families. What's more, this latter number has been falling.[30]

Nor is the inadequate supply of accommodation only about the number of housing units in relation to the number of households, whether open or concealed. There is also the matter of space. As explained above, on average UK houses are very small by international standards.

Mulheirn focuses on the number of households issue and pays little attention to the other drivers of demand for housing. The fact is that people want to have more and better housing. In other parts of the economy, expressions of extra demand call forth increased supply. In the case of housing, however, the supply response is low. The bulk of the adjustment falls upon house prices.

Whatever the causes of the spate of very high house prices, why not simply increase the stock of property anyway? Mulheirn argues that increasing the stock of vacant property has a cost for the economy. There is, indeed, in principle, some opportunity cost but, as discussed below, this is in many ways small by comparison with the huge costs imposed on people through having to put up with cramped housing conditions and the costs imposed on the economy by being unable to build suitable homes close to where the jobs are.

23. Mulheirn, 'Tackling the UK housing crisis: is supply the answer?', UK Collaborative Centre for Housing Evidence, 2019.
24. Redfern, 'The Redfern Review into the decline of home ownership', 2016.
25. Mulheirn, op. cit., p25, 2019.
26. Hilber and Vermeulen, 'The impact of supply constraints on house prices in England', Economic Journal, vol 126, 2016.
27. Redfern, op. cit., p15, 2016.
28. ONS, 'Young adults living with their parents', 2024.
29. Halligan, 'Home Truths', p59, 2019.
30. Judge, 'The one million missing homes?', Resolution Foundation, 2019.

4. The idea that there is simply not enough land for development in the UK

Even if we accept that there is a large and unsatisfied demand for housing, resulting in high property prices, this does not necessarily clinch the argument that there should be a large increase in the rate of housebuilding. For here we run straight into the contention that there is simply not enough available land to permit more building. Already, runs the argument, much of the country is developed, or even over-developed. Moreover, what little land there is in the more highly populated areas that is still green space is highly prized. We shouldn't seek to "concrete over" this much valued public amenity.

Although this view is widely held, it runs completely counter to the facts. According to the 2011 National Economic Assessment, only 2% of all land in England is covered with buildings. Of this, just over a half is accounted for by domestic buildings.

Research by Woods Harwick, the Built Environment services provider, puts England's green belt land at about 12.5% of the country's total land area, or approximately three times the size of Norfolk. [31] If you assume an average plot size of 222 square metres, this equates to enough space to build 73.7 million new homes. (According to the ONS, in 2021 there were some 24.8 million homes in England and Wales.) In other words, to build an extra million homes would require the release of just 1.4% of current green belt land.

The green belt has increased vastly in size. In 1979, green belt land in England accounted for 721,500 hectares. By 1993, that figure had grown to 1,555,700 hectares. The latest figure for 2022/23 was estimated at 1,638,000 hectares. Remarkably, in Guildford, 88% of the land is covered by green belt. More of Surrey is now covered by golf courses than by residential housing. [32]

Regionally, London's green belt is the smallest at "only" 34,772 hectares but this accounts for 22% of the region's total land area. In the east Midlands, green belt accounts for 20% of the region's land area. And this at a time when the amount of built-up land per capita in the UK has been effectively static since 1990 - indeed, it has slightly fallen this century.[33]

What explains this incredible growth in the green belt? Green belts were a pre-war concept first introduced around London and were intended to provide a reserve of open space for local residents. After 1945, however, Local Authorities, who have responsibility for the designation of green belt land, were encouraged to designate land specifically to reduce urban expansion and were permitted to do this without being required to compensate landowners. As such, Local Authorities were able to expand land under green belt designation significantly without any cost. In consequence, and in addition to other planning constraints and regulations on building heights, British cities – the engines of national economic growth through agglomeration effects – have been artificially prevented from growing for decades.

31. Rankl, Barton and Carthew, 'Green Belt', House of Commons Library, 2023.
32. Cheshire, op. cit., 2014.
33. Resolution Foundation & Centre for Economic Performance, LSE, 'Ending Stagnation: A New Economic Strategy for Britain', Resolution Foundation, 2023.

So, for example, while the original intention for London was a green belt one to five miles wide, the extant green belt is now three times the size of London itself.[34] Local Authorities have strong incentives to add to the green belt, but limited incentives to remove the designation from land that is, or has ceased to be, of environmental value.

5. The deficiencies of the planning system

The current system governing the availability and development of land for building owes its origins to the Town and Country Planning Act of 1947. Before this, property owners were allowed to build on their land and/or improve existing structures subject only to some relatively unintrusive regulations on building height and sightlines. (In the building boom of the 1930s there was a near absence of planning laws.[35])

The Attlee Government turned this situation on its head and effectively nationalised development rights as property owners were now obliged to obtain permission from the state for making improvements or changing land use. What's more, the ability to grant permission to develop was devolved to local authorities and they were able to exercise their discretion.

The 1947 Act laid down that the "betterment" or uplift in the value of land that followed from a permitted change of use should fall to the state. It allowed developers to purchase land at existing use value and then charged them a development levy. The 1947 Act allowed the state to use Compulsory Purchase Orders (CPOs) to purchase land at existing use value when acquiring land for social housing.

The 1946 New Towns Act had Land Value Capture (LVC) at its heart. It led to the creation of 32 settlements which now house 3 million people. The cheapness of land enabled local authorities to build large amounts of low-density social housing.

This approach was radically changed in 1954 when the development charge was abolished. And in 1961, the Conservative Government further amended the 1947 settlement by passing the Land Compensation Act, allowing the "planning gain" that resulted from the granting of planning permission to accrue entirely to the landowner.

Subsequently, the Labour Government sought to capture more of the increased value created by development through a "Development Land Tax" but that was abolished by the following Conservative Government.

Today, there are two ways that some value uplift is captured by the state rather than landowners or developers:

i. The Community Infrastructure Levy (CIL), which is an optional and locally determined charge;
ii. Section 106 Agreements, which are legally enforceable under the 1990 Town and Country Planning Act but are negotiated by local authorities with developers on a case-by-case basis, obliging developers to build so many "affordable homes" and contribute so much to the local infrastructure.

34. Airey and Doughty, 'Rethinking the Planning System for the 21st Century', Policy Exchange, 2020.
35. Halligan, op. cit., p8, 2019.

The previous Conservative Government proposed and consulted on the introduction of an Infrastructure Levy (IL) to replace CIL, with Section 106 retained for many forms of development. IL would be compulsory, but the rate would be nationally set, which may reduce the flexibility available to local authorities to adjust incentives. It also would be paid at the point of sale of properties rather than at the point they receive permission – a point to be picked up later.

The current planning system creates two distinct problems. First, the process of seeking and acquiring permission is extremely long and expensive and the outcome uncertain, thereby increasing the costs for developers and deterring many from making an attempt. The burdens of costs and uncertainty are particularly severe for small housebuilders and developers. This is a major factor behind the decline in the number of small builders, which has had serious adverse consequences, as discussed in the section below about the housebuilding industry,

Second, there has been a decided tendency for local authorities to deny planning permission. There is a systematic reason behind this tendency. Existing residents in an area always tend to oppose new developments, and/or changes in the nature of land or business. The reason is clear. They see no advantage for themselves and several disadvantages, including increased pressure on local infrastructure and public services, more crowded roads, noise and pollution and perhaps loss of some "greenery" and open space which is thought to have amenity value. These residents all have a vote in council elections, and they exert influence over local authorities.

Even without the exertion of raw political power or the fear or prospect of it, many local councillors will instinctively be against development, having a natural "conservative" bias and feeling a duty towards their local area and its residents.

The key failing here is that all those people who could be housed were development to go ahead do not have a vote in the relevant local elections because they do not yet live there. Worse than that, no one knows who they are – including themselves. There is no list of prospective residents who would move in if a certain development were to go ahead. This group of people is faceless and voiceless. Their interests, and the interests of wider society, have to be imagined – or some way has to be found to overcome the natural inclination of local authorities to say "no".

Over and above this, there is the further constraint imposed by the existence of extensive "green belt" where development is effectively forbidden. In fact, local authorities are able to give planning permission on green belt sites if that is the only way to meet housing need. Yet this rarely happens, probably for the very reasons given above for the predisposition against development.

Thus, the system has an inbuilt bias against development which restricts the amount of development that takes place, whilst the gains to landowners and developers on such permissions that are granted can be stupendous and a relatively small proportion of this accrues to society as opposed to the land owners and developers.

Paul Cheshire and Christian Hilber have put matters starkly:

"That land in the green belt in a north London borough with planning permission but no planning obligations costs more than £30mn a hectare while adjoining land without permission costs perhaps £30,000 a hectare tells one something very powerful about the misallocation of resources our current system generates." [36]

Edward Glaeser, Fred and Eleanor Glimp Professor of Economics at Harvard University has made the deficiencies of our planning regime crystal clear. He has written: "the English planning system has evolved in a largely haphazard fashion with little attention to any broader consequences. After 1947, the government first assumed total control over land use within England and then devolved the power to deny new construction to tiny boroughs and townships. Large national policies, like the Green Belts, made vast tracts of land off limits to any serious development. Local opposition to change meant that local communities ferociously fought rear guard actions to thwart any nationwide push to encourage more building." [37]

To be clear, there has to be some system of regulation and restraint in relation to land use. There cannot sensibly be a purely market driven approach. This is because of the strong presence of externalities and public goods in land use.

Surely no one would suggest abandoning all control over land use in such places of outstanding natural beauty as the Lake District. But similar considerations apply in many urban areas, albeit on a less visually impressive way.

When a possible development would ruin the splendid view of an existing community of home-owners over open countryside they have a legitimate interest in opposing development. If the development goes ahead, they will experience a genuine loss.

That does not mean, however, that they should be allowed to veto the development. Yet that is exactly what our current system effectively does. The system is biased in favour of the status quo and against development. A sensible approach to the question of land use planning would be to retain some system of control and regulation but to tilt the balance towards development.

To some extent there is an important issue of terminology here. The word "planning" carries connotations of the soviet system which has failed wherever it has been tried. The notion that local authority planners can and should envisage the "appropriate" economic and residential balance of different areas and decide on land use according to perceived "needs", with scant regard to market forces, is bizarre. Planned economies do not work. With regard to land use, it might be helpful to discard the word "planning" and replace it with the word "regulation".

36. Cheshire and Hilber, op. cit., 2024.
37. Foreword to Airey and Doughty, op. cit., Policy Exchange, 2020.

6. What is wrong with the housebuilding industry?

It is widely acknowledged that the UK's planning system leaves much to be desired. But there is also a widely held view that the problems of the housing market are at least as much, and possibly much more, due to the structure and behaviour of the housebuilding industry.

It is vital to establish the relative importance of these two failings. For if the problems of the UK's housing market are mainly due to the deficiencies of the housebuilding industry, then we could radically reform our planning system without bringing much real benefit. Equally, if the problem mainly lies with the planning system, then even a radical intervention by means of regulation or tax in the workings of the housebuilding industry would bring little result.

There is no doubt that, on the face of it, there is a good deal in the UK housebuilding industry that seems dysfunctional. For a start, the industry has become highly concentrated. Many small and medium sized builders were wiped out after the 2009 banking crisis.

And the workings of the planning system make it extremely difficult for them to operate. The large costs, delays and uncertainties of the planning process are difficult for smaller operators to bear. Equally, their limited access to finance means that they are unable to compete with the big boys in land banking.

