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Housing Policy and the Changing Tenure Mix

Introduction

Housing is once again rising up the political agenda. The Ipsos Mori Issues Index in March this year suggested it is now the fourth most important issue facing Britain - its highest position since 1974 and massively higher than in 2010 (Ipsos Mori, 2018). This concern is reflected particularly in government policy to ensure a massive increase in new house building; but also to provide more social housing; to improve access to owner-occupation; and more generally to help younger people find affordable homes. In other words housing policy is expected to solve the housing problem by a range of interventions involving planning, modifying the construction process, taxation and specific initiatives to support consumers and providers.

Yet this avoids the question as to whether housing policy is actually capable of addressing these issues - given the economic and political environment and, in particular, the accretion of existing policies in which it has to function. In this paper we look at some of these questions - looking first, at who actually determines policy and then at three examples - of the limitations of policy intervention in the face of market pressures, notably in the context of taxation; of its inconsistency with respect to the messages it sends to stakeholders; and the impact of particular initiatives to expand new supply and support owner-occupation.

A starting point is the Government's 2017 Green Paper 'Fixing Our Broken Housing Market' (DCLG, 2017) the title of which in itself raises three issues: is it broken; how is it broken; and will the emphasis on new build actually fix it. First, it is almost certainly still the case that the vast majority of households are happy with their housing conditions - although the question is no longer asked on a regular basis. Importantly the Ipsos Mori survey shows that concerns are very much stronger in London and to a somewhat lesser degree in the South than in the Midlands and the North. This suggests that the concerns in many parts of the country are more related to affordability and access than to new build as such. Moreover the econometric evidence shows that any levels of new build that are within the range of possibilities will have relatively little direct impact on house prices and affordability - hardly surprising seeing that new additions have accounted for less than 1% of the total stock for decades.

Who Makes Housing Policy?

One big issue for housing policy is who is in charge? Housing policy is technically the remit of the Ministry of Housing, Communities and Local Government. But any policy that involves taxation or subsidy needs at least the agreement of the Treasury - and indeed is often led by them as for instance is the case with respect to Help to Buy which was first announced in the 2013 Budget by George Osborn. Equally any policy which involves lending or interest rates is part of the monetary policy remit of Bank of England – so access to mortgage finance for instance is significantly determined by their views on overall financial stability with regulations implemented through the Prudential Regulation authority and the Financial Conduct Authority. The National Infrastructure and Projects Authority is a non-Ministerial Department set up in 2016 is as its name implies in charge of major initiatives many of which involve large scale housing development. The Department of Work and Pensions plays a key role in housing affordability through the housing benefit system as well as by exercising significant control over rent setting in the social sector. Other spending Departments, such as the Department of Business, Energy and Industrial Strategy, also impact directly on the ministry's capacity to implement housing policy. Given this range of interests it is hardly surprising that policy can seem incoherent and indeed inconsistent. It is also one reason why the White Paper concentrates so heavily on new build (which is firmly within their remit) but says little about the many other factors which help determine whether the housing market functions effectively.

The problems are made worse by the accretion of housing policies that has occurred over the years. The Housing Policy Review published in 1977 (Dept of Environment, 1977) had the remit to attempt to simplify the system. It failed and was all but swept away by the IMF crisis of 1976 when housing had to accept significant cutbacks. Since then there has been regular attempts at making the system more coherent, but these are often impeded by other Departments' priorities as well as by the need to be seen to be doing something.

Perhaps most importantly, more general economic and social/cultural factors may actually be stronger than any policy initiative - so policy makers are often in the position of fire-fighting especially when there is a financial crisis or being behind the curve when new and unexpected trends appear unexpectedly.

Here I concentrate on three examples. The first looks at how market factor have dominated; the second how other priorities can generate further policy incoherence; and the third how specific policies may generate different outcomes from those expected at the inception of the policy.

