Reboot: building a housing market that works for all

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1. Executive summary

The UK has entered a housing market downturn, sparked by a new phase of higher inflation and interest rates. This is already having far-reaching consequences for individuals, the housing system and the wider national economy. Although attention will inevitably focus on those experiencing immediate financial pressures, any Government response to this downturn must also recognise the deeper weaknesses in our housing system.

It has been clear for many years that house prices are far too high, and that many of the negative outcomes and dysfunctionalities of the housing system – from homelessness and housing poverty to declining homeownership and inadequate housing supply – are rooted in this simple fact. The sheer scale of house price inflation in recent years, on top of entrenched assumptions that prices will always rise, means that the current market downturn is unlikely to reset prices to more affordable levels. Instead, market stagnation is the most likely path for the next few years. This is likely to make those who are currently locked out of or struggling to cope in the housing market even worse off, risk serious consequences for the wider economy, and cause long-term scarring of our ability to build enough of the right homes.

In this context Government intervention must both mitigate the worst impacts of a downturn and seize the political opportunity for lasting reform that a crisis creates. As we enter the fifth market downturn in living memory, on top of decades of accumulated housing pressures, there is an urgent need for Government to articulate a clear vision of a more sustainable, affordable and equitable housing market – and set a determined course towards it. The first step must be to understand the situation and admit that we have a problem. The next must be to set out coherent plans for reform.

The challenges we face

This report draws on detailed analysis of past housing market downturns and current market conditions to argue that the downturn is likely to manifest in four key areas.

A slowdown in housebuilding

Softening house prices are already triggering a rapid slowdown in housebuilding activity.

Volume housebuilders are in a much more robust position than they were at the start of the last housing market downturn, with higher profits, lower levels of debt and substantial cash reserves. Yet the end of Help to Buy subsidies, falling prices and rising construction costs mean that developers are already retrenching and mothballing sites, a trend that is likely to continue. Developers will avoid selling into a falling market and will seek to ride out the downturn and wait for house prices to recover, suppressing new housing supply. This risks further entrenching the dominance of the volume developers and their speculative business model.

Housebuilding will be further impacted as housing associations – which face constrained finances, lower grant rates and an increased reliance on cross-subsidy from market supply – are also cutting back development pipelines. This will undermine their ability to play the counter-cyclical role that has supported housing supply in previous downturns.

An investors’ market

Modest price falls and tighter mortgage conditions risk the creation of a cash buyers’ market. Those with existing capital will be able to swoop in and buy property for letting as private rentals, short lets or other suboptimal uses – or simply to leave homes empty while waiting for house price growth. Meanwhile, those seeking to buy homes to live in, particularly first-time buyers, will find any benefit from modest price falls offset by higher interest rates. These factors risk exacerbating the current, unequal distribution of homes, which the Joseph Rowntree Foundation’s 2022 report 'Making a house a home' found is at the heart of the UK’s housing crisis.

Serious impacts on vulnerable groups

These housing market conditions, in combination with higher inflation and interest rates, are already placing significant pressure on household finances. Rising costs disproportionately impact particular groups of owners, such as those on low incomes, shared owners, and those who have recently bought through Help to Buy, especially those using larger equity loans in London. The result will be more homeowners who find themselves struggling with their mortgage costs but are unable to move easily to a more affordable home, feeding through to reductions in consumer spending that could lengthen the economic recession.

Renters, both social and private, are under even greater pressure. They have been coping with worsening affordability for years and are now also facing rapidly rising rents and other costs, alongside restricted social security support. An increasing tax burden, regulatory changes and exposure to interest rates may encourage more private landlords to look for more profitable short-term uses of their homes, such as Airbnb short lets or nightly-paid temporary accommodation, which are putting further pressure on the stock of homes available for long-term lets, especially for renters on low incomes.

Expectations of future house price inflations suppressing transactions

In addition to lower housebuilding levels, we are likely to see lower market transactions in general, due to price anchoring behaviour and relatively few forced sales. This would perpetuate stagnation and could feed into a more generalised economic recession. Price anchoring by homeowners under financial pressure reduces their disposable income, while price anchoring by secure homeowners, negative equity and lender forbearance all discourage down-market moves, reducing allocative efficiency and weakening opportunities for price correction in the housing market. A stagnant, low transaction housing market also offers fewer opportunities for first-time buyers and for those seeking to move for work, and so increases the pressure on private rents in employment hotspots, likely worsening already high rent inflation.

The case for action

In combination, these challenges suggest we are heading for a period of market stagnation – a situation in which the housing market faces serious difficulties but is unlikely to undergo a dramatic crash. This scenario is, in some ways, the worst of all worlds: bad enough to cause real problems for some households and the construction industry, with potentially very serious secondary impacts for the wider economy, but not sufficiently acute for the development market to reset and allow new entrants and new models to emerge, or for house prices to correct to the more affordable levels needed for a new generation of first-time buyers. Addressing these problems therefore requires an urgent policy response to avoid widespread harm and longer-term scarring in the housebuilding industry.

Drawing on a historical analysis of past downturns, this report argues that the political pressure to bail out the losers from price falls and the fast-moving, volatile nature of market crises have militated against enacting more structural reforms. Worse, reactive policy responses to past downturns have often exacerbated deeper problems in the system, entrenching dysfunctional features such as market volatility and systemic undersupply by, for example, preserving the assets and market position of current actors at the expense of new entrants or market efficiency.

This is a key lesson for policy makers. The challenge they face in the current situation is to understand both the immediate pressures and the longer-term dynamics of the housing system, and design policy responses that can address both successfully. Crucially, policy responses to the downturn must balance the need to address the immediate pressures facing households with efforts to steer the housing market onto a more sustainable and equitable footing in the medium to long-term – above all by moderating future rises in house prices.

Policy recommendations

Sustaining the supply pipeline and construction activity

Ensuring that developers continue to build out sites rather than sitting on them, and avoiding the loss of construction sector capacity, requires both incentivizing development and disincentivizing mothballing. In the immediate term, Government should:

- Support housing associations, local authorities and community-led housing groups to deliver more genuinely affordable housing – through both new build, by **recycling imminent underspends on Homes England grant programmes into new social rented supply**, and conversions of existing homes, by **giving social landlords more certain funding and the flexibility to use Homes England grants to acquire and improve existing homes.**
- Sustain capacity and output by **funding affordable housing providers to acquire and redesign stalled sites to include more non-market tenures** that can be built out fast.
- Disincentivize mothballing by **reforming Compulsory Purchase compensation rules to compel developers to either complete construction or hand over schemes** to those that do not need high levels of profit, at prices that enable schemes to be built out.
- Impose a holding cost on developers to give them an incentive to complete or sell schemes, and to build them out faster, by **levying Council Tax or business rates on sites with planning permission as if the property had been built and occupied** (after a suitable period for construction, for example 18 months from when planning permission is first granted)**.**

Longer-term, recovering from a downturn is a huge opportunity to grow new models of housing development, diversify the housebuilding sector, and permanently increase the share of new supply made up by social rent and other genuinely affordable homes. To achieve this, Government should:

- **Task Homes England with diversifying the housebuilding industry** by growing the self-build and community-led housing sectors and deploying their Building Lease model to compel partners to build out sites under a publicly approved masterplan and timetable in exchange for planning certainty. Large schemes should be supported through public investment in infrastructure, tax changes and Government guarantees to leverage private and philanthropic finance.
- **Launch an ambitious new programme of powerful development corporations** to take over stalled projects and coordinate large-scale developments, with improved Compulsory Purchase powers to allow efficient land assembly, and access to long-term finance via the Public Works Loan Board. HM Treasury's 'best consideration' regimes and claw-back rules should be reformed to allow public land to be invested for the long-term public benefit.

Rebalancing the market power of different purchasers

Intervention is needed to disincentivize the further proliferation of suboptimal, short-term uses of homes, while also ensuring first-time buyers can remain active in the market and can benefit from lower prices. Government should:

- Build on the success of the Stamp Duty Land Tax surcharge on investor purchasers, increasing this by at least double to further disincentivize unproductive, speculative investment, and remove tax breaks on short-term lets, which currently incentivize landlords to shift residential properties into short-term uses.

- Resource councils to enforce standards in temporary accommodation and specialist supported housing.
- Enable would-be first-time buyers to capitalise on falling prices by introducing Government-backed mortgage insurance for loans above 80% of value to increase the availability and reduce the price of first-time buyers' mortgages; and supporting first-time buyers to acquire existing homes in need of renovation.

Targeting support for vulnerable groups

In response to the real hardship facing some highly leveraged and low-income homeowners, particularly shared owners and those who have recently bought using Help to Buy equity loans, Government must:

- Build on recent, and welcome, reforms to provide **Support for Mortgage Interest as an interest-free loan** so that homeowners at risk of financial distress are not dissuaded from getting help by the prospect of unsustainable interest costs.
- Provide an exit route for distressed homeowners by **establishing a new version of the Mortgage Rescue Scheme** launched in the wake of the Global Financial Crisis, which would fund social landlords to buy the homes of mortgaged homeowners in distress.

To address the extreme pressures facing private renters, Government should:

- Immediately unfreeze Local Housing Allowance (LHA) and re-peg support with housing costs to the 30th percentile of local market rents, enabling renters to pay the rent and improving landlords' incentives to provide long-term lets.
- Encourage the growth of an ethical private rented sector (PRS) by supporting local authorities, housing associations, community-led housing groups and charities to purchase homes private landlords are selling and let them with decent standards and more affordable rents. Additionally, local authorities should increase the use of long leasing arrangements with private landlords to provide decent temporary accommodation.

Reducing expectations of a return to high house price inflation

Ultimately we have to recognise that a housing system beset by regular booms and busts does not meet the needs of the national economy or those seeking safe, secure and affordable housing, and that a more sustainable, equitable and economically efficient housing system must be one in which house prices do not rise much faster than earnings. That will mean encouraging current homeowners to accept lower asset values, embracing new versions of homeownership that are not predicated on expectations of endless house price inflation, and reforming the tax system that does so much to encourage those expectations. Beginning to change public and political assumptions about homeownership, wealth and taxation will require political leadership and bold policy making. This latest downturn presents a generational opportunity for a reforming government to shape the policy framework, invest resources and use its signalling power to steer the way towards a more sustainable paradigm. To that end, Government should:

- Work with lenders to promote understanding and take-up of existing products designed to allow mortgage holders to move with negative equity, and to encourage more lenders to enter this market.
- Support new models of homeownership that separate the control and security that come with homeownership from the speculative wealth gains that undermine its sustainability. Ensuring that First Homes are genuinely additional homes on a genuinely new model of ownership will be a critical first step towards this goal.
- Moderate future house price gains by replacing Council Tax and Stamp Duty Land Tax with a Proportional Property Tax (PPT), reducing expectations of capital gains from house price growth. Existing and proposed investor surcharges should be carried over into the new tax.
- Start the transformation to a more sustainable housing market by making an unambiguous commitment that house-price-to-income ratios will be brought down to a reasonable level of affordability, and kept there permanently, and pledge to use all the tools available to Government achieve this.

Getting house prices to more affordable levels is necessarily a long-term project that will require bold new thinking and political courage. The current housing market downturn could be a turning point that we must not waste.

2. Introduction

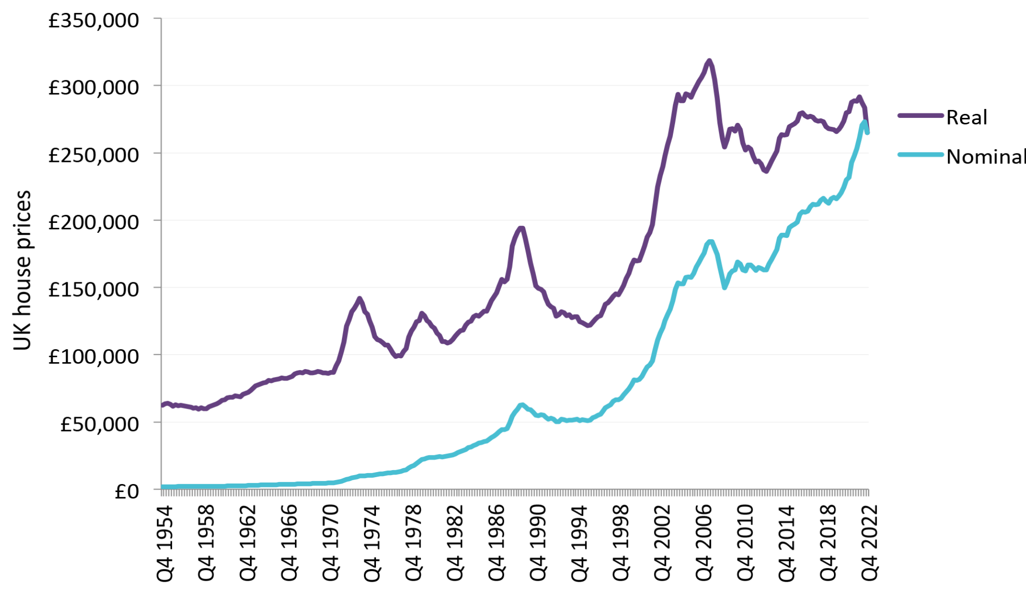
The UK economy is entering a new phase of higher inflation and interest rates, which will have major impacts on the housing market and on the politics of the policy response.

Historically, long-term interest rate changes have heralded seismic shifts in the housing market, the wider housing system and the policy framework that governs it. After more than a decade of ultra-low interest rates, the return to more normal rates is already affecting the market. Mortgage approvals fell 33% in November 2022 compared to the same month last year, and the OBR forecasts that house prices will fall by 9% over the next two years. What happens in the housing market has major implications for the wider economy, and vice versa, from construction sector activity and the financial sector (both major drivers of GDP), to household finances, demand for healthcare and other public services, and the welfare system. Pressure for politicians to respond is growing.

We have, of course, been here before. Since the liberalisation of the financial sector that began in the 1970s, and arguably since long before then, there have been regular housing market booms and busts – each time with significant economic and political ramifications. As we enter a new phase of market turbulence, policy makers should consider the history of previous housing market downturns, and the policies they engendered, to inform responses over the coming months and years. This history contains positive lessons from successful attempts to tackle the problems of the day and warnings gleaned from the mistakes of the past. This report will make the case for a coherent strategy of funding and policy interventions to both address the immediate challenges of a downturn and initiate fundamental reform of the UK's housing market,

building on JRF's 2022 briefing, 'Making a house a home: Why policy must focus on the ownership and distribution of housing' (JRF, 2022).

Figure 1: Real and nominal UK house prices



Source: Nationwide, ONS.

Note: Real series is Q4 2022 prices, calculated using ONS RPI: Long run series.

Despite softening in recent months, house prices remain far out of reach of ordinary families, and well above historic norms. Today many UK households struggle to access homes that meet their needs, causing multiple harms for them and for our economy. Homeownership has fallen to the levels of the 1980s, and social renting to those of the 1940s, while private renting has jumped to the levels seen in the 1960s. High housing costs reduce labour market mobility and increase public spending on housing benefit (which reached £29.6 billion in 2021/22) (DWP, 2022). House price inflation has led to a rising share of the UK's total capital allocation being absorbed by mortgage lending, at the expense of funds for the productive economy, like loans for business expansion or infrastructure (Bezemer et al, 2021). Poor energy efficiency in much of the existing housing stock is driving fuel poverty and cost of living pressures and increasing the costs of government programmes to mitigate these (Smeeton, 2022). Housebuilding has remained well below target for decades, worsening shortages and adding to pressure on prices.

Housing market downturns create their own problems, and government responses to them are an important part of the evolution of the housing system we live in. But downturns are symptoms as much as causes, and the history of market busts alone does not explain how the UK's housing market has grown to be so dysfunctional. To understand this, we need to review how the overarching policy and funding framework for housing has evolved, driven by wider economic and political currents. Section 3 therefore starts by outlining the broad sweep of housing policy since the Second World War, identifying three eras in which different paradigms became established. Broadly, the UK has shifted from a paradigm characterised by strategic intervention and tight regulation immediately following the Second World War, via market-orientated deregulation from the mid-1970s, through to what we describe as 'the decadent era'

from the mid-2000s: a period of rampant house price inflation, in which governments have struggled to respond to the interrelated challenges of falling homeownership, stagnating housing supply and increasing competition for rented housing. We then describe the course of the last four housing market downturns, analysing how policy decisions made in the wake of each downturn interacted with economic reality and the overarching policy framework of the time to ease or prolong hardship for different groups.

In Section 4 we turn to the present, drawing out the lessons from previous downturns, and the policy responses to them, and applying these to the current situation of the UK housing market. We analyse recent evidence to assess how different types of households and industry actors are positioned going into the current downturn. In Section 5, we extrapolate from our analysis of the present to arrive at a set of five potential scenarios for the housing market: a return to rising house prices; a minimal fall in prices; a small house price correction of 10%; a more significant house price correction of 20%; and a crash of 30% or more. We briefly summarise the implications of these scenarios for housing supply, transactions and different groups of households and market actors. Our assessment of the most likely near-term scenario for the UK's housing market is a picture of stagnating housing supply and transactions, with only modest house price reductions in most places meaning that homeownership remains out of reach for millions of households.