Whereas in 1960 the ten biggest housebuilders accounted for only 9% of all new homes built, by 2021-22 the single biggest builder, Barratt, was responsible for about 8% of new homes built in GB. The largest 11 firms together accounted for about 40%. [38]

Professor John Muellbauer points out the sharp contrast with Germany. There, he says, small and medium-sized builders build 50% of homes and really large builders, with over 250 employees, build only 22%.[39]

Here in the UK, you can see the fruits of the large builders' market power in their financial results. The five largest housebuilders made an average profit of £57,000 per house sold in 2018 compared with only £29,000 in 2007.[40] Between 2012 and 2016 while private sector housing completions increased by 22% per annum, the profits of the UK's five largest housebuilders rose by 388%. [41]

Even so, while a recent report from the Competition and Markets Authority stated that in the 2010s the average profitability of housebuilding firms was well in excess of their cost of capital, it acknowledged that this was preceded by a period when the opposite was true. It reckoned that recent strong profitability was partly driven by external factors such as the Help-to Buy scheme and ultra-low interest rates. It concluded: "We therefore do not take this to indicate that intervention is required to directly tackle housebuilder profitability".[42]

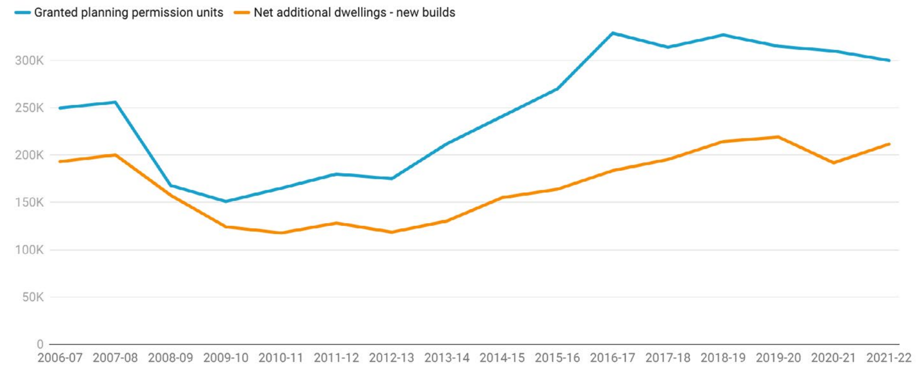
38. Competition and Markets Authority, op. cit., p15, 2024.
39. Muellbauer, 'Housing, debt and the economy: a tale of two countries', National Institute Economic Review, vol 245, 2018.
40. Halligan, op. cit., p160, 2019.
41. Halligan, op. cit., p86, 2019.
42. Competition and Markets Authority, op. cit., p 23, 2024.

Effects on the rate of housebuilding

Allegedly, the structure of the industry has had a major effect in reducing the rate of housebuilding. Of course, some delays to the delivery of new housing – the provision of infrastructure, labour and material shortages, the untimeliness of planning decisions themselves – are out of the hands of builders. Yet at the same time, landowners and large developers who increasingly dominate the industry, may have every incentive to sit on their landholdings, even if they have planning permission, so as to avoid upsetting the market for their offerings and to drip feed property onto the market so as to maximise the selling price.[43]

Between 2010 and 2015 the number of planning permissions granted each year rose by 75% but the rate of housing completions rose by only 33% (See Chart 14.) In 2013, once detailed planning permission had been granted, developers took an average of 1.7 years to complete a home. By 2017 the delay had risen to at least four years. [44]

Chart 14: Net additional new builds and net additional planning permissions in England, 2006 - 2021



Sources: UK Finance, DLUHC, and Capital Economics calculations.

An IPPR report has contrasted the interaction of the planning system and the building industry in the UK and Germany. It says that in 2014 in the UK, 261,00 homes were permitted to be built but only 46% of them were built. In Germany, however, the building of 285,00 homes was permitted and 86% of these were built.[45]

One of the present authors has put the problem pithily: "big housebuilders are not currently competing on house delivery performance or even product development but on who can best mitigate market uncertainty by acquiring land." [46] And fundamentally, this comes back to the planning system and the incentives it generates for builders, landowners and local authorities.

43. Halligan, op. cit. , pxvi, 2019.
44. Halligan, op. cit., p83-84, 2019.
45. IPPR, 'German model homes? A comparison of UK and German housing markets', 2016.
46. Vitali, 'Homes for Growth: How Housebuilding can Revitalise the UK Economy', Policy Exchange, 2023b.

Putting the failings of the housebuilding industry in perspective

There is no doubt that there is a problem with the UK housebuilding industry. The UK is unusual in combining the acquisition of land and doing long term development with actual construction. The 2007 Callcutt Review acknowledged "identifying, acquiring, preparing, developing and selling land is the key activity of all (UK) house building companies".

But we should go easy on the outrage and concentrate on sound analysis. First, it is unhelpful and unfair to attach blame to the builders for making large profits. They have a duty to their shareholders to try to make large profits. They operate in the way they do because that is how they are incentivised to behave. It is the system that is broken.

Second, is it the oligopolistic nature of the industry that explains the practice of land banking? Admittedly, it is this that explains how and why large builders should control the release of new houses in order to bolster their prices. Small housebuilders would not be inclined to do this because their rate of building would have no discernible effect on market prices.

The alternative explanation to the oligopolistic one is that the practice of extensive land banking stems from the expectation of continual real appreciation in the price of land. If there were not this general expectation then even oligopolistic builders would not want to tie up large amounts of capital in holding land yielding nothing.

Third, if major housebuilders were persuaded by regulatory intervention or a new tax substantially to reduce their land banking, would this have a material effect on house prices? It is not easy to obtain good data on the extent of land banking but in 2023 the Competition and Markets Authority (CMA) published a paper on landbanks[47]. It said that the 11 largest housebuilders across Great Britain, which together accounted for 40% of new homes built in 2022 owned or controlled land equivalent to 1.17 million plots. Of these roughly 658,000 did not yet have planning permission and 522,000 did have some form of planning permission.

Earlier in this paper we referred to the size of the green belt. We said that building an extra one million homes would require the release of about 1.4% of current green belt land. Accordingly, the CMA's estimate of the total size of landbanks held by the 11 largest housebuilders is the equivalent of about 1.6% of the green belt.

Accordingly, the inefficiencies created by extensive land banking are really second order stuff. For all the outrage about housebuilders, the most important issue is ensuring a good supply of developable land such that land prices do not constantly increase substantially in real terms. In this scenario, land banking would diminish, and small and medium-sized housebuilders would re-emerge, causing the industry to become more competitive.

47. Competition and Markets Authority, 'Housebuilding market study: Local concentration and land banks working paper', 2023.

Consequences

7. How the deficiencies of the planning system affect non-residential development, including infrastructure, and thereby impede economic growth

Our planning system does not merely affect the housing market; it has implications for the entire supply side of the economy. Accordingly, a reform of the planning system should address both these areas of concern.

If you want to build new energy infrastructure, new roads, new commercial or lab units, or even manufacturing space, then you will require planning permission to do so. And since, as discussed, land is a factor in production, when the planning system constrains the supply of land for these uses or activities, the cost of doing them increases.

We have strong evidence that planning constraints diminish retail productivity and push up office space costs. In the case of the former, studies show that Britain's 'town centre first' policy, which came into effect from 1996 and inhibited the development of larger out-of-town retail stores, restricted the availability of land for retail premises, limited store sizes, increased costs, and reduced sectoral productivity.[48]

In the case of office space, the "regulatory tax" imposed on new commercial units through the planning system, in addition to the lack of incentives for local authorities to grant permission for an expansion of commercial units from a tax revenue standpoint, have constrained the supply and increased the cost of UK office space significantly. Office space in London is now three times as expensive as in Manhattan.[49]

The retail sector might just be a small part of the economy in aggregate terms. But the services industry is of immense importance to the UK, and office costs are a significant overhead for business. (Admittedly, at the moment at least, this is a less significant factor due to the growth of WFH after Covid.)

Additionally, our planning system affects our ability to provide the critical infrastructure – the basic plumbing – upon which our economy depends: roads, hospitals, transportation and utilities.

Take energy, for example. Unit costs are far higher in the UK than in other similarly sized countries because energy is far less abundant here. And that is because we have less production, storage and grid capacity. The UK generates around half as much electricity per capita as the US does, and about a third less than France. (See Chart 15.)

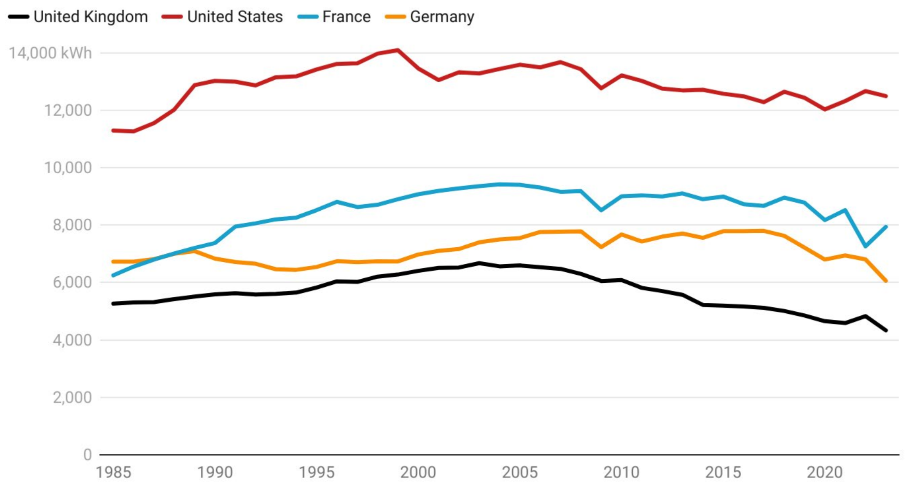
48. Paul Cheshire, Christian Hilber and Ioannis Kaplanis, "Land Use Regulation and Productivity – Land Matters: Evidence from a UK Supermarket Chain", SERC (2013).

49. Cheshire and Hilber, op. cit., 2024.

The imperative to deliver new energy generation capacity is clear, but the planning system acts as a significant drag on achieving this. As Policy Exchange has argued recently, it takes less than a year to engineer and build a wind energy facility, but between three and five times as long to secure consent and deliver the project.[50]

Chart 15: Per capita electricity generation in selected countries, 1985 - 2022

Annual average electricity generation per person, measured in kilowatt-hours.

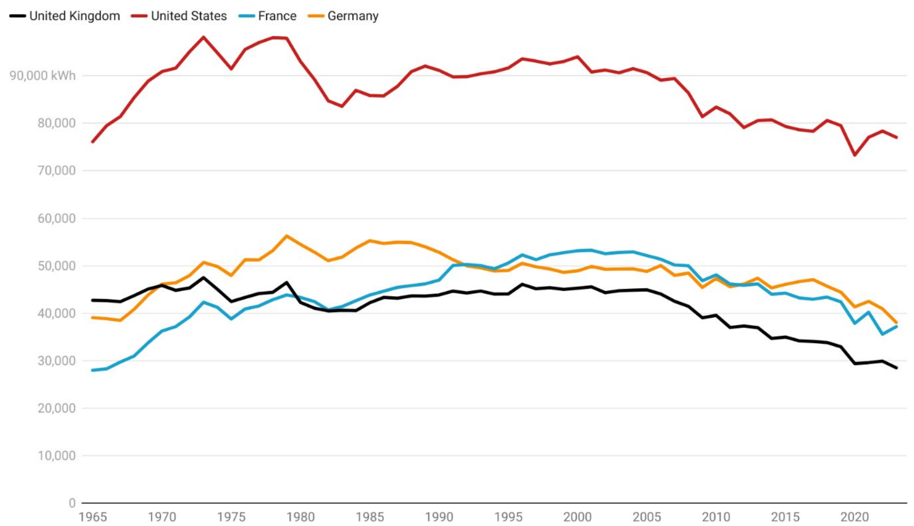


Source: Our World in Data: 'Total electricity generation per person'.

The international price of gas certainly remains a significant driver of energy costs, given that more than a third of UK energy is generated by gas. But low production and storage capacity must be a factor in high electricity prices too. UK energy prices are higher than those in France, Germany and the USA.[51] The inevitable upshot is lower energy usage per capita in the UK than other countries, as Chart 16 shows.

Chart 16: Energy use per person in selected countries, 1965 - 2022

Measured in kilowatt-hours per person.



Source: Our World in Data: 'Primary energy consumption per capita'.

50. Vitali, 'Re-engineering Regulation: An A-Z of Reform', Policy Exchange, p30, 2023c.
51. Department for Energy Security and Net Zero, 'International industrial energy prices', 2024

All of this comes back to the fact that it is expensive, timely and vexatious to deliver new energy infrastructure which will generate, store and convey energy across the country. And it is getting worse.

Many proposals for new plant and infrastructure go through an alternative planning route than standard applications called the Nationally Significant Infrastructure Projects (NSIP) regime, which was introduced to streamline permissions for new development of strategic importance to the UK. But it is clear that this has not dealt with the fundamental causes of planning dysfunction.

Britain Remade estimate that the number of documents required to secure planning permission through the NSIP regime tripled between 2012 and 2020, from an average of 381 documents to 1143.[52] Whatever your substantive views on HS2, it is a representative example of how the planning system adds delay and expense to UK critical infrastructure projects. A significant part of the project was pulled by the Prime Minister in late 2023.

To recapitulate, the UK's discretionary and uncertain planning system adds delay and expense onto almost all forms of proposed development, and not simply housing. And the upshot of this is higher business costs, lower productivity, and a less dynamic economy.

8. The effects of a poorly functioning housing market on economic growth

Other things equal, an increase in the housing stock should increase citizens' welfare through the increased quantity and quality of housing services available for consumption. Such improvements are likely to bring decided benefits to the quality of peoples' lives, as discussed below.

