DON'T BET THE HOUSE ON IT

No turning back to housing boom and bust

Toby Lloyd

compass

DIRECTION FOR THE DEMOCRATIC LEFT

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Toby Lloyd, April 2009

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Foreword

Housing policy is in crisis: 75,000 repossessions are forecast for this year; 5 million people are in need of social housing; and the private rented sector is riddled with abuse. The government recognises that we need an extra capacity – which is conservatively estimated at 240,000 new homes a year – we live longer, marry later, break up earlier and have to deal with the consequences of extraordinary demographic changes. Yet the supply of new homes is hopelessly inadequate – many experts assume there will be fewer than 80,000 new starts this year. The facts speak for themselves:

- In 2009 there are 1 million fewer social homes to rent than there were in 1979
- Almost 600,000 families are overcrowded
- The rate of replacement means that a new home built today must last 1,200 years
- The UK is more polarised by housing wealth than at any other time
- There are currently 3.8 million children in the UK living in poverty; without significant action to end bad housing for children, the government's target to halve child poverty by 2010 and end it by 2020 will not be reached
- Councils accepted over 57,000 families as homeless in 2008
- In England 67,000 families were living in temporary accommodation at the end of 2008

How did we get here and is there a way out?

Arguably the analysis of the housing crisis contained in this new Compass pamphlet offers the most comprehensive picture of the housing market and the failings of housing policy for many a year.

All roads lead back to supply and price. The picture that emerges from the pamphlet is one where the government thought it could condition the private sector to meet our housing needs. We bet the ranch on our ability to alter the economic model of the private housebuilders. We failed because the private sector model remains remarkably durable and it is one which rations housing so as to force up price and maintain profit streams.

Historically, the way that the state has sought to curtail the excesses of the private sector is through the maintenance of a mixed economy. At its peak hundreds of thousands of new council homes were built every year; successive governments knew the public sector had to take much of the strain. The contrast with today could not be starker. Latest figures show housing associations started building just 22,000 new homes across the UK in 2007/08.

Councils started just 680 (450 of these were in Scotland), effectively leaving the supply side to a housebuilding oligopoly. We must start to rebuild a genuine mixed economy in terms of supply. This document explains how we can do this. It is an economic and social imperative that this is done as a matter of urgency.

We literally need a new political economy of housing

But it is not just about supply. In order to build a more resilient market we also need to confront fundamental issues of equality, tax breaks and subsidies as well as the provision of mortgages and bank lending. We have to invest equitably in the existing stock. We have to rethink our approach to design and environmental standards. We must overhaul the regulation of the private rented sector. We must do so much more; we literally need a new political economy of housing.

Housing is central to the economic crisis. Sub-prime is not unique to the US; the housing economy has been the cornerstone of our consumption bubble – ever wilder financial products constructed and introduced to keep us shopping. Now the music has stopped; it is time to take stock. This document is one of the most important that Compass has produced. It returns to the fundamentals of housing so as to force us all to return to the very foundations of economic and social policy. It contains a series of policies whose time has come.

Jon Cruddas MP

The housebuilding industry is a classic case of market failure – as prices soared production failed to keep up, but when prices began to fall, output plummeted

Executive summary

Housing is central to the British economy, and to the current crisis we are facing. It is now clear that the housing market has failed. A housing market bubble was artificially inflated by reckless mortgage lending, while housing policies and subsidies encouraged ordinary households to take on dangerous levels of debt in order to get onto the housing ladder. The bubble created an artificial sense of wealth that was used to compensate for relative wage suppression and a declining pension system as it encouraged people to borrow more against rising paper values of their home. In housing we see most clearly the overarching political story of the last 30 years: risk that was once socialised transferred to the individual. Once, more secure employment and higher actual and social wages meant a less anxious life because risk was spread. Now labour market flexibility, declining real wages, lower deferred earnings (pensions) and decimated social wages have been compensated for by rising house prices. Until of course the bubble burst.