We then summarise the four major policy challenges presented by this scenario: a slowdown in housing supply reducing capacity in the industry; an increase in investor activity driving suboptimal uses of existing housing stock; damaging impacts for vulnerable groups in society; and expectations of a return to house price inflation suppressing market transactions. These challenges all have deep roots, resulting from decades of short-termism in policy and funding decisions, and there are no immediate or complete solutions. Nonetheless, each of these four challenges will improve or worsen in the coming years depending on how Government responds to the current market downturn.

In Section 6, we recommend priorities for policy in response to these. Our proposals seek to balance the need to mitigate the immediate social and economic threats from market correction against the need to ensure the UK's dysfunctional housing market does indeed correct – meaning that prices and rents become more affordable in relation to the incomes of ordinary people – while also recognising that we cannot rely on a price correction alone to reset the market and allow homeownership to return to the levels of previous decades. House price inflation has simply been too high for too long for the market to clear in the way seen after some previous downturns.

We therefore propose packages of policies that can hold those facing financial distress steady, whilst ensuring that the modest falls in land and house prices expected can be leveraged to improve access to decent, affordable homes and to create a better, more sustainable housing market over the long-term. Together, these policy packages seek to create a new paradigm for housing policy in the UK, including a return to more strategic, 'upstream' intervention in the housebuilding process, stronger protections

for people facing the worst hardship, and a more ambitious, positive approach to tenure choices and affordability.

Such a framework for housing policy and funding decisions is essential for the evolution of a better, more sustainable housing system in future – one that ensures everyone has a decent home, minimises the economic and social gaps between tenures, and supports a healthy economy.

3. Past: shaping the UK housing market

Three eras of modern housing policy

Our historical analysis of the UK's housing market reveals three eras since the end of the Second World War. The governments of each of these eras had distinct political aims for housing, and crafted distinct policy and regulatory frameworks accordingly. These frameworks influenced whether housing market downturns occurred, how they played out, and the choices governments had for responding to them. The dates given for each era are only approximate, as policy frameworks evolve through multiple and overlapping political, legal and market changes.

Late 1940s to mid-1970s: the reconstruction era

This was an era of strong market intervention and high taxation, following on from the wartime economy. Government spending on housing was concentrated on new supply, and above all council homes to rent, improving the affordability, security and quality of the housing accessible to households on modest incomes. Social housing programmes were almost entirely publicly funded using central and local government resources, and the costs of building new social homes were relatively low and stable. A comprehensive planning system was created for the first time, while governments intervened heavily 'upstream' in the development process, acquiring land at low cost and using the land value captured to fund housing estates and whole New Towns. Between 1946 and 1980, local authorities and housing associations in England built 4.4 million new social homes, at an average rate of 126,000 a year (DLUHC, 2021).

Mortgage lending for homeowners was limited to building societies operating on a conservative lending model and restricted to select groups (excluding women, for example) (Beugge, 2014), while Bank of England credit controls steered private credit into sectors deemed socially and economically desirable. Before it was abolished in 1963, Schedule A tax on the imputed rental income of owner occupied homes helped to suppress house prices and equalise incomes for people living in different housing tenures, while development taxes reduced gains for landowners. Private rents were controlled by law, though standards were often very low.

This framework largely avoided excess house price inflation and downturns, suppressing land prices and ensuring social housebuilding would offer construction companies profits comparable to those available for market housebuilding. House prices rose gently but consistently across the period. Both owner occupation and social housing grew steadily, so that the share of households renting privately plummeted

from over half at the beginning of the period to only one in five by the end (MHCLG, 2012).

Mid-1970s to early 2000s: the deregulation era

The controls of the pre-downturn era were largely relaxed over the following three decades, with public housebuilding scaled back or removed entirely. The New Towns programme was ended, partly as a result of the Myers Case enshrining the concept of 'hope value' in the prices that landowners could expect, which helped drive up land values. The costs of building social housing also became higher and less stable, as rapidly rising residential land costs collided with the dismantling of earlier legislation that had made it possible for social housebuilders to purchase land at a lower cost than land for market housing.

After the easing of credit conditions in the Barber Boom of 1971–3 and the subsequent recession, mortgage lending was progressively deregulated, leading to an explosion in mortgage credit and house prices. This helped to consolidate the perception that rising prices are an inevitable or even healthy feature of the UK housing market and a barometer of confidence in the economy, and stimulated the impetus to 'get on the housing ladder'. Taxes were shifted further away from property with the replacement of local rates with first the Poll Tax, and then Council Tax.

This was the era of boom and bust. Three housing market downturns caused major disruption, but also allowed the housing market to reset, as real terms falls in house prices improved affordability for first-time buyers. The Right to Buy gave a final boost to homeownership levels and started the long-term decline of social housing. At the same time, capital grant for new social housing was slashed and the Government encouraged local authorities to transfer their remaining social housing to housing associations: 40 councils had transferred all of their stock by 1995. However, the growth of housing associations only partially replaced lost local authority capacity, and affordable housing supply remained low by historical standards.

By the mid-1990s affordable housing programmes, which had previously provided counter-cyclical demand, had become more dependent on cross subsidy from private development, intensifying the ups and downs of total supply as construction followed the housing market. The housebuilding industry became more concentrated as smaller builders struggled to ride the booms or survive the busts.

The transformative 1988 Housing Act replaced regulated tenancies with 'assured tenancies' and 'assured shorthold tenancies', ending rent control and allowing private landlords much more freedom to end tenancies. Declining affordability meant that mortgaged homeownership peaked after the Right to Buy spurt in the 1980s. Combined with the decline in social renting, this set the stage for the private rented sector to stop shrinking, and then to grow rapidly from 1996 following the introduction of Buy to Let mortgages, which contributed to a boom in house prices. The effects of years of social housing sales and house price inflation were accumulating to limit housing options for many households with modest incomes. During this period government spending flipped dramatically from funding new supply to demand-side

subsidies, including schemes to subsidise homeownership (MIRAS) and housing benefits to help tenants pay rents.

A further significant development at the end of this period was the devolution of most aspects of housing policy to the Scottish Government, and many aspects to the Welsh Assembly and Northern Ireland Assembly. This has allowed approaches to housing policy to diverge between the four UK nations in more recent years.

Mid-2000s–present: the decadent era

The last two decades have seen UK housing policy become more interventionist again but in a more reactive form, as governments have struggled to mitigate the impacts of market pressures without challenging the fundamental framework established in the deregulation era. Boom and stagnation has largely replaced boom and bust, while the overall policy landscape has been marked by drift, short-lived initiatives and strategic confusion more than the ideological clarity of the preceding era.

Following the Global Financial Crisis (GFC), stricter affordability tests for mortgage finance combined with sluggish wage growth and historically low interest rates to create insurmountable barriers for many would-be first-time buyers, further swelling the private rented sector. Crucially, house price falls following the GFC were modest compared to the preceding boom, so house prices did not reset relative to earnings as they had in previous downturns. Political debates largely avoided difficult questions about demand pressures on affordability and the decline in homeownership, preferring to focus on the consensus behind the need for more supply. Consequently governments relied on demand-side policies to prop up homeownership and housing supply, despite spiralling house-price-to-income ratios. Above all, Help to Buy equity loans from 2013 boosted new homebuyers' purchasing power. Nonetheless, the share of households in England and Wales in mortgaged homeownership or shared ownership fell from 33.5% to 29.7% between 2011 and 2021, while outright owners overtook to become the largest single tenure (ONS, 2023).

The decline of social housing stock in England slowed but continued through the New Labour years, and the austerity period from 2011 to 2018 witnessed a significant withdrawal of funding from affordable housebuilding, and especially from social rented homes. At the same time, existing homeowners benefited from ultra-low mortgage costs and rapidly rising house prices after 2013, widening the social and economic gap between people living in different tenures.

By contrast, Scotland ended the Right to Buy in 2016, followed by Wales in 2017, while Northern Ireland ended the policy for housing association tenants in 2022. In England, the Right to Buy has been revived through increased discounts, changes to eligibility criteria and promises to extend the policy to housing association tenants. Administrations in Scotland, Wales and Northern Ireland have funded new social rent homes, producing annual net positive supply in these countries, while social supply in England remains net negative (Stephens et al, 2021). Yet many crucial housing policy levers (from the Bank of England base rate to housing benefit levels) are not devolved, limiting the divergence in outcomes between the four nations.

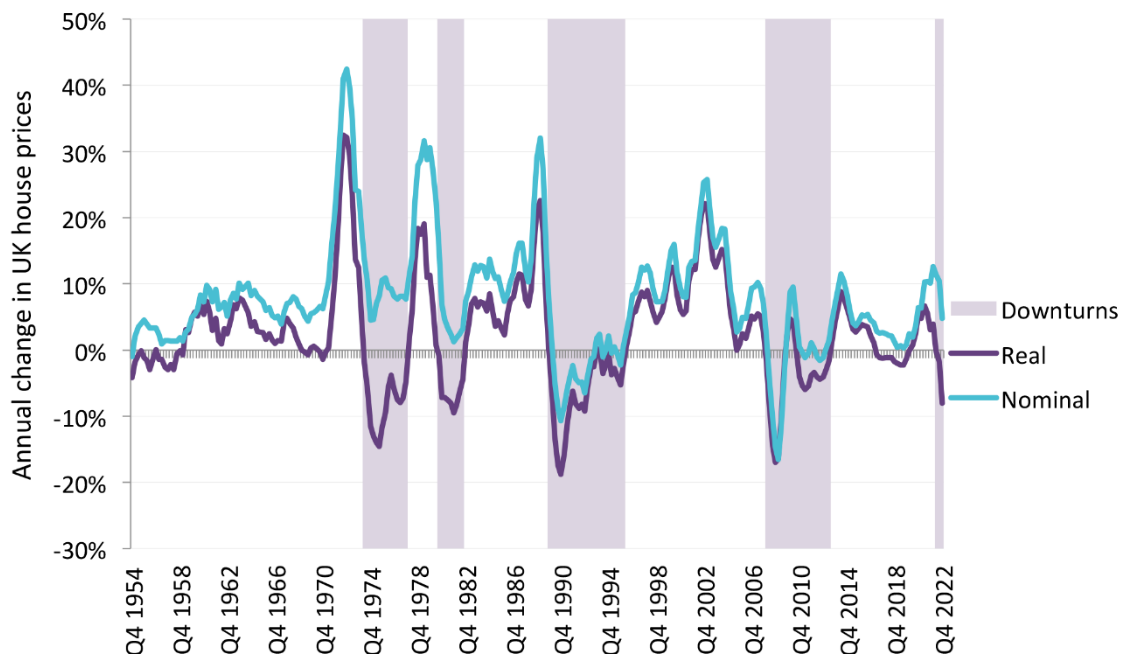
UK government spending on housing has continued to concentrate on demand-side measures, including subsidising ever more low-income households to live in the private rented sector, and subsidising homeownership through Stamp Duty cuts. Supply-side intervention has typically been weaker and more 'downstream' in the development process, such as changes to planning policy and subsidies for homebuyers. Whereas in 1975, 82% of government spending on housing came in the form of supply-side subsidies, mostly for social homes, by 2015 this figure had fallen to 4.3% (Perry and Stephens, 2018).

Occasional steps forward for housing policy in this period have usually been followed by two steps backwards. The introduction of the Stamp Duty Land Tax investor surcharge of 3% in 2016 was effective at boosting the relative purchasing power of owner occupiers over landlords and second homeowners – but the decision to cut Stamp Duty for all purchasers during the pandemic led to a spike in investor purchases, producing acute shortages of homes available for long-term occupation in UK tourism hotspots, as well as a huge increase in Buy to Let purchases in deprived communities where rental yields are highest (Partridge, 2020).

Four housing market downturns

The changing housing policy framework has shaped and been shaped by four major housing market downturns since the early 1970s, each with its own characteristics, reflecting the different economic and political conditions in which they occurred.

Figure 2: Annual change in real and nominal UK house prices



Source: Nationwide, ONS.

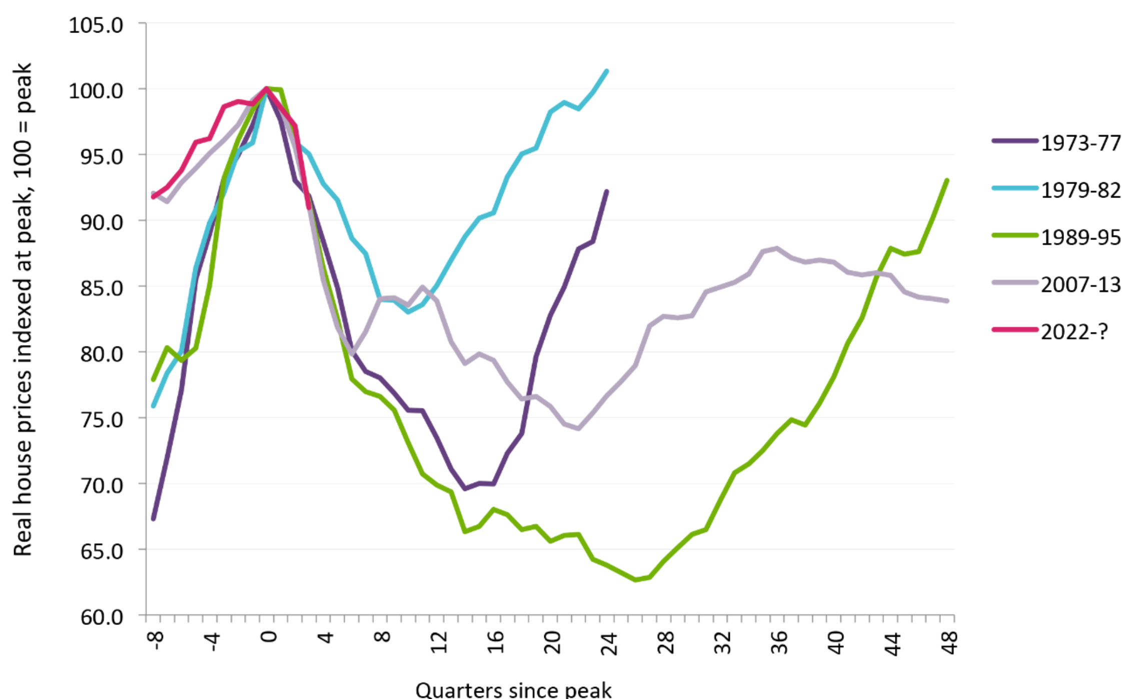
Note: Real prices calculated using ONS RPI: Long run series, shading marks previous downturns.

Note that during the first two downturns during the 1970s, nominal prices never actually fell, although given the high rates of inflation at the time, the real price falls were significant.

1973–7 downturn

Real house prices increased by 63% during the Barber Boom of 1971–3. Mismatches between the regulated interest rates offered by building societies (which held over 90% of household mortgage debt) and market interest rates drove a boom-bust cycle in mortgage lending. Net lending peaked in March 1973 before falling in real terms the following year.

Figure 3: Comparisons of real UK house prices during downturns



Source: Nationwide, ONS.

Note: Real prices calculated using ONS RPI: Long run series.

This prompted the Bank of England to intervene – first with a 'guideline' scheme and then, faced with the imminent collapse of several institutions, with a 'lifeboat operation' to bail out the lenders. This financial crisis combined with a falling pound, the 1973 oil crisis, a crashing stock market, rising inflation, political uncertainty and the imposition of the Three-Day Week, causing a recession in 1974. Housing market transactions fell by 39% between Q1 1973 and Q2 1974, and private housing completions also fell by 30% from 1972 to 1974. Real house prices fell by 30% between 1973 and 1977. The downturn was greater in London and the south of England, while real prices in Northern Ireland fell the least.

Limited data suggests that first-time buyers were most affected, while the impact of the downturn on existing homeowners was relatively limited. As house prices continued to rise in nominal terms, there was minimal risk of negative equity. Unemployment rose from post-war lows to 5.7% in 1977, but there was only a small increase in properties taken into possession. Although inflation rose rapidly, average wages managed to keep pace during the early part of the downturn. By the end of the downturn, many mortgage holders found themselves with large amounts of equity in their homes thanks to inflation eroding the value of their mortgages.

Policy responses

Council housebuilding had fallen in the run up to the recession. Rent rises were limited by government policy and inflation was driving up local authorities' costs. However, following the election of a Labour government in 1974, a new rent settlement and subsidy scheme prompted a rise in council supply, while some authorities took advantage of market conditions to acquire private sector housing stock.

The UK economy returned to growth in 1976, with real house prices following in 1977. Public spending was cut and pay rises were limited in an effort to control inflation, setting the scene for the next housing market downturn.

