# Homes for Growth:

## How Housebuilding Can Revitalise the UK Economy

James Vitali

Foreword by Rt Hon Brandon Lewis CBE MP

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# Foreword

*Rt Hon Brandon Lewis CBE MP*
*Former Lord Chancellor and Minister of State for Housing and Planning*

"Housing", as Winston Churchill put it in 1951, "is the first of the social services. It is also one of the keys to increased productivity. Work, family life, health and education are all undermined by overcrowded homes". In this passage, Churchill pointed out a fundamental truth that we would do well to remind ourselves of: housing touches all parts of British life, particularly our economic performance. Our economy is stuck, but we seem to be ignorant of the substantial part that inadequate housing supply is playing in this stasis.

Housing undersupply is not a novel problem. The truth is that since the 1970s, we have consistently failed to deliver enough new housing to meet demand. I was proud that as Minister of State for Housing, we were beginning to boost the number of new homes built each year. In 2015, we increased the number of new houses built by almost 20% on the previous year. But we need to go much further to meet existing need and begin to address the backlog of demand. The toll on British households of our failure to build enough new housing in the form of higher house prices, higher rents and higher monthly mortgage repayments is clear.

Yet the costs of housing undersupply are not confined to the housing market alone. As this new report by Policy Exchange comprehensively sets out, dysfunction in the housing market is spilling over into the wider economy, holding back growth and productivity. The undersupply of housing is bidding up prices across the UK and this in turn is having a number of deleterious economic effects, diverting capital away from productive parts of the economy and reducing the mobility of our labour force. The chronic shortage in housing is holding our country back.

I am also profoundly concerned about the social impacts of housing undersupply, something this report admirably raises. A lack of housing is preventing young people from leaving their parents' home to seek out opportunity, and it is preventing couples from moving into a house of their own to start a family. Our failure to deliver enough new homes is dashing the hopes of those that want to work hard and get on in life, and it is exacerbating a growing tension between generations in British society. What is more, our laborious process of planning approval is currently failing to deliver either the certainty that house builders require to build more homes, or the assurance to local communities who wish those homes to be beautiful.

To fulfil our country's great potential, we must give young people cause to believe that, like their parents, securing a good job will enable them to buy a home of their own, and to settling down and have children. These ambitions depend on us delivering more homes. Addressing the UK's housing shortage is a huge challenge, perhaps the greatest that we face as a country. At the same time, though, solving the crisis holds out the dual prospect of placing rocket boosters under our economy and selling a new generation on the "British dream" of homeownership.

The passage I opened this foreword with comes from the 1951 manifesto that delivered Churchill election victory and a second term as Prime Minister. In it, he also promised that his government would build 300,000 homes a year. It was a bold pledge, and one that was met with cynicism on both the left and the right. Many said it could not be achieved. Yet by 1953, the government was surpassing its target. We must demonstrate that same level of ambition today.

Throughout this report, Policy Exchange makes the argument for restoring trust in the planning system by giving businesses greater certainty about the availability of developable land, and by proving to residents that housebuilding in their local area will be high quality and in keeping with character of their community. Doing so will help create a coalition in favour of building many more new, beautiful homes.

*Homes for Growth* sets out the economic and social case for why we must significantly expand housing supply in the UK, and the practical measures to achieve this. I commend it to the reader.

# Executive Summary

The British economy has stalled. Our trend growth rate in the 1960s was 3.4%; since the turn of the century, it has been 1.6%. We are also falling behind our international competitors: the UK is currently on a path to be the poorest country in the Anglosphere by 2028.[1] The main factor in this underperformance has been sluggish productivity growth, including a lack of capital deepening; whereas two thirds of the productivity gains between 1987 and 1997 were due to the increased amount of capital available per hour worked, a lack of capital has been a key factor holding down improvements to productivity since 2008.[2]

Low growth has had material effects on the living standards of the UK population. Wage growth has stagnated over the last two decades, whilst inflation has meant that at intervals real pay has actually decreased for many households. Low economic growth has also forced the government into increasingly difficult decisions on tax and spend in order to fund public services.

A key driver of the UK's weak economic performance is the chronic shortage in housing supply. Demand for new housing has increased consistently, through population growth and through the shrinking size of households. However, housing supply has failed to meet rising demand for a prolonged period. Estimates suggest that some 340,000 homes a year need to be built in England alone to address the backlog and existing demand, and the government itself has set a target of building 300,000 new homes per annum; annual housebuilding in England has averaged around half of that figure since the turn of the century. The last time 300,000 homes were built in England was the 1960s.[3] The result of housing shortage has been rapidly deteriorating affordability, vastly increased mortgage debt, an inflated housing benefits bill, and most damningly of all, declining homeownership levels, especially amongst younger adults.

The trends in housing supply and low economic growth are not independent from each other. The housing shortage is having a negative impact on the UK economy in four distinct ways:

- High house prices driven by supply and demand mismatch means bank credit is diverted into mortgage lending and away from more productive areas of the economy. This is a serious issue, given that a key factor in low productivity growth is the lack of available capital per hour worked. Mortgage lending has tripled since the 1970s, but the allocation of lending for private non-

1. Policy Exchange, *Unleashing Capital*, 2022.
2. ONS, "International Comparison of UK Productivity", 2020
3. Unless otherwise stated, this paper defines "new supply" as new builds. It thus excludes conversions and changes of use, for example, under permitted development rights.

financial businesses has flatlined over the last two decades. Capital is being invested in unproductive mortgage finance rather than the real economy of goods and services. However, investment in housebuilding *could* be highly beneficial to economic growth; boosting housebuilding by 100,000 homes could directly add £17.7 billion a year to the UK economy before even considering the indirect benefits.

- Housing undersupply and high prices constrain labour mobility. The British economy needs skilled workers to move to productive jobs. The primary "pull" factor in someone moving to a more productive area is the boost to living standards achieved by relocating. However, workers moving from an area in lower earning deciles to those in high earning deciles today may be left *worse off*. This is because house prices in productive areas have grown faster than wages.
- High housing costs in the UK's most productive cities are eating into putative gains in productivity. Manchester and Birmingham, the two cities with the greatest productivity potential outside of London in the UK, also have some of the greatest restrictions on development in the form of green belt. Improvements in productivity are being capitalised in higher house prices.
- Worsening wealth inequality is subduing consumer spending on goods and services. The increasing wealth to income ratio reflects a net transfer of wealth to the already rich at the expense of poorer groups. A key driver of growing wealth inequality is property and land. Property wealth now constitutes 35% of total wealth (behind only pensions as a proportion), and a significant component of property wealth is comprised by land. Wealth inequality is not just inequitable - between August 2021 and August 2022 average house prices grew by £35,473 across the United Kingdom, whilst the median household disposable income was £31,385 – but it is also having a non-neutral effect on the economy, because capital is being transferred away from those with a high propensity to consume to those with a low propensity to consume.
- The housing shortage also has significant human costs. Housing undersupply is having a negative effect on household formation, and it is decreasing homeownership amongst people between the ages of 25 and 34 - precisely the age that couples tend to have children. It is also a factor in rising homelessness, it is preventing young people from leaving their parents' home and finding a job, and it is making it harder and harder for families to save. This is vitiating the dream of homeownership.

# Recommendations

The planning system is the underpinning cause of the UK's low-supply status quo in the housing market. The UK has a highly idiosyncratic, discretionary system, in which planning permission is granted on a case-by-case basis by local authorities. This makes the availability of land with permission for development highly uncertain and incentivises the strategic acquisition of land by housebuilders in order to mitigate that uncertainty. The current system also encourages developers to control the quantity of new builds to ensure that local markets can absorb increases of supply without compromising house prices. Nevertheless, there are no simple solutions to the UK's acute shortage in housing, and the government must make progress in a number of areas. A comprehensive plan to boost housing supply should include the following:

- **Reducing uncertainty for businesses by ensuring local authorities have an up-to-date Local Plan and give confidence to local communities by supplementing these with design codes.**
  - Developers should know what local authorities want built in their communities. Local Plan's provide businesses with a greater strategic sense of what will receive planning permission, but only 40% of authorities had up-to-date plans in 2020. The government should make up-to-date Local Plans a statutory requirement with teeth: local authorities without a Local Plan should see the proportion of business rates they retain fall, but those with an up-to-date plan should see that proportion rise.
  - Local residents should have a clear idea of what development in their area will look like. Design codes can provide this, and should be based on the principle that beautiful buildings and development have positive externalities and are more likely to receive planning permission and local buy-in.
  - Local planning departments need to be better resourced to achieve these ends. This should be achieved through development charges, so that developers directly support and improve the system they use, and local authorities are incentivised to deliver new homes, creating a virtuous circle.
- **Piloting changes to planning regulations on a limited basis via "regeneration areas".**
  - These should have a "local consent lock", and they could

trial a system in which planning permission is granted in principle for all development that conforms to a Local Plan and design code. Testing these proposals at a limited scale will help convince voters that development can enhance local communities in a way that is in keeping with their character.

- **Increasing trust in the planning permission process by introducing contractual obligations on both sides.**
  - Considerable delays exist both in the planning permission process and in the delivery of new homes once planning permission has been granted. This is shaking trust in the system. Further contractual obligations should be introduced into planning permissions, both for the local authority to decide on a planning application within the 8-13 week statutory window, and for developers to produce a certain percentage of new homes it has received planning permission for within an agreed timeframe. If developers miss their deadlines, council tax should be levied on uncompleted homes; if local authorities miss their own, they should lose their New Homes Bonus, which should be augmented to provide a greater incentive to deliver new homes.
- **Phasing out both the Community Infrastructure Levy and Section 106 Agreements and replacing them with the Infrastructure Levy.**
  - Section 106 obligations are greatly delaying the delivery of new homes, whilst the Community Infrastructure Levy is currently optional. Replacing both with a locally set Infrastructure Levy with limited exemptions would promote greater certainty for businesses and should be raised to a level that ensures such changes are tax neutral. Infrastructure Levy receipts should be retained entirely by local authorities, they should be able to build up cash reserves and borrow against those receipts, and revenues from the levy should be hypothecated for planning and infrastructure investment, as well as social housing.
  - A potential discount should be considered for infill or brownfield development, given that such sites are often expensive to prepare and that the former is especially suited to SMEs builders.
- **Embarking on a programme to significantly expand social housebuilding.**
  - The demand on social housing is largely a consequence of failure in the private market. However, social housebuilding will be strongly counter-cyclical in a period of economic downturn.
  - Social housing is not an end in itself, but a means to restarting the stalled conveyor belt of homeownership. Young people need low-cost housing in which they can save up for a home of their own.

    - In line with previous Policy Exchange research, there should be greater attention to building beautiful and emphasising quality to help reduce the social stigma surrounding council housing, and the government should dispose of public land for new houses to be built on. A significant proportion of disposed land should be reserved for SME builders. Increasing the social housing stock will have a positive impact on house prices and could help the government reduce welfare spending on housing benefits by 6.5% per annum and by around £10 billion over five years.
- **Providing more support to SME builders by strategically disposing of public land, reforming the planning system and streamlining infill development on brownfield sites.**
    - The housing market has become increasingly concentrated because of the barriers to entry for smaller builders, and this has resulted in a lack of competition. The low supply of new homes has thus gone unchallenged. The government should support smaller builders in the sector, who are more dependent on cashflow and thus are more incentivised to deliver new homes more expeditiously.
    - SME builders are also nimbler and best suited to deliver infill development on brownfield. In cities of high housing demand, planning authorities should have an SME coordinator to expedite planning permission for infilling.
- **Reforming Help to Buy over time**
    - The government should move away from subsidising demand and towards subsidising increases to supply. However, given the fragility of the market and the dependency of first-time buyers on government support, this should be done gradually.
    - Furthermore, the government should, over an extended period, also phase out stamp duty for primary residences.

The government does not face a challenge that is more pressing and more urgent than that of the UK's chronic housing shortage. Failure to confront the undersupply of new homes will diminish the effectiveness of other measures to boost productivity in the UK. The potential rewards for unlocking the housing market, however, are huge: a more mobile labour force, more productive cities, more investment in productive businesses, a reduced benefit bill, and renewed faith in the galvanising British ideal of home ownership.

# Introduction

The economics of the UK housing market are highly dysfunctional. For decades, demand for housing, through population expansion and changes to the nature of households, has consistently outstripped the supply of new homes, and this has translated into vastly inflated prices across the UK. In an effective market, supply is responsive to demand, and this has a balancing effect on prices. When it comes to housing, inelastic supply has instead facilitated rising prices.

Some of the effects of housing undersupply are plain and obvious. House prices rose 13.6% in the year to August 2022. This is not just a consequence of the pandemic or the inflationary shocks that have taken place this year; house prices have increased five-fold since 1995.[4] More homes are going for their initial asking price or even more than ever before, as potential new owners compete over an increasingly scarce asset.[5] As house prices have continued to outstrip incomes, mortgage debt has spiralled as households rely increasingly on credit to purchase their homes.[6] However, many of the effects of shortage in housing are hidden or indirect. They relate to the increase in homelessness, the decrease in new household formation (and all the implications this might have for family life in modern Britain) and the increase in wealth inequality.

A lack of adequate housing supply has also, both directly and indirectly through inflating house prices, had a chilling effect on the economy as a whole. That effect is the subject of this paper. The UK's growth dilemma has returned to the sharp end of the policy debate between the major parties. As Britain's economy has failed to grow discernibly over the last decade, the government has increasingly been required to make tough decisions on tax and spend to meet growing demand for public services. The UK tax burden is at its highest point in over 70 years at a time when growth in earnings has been essentially non-existent. As a result, individuals and families across the country are feeling the pinch and, with rising inflation too, some are even worse off in real terms than they would have been ten years ago.

Housing is at the centre of this bleak picture. As will be identified in the pages that follow, the shortage of homes, and the effect that this has had on house prices, has reduced the mobility of the labour force, absorbed potential productivity gains in the UK's cities, dampened consumer demand and diverted bank lending away from productive areas. The housing crisis does not simply have localised effects on regional markets; it is holding back growth everywhere.

The obverse point, however, is that addressing the housing shortage

4. Land Registry, "House Price Index", Link.
5. Right Move, "Record Number of Homes Selling for Asking Price or Above", 25th June 2021, Link.
6. Bank of England, Table A4.3.

offers immense economic opportunities for the country. As in previous historical periods like the 1930s and the 1950s and 1960s, expanding housing supply could provide a platform for sustained growth that balances the economy and spreads prosperity widely. It could help reduce government expenditure on benefits, it could make our urban areas more productive, and equally importantly, it could restore faith that the aspiration of homeownership – an aspiration that is held abidingly by the overwhelming majority of British citizens – remains attainable for hard working people.

The Truss government spent its limited stockpile of political capital on tax cuts rather than substantive supply-side reform. But whilst tax cuts might offer a transient, sugar rush uptick in economic growth, it is the latter that will generate the changes in the real economy that will produce sustainable and consistent economic growth for our country. The government must now be relentless in its focus on these reforms, of which, as this paper argues, increasing the number of new homes built each year is the most important.

The following is split into five sections; Section One will look at the wider policy context of Britain's sluggish economic growth. Section Two will outline the nature of the UK's housing crisis and its causes. Section Three will identify the causal relationship between the undersupply of housing and the effects it has had on house prices and the performance of the economy more broadly. Section Four will briefly consider some of the more human impacts of housing undersupply in the UK, before Section Five sets out how the government should go about building more homes and promoting economic growth.

# Policy Context: "The Growth Agenda"

Economic growth can feel like an abstract and intangible concept, but it is essential to modern democratic societies. It increases opportunity and improves living standards for all, it enables states to meet the challenges of providing good public services for expanding populations, and it offers the prospect that each successive generation will enjoy greater prosperity than the last – a vital component in a political system's legitimacy. Yet low growth has plagued Britain for decades. In the 1960s, the average GDP growth rate was 3.4% per annum; in the 1970 and 1980s, it was around 2.6%. Since 2000, average GDP growth has wallowed at around 1.6%.[7] A British Prime Minister could once say to voters that Brits "had never had it so good". Today, it is no longer clear that such a statement would apply automatically.

