HOW TO FIX THE HOUSING CRISIS: TAKE LAND SERIOUSLY

POLICY BRIEFING

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SUMMARY

The government's Housing White Paper is set to join the decades of policy interventions that have failed to fix the housing crisis because they do not seek to address the broken land market and its role in an increasingly unequal economy. The government's ambitions to reduce the dominance of speculative development of new homes and strengthen the role of planning are welcome. But countervailing policies to hand over ownership of public land to private developers and continue to prop up house prices with subsidised mortgages means these ambitions are unlikely to be fufilled.

Targets for building new homes will not be met if we continue to cede control over how land is used. Our research[1] shows that the government's insistence on selling off public land is fuelling the affordability crisis:

- Only **one in five** of the new homes forecast to be built on public land and sold off are likely to be classified as 'affordable.'
- As little as **6%** of new homes are likely to be social rented housing, and in some cases developments comprise solely of luxury properties.
- New homes on formerly public land are dramatically behind schedule. At the current rate, the government's target of building 160,000 homes by selling off public land will take until 2032 to achieve, **12 years later** than promised.

In this briefing we highlight the role of land in the economy and its impact on the housing crisis. We provide a series of recommendations designed to put land to better public use and to start to break the housing market's dominance over our economy. These include:

1. **Halting the public land sale** and retaining land for public or community ownership and the development of homes suitable to community needs
2. **Genuinely strengthening compulsory purchase powers** allowing councils to acquire land at the existing value and retain land value rises for public benefit
3. **Establishing a national land bank** responsible for purchasing, developing and leasing land for residential and commercial use

The arguments and recommendations are explored in more depth in our book, *Rethinking the Economics of Land and Housing.*

1. WHY HOUSING POLICY IS FAILING TO FIX THE CRISIS

The title of the recent Housing White Paper – *Fixing our broken housing market* – suggests a new urgency to government policy, but it is only the latest in a long line of strategies and initiatives promising to solve the housing crisis. All have failed for the same fundamental reason. For decades now we have failed to address, or even understand, the role of land in the economy.

In this section we highlight the role of inflated land values in incentivising the development of poor quality, unaffordable homes and negatively impacting our living standards. In section 2 we provide a series of recommendations to address this.

We're ceding more control over the land market

As we enter Brexit negotiations, new private housing supply is likely to falter further as firms suffer increased material costs for their imports, skills shortages and uncertainty over the sale price of their projects. In the midst of this uncertainty, the government is continuing to pursue its policy of selling off land owned by government departments, such as the Department of Health, Ministry of Justice and Ministry of Defence, to stimulate the development of 160,000 new private homes by 2020.

This approach to boosting new housing supply through privatising land is, however, dramatically failing. Our analysis[2] of government statistics reveal that:

- Only one in five of the new homes to be built on public land sold off are likely to be classified as 'affordable.'
- As little as 6% of new homes are likely to be social rented housing, and in some cases developments comprise solely of luxury properties.
- New homes on formerly public land are dramatically behind schedule. At the current rate, the government's target of building 160,000 homes by selling off public land will take until 2032 to achieve, some 12 years later than promised.

Releasing land into the private market is not delivering the quantity or quality of homes required at prices that are affordable for most people. As more land is sold, there is less opportunity to reverse these trends.

Despite welcome proposals in the White Paper to improve the power that local authorities have over land acquisition – for example through encouraging "a more active use of compulsory purchase powers to promote development on stalled sites for housing" – in areas where land values are inflated this power will be largely benign if the council cannot purchase the site for a reasonable fee. The proposed £45m Land Release Fund has the countervailing aim of accelerating the privatisation of local authority land, and could be redirected towards aquiring more land for the development of new, affordable homes.

The role of the land market in the housing affordability crisis

House price volatility is primarily driven by land values, as economic growth and a rising population increases demand for a resource that is inherently fixed in supply. The value of a property is made up of two distinct components: the value of the building itself and the value of the land that the structure is built upon.