1979–82 downturn

Real house prices had risen by 33% between the trough of the previous downturn in 1977 and the subsequent peak in 1979. But economic instability and rising inflation persisted and, following the second oil crisis in 1979, the new Conservative government focused on restraining inflation and raised the base rate to a record high of 17%. The 1979–82 housing market downturn then hit, with real price falls of 17% (though nominal prices still rose by 12%). Housing market transactions fell by 14%, and private sector housebuilding by 22%. Unemployment rocketed, reaching 8% at the end of 1980 and peaking at nearly 12% in 1984. This contributed to a rise in the number of properties taken into possession through the 1980s.

Policy responses

The recession coincided with the removal of the 'corset' on bank lending from 1981, enabling banks to compete effectively with traditional building societies for residential mortgages for the first time in the UK's history. This was followed by deregulation of building societies as part of the 1986 'Big Bang' financial reform in Thatcher's second term as Prime Minister. As a result, domestic mortgage credit exploded from just over 20% of GDP in the late 1970s to 55% in the late 1980s, and house prices doubled over the same period (Ryan-Collins, 2019).

Homeownership and social renting had both been increasing since the 1920s, but the introduction of Right to Buy in 1980 helped accelerate the growth in ownership while kicking off a long-term reduction in the stock of social housing. The new Conservative government cut subsidies for local authority rents, and local authority rents rose by 44% in real terms between 1980 and 1982. The national economy returned to growth in the second half of 1981 and inflation eased, leading to real house price growth by the end of 1982. Although unemployment remained high, the Thatcher government's economic liberalisation had set in motion the next house price boom.

1989–95 downturn

The Lawson Boom of the mid-1980s saw strong economic growth and falling interest rates. Real house prices rose by 79% from the trough of 1982 to a peak in 1989.

Financial deregulation led to increased mortgage lending by banks and, along with Right to Buy, helped increase homeownership. Household debt also increased.

The 1987 stock market crash was one of the first signs of trouble, but interest rates were cut and the economy continued growing. Chancellor Lawson announced the end of the option to pool Mortgage Interest Relief At Source (MIRAS) allowances at the March 1988 Budget. However, the implementation was delayed until August. House prices rose rapidly, and housing market transactions spiked in Q3 1988 as buyers rushed to beat the change. Private housebuilding also peaked in 1988.

To tackle rising inflation, the base rate was increased rapidly, reaching 12.875% in November 1988 and 14.875% in October 1989. Mortgage rates followed the same pattern and mortgage holders found themselves facing rapidly increasing repayments. First-time buyers' mortgage costs reached an average of 30% of gross income in 1990.

As the country entered recession, unemployment began to rise again. Housing market transactions fell by 56% and real house prices initially fell by 34% over the first 3.5 years while nominal prices fell by 20%. Although interest rates fell back in 1991, the damage had been done: nominal house price falls led to negative equity, which combined with rising unemployment and higher mortgage bills to produce an increase in arrears. In 1991, repossessions hit a record high of 75,000, lending to firms involved in real estate fell into the negative, and private housebuilding completions fell by 34%. Private rents rose by 28% in real terms during the recession, while housing association rents rose by a similar amount, and council rents by 43%.

Policy responses

Preventing repossessions

The wave of repossessions prompted Government intervention, including the direct payment of Income Support for Mortgage Interest to lenders, which may have helped possessions peak at 0.8% of loans in 1991 even though arrears continued to rise in 1992. To support transactions, a Stamp Duty holiday for purchases under £250,000 was also introduced, which covered the majority of the market.

Supporting supply

In 1992 the Government's Housing Market Package provided £612 million in funding for housing associations in England and Wales to buy homes from developers, the open market, and from lenders, helping to stabilise prices while also increasing the supply of social rent homes affordable to low-income renters. Housing associations exceeded their target, but there are suggestions some may have struggled with management, given the scale and location of their new acquisitions. House prices continued to fall and eventually reached a low in 1995 of 37% below the 1989 house price peak in real terms.

2007–13 downturn

House prices rose rapidly during the late 1990s and 2000s, increasing by 162% in real terms between 1995 and 2007. A combination of falling interest rates, excessive credit

supply, an undersupply of housing relative to demographic changes, and several other factors all helped drive house prices to new record highs.

There were growing concerns about the unaffordability of the market in the face of rising interest rates and by 2005 house prices were expected to stabilise. However, house price growth picked up again during 2006 and it wasn't until the credit crunch hit in 2007 that the market slowed. Following the Northern Rock bank run in September 2007, mortgage approvals collapsed by 72% from Q3 2007 to Q4 2008, and transactions fell by 61% over the same period. House prices fell by 20% in real terms during the first six quarters of the downturn. Nominal price falls were similar across all regions, except for Northern Ireland where prices spiked sharply in 2007 before falling further and faster than in other regions the following year. There was a partial recovery in late 2009/early 2010, but real prices continued to fall in the second half of 2010, eventually hitting a low in 2013, 26% below the 2007 peak.

Mortgage lending criteria had loosened significantly in the run up to the 2007 peak. Falling interest rates had enabled borrowers to take out ever higher loan-to-income mortgages and many borrowers avoided proving their income by using self-certification mortgages. When the credit crunch hit, riskier mortgages disappeared from the market. This included higher loan-to-value ratio mortgages typically used by first-time buyers, while some borrowers became 'mortgage prisoners' due to their inability to refinance in the tougher lending market.

With constrained housing supply suppressing household formation and affordability barriers to homeownership, many younger adults were forced to either stay living with their parents or live in the private rented sector. Although the ONS private rental index shows real falls in rents during the recession, there are suggestions this data may be flawed and that private rents increased in markets with strong economies such as London. For those living in the social rented sector, rents continued to rise during a period when earnings were falling in real terms, putting pressure on household finances.

Policy responses

Preventing repossessions

After the experience of the previous downturn, both Government and lenders made considerable efforts to avoid repossessions and forced sales. The Bank of England initially reacted by cutting interest rates to 5% by April 2008 before more substantial reductions following the bankruptcy of Lehman Brothers in September 2008. The base rate finally reached 0.5% in March 2009, and remained below 1% for the next 13 years. Ultra-low interest rates eased the financial pressures of the recession for the many borrowers, particularly those who had tracker or standard variable rate mortgages, and helped keep repossessions below the levels seen in the early 1990s.

The Government supported homeowners through an increased Support for Mortgage Interest offer, a targeted Mortgage Rescue Scheme (MRS) (which allowed homeowners at risk of statutory homelessness to swap into shared ownership or social renting without losing their home) and a more systemic Homeowner Mortgage Scheme (HMS) (which

indemnified lenders against some losses if they avoided repossessions. Neither the MRS or the HMS were used as much as anticipated – and the shared ownership variant of MRS barely at all (NAO, 2011. This was partly because the schemes themselves were unattractive to homeowners and eligibility was quite tightly drawn, but also because ultra-low interest rates, voluntary bank forbearance and the relatively small increase in unemployment meant that there were fewer homeowners in distress than had been expected based on memories of the 1990s downturn. The steady decline in first-time buyer numbers over the preceding decade due to affordability pressures must also have reduced the numbers of exposed mortgage holders.

Supporting supply

Housebuilding, which had been below the levels required to meet demographic change since the early 1990s, peaked at 200,000 homes in England in 2007/08 before collapsing. Home starts fell by 48% in 2008/09 alone as developers rapidly cut their output (DLUHC, 14 December 2022) – both because of softening sales prices and because the credit crunch directly affected their ability to raise capital. Developers' share prices fell dramatically, and it was widely assumed that many had breached their banking covenants: as with mortgaged homeowners, banks' reluctance to crystalise these losses by enforcing their covenants may have saved many of the developers from bankruptcy.

In 2009, the Government stepped in with funding for private developers and housing associations to continue development, in many cases shifting development from market sale or shared ownership to social rent. This was followed by the Kickstart Housing Delivery programme and further money for new social housing. These interventions were not enough to significantly increase housebuilding but may have prevented further declines in the sector's capacity.

Boosting demand

Housing markets in central London continued to rise from the initial recovery in late 2009/early 2010, but house prices remained flat or falling across most of the country. In mid-2012, amid speculation over a double-dip recession, the Chancellor launched the Funding for Lending Scheme to encourage banks and building societies to expand lending by providing funds at sub-market rates. While the direct effect of these on the housing market has been questioned by some, its introduction sent a clear signal to lenders and others that the Government was committed to maintaining house prices at or above their then level.

This message was further reinforced with the announcement of Help to Buy schemes in early 2013. The Help to Buy equity loan provided buyers with a government loan of up to 20% of the purchase price of a new build home (up to 40% in London. These schemes have been widely criticised for adding to house price inflation (House of Lords Built Environment Committee, 2022. Higher loan-to-value mortgages began to reappear in the market, and real house prices began to rise again from 2013 onwards.

Lessons of past housing market downturns

Each of the four previous market cycles have unique features, but there are consistent themes, and lessons for policy can be drawn from the varied ways in which governments responded.

Financial factors drive booms and busts…

In each case, rapid increases in house prices during the boom phase were fuelled by increased mortgage lending, driven by policy choices and financial market conditions. Perhaps the most influential factor in the housing market cycle is the interest rate, as this affects capital flows, developer finances and homebuyers' ability to pay a mortgage all at once. Changes in interest rates can obviously trigger downturns (or at least affect their timing) for all the same reasons. Unsurprisingly, the immediate causes of each bust were in the financial markets: rising interest rates in 1979 and the late 1980s, and crises of confidence in mortgage lenders in 1973 and 2007.

As in other financialised markets, confidence and expectations are important factors – and signals of intent by Government or the Bank of England can be significant interventions in their own right. The decision to delay the withdrawal of pooling MIRAS in 1988 inflated a housing market bubble, while repeated emphasis on the benefits of homeownership have fuelled the belief that prices can only ever rise long term.

… but wider economic conditions shape their impacts, and vice versa…

How the downturns played out for households depended on wider economic conditions such as levels of consumer spending and the unemployment rate. Rising unemployment, in particular, increases the risk that mortgage holders will fall into trouble and is closely linked to repossessions and forced sales. Repossessions and negative equity were only significant features of the mid-1990s downturn. In the previous two, inflation eroded the value of mortgage debt faster than house prices fell, while the 2007 downturn saw interest rates fall to near zero, reducing the pressure on most mortgage holders.

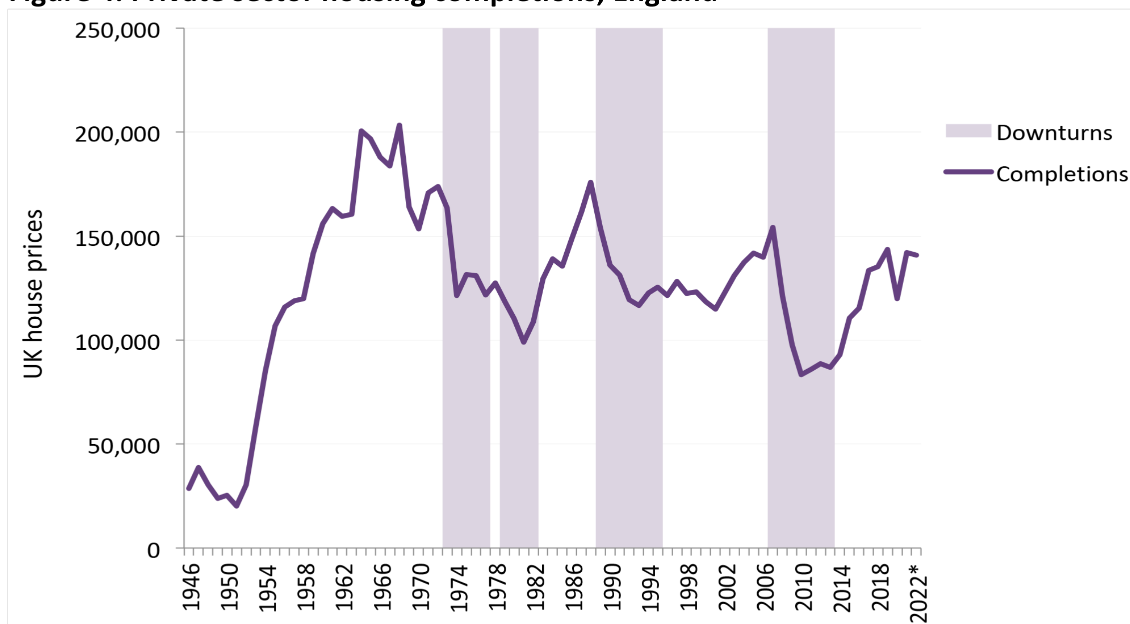
Causality works the other way too, as housing market downturns can have wider economic consequences. As well as having a direct impact on overall economic activity and growth, lower construction activity, fewer market transactions and weakened consumer confidence can also generate second order effects, as the initial impacts feed through to lower incomes and higher unemployment. In turn putting further downwards pressure on the housing market.

… as downturns impact on transactions and supply…

Transaction volumes fall sharply in downturns. On the one hand, many first-time buyers choose to wait in the expectation that prices will fall further, while others cannot buy during a downturn because their employment situation changes, or because they struggle to access affordable mortgage finance, or both. On the other, existing homeowners refuse to sell for less than they think their homes are worth, often choosing to delay moves until nominal prices have recovered (an effect known as price anchoring).

Market housebuilding also falls quickly in this situation. Private housebuilding completions (excluding affordable housing) have tended to closely track the number of sales in the existing homes market, with new builds making up around 10% of total transactions since at least the 1980s (Hudson, 2022b). Once they have fallen, new build completions tend to recover slowly. After each past downturn, the new peak in private supply has struggled to recover to the preceding one, so the cyclical pattern has overlaid a long-term decline in private supply.

Figure 4: Private sector housing completions, England



Source: DLUHC.

Note: This series under-counts delivery in recent years, especially in city centres. However, it is likely to be representative of the larger traditional housebuilders. 2022 is year to Q3 2022.

During housing market recoveries, prices tend to bounce back well before supply levels do, which in turn precede any stabilisation or increase in homeownership rates. This suggests that attempts to increase homeownership by relying on private supply in a volatile market are unlikely to succeed.

… although affordable housing programmes can soften the impact.

Affordable housing construction and purchases have been important during the recovery stages of most housing market downturns, in terms of propping up the numbers of homes built, maintaining construction sector capacity and supporting wider economic recovery. Increased council housebuilding was a major part of the economic recovery after the 1973–7 downturn, but after 1980 the scaling back of grant subsidy and local authority housebuilding capacity reduced this source of counter-cyclical investment.

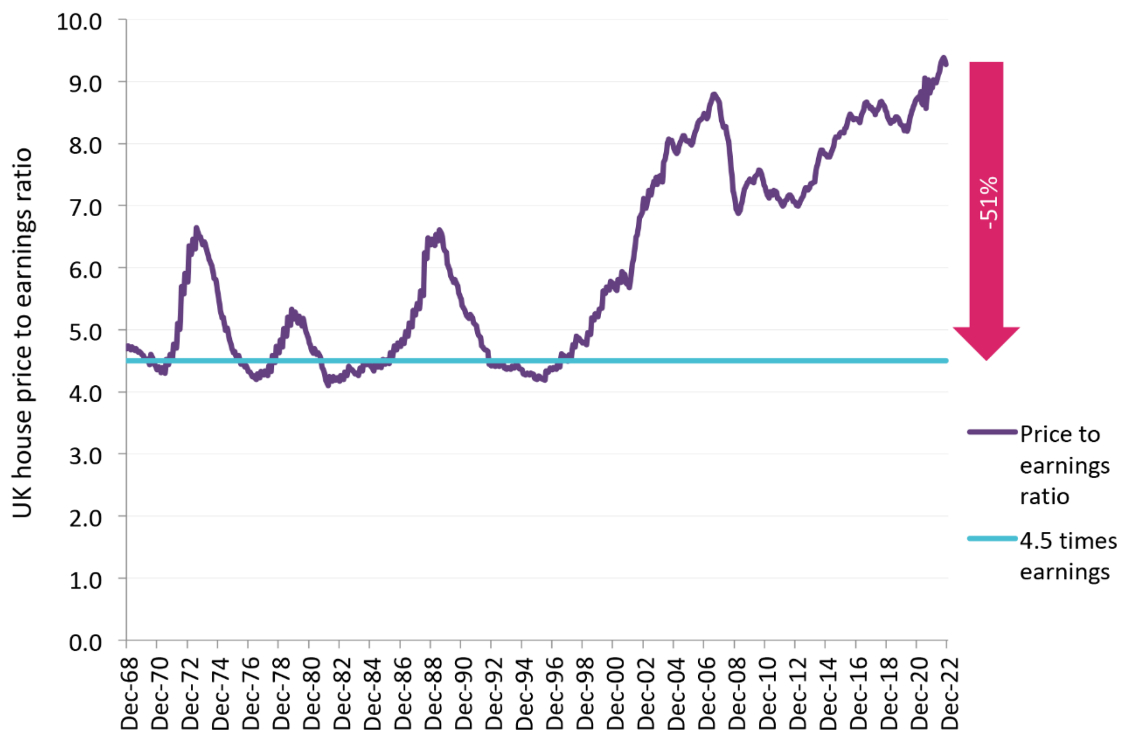
In both 1992 and 2008, governments included funding for social landlords to acquire developers' unsold stock in their housing market recovery packages. Arguably, these interventions helped to sustain the housebuilding sector and allowed market housing to be purchased and converted into affordable housing (overwhelmingly social rent) relatively cheaply. However, these schemes also took money that could have been

spent on new build affordable housing and instead gave it to developers for homes they had already built and could not sell for the prices they wanted. This suggests that the scheme actually reduced construction rates – and kept sales prices higher than they might otherwise have been. Concerns have also been expressed about the quality of the homes purchased under both schemes, as developers may have been quick to offload the lower-quality stock that they found hardest to sell on the open market (HoCCLGC, 2009) (Parvin et al, 2011).