But are increases in the housing stock likely to affect the performance of the non-housing economy? According to Liam Halligan, every UK economic recovery in the past century has been associated with a sharp rise in the number of homes built.[53] Surely the main driving force here has been the boost to demand from a surge in housebuilding. In some economic conditions, such a boost to aggregate demand is sorely needed. This was the case during the 1930s.

But occasions when the output of the economy is demand-constrained are not the norm. And when deficient demand is a problem, the policy-makers can usually apply the conventional fiscal and monetary policy tools to address it.

Accordingly, our working assumption should be that the economy is fully employed, in the sense that there is no shortage of aggregate demand in relation to aggregate supply. (This is not to say, however, that it isn't possible to increase the size of the workforce by tackling the workshy culture and the state of peoples' mental and physical health and their attitudes to it. But this is a completely different matter. For the purposes of analysing the housing market, these things should be taken as given. And if they were to change, although this would alter the sustainable level of employment, this would not impinge on the argument being deployed here.)

52. Dumitriu, 'Why Britain Struggles to Build Infrastructure', Notes on Growth, 2022.
53. Halligan, op. cit., p69, 2019.

In that case, any boost to aggregate demand from a surge in housebuilding is of no value, and may actually be net negative if it stimulates inflationary pressure. The same argument applies to the effects on aggregate demand of high and rising house prices, e.g. through their effects on inequality, as discussed below.

But there are a number of ways in which the constrained size of the housing stock in relation to demand, leading to high property prices (and rents), affects the supply side of the economy and thereby its sustainable level of output and rate of growth.

Labour mobility

The failings of the UK housing market have had a discouraging effect on labour mobility. Economically dynamic cities and regions typically have high property prices and rents compared to less dynamic cities and regions. Anyone wanting to leave the latter and to take up better paying employment in the former has to pay due consideration to the effect of higher property costs on the overall economic attractions of the move. Often the discrepancy in property costs will wipe out any prospective gains in income and people will opt to stay put.

Professor John Muellbauer says that after 1986, high House Price to Earnings Ratios (HPEs) in the South greatly reduced the rate of migration out of the North. For lower earners living in social housing, the risk of losing this benefit effectively ruled out the migration option. [54]

This is not to say that encouraging a mass migration of people out of the North and into the South is an unalloyed "good thing". But even if a more prosperous North dented any desire for migration en masse, at a more micro level there is much to be said for having a flexible labour market where people can relocate and find employment where their particular skills are better matched to the available opportunities.

The diversion of bank lending from business into mortgage lending.

More than three-quarters of all outstanding UK bank loans are property-related. Banks are keen to make loans secured on housing because, given continual real house price appreciation, the security of the asset to which the loan is tied is viewed as very good.

This reliance of banks on mortgage lending has implications for the stability of the banking system. This a powerful factor leading the authorities to be wary of policies that might have the effect of reducing house prices substantially. (We return to this question in section 17.)

But suppose that a programme of much increased housebuilding reduced real house prices. The following analysis applies both to the case when there is an outright fall in house prices and to the one advocated here, where prices do not fall absolutely but they are lower than they would have been without the policy changes advocated in this report. Would this reduce the amount of bank lending via mortgages?

54. Muellbauer, 'The Thatcher Legacy: Lessons for the future of the UK economy', Resolution Foundation, 2022.

There are opposing forces. Lower house prices would imply a reduced average of mortgage per house (unless banks lent a higher proportion of a property's value, with a commensurate fall in the average level of deposits.)

But, on the other hand, the total number of mortgages would be greater, because there would be more houses, requiring more mortgages. Whether total mortgage lending turned out to be higher or lower would depend upon the balance of these two effects, which would turn on the elasticity of average house prices to the supply of new houses.

Over and above these direct effects, there would be a potentially powerful indirect effect. Suppose the programme proposed in this report were implemented and the result was a complete change of regime in the housing market such that real house prices hardly rose over time. In these circumstances banks would probably reduce their desired rate of mortgage lending, and/or significantly increase the level of deposits required from borrowers, because residential property no longer offered the same degree of security as it does under the current regime.

If total mortgage lending were lower then what macro results would follow? Banks might reduce their total lending overall.[55] Alternatively, banks might substitute lending to other parts of the economy, possibly even the corporate sector. This would tend to increase the rate of business investment, especially by small and medium-sized businesses which typically rely on banks for finance and which typically report that banks are often unhelpful or excessively demanding when they approach them for finance.

The answer probably lies between these two extremes. But there is a good chance that there would be a diversion of some bank lending towards business, delivering a boost to real investment.

At any rate, the current banking set-up is an extraordinary state of affairs. At the moment, through the preponderance of mortgages in banks' lending, a high proportion of consumer saving is effectively financing higher house prices – an asset bubble.

The effects on personal savings behaviour and the overall rate of national saving.

The effects of our housing regime on the overall rate of saving are complex. Having to pay a mortgage can be a form of forced saving. In that regard, higher average house prices would normally increase the quantum of this effect.

Simultaneously, all those who are wanting to buy a home normally have to save for a deposit. Other things equal, the higher are average house prices, the higher the deposit that they have to accumulate and therefore the greater the saving that they have to do.

Yet there is a powerful force on the other side of the equation. Greater wealth held by homeowners should encourage consumption both through the mechanism of equity withdrawal and through the simple encouragement to spend more out of income from the fact that people know that they are richer.

55. Other things equal, this would reduce aggregate demand. But, following the conventional assumption of full employment, discussed above, we should assume that the policy-makers boost aggregate demand to compensate, perhaps through lower interest rates.

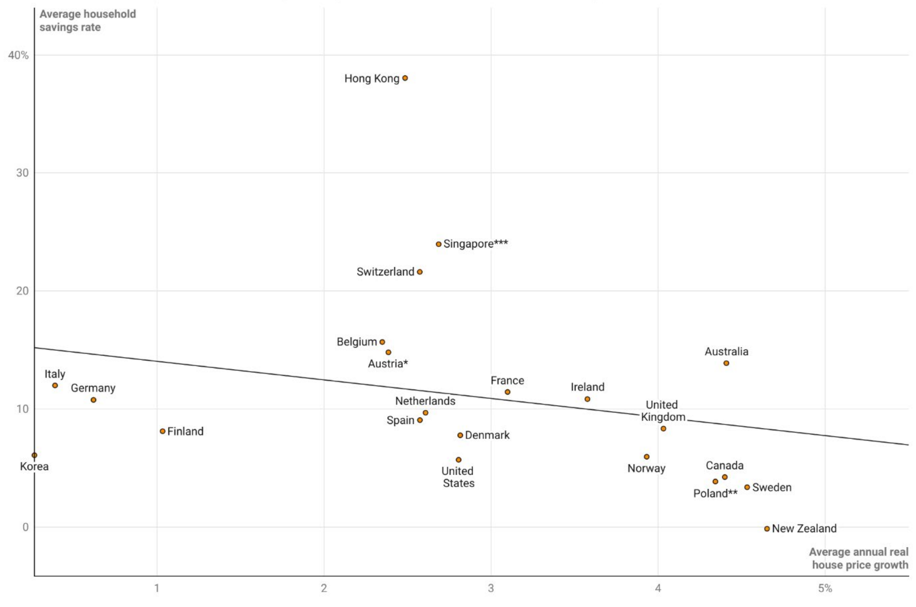
What is the overall balance of these effects? It is impossible to be sure but there is a good chance that if our current regime in which real house prices tend to rise inexorably were replaced by one in which they remained more or less constant or rose only slightly, there would be a boost to overall savings. After all, all those people who currently regard their home as a nest egg or even their pension, would now think differently. They would probably be inclined to save more in conventional ways, including via pension policies.

Although far from decisive, the international evidence is suggestive of the conclusion that rapid growth of real house prices tends to depress the household savings rate. For a variety of European, Anglosphere and Asian countries, Chart 17 plots the average household savings rate against the average rate of increase of real house prices over the period 1998 to 2022. There is a negative relationship.

We should be wary of drawing any firm conclusions. For a start, the relationship is weak and there are some significant outliers, notably Hong Kong and Singapore and, to a lesser extent, Switzerland, which all combine middle of the road increases in real house prices with very high household savings rates. Without these three cases the relationship is much stronger.

Secondly, the direction of causation, if there is any, is unclear. It might be that having a high rate of growth of house prices tends to depress the savings rate but it might be that a low savings rate stimulates high price growth through its effects on consumer spending and hence the strength of aggregate demand. Equally, both phenomena could be driven by some common outside factor.

Chart 17: Average real house price growth and household savings rates, 1998 - 2023



*Source: OECD 'Analytical house prices indicators', Oxford Economics. *Data begins in 2001. **Data begins in 2006. ***Data begins in 1999.*

The costs of business

For any given level of salary, the high cost of housing in this country reduces the real standard of living enjoyed by people. That is a deadweight loss to them. But in a world of international labour mobility, it can become a cost to business. To attract and retain talented employees who could work abroad, companies will have to pay higher salaries and bonuses to make up for the high cost of housing in this country.

By increasing the cost of doing business in the UK, our housing shortage thereby hampers our economic success. This was the view of the Barker Review of 2004.[56] Similarly, Professor John Muellbauer argues that high land prices in the UK make it an expensive place to do business, thereby deterring investment. [57]

Attitudes and entrepreneurship

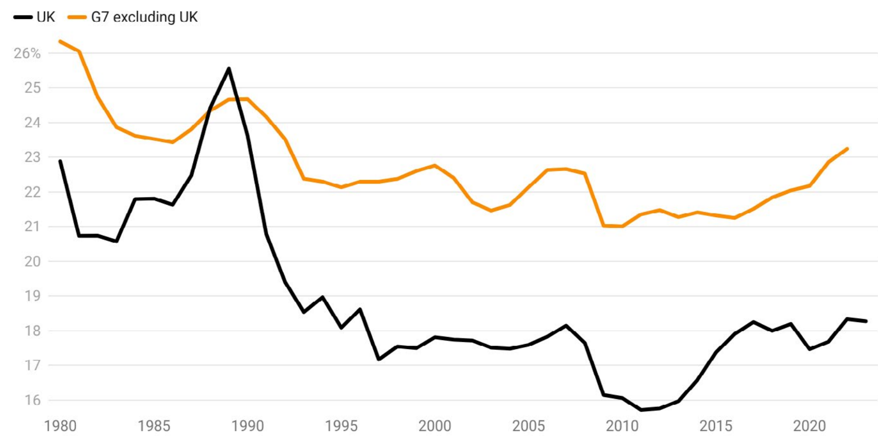
The structure and price performance of the property market has the effect of diverting a good deal of entrepreneurship into gaming the system (which economists often refer to as rent-seeking) and overcoming land constraints.

In addition to the effects on corporate behaviour, there is a comparable effect on millions of ordinary peoples' attitudes to business and wealth creation. After seeing the excellent returns to be had from property appreciation, many peoples' efforts at accumulating wealth will be directed towards property speculation and improving and extending their own properties at the expense of time, effort and money put into starting or developing a business.

Effects on investment

It is well-known that the UK suffers from a low rate of investment compared to most of its international competitors. This is a deep-seated phenomenon but it is surely closely connected with many of the ways, discussed above, in which the workings of the housing market and the planning system impede the performance of the economy. See Chart 18.

Chart 18: Gross Fixed Capital Formation in the UK and G7 (% of GDP), 1980 - 2023



Source: OECD.

56. The National Archives, 'Barker Review of Housing Supply - Final Report – Recommendations', HM Treasury, 2004.
57. Muellbauer, op. cit., 2022.

What is less well-known, however, is that a substantial part of the gap in investment rates between the UK and other G7 countries is accounted for by a much lower rate of investment in dwellings. See Chart 19.

Chart 19: The contribution of different investment types to the gap between UK and rest of G7, 2000 - 2022, average gross fixed capital formation (ppts of GDP)

Source: OECD.

A higher rate of house building would directly tend to increase the UK's rate of investment - but not, of course, necessarily the rate of business investment. That might happen indirectly because of the effects of higher rates of housebuilding on house prices, thereby attenuating the various adverse distortions from high house prices discussed above. But reform of the planning system to make commercial and infrastructure development easier would definitely tend to have that effect.

International evidence

The problems created by a lack of housing supply are not confined to the UK. Accordingly, there is a good deal of evidence about the linkages between the property market and economic growth. Indeed, there is a considerable body of evidence linking credit-fuelled property booms with diminished productivity growth, principally through the crowding out of more productive investment. [58]

In a 2017 paper, the economists Chang-Tai Hsieh and Enrico Moretti estimated that plentiful new home construction accompanied by labour mobility in three high productivity regions of the US, New York, San Jose and San Francsico, would increase US GDP by nearly 9%. [59]

Again for the US, Edward Glaeser and Joseph Gyourko estimate that "the lower bound cost of restrictive land use regulation is at least 2% of national output."[60]

9. The effects on inequality

In the introduction, we argued that for society as a whole, the generation of wealth through property price inflation is an illusion. For much of the time, this illusion can seem to apply also to the individual home-owner. They continue living in their property, enjoying the same services that they enjoyed before.