Though the short-lived Truss government framed its political agenda – the mini-budget and *The Growth Plan* – as a significant shifting of government policy towards addressing low growth, this issue has long been recognised as a priority for government. In 2019, the British Chambers of Commerce wrote to Boris Johnson on the urgent need to "take big decisions to stimulate growth".[8] Policy Exchange itself was issuing a "call to action on growth" well over a decade ago.[9] Nor is the need for growth a partisan issue today; in July 2022, Sir Keir Starmer stated he was "clear" that "Labour will fight the next election on economic growth", and his party is presenting itself as more capable of delivering increased prosperity for the country.[10] Despite the move to fiscal consolidation in Hunt's Autumn Statement in November 2022, the Chancellor still identified growth as one of the government's central priorities, alongside stability and strong support for public services.[11]

Britain's economic stagnation is put into starker relief when compared to the fortunes of other economies. The UK is the fifth largest economy in the G7 and the seventh largest in the world, but when it comes to growth, Britain is the sick man of the group. Whilst the US economy has grown by 3.5% on its pre-pandemic level and the average growth across the Eurozone for the same period is 1.8%, the UK economy has shrunk.[12] This is in keeping with a low growth trend that has persisted for many years. According to World Bank Data, in 2004, GDP per capita in the UK was only behind that of the United States within the G7; today, it trails Canada and Germany too.[13]

The main factor holding back growth in the UK economy has been

7. The World Bank, "World Development Indicators, GDP Growth", Link.
8. The Week, "Boris Johnson Urged To Act To End Economic Stagnation", 2nd January 2020, Link.
9. OECD, "GDP, Volume - Annual Growth Rates in Percentage", Link.
10. The Labour Party, "Keir Starmer's Speech on Labour's Mission for Economic Growth", 25th July 2022, Link.
11. HM Treasury, "The Autumn Statement 2022 Speech", 17th November 2022, Link.
12. House of Commons Library, "Economic Indicators", 3rd October 2022, Link.
13. The World Bank, "GDP per Capita", Link.

productivity. Since the financial crash of 2007-8, the average annual growth of output per hour worked was 0.7%, well below the G7 average and only higher than Italy's rate. The UK lags its rivals in the number of hours worked, as well as in GDP per hour worked.[14] Key to this has been the decline in multifactor productivity (how well inputs are used in the production process) but also a reduction in "capital deepening", a point we shall come on to later.[15]

### Table 1: Compound average annual growth rate of output per hour worked, before and after 2008 economic downturn

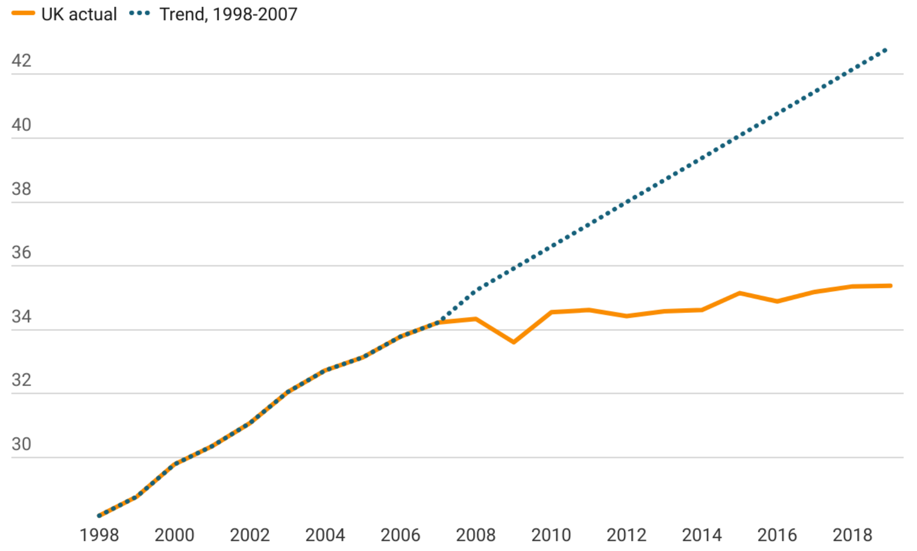
| | Average annual growth (%) 1997 to 2007 | Average annual growth (%) 2009 to 2019 | Difference |
|---|---|---|---|
| **US** | 2.3 | 0.8 | -1.5 |
| **UK** | 1.9 | 0.7 | -1.2 |
| **France** | 1.6 | 0.9 | -0.7 |
| **Canada** | 1.5 | 1.0 | -0.5 |
| **Japan** | 1.6 | 1.2 | -0.4 |
| **Germany** | 1.4 | 1.1 | -0.3 |
| **Italy** | 0.4 | 0.4 | 0.0 |
| **G7 average** | 1.9 | 0.9 | -1.0 |

***ONS: "International Comparisons of UK Productivity"***

There is a spatial dimension to the productivity dilemma too. The UK's big cities, apart from London, are holding down the national productivity average, rather than leading it. Cities like Manchester, Glasgow and Birmingham are vastly outperformed by European cities of comparable size; Manchester itself is 63% less productive than Munich by a 2011 measure and some £15 billion off of its productivity potential.[16] Nevertheless, though London is around a third more productive than the UK average, it too has struggled in the last decade and a half, with the level of labour productivity 24% lower in 2017 than it would have been had it continued to grow at pre-2007 rates.[17]

14. ONS, "International Comparison of UK Productivity", 2020; Financial Times, "The Challenge of Unlocking UK's Low Productivity", 8th October 2021, Link.
15. ONS, "International Comparisons of UK Productivity", 2022.
16. Centre for Cities, *So You Want to Level Up?*, 2021
17. GLA Economics, *Productivity Trends in London*, 2019.

### Figure 1: Output per hour, all industries (chained volume measure) 1998-2019

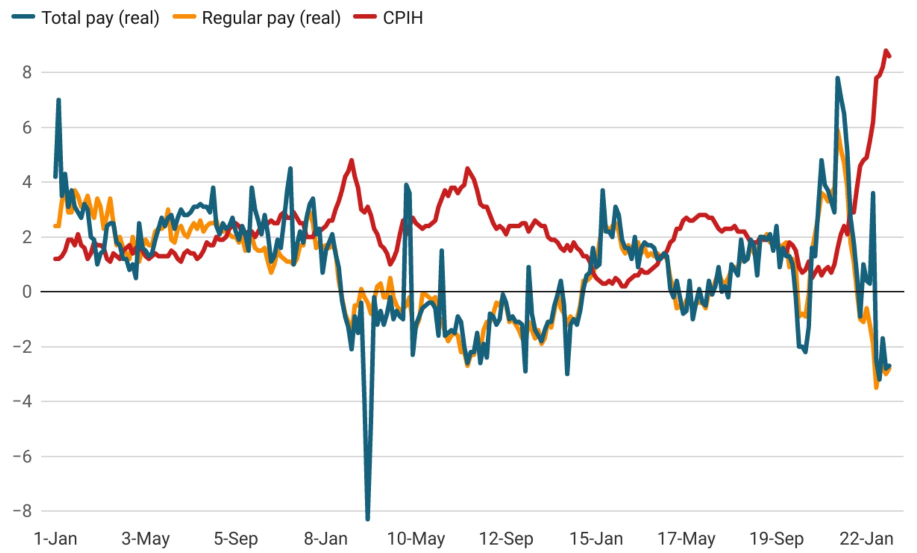



*ONS: Region by Industry Productivity, 2021.*

Low economic growth and low productivity gains hurt Britons in very material ways.

The effect of these trends has been, amongst other things, a flatlining in living standard improvements for working people across the country. Wages have not grown discernibly this century, whilst inflation has meant at frequent intervals real pay growth has actually decreased for many.

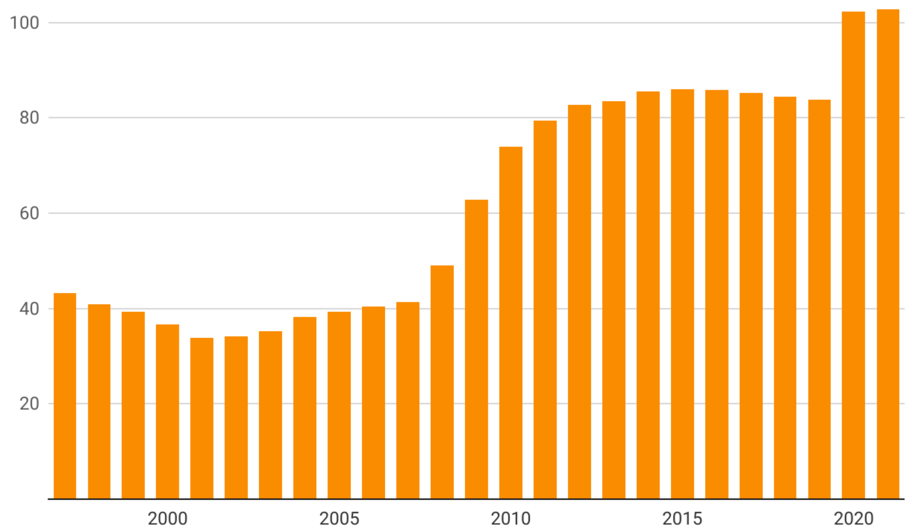
### Figure 2: Growth Rates in Real Average Earnings, Seasonally Adjusted and CPIH, 2001-2022




***ONS**: "Average Weekly Earnings in Great Britain", 2022.*

The lack of economic growth, and the attendant lack of tax revenues that such growth would have brought, has forced the government into increasingly tough decisions to fund public services. As the Office for Budget Responsibility (OBR) pointed out last year, at 36% of GDP the UK tax burden is at a higher level than at any point since the Second World War, and whilst this is partly due to the enormous fiscal outlays required during the covid pandemic – in particular to fund the furlough scheme - it is also a consequence of the fact that the government has not been able to rely on economic growth to generate the cash for government spending.[18] At the same time, though it remains at historically low levels, borrowing has risen considerably, and government debt as a percentage of GDP has shot up to over 100%.

### Figure 3: Debt as a Percentage of GDP




***ONS: UK Government Debt and Deficit, December 2021***

The government must turn this situation around. There are those on both the left and the right who think that growth is antagonistic to other political imperatives, particularly addressing climate change. There are also many who pay lip service to economic growth, but in practice put it behind other priorities like reducing inequality or poverty reduction. Yet a growing economy is a necessary prerequisite for meeting such challenges. Beyond that, economic growth is the only thing that can guarantee improved living standards and ensure that public services can be paid for without an ever-increasing tax burden weighing down UK earners.

## Low Hanging Fruit or Tough Choices?

The Truss Government' framed its mission as a radical attempt to fundamentally transform the country's economic situation; Truss herself reportedly wanted to "move fast and break things", and a key part of the leadership's messaging was its apparent willingness to be "unpopular" in

18. Evening Standard, "UK Tax Burden: What do the Figures Show?", 9th June 2022, Link.

taking tough decisions when they were in the national interest. The fiscal commitments made in September clearly did "break things" and make the government unprecedently unpopular in the process, but in many ways, the decisions taken by the government in the cause of delivering on economic growth were not particularly tough at all. The swathe of tax cuts - to National Insurance, Corporation Tax and the 45p top rate – were easy levers to pull. Indeed, the fact that such cuts have been rolled back so promptly lends weight to this claim.

The UK certainly cannot tax its way to growth, but it cannot simply tax-cut its way to growth either. The tough choices when it comes to delivering economic growth in the UK will concern how to deliver supply-side reforms, and in particular, how best to reform the housing market. As the next section will demonstrate, tackling the dysfunction in the housing market will mean addressing obstacles that have stood in the way of various governments for decades. It will also mean coming up against powerful vested interests and attempting to unblock the housing market will involve decisions that will potentially be very unpopular with these groups. However, it is on these issues that the government must focus if it wishes to deliver economic growth for the country.

The main contention in what follows is that the housing market is not just an area in which the government might deliver sensible reforms, but that the housing crisis has been one of the most serious drags on the UK economy in the past few decades. Rather than supporting economic growth, housing and the shortage of it has been a hindrance to it. To make this point, we must first assess the extent of housing undersupply in the UK.

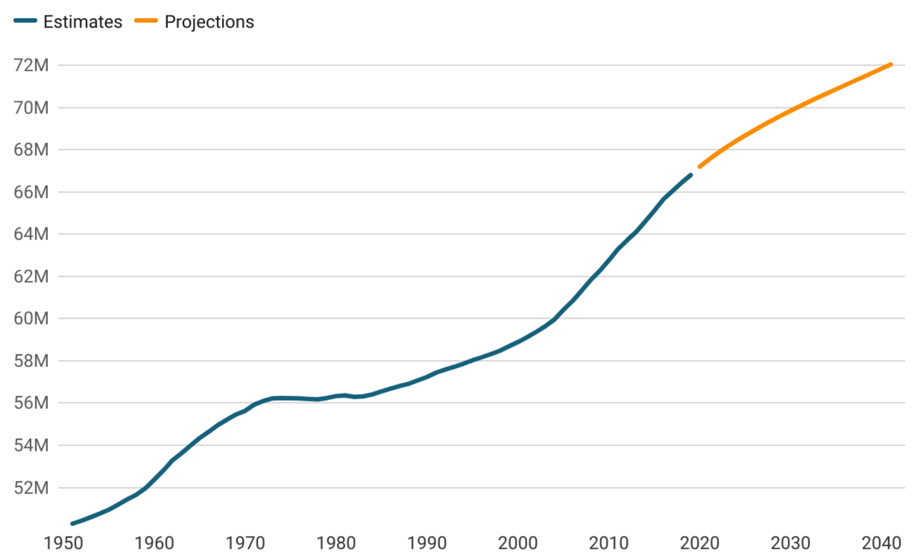
# The Housing Shortage

There is a growing consensus view that the UK has suffered from a chronic housing shortage for many decades.[19] In 2019, all the major political parties endorsed a programme of increasing housing supply. Charities and organisations across the political spectrum, from Shelter to the Centre for Progressive Policy and Policy Exchange, have advocated boosting supply. The simple explanation for the shortage in houses has been that the supply of new dwellings built each annum has not kept pace with the increased demand for those dwellings in the form of population growth and changed household composition. It is worth examining these dynamics in detail.

## Demand

Over the past seventy years, the UK population has grown by approximately 34%, from 50.4 million in 1952 to 67.1 million in 2020.[20] Since 1990, natural change (that is, the total number of births minus the total number of deaths in a year) has been replaced by net immigration as the main factor in population growth (indeed, fertility rates have declined from a high of 1.96 in 2008 to 1.68 in 2018. A fertility rate of 2.1 would be required to sustain current population levels).[21] Figures published by the Office for National Statistics in November show net migration to the UK rose to a record high of 504,000 in the year to June 2022.[22]

### Figure 4: UK Population Estimates and Projections, 1952-2041

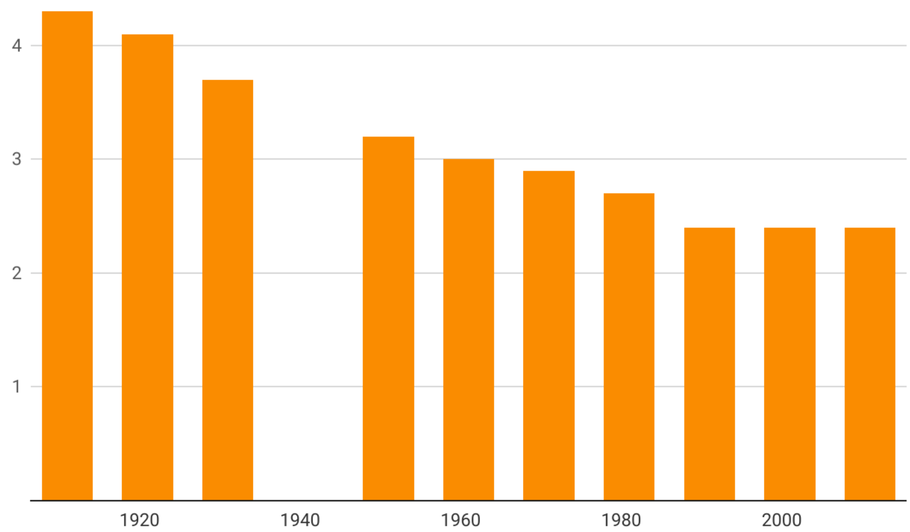



*ONS: Overview of the UK Population, 2021*

19. For a dissenting view, see See Ian Mulheirn, *Tackling the UK Housing Crisis: Is Supply the Answer?* UK Collaborative Centre for Housing Evidence, 2019. Mulheirn's view depends on lower estimates for household formation but, as many have pointed out, this fails to account for the effect that housing undersupply might have on household formation itself.
20. ONS, "Overview of the UK Population", 2022.
21. *Ibid.*
22. ONS, "Long-term International Migration, Provisional", 2022.

At the same time, census data shows that the average size of a UK household has shrunk from 3 to 2 since the 1980s, which has further increased the latent demand for homes.[23] This trend it set to continue. ONS projections suggest the number of households in England will grow 7.1% between 2018 and 2028 – an additional 164,000 households a year - driven primarily by net immigration and the increasing number of one-person households. Whereas in the 1970s just over 300 homes would support 1000 people, now 500 homes are required to support the same number.

### Figure 5: Average household size (persons) in England and Wales, 1911-2011




***ONS: 2011 Census***

## Cumulative Undersupply

Despite the steady increase in the number of UK households, UK housebuilding has failed to meet the additional demand. Throughout the twentieth century housing supply expanded drastically. In the 1930s, whilst Neville Chamberlain was Chancellor, the number of houses built annually by the private sector in England and Wales grew from 133,000 in 1931-2 to 293,000 in 1934-5.[24] In 1953, with Harold Macmillan serving as Housing Secretary, housebuilding breached the 300,000 mark for the first time in the post-war period on the back of a colossal social housing programme. Under Wilson's Labour government, the UK built over 425,000 homes in a single calendar year.