Downturns can have positive consequences for affordability, but this is not inevitable.

By the bottom of the first three downturns, house-price-to-earnings ratios were broadly back to where they had been in 1970. But the mid-1990s was the last time the market corrected in this way. Following the fourth bust in 2007, average prices did not even fall back to the price-to-earnings level of the previous peaks, let alone the four-times earnings level of the previous troughs. This suggests that there has been a more fundamental shift in the position of house prices in the structure of the economy since around 2000, when the house-price-to-earnings ratio began its escalation to previously unseen highs.

Figure 5: UK house-price-to-earnings ratio



Source: ONS House Price Index and Average Weekly Earnings.

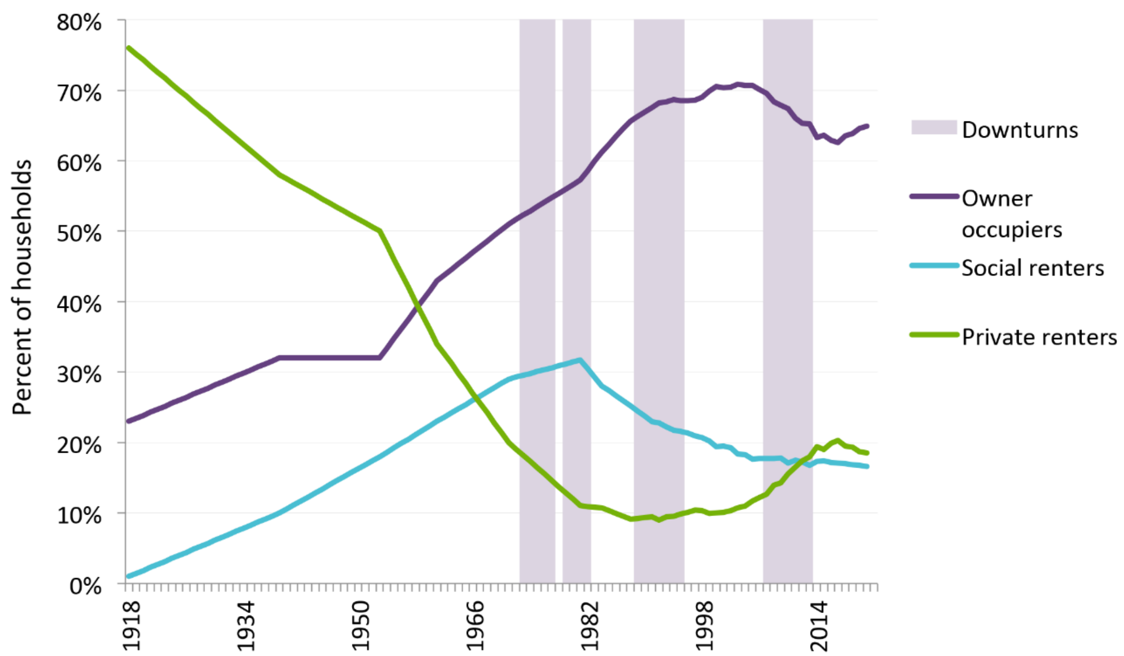
Note: Arrow shows price correction to return to previously affordable ratio.

The clear implication is that governments have learned the political lessons of previous downturns – particularly that of the 1990s – and designed policy to prioritise the interests of existing homeowners and the financial system over affordability.

Ultimately, reactive policy responses to downturns have less impact over the long term than regulatory change.

Bankruptcies famously happen 'slowly, then quickly'. Housing market downturns are the other way around, with rapid shocks giving way to second order impacts. As a result, they tend to prompt a range of rapidly changing policy responses as governments scramble to react to immediate problems like repossessions, and then move their attention to medium-term phenomena like stalling development. But while these policies can be more or less successful at mitigating individual problems, few have a profound or lasting impact on the housing system as a whole. The series of downturns can barely be detected in the changing balance of tenures:

Figure 6: Long-term trends in household housing tenure, England



Source: DLUHC Table FT1101.

Note: Data from 2009 based on financial years, infrequent data prior to 1991 with linear interpolation.

Changes to more structural aspects of the policy framework are much rarer, but their effects are much more enduring. For example, the Housing Market Package of the early 1990s included significant funding for housing associations to keep housebuilding levels up, but changes to council housing finance more or less terminated what had previously been the largest source of non-market housebuilding. The result was a rapid decline in both social and overall housebuilding, which has never been fully reversed. With hindsight, the tenure law changes of the 1988 Housing Act also had a more far-reaching impact than the Housing Market Package that followed it. Mortgaged homeownership had been rising and private renting falling, more or less steadily, since the beginning of the century. Since the 1990s both those trends have reversed as mortgaged homeownership has declined and private renting has grown through several market cycles and changing political climates.

Structural changes can also take a long time to show their effects. The policy changes behind the decline of social housing in England were initiated in the 1980s, but it took a long time for the full consequences to materialise. This is partly because

housebuilding takes years from conception to occupation, so the impact of changes to capital grant allocations or other crucial inputs won't be fully evident in new supply statistics for years – and often not within a government's time in office. Even in 1990–1, after a decade in which government support for social housebuilding had been progressively slashed, 28,000 new social rent homes were delivered in England (DLUHC, 2021). Furthermore, in any given year, the existing stock of social housing is far more significant in determining people's access to social homes than new supply of social housing, which only increases the total stock of social housing by at most a few percentage points. Right to Buy has been reducing the existing stock of social housing over time, but its effects on access to social housing likewise took years to accumulate.

For decades, it was therefore possible for governments to withdraw financial and policy support for new social housebuilding, and to benefit politically from selling existing social homes to their occupiers at significant discounts, whilst simultaneously drawing on the remaining stock of social homes to address social problems, prevent homelessness and increase ordinary people's housing choices. By extreme contrast, social housing today is tightly rationed and functions largely as an 'ambulance service' for those in the most acute need.

Despite the repeated booms and downturns, and the plethora of policy changes and funding initiatives over the last 40 years, the housing system is still essentially that created by the fundamental policy framework established during the deregulatory era centred on the 1980s. This determined the legal position of different tenures; the principles of mortgage market regulation and practice; property taxation; the affordable housing subsidy regime; the housing aspects of the welfare system; the basic form of the planning system; and the business model of the development industry.

Pressure to respond to immediate issues of a downturn can easily distract policy makers from even thinking about these longer-term considerations. And the fast-moving, volatile nature of market crises militates against enacting deeper structural reforms. Worse, reactive policy responses can even exacerbate deeper problems in the system, entrenching dysfunctional features such as market volatility and systemic undersupply by, for example, preserving the assets and market position of current actors at the expense of new entrants or systemic efficiency. The challenge for policy makers in the current situation is to understand both the immediate pressures and the longer-term dynamics of the housing system, and design policy responses that can address both successfully.

4. Present: the current situation

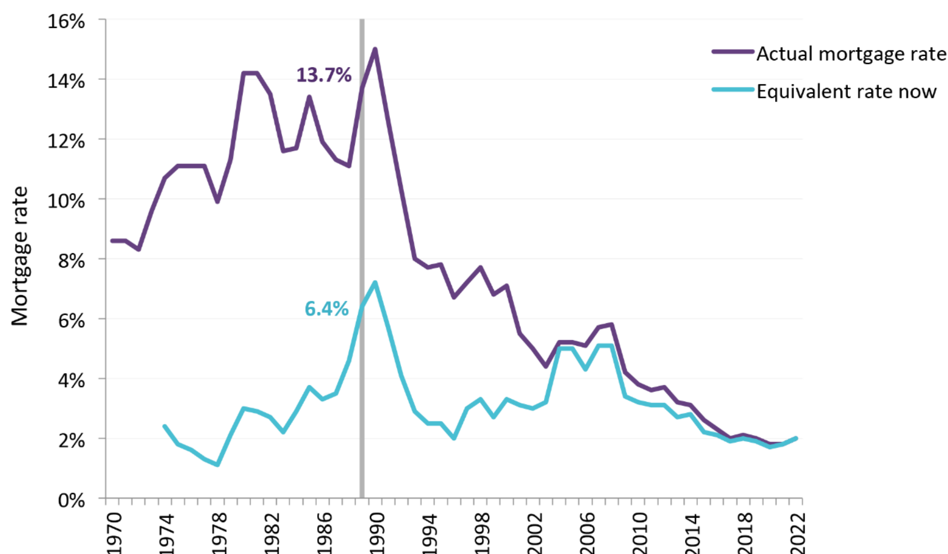
This section will review how different types of households and institutional actors in the housing market are currently positioned and how they may be affected by this market downturn.

Homeowners

Since the last market downturn, those who own their own home have benefitted from low mortgage costs, security of tenure and – in many places – rising house prices. House prices increased by 23% in real terms between 2013 and 2022. Now 54% of owner occupiers own their homes outright, so the proportion of households exposed to rising mortgage rates is smaller today than in previous market downturns. The number of outstanding owner occupier mortgages is now down to levels last seen in 1989 (UK Finance, 2022) (MHCLG, 2014). However, within this smaller share, some sub-groups are particularly exposed to current and emerging conditions. These sub-groups include recent first-time buyers with larger mortgages in the least affordable places, shared owners, and those who have used Help to Buy (particularly to fund purchases of flats in London, where larger equity loans of 40% have been available). These sub-groups have overcome significant barriers to get on the housing ladder in recent years. Their vulnerability to current economic and market conditions is largely a product of the compromises they have made to do this, often enabled and encouraged by government policy.

Mortgage rates started 2023 at around 5%. This is a significant increase on trends over the last decade but remains far below typical mortgage rates in the 1980s and for most of the 1990s. Yet rising mortgage rates today are still a problem for the housing market and for some homeowners for one reason: the steep increase in loan-to-income ratios for new mortgaged purchasers, and above all for first-time buyers, since the last market downturn. Particularly in the least affordable parts of the country, homebuyers have been taking out much larger mortgages than was the case in the run up to previous downturns, so that even small rises in mortgage rates risk sharply increasing these households' monthly outgoings, in the context of broader cost of living pressures.

Figure 7: Equivalent mortgage rates: a 6% rate now has the same repayments as a % of income as a 13% rate in 1989



Source: BuiltPlace calculations using ONS, Bank of England.

Note: The equivalent rate shows how what current rate would give the same repayments as a % of income for that year.

Fewer mortgage holders are on variable rate mortgages and many more are on fixed rates compared to previous downturns – but the majority of those fixed rates are for two- and five-year periods, so higher mortgage rates will feed into household finances in waves as these fixes come to an end. The Resolution Foundation forecasts that over 5 million households will be spending more on their housing costs by the end of 2023 than they were in Q3 2022, at an average cost of £3,500 a year (Judge et al, 2022). Yet rising mortgage costs may not feed through to widespread mortgage holder distress in the ways previous downturns might lead us to expect, because the profile of mortgage holders has changed. Decades of restricted affordability have meant a long-term decline in homeownership rates, particularly for young people. Between 1989 and 2016, the share of UK 25- to 34-year-olds owning their own home more than halved, falling from 51% to 25% (Corlett and Odamtten, 2021). This effect sped up following the last housing market downturn, fuelled by rising house prices relative to incomes, slow wage growth amongst the under 40s, regulatory changes since the Financial Crisis, a lack of available housing stock in the highest demand locations and competition from investor purchasers in both high- and low-demand local housing markets.

Since 2016, homeownership rates for young people have recovered slightly as government policy has targeted first-time buyers, for example through changes to Stamp Duty Land Tax to boost the buying power of first-time buyers and reduce the buying power of landlords and other investors. However, such changes have moderated rather than fundamentally changed the trend for younger households to face significant challenges in entering homeownership.

As a result, recent mortgaged buyers have been some of the least risky seen over the last 50 years. They have been stress-tested and had their bank accounts closely examined. The typical first-time buyer is from higher up the income distribution and has a bigger deposit than previous cohorts. Of course, this has come at a cost, with many prospective buyers excluded from homeownership, increasing pressures and competition in the rented tenures.

Some mortgage holders have also benefited from increased savings in recent years, as many households were able to save considerable sums during the pandemic: the aggregate household saving ratio rose from 5% in 2019 to 14% in 2020 (ONS, 2021). Many mortgage holders outside the vulnerable sub-groups (discussed further below) will therefore be financially resilient in the current housing market downturn, able to absorb increased mortgage costs and their effects. Housing costs will increase and there will no doubt be real pain for some, but, crucially, the risk of negative equity, foreclosures, serious financial distress and homelessness is low for most. The bigger short-term risk from rising mortgage rates is a sharp fall in consumer spending, which would worsen broader economic conditions in ways that could feed back into the housing market later down the line.

Vulnerable sub-groups of homeowners

Recent first-time buyers – Despite all the caveats above, some recent first-time buyers remain a significant at-risk group. Not every first-time buyer household will have the

savings or income to absorb increased mortgages rates, and some mortgage holders with low levels of equity will be vulnerable to falls in house prices. This is especially the case for those that bought within the last two years, given significant jumps in house prices during the pandemic – fuelled in part by the decision to cut Stamp Duty for all buyers, including investors, from July 2020. Recent first-time buyers with limited options for trading down will be at particular risk if their housing costs rise unsustainably and they are unable to move using the equity they have.

Shared owners – Shared owners face multiple housing cost pressures, from rising rents (which National Housing Federation members have agreed to cap at 7% this year), to rising service charges (which remain uncapped) and higher mortgage costs. Since shared ownership is concentrated in the country's least affordable housing markets, and shared owners have often stretched their finances to enter the tenure, many households are at the sharp end of current market trends. Shared owners were more likely than those living in other housing tenures to report an increase in their housing costs in 2022.[1] In addition, a new model of shared ownership was introduced in 2021 that is likely to be more attractive to new shared owners (for example, because new-model shared owners have less responsibility for repairs costs). This may make it harder for old-model shared owners to sell their equity stake if their housing costs become unsustainable.

Help to Buy equity loan recipients – Some buyers who have funded purchases using Help to Buy equity loans will also be at risk from rising mortgage costs, especially those who have bought flats or smaller properties and who therefore have limited trading down options. This is a particular risk for households who have used the larger 40% equity loans available in London. Since buying with limited equity was the point of the scheme, house prices don't need to fall far for households to see their equity wiped out. The House of Lords Built Environment Committee and many others have also criticised Help to Buy for inflating house prices, which could also make moving difficult, since the buyer of a distressed Help to Buy asset will of course not benefit from the scheme (House of Lords Built Environment Committee, 2022). If households cannot move or find another way to repay their equity loan, they will eventually be hit by steep interest payments on the equity loan, causing their housing costs to rise even further.

These risks should not be over-emphasised, however. Analysis of Homes England data suggests large proportions of earlier Help to Buy recipients have repaid their loans, while the numbers taking up the scheme have decreased since it was limited by regional price caps from April 2021 (Hudson, 2022a).

Private landlords

The private rented sector expanded rapidly from 2000, supported by the ready availability of Buy to Let mortgage finance. The number of outstanding Buy to Let mortgages in the UK rose from 120,300 in 2000 to 1,892,600 by 2017, with Buy to Let's share of all residential mortgages ballooning from 1.7% to 17.4% over the same period (UK Finance in Rugg et al, 2018). Buy to Let mortgages have continued to slowly increase since (UK Finance, 2022). The 2014 Mortgage Market Review tightened

lending criteria in response to the last housing market downturn, but the impact of these changes fell more heavily on those seeking to buy a home to live in than on landlords. Interest-only Buy to Let mortgages continued to be available, with access generally based on expected rental income and not on the new stringent assessments of personal income would-be owner occupiers have faced. Today, 57% of all landlords in England own with a Buy to Let mortgage, amounting to 68% of all private tenancies (DLUHC, May 2022).