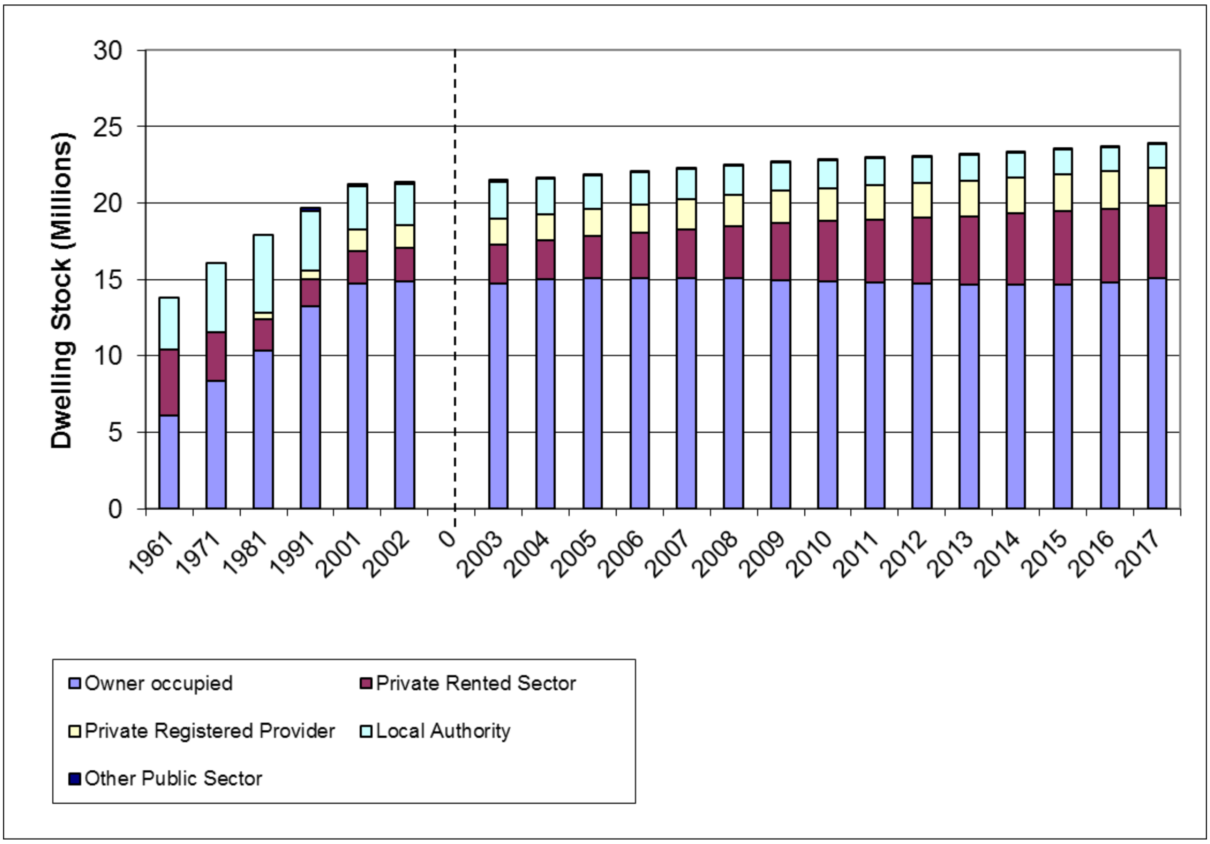
Example 1: the growth of the private rented sector since the turn of the century.

In 1961 some 30% of all dwellings in England were privately rented. Over the next thirty years the proportion declined to just under 9% of all dwellings with the sector being seen as playing a residual role for those with accommodation related to employment, some younger and more mobile households and those who could not enter either owner-occupation (Bovaird et al, 1985; Whitehead and Kleinman, 1986). Importantly many economists saw private renting as an inferior good – with both owner-occupation and social housing offering much better value for individual households – to the point where many commentators thought it would almost disappear.

Yet, as it obvious from Figure 1, in fact the proportion of dwellings that are rented privately started to rise from 1991 first quite slowly but more rapidly after the introduction of the Buy to Let mortgage in the late 1990s. In 2003 when data were revised in the light of the census, private renting accounted for 11.8% of the total stock. Thereafter the private rented sector stock increased from a little over 2.5m to 4.8m - and thus from around 12% to almost exactly 20% by 31st March 2017.

How did this process occur – especially given that almost no new housing has been built directly for private renting? Between March 2003 and March 2017 more than 1.35m units were completed in the private sector – mostly for owner-occupation. Over the same period, the total number of owner-occupied dwellings increased but by only just over 300,000 (resulting in a reduction in the percentage of the total stock which was owner-occupied from 69% to 63%).   In the social sector 330,000 units were built, but the stock declined by 110,000 (20% reduced to 17%). Thus basically while new build was concentrated in the majority sectors the dynamics were basically that they were building for the private rented sector!

Figure 1: Dwellings by tenure: England



Source: MHCLG live tables

Importantly similar patterns were observed across the country as well as in Wales and Scotland – all that has differed is the starting proportion. In particular it is NOT just a London phenomenon – there was of course more to start with but the rate of increase has been fairly similar (Whitehead et al, 2018).