Nevertheless, since the 1980s, housebuilding has tailed off significantly. Private sector housebuilding has remained relatively stable. In the period between 1960 and 1980, private enterprise added on average 181,000 new per financial year to the housing stock in the UK; between 2000 and 2020, this figure has fallen marginally to around 178,000 a year. Far more discernible in the decline in annual housebuilding has been the virtual disappearance of new social homes. In the 1970s, social

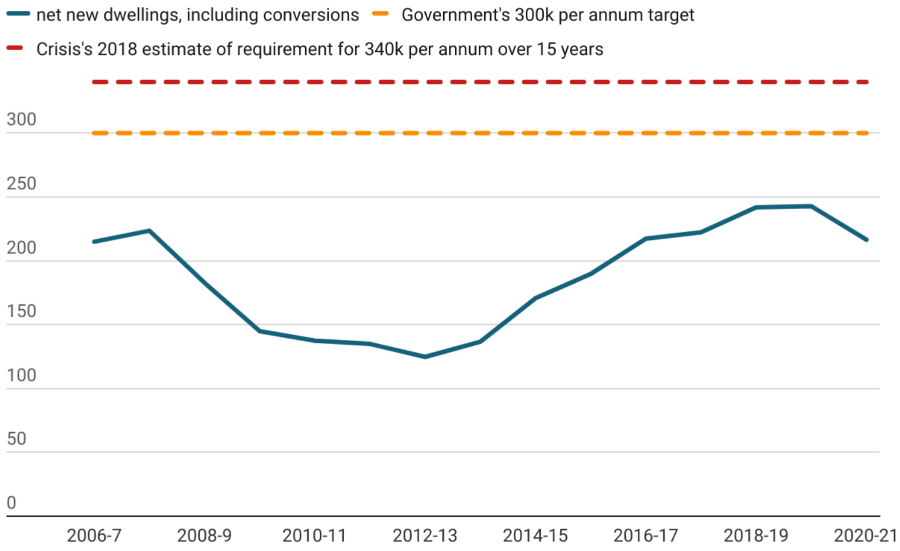
23. ONS, "Household and Household Composition in England and Wales", 2011.
24. Nicholas Crafts, "Returning to Growth: Policy Lessons From History", *Fiscal Studies*, Vol.34(2) (2013) pp.255-82.

housing contributed between a third and a half of total new builds. But since the 1980s, the proportion of new builds made up by council and housing authority homes has decreased dramatically.[25] As Brian Lund has pointed out, Margaret Thatcher's programme to boost homeownership in the UK was also a strategy to reduce the size of the state; Right to Buy enabled council tenants to purchase their homes from local authorities at a discount, taking dwellings off the government's books.[26] The policy proved immensely popular, and successive governments have either tacitly accepted it or actively sought to extend it, as both the Cameron and Johnson governments did in their respective periods in office. The upshot is that the proportion of total housing stock in England that is socially rented has shrunk considerably. In 1977, 115,840 new local authority houses were built in England; the figure in 2020 was just 1290 – a mere 1.1% of the 1977 number of completions. [27] Private sector housebuilding has not expanded sufficiently to replace the supply of new homes that used to be provided by the public sector.[28]

In the face of rising demand, the primary outcome of this fall off in housebuilding activity has been a vastly inflated backlog of supply shortage in the sector. The seminal Barker report, published in 2003, noted that between 1990 and 2000, an average of 196,000 households formed each year in England.[29] By 2002, however, housebuilding had slumped to just 138,000 new dwellings annually. These trends, the review argued, had left a supply backlog at the time of 450,000 homes, and unless the government was "prepared to accept increasing problems of homelessness, affordability and social division, decline in standards of public service delivery and increasing the costs of doing business in the UK", it needed to build around 250,000 new homes a year to meet current and future demand.[30] The last time the UK managed to build at that rate was in the 1970s.[31] Since the Barker Report, housebuilding has averaged around 177,000 new homes annually, well under the target set in 2002. A more recent publication put the housing backlog in England specifically at four million, with 340,000 new homes required each year over the next fifteen years to address the shortage.[32]

25. ONS, "Housebuilding, UK: Permanent Dwelling Started and Completed", 2022.
26. Brian Lund, *Housing Politics in the United Kingdom* (Bristol, 2016).
27. House of Commons, *Socially Rented Housing (England): Past Trends and Prospects*, 2022; ONS, "Housebuilding, UK: Permanent Dwellings Started and Completed by Country", 2022.
28. Economic Affairs Committee, *Building More Homes*, 2016.
29. Kate Barker, *Review of Housing Supply: Final Report*, 2004. p.16.
30. *Ibid*, pp.1,16.
31. ONS, "Housebuilding, UK".
32. Crisis, *Housing Supply Requirements Across Great Britain: For Low-income Households and Homeless People*, 2018.

## Figure 6 : Net New Supply in England Against Targets, 2007-2021




*Adapted From House of Commons Library, Tackling the Undersupply of Housing, 2022.*

There is a regional specificity to cumulative undersupply in the UK too. Whilst a cumulative undersupply has developed over the last two decades in most of England and acutely in high demand areas like London and the South-East, there has been a cumulative oversupply in the North East, Scotland and Northern Ireland.[33] Homes, in other words, are not being built in the places that need them the most, and even when they are, evidence suggests that they are often not built near transport infrastructure.[34]

## Causes of undersupply

Why hasn't housing supply risen to meet demand? A number of factors have contributed to the UKs inelastic housing supply and its unresponsiveness, the most important of which – and the root cause of other issues that have affected supply – is the availability of land for residential use, or more specifically, *the deep uncertainty about the availability of land for residential use*. This is determined by the planning system.

Planning is a devolved function, and so the system utilised in England is different to that employed in the rest of the UK. Several key pieces of legislation have defined the planning framework that we inherit today. Perhaps the most decisive is the 1947 Town and Country Act introduced by the Atlee Labour Government. Prior to 1947, property owners were permitted to develop and build on their land or improve existing structures provided they kept to some regulations on building height and sight lines. In the aftermath of the Second World War, with around half a million homes destroyed by bombing and a further 250,000 badly damaged, the government legislated to nationalise development rights, meaning property owners would be required to secure permission from the state on a discretionary basis for changing land use or making improvements.[35]

33. Centre for Policy Studies, *Homes for Everyone*, 2017.
34. Centre for Cities, "Why are Cities in Britain Building So Many New Homes Out of Reach of Public Transport?", 13th April 2022, Link.
35. Lund, *Housing Politics in the United Kingdom*; Policy Exchange, *Strong Suburbs*, 2021.

Influenced by the Uthwatt Report of 1942, the government also legislated that the "betterment" or uplift in the value of land deriving from change in use should accrue entirely to the state itself, which would then be used to pay for infrastructure investment. It would do this by enabling developers to purchase land at existing use, and then charging them a development levy.[36]

Additionally, provisions were made for restrictions to urban sprawl around major urban conurbations by prohibiting development on the surrounding land, what we now call the green belt. Such provisions built on the legislation that had already been introduced by the London Regional Planning Committee to restrict urban sprawl around the capital. A 1955 Green Belt Circular encouraged further expansions to the protected areas around UK cities.[37] The size of green belt land has since ballooned by around 126% to 1.64 million hectares, or 13% of land in England. In comparison, just 2% of land in England is covered by residential buildings.[38]

In 1952, Macmillan, Housing Minister at the time, wrote that the development charge introduced in the 1947 Planning Act was "an odious imposition" and "an almost fatal bar to the increase of private development".[39] In 1954 it was thus abolished. In 1961, the Conservative government then passed the Land Compensation Act, which further amended the 1947 provisions on betterment. Henceforth, "planning gain" derived from the granting of development permissions would accrue entirely to the landowner, rather than the state, and the former would be entitled to "hope value" for land sold – that is, the value of the site they would hope to achieve with planning permission granted.[40]

Various attempts to capture the uplift in land value from development or changed usage have been introduced and scrapped since, from a "Betterment Levy" to a "Development Land Tax". The two main land value capture mechanisms that subsist today are the Community Infrastructure Levy (CIL), an optional, locally determined, fixed-rate development charge, and Section 106 Agreements, legally enforceable obligations introduced by the 1990 Town and Country Planning Act that are negotiated by local planning authorities and developers on a case-by-case basis.[41]

Unlike many European equivalents, then, the UK has a highly discretionary planning system which creates considerable uncertainty and perverse incentives for landowners and developers alike. Land use is determined by local authorities on a 10–15-year basis and each development project is granted permission on a case-by-case basis. The system is slow and prone to capture by voters opposed to housebuilding in their local area. To participate in the planning decisions, constituents need to have the time and patience to turn up to public consultations. This means minority voices – those with the dedication to attend such committee meetings – are amplified at the expense of the majority.[42] The effect of this system for determining land usage has been to severely constrict the supply of land available for housebuilding.

36. On the intellectual history of betterment, see the debate on land value taxation in Josh Ryan-Collins, Toby Lloyd & Laurie Macfarlane, *Rethinking the Economics of Land and Housing*, (London, 2017) pp.37-65.
37. Policy Exchange, *Rethinking the Planning System for the 21st Century*, 2020.
38. House of Commons Library, *Tackling the Undersupply of Housing in England*, 2022.
39. Harold Macmillan, *Tides of Fortune*, (London, 1969) p.422. There has been a longstanding debate amongst conservatives about the legitimacy of capturing value from land and developers. Compare Cecil, *Conservatism* (London, 1912) pp.126-44; Donald Denman, *Land in a Free Society*, Centre for Policy Studies, (1980); Brian Lund, Housing Politics in the United Kingdom, pp.34-40.
40. Liam Halligan, *Home Truths* (London, 2019) p.14.
41. Housing, Communities and Local Government Committee, *Land Value Capture*, 2018.
42. Policy Exchange, *Rethinking the Planning System for the 21st Century*, pp.34-7.

## Table 2: International Comparison of Planning Systems

| | England | France | Germany | Netherlands | United States |
|---|---|---|---|---|---|
| Type of Planning System | Discretionary | Zoning | Zoning | Zoning | Zoning |
| Policies to Constrain Land Provision | Green belt | Urban growth limits in pressured areas | Urban growth limits in pressured areas | Urban growth | Urban Growth Boundaries, Green Belts |
| Policies to Increase Land Provision | Public Land Disposal via Homes England | Proactive in land market | Proactive in land market | Proactive in land market | Housing Land Trusts |
| Taxation | Community Infrastructure Levy (CIL) | Hypothecated tax for infrastructure | Infrastructure levy for urban renewal and road renewal | Infrequently used infrastructure levy | State-level infrastructure levies and development charges; |
| Subsidies | Help to Buy; New Homes Bonus | Direct subsidies for housebuilders | Subsidies for low-income households | Subsidies on regeneration sites | Affordable Housing Subsidy |
| Other Measures | Section 106 Agreements | Strategic Land Management | Land Readjustment | Direct Compensation to Individuals; Developer Obligations | Tax Incremental Funding (TIF) for infrastructure |

***Based on the OECD Global Compendium on Land Value Capture and The Joseph Rowntree Foundation,** International Review of Land Supply and Planning Systems, **2013.***

The uncertainties inherent in the planning system – uncertainties produced by the fact that permission is not granted according to general rules but on a discretionary basis largely vulnerable to capture by interest groups hostile to development – have had a direct effect on the development industry, leading to what might be termed a speculative housebuilding business model. Under this model developers derive their profits from the difference between the sale price they achieve for the houses they build and the total amount spent on the development process. Developers purchase the land, seek to secure planning permission on that land, before constructing homes on it and selling those homes on the open market. Speculation is made both on the likelihood of securing planning permission for a given site and the price at which houses on that site can be sold. The price to be paid for land will be based on a residual valuation conducted by the developer, whereby they will estimate the sales value they will achieve for the houses they intend to build, and then subtract the various costs they expect to incur in development to arrive at a residual amount.[43]

Since there is a considerable amount of uncertainty involved in the development process – particularly regarding the securing of planning permission – developers look to acquire land strategically to mitigate risk.

43. Ryan-Collins, Lloyd and Macfarlane, *Rethinking the Economics of Land and Housing*, p.98; Royal Institute of Chartered Surveyors, *Land Value Capture: Attitudes from the House-building Industry on Alternative Mechanisms*, 2020.

This has led to consolidation in the housing market. SME developers lack the capital to compete with larger builders and increases in borrowing costs deriving from the time lags in development can make projects unviable for smaller businesses. Small and medium size builders contributed 39% of new builds in the 1988; in 2020, they provided just 10% of new stock.[44]

This behaviour in the industry stems principally from "the interaction between private firms and the planning system – specifically the weakness of the system's ability to determine appropriate land use in advance, which creates uncertainty".[45] This speculative housebuilding model has itself contributed to what might be called a "low supply equilibrium" in the UK. Since a significant increase in housing supply in local markets would compromise the value of developers' assets, large housebuilders are incentivised to control the output of new homes.

To this end, the notion of malign businesses hording land and extracting profits – or "land banking" - is a heavily caricatured account of the dynamics of the market; businesses are currently doing what is necessary to deliver on their fiduciary responsibilities. Whilst at the aggregate level there is immense housing need, developers need to be careful that local markets can absorb new supply without compromising prices.[46]

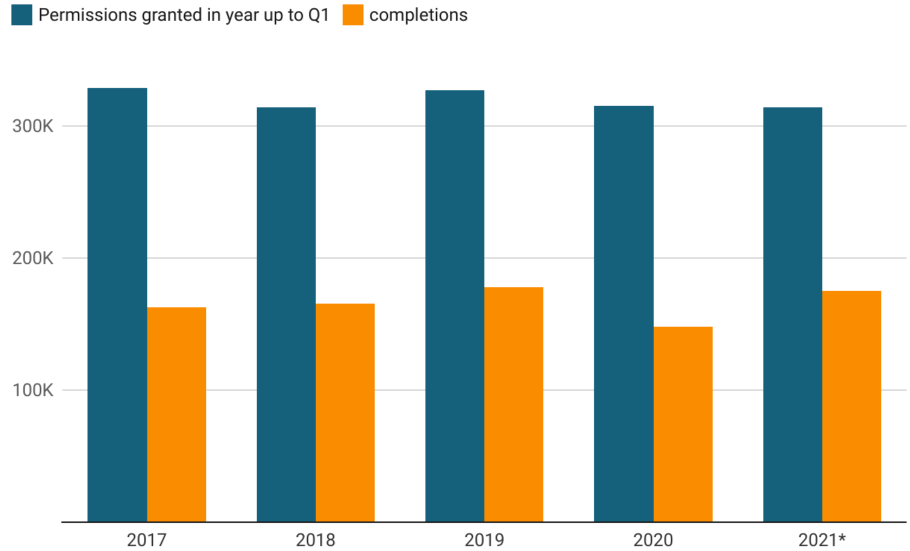
## Housing Delivery

It should be noted that the lack of land available for development at an aggregate level is not the only factor in the UK's constrained housing supply. As has been recognised, the number of sites granted planning permission has grown since the financial crash. In England, the number of housing units granted permission reached a nadir in 2009. But since then, the figure has been steadily rising, primarily as a result to simplifications to the planning framework. Indeed, since 2016, in every year apart from that of the pandemic, the government has granted in excess of 300,000 permissions in England, enough for it to meet its goal of 300,000 new homes a year.[47]

The number of completions, however, lags significantly behind. For example, between 2017 and 2020, housing completions have generally amounted to around half of average granted permissions per annum.[48]

44. Built Environment Committee, *Meeting Housing Demand*, 2022.
45. Ryan-Collins, Lloyd & Macfarlane, *Rethinking the Economics of Land and Housing*, p.95.
46. Centre for Cities, "No, Land Banking Does Not Cause the Housing Crisis – Here's Why", 17th July 2020
47. Ministry of Housing, Communities and Local Government, "Units Granted Planning Permission On All Sites, England", Link.
48. Department for Levelling Up, Housing and Communities, "Planning Applications in England: January to March", 2022

## Figure 7: Annual Planning Permissions and Completed New Dwellings in England




*Department for Levelling Up, Housing and Communities: Annual Permissions and Completions*

Of course, many sources of delay are the result of entirely unavoidable contingencies. Global pandemic, energy crisis and economic recession have all contributed to labour shortages, volatile material costs and uncertain supply chains. The policy environment has only added to the confusion in the market - there have been 15 housing ministers since 2010. This has made forward planning for developers especially difficult.

However, delays in the delivery of new housing have not been confined to the last three years; Oliver Letwin's independent review into build out rates was commissioned back in 2017.[49] As Letwin himself pointed out, the explanation for delays in build out rates comes back to the business model on which developers operate; house builders must think about profit margins and the effects that "flooding" the market with increased supply would have on prices. In other words, the number of houses built each year is currently not a function of the number of new plots of land that secure permission, but the rate at which local markets can absorb new homes.[50] Whilst the number of outstanding permissions may not be as a high as the 1.1 million estimated by the Local Government Association, it is still likely to be a very significant figure.[51]

It is vital to remember that the behaviour of actors in the sector is determined by the incentive structures in place. To that end, the relationship between permissions secured and houses completed is a second order issue to that of the supply of land. It is the scarcity of land, and the discretionary nature of decision-making on land usage that characterises the planning system, that drives a business model in which it makes sense to strategically acquire land and tightly control the supply of new homes. That is why it is more precise to say that the undersupply of

49. Oliver Letwin, *Independent Review of Build Out: Final Report*, 2018.
50. Centre for Policy Studies, *The Housing Guarantee*, 2021
51. Housing, Communities and Local Government Committee, *The Future of the Planning System in England*, 2021.

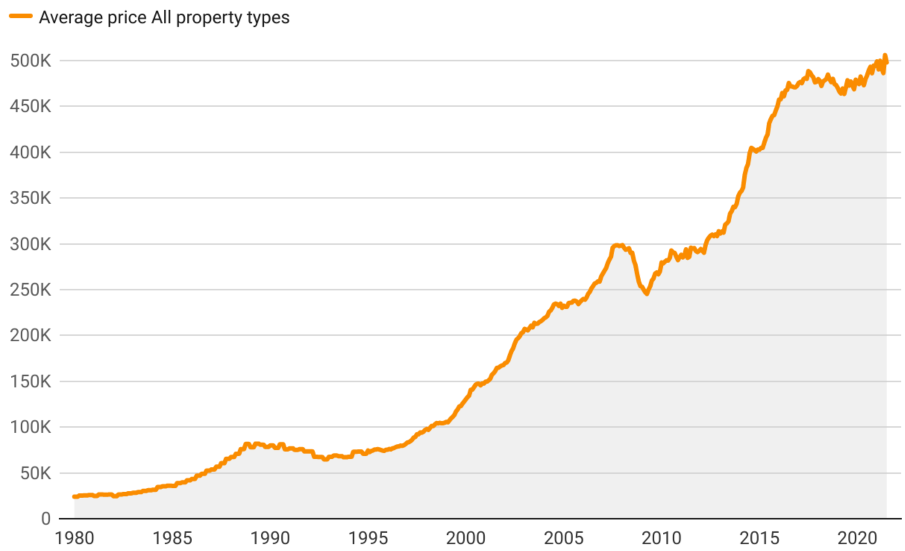
new homes has been driven by the uncertainty of land availability as much as the overall amount of land available for development.