Determinants affecting land value include:

- Public investment in infrastructure increases the value of land by increasing the range and quality of uses it can be put to. New transport links, or being in the catchment area of a good school, dramatically affect the market value of homes in that area, because they boost the locational value of the land underneath those homes.
- Inflated land and housing values distort investment decisions as they encourage those with capital to over-allocate it to land and property purchases, rather than other productive uses such as housebuilding. The permanence and inherent scarcity of land make it a highly favoured asset for speculation. For similar reasons, land is also an excellent asset to act as security (or 'collateral') for extending credit and finance.
- Today most land and property is purchased with the support of mortgage credit. This involves banks creating new money[3] against, in the majority of cases, an existing asset (a property) which naturally can result in asset-price inflation. If left unchecked, a liberalised financial system can create a positive feedback cycle between the supply of credit, land and property values and the wider economy, resulting in destabilising booms and busts.

Inflated land values incentivise development of costly, low-quality homes

Because land acquisition is usually the largest single cost in a new housing development, the price that the developer pays determines much of what happens on site. In a competitive market for land, the developer that makes the most bullish expectations of sales prices will typically be able to offer the landowner most and secure the site. This drives development towards lower construction costs and higher densities – meaning smaller, poorer-quality homes.

Despite the poor quality of many new homes, prices are maintained by demand coming from both first-time buyers and multiple homeowners, propped up by successive government policies to incentivise home purchase. As first-time buyers are increasingly priced out of the new homes market, policy incentives to subsidise ownership run the risk of supporting a further concentration of property wealth among existing property owners. An evaluation of the Help to Buy equity loan scheme revealed that 57% of those using the scheme could have in fact afforded to buy a property anyway without assistance, with 18% already owning one or more homes.[4]

The Housing White Paper fails to offer solutions to land price inflation. Despite encouraging "local authorities to take action against those [developers] who do not build out once permissions have been granted over land use" new powers are needed to substantially improve public control over land use and valuation. The extension of policies that prop up excessive demand for homeownership, such as the Help to Buy equity loan which has a further £8.6 billion committed until 2021, will continue to inflate values.

Inflated land values impact our living standards through rent increases

Land values play a key role in determining standards of living and the distribution of income and wealth. Because land is fixed in supply but essential for all economic activity, landowners can command returns from those who must use their land based purely on their ownership of it, unrelated to any efforts they have expended. This extraction of economic rent seems intuitively unfair to many but it is also economically inefficient.

In its simplest conception, as the economy grows, landowners can increase the rent they charge non-owners to absorb the additional value that their tenants (such as private renters and businesses) generate, meaning that:

- Soaring land and housing costs can end up absorbing the majority of people's incomes resulting in less spending back into the economy
- Businesses are burdoned with high rental charges and property taxes reducing their resilience to economic shocks and inhibiting their ability to invest.

The Government has responded to the spiralling rents in the private rented sector with a proposal to encourage longer tenancies of up to three years, as well as a ban on letting agency fees.

In addition to these measures, the White Paper proposes a £1bn Build to Rent Fund which aims to "attract major institutional investment in new large-scale housing which is purpose-built for market rent." We welcome this proposal in principle. However, the new model of submarket housing proposed to encourage uptake of Build to Rent, "Affordable Private Rent", proliferates a faulty measure of affordability based on market rent levels, rather than incomes. The use of this measure will allow developers to side-step their planning obligations for social housing and cut out the involvement of registered housing providers, such as Housing Associations.

In addition, the terms set out for the new rental model suggest that the selection process for the allocation of the sub-market units will be left to the developer, with no involvement of the local authority or local community. This further ceding of public control to private housing developers, whose primary interest, entirely rationally, is profit margins, is likely to worsen the structural drivers of rent inflation whilst underpinning the return for the developer. As house and land prices continue to climb, rents will continue to rise for the captive market of private tenants.

2. WHAT NEEDS TO HAPPEN?

Solving the 'land problem'

To solve these problems and to create a fairer, more efficient and more sustainable housing market, the special characteristics of land need to be recognised.

The 'land problem' is not something that can be addressed by any one 'big bang' policy solution on its own. Most of the policy levers open to governments have long time lags, and interact with each other and the property market they seek to influence in unpredictable fashions. Solving the problem requires a multi-pronged approach, encompassing ambitious reforms to ownership, tenure, planning, taxation and financial regulation.

