

Why are house prices in London so high?

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House prices in the South East of England would have been roughly 25 percent lower in 2008 and perhaps 30 percent lower in 2015 if the region had planning regulations of similar restrictiveness as the North East of England. That is one of the findings of our new research paper. Real house prices – but not real incomes – have grown faster in the UK over the last 40 years than in any other OECD country. Today housing space in England – particularly in London and the South East but also in other urban centres and large pockets of rural England – is among the most expensive and unaffordable in the world. Our study shows that this is in large part due to supply constraints imposed by the planning system.

According to the research, the problem is clearly that there is too little supply given the strong demand for housing in parts of the country. But why? The study explores three possible types of supply constraints:

- The first type is regulatory and dates back to the Town and Country Planning Act of 1947. The UK planning system since 1947 is extraordinarily rigid by world standards. Urban containment through 'green belts', strict controls on height, lack of fiscal incentives at the local level to develop and 'not in my backyard' (NIMBY) behaviour facilitated by the planning regime all make it very difficult to build new homes.
- The second type is physical. Local scarcity of brownfield or greenfield land makes residential development in desirable locations very costly.
- The third type is uneven topography. It is very difficult to build new homes in places with steep slopes.

So which of the three types is most important in the case of England? We use data from over 350 local authorities from 1974 to 2008 to explore this question. Our findings strongly suggest that regulatory constraints are the main culprit. In our estimates, house prices would have risen by about 100 percent less in real terms between 1974 and 2008 if, hypothetically, all regulatory constraints were removed. But removing all constraints is of course neither practicable nor desirable.

More pragmatically, if the South East – the most tightly regulated English region – had the regulatory restrictiveness

of the North East of England – still highly regulated by world standards, house prices in the South East would have been roughly 25 percent lower in 2008 and perhaps 30 percent lower in 2015. In England, housing is being built where there are the fewest disincentives to permit development rather than where demand is greatest. This, over time, created a serious affordability crisis in the most desirable places of the country.

What about physical and topographical constraints? The effect of constraints due to scarcity of developable land is largely confined to highly urbanised areas. But in these areas – most pronounced in the Greater London Area – the effect is important. So house prices in London would still be fairly high by world standards if the planning system was reformed and various constraints relaxed. Topographical constraints matter too in a statistical sense, but they are not very important economically.

So who are the losers of the planning-induced affordability crisis? The obvious losers are young households. But although existing homeowners seemingly benefit from higher asset prices, most of them are also adversely affected. This is because they cannot realise the ‘gains’ unless they downsize their housing consumption, give up owner-occupation and rent or sell their house to move abroad. In the interim, they too have to live in increasingly cramped spaces.



Notes:

- This article is based on the authors’ paper [The Impact of Supply Constraints on House Prices in England](#), March 2016, *Economic Journal* (Volume 126, Number 591, pages 358-405).
- This post gives the views of its authors, not the position of LSE Business Review or the London School of Economics.
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Christian Hilber is Associate Professor of Economic Geography at LSE. His research interests are in urban and real estate economics: location choice; home ownership; housing supply and land use regulations; house price capitalisation; social capital investment; education; and local public finance. He tweets at [@ChrisALHilber](#)



Wouter Vermeulen is Programme Manager in Decentralised Governments at Centraal Planbureau (CPB), Netherlands Bureau for Economic Policy Analysis. He is also an Associate of LSE’s Spatial Economics Research Centre ([SERC](#)).



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