## House Prices

House prices cannot be explained by supply-side dynamics alone. As Joshua Ryan-Collins has persuasively argued, the proximate cause of house price inflation since the 1970s is financial deregulation and the vast expansion of mortgage credit which has fuelled demand.[52] Nevertheless, this only gives us half the story, and the reason why the demand for homes has not been met with increased housebuilding concerns the constraints on supply and uncertainties about land use allocation.

The consequence of the severe constrictions on new housebuilding has been an enormous spike in house prices across the country. In just over two decades, the average price of a home in the UK has quadrupled, from £72,903 in 1999 to £294,559 in the September of 2022.[53] Just last year, house prices increased by 11.8%.[54] In real terms, according to OECD data, UK house prices have more than doubled in the last two decades.[55] House prices have grown most significantly in places of high demand; prices in London last year were *twenty* times what they were in 1980.[56]

### Figure 8: Average property Prices in London, 1980-2021




***Land Registry: UK Price Index, London***

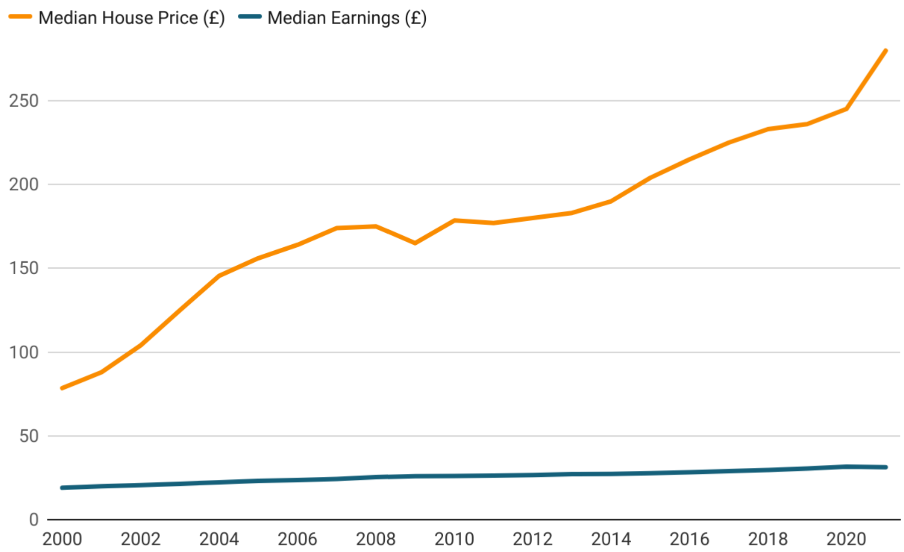
Primarily, this house price growth has been driven by inflated land prices. In the last few years, there have been significant increases in material costs driven by inflation and supply chain pressures. However, it is the case that construction costs have broadly levelled off and remained stable since the 1970s, especially when compared to the rising cost of purchasing a house.[57] Knoll, Schularick and Steger estimate that 73% of the increase in house prices between 1950 and 2012 can be attributed to land prices.[58] By another measure, the share of land in total housing value increased

52. Joshua Ryan-Collins, *Why Can't You Afford a Home?*, 2018.
53. Land Registry, "House Price Index".
54. ONS, "UK House Price Index", 2021.
55. OECD, "Analytical House Price Indicators – Real House Price Indices", Link.
56. UK Land Registry, "London House Price Statistics: 1980-2020", Link. Indexed to 2015 Prices.
57. Edward Glaeser & Joseph Gyourko, "The Economic Implications of Housing Supply", *Journal of Economic Perspectives*, Vol.32(1) (2018) pp.9-10.
58. Katharina Knoll, Moritz Schularick & Thomas Steger, "No Place Like Home: Global House Prices, 1870-2012", *American Economic Review*, Vol.107(2) (2017) p.348.

from 11% in 1980 to 54% in 2010.[59] The value of land under dwellings in the UK is now estimated to be worth £5.4 trillion, some 40% of UK net wealth and over two and a half times annual GDP.[60]

The upshot for families across the UK has been a radical deterioration of house price affordability, given the aforementioned stagnation in wage growth in recent decades. The house price affordability ratio – the ratio between average house price and average earnings - over the same period has increased from 4.1 to almost 9. In London, the ratio is closer to 13. Given that mortgage lenders generally only offer loans of four to five times earnings, this presents an immense challenge to would-be buyers, particularly those looking to purchase their first home.[61]

## Figure 9: UK House Price to Incomes, 2000-2021




*ONS: House Price to Workplace-based Income*

Homeownership has subsequently fallen, from a peak of 71% in 2005 to 65% in 2019. As of 2020, there were only three countries in the EU with lower rates of homeownership.[62] The fall has been far more pronounced amongst younger age groups. Whilst the levels of homeownership have marginally increased for over 65s, from 76% in 2009-10 to 80% in 2019-20.[63] Owner-occupancy amongst 25-34 year olds, however, has collapsed, from 67% in 1991 to 38% in 2016.[64] There has been an uptick in homeownership for young people in the last eight years, supported in large part by government interventions to sustain demand (covered below). However, these trends are unlikely to continue, considering static wages and the surge in inflation and interest rates through 2022, as well as the withdrawal of certain mortgage products by lenders.[65] This 25-34 age bracket is of vital importance. Given the public believe that the ideal age to have a child is 29, such a severe fall in homeownership for this group has profound social implications for the United Kingdom.[66]

As homeownership has decreased, the private rental market has swelled,

59. *Ibid*, p.347.
60. ONS, "Improving Estimates of Land Underlying Dwellings in the National Balance Sheet, UK", 2022.
61. ONS, "House Price to Workplace-based Income", 2022.
62. Department for Levelling Up, Housing and Communities, *English Housing Survey: Headline Report*, 2020-21; Economic Affairs Committee, "Uncorrected Oral Evidence: Building More Homes", 2020.
63. Department for Levelling Up, Housing and Communities, *English Housing Survey: Headline Report*.
64. *Ibid*; Halligan, *Home Truths*, p.42.
65. City AM, "Mortgage Lenders Withdraw Some Products After Mini-budget Turmoil", 27th September 2022, Link.
66. YouGov, "What Is The Ideal Age To Have Children?", Link; Halligan, *Home Truths*, pp.41-8.

doubling between 2000 and 2020.[67] Housing costs for those in the private rental sector have grown greatly too; whilst in the 1990s, average renters spent 12% of their income on housing, that figure is now around a third. In London, renters spend as much as 42% on housing costs on average.[68]

## Social Housing

The shortage of social housing has its own implications for housing costs. As a result of the depletion of council-owned stock since the 1980s, the waiting list for those wanting to go into social housing stood at 1.19 million in 2021, and some 86,000 households are in temporary accommodation.[69] Families unable to access social housing are residing in the private rental sector, pushing up demand and average rents, and this in turn is working to inflate the housing benefit bill for the government. Total spending on housing benefit payments was £24.8 billion in 2019-20, with £6.4 billion being spent on the housing element of Universal Credit (UC).[70] Total expenditure on housing benefit is due to rise to £31.3 billion in 2025-26, with £19.7 billion coming out of the housing element of UC as claimants are moved onto the system.[71] Government spending on social housing has thus over a number of decades moved away from funding new builds and towards direct subsidies – from "bricks to benefits".

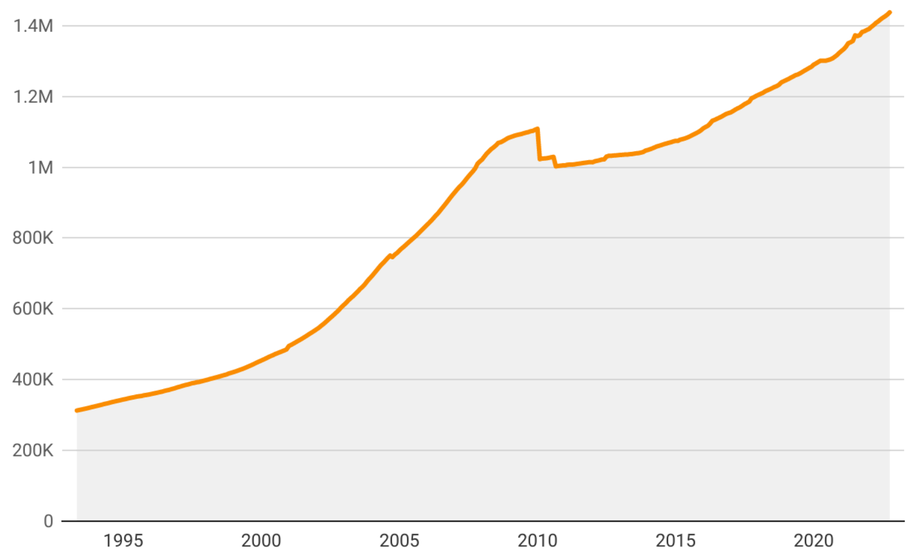
## Debt

A final factor worth considering is the role of credit expansion in a context of undersupply. As Ryan-Collins, Lloyd and Macfarlane argue, mortgage lending used to be confined to building societies.[72] In the 1970s other financial institutions entered the banking sector in London to lend to developers and to capitalise on the rising land prices in the city. Rapid property price inflation in the 1970s led to the Bank of England introducing credit controls and regulations on liquidity ratios and deposit holdings. During the Thatcher government, however, controls on foreign exchange were removed, and to make UK banks competitive, restrictions introduced during the 1970s were lifted. Consequently, mortgage lending increased significantly.[73]

This trend was compounded by the securitisation of mortgage finance, in which financial institutions repackaged housing-related debt and sold it on to third party investors. Residential mortgage-backed securities ("RMBS") were considered safe asset types because they were secured against land as collateral. In selling on the debt to other investors, credit risk was transferred away from the "originator" bank, and this enabled the latter to offer more mortgage products and at higher loan-to-value ratios, in turn allowing more people to access mortgage finance. Banks, in other words, were able to take on more risky behaviour, and this was financed by short term, "wholesale" funding from the financial markets. Between 1999 and the collapse of the RMBS market during the 2007-8 financial crisis, RMBS as a proportion of GDP grew from 2% to 27%, which matches the increase in mortgage lending over the same period.[74]

67. Built Environment Committee, *Meeting Housing Demand*, p.29.
68. *Ibid.*
69. Economic Affairs Committee, "Uncorrected Oral Evidence: Building More Homes", 2020; House of Commons LIbrary, *Socially Rented Housing (England): Past Trends and Prospects*, 2022
70. Department for Work and Pensions, "Benefits Expenditure and Case Load Tables", 2020.
71. *Ibid*
72. Originally, building societies were self-terminating institutions that helped members to purchase their own home. Over time, they started to accept deposits from members who were not necessarily looking to purchase a home. Individual building societies also began to merge, pooling resources to fund bigger projects and paying interest on savings. See Ryan-Collins, Lloyd and Macfarlane, *Rethinking the Economics of Land and Housing*, p.129.
73. *Ibid*, pp.128-32.
74. Alistair Milne and Justine Wood, "An Old Fashioned Banking Crisis: Credit Growth and Loan Losses in the UK 1997-2012", in Chadha et al. (eds), *The Causes and Consequences of the Long UK Expansion* (Cambridge, 2016) p.232

## Figure 10: UK mortgage debt, £bn, 1993-2022



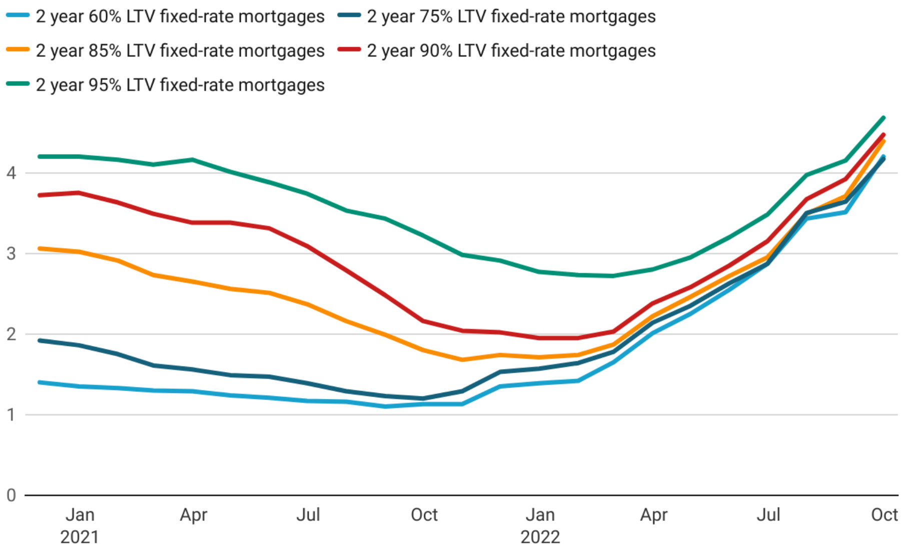

***Bank of England: Table A4.3***

Despite a brief dip in the immediate aftermath of the 2007-8 financial crash, credit expansion has progressed in a linear fashion. Mortgage debt amounted to £316 billion in 1993; at the start of 2022, it totalled £1.43 trillion.[75] Between 1993 and 2021 mortgage debt grew from 24% of GDP to 67%.[76] Since 2013, the government has also further helped to increase access to credit through its 'Help to Buy' scheme, in which the Treasury guaranteed high loan to value mortgages to house buyers. Mortgages of up to 95% of the value of a new property were made available via a 20% equity loan provided by government to mortgagers.

Ryan-Collins, Lloyd and Macfarlane are certainly correct that demand-side measures since the 1980s have had a significant role in growing prices and unaffordability. However, the core issue to be grappled with remains undersupply. With an inelastic supply of new homes, increased credit availability has worked to artificially sustain demand, even as house prices have continued to outstrip affordability. A positive feedback loop has ensued in which, because the supply of housing is relatively static, credit expansion inflates house prices, meaning individuals and households need to borrow further – potentially many multiples of their incomes - in order to become homeowners.[77] Credit expansion, put differently, has created its own demand, and in conjunction with speculative investment in the surging housing market, this has bid up prices further.[78] It has also led to a remarkable increase in indebtedness, which has made households in the UK extremely vulnerable to inflation.[79] Indeed, this has been accelerated recently after the fall out from the ill-fated mini budget delivered in September 2022; the interest rates on a 95% two year fixed-rate mortgage rose by 129 percentage points last year.[80]

75. Bank of England, Table A4.3, Link.
76. ONS, "GDP Chained Volume Measures: Seasonally Adjusted £m", 2022.
77. Ryan-Collins, Lloyd and Macfarlane, *Rethinking the Economics of Land and Housing*, p.111
78. A House of Lords Report estimates that the Help to Buy scheme itself has inflated house prices by more than the subsidy value. Built Environment Committee, *Meeting Demand*, p.5.
79. Halligan, *Home Truths*, p.67.
80. Built Place, "Market Commentary", 29th September 2022, Link.

## Figure 11: Quoted household interest rates on 2 year fixed-rate mortgages




*Bank of England: Quoted Household Interest Rates, 2022,* link.

Housebuilding hit a historic low in the 2012-13 financial year. Since then, and exempting the pandemic, the number of new dwellings has grown year on year. Nevertheless, annual housebuilding has remained below both the requirement estimated by commentators and the government's own target set in the 2019 manifesto. The cumulative undersupply of homes has thus grown, and in conjunction with increased demand – facilitated both by lenders and the government – this has precipitated a powerful upwards trend in housing costs, both for mortgagers and renters.

# The Macroeconomic Implications of Housing Undersupply

Much of the foregoing is now widely recognised. Economic indicators have suggested for some time that the UK economy has struggled to recover from the 2007-8 financial crash as quickly as international competitors. Whilst some dissenters exist, there is also as noted growing consensus that the annual supply of new homes has failed to keep up with rising demand. What is less well understood is the linkages between these two trends.

A number of existing studies have revealed a strong correlation between economic performance and housing undersupply. Generally, these make use of some important academic literature deriving from the United States. In particular, Chang-Tai Hsieh and Enrico Moretti produced a model that suggests the undersupply of housing in a number of US cities has lowered aggregate economic growth across the whole country by 34% between 1964 and 2009, and that increasing supply in just three cities – New York, San Francisco and San Joe – would add 8.9% to total US GDP.[81] Edward Glaeser and Joseph Gyourko argue that Hsieh and Moretti might be overestimating the impact, but that a reasonable projection would still suggest that increased housebuilding in US cities of acute shortage would lead to a 2% growth in GDP.[82] Though valuable for theorising the relationship between constraints on housing supply and the economy, these papers have limitations when it comes to applying them to the UK context. Most importantly, the UK's planning system is highly idiosyncratic. As outlined above, it is discretionary, allocating use for individual plots of land on a case-by-case basis, which contrasts to the American system in which land usage is determined in advance.[83] Comparisons thus only go so far (indeed, given that the value of land under dwellings is estimated to be a greater proportion of GDP in the UK than in the US, it is plausible that the UK's planning system might be even *more* economically damaging here).[84] There is some literature too on price distortions generated by the UK's undersupply of housing, as well as the effects that planning restrictions and "regulatory taxes" have on business productivity, particularly that of supermarkets.[85] However, this body of work does not deal specifically with the question of the effects of housing shortage on economic growth in the UK.