Mortgaged homeownership's loss has been the private rented sector's gain, both because landlords have had some important advantages over owner occupiers in purchasing homes since the last downturn, and because would-be first-time buyers frozen out of homeownership have provided additional demand for privately rented homes, supporting yields for landlords. Likewise, the social rented sector has shrunk in almost every year of the last four decades, while demographic changes, including the significant expansion of the student population, have further boosted demand for private rented homes (Bolton, 2023).

However, recent years have seen the policy environment become less accommodating to private landlords. From 2016, landlords have had to pay a 3% Stamp Duty Land Tax surcharge on new purchases, while the 10% Wear and Tear Allowance for fully furnished properties was replaced with a less generous system. These and other changes have contributed to a slight retraction in the overall size of the sector. The devolved administrations in Scotland, Wales and Northern Ireland have passed legislation to reform private tenancies with a focus on improving security for renters, with similar changes planned for England through the Renters Reform Bill expected in 2023. Thus far there has been limited evidence of significant sell-offs in response to these and other policy changes, though many sources suggest an increase in landlords intending to reduce their portfolios or exit the sector entirely – particularly those with smaller portfolios (DLUHC, 2021).

Before 2017, private landlords were also able to deduct finance costs from their rental income for tax purposes. HMRC phased out this system between 2017 and 2020, replacing it with 20% tax relief on landlords' mortgage interest payments. This is less generous than the previous system for higher-rate taxpayers, who effectively received 40% tax relief on mortgage payments. While many larger portfolio landlords have been able to avoid paying additional tax by changing their ownership arrangements, smaller portfolio landlords are less likely to have access to this option. Over 80% of landlords in England currently own fewer than five properties (DLUHC, May 2022), so it is likely that we will see the sector consolidate over the course of the coming market downturn.

Crucially, this change in tax policy – combined with the overall growth in the numbers of mortgaged landlords – means that private landlords are now more exposed to rising interest rates than they have been in previous housing market downturns. Some may even find themselves paying income tax on rental income that does not cover their mortgage costs as rate rises feed through. Previous downturns have highlighted the risk of a 'domino effect' amongst landlords that own several properties, where income issues in one property impact the viability of the whole portfolio.

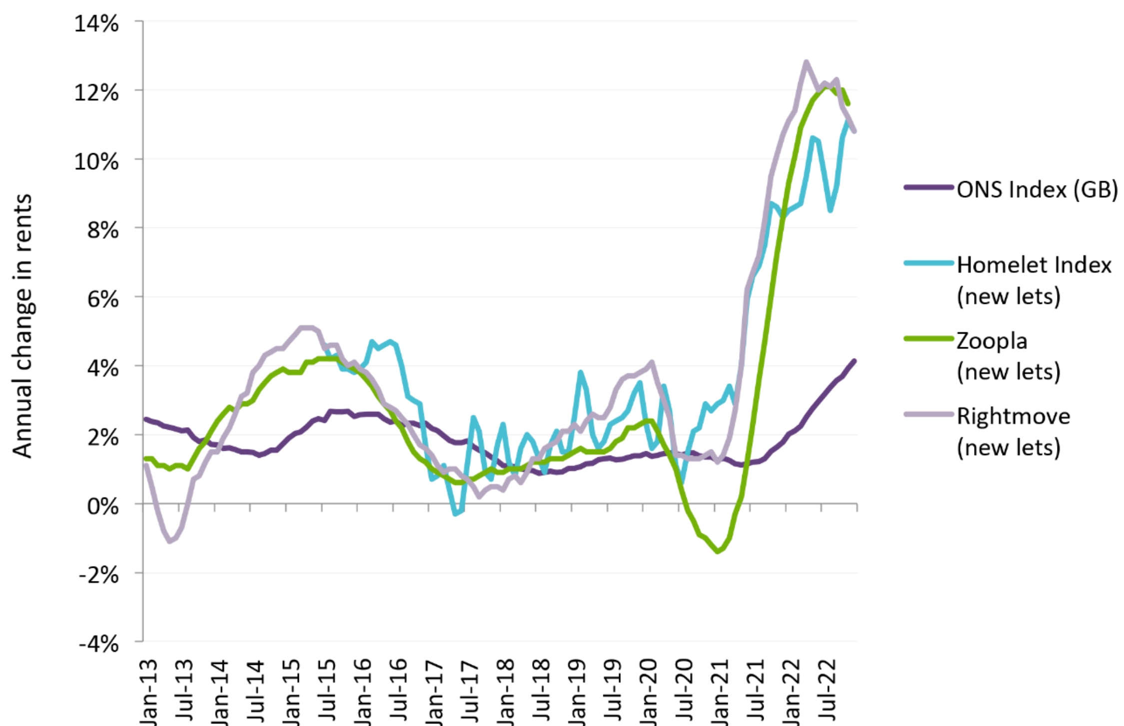
While still nascent, the ‘professional’ landlord sector has rapidly expanded in recent years, particularly via the Build to Rent sector. The UK’s Build to Rent stock now stands at 76,800, with a further 49,800 homes under construction (Savills, 2022). This sub-sector has tended to focus on city-centre ‘multi-family’ developments of flats, but recently it has begun expanding into the ‘single family rental’ market of detached or semi-detached houses. This side of the private rented sector will also be under pressure from changing market conditions, as rising interest rates produce more attractive investment opportunities elsewhere. However, given rising demand for rented homes, Build to Rent is likely to be more resilient than new development for sale, particularly in the ‘single family rental’ market.

Private renters

A significant number of households live in unaffordable, insecure, poor-quality rented homes and are locked out of opportunities to sustainably build wealth. These problems are both more common and more severe for private renters, although the social sector is not immune.

Demand for private rented housing declined during the pandemic as non-UK tenants left, students and other (typically younger) people moved in with family and there was a broad shift away from urban living. The year 2022 then saw a rebound in demand for private rented housing, but the available stock of homes to rent has collapsed. Zoopla recently reported rental demand in August was 142% higher than the five-year average, while the stock of homes for rent was 46% lower during the same period, which inevitably has driven rents up rapidly (Hometrack, 2022).

Figure 8: Annual change in rental price measures



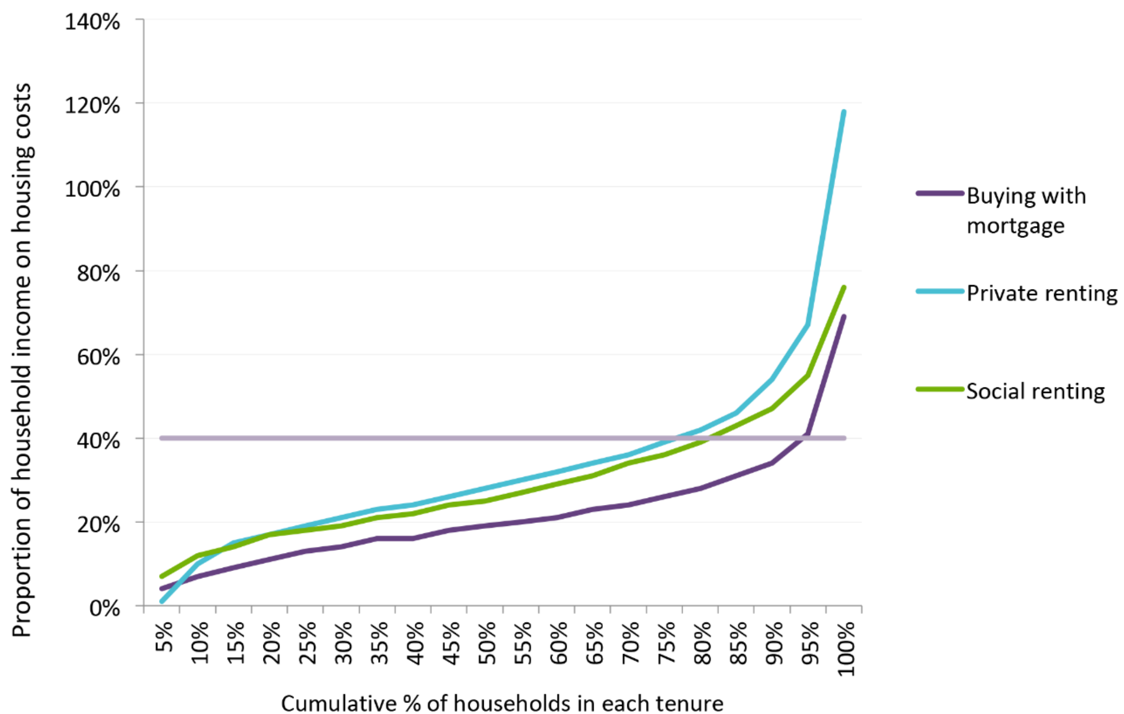
Source: ONS, Zoopla, HomeLet, Rightmove.

Note: The ONS index is based on all stock while the other indices measure new lets.

There are competing explanations for the current shortfall in rental homes, including landlords selling up, a shift in homes to the short-let market (such as Airbnb), demographic changes, and an increase in tenancy lengths reducing turnover. These upward pressures on rents are set to become even more extreme this year as high mortgage rates, the cost of living crisis and market uncertainty cause would-be first-time buyers to delay purchases and keep renting for longer.

The challenges facing the private rented sector are considerable. It now houses a much greater diversity of household types than in the past, exposing more younger households, lone parents and single-person households to unaffordable housing costs,[2] putting them at risk of financial distress and homelessness. It has the lowest quality homes of any tenure and the lowest security of tenure, particularly in England where the long-promised Renters Reform Bill to improve security for tenants has not yet been introduced. Analysis shows that larger proportions of privately renting households spend more than 50% of their income on housing costs compared to other tenures.[3] The failure to uprate Local Housing Allowance is driving affordability pressures for lower-income renters, as the LHA rate for a two-bed home is now lower than the 30th percentile market rent in 91% of English areas (VOA, 2022).

Figure 9: Distribution of housing costs by tenure



Source: JRF analysis of Family Resources Survey 2020/21.

Social renters

While rents are lower and tenancies more secure in social housing compared to the private rented sector, many social tenants are still highly exposed to worsening economic conditions. As the social sector has shrunk over the last four decades, in most places new lets have become tightly rationed. As a result, a higher proportion of social tenants today than in the past have low incomes, are above working age, are

disabled, or have caring responsibilities (DLUHC, July 2022). Many social renting households are therefore vulnerable to the current cost of living crisis because they have limited savings, limited incomes, and limited opportunities to increase these. JRF research from mid-2022 showed that for those in the bottom 40% of incomes, social renters were more likely than those living in other tenures to be going without essentials.[4] Unfortunately, this problem is set to get worse as pressures mount.

Rental affordability is a growing issue in the social rented sector, driven by changes to the benefits system and changes to social housing over the last decade. In 2011, the Coalition Government introduced the new Affordable Rent tenure, with rents set at up to 80% of market rents and less secure tenancies compared to social rent homes. New supply of social rent homes has since been largely replaced by Affordable Rent, which requires less capital grant per home. In addition, 125,000 existing social rent homes were converted to Affordable Rent homes between 2011–12 and 2020–21.[5]

Since 2013, the household benefit cap has limited some households' welfare entitlements below the levels needed to cover rents – particularly in Affordable Rent homes (Network Homes, 2022). As a result, housing support through the benefits system only covers some of the rent for significant proportions of social renters (and around half in London) (DLUHC, July 2022). The Government's decision to cap all social rent increases (including Affordable Rents) at 7% for 2023 is welcome, since allowing social rents to rise with inflation as planned would have caused further hardship for these households, and for other social tenants who don't receive any housing benefits. Yet these households will still have to absorb a significant rent increase and perhaps service charge increases too, in the context of broader cost of living pressures. This is likely to make it harder for social tenants to purchase their homes at a discount using the Right to Buy. Previous market downturns have also seen Right to Buy transactions dip.

Many (though not all) social tenants are less exposed than other households to rising energy bills. Social housing is the most energy efficient tenure overall, with 66% of homes in the highest energy efficiency bands A to C, compared to 42% of both private rented and owner occupied homes (DLUHC, 13 December 2022). Social housing also benefited from £22 billion of much-needed public investment to improve conditions through the Decent Homes Programme between 2000 and 2009. Yet coverage was far from total, and a minority of social housing continues to suffer from extremely poor conditions, often related to the age of homes.

Homeless households

Homelessness has increased significantly since the GFC, with the number of people living in council-arranged temporary accommodation in England increasing by 83% between 2010 and 2020, amounting to 115,040 people (Shelter, 2020). Scotland, Wales and Northern Ireland have all registered more modest increases in homelessness, but the problem remains a stubborn one in all four nations (Crisis Homelessness Monitor, 2010–20). Much of this increase has been concentrated in the country's least affordable cities and towns, including London, Manchester, Luton, Brighton and Birmingham. Declining availability and affordability in both the private

and social rented sector, changes to benefits and other factors have combined to squeeze more households out of the housing market and into emergency and temporary housing solutions.

At the same time as the overall numbers of homeless households have grown, we have also seen changes in how temporary accommodation is sourced. For example, the use of emergency B&Bs as temporary accommodation (TA) in England increased by 334% between 2010 and 2022, while the use of nightly-paid, privately managed TA has increased by 552%, and the use of private rented homes leased by councils has fallen by 12% (DLUHC, November 2022a). B&Bs and nightly-paid TA both tend to be more expensive than other forms of TA, and lead to worse outcomes for homeless households, so that the costs of temporary accommodation have increased at a faster rate than the numbers of people living in temporary accommodation (Rich, 2022). Councils have also increased the use of social housing to provide temporary accommodation by 225% between 2010 and 2022. This has provided partial mitigation against rising costs, but councils in England still spent £1.6 billion on temporary accommodation placements in 2021–22 (Donati, 2022).

Homelessness spiked during the pandemic and numbers have since dropped slightly, though not back to their pre-pandemic levels. Given extreme pressures in the private rented and social rented sectors, current economic headwinds are likely to produce increased homelessness and need for temporary accommodation – particularly if unemployment rises in places where housing affordability is already strained. As there is an acute lack of cost-effective, sustainable sources of TA in most communities, it is difficult to see how this need will be met within the confines of the current housing system.

Developers

The volume housebuilders are in a much more robust position in the run up to this housing market downturn than they were last time, with higher profits, lower levels of debt, substantial cash reserves and more robust business models. Following the bruising experience of the financial crisis, the largest housebuilders have been able to control land costs and increase their profit per home, leaving them less exposed to the current downturn. There is also no quantum shortage of capital for development as there was during the credit crunch in 2007–08.

However, the market has become dependent on the Government's Help to Buy equity loan to increase delivery and was always likely to struggle to maintain output as the scheme comes to an end in April 2023. Construction costs continue to rise, and new environmental and other regulations will add to these. Rising interest rates and the tightness of the labour market and supply chain are all adding to high development costs. Any fall in house prices will also threaten the viability of current schemes, as developers purchase land in advance of building based on current prices. When developers cannot sell homes for as much as they expected when buying land, their profit margins are squeezed, incentivizing them to slash new housing starts and mothball sites as they wait for prices to rise again. This risks a further permanent loss of construction capacity, as much of the ageing workforce is likely to retire or find

alternative employment rather than returning after the market downturn (Farmer, 2016).

This effect may be less severe than during the last downturn in at least some local housing markets. Some volume developers – like Persimmon – now employ more people directly and are therefore more incentivized to maintain construction activity. The nascent Build to Rent sector now also purchases a higher share of new builds in major cities like Manchester, London and Edinburgh, which could support supply as demand for private rented homes remains high. On the other hand, rising build costs and uncertainty around where investment yields will settle could hit city-centre development harder than other places.

Housing associations

Conversely, housing associations are not in such a strong position. Twelve years of austerity have brought rent cuts, benefit freezes and reduced grant rates. Repeated changes to the grant and rent regimes have made long-term financial planning harder. Below-inflation rent caps from next year will further impact their financial strength – although the 7% cap has been largely welcomed by the sector and will produce better financial conditions than many of them were expecting. The costs of fire safety and remediation works, social housing decarbonisation, implementing regulatory reform under the Social Housing Bill, and addressing other urgent maintenance and repairs issues in response to growing media and political scrutiny (including the emerging 'damp and mould' crisis) are all weighing heavily on social landlords' finances.

In response to capital grant cuts, housing associations have increased their use of the 'cross-subsidy' model since the last downturn: building market homes and channelling the profits from this into affordable housebuilding. As a result, they are now more exposed to a housing market downfall than at any point in the past. Many housing associations are already mothballing sites due to rising construction costs and softening market prices.

That said, many of these factors are not new, and most traditional non-profit housing associations in England have been retreating from new affordable housing supply for some years to focus investment on their existing stock (Cuffe, 2021). Instead, new for-profit housing associations are increasingly dominating new affordable housing supply in England, above all via Section 106 planning obligations. Sage Homes, a for-profit housing association, delivered the most new build affordable homes of any registered provider in 2021–22 (Cuffe, 2022). This shift brings with it new risks and challenges, as for-profits have generally preferred less affordable tenures (Lloyd, 2022) and have sometimes split the ownership and management of affordable homes in ways that could create problems for tenants and landlords later down the line, particularly in light of recent failures in social housing management (Barker, 2019). Yet with the right funding and policy support, for-profit housing associations could still provide options for maintaining affordable housing supply and development capacity during the coming downturn.