Housing supply is down to a record low, but has been inadequate ever since the state withdrew from meaningful housing provision in the 1980s, leaving housebuilding almost entirely to a private sector that failed to provide enough homes and seemed to build mainly for the benefit of buy-to-let investors. The housebuilding industry is a classic case of market failure – as prices soared production failed to keep up, but when prices began to fall, output plummeted. There is now no hope of reaching the target of building 240,000 new homes per year for the foreseeable future; worsening the long-term shortage of homes.

Even during the boom years the ever rising property market created serious problems of its own. Increasing asset wealth for some drove economic inequality higher while those in social housing became increasingly marginalised. Rising prices and inadequate supply created an affordability crisis that excluded millions of working people from the market. Many of those who did well out of the housing market found they had to withdraw equity to help their children buy a home or pay for previously free public services such as university fees. Placing all our eggs in the basket of rising property prices has exposed our economy to systemic risks, and left our homes and financial security at the mercy of a volatile market. Now that the bubble has burst it will be the most vulnerable who are hit hardest, as marginal home owners face losing their homes and ever more people join waiting lists for social housing. But millions of working and middle class households will also be affected by negative equity, unsustainable debt and inadequate housing.

Thatcherism used housing as a political vehicle. Thatcher's mantra was that "the economy was the means, the goal was to change the soul". The property owning democracy was the key method by which we were to become possessive individuals. There would be no such thing as society – just home and share owners, making their way on the basis of their own hard work, good fortune and brute luck. Home ownership and rising house prices provided the glue that held it all together. And it would have worked but for one inconvenient fact: bubbles always burst. The crash changes everything by exposing everything. Not least the illusory gains of rising house prices that fuelled consumption and compensated us with turbo-consumed lives that made us no happier, only more anxious and insecure.

Thatcherism got what it wanted: a less equal and more divided society. It is time to heal those divisions and reorientate the housing market – not by going back to a bureaucratic housing past but by using the crisis to build a new pluralistic housing future.

The roots of the credit crunch lie in the exotic financial instruments built on top of millions of ordinary people's mortgages, which were lumped up, sliced, repackaged and sold on in a dizzying spiral of financial abstraction. The resulting flow of easy credit sustained years of apparent growth, but in the process we lost control of the basic commodity at the bottom of the pyramid – our own homes. The debt fuelled gamble to spend as much as we possibly could has exposed millions of ordinary people to the dangers of casino capitalism.

The response to the banking crisis has been bold and dramatic, but the housing response has so far lacked direction and full recognition of the underlying causes. The answer to the systemic crisis of free market capitalism cannot be to try to get back to where we were two years ago – an unsustainable world of unrestrained, deregulated markets. People all around the world have abandoned the neoliberal mantra that the market always knows best – Gordon Brown himself has said that "laissez-faire has had its day".[1]

The same is true for the housing bust that is now upon us. The defenders of market fundamentalism hope that we can return to the status quo ante sooner or later. But the solution cannot be another unsustainable housing bubble. We must not replicate the last, lost decade of undersupply and growing waiting lists for social housing. We urgently need a new political economy of housing, one that delivers financial stability, environmental sustainability and social equality.

The question is now – where are we going? Will our response be to hunker down and wait for the market to return, or to seize the moment to transform our dysfunctional housing economy? Can we now use a different housing model to provide homes in which we want to live; can we junk the risk and wild speculation while allowing a different vision of the

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1 *Guardian*, 17 March 2007

good life and the good society to prosper and function? One in which aspiration and risk become more socialised and the burden and rewards shared? A housing market that is more equitable, more sustainable and that works for all of us? As ever, we need to intervene to make the market work effectively and save it from itself and its tendency to fail. More than anything we need pluralism, a balanced mix in both supply and tenure that can provide homes fit to live in, with real choices and security for all.