Importantly the rapid growth in the private rented sector was hardly noticed by government policy let alone predicted by policy makers. The major Green Papers of 2000 and 2007 (DETR, 2000; DCLG, 2007 did not really mention the PRS. The Department did provide broad terms of reference for an an independent review in 2008 (Rugg and Rhodes, 2008) some of which was taken forward in the 2011 Housing Strategy (HM Government, 2011 – note not CLG). Thereafter, the Department set up a review chaired by Sir Adrian Montague (Montague, 2012 which recommended a private rented sector taskforce concentrating mainly on brining institutional investment into the sector. Thereafter this has led to polices around both subsidy and guarantees and the development of a Build to Rent model which is only now beginning to add significantly to the housing stock (British Property Federation, 2017). Overall, therefore positive policies have come very late to the party.

However the growth of the private rented sector has been in part an unintended consequence of other policies, including:

- The Right to Buy has transferred almost 2 million dwellings into the owner-occupied sector private rented sector since 1980. But over the years many of these dwellings, especially those located in poorer quality accessible areas, have been transferred into the private rented sector. Current suggestions are that around 40% of right to Buy homes now being privately rented;
- Reductions in the availability of social rented housing have led to increasing numbers of lower income households becoming private tenants. This in turn has led to a massive increase in the housing benefit bill. Indeed while the proportion of private tenants in receipt of housing benefit has been relatively stable at 20% of all private tenants. However this implies a very large increase in the numbers claiming benefit to the point where the sector accounts for about 40% of the £24bn budget;
- Regulatory changes together with relative stagnation in incomes and insure jobs among younger households has meant that many potential owner-occupiers are being excluded from the sector even though they could well afford to buy.
- In this context the median first time buyer is paying around 17% of income in capital and interest payments. The equivalent figures for private tenants are between 35% and 40% depending on whether housing benefit is treated as income. This gap is indicative that many households are being excluded from entering owner-occupation putting further pressure on the private rented sector.
- Importantly regulatory requirements include a stress test on monthly payments which means that potential mortgagors must show that they can cover at the time of purchase a 3% increase in interest rates - way outside any macro-prediction of interest rates by either the Bank of England or other central banks. Together with uncertainties in the job market and the costs of private renting while people try to save up for the large deposits required because of the relative lack of high loan to value ratio mortgages mean that large numbers of those who could afford to pay for owner-occupation are excluded (Whitehead and Williams, 2017).
- The impact of the government's quantitative easing policy, as in most other countries, has had a major effect on asset prices – which has fed through to house prices in part because of the lack of alternative investment opportunities for many households.
- More fundamentally the Bank of England's core role is to stabilise the overall financial system. If this means that housing suffers that is to a significant extent not something that they can worry about.

Example 2: Policy inconsistency: taxation and its impact on tenure choice

This topic could fill many books but here we look briefly at two issues: the relative taxation position between tenures and the differential impact of stamp duty on private landlords.

Originally owner-occupation was treated as an investment good, with taxation based on net income including mortgage tax relief and the taxation of imputed income. In the 1960s however the tax on imputed income was removed and capital gains tax was introduced but not for the primary home. On the other hand from 1969 there were increasing constraints on mortgage tax relief until it was finally abolished in 2000 – at which point owner-occupied housing became a consumption good for taxation purposes. In addition there have been subsidies to enter owner-occupation including for instance shared ownership and rent to own both of which involve below market rents and currently Help to Buy – see below)

Private renting on the other hand has historically been treated as an investment good with taxation based on net income. However, as compared to other countries there is no depreciation allowance as property is perceived by the taxation system to be a perpetual asset (see Whitehead et al 2016 for an assessment of relative taxation across four European countries) so it is reasonable to argue that private renting in the UK is particularly badly treated.

This was the position until the Treasury decided that from April 2017 mortgage tax relief for individual landlords should be limited to the standard rate of tax phased in over four years. At the same time allowances for wear and tear expenses for furnished lettings have been cut and there is a shift from net to gross rental income when determining the tax rate to be charged. This puts individual landlords at a considerable disadvantage as compared to company landlords as well as owner-occupiers. The policy change was rationalised on the grounds that Buy to Let landlords were outbidding potential owner-occupiers for property suitable for first time buyers and that the expansion of Buy to Let mortgage debt could increase the risks of market volatility. The result however is to produce an even more inherent taxation framework across tenures and indeed types of owner.

A second major issue is the inefficiencies associated with stamp duty land tax (SDLT) – as well as again its differential impact on different owners. Stamp duty is regarded as a bad tax by almost all economic commentators in that it reduces the incentive and capacity to move to more productive jobs and to adjust housing consumption to people's changing circumstances (see eg the reports by Henry et al in 2010 for Australia and Mirrlees et al, also in 2010 for the UK). However it is now charged on some two thirds of all residential transactions and has been an increasingly important of tax revenue over the last decade as rates have risen, transactions have increased and house prices have risen. In the financial year 2016 - 2017 SDLT, brought in some £9.3 bn from residential sales more than double the take in 2011/2012. Over 50% of these receipts come from London and the South East where the costs of immobility are likely to be greatest.