The most proximate research available on the connection between housing supply and growth is a paper produced by Savills in 2010, which

81. Chang-Tai Hsieh and Enrico Moretti, "Housing Constraints and Spatial Misallocation", *American Economic Journal*, Vol.11(2) (2019) pp.1-39.
82. Edward Glaeser and Joseph Gyourko, "The Economic Implications of Housing Supply", *Journal of Economic Perspectives*, Vol.32(1) (2018) pp.3-30.
83. Royal Town Planning Institute, *Planning Through Zoning*, 2020
84. Halligan, *Home Truths*, p.65.
85. Paul Cheshire, "Broken Market or Broken Policy? The Unintended Consequences of Restrictive Planning", *National Institute of Economic and Social Research*, Vol.245(1) (2018) pp.9-19 & Paul Cheshire, Christian Hilber & Ioannis Kaplanis, "Land Use Regulation and Productivity – Land Matters: Evidence from a UK Supermarket Chain", *Journal of Economic Geography*, Vol.15(1) (2015) pp.43-73.

contended that housing development positively impacted the economy through increased investment, job creation and tax revenues. Savills estimated at the time that increasing housebuilding by 100,000 new homes per annum would support 228,000 construction and add 1% to GDP, whilst indirectly increasing annual tax receipts by £2.3 million and reducing the debt burden by £23 billion over the life of a Parliament.[86] However, some of the claims made as to the "indirect" benefits of increased housing supply in this report were not fleshed out in detail.

Nevertheless, the contention in this paper is that housing undersupply *is* indeed connected to economic performance and delivering more homes will be critical to the government's push to return growth to a 2.5% trend rate. Partly, this connection has not been adequately recognised because the role of land as a factor of production within the economy more broadly is frequently overlooked; when we are talking about the undersupply of housing, we are really talking about the undersupply of developable land, rather than simply the bricks and mortar that sit on it.[87] As Donald Denman, the founder of the Land Economy Department at Cambridge University, put it in 1980: "land is a primary resource whose use affects every aspect of the economy and social order. Decisions for the use of land, however made, will eventually affect the use and distribution of capital and labour in their manifold forms".[88] The task here is to set out what those effects and implications are. To do so, it is important to bear in mind both the direct effects of housing undersupply itself on the economy as well as the indirect effects that it has via house price inflation.

Directly and indirectly through scarcity-induced house price inflation, the housing shortage has hurt the economy by diverting investment away from productive activities, reducing labour mobility, absorbing productivity growth in major cities, and dampening consumer demand.

## Investment

With consistently rising house prices, UK housing wealth has increased enormously. ONS data on the UK balance sheet indicates that total housing wealth amounted to £1.6 trillion in 1995. In 2020, it constituted £8.1 trillion. Whilst this trend is astonishing, far more salient is the proportion of that value derived from land. In 1995, 67% of housing wealth was made up of the land underneath dwellings; 25 years later, land represents 78% of housing wealth, and a total value of £6.3 trillion.[89] Land alone now thus comprises about 60% of UK net wealth.[90]

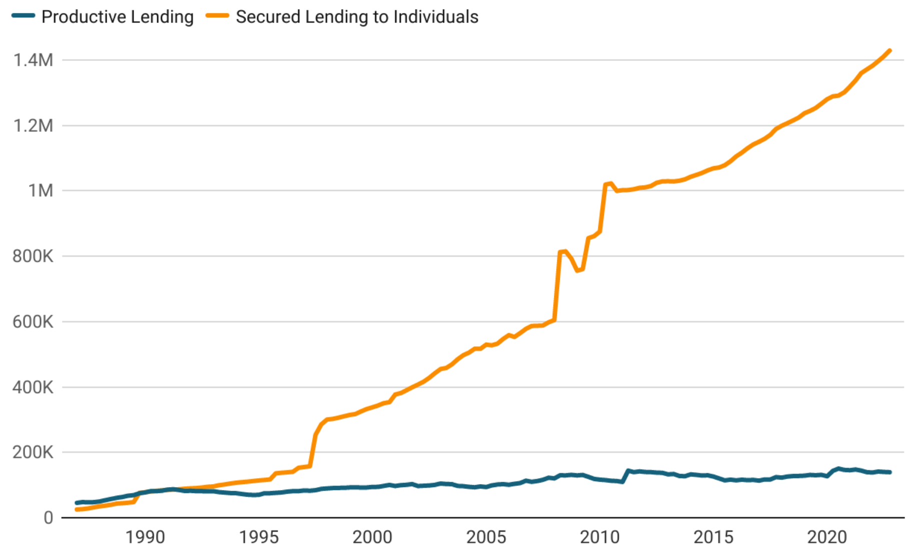
This growth in the value of land is not the result of any increase in the *productivity* of land. Rather, it reflects the persistent scarcity and uncertainty of land available for development in a context of increasing demand. The value increases thus represent a windfall gain. The problem is that such a trend has a distorting, "non-neutral" impact on the wider economy.[91] The expectation that land values will increase drives the behaviour of financial institutions - just as much as the behaviour of housebuilders as mentioned above – as they look for strong returns on investment. Capital is thus being absorbed by rising land prices and diverted away from more productive

86. Savills, *The Case for Housing*, 2010.
87. Ryan-Collins, Lloyd & Macfarlane, *Rethinking the Economics of Land and Housing*, p.14.
88. Donald Denman, "Land in a Free Society", *Centre for Policy Studies*, 1980.
89. ONS, "UK National Balance Sheet Estimates, 2021", [Table 2]
90. *Ibid* [Table A]. This includes all land, not just that underneath dwellings.
91. Ryan-Collins, Lloyd & Macfarlane, *Rethinking the Economics of Land and Housing*, p.111.

areas of the "real" economy.

Access to finance is vital for business and growth, but it is clear that banks are favouring mortgage lending. The amount of mortgage credit provided by banks has grown immensely since the 1970s. Then, mortgage lending constituted just 20% of GDP; now it is triple that.[92] At the same time, as Figure 13 shows, lending to private non-financial companies has flatlined, with the exception of the government's intervention during the COVID-19 pandemic. More recent data suggests these trends are persisting. In 2019, mortgage lending to households was growing by £0.65 billion each month, whereas lending to non-financial companies was rising by less than £0.4 billion a month. At the start of 2022, lending to non-financial companies was actually falling, whilst mortgage lending continued to rise. Lending to households, of which the largest component is mortgage credit, was 67% of aggregate lending in the same year, whilst lending to private non-financial companies constituted 19.5% of the total.[93] Further evidence suggests that increasing land and property values are seeing banks substitute away from commercial lending and in favour of mortgage lending; indeed, house prices appear to be negatively correlated with interest rates for business borrowing.[94]

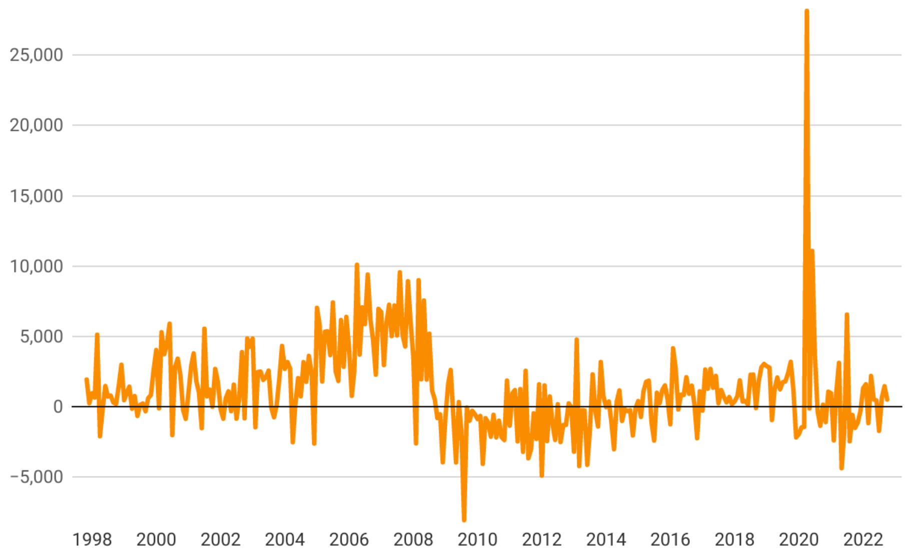
## Figure 12: Lending by UK Financial Institutions (£mn), Not Seasonally Adjusted




*Bank of England: Industrial Analysis of Sterling Monetary Financial Institutions Lending to UK residents: Long Runs*[95]

92. Bank of England, "A Millennium of Macroeconomic Data", 2016.
93. Bank of England, "Money and Credit Summary Tables", November 2019 & January 2022.
94. Indraneel Chakraborty, Itay Goldstein and Andrew MacKinlay, "Housing Price Booms and Crowding-Out Effects in Bank Lending", *Review of Financial Studies*, Vol.31(7) (2018) pp.2806-2853. Of course, this applies in particular to banks which are more capital constrained banks - smaller institutions, yes, but also across the sector after the financial crisis. There may also be other factors in these lending trends, such as the shift away from a more capital-intensive economy.
95. Productive lending here includes manufacturing, construction, retail and wholesale trade, transportation, storage and communication.

## Figure 13: Monthly changes of monetary financial institutions' sterling net lending to private non-financial corporations (£m) seasonally adjusted




[Bank of England]

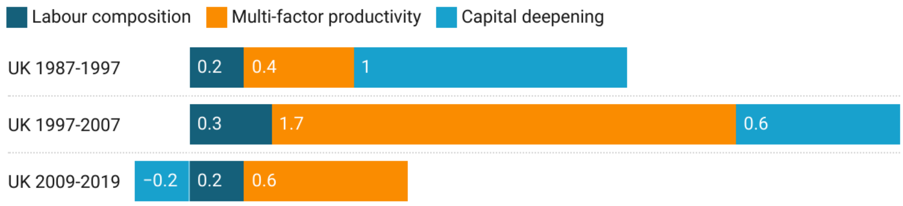
Ultimately, financial institutions seek to maximise profits, and to this end, real estate is seen as a better destination for their investment; land and property is also a secure form of collateral, and mortgage lending scales better than lending to small businesses, which reduces transaction costs. Yet such lending is not productive; it is not leading to the creation of new goods and services. It is simply sustaining demand for a limited stock of housing, which is pushing up prices. As money pours into mortgage finance, investment for businesses in productive sectors is being crowded-out as a result.[96] It is also not finding its way to builders whose profit-making derives primarily from building homes. Evidence from the industry itself suggests a lack of access to adequate finances is a key impediment for small to medium sized builders in the sector.[97]

Undoubtedly, as Ryan-Collins, Lloyd and Macfarlane argue, these trends are in large part a consequence of the regulatory environment in the financial sector. Yet we cannot ignore the role that constrained supply is having. Limited housing stock means rising prices and more lending going to mortgages as banks prioritise profitable ventures. That means less lending to parts of the economy that badly need investment.[98]

Indeed, the salience of this crowding-out effect becomes more apparent when it is situated in the context of UK measures of productivity growth. As Figure 14 shows, two thirds of the productivity gains between 1987 and 1997 were due to the increased amount of capital available per hour worked. Between 2009 and 2019, however, the lack of capital was weighing down productivity growth.[99]

96. See Indraneel Chakraborty, Itay Goldstein and Andrew MacKinlay, "Housing Price Booms and Crowding-Out Effects in Bank Lending", *The Review of Financial Studies*, Vol.31(7) (2018) pp.2806-53.
97. Home Builders Federation, *Reversing the Decline of Small Builders: Reinvigorating Entrepreneurialism and Building More Homes*, 2017.
98. Policy Exchange, *Looking to the Future of Growth*.
99. ONS, "International Comparisons of UK Productivity", 2020.

## Figure 14: Percentage contributions of capital deepening, labour composition and MFP to market sector output per hour worked growth, UK.




*ONS: "International Comparisons of UK Productivity, Final Estimates: 2020"*

The undersupply of homes itself produces a vicious economic circle; constrained new supply increases the scarcity value of houses, which has the effect of both reducing the incentive to drastically increase supply – as at a local level this will dilute the value of houses as a scarce asset – as well as encouraging more speculative investment and more lending secured against property.[100]

Current trends in lending and investment are hurting UK productivity. Yet there is strong evidence that lending for and investment in *new* housing would be highly beneficial to economic growth. As per Table 3, on average, every 100,000 new dwellings contributed 0.83% to UK GDP in the decade to 2018. Applied today, boosting housebuilding by 100,000 homes – and so meeting the 340,000 new homes per annum estimated requirement - would add £17.7 billion a year to the UK economy, and that is just the immediate, direct effects of boosting the construction industry, leaving aside increased employment and tax receipts.[101] Indeed, historical studies show that housing construction can act as an effective "transmission mechanism" for inflationary pressures. In the 1930s, housebuilding worked to "crowd in" private spending, ensuring that cheap money was invested in the real economy of goods and services rather than fuelling price rises.[102] Though the contemporary economic landscape of high interest rates is fundamentally different, increased housing supply would be an effective counter cyclical policy.

100. Tom Archer and Ian Cole, *Profits Before Volume? Major Housebuilders and the Crisis of Housing Supply*, 2016.
101. ONS, *UK National Accounts, The Blue Book*, 2019; & "Construction Statistics, Great Britain: 2018" 2019.
102. Nicholas Crafts, "Returning to Growth".

### Table 3: Contribution of the Construction Sector to Annual UK GDP

| Year | New Private and Public Dwellings, £bn | Annual GDP, £bn | Construction of new homes as % of GDP | Total new dwellings | % of GDP per 100,000 homes |
|---|---|---|---|---|---|
| 2008 | 21.437 | 1918.064 | 1.117637368 | **187,320** | 0.596646043 |
| 2009 | 15.919 | 1831.55 | 0.87 | **157,140** | 0.55 |
| 2010 | 19.731 | 1876.058 | 1.05 | **135,980** | 0.77 |
| 2011 | 21.272 | 1896.087 | 1.12 | **140,710** | 0.80 |
| 2012 | 20.114 | 1923.551 | 1.04 | **141,610** | 0.74 |
| 2013 | 22.409 | 1958.557 | 1.14 | **135,590** | 0.84 |
| 2014 | 29.525 | 2021.225 | 1.46 | **145,120** | 1.01 |
| 2015 | 31.169 | 2069.595 | 1.51 | **172,020** | 0.88 |
| 2016 | 35.368 | 2114.406 | 1.67 | **171,870** | 0.97 |
| 2017 | 40.11 | 2166.073 | 1.85 | **193,700** | 0.96 |
| 2018 | 43.474 | 2203.005 | 1.97 | **199,110** | 0.99 |

*ONS: Blue Book Series, 2019*

## Labour Mobility

Housing shortage has also worked to constrain economic growth by reducing mobility in the labour market. To get the economy growing, the UK needs skilled workers in productive jobs. Such jobs are to be found in areas with strong "agglomeration effects" – that is, areas in which economic activity is clustered and there is good, shared infrastructure and a high spill over of ideas and information.[103] At the same time, it is also essential that workers are capable of moving and indeed incentivised to move into the jobs created in these areas of high productivity. To do so, adequate and affordable housing near workplaces is essential.

One might think of there being "push" and "pull" factors when it comes to the internal economic migration of people into more productive areas. Push factors might refer to the lack of employment opportunities in a given area. Pull factors pertain primarily to the quality of living premium that is secured by taking up higher-paying employment; people are incentivised to move when they believe that a higher wage will translate to a higher quality of life.[104]

The push factor for economic migration has diminished in many areas as the deficit of employment between different areas has fallen. From a levelling up perspective, that is at a minimum an equivocal trend, and might even be welcome. Yet pull factors have fallen too, and this is deeply undesirable: the severe undersupply on housing in places of high productivity has driven up housing prices and this has reduced the "living standards premium" that workers could expect to benefit from by moving to a better paying job. Data on migration has been distorted considerably in the last few years by the impact of covid but trends in the two decades before strongly indicate that the incentive for workers to move to more productive areas has been significantly diminished. In 1997, a median

103. Stuart Rosenthal and William Strange, "Evidence on the Nature and Sources of Agglomeration Economies" in Vernon Henderson and Jacques-Francois Thisse, *Handbook of Regional and Urban Economics: Volume IV*, (Amsterdam, 2004) pp.2119-2171; Gilles Duranton and Diego Puga, "The Economics of \urban Density", *Journal of Economic Perspectives*, Vol.34(3) (2020) pp.3-26.

104. Resolution Foundation, *Moving Matters*, 2019.

renter moving from an area in the third earning percentile to a private rental in an area in the fifth percentile would have seen their earnings after housing costs rise by 6%, yet in 2019, such a move would only have yielded a 1% increase. A move in 1997 for a median renter from a third decile area to a ninth decile area would have seen a 26% uplift in their after-housing-costs earnings; in 2019, that same move would have left the earner *worse off*. This reduced quality of living premium has had a direct bearing on the UK's internal migration patterns: the number of working age people moving into a higher housing cost area – predominantly productive, urban areas - has decreased by 3% between 2002-3 and 2017-18. [105]

The trends for owner-occupiers are comparable. In three of the UK's most productive cities, house price affordability has deteriorated greatly this century. London's soaring house prices are well-known, but in the combined authorities of Birmingham (West Midlands) and Manchester, house prices have become 86% and 112% less affordable respectively too since 2000.[106] Wages, by contrast, have grown less than half as quickly in nominal terms over the same period in those two cities.[107] In lower earning areas, wages have grown faster than house prices, which has decreased the desirability of moving to more productive areas further.[108]

The result of all this is that the UK labour market is less mobile, and skilled workers are being disincentivised from moving into the jobs that would drive UK productivity and growth. This is reflected in ONS figures which suggest that there has been a downward trend in internal migration – a trend occurring independently of the strong impact of the pandemic between 2019 and 2020.[109] Individuals and households thinking about moving to places of high productivity can expect to be less well off than twenty years ago. Those intending to purchase a home in such an area will come up against a significant equity barrier and mortgage hurdle because of high house price to income ratios.