The public sector must step in to bring sites forward, retaining ownership to ensure a good return on public investment

Rapid intervention and investment is essential to keep supply going, preserve jobs and provide a fiscal stimulus to the economy. The 2020 Group's recent call for major public investment in social housing construction must be answered. More fundamentally, we need a new mixed economy in housebuilding – the current model of speculative private development is broken. To increase supply, reduce volatility and provide real choices to individuals we need to ensure real diversity in housebuilding, with councils, housing associations, community groups and co-operatives, smaller building firms and self-builders all contributing to a diverse and vibrant housebuilding sector. The public sector as a whole needs to rediscover the skills and confidence to lead the market and shape development by providing infrastructure and strong, strategic visions for the places we want to create. We should learn from positive examples of housebuilding in Europe and our own past: long-term public land ownership is the key to providing quality homes in attractive places. Land is now cheap, but the market will not develop it – the public sector must step in to bring sites forward, retaining ownership to ensure a good return on public investment. Regulation is necessary to ensure quality and environmental sustainability, and to improve employment practices in the construction industry.

But we also need to use the opportunity presented by the current crisis to reform the housing market for good and make housing booms and busts a thing of the past. A stable and socially equitable housing market is possible, one which provides real people with real options about tenure by offering high-quality private renting, social housing and sustainable, affordable home ownership. Improving the quantity and quality of rented and intermediate options is essential, but we also need to reform home ownership itself. To make home ownership sustainable and accessible to ordinary people we need to tame the market and begin to separate our need for decent places to live from our desire for financial investments. To prevent future bubbles and share the benefits of rising property values more equitably we need to look carefully at the tax system, which encourages excessive lending and borrowing to buy homes. Gradually replacing the regressive council tax and business rates with a modest land value tax would help stabilise the market and could remove the final vestiges of the poll tax. Allowances at the lower end and a right for pensioners to postpone some or all of their payments until their homes were sold would shift the tax burden away from ordinary households towards those with large amounts of landed wealth. We should start to shift taxes away from our effort and labour and towards taxation on unearned windfall gains like land values.

But a functioning housing market will require other innovations: we need to revive the New Town Development Corporations model to masterplan and deliver large developments; a public clearing house for homes would make the market operate more effectively; local authorities should be given real powers to build and direct housing development; a community right to buy would bring property back into use and build local community assets; and we need new rights for private tenants and the effective regulation of the mortgage market.

We all need a home to live in; this must be separated from any desire to speculate on complex and risky financial products. The vision of the good society is one in which everyone has access to a decent, sustainable home that meets their needs, where the risks and rewards of the market are fairly shared by society as a whole.

The crash provides a unique opportunity to start again. This crisis is too important to waste. Housing has been at the centre of the failure of our political economy for the last 30 years; there can be no turning back to housing booms and busts.

The problem: bubbles always burst

1. The political economy of housing

To a large extent, the housing economy is the UK economy: the value of private housing assets topped £4 trillion in 2007,[2] equivalent to almost three times GDP. Mortgage finance is the main source of both the money supply and the rising debt mountain, which reached £1.44 trillion in 2008.[3] All of us, including non owners, now spend more on our homes than ever before – having risen steadily for 30 years – housing costs are now the single biggest item of weekly household expenditure for the first time. As our main financial investments our homes are also our main source of wealth. As both state and private pensions have lost value and credibility, millions have had little choice but to rely on housing wealth to pay for their retirement.

Economists tell us that the 'wealth effect' caused by rising house prices is essential to sustain consumer spending. But it has been paid for with higher consumer debts, which we hoped would be paid off by further house price rises.

We bet everything on ever increasing house prices – and we lost.

The housing market is a crucial part of the macro economy, but it is also the main interface between the abstractions of the global financial economy and the real world of people's jobs and personal finances. Whichever way the housing market is going, we all need somewhere to live – but this most basic need is threatened by the unfolding financial crisis. The house price bubble and attendant debt crisis were the origins of this recession, and many of its worst effects will be played out in the housing economy. We bet everything on ever increasing house prices – and we lost.