58. For the US, see: Doerr, 'Housing booms, reallocation and productivity', BIS Working Paper 904 Bank for International Settlements, 2020, and Chakraborty, Goldstein and MacKinlay, 'Housing Price Booms and Crowding-Out Effects in Bank Lending', Review of Financial Studies, 31 (7), 2018. For China, see: Hau and Ouyang, 'Capital Scarcity and Industrial Decline: Evidence for 172 Real Estate Booms in China', Swiss Finance Institute Research Paper Series 18-38, Swiss Finance Institute, 2018. For Spain, see: Basco, Lopez-Rodriguez and Moral-Benito, 'House Prices and Misallocation: The Impact of the Collateral channel on Productivity', Banco de Espana working paper 2135, summarised in SUERF Policy Brief 284, 2021. On European Countries, see: Grjrbine, Hericourt and Tripier, 'Real restate booms are behind Europe's productivity divergence', CEPR Vox EU, 2022.
59. Hsieh and Moretti, 'Housing Constraints and Spatial Misallocation', NBER Working Paper 21154, 2017.
60. Glaeser and Gyourko, 'The Economic Implications of Housing Supply', Journal of Economic Perspectives, Volume 32, 2018.

Nevertheless, the gain for individual home-owners is not illusory. They have the option of selling their home and downsizing to a smaller one, thereby realising money which can be used to support their consumption. The higher property prices rise, the greater the real value of the "bit of property" that they are releasing and therefore the greater the amount of consumption that this can finance.

Something similar is possible without moving home through home-owners taking out a loan against their property and thereby using the proceeds to increase their consumption. The higher real house prices are, the greater the size of the loan that can be secured and the larger the amount of extra consumption that this can support.

And then, of course, they are able to leave their property to their heirs, who will usually be their children. Other things equal, the higher real house prices are, the greater the sums that can be bequeathed.

The redistribution of wealth

Where does the redistribution element come in? Let us accept that a burst of house price inflation unrelated to any house improvements does not increase the real wealth of society, even though home-owners are enriched. If home-owners enjoy increased real consumption possibilities through any of the channels discussed above, then their increased consumption must ultimately be financed by someone else. Who? Unless their extra consumption is funded wholly from abroad, i.e. it increases the country's current account deficit by an equivalent amount then, for any given level of overall consumption, there can only be one answer: i.e. non home-owners. How does this work?

Other things equal, higher real house prices lead to higher real rents. If this did not happen then, as house prices rose, people would have a greater incentive to rent rather than buy. Moreover, the investment yield on residential property would fall, inducing landlords to sell rental properties, thereby reducing the supply of property for renting and consequently acting to increase rents, while reducing the price of residential property. These two forces are constantly in play.

Of course, there are other factors at work, including the influence of interest rates. Accordingly, rents and residential property prices do not move in lockstep. But, for the reasons given above, they will not usually move wildly out of line with each other.

The effects of this process are usually disguised until later in a person's life because as rents and house prices rise, then typically so do mortgage payments. If the percentage of an average property's purchase price financed with a mortgage is constant and real interest rates are constant then, as real house prices rise, then so do real mortgage payments. For two comparable people, one who rents and the other who buys their property, the share of their income going to pay for their accommodation will be broadly similar – the one paying the monthly rent and the other paying the monthly mortgage.

But the difference is that the home-owner owns an asset whose real value is rising and who can therefore, at some stage in their life, augment their consumption through the channels explained above.

Rapid house price inflation is a major driver of inequality in wealth. As the above makes clear, even if there isn't a corresponding effect on income inequality, nevertheless there is a clear impact on consumption inequality. The effect is likely to show up most clearly in older age groups.

As one of the authors of this report has put it: "the hope that house prices will continue to trend upwards is tantamount to an expectation that someone down the line will pay for those higher prices. To this end, those in the private rental market will have to wait and save longer, and in the process transfer a greater sum of capital to existing property owners in the form of rent, to purchase the same asset. " [61]

The inheritance factor

All this is before we take account of inheritance. It is possible to imagine a situation in which the inheritance of family property wealth was distributed evenly across the population. But such a scenario is pretty implausible. It is more likely that the inheritance of property wealth will fall disproportionately on heirs who are themselves property owners. Indeed, being a property owner makes it more likely that your children will be property owners, not least because the wealth acquired through real property price appreciation enables parents to help their children in the difficult first stages of "getting on the housing ladder".

Thus, property price inflation is a major factor in the generation and perpetuation of inequality in Britain today. Society can be subdivided into two groups: the property owning and inheriting class and the renters who have difficulty building up assets themselves and typically do not inherit much, if anything, at all.

10. The effects on the quality of peoples' lives

Cramped living conditions

We gave the figures on the average amount of space in British homes in section 2 above. The amount of living space occupied on average in the UK is among the smallest in the world. What's more, it has been declining over time.

You can see the evidence for this all around you. In many towns and cities, but especially in London, you can see modest terraced houses which used to be occupied by ordinary workers and their families. These are now so expensive that their modern day equivalents could not possibly afford to live there and are instead obliged to live in small flats or to move away to cheaper areas. Such modest houses are now the homes of supposedly prosperous middle class people.

Equally, there are many fairly large properties, formerly occupied by single middle class families, and their servants, which are now broken up into several individual apartments.

61. Vitali, op. cit., Policy Exchange, 2023a.

Admittedly, to the extent that there has been a decline in peoples' living standards because of a lack of space, there has been, at least to some extent, an offsetting improvement in living conditions through the increase in, and improvement of, various domestic facilities such as internal flushing toilets, central heating, abundance of hot water, fridges, etc.

At the very least, we can say that the supply of domestic space has not kept up with advances in average living standards in other aspects, including travel (cars), holidays, the quality and quantity of food, entertainment etc.

Family formation

The high price of living accommodation has had a major effect on family formation. The number of people aged 20 to 34 still living with their parents has increased from 20% in 1998 to 28% in 2023. Fully one third of men in the same age bracket live with their parents.[62]

This is the precise age bracket in which people want to settle down and start a family, and frequently, they wait for the security of a home of their own before doing so. As a result, younger generations are having fewer children, later, and this is contributing to the UK's low birth rate.

Commuting times

One of the ways in which people try to avoid these constrictions is by moving long distances away from their place of work. Even after the growth of working from home, this leads to other large negative effects on the quality of peoples' lives.

According to data published by Eurostat, in 2019 the UK had the second highest average commuting times in Europe, after Latvia. Moreover, according to this same data, there were 4,130,500 workers in the UK with one way commute times of an hour or longer. [63] According to Liam Halligan, there are now 3.2 million workers with daily commutes exceeding 2 hours each way, some 34% more than in 2007.

Environmental effects

It is widely believed that cities are bad for the environment, and on the surface, this appears to be true: the UK's 63 largest towns and cities account for just under half of all emissions.

But, as the Centre for Cities has found, on a per capita basis the opposite is in fact true: air pollution is about a third less than in cities than in non-urban areas. Denser urban conurbations have lower carbon footprints because more people commute to work on foot or via public transport. Moreover, flats tend to have lower emissions than houses per m^2, so the environmental impact of the physical buildings is also less significant in cities.[64]

UK cities are remarkably less dense than European counterparts. Indeed, the population density of London is less than half that of Paris, and less than a third of Barcelona's.[65] That means more people commuting into work over a longer distance, and consequently higher emission levels.

62. ONS, 'Young adults living with their parents', 2024.
63. Eurostat, 'Persons in employment by commuting time, educational attainment level and degree of urbanisation', 2022.
64. Centre for Cities, 'Net zero: decarbonising the city', 2021.
65. Eurostat, 'Population density per sq km', 2011.

Poor building quality

In addition to the above adverse effects, planning constraints have consequences for the carbon footprint of individual buildings too. Within the existing framework for land use allocation provided by the planning system, developers calculate how much they are willing to pay for land on a "residual basis".[66] In other words, they estimate what sales price they can achieve for a unit of housing before deducting all the costs involved in the development process. The residual amount is what is left to spend on land. But because developers will want to ensure an adequate profit margin, and because land is the most scarce input factor, they are incentivised to reduce costs on construction and building materials. That means less heat insulation or energy saving measures for new homes.

There are also implications for the quality of new development more generally. Sometimes in the public debate, it is presumed that although our planning system will reduce the number of houses built, it will ensure higher quality. Yet, on the contrary, our planning system heavily incentivises developers to allocate a significant amount of their time and resources to strategically acquiring land, and less to quality, beauty and sustainability.

At the general level, planning constraints mean that demand persistently outpaces new supply in local areas. The uniform, identikit housing estates that we see cropping up on the edge of existing communities are the inevitable result of a situation in which supply does not respond to demand on a more organic basis. Such estates provide low quality supply quickly. But they feed into the vicious cycle of low-quality development, the decreasing legitimacy of development amongst existing residents, and increased local opposition to further housebuilding.

There is a health dimension too to our constrained housing stock. A failure to deliver new, improved supply means our existing homes are older, colder, and potentially more hazardous than those in other countries. (Indeed, the Home Builders Federation believes we have the oldest housing stock in Europe.)[67]

The Health Foundation estimates that roughly one in six homes in England are 'non-decent', which is defined as containing a hazard or immediate threat to life, not being in a reasonable state of repair, lacking modern facilities, or being insufficiently insulated or heated. And such homes can be the source of injuries, respiratory problems, excess deaths due to cold, and psychological stress for occupants. These factors in turn drive demand for Government health and social care services.[68]

66. Ryan-Collins et al., 'Rethinking the Economics of Land and Housing', 2017.
67. HBF, 'Housing Horizons, Examining UK Housing Stock in an International Context', 2023.
68. The Health Foundation, 'Housing: Why housing matters for health', 2024.

Attitudes to capitalism

The low and unresponsive supply of housing, caused principally by our planning system, is making some of the most basic human aspirations unrealisable for young British people. Owning your own home, starting a family, building wealth – all of these things are becoming extremely difficult for all except those who will inherit property from their parents.

And here, the issue of ownership comes back into focus. For a system in which house price affordability deteriorates is also a system in which it takes longer for young people to save up the funds to put down a deposit for a home of their own. As a result, they will end up transferring a greater quantity of their earned wealth to the older, property-owning generation in the form of rent. Such a state of affairs is destructive of the incentives for hard work, thrift and enterprise upon which capitalism depends. The affordability crisis in the housing market constitutes the very core of the crisis of confidence in capitalism itself.[69]

69. Vitali, op. cit., 2023a.

Cures

11. The case for a Land Value Tax (LVT)

Probably the most radical proposal for dealing with our housing crisis is the introduction of a Land Value Tax (LVT). This is an idea with a long pedigree and some distinguished proponents. It derives its force from the realisation that land is different from the other factors of production, namely capital and labour.[70] In its purest sense, land is God-given, rather than being the result of any human effort. Whereas if you tax labour and capital this will disincentivise work and saving, if you tax land, there is nothing to disincentivise.

Accordingly, a Land Value Tax (LVT) has been favoured by the likes of Adam Smith, David Ricardo, James Mill, his son, John Stuart Mill, and Alfred Marshall. Its most fervent proponent was the 19th Century American economist, Henry George, who argued that a single tax on land could raise sufficient revenue to replace all other taxes. In more recent times, LVT has been endorsed by Milton Friedman as the "least bad tax", and it was favoured by the authoritative Mirrlees Review of the tax system, published in 2011.[71] It is strongly supported by Martin Wolf, the distinguished Principal Economics Commentator of the Financial Times.[72]

Some advocates of LVT see its merits primarily in the advance of social justice, that is to say, taxing the owners of an asset who have not contributed to its creation. But that raises all sorts of awkward questions because anyone buying land, or acquiring land value in the process of buying some physical asset which sits upon the land, just before the transition point to LVT, will have paid good money for the asset and they surely deserve to be credited with the creation of the wealth they use to purchase it.

For most economists, however, the primary appeal of LVT is its potential impact on economic efficiency. If receipts from LVT can be used to reduce taxes on capital and labour then there is a potential gain to overall GDP. Moreover, a properly structured LVT would penalise the waste of land, land speculation and land banking. It would also encourage greater housing densities. Furthermore, if an LVT were designed such that at least some of the proceeds went to local communities, it could help to increase the legitimacy of new housing in the eyes of existing residents, and thus create a virtuous cycle of incentives for development.

