

# We need to break out of the vicious land market trap and deliver more homes more cheaply

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*To solve the UK's housing crises we need more genuinely affordable options. **Toby Lloyd** investigates the challenges and suggests a solution which will meet people's need for a decent home and enable the development industry to move to a higher output equilibrium.*



As a nation, we desperately need more homes for people to live in. We've been running a massive deficit in new housing construction for decades, which the economic travails of the last five years have only worsened. Every year around 240,000 new households form in England, as people grow up and leave the parental nest, immigrate, start families and divorce. Every year we build less than half that many homes.

Inevitably, people on lower incomes feel the effects of the homes deficit most keenly. Shortages push prices up, and those with least buying power struggle most to make the rent or mortgage payments, or are forced out of the market altogether. This in turn puts greater pressure on the two main housing parts of the welfare state: social housing and housing benefit. The waiting list for social housing now includes about 5 million people. It has taken [twenty years to add 0.5 million social rented homes to the total stock](#), so that queue's not going to get shorter any time soon.

And despite some pretty stiff cuts to the amount of housing benefit claimants can receive, the total bill is rising as more and more people need help bridging the gap between stagnant wages and rising rents. So we urgently need more affordable housing – including traditional social homes and better versions of shared ownership for those that aspire to own – just to meet current and future need.

But there are other reasons why a major increase in affordable housing provision is needed. The private sector ought to be building more homes than it does. However, it has proved largely incapable of increasing its output significantly in recent decades, even when house prices were booming and mortgage credit was easy to come by. From the depths of the bust in 1995 to the height of the last boom in 2007, real average house prices grew by over 150%. Private supply only rose by 23%, before crashing back to levels not seen since the immediate post-war years. The private house building sector has only delivered more than 150,000 homes in five of the last forty years; no wonder the market leaders queued up to brand Ed Miliband's fairly modest target of 200,000 homes a year as ["not physically possible"](#).

In earlier periods the industry built far more. The missing factor now is direct public investment. When the state built more, the market also built more. When the state withdrew in the 1970s-80s, the market never made up the shortfall. Crowding out does not seem to be a problem in this industry. Quite the opposite: in decades when 300,000 homes were built each year, public investment in affordable homes actually supported the growth of private contractors and developers, and helped smaller market players to survive the ups and downs of the development process. A successful mixed economy, you might call it.

Those with a longer historical view often point to the private housing booms of the 1920s and particularly the 1930s, when private builders alone churned out more than double our current levels of total output. But just as in the post-war period, these private supply booms were preceded by spikes in public investment, which pump primed the system and supported private builders as they pushed total supply into a higher gear. In other words, if you want more private house building – and almost everyone does – the best way to get it is to invest intensively in affordable housing supply to kick start the engine. You then need to sustain investment to support a healthy mixed economy and prevent a low output market equilibrium reasserting itself.

Going a little deeper, one of the most damaging characteristics of the current supply system is the relationship between the economics of development and the second hand homes market. Existing homes set the price of new builds because there are far more homes changing hands than being built.

The prices developers can sell new builds for set the cost of development land, as developers bid for sites based on their estimation of what they'll be able to sell the homes for in the end. The developer who expects house prices to rise the most can offer the landowner more for the site, out bidding the developer who takes a more cautious view. This means that the returns from higher house prices ultimately benefit land owners far more than developers themselves.

So second hand house prices dictate land prices – but it's not a simple relationship. Lots of homes are bought and sold every month, but sites are few and far between, and land trades are much rarer, so the effect of any price movement in the housing market is amplified in the land market.

If house prices rise a bit, land prices rise a lot, quickly. This increases the upfront costs developers have to pay, and hence their risks, making them increasingly nervous about releasing too many homes onto the market, which might lower the prices they can sell for. So in a rising housing market, rapidly rising land *prices* limit the supply the new homes.

But if house prices fall, development schemes instantly become 'nonviable' and many stall. They no longer have the potential to make enough profit for the developer to justify the price paid for the land. So in a falling housing market, lower land *values* limit the supply of new homes. This is the land market trap, [which is the major constraint on new build rates](#). To break this vicious cycle and deliver more homes more cheaply, more land needs to be brought forward at reasonable prices.

There are various ways this could be done – including [garden cities, community land auctions and rural exception site policies](#) – which would enable new homes to be built cheaply. But if these homes are sold on the open market, they'll fetch the same high prices as similar existing homes, regardless of how little it cost to build them. Developers get higher profits, but we don't get any more affordable homes. Similarly, if the homes are sold cheaply the first buyers would be able to cash in immediately by selling them at the open market price. Either way, the benefit from public intervention to lower the price of that land is lost. Land prices on other sites stays high, and development remains constrained.

To prevent this happening, we'd need *all* house prices to come down to the level that cheaper land could achieve. But a wholesale house price crash of that magnitude would be disastrous for many mortgaged homeowners, banks and developers alike, and could torpedo the economy. Perhaps what's needed instead is a mechanism for building new homes on cheap land, selling them cheap and then keeping the price of them stable at an affordable level, which means keeping them insulated to some degree from the second hand market.

Social housing can have this insulating effect, as it remains outside of the market: social rent levels can remain far below private rents, while still covering the cost of management and maintenance and paying off the debts incurred in its construction. But the current model of funding social housing relies on cross subsidy from the profits from selling private homes. So when the private market busts, the supply of social housing falls too, meaning that it can't provide a counter-cyclical source of stable demand.

Shared ownership attempts to bridge that gap, and is now home to 1 million people. This is almost a proper sub-market sector but the lack of real tradability in a second hand market means that few of these homes are resold for shared ownership, as owners usually have to staircase out to full ownership before selling. Again, the value of the initial subsidy is lost as the home reverts to the price set in the existing homes market. And when prices are set in the second hand homes market the land market trap applies and overall development levels stay low.

One way out of the trap might be to develop a genuinely affordable new sector, rather than subsidising affordable

homes which quickly cease to be affordable in the existing market. Homes could be provided at well below market rates on cheap land, and could then be bought and sold – but only at prices reflecting the cost of building them, not what they could fetch on the open market. The value of the intervention that got them built in the first place would not be lost, and a permanent middle market of tradable lower cost homes would emerge. This in turn would help prevent land market volatility from restricting the overall amount of homes built.

Restricting the resale value of homes built like this is not impossible – it's the standard model for Community Land Trusts in the US, and [a similar model is used by Pocket](#) here. It feels pretty fair to most people: you get to buy a home at a discount, but pass that discount on when you come to sell.

Providing lots of restricted price homes could offer people what they really want: a home they can buy at a price they can afford. But it would also provide the mechanism for ensuring that the land market interventions we need to radically boost supply were sustainable, and support a step change in house building in all sectors.

*Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our [comments policy](#) before posting.*

### **About the Author**

**Toby Lloyd** has worked in housing policy across the public, private and voluntary sectors for ten years, and joined Shelter as Head of Policy in 2011. Previously he led Navigant Consulting's policy and strategy division, where he advised local and national government and the private sector on housing, planning and regeneration. He has been a senior policy manager for the Greater London Authority, a project manager for the London Rebuilding Society, and taught financial history at LSE. In his spare time he is part of the Hackney Cohousing Project, a community led scheme seeking to develop fifteen homes in a mixed tenure, multi-generational neighbourhood.