Below we set out six key objectives which any package of reforms should seek to achieve. We also include relevant policy recommendations to help achieve these objectives.

Objective #1: Make housing supply less dependent on the volatile private market in land and homes

- Recommendation 1.1: Halt the public land sale and retain the freehold in public or community ownership, or as a long term equity stake that allows local authorities to ensure any homes built are designed to meet the needs of local communities. Rather than focusing solely on the sale value, prioritise developments that offer the best long-term value for the land, through achieving wider social benefits.

- Recommendation 1.2: Boost the stock of non-market housing, including homes with social rents and community-led schemes (such as community land trusts and mutual home ownership), to ensure that different housing types and sizes are available in all tenures and to make housing supply less dependent on the private market.

- Recommendation 1.3: Promote restricted sale tenures which give occupiers full ownership rights but restrict the value at which they can sell their homes when they choose to do so. Such models are useful for providing subsidised homeownership while ensuring that the subsidy is preserved for future occupiers, rather than being captured by the lucky first beneficiary of the subsidy.

- Recommendation 1.4: Make the private rented sector more secure, with longer guaranteed tenancies, limitations on rent rises and stronger tenants' rights. The affordability of rental housing should be calculated according to local incomes, rather than local market levels, in recognition that rent levels in the UK's unregulated rental market are driven by inflated land and property values.

- Recommendation 1.5: Give planning authorities more resources and stronger powers of plan-making or zoning so that they can become effective 'market makers' rather than 'market stiflers'. Authorities should be empowered to decide what land can be used for, providing the certainty and preconditions for investment that private markets need. There is evidence from European cities, for example in Germany and the Netherlands, that when planning authorities have been given more legislative power and financial support, better results have been achieved in terms of development quality and more sustainable local economies and built environments.[5]

Objective #2: Capture uplifts in the value of land for public benefit

- Recommendation 2.1: Genuinely strengthen compulsory purchase powers to enable the state to capture land value uplift for reinvestment in infrastructure and services. Improving the ability of the state to buy land at closer to existing use value, so as to enable much greater land value capture, would be a powerful tool for reducing landowners' ability to extract economic rent, even if the state does not actually use its powers to capture the uplift directly.

- Recommendation 2.2: Examine the case for introducing a land value tax on the market value of unimproved land to capture the unearned windfalls from collective development for the state and wider community. This should be introduced as a replacement for other taxes such as council tax, thereby offsetting the burden on households, and phased in gradually over an extended period of time.

- Recommendation 2.3: Establish a national land bank, responsible for purchasing, developing and leasing land for residential and commercial use, acquiring idle and vacant land for resale, and developing new towns. A land bank would use public money to buy land without planning permission and then lease or sell land to private developers at development prices following the grant of planning permission. As well as being a source of land release for housing and other development, the increase in land values would provide significant sources of revenue for the government, as currently happens in South Korea and Singapore.

Objective #3: Establish new sources of low-cost finance for the construction of new housebuilding

- Recommendation 3.1: Introduce reversionary tenures (time-limited leases) to match up the investment needs of financial institutions like pension funds with social needs for low-cost rental housing. In this model, a pension fund finances social housing construction on land acquired from a local authority; the local authority then leases the homes back from the pension fund for a period of 25–50 years, paying a guaranteed inflation-indexed rent for the duration. Retaining the freehold gives the pension fund sufficient security on its investment, and the lease agreement gives it the long-term income stream it needs. At the end of the lease period the pension fund can gift the land back to the authority, as it has achieved its goal of investing capital to secure long-term income.[6]

- Recommendation 3.2: Establish a state housing bank to raise large amounts of finance and make it available for new house building. Such banks are commonplace in Europe and play a key role in funding both affordable homes and the large-scale infrastructure that is required for new housing developments.

Objective #4: Level the playing field between tenures so that people are not incentivised to overinvest in homeownership

- Recommendation 4.1: Scale back taxation policies that favour homeownership over other forms of tenure. This should involve the gradual abolition of capital gains relief on primary residences and the transferable main residence allowance for inheritance tax.

- Recommendation 4.2: Scale back subsidy policies that favour homeownership over other forms of tenure. This should involve a review of the various initiatives which have been introduced over the years to subsidise the cost of home purchase via help-to-buy schemes, equity investment, mortgage guarantees and most recently a 'Help-to-Buy ISA'.