A recent study focused on the US has suggested that the consequence of the introduction of an LVT could be a dramatic increase in GDP.[73] The authors say that the share of land in the US economy's non-financial assets amounts to over 50%. They model a 5 percentage point increase in the tax rate on the value of US land, excluding buildings and equipment situated on the land, balanced by reductions in the tax rates on labour and capital.

They claim that a fiscally neutral shift of this nature would permit a reduction in the tax rate on capital of 28 percentage points and a reduction in the tax rate on labour incomes of 10 percentage points. The result – which, admittedly, takes up to 80 years to reach full fruition – is an increase in real GDP of almost 15%.

So what's not to like? In fact, some form of LVT has been enacted in a number of countries, although in all of these cases it has been an additional form of taxation, rather than a single tax replacing all others, as championed by Henry George.

Of 167 countries analysed in one recent study, only 7 had an implemented a tax on land as such, as opposed to the combined value of land and buildings.[74] Moreover, where an LVT has been introduced, it tends to be one of a group of land and property taxes and raises a comparatively small amount of revenue.

A recent study of the practical difficulties of operating an LVT looked at six cases where some form of it had been introduced - Estonia, Namibia, Queensland (in Australia), Denmark, New Zealand and South Africa. These difficulties explain why, as implemented, an LVT stops a long way short of the Henry George ideal.[75]

In summary, there are two serious drawbacks to operating an LVT. First, it is extremely difficult to ascertain the value of land, pure and simple, apart from the buildings and structures that sit on it – or could sit on it, if fully developed in its "highest and best use". It is an enormous administrative task and if a proper system of LVT were attempted, because of the difficulty of establishing values, it would be extremely unpopular and would lead to a large volume of disputes.

Second, the introduction of an LVT would be bound to reduce land values, possibly substantially. While this might be desirable in the long-term, it could cause considerable short-term difficulties. It would, of course, be extremely unpopular with all those who owned land, including ordinary householders who would see the capital value of their primary asset diminishing. More importantly, the fall in land values could have a catastrophic impact on the stability of the banking and financial system since property values are the collateral for a good deal of bank lending.

Accordingly, we do not think that it is either politically possible or practically desirable to move in the direction of introducing an LVT in the UK. But we must not let the perfect be the enemy of the good. In designing a reform programme for the housing market what we should aim to do is to mimic some of the principles of an LVT and get as close as reasonably possible to achieving the objectives that it would secure.

There are two possible ways forward. The first is a radical overhaul of the current Planning system which completely replaces the regime put in place by the 1947 Town and Country Planning Act. The second is a set of radical proposals to work within the present system.

70. Virtually from the beginning of the subject of economics, the great economists have treated land as separate from capital and labour. By contrast, starting in the late 19th Century and continuing until the present, most economists lumped land together with capital in their "two factor" models of the economy. In the process they obscured some key features.
71. Adam et al., 'Mirrlees Review of tax system', The Institute for Fiscal Studies, 2011.
72. Wolf, 'The case for the land value tax is overwhelming', The Financial Times, 2023.
73. Goodhart et al., 'Post-Corona Balanced-Budget Super-Stimulus: The Case for Shifting Taxes onto Land', CEPR Discussion Papers 2021, 2021.
74. Almy, 'Effective and sustainable systems for valuing property for taxation: a comparison', A paper prepared for presentation at the 2016 World Bank conference on land and poverty, The World Bank – Washington D.C., 2016.
75. Hughes et al., 'Implementing a land value tax: considerations on moving from theory to practice', 2020.

12. The case for abolishing the current Planning system

The current approach to land use planning in this country runs against all the principles of a market economy. The very word "Planning "conjures up visions of a Soviet, controlled economy. Yet we know that such economies do not work. The current system is fundamentally wrong in putting such store by supposed housing "needs", as perceived by the planners.

Of course, in market economies there have to be regulations, and even more so in relation to land use because of the extensive presence of externalities and public goods. But the current system is biased against development, both commercial and residential.

There is a strong argument that the system should be turned on its head, with the 1947 Act repealed and replaced by a system in which, outside designated areas of outstanding natural beauty or architectural or historical significance, all development was permitted, subject to meeting the standard building regulations and subject to the test that the development causes no harm to existing residents or land users.

This would stop well short of giving the latter a veto over such development. Undoubtedly, however, there would be disputes over whether harm was going to be done by a potential development which would have to be reviewed by a development authority. The aim should be to minimise the scope for delays and complications created by extensive recourse to the courts.

The objective would be to create an abundance of developable land. The result would be not just more housebuilding and lower house prices but also that many of the current difficulties that people see with the housebuilding industry would fall away. The incentive for land banking would disappear and the barriers to entry would decrease significantly, leading to a more diverse industry by size and type of developer. Competition in the building industry would increase, leading to a better result for consumers all round, including higher quality building and more choice. There would be no need to create "affordable" housing as housing would become more affordable as a simple result of it being in much increased supply.

This would be a comprehensive, radical change in the planning regime. As such, we recommend the establishment of a commission to consider its feasibility, with a view to a potential pilot scheme in a defined area. If successful, then this new regime should be put in place for the whole country.

However, the housing crisis also demands more immediate action in the here and now. We need to press ahead with measures to boost the existing rate of housebuilding within the current broad planning framework, albeit reforming it so as to accommodate the government's housing objectives, in the ways we lay out below.

13. Reforming the current Planning System

We laid out under the "Causes" section of this report how our Planning System fails us. There may not be a silver bullet for solving the housing crisis, but the single most important remedy would be a vast increase in the abundance of developable land. Indeed, without a more abundant supply of land, any attempts to address housing market dysfunction or unaffordability will necessarily falter.

- The system must be rules-based. Our current system is highly discretionary, and this means that housebuilders have little certainty in advance on whether their proposed united will receive permission or not. This uncertainty is realised in delay, higher costs and greater premium on strategic land acquisition, all tending against the expeditious delivery of new housing supply. And this in turn makes the housing market less competitive, entrenching the position of large builders and quashing smaller, often locally-based builders. We must shift towards a model in which, so long as their proposals conform to rules specified in advance, housebuilders can be confident that they will receive the requisite permissions. Amongst other benefits, this would reduce the barriers to entry in the building industry and thereby stimulate competition.
- We recommend that the Government scrap the 1947 Planning Act and introduce primary legislation for a reformed planning system based upon zones with appropriate stipulations for mixed-use areas, conservation areas, and urban densities.[76] These would be set out by Local Authorities in Local Plans, which would also be accompanied by a design code, devised by architects in consultation with local residents. All detailed planning would be stripped out of this system. So long as proposed development conformed to the Local Plan, the urban density stipulations, the design code and so on, it should not require further permissions. Instead, high levels of local input should be front-loaded in the process.
- Existing residents should have considerable input over what new development will look like, where specifically it will be sited, and critically too, which areas of high environmental value should be protected. But they should not have a veto over the principle of new development itself. We want strong, cohesive, self-sufficient local communities that provide people with a sense of place and belonging, because these are more likely to nurture individuals and households that will flourish and contribute to society. And for such communities to emerge, there must be a real sense of ownership amongst their residents.
- A pilot for these changes could be implemented first within city limits, where housing demand is most acute and where the wider economic benefits of more abundant housing would be greatest. Primary legislation would not be required to achieve this; it could

76. The zonal system set out above represents the ideal planning model that Policy Exchange has advanced for some time, first in our influential 2020 paper Rethinking the Planning System for the 21st Century, and more recently in The Property Owning Democracy. But for a variety of reasons, introducing such a framework has proved to be very difficult politically. What should be considered now is whether the principles of that model – less discretion, a rules-based approach, greater certainty – could be applied more cannily.

be implemented by the relevant Secretary of State through a Local Development Order (LDO). This would amount to a scrapping of the 1947 regime on a limited basis in areas where the economic benefits would be most pronounced.

- Local authorities should be incentivised to produce Local Plans by retaining the presumption in favour of sustainable development when an up to date plan is not in place, in addition to the financial incentives set out below.
- Within this broad framework, the Government should encourage the maximum degree of flexibility and innovation at the local level in the delivery of new housing, so long as it is plan led. In areas zoned for development, communities should be encouraged to produce Neighbourhood Plans which will set the parameters of any new housebuilding. Community Land Auctions should be piloted by interested Local Authorities.
- The Government should establish development corporations, particularly in strategically important urban centres. **But the principle of a rules-based system, in which a higher degree of certainty is available for market participants than under the current regime, must undergird all of these potential delivery strategies.** A development corporation would not be responsible for detailed planning or assessment of need.

Non-residential Development

As set out earlier in this report, the flaws in the planning system affect the entire supply side of the economy, not just our ability to deliver housing. For office space and commercial sites, we believe our proposed planning reforms would have a material, positive effect. Areas could be appropriately zoned for industry, metro-area commercial use and light commercial use, and applications meeting the requirements set out by the planning authority (and any relevant building regulations) would be automatically granted permission, greatly increasing the certainty and speed of the planning regime.

But we would also recommend a number of steps to help speed up infrastructure projects. For new green energy plants, we argue that a new pathway for community ownership or benefit schemes in energy infrastructure like windfarms and solar farms should be introduced. Developers willing to make a community ownership or benefit offer should be able to access a fast-tracked planning process based on a local referendum, akin to the new Street Votes provisions in the Levelling Up and Regeneration Act. The government could consider introducing new zones for green infrastructure via Development Consent Orders (DCOs), particular for onshore wind.

For larger, strategic infrastructure projects, we believe that hospitals and prisons should be added to the existing Nationally Significant Infrastructure Projects (NSIP) regime. New National Policy Statements (NPSs) on energy, prison and hospital infrastructure should be published to help safeguard legitimate planning applications from legal challenge.

Self-build

The Government should improve the support available to self-build and custom built housing. Self-commissioned homes add density to existing areas in a gentler and more organic way than large housing estate and they are likely to be of high quality – given that those commissioning the homes will reside in them. But more profoundly, there seems something morally wrong about families requiring permission from the state to build a roof over their own head.

As we know, land is the most expensive component in the construction cost of a new home, and it might be the biggest impediment to smaller and indeed single-unit builders competing in the housing market. So the Government could support small builders by reforming the 'Right to Build' register, requiring that local authorities supply enough serviced plots to meet self-build home applications within two years. Self-builds could be required to conform to a design code, but the provision of land for a single housing unit would be guaranteed. Custom and self-build homes could be made a material consideration in the NPPF, and they would be eligible for the New Homes Bonus discussed below.

One might query whether self-builds can deliver new supply at the scale required to make a real difference. However, the question surely is not whether self-builds will solve the housing crisis, but whether they will actually improve the supply of new housing, to which the answer is surely yes.

And the potential of self-builds is far higher than might be assumed. By the Government's calculations, raising self-build rates to Dutch levels could triple the number of such homes delivered each year to 40,000 at an upper estimate. And what's more, it could help support the development of a market for smaller builders and a better mix of supply.

Capturing more of the development uplift in value

Reforms to the planning system which increase the abundance of developable land should work to diminish the remarkable uplift in land value that occurs when plots are given permission for building. Which speaks to a wider a point about land value capture; that it only addresses a symptom of the dysfunction in the market, not the cause.

Nevertheless, the effects of reducing land scarcity will not be comprehensive or immediate, and so capturing some of that uplift is important if we are to ensure that communities benefit from new development. Not only is that just in and of itself, but it will help greatly in rendering new development legitimate in the eyes of existing residents.

As it stands, the way we currently capture land value uplift is through developer contributions, specifically the voluntary community infrastructure levy (currently only used by 162 charging authorities), and more importantly, section 106 agreements. These are discretionary contributions made by the developer towards affordable housing and infrastructure negotiated on a case by case basis, but with opt outs if meeting this contribution compromises the financial viability of the development.

In practice, the system has two significant flaws: one, it is highly uncertain for developers as each contribution package is negotiated on a discretionary basis with the local authority, adding delay and uncertainty (and thus expense to the process of securing permission); two, the system is simply not raising enough money. In 2018-19 survey, over half of local authorities were receiving 50% or less of the contributions they had negotiated in the two years previously.

We propose replacing the developer contribution system as it stands with a single, flat rate, locally set infrastructure levy. It should be mandatory, and with very limited opt outs for social or affordable housing, self or custom builds, or home improvements. This differs from the previous administration's plans for a nationally set levy, but with section 106 retained (and expected to continue to generate consider receipts.)[77]

Our proposed system would greatly enhance certainty for both local authorities and developers but would retain some flexibility for authorities to set an appropriate rate, given the vast geographical variations in land values and property prices across the country.