Of course, it might be argued that, with the spread of working from home practices, the importance of labour mobility has diminished. People do not need to live in cities to do productive work. However, as the *Centre for Cities* have contended, this argument has appeared before in a similar guise: that new technologies would make geography irrelevant to work. The reality is that private sector jobs have become more, not less concentrated in successful cities, as businesses continue to benefit from the agglomeration effects of urban areas. This is particularly the case for the UK because of the predominance of knowledge-based industries which greatly benefit from the clustering of labour and expertise.[110] "Agglomeration benefits are here to stay", and this makes diminished labour mobility a significant cause for concern.[111]

## House Prices and Productivity

House prices do not just deter the net inward migration that might drive future productivity improvements in our cities, but they also ensure that any putative gains in productivity are stifled. As part of his model of spatial

105. *Ibid*, pp.16-17.
106. ONS, "House Price Affordability in England and Wales", 2022.
107. ONS, "Earnings and Hours Worked, Place of Work By Local Authority", 2000, 2009 & 2021. Link. Though less severe, house prices have still outgrown wages since 2009, even in the specific local authorities of Birmingham and Manchester: house prices have grown by 35% in the former and 47% in the latter, but wages have only increased by 30% in both local authorities.
108. Resolution Foundation, *Moving Matters*.
109. ONS, "Regional Economic Activity By Gross Domestic Product, UK: 1998 to 2020"; & "Population Estimates For The UK, England and Wales, Scotland and Northern Ireland", 2020; See also Resolution Foundation, *Get a Move On? The Decline in Regional Job-to-Job Moves and its Impact on Productivity and Pay*, 2017.
110. Centre for Cities, *Beyond the High Street*, 2013. There are exceptions to these trends, but that is usually when cities have been "hollowed out", or there has been considerable business investment around the outskirts of the city, as has occurred with Cambridge and research and development companies.
111. Ben Southwood, "Agglomeration Benefits are Here to Stay", *Works in Progress*, 26th October 2022, Link.

equilibrium in local labour markets, Moretti argues that. hypothetically, in cities where housing supply is completely inelastic, any productivity gains will be entirely capitalised in land value and will accrue to landowners; by contrast, in cities where housing supply is infinitely elastic, housing prices will not change, and for each additional worker who moves to a productive area, a new home will be built, with productivity improvements translating into higher wages which can then be spent in the wider economy. Of course, the reality is that housing supply elasticity is somewhere between these two polarities; nevertheless, in the UK, planning restrictions and in particular green belt regulations mean our cities more closely resemble the first rather than the second scenario, in which house prices rise at the expense of wages and productivity.[112] Real estate booms also discourage investment in productive businesses and companies. As set out above, as house prices rise, so does mortgage lending, whilst firms in the area of a house price boom experience lower loan growth and have to pay higher rates of interest on loans from banks.[113]

These dynamics do not just affect local labour markets but the UK economy as a whole.[114] This is not surprising in the case of London, which accounts for almost a quarter of UK annual GDP at the same time as having the most acute housing need in the country.[115] Yet it is also the case for other large cities. The Centre for Cities estimates that Manchester and Birmingham are £15 billion and £11 billion respectively behind their productive potential.[116] It is no coincidence that the urban cores of these two cities also have the second and fourth largest proportions of the country's green belt too. Manchester's constitutes an area 2489 km$^2$, whilst Birmingham's equates to 2270km$^2$; London's is a whopping 5062km$^2$.[117] Whilst serving an important purpose, green belts have grown to encompass a mass of land that far exceeds that taken up by the cities they were intended to constrain the outward expansion of. Though preventing urban sprawl remains a vital function of these protected zones, the UK's green belt also contribute to the significant constraints on the supply of land for new homes that skilled workers need to work in productive areas. Strangling housing supply in productive cities has localised effects, but it also bears substantially on the economy generally.

There is a debate about whether productivity derives from "people" or "place", and thus whether governments should prioritise support for the workforce via training and skills and improving mobility or the productive potential of particular spaces. If the former, it might be the case that improving the accessibility of certain cities simply moves productivity around rather than augmenting it.[118] From a housing and planning perspective, though, the fact that the places where agglomeration effects are strongest in the UK - the places with the greatest productive *potential* - also have the most significant constrictions on housing supply is a cause for significant concern.

112. Enrico Moretti, "Local Labour Markets", in Orley Ashenfelter & David Card (eds), *The Handbook of Labour Economics: Volume 4b* (New York, 2011) p.1264.
113. Chakraborty, Goldstein and MacKinlay, "Housing Price Booms and Crowding-Out Effects in Bank Lending".
114. Hsieh and Moretti, "Housing Constraints and Spatial Misallocation".
115. Crisis, *Housing Supply Requirements Across Great Britain: For Low-income Households and Homeless People*, 2018.
116. Centre for Cities, *So You Want To Level Up*.
117. House of Commons Library, *Green Belt*, 2022.
118. A similar debate took place on the government's enterprise zones. See House of Commons Library, *Enterprise Zones*, 2022.

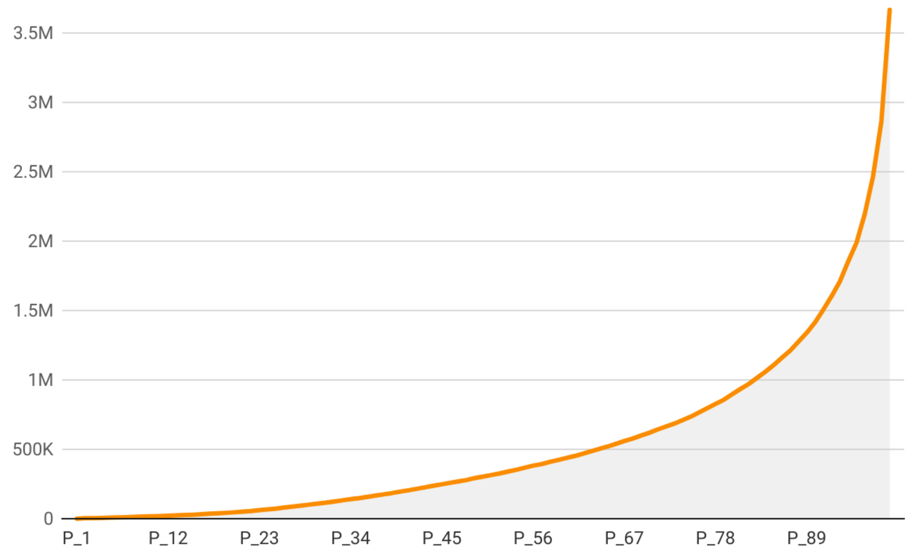
## Inequality and Consumer Spending

Finally, the under supply of new homes has, by driving up house prices, contributed to increased wealth inequality, and this has had a further drag on the UK's economic performance by dampening consumer spending.

As Picketty has argued, an important historical economic development in the UK and across the world has been the increasing "capital to income ratio".[119] The dominance of wealth over income is salient because it reflects an increasing accumulation of wealth amongst those who already own it, at the expense of those that do not, underscoring worsening levels of inequality. The trends that Picketty identifies have broadly continued today, especially when one looks at housing wealth rather than capital more generally. At the turn of the century, housing wealth was around one and a half times UK GDP; in 2020, it was over four times GDP.[120] Aside from pensions, property now constitutes the largest component of aggregate wealth in the UK at 35%.[121]

The consequence is that the UK has high levels of wealth concentration – higher indeed than that of income concentration. In the UK the highest 5% of households own 39.6% of total wealth, whereas the top 5% of earners hold 18.3% of total income.[122]

### Figure 15: Household Wealth by Percentile, £m, 2018-2020




*ONS: Wealth and Assets Survey*

That the ratio of wealth to income has grown in the UK is a cause for concern because overall increases in wealth have not come from productive activity or work, but (given the proportion of net wealth constituted by property) from the appreciating value of housing – and specifically the value of residential land. And given that the holders of housing wealth are predominantly older – the median net property wealth of someone over the state pension age is over three times that of someone aged between 35 and 44 and over 16 times that of someone aged between 25 and 34 – the

119. Thomas Picketty, *Capital in the Twenty-First Century* (London, 2017)
120. ONS, "UK Balance Sheet", 2020; ONS, "UK GDP", 2022.
121. ONS, "Total Wealth in Great Britain: 2016-18", 2019.
122. Fabian Pfeffer and Nora Waitkus, "The Wealth Inequality of Nations", *American Sociological Review*, Vol.86(4) (2021) p.594.

increased dominance of wealth compared to income suggests a net flow of money from the young and poor to the old and rich.[123]

To give a more relatable measure, between August 2021 and August 2022 average house prices grew by £35,473 across the United Kingdom, whilst the median household disposable income was £31,385. In other words, the average homeowner became richer through capital gains than the average non-homeowner did from working.[124]

In practical terms, for either renters or mortgagers, this has translated into a far greater proportion of take-home pay being consumed by housing costs. In England, average private renters in the 1960s had to set aside 10% of their income for housing costs. Now, that figure is 33%, and estimates suggest that 23% of people in the private rented sector spend over 40% of their income on housing.[125] For average renters in London, the figure is 42%.[126] For mortgages, the proportions are comparable. For a median earner in England with a 90% mortgage on a median priced home, monthly repayments are 37% of income; in London, a median earner with a 90% mortgage on a median priced home would have to spend an eye-watering 68% of their wage on monthly repayments.[127] Another set of estimates suggest that over the last two decades, 90% of income growth for the lowest income families have been absorbed by higher housing costs, whilst for high-income, home-owning families, the reduced costs of housing have seen their incomes grow by 13%.[128] High housing costs are commanding significant quantities of cash that otherwise could be spent in more productive sectors of the economy.[129]

Arguably, the transference of wealth from poorer to richer groups might have a net-neutral effect on the economy as a whole from a demand perspective. Increasing the wealth of the already wealthy would serve to stimulate their demand, and this might offset the diminished demand of poorer demographics. However, this overlooks the fact that poorer (and indeed) younger groups have a higher marginal propensity to consume and spend in the wider economy on essential goods and services.[130] Whilst accumulated capital for wealthy groups could be used both directly and indirectly via savings for productive investment, given the case made above, individuals and institutions would be more likely to invest in unproductive but highly lucrative speculation on housing and land, rather than sectors and businesses that might contribute materially to the real economy. Aside from any moral or social considerations, the likelihood therefore is housing wealth inequality has a net negative economic impact on the economic performance of the UK.

Whilst inequality is not in and of itself a problem always and everywhere – indeed, a degree of inequality is inevitable in any market economy – chronic inequality can be unsustainable in certain contexts and macroeconomics, leading to market fragility. With wealth concentrated in a narrower, richer and older demographic, and a vast proportion of the population relying on borrowing to fund ever increasing housing costs, housing undersupply is driving a dynamic that is unbalancing the economy.[131] This situation has only deteriorated further with the recent

123. ONS, "Household Total Wealth In Great Britain, 2018-20".
124. Land Registry, "House Price Index"; ONS, "Average Household Income", 2021.
125. Resolution Foundation, "Housing Outlook, Q3", 2022; The Affordable Housing Commission, *Making Housing Affordable Again: Rebalancing the Nation's Housing System*, 2020, p.15.
126. Built Environment Committee, *Meeting Housing Demand*, p.29.
127. ONS, "Mortgage Repayments Affordability", 2020.
128. Affordable Housing Commission, *Making Housing Affordable Again*, p.69.
129. Kate Barker: *Review of Housing Supply: Interim Report*, 2003, p.25-6.
130. Ryan-Collins, Lloyd and Macfarlane, *Rethinking the Economics of Land and Housing*, pp.185-6.
131. *Ibid*

upsurge in interest rates. As Neal Hudson has argued, mortgage repayment affordability – that is, monthly mortgage repayments as a proportion of income – may be approaching the levels observable immediately prior to the 2007-8 crash.[132] Housing wealth inequality thus directly weakens the UK economy's resilience and makes it more vulnerable to inflationary shocks.

All of this fundamentally comes back to housing undersupply. A lack of new homes (and land for them) has augmented the scarcity value of existing ones, pushing up prices. Those without property must contribute greater proportions of their income to housing costs, whilst homeowners see the value of their assets rise. Capital is thus drawn away from groups with a high propensity to consume, as more and more of their income is absorbed by rent or mortgage repayments, and correspondingly less is spent on other goods and services.

132. Built Place, "Market Commentary", 29th September, 2022, Link.

# Human Costs of Housing Undersupply

This paper's focus is the macroeconomic implications of the undersupply in housing. However, it would be remiss to not acknowledge the very material, human costs that the housing shortage is having across the country, both socially and in terms of household finances.

Certainly, one of the most proximate and tangible impacts has been on the monthly budgets of individuals and families up and down the country. As noted above, 33% of income for average households is spent on rent in the UK. In Germany, the figure is 30%, which is relatively high by European standards.[133] If the proportion of income spent on housing for UK renters was reduced to that spent in Germany, the median household would be £942 better off a year. Given that there are around 4.4 million households privately renting in England, £4.1 billion might be unlocked in annual consumer spending.[134]

Prohibitively high rents and house prices in cities are deterring skilled workers from moving to jobs that will not only boost the economy but will materially improve their living standards. Indeed, "job changers" experience a greater pay lift and thus boost to their living standards than "job stayers".[135] Yet because high housing costs are cutting into the gains that movers can expect to receive, they are increasingly disincentivised from doing so. Internal migration in the UK has fallen, and there is a net flow of people out of productive places like London. Young people in particular are being affected: between 1997 and 2018, the proportion of 25-34 year olds moving home to start a new job fell from just under 40% to just under 20%.[136] In 2008, 20% of adults aged 20-34 were living at home with their parents; now, 28% do.[137] High house prices, driven by a lack of adequate supply, mean that younger groups have less money in their take-home pay to save for a deposit, and they are less likely to move to a new job that will boost their earnings. This has made the dream of homeownership increasingly unattainable, especially for younger generations. Homeownership is now a mixed blessing for those that can get onto the house ladder, for it will come at the cost of immense levels of debt, which as we have seen recently are highly vulnerable to inflationary shocks.

Yet higher housing costs have not necessarily seen a corresponding improvement in the quality of homes across the board. It is worth noting that satisfaction levels have improved greatly in the last half a decade, both amongst new homeowners and private renters.[138] Nevertheless, on other

133. Eurostat, "Is Housing Affordable?", 2021, Link.
134. ONS, "House Price to Income Ratio", Built Environment Committee, *Meeting Housing Demand*.
135. ONS, "Analysis of Job Changers and Stayers", 2019; Resolution Foundation, *Moving Matters*, p.4.
136. Resolution Foundation, *Moving Matters*, p.13.
137. ONS, "Why Are More Young People Living With Their Parents?", 2016 & "Young People Living With Their Parents", 2022.
138. See House Builders Federation, *National New Homes Customer Satisfaction Survey*, 2022; Social Market Foundation, *Where Next for the Private Rental Sector?*, 2022.

metrics, significant issues with housing quality persist. A report in 2018 suggests that the average floor space of a UK home has fallen every decade since the 1970s.[139] An earlier study argued that homes in England are on average 53% smaller than those in the Netherlands, and 80% smaller than those in Denmark.[140] More worryingly, despite the fact that levels have fallen considerably over the last decade and a half, 17% of the population are still living in housing considered non-decent; for those living in private rented accommodation, the figure is 23.3%. Given that non-decent housing homes are defined as those "with a hazard of immediate threat to a person's health, not in reasonable state of repair, lacking modern facilities or not effectively insulated or heated", that almost one in five households across the country and almost one in every four private renters are residing in such accommodation is troubling.[141]

Some make the case that renting brings with it the advantages of mobility and flexibility, and that therefore the concerns over the shift towards the private rental sector and the decline of homeownership are overstated. Of course, the private rental sector does serve a purpose within the overall stock of housing, particularly as an appropriate tenure type for students. Yet the fact of the matter is that homeownership remains deeply popular in the UK, and an aspiration held by many. In a 2014 poll, 86% said they would rather own their own home than rent.[142] In a more recent survey, over 80% of renters under the age of 34 said they hoped to own their own home in the future. At the same time, about half of those in the same age bracket who said they didn't think they would own a home in the future cited unaffordability as the main barrier.[143] It is not at all clear that people are *choosing* to be renters; rather, it appears that people are involuntarily renting because of a lack of available housing that they can afford.

Furthermore, that homeownership has declined discernibly amongst 25–34-year-olds this century is of special concern because this is the period in which couples tend to want to start families. A YouGov poll suggests that the UK public think the best age to have a child is 28; official data suggests the median age that women give birth is 30.7.[144]

It is true that significant improvements in satisfaction rates amongst renters have occurred in the last decade, and the vast majority of renters are content with the standard of their housing arrangements. Nevertheless, and as stated above, people generally and renters in particular *want* to own their own home. Home ownership not only provides a stable asset and a generally reliable store of value for families, but it provides greater stability than private rental arrangements based on standard one-year tenancies, and this is vital for young families who want to provide their children with consistency and certainty in their lives. Some have argued that the need for new homes is overstated because household and family formation is lower than projections. Yet this is to ignore the causal, circular effect that the housing shortage itself is having; new households are failing to form because there is not suitable housing to support them. Instead, young adults are remaining in their parents' home or joining house shares

139. Local Authority Building Control, "What is the Average House Size in the UK?", 2018.
140. Royal Institute of British Architects, *The Case for Space: The Size of England's New Homes*, 2011.
141. The Health Foundation, "Trends in Non-Decent Homes by Tenure", 2021.
142. House of Commons Library, *Extending Home Ownership: Government Initiatives*, 2021.
143. Department for Levelling Up, Housing and Communities, *English Housing Survey: Private Rented Sector*, 2020-21, pp.27-9.
144. YouGov, "What is the Ideal Age to Have Children?", 2021; ONS, "Births in England and Wales", 2022.

or becoming homeless and "sofa-surfing".[145] The housing shortage is worsening trends that have contributed to the decline of traditional family dynamics in the UK and the continued fall in the country's birth rate.[146]

These are not the macroeconomic costs of the UK's chronic shortage in housing supply, but they are just as pertinent for the overall vitality of British society. They are also the costs that the government needs to start talking about more loudly if it wants to convince current homeowners – those most opposed to new development in their local areas – that building new homes is in their and their family's interest. There is good reason to be sceptical about the claim that there is a majority against the building of new homes in the UK in principle. A poll conducted in 2021 suggested that not only do more people support than oppose housebuilding in their local area, but that the majority of Brits would support housebuilding if there were confident that it would bring benefits to their family, enabled their children to move out of a family home, or meant that family members could afford a home nearby.[147] These are the issues that make the housing shortage and the damage it is causing tangible for individuals and families.