Objective #5: Reduce reliance on the housing market as a way of accumulating wealth and paying for retirement

- Recommendation 5.1: Ensure the availability of stable investment alternatives and secure pensions so that households are less prone to invest in the housing market to pay for their retirement, or to rely on it to fund their care in old age.

Objective #6: Break the positive feedback cycle between the financial system, land values and the wider economy

- Recommendation 6.1: Review bank regulatory capital requirements to reduce the strong favouritism shown towards property lending. Regulations should instead support banks that are able to de-risk their loans via methods other than land-based collateral, most obviously via the building up of long-term relationships with non-financial businesses.

- Recommendation 6.2: Examine possible structural changes to the ownership and function of the banking sector to support business lending over property lending. One option would be to establish a network of interconnected, mutually supporting local stakeholder banks, modelled on the German public savings bank model, through the transformation of the taxpayer owned Royal Bank of Scotland (RBS).

- Recommendation 6.3: Promote new forms of financing for home purchase where the risk of house price depreciation is shared with the lender. This could involve the use of Islamic finance mortgages where resident households and banks become the joint owners of a property until it is fully repaid by the resident. Similarly, 'shared responsibility mortgages' would involve mortgage payments falling in value with the house price, but lenders would gain from any increase in the house price if the home is sold. Institutional investors with long-term liabilities, such as pension funds and insurance companies, may be in a good position to agree to these equity-like repayment contracts given their long time horizons.

The arguments and recommendations are explored in more depth in our new book *Rethinking the Economics of Land and Housing* http://neweconomics.org/2017/02/britains-housing-crisis-get/

In particular, the final chapter of the book lays out the solutions proposed above in greater depth with extensive references.

We are preparing a discussion paper outlining a modern land reform policy that seeks to build on the recommendations made here, specifically the practices of community land trusts, public land leases and land value tax theory. Please get in touch via the contact details below if you are interested in discussing this with us.

ABOUT US

The New Economics Foundation is a think tank formed in 1986 which aims to build a new economy where people are really in control. It aims to forge new partnerships with institutions with real power ranging from devolved government and city mayors, business and trade unions, communities, campaigns and movements. The Foundation's programmes include work on housing, reform of the financial system, the future of work, democracy and devolution and climate and environment.

The New Economics Foundation's work on housing is supported by the Nationwide Foundation, an independent charitable funder which aims to increase the availability of decent, affordable housing for people in need. A key part of the Nationwide Foundation's strategy is backing community-led housing to increase the number of available homes. To help achieve this, the grant given to the New Economics Foundation will increase access to land and properties currently not used as homes. Find out more: www.nationwidefoundation.org.uk or follow @NationwideFdtn

CONTACT

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Endnotes

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[1] See *Selling public land is making the housing crisis worse – new research* (New Economics Foundation), available at: http://neweconomics.org/2017/03/selling-public-land-making-housing-crisis-worse-new-research/?_sft_latest=articles,campaigns,coverage,events,podcasts,press-releases,videos

[2] See *Selling public land is making the housing crisis worse – new research* (New Economics Foundation), available at: http://neweconomics.org/2017/03/selling-public-land-making-housing-crisis-worse-new-research/

[3] McLeay, M., Radia, A. and Thomas, R. 2014 'Money creation in the modern economy', *Bank of England Quarterly Bulletin* 54(1)

[4] See *Evaluation of the Help to Buy Equity Loan Scheme*(DCLG) available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/499701/Evaluation_of_Help_to_Buy_Equity_Loan_FINAL.pdf p99

[5] Falk, Nicholas. 2014. Funding Housing and Local Growth. London: The Smith Institute; RTPI (Royal Town and Planning Institute). 2015. 'Planning as "Market Maker"'. RTPI Research Report no. 11, November. http://www.rtpi.org.uk/knowledge/research/projects/small-project-impact-research-spire-scheme/planning-as-market-maker/

[6] See *Flexible Rent White Paper* (HomeGroup & NEF) https://www.homegroup.org.uk/Media/News/Home-Group-news/Home-Group-launches-Flexible-Rent-White-Paper