One key issue to address will be the need to forward fund significant infrastructure. Our proposed infrastructure levy would be levied on the Gross Development Value (effectively the final value of the completed development) rather than at the point of permission, as the Community Infrastructure Levy is charged.

So the Home Building Fund Infrastructure Loans, instead of being directed towards developers, should be targeted at local authorities, who apply for the funding. Local authorities should also be able to borrow against their infrastructure levy receipts in order to forward fund infrastructure in the future.

We also recommend that any developer contribution receipts should be ring-fenced for infrastructure development and resourcing local planning departments. Although in principle we have reservations about hypothecation, planning and development is a highly unique issue, in which it is essential to better connect new development to improved infrastructure in the minds of the local community. Wider financial incentives for the council to support new housing can be achieved through our recommendations on the New Homes Bonus below.

Financial Incentives for Local Authorities

Currently, the way we fund local government is doing little to encourage support for development. New houses might mean higher council tax revenues in the future, but supporting development on that basis is to embrace certain pain in the here and now in return for potential gains in a hypothetical future.

The Government runs a programme called the New Homes Bonus, which meets council tax receipts from new homes pound for pound, with an additional £350 per unit for affordable housing, and a premium for bringing empty houses back into use. Frankly, though, the scheme it is not of a sufficient scale to meaningfully affect incentives. The total allocation for the year 2023-24 was £291.2 million.[78] Between 2013 and 2023, the Government spent roughly ten times that amount on average per annum on the Help to Buy equity scheme.

Local Government funding is a notoriously complicated subject, but we believe something must be done in this area. Carrots and inducements must be introduced to compensate for the unavoidable costs that come with the building of new homes. The New Homes Bonus should be augmented. For every £1 of new council tax revenue, the government should provide a £3 bonus. On top of this, there ought to be an additional £1 bonus if the new development conforms with an up to date local plan, as this will incentivise Local Authorities to put these in place and positively support the type of strategic development that can command legitimacy amongst local communities.

Ending Help to Buy

The Government is still contributing to the mismatch between supply and demand by bolstering demand through the Help to Buy scheme. This despite evidence submitted in a recent House of Lords report that the scheme has led to an increase in house prices greater than the subsidy value it offered first time buyers.

The Government should reallocate that spending towards boosting housing supply. In particular, it should shift that funding towards resourcing local planning departments, so that Local Authorities are sufficiently well staffed – and their staff have the requisite skills and training – to execute their role in the planning system expeditiously.

14. Releasing land from the Green Belt

A reform of the planning process as outlined above should increase the supply of new homes appreciably. What's more, a proportion of these could be on so-called "brownfield" land. But on its own, this is unlikely to be enough to end the country's shortage of housing. In addition, we will need to release some land from the Green Belt.

As argued for in previous Policy Exchange papers, Green belt designations in the United Kingdom should be overhauled. Land of genuine environmental value within them could be categorised and protected as Areas of Outstanding Natural Beauty. Areas which do not meet this standard, and which are within a certain radius of existing transport infrastructure, could then be zoned as land for permitted development.. Unlocking land here would likewise be an especially targeted approach to meeting acute housing demand.

According to Professor Paul Cheshire of the LSE, "greenbelts in fact cover one and a half times as much land as all our towns and cities put together." Moreover, he says: " our towns and cities are far greener than greenbelts: not only is the biggest land use within them parks and

77. Department for Levelling Up, Housing and Communities, 'Government response to the Levelling Up, Housing and Communities Select Committee report on The Future of the Planning System in England', 2022 and Vitali, op. cit., 2023b.

78. Department for Levelling Up, Housing and Communities, 'New Homes Bonus final allocations 2023 to 2024' , GOV.UK, 2023.

gardens, but they also provide far richer biodiversity than intensively farmed land. Just less than 10% of England is built up, but gardens cover nearly half that area." He also says: "Green belts are a handsome subsidy to "horseyculture" and golf."

Nor, according to Cheshire, do greenbelts provide much social or amenity value. "The reality is that a child in Haringey gets no welfare from the fact that five miles away in Barnet, there are 2,380 hectares of greenbelt land." [79]

If we move to a zonal system (either entirely or by applying one first to cities as suggested above), then we could specify that green belt land that was not adjudged by to be of genuine environmental value and was within a certain radius of a train station be zoned for development. Alternatively, such considerations could be part of a new provision inserted into the NPPF.

15. Encouraging the Public Sector to release more land

We have argued that land scarcity is the main issue for developers constraining the delivery of new housing. The Government can help address this by expediting the permissions process, but it can also directly release publicly owned land for development, for it owns hundreds of thousands of acres of land which might be used for residential development. The state owns almost one million hectares. Given a housing density of 45 units per hectare, releasing just a tenth of this land would provide enough space for over a million homes.[80]

Of course, some of this land, particularly that owned by the Ministry of Defence, is not in a prime location where we need to be delivering new housing. But much of it, for example that owned by the Department of Transport, is.

Between 2015 and 2020, the Department for Levelling Up, Housing and Communities ran a moderately successful programme for the disposal of public land, which by March 2020 had released land with capacity for 61,302 new units.[81] Nevertheless, the programme missed the original target of releasing land for 160,000 units of housing by some distance.

There was also a contradiction in the programme's two disposal targets, one of which was for releasing land for a number of new housing units (160,000), and another for proceeds from the land sales (£5 billion); releasing plots with the potential to develop the most homes might not secure the greatest receipts, something the Public Accounts Committee identified in its report on the programme in 2019. The Committee also identified that the Government did not keep a record of how many new homes were delivered on the land they disposed, which would have made it difficult to judge the effectiveness of the programme.[82]

We believe a new, more ambitious Public Land for Housing Programme should be launched, which requires government departments to transfer land to Homes England for new housing. To ensure that this programme has real teeth it should be managed by HM Treasury.

79. Cheshire, op. cit., 2014.
80. Halligan, op. cit., p120-121, 2019.
81. Department for Levelling Up, Housing and Communities, 'Public Land for Housing Programme, 2015-20: Concluding Summary Report', 2020.
82. Public Accounts Committee, 'Sale of Public Land', 2019 and UK Parliament 'Government will fail to meet key land disposal targets', 2019.

Secondary legislation would be introduced to specify targets for each department. The programme should have a duty to maximise the delivery of new homes, and should be assessed against three key performance indicators: the total number of housing completions it supports; the housing capacity of the land unlocked; and the receipts generated by the disposals. The Government should make it explicit in relevant strategic asset management plans that the programme should prioritise the delivery of new homes over receipts.

With the assembled land, there should be a focus on diversity of supply and diversity of developers, with an attempt made to support SME builders in particular. Given that TfL has a property portfolio of over 5000 acres in London, pressure should be brought on the mayor to release some of this land for London boroughs too.

16. Changing the tax treatment of housing

It is widely accepted that attenuating, never mind stopping, the process of continually rising real house prices will require a rebalancing of supply and demand. So far we have concentrated on measures that could increase the abundance of developable land and boost the supply of houses.

But there is another way of rebalancing demand and supply, namely through reducing the demand. Clearly, we cannot reduce the number of people in the country and that has a huge bearing on the number of households. (The UK could, however, substantially reduce the rate of immigration and if that were to happen, not only would it reduce the rate of new building required in the steady state, but it might lessen some of the opposition to increased housebuilding from people who resent what they see "as concreting over the countryside to house immigrants".)

Yet, as we argued above, demand is about more than simply the number of people in the country. Demand is an economic concept. It is about the willingness and ability to pay a certain price. This depends upon a whole host of factors. It may be possible to influence the demand for housing in a way which leads to more efficient use of the housing stock, while also bringing other economic benefits.

One of the major influences on demand is tax. Any government determined to attenuate the demand for housing would review the tax treatment of owner-occupied property, making capital gains subject to CGT like other assets and/or subjecting the imputed income on owner-occupied property to income tax, as used to happen in the UK under the so-called "Schedule A" until 1963.

But both these tax changes look to be completely impossible politically and accordingly we devote no time to assessing their desirability or feasibility. That is not to say, however, that there is nothing that can be done. We discuss below four different sorts of tax measure which could be deployed to reduce the demand for residential property or make better use of the housing stock.

i. Council tax

The first thing to address is Council Tax, which is levied on properties according to bands based on their estimated or notional value in 1991. It is an unpopular tax, but it is also a remarkably unfair one too. Property values, as set out elsewhere in this paper, have risen considerably since 1991, yet the tax bands have remained unchanged. To this end, some of the most valuable properties in the country have the lowest proportional tax liability. The tax bands increasingly bear little relation to current property values.[83]

There are also economically damaging carve outs and exemptions within the system. For example, single-person occupants are in receipt of a considerable discount on Council Tax, which encourages under-occupation and the inefficient use of housing stock more generally. Until 2024, there were exemptions for empty properties too, but this has recently been addressed by the Government.

The artificially favourable tax treatment of property in the current system increases the attractiveness of investment in residential real estate which, as argued above, has fuelled house price inflation and diverted capital away from other, potentially more productive parts of the economy. [84]

A tax regime for property that was more consistent with the object of economic growth would seek to capture some of the considerable value uplift in housing that has derived from asset price inflation over the last thirty years, and potentially use that to reduce the tax burden on earned income. It would also seek to reduce some of the perverse incentives against the efficient use of housing stock which distorts the present system.

From the perspective of an economist, a proportional property tax would be an ideal system, but we think that the political obstacles in the way of delivering one would be prohibitive. Nevertheless, this does not prevent the introduction of reforms that would make the existing regime more proportionate. Perhaps the simplest and politically most viable option would be to adjust the tax bands based on a regular revaluation of residential property, and potentially add some further bands at the bottom and top of the value scale. But given that less than 1% of homes are in the top council tax band, the rate will need to be increased too.[85]

A further step would be to make liability for council tax proportional within the bands, so that properties at the bottom of the band do not pay more than those at the top as a percentage of the house's value. The exemptions currently available to single-person occupants could also be removed (in combination with the stamp duty reforms we have proposed).

These changes could be made to be revenue neutral, but we would rather see such a reform utilised to make a structural change to UK taxation. Some of the increased revenue could be retained by local authorities to fund local services, and a portion of it could be remitted to central government and used to finance targeted tax reductions on earned income, which we believe would be highly beneficial for economic incentives. This would not only be a positive step in terms of the tax treatment of earned income versus capital income, but also in the tax treatment of different forms of capital.

83. Sandford, 'Local government taxation', House of Commons Library, 2023.
84. Adam et al., 'Revaluation and Reform: Bringing Council Tax in England into the 21st Century', IFS, 2020.
85. Valuation Office Agency, 'Council Tax: Stock of Properties Statistical Summary', 2021.

The losers would be those who have benefited from considerable increases in house prices over recent decades, and in particular elderly, single-occupant households in valuable homes. But this could be offset by the Stamp Duty changes recommended below to incentivise downsizing. And moreover, some deferral mechanism for the payment of tax liability on property could be paired with a significant cut, or even the abolition, of inheritance tax. There could also, as recommended by the campaign group Fairer Share, be a cap on monthly increases in tax liability deriving from the move to a proportionate system.[86] Stamp duty should be retained for foreign purchases and second homes.

Whichever course of action is taken, the foundation of a better system is a regularised property revaluation framework. Properties should be revalued every ten years, and this should be done by the Valuation Office Agency, which already conducts the valuation of non-residential property for business rates.

ii. Stamp Duty

A radical reform of Council Tax could do much to incentivise downsizing and thereby make more efficient use of the housing stock Another tax that bears on this issue is Stamp Duty. Often surplus space arises when older people, whose children have left home, continue to reside in a large family house.

Why do they choose to hold on to such houses? Of course, often the reasons are emotional. They may love their home which may have many happy memories for them. Let us be clear. This is their free choice. There is no sense in which such people are "blocking" other, younger, home-owners. Still less is there any defensible policy to force such people to sell up and move out.

Yet some analysts have suggested exactly this. A report from the London School of Economics' Centre for the Analysis of Social Exclusion says that third of households have two or more bedrooms over the "national space standard". It favours a surcharge on "excess housing", forcing single people to share and banning second homes.[87] We have no truck with such Stalinist proposals to allocate privately owned property.

But the tax system plays a large part in persuading many such people to stay put. It can and should be changed. Rather than measures to force such people to sell up, we should be focusing on removing the various factors which give them a financial incentive to stay put.

There are two aspects of the current system which may deter potential downsizers. The first is Stamp Duty. It has to be paid on any new property that downsizers might buy, thereby reducing their overall wealth and the sum that they can leave to their children. No such loss occurs if they simply decide to stay put.