2. The credit crunch and house price bust

When bubble markets burst the worst impacts are always felt by those least able to bear them. Those with least choice about where to live, who were actively encouraged to borrow too much or lured into the market at the peak, are now facing negative equity and the possible loss of their homes. Falling prices are good for those seeking to buy their first home – but the lack of mortgage credit and the sensible aversion to buying into a falling market is keeping first time buyer purchases at record lows. Falling interest rates will help those on

2 HBOS, 12 January 2008, www.hbosplc.com/media/includes/12_01_08%20_Value_%20of%20_UK%20_Housing%20fv.doc
3 Grant Thornton, August 2008, www.independent.co.uk/news/business/news/personal-debt-in-uk-exceeds-gdp-for-second-year-905461.html

tracker mortgages, but this will not save many marginal home owners as both repossessions and unemployment rise. An inevitable result of the bust will be growing homelessness and more pressure on social housing waiting lists. The rise of the BNP across the country is just one example of how competition for increasingly scarce social housing among those excluded from the market is likely to exacerbate social tensions and undermine community cohesion. With repossessions forecast to hit 75,000 this year, 5 million people will be waiting for a social home by 2010.[4] Unless change is enacted urgently they may have to wait a very long time: just as demand grows, the supply of housing is plummeting.

The collapse of housing production

From a very modest high of around 174,500 new homes (both public and private) built in England[5] in 2007 the number of completions fell dramatically to 142,000 in 2008 – and worse is certain to follow. Housing starts fell to 105,000 in 2008. For the next few years there may be as few as 60,000 new homes built each year. Compare that to the 230,000 new households forming each year, let alone the government's annual target of 240,000 new homes. Production fell dramatically during the last house price bust in the late 1980s and took a very long time to recover, growing at 1% per year for five years, then at 1.5% per year for another five. At the high point in 2007 housing supply was still not back to the 202,000 built in the previous peak in 1988. It is clear that the crisis of housing supply is set to worsen further. This time around there is good reason to fear that the slump will be even worse. The credit crunch is hitting developers at both ends, as demand dries up and development finance becomes scarce. The price bubble is also much bigger than that of the late 1980s, and the burst will surely be correspondingly harder. But there have also been important changes in the industry itself that make the pattern more pronounced and consequences even more severe.

Table 1 Share of housing output of the largest firms, Australia, US and UK[6]

Concentration	Australia	US	UK
Largest firm	3%	3%	8%
10 largest	14%	15%	44%
100 largest	40%	29%	70%

4 Andrew Sparrow, August 2008 www.guardian.co.uk/politics/2008/aug/08/economy.housing
5 The housebuilding figures throughout are for England, as UK-wide data is not directly comparable following the devolution of government housing functions.
6 Michael Ball, Firm Size and Competition, RICS Research, July 2008

First, the UK industry is far more concentrated than in the past, or in comparable countries (see table 1), with supply highly dependent on a few major companies that are now very exposed to the credit market following a series of heavily leveraged takeovers and mergers that created mega firms like Taylor Wimpey and Barratt. In the UK, the top ten firms now build 44% of all new homes, so even a small reduction by the majors can have a serious impact on overall supply.

To meet their obligations to shareholders and creditors, publicly quoted housebuilding firms have little choice but to scale back output and reduce costs in these difficult market conditions. Concentration also impacts on the industry’s ability to increase production once economic conditions improve, as the scale of the land banks held by the leaders makes it harder for competitors to enter the market to replace their output.

Second, the shift towards high density flats on brownfield sites has increased the industry’s exposure to financial shocks, and reduced its ability to bounce back rapidly. Such schemes require considerable upfront investment with long time-lags before any returns are made, a gap in cash flows which must be bridged with borrowing or by pre-selling homes before they are built. Few people buy flats in unbuilt inner city blocks because they want to live in them, but for a while the buy-to-let phenomenon came to the rescue. Investors were prepared to buy off plan without asking too many questions about what they were buying. At the height of the boom, 70% of new homes in London were bought by investors.[7] But unlike the purchases of owner occupiers, buy-to-let investors’ purchases are entirely discretionary. As soon as prices start to fall they stop buying, leaving developers with nowhere to go.

The severity of the current crisis and the exposure of the big housebuilders mean that many housebuilders may not survive at all. Their share prices have fallen to almost zero, and many are being kept alive only because their creditors do not want to crystallise the losses by foreclosing on their land assets, which are now worth far less than their balance sheets claim.

