

Britain's Property Problem: Demand increases are rapidly transmitted into rising prices rather than expanded output

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*The government's housing policy has been controversial. Some applaud Help to Buy for kickstarting activity in the housing market, while others warn of potential pitfalls, especially regarding the second phase that will be implemented from January. **Alex Marsh** argues that more credit being poured into the housing market will only be able to deliver a modest supply response. This means increasing housing costs.*



This week has brought a slew of news about the UK housing market. Industry commentators are telling us the sector has “turned a corner”: levels of market activity increased significantly in July alongside a sharp upturn in prices. Average prices are now near or above those reached prior to the 2007-8 crash, although experience is diverging across the regions.

While some news outlets are reporting these developments in decidedly positive terms, the commentary is more mixed and critical than perhaps the government would like. As prices rise more households are shut out of the home ownership market. This in turn can have negative consequences for private rent levels. For those within reach of home ownership affordability is deteriorating: first time buyers are having to borrow more, when wages are largely stagnant. Loan-to-value ratios are reported to be edging up towards levels that must be deemed unwise. And all this is happening at a time when many existing home owners are only managing to sustain their current commitments because we are experiencing an unprecedented period of very low interest rates.

Many commentators are crediting the government's Funding for Lending and Help to Buy schemes as contributing to “kickstarting” market recovery. Yet, phase one of Help to Buy is a relatively modest initiative. Funding for Lending has likely made more of a difference. Originally the scheme was intended to ease access to business credit, as part of the attempt to rebalance the UK economy away from investment in residential property and towards more productive activity. But then it was made available to Buy to Let landlords, who can take advantage of low interest rate loans to extract a significant return on the basis of rental income alone.

We are in a situation where more credit is being poured into a housing market that is only able to deliver a modest supply response. That can only mean one thing: increasing housing costs.

A significant concern is that Help to Buy II has yet to arrive. It is due to be implemented in January 2014 and is a much bigger intervention. If prices are already increasing rapidly then the last thing we need is the government intervening to allow significantly more marginal borrowing while underwriting much of the associated risk. That is a recipe for disaster.

I know of no one beyond the government and industry representatives who thinks Help to Buy II is a good idea. All informed commentators – both domestic and international – see it as bad policy. It is likely to distort the market significantly. Even Vince Cable has tried to distance himself from his own government's policy. But then he is one of the few people at the heart of government who actually has an economics background.

The key point is that if the government aimed to “kickstart” the housing market then that has arguably already worked. Indeed, if anything the market might already be heading towards overheating in certain parts of the country. Help to Buy II is therefore unnecessary. Calls for its abandonment are increasing. Politically that change of direction could be portrayed as a success of existing policy measures, rather than as a failure. And many people would see it as a case of sense prevailing. So the political costs of dropping Help to Buy II could be relatively small.

The housing market in Britain is in a mess, at a number of different levels. The very fact that persistent price rises

can feature in any definition of market recovery is one indicator of this. In any other market this would be taken as a sign of dysfunction.

Several factors have contributed to this situation. A key issue is the UK housing market's sluggish supply response, which means demand increases are rapidly transmitted into rising prices rather than expanded output. This is not a new problem. For twenty years we have known that new construction has failed to keep pace with rates of household growth. And following the Global Financial Crisis we witnessed the lowest output figures for nearly a century.

Economists have a tendency to attribute this lack of supply responsiveness to a restrictive planning system. Liberalisation is therefore prescribed. It is surely the case that the planning system plays a role. But to stop the analysis there is to offer a rather partial answer. The "planning system" is not an entirely independent agent. It reflects the values and priorities of political actors. This can be seen following the coalition's abolition of Regional Spatial Strategies. Without top down pressure, many local councils took the opportunity to reduce their planned levels of new house building: not so much because "planners" wanted fewer homes but because that reflected local political priorities and local residents' preferences. The bigger question is why local communities are so resistant to new development.

Equally importantly, the planning system is only one part of the housing supply system. It needs to be understood in relation to the operation of developers and the house building industry, the land market, and the way in which development is financed.

Clearly, there is a complex interaction between these components. It can be argued that the recognised problem of land speculation by developers, for example, is a response to the vagaries of the planning system. That would imply that land release would not be a problem in the absence of planning. But that makes some strong assumptions about the behaviour of landowners. Experience prior to the arrival of our current planning system suggests that, in the presence of increasing demand and growing cities, land speculation would not disappear.

In addition, the housebuilding industry in the UK has a higher level of industrial concentration than most other developed countries, and concentration has increased over the last decade. The industry also has a distinctive subcontracting structure that delivers flexibility but not necessarily quality. The small-scale builder and self-build sectors are small: these sectors account for a more substantial proportion of output in other countries. The Coalition has made modest attempts to stimulate this sector of the industry, but it faces significant barriers.

Finally, the interaction between the planning system, high prices, volume building to standardized templates, and the absence of minimum space standards can conspire to mean that when new construction does occur it is not always viewed as a positive and high quality addition to a neighbourhood. That, of course, folds back into the concerns of local residents about further development.

One of the solutions to this problem could be, perhaps counterintuitively, for new build to occur on larger scales. That would allow developments to be appropriately masterplanned – with sufficient allowance for public spaces and amenities – so that sympathetic, well-designed and high-quality construction can allay residents' fears about allowing new development locally.

But to achieve this sort of outcome requires political bravery at local level, and for a different balance of power in the planning process. The seemingly intractable difficulty of overcoming local resistance to new development is one reason why a new era of new towns has been discussed as a potential solution to the housing supply problem.

The problem of supply underpins the housing problem. Yet, very little has been done to tackle it. Without broad-based structural change we are destined to continue to experience the sort of volatile housing market cycles that we are only too familiar with. But the political costs of attempting reform suggest that it is unlikely any time soon.

Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the

About the author

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