Naturally, this problem would be completely eliminated if Stamp Duty were abolished. There is indeed a sound argument for doing this. In fact, the authoritative Mirrlees review said: "Stamp Duty is among the most

86. Fairer Share Campaign, 'Proportional Property Tax', 2020.
87. Giles, 'The solution is simple: just build more homes', Financial Times, 2024.

inefficient and damaging of all taxes". Other things equal, however, if Stamp Duty were abolished, house prices would rise. Accordingly, it would be wise to combine its abolition with some increase in another form of tax on housing. The reformed system of Council Tax, described above, could be a perfect candidate.

But if Stamp Duty were not abolished then it should be possible to engineer a concession which would get round the problem of discouraged downsizers. Essentially, there could be a Stamp Duty exemption for last time buyers. If people who benefited from this concession subsequently bought another property then they would have to pay full duty on not only their new purchase but also the previous one which had carried the Stamp Duty concession.

Nevertheless, if this Stamp Duty wrinkle were introduced it would have to be carefully managed. Suppose somebody bought a family house at age 30 and declared that this was their last house purchase and so should be exempt from Stamp Duty. This would act as a deterrent to downsizing later in life. In practice this objection could be overcome by stipulating that the special treatment for last time buyers only applied to people over a certain age, say 60 or 65.

Another potential difficulty could arise when a couple downsize and thereby avoid having to pay Stamp Duty on their new purchase but then one of them subsequently dies. If the remaining person wishes to downsize again, the liability to pay Stamp Duty on the previous purchase effectively disincentivises this subsequent downsizing. Perhaps a further exemption from Stamp Duty could be made in such cases.

An alternative suggestion would be to exempt people from Stamp Duty when their new primary residence cost less than 80% of the one sold.

Whichever suggestion were adopted, creating artificial exemptions is distinctly second best. The optimum solution to the problem of discouraged downsizers is to abolish Stamp Duty for property purchases altogether.

Nevertheless, this would still leave us with a second potential barrier for downsizers, which is trickier – capital gains. As noted above, residential housing is uniquely tax privileged compared to other investments. If an older homeowner downsizes then any capital released will be subject to CGT if invested in equites or other comparable assets. Given that property has a long record of giving substantial capital gains that are free of CGT, this may seem to be another deterrent to downsizing.

One way of eliminating this deterrent this would be to make the capital released by downsizers free of CGT. Essentially, this could be done by creating a new type of designation of asset holding, rather like ISAs or Tessas. Inside such a downsizer's "wrapper", any asset could be held, free of any liability for CGT. If the authorities were especially keen to make this scheme attractive then, as with ISAs and Tessas, investment within the wrapper could be made free of income tax as well as CGT. If this were deemed to be too generous, then the concession could be limited to CGT only.

Again, though, there would have to be restrictions on the age of people claiming this treatment and some arrangement would have to be made for people downsizing again after a bereavement.

iii. Increasing the generosity of the "rent a room" scheme.

Another possible measure concerns the incentive to let out surplus space in your house. There is already a measure in place called the "Rent a Room Scheme" which allows you to rent a room or rooms in your owner-occupied home without liability to income tax up to a ceiling of £7,500 per annum. Rent received above this amount is subject to tax in the usual way.

This is a good scheme but the ceiling is too low. When the scheme was first introduced in 1992 the ceiling was £3,250. This was increased to £4,250 from 1997/98, and increased further to £7,500 in 2016/17, where it has remained ever since. So the allowance has remained unchanged for 8 years, during which time the Consumer Prices Index has risen by 30%. The ceiling could easily be raised to £10,000, roughly in line with the increase in the consumer price level since the ceiling was last increased.

There is no pretending that on its own, even with a higher ceiling, this scheme is any solution to the high level of rents, let alone the overall housing crisis. But it is a useful measure which, at the margin, helps to increase the availability of rented accommodation within the existing housing stock.

Although we have argued here that the solution to our housing crisis largely lies with increasing the housing stock, this scheme helps us to get the most out of the housing stock that we have. It would be an easy matter to increase the tax exemption ceiling significantly with little loss of tax revenue.

iv. Restrictions on the foreign ownership of UK property.

Along with the housebuilding industry and the owners of empty and second homes, there is another set of characters in the rogues' gallery of people who are supposedly responsible for the acute shortage of residential property in this country - foreigners who buy property here for investment purposes. Accordingly, another possible measure to attenuate the demand for property would be the introduction of restrictions, or extra taxation, on non-residents buying UK residential property.

You can see the appeal of such a policy. Parts of London are apparently dominated by foreign-owned properties that are seldom, if ever, occupied, thereby having a deleterious effect on the character of the area.

Nevertheless, other than in a few, relatively small, enclaves, this is a case of popular outrage running way ahead of the facts. Highly restrictive supply side constraints, in the context of a stable legal system and strong property rights, do create very strong incentives for foreign investment in UK residential property – stronger, as it stands, than most other areas of the British economy.

But in the context of the national picture, the numbers are comparatively small. It is thought that some 180,000 homes in the UK are registered with an overseas correspondence address – a doubling of the figure from 2010.[88] This means that foreign owned homes account for less than 1% of our housing stock.

Reducing international demand for UK real estate then, perhaps through restrictions or taxation, will not have a transformative impact on the housing market. Reduced overseas demand would leave unaddressed the fundamental cause of dysfunction in the market, and the thing that creates incentives for high levels of investment in the first place – that is, artificial constraints on new supply.

By contrast, if the proposals in this paper were enacted and a huge construction programme was begun, then that would undermine much of the motive force behind foreign investment demand for UK property.

Even so, there may well be a political case for increasing the tax burden on foreign owners of British housing. A move to increase the tax on foreign ownership of housing might help build a coalition for tackling thorny supply side dilemmas. It would be presented that in future British housing policy would be designed to promote growth and prosperity for the direct benefit of British citizens.

Thus, the Government's recent move to allow councils to levy double council tax on long-term empty properties should be retained.

v. Making Buy-to-Let (BTL) less attractive?

There are some arguments for making BTL less attractive:

- Housing is an asset that has normally produced significant capital gains. Excluding a substantial part of the population from home ownership as a result of property being snapped up by BTL owners thereby increases inequality.
- Home ownership offers non-financial benefits in the form of security and control.
- Home ownership makes people feel they have a stake in society and thereby arguably makes society stronger and more stable.

Even so, penalising BTL is not the way forward for an open, competitive and market economy, and it would not be in society's interests. The BTL sector has provided real benefits to many people. Owner-occupation is not essential or desirable for all people at all stages of their lives. Admittedly, the tax treatment of BTL was originally very favourable and this contributed materially to the returns to Buy-to-Let investors. But the tax treatment has subsequently been tightened.

- Ending special, favourable tax treatment for BTL is prima facie advisable. But there is no compelling case for going further and positively discouraging BTL.

88. Powell-Smith, 'New data on property in England & Wales owned by overseas individuals', 2023.

Conclusions

17. Stating the bleeding obvious: The key is more housebuilding

This report has concluded that the key to resolving both aspects of the UK's housing crisis is a far greater abundance of developable land and a much increased rate of housebuilding, permitted and encouraged by radical reforms to the planning system, the release of public sector land and the release of some Green Belt land, buttressed by some tweaks to the tax system. Yet the Man from Mars could reasonably counter by asking why this needs to be stated; isn't this an example of the "bleeding obvious"?

It ought to be but evidently it isn't. An increased rate of housebuilding is opposed by many people in this country, often vehemently, on the basis of a cocktail of fallacious arguments:

- There is no problem with high house prices and rapid house price inflation; this creates wealth.
- There is no shortage of housing in relation to demand.
- To the extent that there is a shortage, then it is all down to Buy-to-Let landlords/large amounts of unoccupied property/immigrants/second homes/foreign investors.
- It is all the fault of the greedy and inefficient building industry which deliberately seeks to restrain rates of housebuilding in order to support house prices and boost their profits.
- Lots of people have too much space for their legitimate needs. They should be restricted to amounts of space commensurate with their "objective" requirements.
- More housebuilding would have a negligible effect on house prices.
- There isn't any available land on which to build. The country is effectively "full up". Taking more land for housebuilding would involve concreting over green space which provides a valuable public amenity.
- It would be impossible to increase the rate of housebuilding appreciably because there simply isn't the capacity in the housebuilding industry.
- It would be impossible to increase the rate of housebuilding without provoking a house price crash which would imperil the whole financial system.

This report has shown that these arguments are all fallacious:

- House price inflation is not a wealth creator. It is a wealth redistributor. It is a powerful machine for the creation of inequality.
- There is a clear shortage of supply in relation to demand as expressed in high house prices and as experienced in cramped conditions for both owner-occupiers and renters alike.
- Empty property is negligible in relation to overall demand and second homes are an insignificant factor. High immigration does increase demand for property but, although we could restrict future rates of immigration, we cannot whisk away people already here. The rate of housebuilding simply failed to keep pace with the increased demand for property even before the recent surge in immigration. The current rate of housebuilding struggles to keep pace with the increase in population and so makes no inroads into the historical backlog of underbuilding.
- The housebuilding industry can be improved but land banking by builders is on a small scale compared to overall demand. Building companies are merely responding to the market incentives which the market sends out. A reformed planning system and much more housebuilding would lead to marked changes in the structure and practices of the housebuilding industry.
- It is not up to some scary, Orwellian, central housing authority to say how much living space people should have.
- Any plausible increase in the annual rate of housebuilding would indeed initially have a negligible effect on average house prices because the stock is so large. But that simply means that you have to go on administering the treatment for many years.
- There is lots of available land for building and much of it is not "green and pleasant" but "brown and nasty".
- The housebuilding industry is the size that it is today because of the current rate of housebuilding. If sufficient land were made available to increase the rate of housebuilding then the size and capacity of the industry would increase.
- There is no need to engineer a house price crash and a gradual and sustained increase in the housing stock would not bring one about.

So the Man from Mars is half right. It should be bleeding obvious that we need an increased rate of housebuilding, but to many people it isn't. The failure of government to confront the combination of vested interests and the wall of ignorance on this issue constitutes the greatest single failure of British post-war policy-making.

18. What would a reformed housing market look like?

In this report, we have laid out a path for reform. But if it were followed, what would the effects be?

What would happen to house prices?

The primary objective of the reforms to the housing market that we are suggesting in this report is to increase the amount of living space available to people resident here. Over and above that, the secondary objective is to increase the rate of owner-occupation. The dominant change needed to achieve these objectives is a substantial increase in the rate of housebuilding, leading over time to a much larger housing stock.

Other things equal, this could be expected to lead to lower real house prices than would be the case without the change in building. But what would be the likely size of the effect on house prices and what would be their likely path over time?

To a large extent the answer to these questions lies with the policy-makers. After all, they could opt for a smaller or larger change in the rate of housebuilding. So perhaps the key to this question lies with the answer to another, namely what should happen to house prices?

In many ways this is a bizarre question to ask. Why should the state in any of its guises have any objective for house prices? After all, it does not have an objective for bread prices, or car prices or for the prices of any other good or service. The point is that the market price of houses is to a considerable extent determined by government policies with regard to land use. They could make these policies tighter or looser.

These land use policies are in place to try to temper the market demand for land for building with due consideration for various externalities and public goods. (In practice, as we have argued, the UK planning system has gone way beyond this point.) As a government relaxed land use restrictions to permit more housebuilding and commercial development, land would be transferred from other uses. At some stage such reallocation could go too far. How is it to know when to stop? There is no precise answer to this problem. We are in practice surely a long way from any such point. But it would be useful to have in our minds a scenario of future housing affordability against which to make such a judgment.

The House Price to Earnings Ratio (HPE)

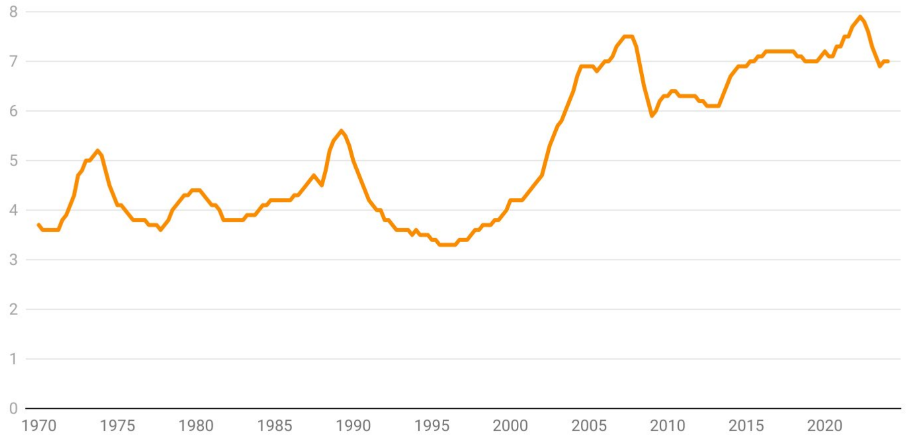
There is no societal interest in engineering a sudden sharp drop in house prices, even if that were possible. Not only would a housing "crash" imperil the stability of the financial system but it would also deal a severe financial and emotional blow to millions of people whose overall wealth position depends critically on their stake in the housing market. So what is the way forward?