As house prices began to fall, in late 2007, developers began to rein in production and sought to sell more of the homes that were already in construction to the only buyer left in the market – the public sector. Affordable housing supply actually went up, both as a percentage and as an absolute number.

But this is only a short-term effect, because affordable housing is now largely dependent on cross-subsidy from the private sector. Under Section 106 agreements, developers are forced

7 Greater London Authority, *Who Buys New Market Homes in London?*, December 2006

to contribute affordable housing and other public benefits as the price of planning permission. Making the market subsidise social housing worked reasonably well during the boom years – but housing associations were exposed to the same credit markets as developers because their debt was kept off the public balance sheet – even though there is no essential difference between an association and a local authority borrowing money to invest in social housing construction. This was to meet the government's strict borrowing rules, which have been blown apart by a housing led crash.

Unfortunately this strategy relied on eternally rising property markets. When the market went into reverse, the Section 106 deals dried up. Associations now find it much harder to borrow, so only higher grants can sustain affordable housing delivery.

3. The deeper crisis in the housing economy

The heyday of housing production peaked at over 350,000 in 1968, based on a mixed economy of private and council housebuilding. Many smaller and regional building firms built both for the council and on their own account – a strategy which enabled them to see through difficult market conditions more easily than today's behemoths.

Over a series of cyclical peaks and troughs the trend has been relentlessly downward. Both public and private sectors responded to the economic shocks of the 1970s by cutting back, and in the 1980s the post-war mixed housebuilding economy was finally brought to an end. The Thatcher government ended the council-housebuilding programme and began the process of privatising the existing social stock under the right to buy scheme – over 2.2 million homes have been sold. Housing associations became the only source of new social housing, but have never had enough money to fill the gap left by the sale of council housing; 30 years on there are 1 million fewer homes in the social rented sector than in 1979.

Social housing has suffered chronic under investment ever since, because successive governments have placed restrictions on the public borrowing rules that largely preclude the high capital costs associated with housebuilding. These self-imposed accounting problems are not shared internationally: in most of Europe borrowing undertaken by trading entities within the public sector, including housebuilding, is not counted as part of the main measure of public borrowing.[8] Public housebuilding in the UK therefore suffers from the same unnecessary and self-imposed constraints as the Royal Mail or public transport.

8 Steve Wilcox, *UK Housing Review* 2008/09

The billions Labour has poured into repairing the existing social stock through the Decent Homes programme were a necessary palliative following years of underinvestment, and have made a huge difference to millions of households. But this investment did nothing to improve supply, and the overall amount of social housing continued to fall as right to buy sales outstripped modest housing association construction. Private housebuilding didn't fill the gap, leaving total supply in England to bump along between 130,000 and 175,000 per year from 1982 and 2007.

Figure 1 Housing supply and real house prices (adjusted for inflation) 1945–2007[9]