Importantly from the point of the impact on tenure choice and investment the government introduced an additional dwelling supplement of 3% on second homes and buy to let properties in April 2016. Some 46% of residential receipts in the first quarter of 2018 came from 'additional' dwellings with over 40% of that coming from the 3% surcharge.

Finally in terms of tenure differentials from November 2017 first time buyers were given additional relief by which those buying properties at less than £300,000 pay no tax while those buying at under £500,000 only pay 5% on the portion over £300,000. This again favours owner-occupation over other tenures.

All these differentials distort the market and in particular reduce the individual landlord's incentive to provide rented accommodation (Scanlon et al, 2016; Scanlon et al, 2017). More generally they give the impression that revenue raising is far more important than rationality – and all these changes are brought in by the Treasury who inherently have a wider range of objectives than simply ensure adequate provision.

Example 3: direct assistance for new build and owner-occupation

Direct assistance for housing is now almost entirely limited to supporting new building – in line with the government's emphasis on increasing net new additions to 200,000 until 2020 and up to 250,000 thereafter. The only exception is transfers at below market price from the social sector.

The two biggest schemes are shared ownership and now Help to Buy. Shared ownership is a long running scheme introduced by local authorities in London and Birmingham in the 1970s (as the Half and Half scheme) and introduced by central government in 1980. It was and is a part purchase (initially usually 50%) part social rent model normally with the right to 'staircase' up to 100% ownership. It has filled a gap in the lower end of the market and has generally been much liked by purchasers. However there have been continuing problems with respect to the cost of mortgages and the security available to lenders; the capacity to re-sell in the market. It has involved relatively little direct subsidy notably because it counts as affordable housing in the context of S106. Perhaps the biggest issues have been on the supply side where housing associations in the run up to the financial crisis did not recognise the risks they were taking on. The current government has provided significant support for the scheme and there are now new entrants into the funding market. As such, despite some issues, it has been one of the more successful initiatives- long lasting; liked by consumers; undoubtedly a bit too complicated; and difficult to scale up. But by policy standards it is fine.

Help to Buy was introduced in 2013 for 2 purposes: to support owner-occupation (not restricted to first time buyers) and to support new housing development. It has been heavily criticised for being a demand led product aiming at expanding supply. However perhaps this makes more sense than in other contexts because the speculative development model which dominates in the UK is itself demand led – so it plays to the market (Letwin, 2018). It was introduced in 2013 when the market was already slowly picking up – but developers were reaching the end of their capacity to provide funding for part equity products such as First Buy. The 2015 evaluation suggested that maybe 40% of those who purchased would not have been able to buy a new build product at the time of purchase leading to perhaps a 15% plus increase in new private completions (Finlay et al, 2016). On that basis there is clearly considerable deadweight loss and some upward pressure on new build prices (notably because the only government assistance available is now for new build). However it has done 'what it said on the tin' – expanded output considerably; helped purchasers to buy by reducing loan to value ratios and deposit requirements and notably increased confidence among both developers and purchasers. The main issue at present is how to maintain these benefits while enabling the market to return to normal.

Partial equity products have been favoured by the Bank of England for many years as a means of reducing and sharing risk. The Help to Buy product means that government bears a proportion of the risk especially in the early years but also can be expected to make a reasonable return as long as there is general inflation – even if real house prices return. One question for the future is whether such a model could become self-sustaining – gaining the risk sharing benefits at the same time reducing the distortionary impacts.

Underlying this discussion of specific products is a more fundamental question of why support home ownership rather than rental which can at least in principle manage risks more effectively than owner-occupation. There are longer term benefits to government in that people should be able to pay for their own housing in older age as well as the simple fact that the majority of people want to be home owners once they are a settled family, location and job. But fundamentally this is a political decision.

Concluding comment

Housing policy has always been a mess, partly because it is affected by some many different factors at the same time as being extremely important to everyone individual in society. The current emphasis on new build makes sense if investment can be significantly increased simply because it provides more housing. However prices are determined in the whole market and affected in particular by the health of the economy as well as household income growth. New build will therefore have very little impact.

In the last few years – and we are talking two or three- Build to Rent and Permitted Development have made significant impacts on the new build market. The first has been market led but supported by government; the second involves identifying development that does not require individual planning permission. Both, especially permitted development, have their costs and issues around how much they can effectively be scaled up. Policy could be tuned to address them more effectively. So despite the many concerns raised in this paper around how policy continues to develop there are some hopeful sign.

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