Banks and investors

Mortgage lenders are in a far more secure position than in the run up to the last housing market downturn, as this crisis is not a fundamentally financial one, and the UK banking sector is in any case much better capitalised compared with the pre-GFC position. In addition, lower outstanding household mortgage debt and tighter regulation of mortgages since 2014 mean UK banks are less exposed to household vulnerabilities than they were in 2008. Indeed, rising interest rates will be positive for bank balance sheets.

As a result, fewer borrowers will be in deep financial distress compared to the last housing market downturn, and banks can be expected to exercise a high degree of forbearance towards those mortgage holders who do enter distress. The risk for banks is if the initial signs of a housing market downturn we can see now worsen broader economic conditions in ways that cause unemployment to spike. This could then increase pressure on more mortgage holders beyond what banks can manage.

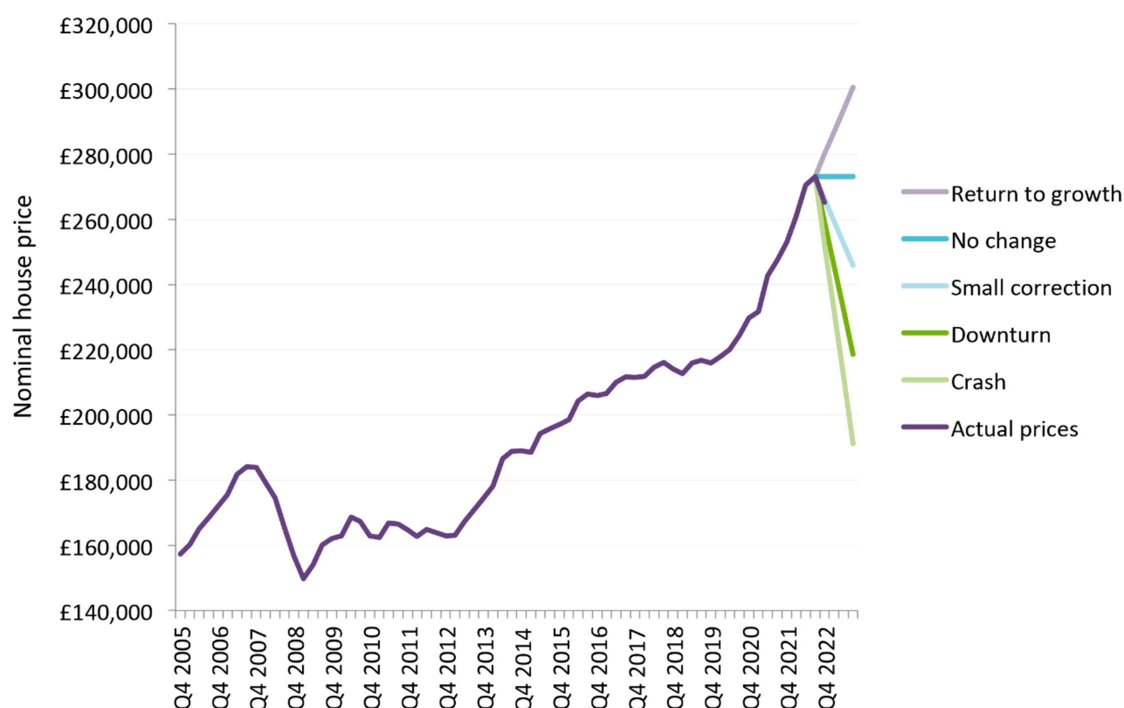
Large, institutional investors like pension funds have long been mooted (RIBA, 2012) as potential sources of long-term investment in housing supply – including social and affordable housing – as their need for secure assets with reliable yields suits rented property well. In recent years, there has been some evidence that this promised 'wall of money' has started to overcome the barriers that have delayed its deployment. In theory, these investors should be less susceptible to short-term market movements and should welcome opportunities for long-term investment in income-producing assets – especially if these assets become cheaper and alternative sources of capital are scarcer.

But equally, the recent growth of institutional housing investment was partly a result of low interest rates making the yields on social housing relatively attractive: as rates on government debt return to more historically normal levels, it remains to be seen if they will continue to expand into housing development finance. If they do, it could prove a serious opportunity for the sector to evolve towards more long-term business models, prioritising income from quality and professional management rather than short-run asset price growth.

5. Future: potential scenarios

The final quarter of 2022 was marked by intense market turmoil, prompted by international and domestic political upheaval, which at points has threatened to trigger a wholesale housing market crash. At the start of 2023, market conditions have calmed somewhat, but the economic pressures remain very real. This context makes predicting housing market movements very difficult, but we can sketch out five possible paths that the housing market may take and provide a broad central forecast. These paths are narrative driven but framed by our analysis of previous downturns and current conditions.

Figure 10: Possible future trajectories For UK house prices



Source: BuiltPlace calculations using Nationwide.

Five housing market scenarios

Back to normal (rising house prices)

Even if there is a return to the economic and political conditions of 2022, the recent turmoil would leave a long-lasting impact on the mortgage and housing markets, as lenders' and regulators' assessment of risk will have changed. This would make the regulatory barriers to homeownership tougher while keeping the affordability barriers at current high levels. While the cost of living crisis might ease, it is unlikely to result in an outright fall in the price of goods and services. This scenario would see a continuation in the inequalities in housing and living conditions that have been evident in recent years.

Stagnation (minimal falls in house prices, much lower turnover)

Mortgage rates fall back but remain higher than at the beginning of 2022, and a lack of forced sales helps avoid a downturn in nominal house prices (though inflation means some real-terms decline). A moderate recession means no large increase in unemployment and few forced sales, so sellers either withdraw from the market or wait for their expected price. Transactions fall significantly, with most housebuilding following closely, particularly given the end of Help to Buy in April 2023. Homeownership remains inaccessible, driving up private rents and leading to continued struggle for lower-income households.

Small correction (10% fall in house prices)

House prices only fall back to the level of late 2021 in most regions. Few buyers are in negative equity, but price falls are not sufficient for any serious improvements in housing affordability. Transactions fall, though the small price correction quickly

encourages more buyers back into the market when confidence returns. Housebuilding likewise suffers a temporary fall but bounces back reasonably quickly.

Downturn (20% fall in house prices)

Recession and rising unemployment cause house prices to fall by a similar scale to the post-2007 downturn, taking prices back to mid-2020 levels. Transactions fall fast, but mortgage lenders quickly return to the market, focusing on wealthier/higher-income borrowers due to the risk of further price falls. Investors also return to the market, attracted by higher yields. Negative equity is largely limited to recent buyers or those in markets that have experienced lower price growth in recent years like London and the North East, but homeownership falls as investors return faster than first-time buyers. Lower-income households suffer most from the recession and unemployment while also faced with further pressure from rising rents. Housebuilding suffers significantly, at least until purchases return to former levels.

Crash (30% or more fall in house prices)

High mortgage rates and a severe recession lead to large numbers of forced sales, so house prices fall sharply and transactions collapse. Large numbers of households in negative equity suppress transactions for years to come. Mortgage lenders are hit hard and their appetite for returning to the market is limited, further suppressing the recovery. The housebuilding industry collapses, producing a permanent loss of capacity. Homeownership falls dramatically and private renting increases. This leads to large increases in private rents and further pressure on low-income households.

Assessment: modest falls and stagnation

The most likely initial scenario is one of stagnation in transactions and new supply, with modest declines in nominal house prices, though inflation means that real price falls will be deeper than many people realise.

The immediate challenge of the financial market turmoil during the Truss Government has eased. However, interest rates are still much higher than in early 2022, and immediately before Truss became PM, and the cost of living crisis is hitting households hard. As such, it is still highly uncertain what will happen to the housing market and economy in the coming months.

The year 2022 has shown the housing market can be incredibly buoyant despite the impact of both the cost of living crisis and rising mortgage rates. During the last downturn, activity levels fell first. It then took almost six more months for house prices to start falling, but even then the initial price falls were less than 5%. House prices only fell sharply through the latter half of 2008 as the recession hit with rising unemployment and repossessions.

This time, house prices and activity could fall together – and there are already signs of both. It now looks possible that we might see a relatively large fall in activity given the affordability constraints posed by higher mortgage rates and the cost of living crisis. However, house price falls could be smaller than originally envisaged back in October –

though there is still the potential for the ‘small correction’ scenario of up to 15% given the increase in mortgage rates above 4%. However, as owners are under little pressure to sell thanks to low leverage and likely forbearance from lenders, it could take some time for sellers to re-adjust their expectations down to meet buyers’ smaller budgets. Additionally, with house prices only falling back to levels seen 18 months ago, this would not be enough to significantly improve affordability, particularly given higher mortgage rates. This could then produce stagnation in the housing market – unaffordable house prices and much lower turnover.

With a large proportion of new housing supply dependent on market sales, a stagnant housing market could be disastrous for the construction of new homes. Since volume housebuilders are in a far healthier financial position than prior to the previous downturn, the immediate danger is that developers will simply cut back on delivery, concentrating on stronger markets and using Build to Rent to support enough sales to keep the business running. This outcome risks starting another cycle of housebuilding collapsing and taking years to recover. In the medium term, the danger is that the combination of higher mortgage rates and the cost of living crisis lead to a combined hit on consumer spending that further worsens the prospects for the economy later in 2023. A consumer-led recession could then lead to rising unemployment and create the conditions usually required for a large fall in house prices later in the year or in 2024. The OBR is already forecasting a 4.3% fall in real disposable household income per head in 2022–23 followed by a 2.8% fall the following year.

Four challenges

Our central scenario can in some ways be seen as the worst of all possible worlds, with four main challenges dominating the agenda.

A slowdown in housebuilding

Housing supply could collapse, with damaging consequences for the future housing market and the wider economy, but without forcing sites onto the market or creating opportunities for new entrants. Smaller builders would be likely to go under, while the well-capitalised developers would be able to mothball sites, wait out the downturn and consolidate their dominant position by acquiring rivals or their landbanks – as has happened in previous downturns (Griffith, 2011). This would therefore entrench the low competition, low supply, high price, high volatility characteristics of the housebuilding system, rather than disrupt them. Affordable housing supply, tied to market provision, would also fall.

An investors’ market encouraging suboptimal uses of the existing stock

Modest price falls and tighter mortgage conditions would advantage cash rich property owners over first-time buyers, enabling them to acquire more property for letting second homes or other suboptimal uses. While there is a legitimate role for short-term uses (holiday homes, PRS) and for temporary vacancy, these uses can become problematic when overly concentrated in particular local housing markets and when they cannibalise the supply of long-term lets or owner occupation.

Acute problems can also occur where private landlords have switched properties from long-term lets (where Local Housing Allowance can help with the rent) to nightly-paid, privately managed TA (which attracts both Local Housing Allowance and a ‘housing management’ element) or supported housing, which is exempt from the housing benefit caps. Market stagnation risks increasing these suboptimal uses, as those with access to capital could take advantage of lower prices and ordinary homebuyers being shut out to acquire stock at reduced prices to use for short lets – or simply to leave empty while waiting for house price growth.

Serious impacts on vulnerable groups

Market conditions could be tough enough to create real hardship for some highly leveraged and low-income homeowners, but not acute enough to force a general price correction on the scale needed to improve affordability back to historic levels. Raising a deposit and requiring above-average incomes to buy will still be a significant barrier to homeownership. Shared owners and those with large Help to Buy equity loans could face unaffordable pressures on rent, mortgage interest, service charges and repairs costs, yet find themselves unable to sell their shares and trade down. Private renters in high-pressure markets would continue to face rapid increases in rent and declining availability of homes to rent, while homelessness and pressures on temporary accommodation would be made worse by the ongoing shortage of social housing.

Expectations of a return to house price inflation suppressing transactions

This scenario would also mean lower market transactions in general, due to price anchoring behaviour and relatively few forced sales, perpetuating stagnation and potentially leading to a more generalised recession. As well as the impact on housebuilding, falling transactions have negative consequences for the market in existing homes and the wider economy. Reduced moves mean lower spending on goods and services, and indirectly contribute to reduced labour mobility and overall economic productivity. Price anchoring by homeowners under financial pressure reduces their disposable income, while price anchoring by secure homeowners, negative equity and lender forbearance discourages down-market moves and so reduces allocative efficiency and opportunities for price correction. A stagnant, low transaction housing market offers fewer opportunities for first-time buyers and for those seeking to move for work, and so increases the pressure on private rents in employment hotspots.

6. Policy responses

Designing a strategic response to the coming downturn

In responding to the downturn, Government must balance supporting those in need now while setting bold new policy directions aimed at the longer-term goal of a more sustainable housing system. The lessons of the past are clear: policies prioritising immediate demands from affected groups in isolation are not only likely to fail on their own terms but are also likely to worsen structural problems in the housing system, many of which stem from short-term, uncoordinated policy in the first place.

For example, it is widely agreed among policy makers that the primary solution to chronic affordability pressures is more supply. Successive governments have accordingly set housebuilding targets. But, given the current market-led model of housebuilding, it is clear that developers will not release more homes into a falling market – so policy makers accept that in order to meet supply targets, it is vital that house prices continue to rise, even though this obviously worsens the affordability problem that supply is meant to address. As the affordability problem worsens, fewer households can afford to buy homes, which limits how many homes builders can profitably bring to market, and hence overall supply. A strategic response to the coming housing market downturn must find ways to maintain – and ultimately to grow – housing supply without relying on house price inflation continuing to outstrip wage growth, for example by increasing the proportion of new homes built as social and affordable housing.

Similarly, many less wealthy and vulnerable households are currently dependent on the PRS for a place to live because they cannot afford to buy and cannot get a social home. But policy makers understandably fear any intervention that might improve the quality or affordability of the PRS, in case it causes landlords to exit and reduce the availability of rental homes. Short-term policy making therefore tends to defend landlords' interests, which further concentrates property ownership as second homeowners and speculative investors squeeze out long-term occupiers – worsening the exclusion of those poor and vulnerable households. A more strategic response would see Government pursue necessary changes to improve the quality and affordability of the PRS together with policies to manage the impacts of some landlords leaving the sector, for example by funding local authorities, housing associations, community-led housing groups and charities to purchase homes from private landlords.

Failure to address systemic problems will mean ever more expensive mitigation (like homelessness support, welfare costs and developer subsidies) – or the acceptance of falling homeownership and ever more poverty. This is the trilemma of housing, welfare and poverty, and the only satisfactory answer to it is more structural intervention (Lloyd, 2017). Strategic intervention requires coherent, joined-up policy, consistently delivered over time – which is a rare commodity in politically turbulent times.

As a heavily financialised system, the housing market is strongly affected by expectations, which can be influenced by clearly expressed messages from government. An effective response to a housing downturn should therefore include clear and unambiguous statements of the Government's long-term aims and willingness to act to achieve them. Without, for example, a clear statement that house prices need to adjust down to a more affordable level, and then stay down, contradictory objectives will continue to coexist and distort policy making and market actors' behaviour alike.

In this section we outline a series of potential policy responses to a market downturn. These are organised around the four challenges set out above, but like the housing system itself, this programme is full of complex interactions and dependencies. Some of the measures proposed are mutually dependent – and on their own could fail or

have unintended consequences. Others are not necessarily mutually dependent but are nonetheless mutually supportive – they are designed to evolve the housing system towards a more sustainable and equitable paradigm. And some could more accurately be considered opportunities presented by a downturn than responses: policies that would support the move towards that paradigm that may be more politically deliverable in the context of a market downturn.

1. Sustaining the supply pipeline and construction activity

A key focus of any downturn response will be ensuring the supply pipeline and keeping construction activity moving. As above, this will need to ensure that developers, who may otherwise sit on sites, continue to build out. This will require policy focused on incentivizing development and disincentivizing mothballing, while also posing an opportunity to grow new models of development that diversify the housebuilding sector and place it on stronger footings over time.

Switching stalled development schemes to affordable housing

In the immediate term, Government should develop tenure switching programmes that work to sustain capacity and output. These need to be swift and decisive and must focus on acquiring development sites that can still be redesigned, rather than buying unsold properties that developers would otherwise have to sell at prices low enough to find buyers. Social landlords purchasing properties from the market to convert to social and affordable housing should ensure they benefit from falling prices and should ensure those selling market homes take a reasonable haircut.

The acquisition and conversion of early stage developments should prioritise conversion to social rented housing, as there is huge need and untapped demand – meaning there are none of the absorption rate concerns that depress build out rates on large market housing schemes (Letwin, 2018). As social housing is almost entirely insulated from the market, its provision doesn’t crowd out private investment. While Affordable Rent can meet some of the need in some places, it is priced in relation to the market (at up to 80% of local private rents), meaning it is not insulated from market forces in the same way – making it a far less effective counter-cyclical source of demand than social rented housing.