145. Civitas, *Housing Supply and Household Growth*, 2016; Economic Affairs Committee, "Oral Evidence, The Economics of the UK Housing Market", 2016. p.1433.
146. ONS, "Births in England and Wales", 2022.
147. Adam Smith Institute, *Build Me Up, Level Up: Popular Homebuilding While Boosting Local Communities*, 2021.

# Policy Recommendations

There are no "silver bullets" for the housing crisis – governments, think tanks and journalists have spilt much ink on the subject for decades without huge improvements to the responsiveness of supply to demand in the sector. At the most basic level, the existing situation is the product of an incentive structure that encourages speculation rather than supply, that fails to create communities of interest in favour of new housing, and that generates significant uncertainty for business. At the heart of this incentive structure is the UK's planning system, and it is vitally important to recognise that without action here, the housing market will continue to exhibit perverse characteristics. That is why modifications to the planning system are recommended first. The government can make progress on a number of fronts in the cause of improving the supply of new homes, but market distortions will persist unless it improves the planning system to provide greater certainty and facilitate good development.

## The Planning System: Increasing Certainty and Building Trust

If you wanted to get to an augmented planning system, so the saying goes, you would not start from "here". The UK has a highly idiosyncratic framework, in which land use is entirely determined by the state on a discretionary basis and green belts prohibit development on vast swathes of land around the UK's most productive cities. Many voters see the planning system as an important bulwark against ill-thought-out development that would affect the fabric of local communities or precipitate the sprawl of urban areas. This is a legitimate function of any planning regulation, but the UK's system gets the balance wrong, deterring even sustainable, badly needed development.

Reform is clearly required in the way we allocate land use. Nevertheless, the government must deal pragmatically with the system as it is. The *Planning for the Future* white paper promised "radical reform unlike anything we have seen since the Second World War" and a "levelling" of the system "from the ground up, a whole new planning system for England".[148] Whilst the ambition of developing a planning system that can deliver more homes was sound, it is understandable why so many people were deeply anxious about – and in the end opposed to – the promise of revolutionary changes to how we allocate land use and planning permission in this country. That is *not* to say that there is not a constituency in favour of more housebuilding. As noted, polling suggests that more people support the construction of

148. Ministry of Housing, Communities and Local Government, *Planning for the Future*, 2020.

new homes in their local area than oppose it.[149] What voters care about is some degree of *control* over new development, and development that reflects rather than changes the nature of their local community.

A new white paper on planning reform is not required now; there have been two already this Parliament. Instead, the government should focus on creating communities of interest between local residents, developers, and non-homeowners who would benefit from increases to housing supply. Vitally, it needs to do two things: to demonstrate to those worried about the effects of development that it can be done sustainably and in such a way that adds value to their communities, whilst preserving and enhancing its character; and to give greater certainty to developers who want to build more homes. Much can be done on these two fronts through the existing planning system.

First and foremost, the best way that local government can provide greater certainty to developers is to have an up-to-date Local Plan. Currently, only 40% of local authorities have a Local Plan that was adopted within the last five years. Communities need to be able to shape the growth and development of their local areas, but they cannot do so unless they produce a coherent strategy which details how they would like land to be utilised. The current absence of up-to-date plans means that in the majority of England, housebuilders do not have any clarity as to what sort of development desired by the local community. In fact, as the Royal Institute of Chartered Surveyors has pointed out, under the current framework, local residents do not know what is going to be built in their local area even after a Local Plan is produced either.[150]

Plan-led development can be an effective way to ensure community buy-in for housebuilding. The formulation of a Local Plan involves consultation at the outset and a six-week period for representations to be made on the draft before its submission to the Planning Inspectorate and enables residents to have a say on how the area will evolve. Yet the current system, which does not give clarity either to developers or local people, is not working as it should.

The government should enforce a statutory requirement for local authorities to have an up-to-date Local Plan, and it should proceed with the obligation to have these produced within 30 months. It could use business rates retention as its incentivising device; authorities with an up-to-date Local Plan should see the proportion of business rates they retain rise, whilst those without one should see the amount they keep fall. Efforts should be made to streamline the Local Plan consultation process; for one, the housing requirement figure should be determined prior to the Local Plan. However, the government cannot get around the fact that improvements will not be possible if local planning authorities are not adequately resourced. Funding for local planning departments is around £900 million per annum, with half of that figure recouped via fees and half provided through net public spending. The government committed to an extra £65 million for planning departments in the 2021 Spending Review, but the Royal Town Planning Institute estimates that £500

149. Adam Smith Institute, *Build me Up, Level Up*.
150. Built Environment Committee, "Written Evidence, Royal Institute of Chartered Surveyors – FPS065", 2020.

million over four years is required to address significant delays in local planning.[151] Local authorities should raise funding for planning through development charges, changes to which are proposed below. This will tie local authorities and developer together in an incentive structure that supports the delivery of new homes; developers will be directly funding the improvements they want in planning departments, whilst local authorities will be motivated to approve new development in order to collect development receipts.

Local residents should have a clear idea of what sort of development is going to take place in their area. To this end, Local Plans should be accompanied by a design code, on which there should also be consultation at the outset and prior to submission alongside the Local Plan to the Planning Inspectorate. These codes should be based on the National Design Guide, they should be shaped by expert advice from planners and architects and with input from residents, and the documentation should be kept brief and accessible. As with the Local Plan, local authorities should be obliged to produce such a document within 30 months. Community consent should be secured by local councillors voting on the design code. This system will be compatible with neighbourhood planning: a neighbourhood would be able to adopt their own plan and design code, subject to a referendum and its compatibility with local and national strategic policies.

Of course, within the existing system, there remains a limit to the certainty that can be provided, because the discretionary system means local residents can still veto specific development projects. It seems remarkable that there has essentially been no piloting of alternative planning arrangements in this country. The Localism Act of 2011 does have provisions to allow councils and local neighbourhoods to pre-approve certain types of planning permission subject to initial local consultation, but these have rarely been used.[152] It surely makes sense to trial adjustments to the planning system and gather empirical evidence of their effectiveness before rolling them out across the country at large.

To this end, the government should trial "regeneration areas" at the local authority level. These would be specified areas in which efforts are made to pilot improvements to planning regulations. There could be a "local consent lock" in the form of a requirement that elected representatives in local authorities apply to central government to have a regeneration area. Government would ensure that regeneration areas were allocated only in places of demonstrable high housing demand and undersupply. As with the changes above, local authorities would produce two documents – a Local Plan and a design code. The former would specify areas in advance where anything other than minor development would be prohibited, as well as designating what development is desired in other areas, whilst the latter would outline what that development should look like. Importantly however, once these plans were in place, *there would be a presumption in favour of building in the regeneration areas, and additional permission from the state would not be required so long as development conformed to legal requirements and the design guide set out by the local community*.

151. Housing, Communities and Local Government Committee, *The Future of the Planning System in England*, 2021

152. House of Commons Library, *Neighbourhood Planning*, 2018.

Regeneration areas would be in keeping with the shift by successive governments away from top-down planning and towards greater localism. They would ensure that residents have input on the type of development that would take place in their communities early on in the planning process, and if successful would provide empirical evidence to those sceptical about new housebuilding in other parts of the country that it can be done sensitively and in a way that is consistent with local styles.

The planning system within a regeneration area would also be more representative than the existing system. Rather than amplifying the voice of a particular minority opposed to development and with the time and energy to take part in consultations and decision-making, a design code and Local Plan agreed in advance and sanctioned by locally elected councillors would make for a more representative process.[153] Input from local residents should be frontloaded at the start of a Local Plan and before it is sent to government for sign-off,

At the same time, regeneration areas would offer developers the certainty that they desire for investment decisions. The shift to a rules-based planning environment – in which permission is granted based on pre-established rules rather than on a discretionary, case-by-case basis – would disincentivise speculation in land, and would instead encourage sensible, sustainable housebuilding. Further incentivises for increases in supply could be achieved through taxation, as discussed below.

There is an argument that specifying design codes for developers to abide by simply adds more red tape to an already overburdened market. There is a valid point, but on balance, demonstrating to local residents that any new development will not compromise the character of their community is far more important to the cause of getting new homes built in the present context. Beauty, as Policy Exchange has long argued, is a good with positive externalities that spreads the value of new development across a community.[154] It must be at the heart of the next generation of homes we build as a country. Design codes will ensure better, more beautiful homes are built, and community confidence in the *quality* of development will make it more likely that a greater *quantity* of homes is supplied.[155]

Fundamentally, the housing crisis is just as much a political problem as a policy problem. Various legitimate interest groups are involved, including those currently locked out of the housing market, existing homeowners worried about their neighbourhoods and the value of their most important asset, and businesses that *do* want to build new homes, but are currently incentivised to not do so. The government's job is to reconcile these competing interests, and the proposals above offer an opportunity to do this at a local level and inspire new confidence in the potential of planning.

153. Policy Exchange, *Rethinking the Planning System for the 21st Century.*

154. Policy Exchange, *Strong Suburbs.*

155. Policy Exchange, *Building More, Building Beautiful*, 2018.

## Reducing Delays to Delivery: Contracts to Build

Improving the way land use is allocated in the UK will go a long way towards providing greater certainty to developers and will help to shift their incentives away from speculation and towards building homes.

However, as was pointed out above, improving access to developable land alone will not be sufficient to increase the number of house completions each year. Since 2017, the government has granted permission for over 300,000 units each year, enough for it to consistently meet it owns national housebuilding target.[156]

The government should work to encourage the delivery of housing in a targeted way, rather than simply the acquisition of land on which housing might be built. A part of the existing planning system is a minimal requirement that development work must commence within three years of permission being granted. Beyond this, however, the government lacks any mechanisms to ensure the timely delivery of new homes. There is a device called a "completion notice", whereby a council can invalidate a planning permission if they believe that a project will not be delivered in reasonable time, but this is rarely utilised: local authorities are pressed to deliver housing, and a completion notice requires sign off from the Secretary of State. Moreover, invalidating planning permissions will not in and of itself lead to more homes being built.

Instead, the government should introduce contractual obligations into planning permissions. This will help restore the sense amongst local residents that the lucrative rights granted to companies to develop come with responsibilities. It could specify that a percentage of the housing units committed to as part of the planning permission are delivered within an agreed timeframe. This percentage could be cumulative, so that a developer would be able to make up a shortfall in one year in a subsequent twelve months. Council tax should then be levied on the properties that a developer failed to build as part of the planning permission agreement.

Of course, many delays are legitimate or unavoidable. Some might come from things outside of the control of the developer, like problems with the supply of utilities. For such instances, there should be provisions in the planning contract to exempt developers from being penalised. However, these instances should be specified in advance and be far more narrowly defined than the Section 106 viability assessments, for example, and should relate only to material changes in circumstance.

Indeed, delays might be the responsibility of local authorities themselves. This is a significant grievance to developers as it adds to their costs, particular in borrowing for smaller builders. McCarthy Stone, a larger developer, says that the average time to process one of its applications for planning permission now stands at 46 months, three and a half times as long as the statutory timeframe for permission to be determined.[157] To ensure a parity of esteem between local authorities and developers, the government should make the 8-13 week timeframe specified in the Town and Planning Act a firm deadline, as recommended by the government itself in the its 2020 white paper.[158] Should these deadlines be missed,

156. Department for Levelling Up, Housing and Communities, "Planning Applications in England: January to March", 2022
157. Built Environment Committee, *Meeting Housing Demand*, p.64.
158. Housing, Communities and Local Government Committee, *The Future of the Planning System in England*, 2021.

or planning permission be granted only after appeal, the local authority should lose its New Homes Bonus for the houses due to be built. The New Homes Bonus, which is under review at the moment, should be augmented so that it provides a stronger incentive to local authorities to expedite the planning permission process.

*It is vital to note that this alone will not solve the root issue for why housebuilders are not building out on sites as quickly as they might do.* Ultimately, it is the inherent uncertainty of our discretionary planning system that incentivises the accumulation of land and lower build out rates. Introducing measures to speed up the activity of builders in particular without corresponding measures to address land supply uncertainty will mean that housebuilding remains subdued. However, making the permissions process a more contractual one, with expectations and obligations for both local authorities and development companies, is a sensible move. It will improve trust and confidence in the system, and this is badly needed as part of an overall drive to increase the legitimacy of development in the eyes of the public.

## Tax

Another important lever available to the government when it comes to improving the supply of housing is the tax system. The government currently captures the value uplift generated by development primarily through the Community Infrastructure Levy (CIL) - an optional flat-rate tax set locally, with exemptions for very minor developments on less than 100 square meters, social housebuilding and self-builds - and Section 106 Agreements, which are obligations for developers negotiated with local authorities on a discretionary basis as part of the planning process. In response to the Grenfell Tower tragedy in 2017, the government is also planning to introduce a new Residential Property Developer Tax at 4% on big developers with annual profits in excess of £25 million to help pay for the removal of unsafe cladding on housing.

An effective set of tax arrangements as it pertains to the housing market would promote certainty, incentivise good development, and ensure that the benefits of housebuilding were spread widely amongst the community. Yet as the authoritative 2011 Mirrlees Review argued, the system "is currently something of a mess", generating uncertainty, disincentivising development and funnelling the benefits and uplift from development relatively narrowly.[159]

What action could be taken to improve the situation? In the *Planning for the Future* white paper, the government proposed a nationally set infrastructure levy to replace both Section 106 Agreements and CIL as the means of capturing development uplift. This was a bad proposal, because it lacked local flexibility and thus would have fail to account for the variation in land and property values across the country. Land values vary considerably even within regions; per hectare, land in Harlow is about half the value of land in St Albans, for example, despite their comparable public transport links and proximity to the centre on London.[160] The government has since proposed a locally set, flat-rate Infrastructure Levy (IL) with Section 106

159. Institute for Fiscal Studies, *Tax by Design*, 2011.

160. Ministry of Housing, Communities and Local Government, "Land Value Estimates for Policy Appraisals", 2020.

retained in certain instances.[161]

When it comes to levies on development, there are two conflicting priorities: flexibility and consistency. The British Property Federation argues that "the more any levy can be tailored to individual circumstances, the more it is likely to raise". On the other hand, the Federation of Master Builders argued that levies that are charged in a "clear", "transparent" and "consistent" way are preferrable.[162] The Housing, Communities and Local Government Committee recommended reforming CIL but retaining Section 106 obligations, whilst recognising that the latter will continue to generate the majority of developer contributions.[163] This paper recommends the opposite.

First of all, the government should phase out Section 106 Agreements permanently. Whilst it has already committed to phasing them out in most cases in favour of a flat rate Infrastructure Levy, Section 106 obligations were still employed by 90% of local planning authorities that were surveyed by the government in 2018/19.[164] It is absolutely right that the government seeks to capture value from the significant uplift that comes from development and reinvest it in the local community; this is essential if the education, transport and utilities infrastructure required by those who are to live in newly built homes is to be provided. Yet on balance, the drawbacks of Section 106 Agreements significantly outweigh the benefits. As part of the same survey mentioned above, over *half* of local authorities received 50% or less of the planning obligations they had negotiated two years previously.[165] Having the level of contribution negotiated on a discretionary basis for each planning permission creates considerable uncertainty for business. The regime is simply not functioning as it should, and ought to be scrapped. At the very least, more councils should employ commuted sums so that developers can pay a fixed sum instead of negotiating affordable housing contributions via Section 106.

A flat rate IL set locally should be favoured as the regime that provides a good balance between flexibility on rates and consistency for developers. Irrespective of the rate set by local authorities, moving entirely to IL will provide greater certainty to businesses and spur development. IL should be raised to compensate lost Section 106 takings, but there will still be a significant net gain for developers from the increased clarity that the flat rate will provide. Unlike CIL, it should be obligatory on all development, except for self builds, social housebuilding and improvements on an existing property. Given that 85% of developer contributions come from Section 106 Agreements, this change should be gradually affected over a period of time, during which authorities can move towards accruing an increasing amount of developer contributions from IL. Local authorities should retain 100% of receipts from IL, they should be allowed to build up reserves from the proceeds and they should be able to borrow against those receipts. Proceeds from the IL should be hypothecated for planning and infrastructure investment in order to better demonstrate the connection between housebuilding and community investment to local residents.

Removing Section 106 Agreements raises two issues: infrastructure for

161. 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.
162. Housing, Communities and Local Government Committee, *The Future of the Planning System in England.*
163. *Ibid*
164. Ministry of Housing, Communities and Local Government, *The Incidence, Value and Delivery of Planning Obligations and Community Infrastructure Levy in England 2018-19*, 2020.
165. *Ibid*

larger sites, and affordable housing. On the latter, proposals below for an expanded social housebuilding programme should pick up some of the slack and should in fact improve the overall quantity of affordable housing, given that, frequently, developers are providing less than half of their agreed affordable housing contribution as part of Section 106 Agreements. On the former, since IL would be levied at the point of delivery (rather than the permissions stage, as is the case with CIL), the government will need to forward fund infrastructure. Allowing local authorities to set IL locally should give them the ability to levy the requisite sums for investment in infrastructure, and instead of having developers apply for the Home Building Fund Infrastructure Loans, local authorities should solicit for this funding. Allowing local authorities to borrow against IL receipts would be an important part of this shift.