Across the economic and interest rate cycle, the best measure of housing affordability is the House Price to Earnings Ratio (HPE). (This is not to be confused with the metric often referred to as measuring affordability, namely the share of the average borrower's income taken up with mortgage payments. This is strongly influenced by movements is interest rates. That can be useful for short term analysis but such movements in interest rates come out in the wash in the end. The HPE ratio is a much more enduring measure of value in the housing market.)

There are two issues to be considered here: what is the desirable and sustainable HPE ratio and how should it behave over time? There is no hard and fast or simple answer to these two questions. But we can have a stab at answering them. A sensible and desirable result might plausibly be a return to the HPE that existed before the recent take-off in house prices that began in about the year 2000.

As shown in Chart 20, from 1970 to 2000, when house price inflation really took off, on this Nationwide measure, the ratio of house prices to earnings was between 3 and 6, with the average at 4.1. With increases in the housing stock proportionate to population growth, this provided a context in which people could realistically save and get onto the property ladder. But the ratio recently hit 8 and it is currently about 7. A reasonable objective would be to restore a similar relationship between house prices and incomes to the one which ruled between 1970 and 2000, when the HPE ratio averaged about 4.

Chart 20: House price to earnings ratio in the UK, 1970 - 2024



Sources: Nationwide, ONS, Capital Economics.

Partly, this can be realised through real earnings growth made sustainable by productivity gains. But it will also require us to stem the extremely high annual growth of house prices that we have experienced since the 1990s. We believe that this can come from a significant and sustained increase in the UK's housing stock. Increasing supply materially, adjusting expectations about house price growth, shifting incentives towards investment in other parts of the UK economy – all of these things will take decades, not years.

We can have a stab at outlining a suitable path for house prices and the HPE ratio. At today's average earnings, reducing the HPE ratio from 7 to 6 would imply a fall in average house prices of about 14%. But, as we argued above, such a drop would be in no one's interest. Rather, the same objective could and should be achieved by house prices remaining roughly stable while average earnings rise.

Table 3: How many years it would take to reduce the HPE ratio to an acceptable level from an initial HPE ratio of 7

If house prices rise by 0% per annum		
	To get HPE to 6	**To get HPE to 4**
Earnings increase by 4% nominally	3.9	14.3
Earnings increase by 3% nominally	5.2	18.9
If house prices rise each year in line with inflation (2%)		
	To get HPE to 6	**To get HPE to 4**
Earnings increase by 4% nominally	7.9	28.8
Earnings increase by 3% nominally	15.8	57.4

Table 3 shows some possible outturns. We should emphasise that these figures are illustrative only. In practice there is no way that the Government or Bank of England or anyone else could or should manage house prices in any precise way. And it is likely that even in our reformed housing market, there will still be some price fluctuations. But the table does serve to illustrate the necessary scale and duration of the adjustment.

At a rate of increase of average earnings of 4% it would take just under 4 years to bring the HPE ratio down from its current level of 7 to 6. To get it down to 4 would take over 14 years. Clearly, it would be possible for house prices to rise a bit, rather than be static, and still to reach the same end objective. It would simply take longer.

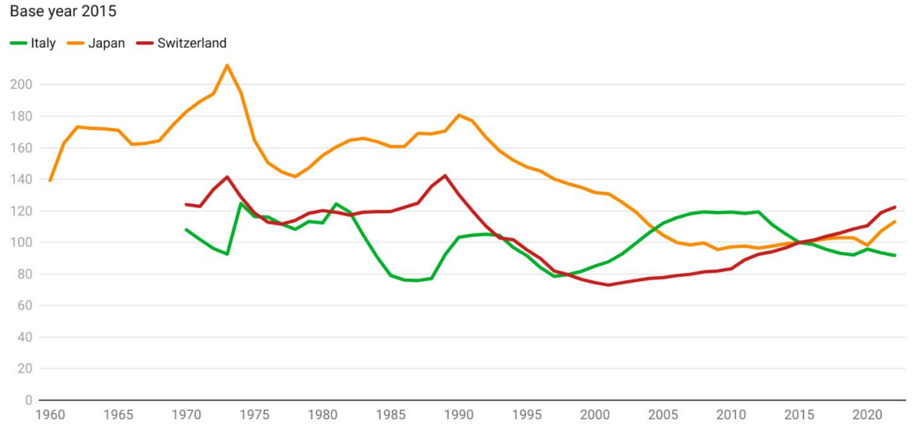
And this might well be preferable. After all, if average house prices were not increasing at all, given general inflation in the economy, this would imply that house prices were falling in real terms. This would cause dismay among most home-owners and it might imply dangers for the financial system – although much less severe than would be the case in the event of a sudden, sharp drop in prices.

Perhaps a more desirable and safer path would be one in which house prices rose in line with the general price level so that real prices remained constant. Given some rate of increase of real earnings, this would still imply a gradual fall in the HPE ratio over time. Let us suppose that house prices rise at 2%, in line with general CPI inflation. This is the scenario examined in the lower part of Table 3. If earnings rose by 2% more than prices each year, i.e. at a real rate of 2%, then it would take just under 8 years to reach the desired HPE ratio of 6. Getting it down to 4 would take almost 29 years.

If real earnings rise by only 1% per annum, i.e. at a nominal rate of 3%, while house prices are rising at 2%, then it would take almost 16 years to get the HPE ratio down to 6. To get it down to 4 would take almost 60 years.

Critics might reasonably ask whether any country has managed to achieve such a dramatic reduction in the HPE ratio as we have suggested is desirable for the UK. In fact, quite a few have experienced substantial reductions although, it is true, this has not necessarily been the result of deliberate government policy. As Chart 21 shows, over the period back to 1970, the HPE ratio has fallen appreciably in Italy, Japan and Switzerland, although in the latter there has recently been a sharp bounceback.

Chart 21: House price to income ratios in selected countries, index, 1960 - 2022



Source: OECD: 'Housing prices'.

A steady state for the housing market

Once the historical under-supply of housing had been eradicated by a sustained higher rate of housebuilding, what steady state rate of housebuilding would then be necessary would depend principally on two factors:

- The rate of population growth, which is likely to depend heavily upon the level of immigration;
- How the demand for housing responds to continually rising incomes.

In many parts of the world, population is already falling. This is true of China, Japan, Russia, South Korea and Singapore. Nearer home, it is true of Germany, Spain and Italy. In these countries, there will soon be an incipient surplus of housing available over ordinary needs. So in these countries you could imagine that at some point the rate of housebuilding could fall to zero and the real price of houses could start to fall. Suffice it to say that anything like this prospect in this country seems far-fetched.

On the second point, we have noted throughout this report that the demand for housing tends to rise as people become richer. Accordingly, we should expect the demand for housing to continue rising, even with a stable population.

There could, however, be a limit. At some stage, the demand for more space might be satiated. After all, increased living space normally entails more incidental and running costs, perhaps a diminished sense of cosiness, and a lack of togetherness with other family members etc. So you could imagine that at some point people would think that enough is enough.

This is possible but we are so far from this point in the UK that it is scarcely worth considering. For the majority of people in this country, more living space is surely going to be towards the top of their list of desirables for decades to come.

What would happen to the rate of owner-occupation?

If a regime of broadly stable real house prices were created by a surge in housebuilding and/or changes in taxation arrangements, the rate of owner-occupation would probably rise naturally, although this is not guaranteed to happen. The balance between owner-occupation and renting could remain roughly as it is now.

But that is unlikely. After all, without the inbuilt assumption of substantial real capital appreciation, the investment demand for housing should subside. In fact, the investment aspect is a driver of the demand for housing from both owner-occupiers and BTL investors. But it is clearly greater for the latter group. Indeed, the investment aspect is entirely what drives BTL activity.

By contrast, demand by owner-occupiers is about more than this, notably about the benefits of living in accommodation that you own. Given that the ability to realise this desire has been held back by high real house prices, a lower path for these than would otherwise have been the case should see the rate of owner-occupation increase.

19. The effects of a reformed housing market on economic performance

A reformed planning system, leading to a much increased rate of house-building, accompanied by increased commercial development and the construction of infrastructure facilitated by a reform of the planning system could have a major impact on the UK economy:

- A higher rate of real investment as the result of the greater ease of commercial development and infrastructure projects.
- More investment as the result of greater preparedness of the banks to lend to business.
- A reduced cost of doing business in the UK.
- A more flexible labour market, allowing labour to move to where the opportunities are.
- More entrepreneurial effort put into real economic activity rather than gaming the system and engaging in speculation in the property market.
- Improved real living standards, health and happiness of workers,

> who will thereby be encouraged to stay in the UK. The effect will be greatest on younger age groups who currently bear the greatest part of the burden imposed by our dysfunctional housing market.

How large could these effects be? It is impossible to make any precise estimates and the outturn would depend upon over how long a period the reforms to the market were adhered to. For various types of housing market reforms ranging from the effective end of planning restrictions in two key US cities to the adoption of a full throated LVT in the USA, the economic studies referred to above came up with increases in real per capita GDP of between 2% and 15%. Because of the probably greater impact of the restraints on land use in the UK, a radical reform package here may have even greater scope to realise substantial gains, bringing a radical improvement to people's lives.

20. Making housing reform politically possible

Exorbitantly high house prices and rents are the result of the greatest government policy failure in post-war Britain. This stems mainly from the system of land use planning put in place after the war and broadly upheld by governments of both stripes ever since. If there were only one policy change that we were permitted to make to enhance the UK's economic performance, radical reform of the planning system including the Green Belt system, thereby increasing the supply of developable land and permitting more residential and commercial development, would be our choice.

There is no doubt that raising the rate of housebuilding to a level that gives the best results for society is a very difficult political problem. The property industry has enormous political influence. There will surely be serious resistance to any erosion of the power of the major property companies have over the supply of newbuilds onto the market and therefore of their prices. Between January and May of 2017, the property sector accounted for over a third of corporate donations to the Conservatives. [89]

Yet this difficulty should not be insurmountable. After all, if housebuilding proceeds at a much faster pace, that can bring an increase in profits to make up for any reduction in the profit per newly built house brought about by the exercise of the housebuilders' oligopoly power.

The great political prize is to win the support of those people who are currently frozen out of the housing market by shifting the planning bias against housebuilding and ensuring that more land is released for building. So far, governments have typically courted this vote by spending large amounts of money to subsidise FTBs, thereby boosting the demand for housing and increasing prices overall. By 2023 the Government had pumped almost £30bn into HTB. [90] Surely by now the penny has dropped. The key lies with increasing housing supply, not cooking up artificial schemes to improve affordability for particular groups which have the effect of boosting housing demand and therefore causing higher house prices.

89. Construction Index, 'Tories boosted by construction donations', 2017.
90. House of Lords Library, 'Meeting housing demand: Built Environment Committee report', 2022.

What makes the political challenge even more daunting is the long time period over which a different approach to land use planning and the supply of housing would need to be sustained. Because housing is a long-lived asset, even major changes to annual rates of home construction have only a small proportionate effect on the overall stock.

To make a material impact, changes have to be sustained over decades. This would require a cross-party consensus that this was the way forward, effectively mirroring the consensus that emerged over the last 80 years. Changes to the tax treatment of housing could help to amplify the effect of a change in policy on housing supply and thereby reduce the time period over which the policy would need to be sustained to secure a meaningful effect.

As we argued in this paper, there is a considerable amount of investment demand built into the UK property market. Decades of sharply rising real property prices have meant that for many people residential property is their main investment. If the future price performance of property were to disappoint these expectations over a number of years, in the context of the clearly recognised consensus objective of boosting supply, perhaps bolstered by some changes to the tax system discussed above, then the investment demand for property might fall back.

Transitioning to a regime in which real property prices did not rise by large amounts every year would undeniably be a difficult change to manage. A large fall in property values is neither necessary nor desirable. But a world in which property prices trended gently up in line with retail prices, or perhaps average earnings, would ensure that residential property remained a good store of value, as well as fulfilling its primary purpose of providing accommodation.

Yet that is a far cry from today's property casino, which enriches some citizens and impoverishes others, while weakening the well-springs of overall prosperity. It is time for radical change.

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