Because the supply of social and affordable housing has become increasingly dependent on cross-subsidy from the profits of building market housing, including via the planning system, a market downturn will cause affordable supply to fall, too, preventing it from playing the counter-cyclical role it has in previous downturns. However, Government can still use social and affordable housing to mitigate the impact of a market downturn by allowing social landlords additional flexibility over how to use existing and new housing funding. In the first instance, the existing Affordable Homes Programme (AHP) could be liberalised to allow Homes England greater flexibility on grant rates, remove the 10% limit on acquisitions of existing homes (to allow completed parts of stalled schemes to be acquired where appropriate), and accept different proportions of market, social and affordable homes than initially planned for.

Preventing mothballing

Alongside providing immediate and targeted support to developers to redesign sites, there will be a need in the coming months to disincentivize developers simply mothballing sites.

Politicians of all parties have decried the number of unbuilt planning permissions and threatened developers with 'use it or lose it' policies. But these threats are largely empty, as expiring planning permissions does little or nothing to change market realities: a site that has been granted permission once is almost certain to get it again. Overcoming the huge financial incentives to mothball sites in a falling housing market will require much stronger measures.

A proactive approach would prevent mothballing by compelling developers to either complete construction or hand over schemes to those that do not seek or need high levels of profit. Public authorities (such as councils, Mayoral Development Corporations, or Homes England itself) could be empowered to compulsorily purchase stalled schemes at prices that would render the existing permission viable at minimal profit margins. This will require reforming the law of Compulsory Purchase to ensure that the compensation paid reflects the current planning status of the site – not putative hope value.

An alternative approach, advocated by Shelter, LGA and others (Gardiner, 2021), would be to levy Council Tax and business rates on sites with planning permission as if the property had been built and occupied (after a suitable period for construction, for example 18 months from when planning permission is first granted). This would impose a holding cost on developers, giving them an incentive to either complete or sell schemes rather than mothballing them, and to build out more rapidly.

Grant flexibility, certainty and volume

A downturn-induced housebuilding slump will demonstrate the limitations of development models that rely on market profits. Adopting a more straightforward model of counter-cyclical public housing investment, meaning higher grant rates and more direct delivery by non-market providers, would sustain activity and capacity in the industry and provide some competition for the dominant developer business model.

There is an immediate opportunity to utilise the imminent underspends on Homes England grant programmes, which have emerged from the challenges housing providers face in delivering homes and demonstrate how market-dependent even non-market housebuilding has become, recycling these existing budgets into new social rented supply.

Giving affordable housing providers longer-term certainty over grant and rent levels would help them to make more robust financial plans, take on more complex sites (including those acquired from developers) and help the industry grow out of the downturn. Extending the AHP from five to ten years would help preserve construction sector capacity and would send a strong signal to the market of Government's commitment to leading strategic change in housebuilding (Milcheva, 2020).

Allowing greater flexibility of grant programmes to enable pivoting of construction sector capacity towards retrofit and regeneration – particularly purchasing existing homes, bringing them up to high decency and environmental standards, and re-letting them at more affordable rates – would help sustain employment and activity in the industry, while helping meet urgent decarbonisation and levelling up goals.

Poor energy efficiency in the country's existing housing stock is driving fuel poverty and cost of living pressures and increasing the costs of programmes to manage these; the Energy and Climate Intelligence Unit estimates that the Government's Energy Price Guarantee will cost £9 billion more each year than it would have done if home insulations had continued at 2012 levels over the last decade (Smeeton, 2022).

Additional grant flexibility to support the reprioritisation of home insulations and retrofitting and re-letting existing homes could be achieved by removing entirely the net additionality requirement for Homes England spending in places with low-demand housing markets, in addition to relaxing the 10% limit on acquisition of existing homes across the country.

Supporting ethical stewardship investment models

In the longer term, intervention must not simply sustain the existing development actors and business models through a downturn but start to grow the alternative models that can deliver better and less volatile outcomes in future. There are many historic examples of public-interest-based development models with a strong track record of delivering high-quality homes and places – from the great estates of the Georgian era and the Victorian philanthropists' model villages through to the Garden City and New Town movements of the twentieth century. These 'civic housebuilding' models have been led by public, private and third sector organisations, but they all rely on the ability to acquire land at reasonable prices, access to affordable long-term finance and a public interest motive (although there is plenty of scope for private returns on investment) (Jefferys and Lloyd, 2017).

Recent years have seen some successful attempts to revive these models, but these have been dependent on the goodwill of landowners willing to forgo the allure of upfront windfall profits in favour of long-term returns, as well as determination and some luck in navigating a policy and market framework that militates against them. The Government should explicitly embrace the revival of such stewardship approaches by private and philanthropic developers[6] and should support them by removing tax penalties on land assembly (Knight Frank, 2020) (CIOT, 2017), providing investment guarantees for stewardship investors, and providing upfront infrastructure investment where necessary.

For large and complex schemes, development corporations are a tried and tested model of state-led civic housebuilding that could make a major contribution both to sustaining capacity during a downturn and shaping a more sustainable development industry for the future. The Government should respond to a downturn with an ambitious new programme of powerful development corporations to take over development sites that become unviable to build out and coordinate large-scale developments. Improved Compulsory Purchase powers are essential to allow these

development corporations to assemble land efficiently (CLG Select Committee Inquiry into Land Value Capture, 2018), as is access to long-term finance via the Public Works Loan Board. Instead of aiming to maximise sales and receipts, the Government's approach to public land should focus on meeting community needs – buying, developing and selling land in line with this. To underpin this shift, HM Treasury's 'best consideration' regimes and claw-back rules (which force public bodies to sell land for the maximum price) should be reformed to allow public land that is right for development to be invested for the long-term benefit of the country and the public finances.

To support the growth of this ethical investment model for new housing, Homes England's targets and strategy should be re-orientated towards longer-term delivery of high-quality places, mixed uses, sustainability, regeneration and retrofit as well as new units. The Government should explicitly task Homes England with diversifying the type of housebuilders procured and partnered with – including growing the self-build and community-led housing sectors – to improve the diversity, quality and resilience of the sector.

At the same time, a downturn offers the perfect opportunity to support the emergence of these models by deploying Homes England's Building Lease model: this offers firms the chance to build out sites under a publicly approved masterplan with severe financial penalties for failing to deliver on time and to quality, in exchange for planning certainty. This would allow developers to reduce their risk and capital outlay (as they do not have to buy the land or battle for planning permission), making them less dependent on maximising final sales prices to compensate for the initial risk. Allowing them to operate more like contractors than speculative developers would both sustain construction activity through a downturn and help the industry to grow more sustainable and resilient business models less dependent on rising house prices.

2. Rebalancing the market power of different purchasers

The current housing market trajectory risks creating a cash buyers' market, where those with existing capital out-compete residential buyers to buy up homes for investment or for suboptimal, short-term uses. Policy must focus on disincentivizing these investors to avoid the further proliferation of these suboptimal models, while also boosting the position of first-time buyers by enabling them to capitalise on falling prices, to ensure they can remain active in the market.

Taxing speculative and short-term uses of property

The introduction of the Stamp Duty Land Tax (SDLT) investor surcharge of 3% on top of the standard rate in 2016 was effective at boosting the relative purchasing power of owner occupiers over landlords and second homeowners – but the decision to cut Stamp Duty for all purchasers during the pandemic led to a spike in investor purchases, producing acute shortages of homes available for long-term occupation in UK tourism hotspots, as well as a huge increase in Buy to Let purchases in deprived communities where rental yields are highest (Partridge, 2020).

In responding to the conditions created by the current housing market conditions and avoiding further speculative activity, the obvious solution would be to build on the early success of the Stamp Duty investor surcharge by raising this to a high enough level to deter speculative investors and give local buyers a relative advantage.

In the first instance this should at least double. Longer-term, the precise rate could be determined by raising the surcharge steadily until the desired effect was achieved, much as the Council Tax premium on second homes has been progressively raised in some places.

As a reference point, applying the Welsh Government's new 300% Council Tax premium to the current SDLT investor rate of 6% would mean a rate of 24% for investor purchases.

Finally, the tax system should not incentivize landlords to convert properties from long-term lets to short-term lets. This gains a greater urgency as a result of current market conditions, where rental stock lost to short-term let could further constrain private rental supply, impacting access and affordability for renters. Immediate action must be focused on addressing this issue.

Those who let a spare room benefit from programmes such as rent a room relief, which allows them to claim up to £7,500 tax-free income on their rents. In 2018, the Government announced plans for a new shared occupancy test to limit this tax relief to live-in landlords taking in lodgers. This would have removed the relief from most Airbnb lets. However, these plans were later dropped. Recent research from Propertymark, a membership body for estate agents, suggests this is one factor driving the continued growth of short-term lets at the expense of long-term lets in tourism hotspots (Propertymark, October 2022). By comparison, landlords renting properties to long-term tenants in the PRS have seen their taxes increase in recent years. In response, the Government should level the playing field between short- and long-term lets by removing tax reliefs for short-term lets.

To complement these measures, the Government should resource councils to inspect landlords and lettings agents who charge higher rents for TA and specialist supported housing. In line with the recommendations of the Levelling Up, Housing and Communities Committee's recent report on exempt accommodation (LUHC Committee, 2022), the Government should significantly expand the Supported Housing Improvement Programme (DLUHC, November 2022b). It is currently too easy and too profitable for owners of substandard properties to exploit the benefits system and the low-income households it is intended to support.

Making mortgages support those on the margins of homeownership

Falling prices could present an opportunity to support first-time buyers into the market. However, higher rates have prevented these falls in prices translating into greater affordability, further exacerbating the risk of a cash buyers' market. This could be addressed with greater support for lending to those with lower deposits, which ought to be rolled out alongside the immediate efforts to stem investor activity.

Easing restrictions on the number of mortgages lent above a loan-to-income multiple of 4.5 for lenders issuing long-term fixed products would help grow this section of the market, enabling more buyers with smaller deposits, but adequate incomes, to enter the market.

Government-backed mortgage insurance for loans above 80% of value, with the state standing behind the portion of the loan above 80% in case of default, would increase the availability and reduce the price of first-time buyers' mortgages (Mulheirn et al, 2022). Making this scheme permanent and compulsory would prevent lenders using the scheme only at the riskiest moments in the economic cycle, while ensuring that banks continue to hold some of the risk safeguard against excessively risky lending in boom times.

There is still more to be done to level the playing field between owner occupiers and landlords in their ability to access mortgage credit: in addition to the measures to deter excess purchases by investors outlined above, mortgage regulation should remove the remaining systemic advantages enjoyed by Buy to Let investors compared to owner occupiers.

3. Targeting support for vulnerable groups

As the analysis in this paper has shown, higher interest rates risk creating significant pressure on some renters and owners. Alongside structural interventions in the housing market, policy needs to focus on supporting these households to remain in their homes.

Strengthening the safety net for low-income homeowners

As an urgent response to higher mortgage rates and the cost of living crisis, the Government should build on its recent reforms of Support for Mortgage Interest (SMI) so that it is further able to support low-income homeowners through the coming market downturn, and to protect households from financial distress and homelessness.

The Autumn Statement 2022 reduced the wait time for SMI payments to start from nine months to three months (as was done in 2009), and integrated SMI into Universal Credit (UC), removing the 'zero earnings' rules and instead using the UC income taper to determine eligibility, so that SMI is available to low-income working homeowners. These changes are very welcome: as JRF has argued, the Government should now go further and provide SMI in the form of an interest-free loan so that homeowners at risk of financial distress are not dissuaded from accessing help by the prospect of unsustainable interest costs (Earwaker, 2020).

Shared owners must be eligible and encouraged to receive both SMI to help with their mortgage costs and LHA to help with their rent costs. Households who have used Help to Buy equity loans and who find themselves with unsustainable housing costs should likewise be encouraged to use SMI. Help to Buy recipients who are eligible for SMI should also have interest payments on their equity loan suspended to avoid them being pushed into financial distress. Together, these measures will protect many of the most exposed low-income homeowners from the risk of losing their home.

Exit strategies for vulnerable homeowners

In a minority of cases, lender forbearance and SMI will not be sufficient to remove the risk of financial distress and homelessness for vulnerable homeowners who do not have the option to trade down, for example because their equity has been almost or completely wiped out. Recent first-time buyers, shared owners and those who have used Help to Buy in London or to buy smaller properties are likely to be at greater risk of unsustainable housing costs, and some may need targeted exit strategies.

There is therefore a good case for Government to move quickly to establish a new version of the Mortgage Rescue Scheme (MRS) launched in the wake of the Global Financial Crisis, which funded social landlords to buy the homes of mortgaged homeowners in distress. The lessons from the patchy results of the 2009–14 schemes in England and Wales – and the older and still-extant Mortgage to Rent scheme in Scotland – are that a new MRS should be simpler and more accessible than its predecessors. It should offer only the option of conversion to social rent (as the far more complex shared equity and shared ownership options were barely used), and should be equally available to conventional mortgage holders, shared owners and Help to Buy users.

Beneficiaries would see their mortgage debts cancelled by the purchasing social landlord with any negative equity gap funded by the Government, but, as social renters, they would not retain any equity – and should also not be eligible for any Right to Buy discount in future. This avoids any moral hazard, enabling the eligibility to be drawn more widely than in the earlier schemes, which were tightly restricted to those who would have been statutorily homeless if their home was repossessed. A new MRS should be open to mortgaged homeowners who are already in poverty or are at risk of poverty due to their housing costs, who face losing their home. As with the Scottish scheme, the new MRS should be open to housing associations, councils or community-led housing organisations becoming the social landlord – whichever is appropriate to the individual case. Funding for the scheme should be via a dedicated pot, although there may be scope to source this from expected underspends on the Affordable Homes Programme.

While most homeowners will prefer to avoid this option if possible, it will be important to provide a last resort option for households whose homeownership becomes unsustainable – and avoid worsening the existing backlog of marginal homeowners stuck with inappropriate products that they can neither afford nor sell, increasing their risk of entering severe financial distress.

Strengthening the safety net for low-income renters

Renters are particularly exposed to a housing market downturn, and have already seen significant increases in asking rents, constraining their living standards. Government must immediately unfreeze Local Housing Allowance and re-peg support with housing costs to the bottom 30th percentile of local market rents as an emergency response to the growing pressures in the private rented sector. Given double-digit annual rent increases in many places, keeping LHA frozen guarantees that households using benefits to pay some or all of the rent will increasingly be squeezed out of the mainstream housing system almost everywhere, increasing financial distress and

homelessness – and ultimately leading to higher costs and worse outcomes from housing more people in temporary accommodation.

This measure should be combined with action to improve security and conditions for renters through the Government's long-promised Renters Reform Bill, so that renters are empowered to raise concerns about the standard of their properties without fear of eviction. This could encourage some landlords to exit the sector, and not all will be replaced by other landlords, so the Government should be prepared to manage the impact of this for low-income renters. In the first instance, increasing the supply of social rented homes in places that are currently over-reliant on the private rented sector to house low-income households will strengthen the safety net by giving more people the option of a secure, long-term tenancy.

Growing an ethical private rented sector

Some of the worst symptoms of dysfunction in the UK housing market could be eased – and ultimately resolved – through a significant improvement in the supply of rented housing that is decent, energy efficient, secure and affordable to households on low and modest incomes on a long-term basis. Expanding the supply of social and Affordable Rented tenures is vital, but given the current size of the private rented sector and the scale of unmet need for rented homes, there is a clear case for increasing public and community control over how private homes for rent can be used. The planned Renters Reform Bill is a crucial step on this journey. However, while welcome, the measures envisaged for this Bill through the Government's Fairer Private Rented Sector White Paper will not on their own provide affordability, long-term security or a framework for landlords to improve properties in the ways needed.

A market where prices have fallen or are falling offers an opportunity for local authorities, housing associations, community-led housing groups, charities and others to be supported to purchase homes from the private rented sector and let them out as social and Affordable Rented housing. This should be supported through greater flexibility to use Affordable Homes Programme funding to purchase existing properties, where this will meet housing need and tackle suboptimal use of the existing housing stock. A wide range of local authorities already regularly use acquisitions of private homes as part of their housing strategies, including Ealing, Enfield, Brent, Bristol and Eden, but these efforts are limited by grant availability.

One alternative is for the same organisations to purchase properties from the private rented sector and maintain them in this tenure in an ethical form, or to develop new ethical PRS homes, with voluntary use of more secure tenancies, investment in energy efficiency and other improvements, and rents capped at Local Housing Allowance levels to ensure the homes will be affordable to most households using benefits. Such homes would still be available on the open market, rather than through council waiting lists, though in many cases the rents would be lower than Affordable Rents.