Exemptions and discounts should generally be avoided to ensure that the tax system does not produce perverse incentives. For example, a discount based on a minimum threshold of housing units might lead to developers taking on smaller projects and thus reduce the net supply of new homes. However, a limited exemption might be considered for infill and brownfield development. In the case of the former, these smaller sites are perfectly suited to SME builders who ought to be supported by the government (see below). In the case of the latter, brownfield development is something that is strongly support across the country and the political spectrum, but such sites are often difficult and expensive to prepare. A tax incentive might make sense in these limited instances, with the obligations on delivery outlined above included.

## Social Housing

The availability of social housing has declined considerably since 1980. Then, over 30% of householders were in the socially rented sector. Now that figure is 17%. This has been driven primarily by the decline in social housebuilding; in 1975 local authorities and housing associations contributed 52% of net new dwellings; in 2019, they made up just 19.6% of new builds. Councils alone provided just 1.78% of the total. At the same time, the Affordable Housing Commission estimates that Right to Buy has seen some two million homes transferred off the government's balance sheet.[166]

Fundamentally, there is good reason to think that any attempt to improve housing supply in the UK must incorporate a programme of social housebuilding. The government has set a target of reaching an output of 300,000 new homes per annum in England; every time that figure has been realised historically – by ONS figures it has done so on six occasions since the Second World War, all in the 1960s – social housing has constituted a significant proportion of new dwellings.[167] Indeed, private housebuilding has failed to expand sufficiently to compensate for the drop-off in social housebuilding over the last 40 years, and this has driven cumulative undersupply.

Furthermore, irrespective of particular political views on state

166. Affordable Housing Commission, *Making Housing Affordable Again*.

167. House of Commons, *The Future of the Planning System in England*, p.53.

ownership of housing, there will always be a requirement for affordable forms of housing provision for a cross section of the population that would normally be met by social housing. Not only does the shortage of social housing mean that many low-income households are having to rent privately with an onerous proportion of their take-home pay being sucked up by housing costs, but it also means that the government's housing benefits bill is higher than it would be were such households residing in housing association or council-owned properties.

The government should commit to – and subsidise - a major expansion in the supply of social housing. The economic rationale for such a programme is clear. There will of course be upfront capital requirements for building new social homes at scale. Nevertheless, investment here would be strongly counter-cyclical, and would support the construction industry in a period of economic downturn. It would also help to reduce the benefit bill immensely. If the 1.19 million people on waitlists for social housing could be moved into a home owned by the council, around £10 billion could be saved over five years.

Critically, any new social housing construction must pay greater attention to design quality and beauty. The housebuilding programmes of the mid-twentieth century, particularly those of the conservative governments under Churchill and Macmillan, ought to be seen as laudable achievements which provided thousands of households with affordable homes. Yet many of the newbuilds in that period were unsightly and of poor quality, and an unhelpful legacy of this has been that a dichotomy is now imagined to exist between quality and quantity when it comes to new homes; either new homes can be well-designed, or there can be a significant number of them. This is a false dichotomy, though. Designing new social housing on the basis of Building Beautiful principles and integrating them better with other tenure types would help to address the stigma that surrounds tenants of council houses whilst increasing the pride they have in their homes, reduce the ghettoization of social housing, and add value to local communities.[168] If we want any increase in social housing to be sustainable and enduring, it is vital that new builds are beautiful.

An attention on build quality has taken on a new significance after the appalling death of Awaab Ishak in registered social housing. Whilst the subject of the quality of existing social housing stock is beyond the scope of this paper, the government should not only ensure that the standard of new social housing is high enough that a similar tragedy can never happen again in council housing, but that both councils and registered providers are made more accountable for the standards of their housing stock.

To facilitate social housebuilding, The government should accelerate the release of public land available for builders. A 2016 report suggested that some 900,000 hectares of land across England and Wales is owned by the state. Between 2015 and 2020, the Department for Levelling Up, Housing and Communities ran a programme aimed at releasing a substantial amount of this land for residential development.[169] By the

168. Policy Exchange, *The Estate We Are In*, 2014; & *Building Beautiful*, 2019.

169. Department for Levelling Up, Housing and Communities, *Public Land for Housing Programme 2015-20: Concluding Summary Report*. Link.

end of the programme in March 2020, land with capacity to build 61,302 housing units had been disposed. This is encouraging, but the government can afford to be more ambitious. Indeed, the programme only succeeded in disposing 38% of its initial target, and houses had only been completed at 42% of those sites.[170] The government should better monitor the progress of housebuilding on the sites that it has disposed of, and potentially introduce contractual obligations on housing deliveries as set out above. The Mayor of London needs to play a bigger part too, given the city's acute shortage of housing; TfL alone has a land portfolio of some 5700 acres across the Capital. The Mayor should move more quickly to provide boroughs with land to build on. Local councils too should be encouraged to collaborate with developers on joint ventures, with the authority strategically acquiring land and the developers providing new homes. Such approaches have been pioneered successfully for larger scale projects in Cambridge and in Elephant and Castle in London, to name just two. They should be employed at a smaller scale too.

Under provisions for the Housing Revenue Accounts, local authorities can borrow against their expected rental income to fund housebuilding. In addition to the tax measures set out above, the government should allow councils to keep 100% of their capital receipts from the sale of council houses under Right to Buy. Government grant funding distributed by Homes England for affordable housing should prioritise the building of new council homes to supplement this.[171]

Social housebuilding is not an end in itself, and Policy Exchange is deeply committed to supporting private homeownership. Yet in the current context, social housing might help to restart the stalled conveyor-belt of homeownership by providing young people with affordable housing, giving them a better chance of saving up for a deposit to buy a home of their own. Through a social house-building programme, the government should aim to rebalance the proportions of different tenure types, as recommended by the Affordable Housing Commission. Boosting the supply of social housing would see the private rental sector contract over time, whilst the levels of homeownership would increase as a result of the corresponding effect on house prices.[172] The provision of more social housing thus would not only provide affordable housing to income groups that really need it whilst adding to the aggregate stock of homes, but it would also contribute towards improving affordability across the market. Vitally, *it would also be fiscally responsible*. Expanding the social housing stock will help reduce expenditure on benefits and costs can be minimised by using state-owned land.

Some, like the Mayor of London have called for the repurchasing of council houses sold under Right to Buy. Whilst this would increase the stock of genuinely affordable housing, it would not help address prices across the market. The government should thus focus on delivering new supply, rather than recycling existing stock.

170. *Ibid*

171. Policy Exchange, *Balancing the Books*, 2022.

172. The Affordable Housing Commission, *Making Housing Affordable Again*. Currently, one fifth of households rent privately, 17% live in social housing, and 65% are owner-occupiers.

## SMEs

The government should support SME housebuilders in playing a larger role in the aggregate delivery of new homes. The housing sector is heavily concentrated; in 2018, Savills calculated that the 13 biggest volume housebuilders in the UK built 63% of new homes in the previous year.[173] This might not be a bad thing in and of itself; the food retail sector of course is highly concentrated and still produces good outcomes for customers. The issue is that in the housing sector, market concentration is producing decidedly bad outcomes in the form of a low-supply equilibrium. Partly, this is because whilst other concentrated sectors may remain *competitive*, this is not the case in the housing sector. The planning system and tax regime presents a high barrier to entry for smaller builders, insulating large developers from competition. This feeds into the business model prevalent in the housebuilding industry; 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.[174]

The government can make the housing market more competitive and more efficient - and in so doing improve the delivery of new homes - by reducing the barriers to entry for SMEs. SMEs are incentivised to build more quickly than larger volume builders because their business models are more dependent on cash flow. They are likely to be able to deliver homes more rapidly than the UK's sluggish three-year average for house completion and thus help the government start to address the supply shortage more swiftly. Yet simultaneously, because of their limited scale individually, SME builders foster "organic growth".[175] Smaller housebuilders are also often based locally, with a greater stake in the community and more sensitivity to vernacular styles and design preferences.

As part of the oral evidence he gave to the House of Lords Built Environment Committee, Brian Berry, Chief Executive of the Home Builders Federation, suggested that the chief obstacles facing SME builders were delays in the planning system, the availability of appropriate plots of land, and access to finance. On the first item, some of the proposed amendments to the planning system mentioned above would be greatly advantageous; compelling local authorities to decide on planning applications within the 13-week timeframe would reduce the borrowing costs that delays imply and providing design codes which would indicate what sorts of proposals would be successful in advance would benefit SMEs greatly by providing more certainty about permission to develop in advance.

In the case of land availability, the government should play a proactive role. Indeed, it already has a policy as part of its public land disposal programme that favours SMEs. For sites of under 50 units, Homes England usually pursues an unconditional freehold sale and encourages SMEs to buy such sites. On sites of over 500 units, Homes England employs a "master developer model" in which land is split into smaller parcels of land that are reserved for smaller builders. On new public land brought forward for disposal, this scheme should be utilised.[176] 50% of new allocations should be allocated to SME builders.

173. Savills, "How Do We Reach 300,000 New Homes? And Who Will Build Them?", 2018, Link.
174. Built Environment Committee, *Meeting Housing Demand*, p.43.
175. House of Commons Library, *The Future of the Planning System in England*, pp.58-9.
176. All Party Parliamentary Group for SME House Builders, *Homes England and SME Housebuilders: How Can the Agency Work with SMEs to Build More Homes*, 2021.

The government should also consider establishing an SME coordinator within the planning authority of cities with high housing demand. The government has identified the need for more development on brownfield sites in urban areas. Smaller, nimbler developers are far more adept at establishing appropriate sites for infilling; these sites are usually smaller and often come with unique requirements or challenges, and for these reasons can be overlooked both by planning authorities and indeed larger developers who seek scale. Planning authorities could improve the delivery of infill development by smaller developers by having a dedicated coordinator who oversees the progress of their applications for planning permission.

Strategic land promoters now play a significant role in the housing market, acquiring sites for developers and taking on the risk for securing planning permission. The government should encourage promoters to use a similar master developer model on larger sites that they acquire, carving up land in smaller allotments for SME builders. This is both in their interest – developers that purchase small parcels of land to build homes on are more likely to make quicker payment to promoters than if one big developer purchases the whole site and pays over a prolonged period – and in the interest of the expeditious delivery of new homes.[177]

On finance, the government is currently helping SMEs through a £4.5 billion National Home Building Fund, which includes a 'Help to Build' equity loan for those who want to build their own homes and loans for SMEs. The ENABLE Build guarantee scheme, administered via the British Business Bank, is additionally providing £1 billion in funding to guarantee loans to smaller housebuilders along similar lines to the guaranteeing of mortgages via the Help to Buy scheme. This is welcome, and if the government phases out Help to Buy as discussed below, it should repurpose that subsidy funding for loans to builders. Across its interventions, the government should ensure that its expenditure in the housing market goes towards boosting supply and not further subsidising demand, since in the present context the latter would only stoke prices further. The government should also, as recommended by the Home Builders Federation, explore ways through which SMEs making use of government finance can recycle equity more quickly.[178]

## The Demand Side?

It is the committed view of this paper that the government should shift the focus of its housing policy programme towards boosting supply and away from subsidising demand. Only by increasing aggregate supply will the government begin to stabilise house prices in the long run, and in so doing reduce the attractiveness of property speculation and the magnetic effect this has on capital.

Nevertheless, demand-side policies should be assessed closely. A House of Lords report found that Help to Buy in particular had pushed up house prices by more than the subsidy value[179]. It certainly makes sense for the government to shift its funding away from such schemes and towards

177. Built Environment Committee, "Written Evidence, Promoters and Developers' Federation – UKH0092", 2021.
178. Home Builders Federation, *State of Play: Challenges and Opportunities Facing SME House Builders*, 2021.
179. Built Environment Committee, *Meeting Housing Demand*, p.5.

bricks and mortar, both in support for the private sector and in the form of social housing too. In particular, the government must keep to the commitment it made in the summer of 2022 to a one-for-one replacement of social housing stock sold under the expanded Right to Buy scheme, and potentially, as the Affordable Housing Commission recommends, tighten the requirements to ensure that replacements are also like-for-like by tenure.[180]

However, withdrawing these subsidies overnight would not sustainably lower house prices, and would almost inevitably worsen affordability, particular for younger demographics who now rely on the provision of high loan to value mortgages. The government absolutely should be wary of stoking demand in the context of constrained supply. Nevertheless, taking into account the leveraged position of UK households, the recent fall in demand and the volatility of house prices, it should make the transition away from demand subsidies gradually.

It is also imperative that we shift the supply of credit away from property speculation and towards more productive areas of the economy, but this cannot be done artificially without distorting the market; capital follows profits. The best way that the government can effect this change is to make property speculation less lucrative by reducing the uncertainty in the planning system upon which such speculation depends.

A final demand side consideration for the government is the question of Stamp Duty (SDLT). SDLT is a tax on property transactions levied at the point of sale with exemptions for first time buyers up to a certain threshold. In the September of 2022, the government increased the minimum threshold for Stamp Duty from £125,000 to £250,000, and from £300,000 to £425,000 for first time buyers. In the 2022 Autumn Statement, it was announced that these cuts would be sunset in 2025.

The government should instead phase out Stamp Duty on residential property in its entirety over an extended period, so long as the transaction is for a first home or to replace a primary residence. Stamp Duty has a distorting effect on the second-hand property market, disincentivising transactions and slowing the turnover of dwellings. This matters, because it means Stamp Duty equates to a "tax on mobility"; elderly households who wish to downsize to more appropriate housing arrangements are deterred from doing so and fewer homes are therefore available to those wishing to move, contributing to the overall issue of labour mobility as discussed above.[181] Indeed, the lost revenue from the levy might be offset by the economic activity generated by increased property sales; Ludgrove, a buying agency, estimated in 2019 that a 36% reduction in Stamp Duty could lead to a 40% increase in residential transactions.[182]

At a minimum, the government should reconsider its decision to sunset the increases to the nil-rate threshold for Stamp Duty. Estimates by the Treasury suggested the cuts would mean a loss in tax revenues of on average £1.4 billion per annum up to 2027.[183] This equates to just 0.19% of annual tax receipts based on 2021-22 revenues, and this might be offset at least partially by increased transactions as argued above.

180. Affordable Housing Commission, *Making Housing Affordable Again*, p.23.
181. Policy Exchange, *Helping More People Become First Time Buyers*, 2022.
182. Ludgrove Property, "The £9.8 billion Opportunity", 5th August 2019, Link.
183. HM Treasury, *The Growth Plan*, 2022.

Without corresponding efforts to increase supply, though, the effect of cutting Stamp Duty will simply be to further boost prices. Changes to SDLT must therefore be complemented by the delivery of new homes.

# Conclusion

There is a view – held in particular by younger generations - that a predicted crash in house prices is something to be excited about, and that the beneficiaries will be those desperate to get on the housing ladder.[184] This is a naive perspective. An immediate and severe fall in house prices would threaten thousands of those who have just made it onto the housing ladder with negative equity, whilst doing nothing to change the fundamentals of the market – that is, a severe mismatch between housing demand and housing supply. Even a significant drop in house prices would still leave many young people unable to take out a mortgage, given the number of multiples of annual income house prices have reached. The only route towards a sustainable house price level is a corresponding sustainable increase in the supply of new homes. Improvements will not happen overnight, but the government cannot continue to put off the strategic action that the housing market requires. Some measures recommended here will make a more immediate impact than others too – particularly social housebuilding.

The next election is going to be fought on the economy, and on which party is more likely to deliver better public services and increased prosperity through growth. A sustainable and durable increase to housing supply will do more to improve the UKs economic performance than any other policy initiative. Indeed, as the foregoing has sought to make clear, without addressing the undersupply of new homes, the housing market will continue to be a sinkhole into which any putative economic advances disappear. Gains in productivity or growing GDP would be dampened by the effects that high house prices have on consumer spending and mobility in the labour market, and by the continued attractiveness of property speculation from the point of view of investors. Increasing the availability of housing of all tenure types will enable skilled workers to move to productive jobs, increase the amount of money that households have available to spend in the wider economy, and make not only London but our cities outside the South-East more productive.

Addressing housing undersupply will do far more than that too. It will enable more couples to move into a secure home where they can start a family, and it will enable more young people to leave their parents' house and seek out opportunity. It will begin to redress a growing schism between the asset-poor young and the asset-rich old, and in so doing soothe a growing intergenerational tension. It will help alleviate homelessness – perhaps the greatest inequity in our society and one that erodes human dignity. Finally, it will help restore faith in one of the most

184. Savills, "UK Housing Market Update", 4th November 2022, Link.

widely held and enduring aspirational values amongst British citizens: that of homeownership.

We need to move away from caricatured accounts which blame the housing crisis on greedy developers, selfish homeowners or the inflated expectations of privileged younger generations who "have it easy". It is when political dilemmas are complicated that people resort to simple framings of the problem at hand, and housing certainly is one of the thorniest and most testing challenges we face. The government needs to redouble its efforts towards the hard work of building communities of interest in favour of development, and it needs to better support businesses in supplying the homes that the country badly needs.

In 1951, following his election victory, Churchill called Macmillan to Chartwell to discuss appointing him as his housing minister. Churchill was under no illusions about the scale of task he was asking Macmillan to take on; the UK had been ravaged by war, the economy was subdued, rationing was still in effect and the need for housing was acute. "But every humble home will bless your name, if you succeed", he told Macmillan. The government would surely win the same affection and esteem today if it addressed the country's chronic shortage in housing.

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