This would improve housing options for those with LHA entitlement, while allowing the existing, limited social and Affordable Rented housing stock to be prioritised for those without LHA entitlement, for example those subject to the household benefit cap. This approach is already used by a growing number of local authorities and local charities,

such as Back on the Map in Sunderland, Giroscope in Hull (No Place Left Behind, 2021), Oxford City Council (Oxford City Council, 2021) and Manchester City Council's wholly-owned Local Housing Company, This City (Manchester City Council, 2022). The model is often pursued in partnership with pension funds and social investors and can therefore require limited or no capital grant. Government guarantees could help finance purchases, particularly by local authorities – who are on the hook for rising homelessness costs and may find this a better long-term option.

Finally, local authorities should increase the use of leasing arrangements with private landlords to provide either temporary accommodation or longer-term housing for low-income households, reversing the decline in this model over the last decade – prior to which long-leased private homes had provided much of the better temporary accommodation. Landlords, who may otherwise be looking for exit routes in a higher rate and more stringent policy environment, would receive a guaranteed income in the form of LHA-backed rents paid by the social landlord, meaning the social landlord would take on voids risk and management risk. Of course, this option is unlikely to appeal to many private landlords while more profitable alternative uses for their homes exist, including nightly-paid TA and short-term holiday lets. It will therefore be vital to implement our other recommendations to change landlords' incentives away from these short-term uses, at the same time as offering them long-term lease arrangements.

4. Reducing expectations of a return to high house price inflation

Keeping the housing market moving will be key to supporting first-time buyers and private sector housebuilding and allowing households to move to support their circumstances. Many of the proposals listed so far will support this aim, but there remain specific challenges for those facing negative equity who may need additional support to move.

Longer term, we must recognise that a housing system beset by regular booms and busts does not meet the needs of the national economy or those seeking safe, secure, affordable housing. A more sustainable, equitable and economically efficient housing system must obviously be one in which house prices do not continue to rise much faster than earnings. But more than that, it must also include a rebasing of house prices at levels within reach of ordinary households – which entails a recognition that prices need to come down to much more affordable levels, and stay down. Alongside efforts to address the immediate crisis, this must also be the moment we embark on the shift towards greater long-term stability. This section considers the longer-range steps that must begin to happen to achieve this.

While many will see this as a politically challenging message, there are reasons to believe that it may not be as unsayable as the conventional wisdom has long taken it to be. Firstly, high and rising house prices have never been quite as universally popular as many assume: the last time the British Social Attitudes survey asked the question, in 2010, 49% of people (and 44% of homeowners) thought prices in their area were too high, with only 2% (3% of homeowners) saying they were too low (DCLG, 2011). In 2021 the Centre for Social Justice found that 55% of people thought housing costs in

their area were high or very high (Centre for Social Justice, 2021). The demographic profile of attitudes to house prices is also counter-intuitive, with older people being the most strongly in favour of stable or falling house prices, despite being the group most likely to be homeowners (Jefferys, 2013). Secondly, the more households are excluded from buying and the longer they find themselves stuck in an expensive and unsatisfactory private rented sector, the closer the political balance gets to a tipping point. London is already a minority homeownership region, and other cities are not far behind. Multiple studies and commentators have highlighted the long-term political implications of this shift (Forsythe, 2018) (Malnick, 2022).

The policy response to excess house prices has long been focused almost exclusively on increasing supply. While the need for more homes and for a better system for developing them is undeniable, the volatile pattern of housing market booms and downturns over the last 50 years has clearly not been driven only by the supply of new build homes: we have to also consider the demand side of the equation, and ask why it is that we seem willing to pump such a large proportion of our national income and wealth into the housing market?

The following recommendations are intended to help steer the recovery out of current market conditions, leveraging the moment to secure lasting change.

Enabling negative equity moves

Falling prices will mean some negative equity is unavoidable, but this need not be as big a systemic barrier to liquidity as it is seen to be. There are long-standing mortgage products on the market that allow owners in negative equity to sell a home and buy another (Nationwide, 2021), though these are not well known and often misunderstood (Koster, 2009). As an immediate response to new market conditions, Government should work with lenders to promote understanding and take-up of these products, and to encourage more lenders to enter this market. Government communication of its intent to moderate house price growth permanently should also help encourage homeowners to accept that their current home may not regain its peak value – and that this should not prevent them making sensible decisions to move.

Supporting new models of homeownership

While there have been countless versions of first-time buyer support schemes and intermediate homeownership products, most have either failed to make an impact or have had unintended consequences. This is largely because they have sought to solve the impossible trilemma of improving affordability while sustaining rising house prices, without requiring vast public subsidy. But there remains a need and a demand for affordable homeownership that a conscious move towards a more stable and equitable housing market could enable, by explicitly beginning to separate the security and control aspects of homeownership from the wealth accumulation aspects.

These twin features of the dominant homeownership model are not inherently indivisible, though they have become closely combined in the popular imagination. A housing market downturn is likely to prompt expectations of government action to mitigate problems, creating an opportunity to make the case for homeownership

without the speculative wealth gains. And after decades of polarisation between those who own and those who do not, with millions of households frustrated by their exclusion from ownership, there may now be a ready market for tenure models based on reduced HPI expectations, particularly in high-demand areas.

The Government's First Homes scheme is a move in this direction, as this will require buyers to pass on the discount they get in perpetuity – creating a permanently lower equity form of homeownership. The proposal has attracted criticism, particularly of the plan to replace other affordable tenures in planning deals with First Homes (Bailes, 2022), but if the tenure was applied to genuinely additional homes provided through new civic housebuilding models, it could contribute to a more sustainable culture of affordable homeownership over the long term. To achieve this the discounts will, in most places, need to be higher than the proposed 30% off market price to be truly affordable to ordinary buyers – and to avoid unhelpful competition with other sub-market products like shared ownership.

In recent years Help to Buy discounts have diverted lower-income first-time buyers towards new, typically edge-of-town developments instead of older homes in low-demand areas requiring renovation. But government and local schemes to encourage these buyers to revive run-down existing neighbourhoods have been successful in the past – for example the £1 homes scheme in the Granby Four Streets area in Liverpool (Liverpool City Council, 2013) – and have additional benefits for decarbonisation and the levelling up agenda.

Taxing property ownership through a Proportional Property Tax

Weaning the UK off its addiction to house price growth will require fundamental changes to the policy framework that ultimately determines the nature of the housing system – including its propensity for damaging boom and bust cycles. The hard truth is that a major driver of rampant house price inflation and our national obsession with housing wealth is that it is given uniquely preferential tax treatment. To create a housing system that is more sustainable and efficient, that doesn't exclude so many people from the chance of a decent home, and that doesn't distort and damage the national economy so much, we will have to tackle the problem of housing taxation.

Countless reviews and studies have pointed out the many flaws in the UK property tax system – most notably the IFS's Mirrlees Review of 2011 (Mirrlees, 2011). Property tax affects many aspects of housing, the economy and the financial system, but the central problem for the stability of the housing market is that there is essentially no tax payable on housing wealth. When all other sources of income or investment profit are taxed more highly, it is small wonder that British people choose to overinvest in the housing market. As the vast bulk of the housing market is made up of existing homes – many over a century old and in questionable condition – most of this is not productive, growth-enhancing investment but debt-fuelled speculation in a zero-sum game. To dampen house price growth and send a signal that house price bubbles will never again be allowed to distort the economy and damage whole generations' life chances, the Government should introduce a new tax on housing wealth.

While the exemption from Capital Gains Tax (CGT) for primary residences is an obvious candidate for reform, there are good reasons for its existence, and most countries that do tax housing wealth gains allow reliefs to enable homeowners to move up the housing ladder, which severely limits the tax's economic impact. As landlords and second homeowners are liable for CGT (although there are questions about how much is actually collected), removing the primary residence exemption would reduce this modest advantage that owner occupiers currently have in the market.

Instead, the real aim of property tax reform should be to prevent house prices rising excessively in the first place. To achieve this, an annual tax based on the current value of the home is needed, as exists already in many advanced economies. In England, this could ultimately replace Council Tax, a discredited and widely detested tax on occupying a home that is deeply regressive and only very loosely connected to house prices, and Stamp Duty, which is a huge brake on transactions. A 2021 study from WPI Economics for Fairer Share estimated that an annual Proportional Property Tax of 0.48% of a home's value, payable by the owner not the occupier, would replace both those taxes on a revenue-neutral basis, and that 76% of households in England would pay less tax than currently – particularly renters, younger households and those in less affluent places (Williams et al, 2021). In other words, it would be a strongly progressive tax that would address multiple structural inequalities. The tax should be collected by councils, with a suitable equalisation mechanism to ensure fair funding for all local authorities despite differential property values. For our purposes here it would provide a strong incentive on homebuyers and lenders alike not to bid up the price of existing homes, as to do so would incur an automatic and ongoing tax penalty. As with the proposal for Stamp Duty above, which a Proportional Property Tax would replace, investors and second homeowners should pay a higher rate than owner occupiers to prevent investor demand re-inflating house prices.

Clearly such a change would face significant political and technical barriers, and the details would need careful consideration. We therefore recommend the Government increases the investor surcharge on Stamp Duty Land Tax in the first instance, as suggested above, to provide an immediate deterrent against speculation in the property market. Yet it is worth noting that the politics of replacing existing property taxes, while never straightforward, should be easier during a housing market downturn, when values have fallen, transactions are low and there is political space to consider radical alternatives.

Signalling the end of excessive house price inflation

Finally, the power of signalling should not be ignored. In financial markets expectations of future price moves are a major driver of behaviour. And where Government has strong levers to influence markets, credible statements of policy intent – like the inflation target that the Bank of England is given, or the fiscal rules the Treasury sets itself – are a major tool of policy in themselves.

These conditions clearly apply to housing, which is a highly financialised market, in which Government has multiple levers to influence behaviour and outcomes – from regulation and taxes to welfare benefits, capital subsidies, planning and tenure law. The messages Government sends can therefore be a powerful influence on the

housing market. Yet unlike in fiscal or monetary policy, this signalling power is rarely used consistently or coherently, as governments have preferred to pretend trade-offs do not exist or that quick fixes can be found. This tendency can be clearly seen in circumlocutions used to avoid references to price falls: it is not uncommon for public policy statements to talk about 'reducing unaffordability' or 'moderating price growth so that wage levels can catch up' rather than lowering the price of homes.

In the context of yet another market downturn, coming after decades of acknowledged housing crises, there is a clear opportunity for a reforming government to use its signalling power to steer the housing market towards a more sustainable paradigm. At its simplest this could involve an unambiguous statement that house prices must be brought to a sustainable level of affordability and kept there permanently. A credible commitment to use all the tools available to achieve this would have a powerful impact on market expectations and behaviours. A bold government should lead its response to a downturn by explicitly rejecting the illusory solution of reflating a new house price bubble – and making an unambiguous statement of intent to keep house prices under control.

7. Conclusion: supporting a shift to a better housing system

House prices are too high; they need to come down…

House price inflation on the scale we have seen over the last 20 years is fundamentally incompatible with rising homeownership and better housing outcomes. It's also the driver of our dysfunctional housebuilding system, poverty, wealth inequality and wider economic distortions that result from ploughing so much of our national wealth into housing market speculation. It is time to wean the UK off its addiction to house price growth so new generations can benefit from the security and sense of autonomy homeownership can bring. Saving these 'good' aspects of homeownership means starting to separate them from the speculative wealth accumulation that has attached itself to homeownership in recent decades. The Government should clearly and publicly commit to keeping house prices under control and should consider replacing Stamp Duty Land Tax and Council Tax with a new Proportional Property Tax to deliver this.

… but suppressing house prices to more affordable levels is necessarily a long-term project that will require bold new thinking and political courage.

The first step is admitting that we have a problem. The second is resisting the temptation of short-term fixes that might sustain the broken system a little bit longer, but only by making fundamental problems worse. The third step will be to enact policies to suppress house price growth and build a better system over the long term.

The coming housing market downturn can be a turning point; we must not waste it…

Downturns are just one, damaging, feature of a dysfunctional housing market – but they are also inflection points that can prompt a rethink and open up space to do

things differently in the future. The overall housing system is determined by a complex policy framework that has evolved through three successive eras since the Second World War – reconstruction, deregulation and decadence. The current 'decadent' paradigm still bears all the structural features forged in the 1980s deregulation era, on top of which reactive governments have layered increasingly desperate responses to growing dysfunctions and crises. We may now be reaching a new turning point, as this decadent paradigm begins to collapse under its own contradictions.

… we must reform the rules governing housing supply to build a more resilient and sustainable housebuilding sector…

Inadequate housebuilding is both a cause and consequence of wider dysfunctionality, and reforming housebuilding will be central to building a better housing system. This means reducing our over-reliance on market housing for new supply by delivering a greater diversity of tenures and types of housing, including social rent homes affordable to households with low incomes as well as low-cost homeownership options targeted at creating genuinely additional first-time buyers – without contributing to house price inflation, as recent schemes like Help to Buy have done. Improved Compulsory Purchase powers are essential to allow diversified housing schemes to come forward and deliver at pace, while tax changes could incentivise landowners to seek long-term value generation over short-term profit maximisation.

In the short-term, this new approach to housebuilding will help to reduce mothballing of sites during the market downturn, allowing housing funding to be used to redesign schemes to include more social and affordable homes to replace lost demand for market homes. In the long-term, this more balanced approach will support less volatile demand for skills and materials, driving efficiencies in the construction sector and helping to manage the economic impacts of future market downturns.

… including significantly increasing the supply of homes affordable to low-income households, and especially low-income renters…

Crucially, a reformed housebuilding system will support a significant increase in access to social and affordable homes, providing meaningful alternatives for households who struggle to meet their needs through market housing options alone. This also means reinvigorating genuinely counter-cyclical new supply of social and affordable housing, freed from the dependence on cross-subsidy from the profits of building market homes that has limited social and affordable housing supply in recent years. This shift can be achieved through additional grant delivered through 10-year funding programmes, government guarantees and changes to Homes England's targets and strategy. Given high construction costs and limited development capacity going into the current market downturn, Government should also give social landlords additional flexibility to use funding from the Affordable Homes Programme to purchase existing homes from the market and to improve homes already in their ownership, where this will support an expansion of the stock of genuinely affordable homes suitable for meeting local need. In the same vein, new 'ethical PRS' options could help to expand choice for lower-income renters.

… but we also need to make better use of the homes we've already got…

However, new housing supply in any given year makes up a tiny proportion of the total housing stock, so we must also tether existing house prices more closely to local incomes by changing how homes are bought and sold. First and foremost, this means limiting the influence of global investor demand on house prices. Alongside the introduction of government-backed mortgage insurance, tax changes would favour owner occupiers, local authorities, housing associations and community organisations over investors in property sales – and could also be used to disincentivize conversions of homes from long-term occupation to short-term uses like Airbnb. In severely stressed local housing markets, local authorities should be empowered to restrict property sales to second homeowners, foreign buyers and Buy to Let landlords, conserving the stock of housing available to meet local need. The Right to Buy in England should also be reformed to slow the rate at which the stock of social housing is shrinking – at least until a reformed housebuilding model has started to deliver a significant uptick in social housing supply.

… and commit to emergency reforms and investment to prevent a rise in homelessness, poverty and distress while our reforms take root.

The dysfunction in the UK's housing market right now is so acute that we need some emergency investment to prevent a rise in homelessness and poverty in the short term. This must include unfreezing Local Housing Allowance, reforming and modernising Support for Mortgage Interest, and updating the Mortgage Rescue Scheme from the last downturn. There is clearly a tension between the need for such emergency measures and our strong steer for Government to focus its resources and attention on fundamental, long-term reform to the policy and funding framework for housing. Over longer timeframes we will be able to reduce our use of emergency investment to plug the gaps in our housing system by fixing the roof: for example by building new homes targeted at meeting local need and reducing the size of the private rented sector in favour of owner occupation and social housing.

Beyond investment, reform is urgently needed to manage the impacts of a housing market downturn and curb some of the worst excesses of the current market for lower-income households. The Government should bring forward its long-promised Renters Reform Bill at the earliest opportunity, so that renters are empowered to raise concerns about the standard of their properties without fear of eviction. It should also work with lenders to promote take-up of mortgage products for households in negative equity who need to move.

Notes

[1] JRF analysis of ONS Opinions and Lifestyle Survey.

[2] Built Place analysis of MHCLG English Housing Survey, 2017–18.

[3] JRF analysis of Family Resources Survey 2020/21.

[4] JRF May–June 2022 cost of living survey – carried out by Savanta Com-Res.

[5] Built Place analysis of Regulator of Social Housing, Statistical Data Returns 2012 to 2021.

[6] See for example the Stewardship Initiative https://www.stewardship-initiative.com/initiative

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About the Joseph Rowntree Foundation

The Joseph Rowntree Foundation is an independent social change organisation working to solve UK poverty. Through research, policy, collaboration and practical solutions, we aim to inspire action and change that will create a prosperous UK without poverty.

We are working with private, public and voluntary sectors, and people with lived experience of poverty, to loosen poverty's grip on people who are struggling to get by.

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