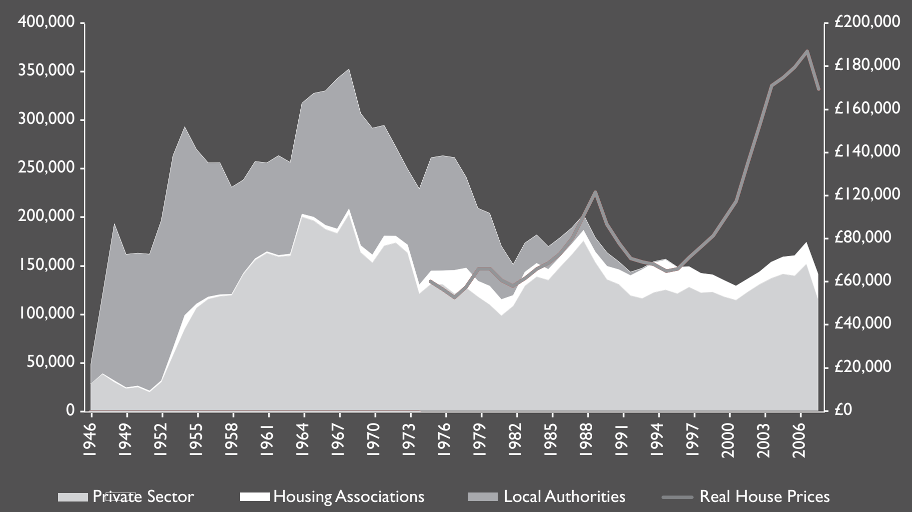

Figure 1 illustrates how the overall level of housing supply has been decided by the level of public sector provision. It shows how the market failed to make up the difference once council housebuilding stopped, and how supply has failed to rise with rocketing house prices in the era of market-led housebuilding.

The inadequate response of the private sector to the huge demand for new homes is a classic case of market failure. The housebuilding industry works on a cycle of land acquisition, securing planning permission, construction and sale – which John Callcutt's recent review of the industry called the 'current trader' model.[10] The costs are loaded at the front end of this cycle when the land must be paid for, and the returns do not come until

9 Communities and Local Government Live Tables on housing supply, Nationwide house price index
10 John Callcutt, *The Callcutt Review of Housebuilding Delivery*, November 2007, www.callcuttreview.co.uk/downloads/callcuttreview_221107.pdf

homes are sold towards the end. The high up-front costs and the length of time it can take to assemble a site, secure planning, design and build large housing schemes expose developers to the risk that the housing market will turn before the homes are sold. Developers are therefore under structural pressure to constrain overall housing production for fear of reducing sales values, a risk only partially offset by off-plan sales to investors. High risk means high level of returns are demanded by housebuilding firms, which generally operate on margins of over 20%, whereas the contractors that actually build the homes typically get around 8%.

While competition for land can be intense between the established players, high returns on capital mean there is little competitive pressure to innovate on the business model itself. The need to understand notoriously opaque land markets and the complexities of the planning process also make housebuilding an extremely difficult industry for new competitors to enter, reducing competitive pressure further. The result is a business model that does not deliver the homes we need, but is very difficult to change.

Under this model, competitive pressures tend to drive quality down rather than up. When supply is tight, credit plentiful and demand insatiable it is easy to sell almost anything. As the winner of the competition for new sites will be the bidder who plans to squeeze the largest number of homes onto the site for the smallest build cost, size and quality tend downwards. Britain not only has the second smallest new homes in Europe at an average of $86.9m^2$, but is also the only country in Europe, with the exception of Italy, where new homes are smaller than the existing stock and getting smaller.[11]

The quality is also questionable – a recent OFT study found that 40,000 serious complaints were lodged by the buyers of 180,000 new homes,[12] while CABE say that 82% of new homes are not well designed. Most damningly, fewer than half of new home owner occupiers say they would recommend their builder to a friend.[13]

Homes are responsible for at least 27% of the UK's carbon emissions,[14] but the take-up of energy efficient and renewable energy technologies in housebuiding remains slow. The Code for Sustainable Homes attempts to address this by requiring new homes to be built to steadily increasing environmental standards on a clear timetable. But the code is applied differently to the market and affordable housing sectors, being voluntary for private builders

11 National Board of Housing, Building and Planning, Sweden, and Ministry for Regional Development of the Czech Republic, *Housing Statistics in the European Union*, 2004
12 Office of Fair Trading, *Homebuilding in the UK – A Market Study*, September 2008
13 Callcutt review, quoting Housing Forum surveys of new home buyers
14 Brenda Boardman, *Home Truths*, November 2007, www.foe.co.uk/resource/reports/home_truths.pdf

until 2010, and even this generous treatment has encountered strong opposition from the industry, which is now claiming the downturn makes the code uneconomic.

For a generation, then, the market has not produced enough homes of high enough quality to meet our needs or those of the environment. By the turn of the millennium the backlog of undersupply had grown to worrying levels, and started to rise up the political agenda. When Kate Barker was commissioned to look into housing supply she found that the rate of replacement was so low that all new homes would need to last 1,200 years.

The affordability crisis

The policy drive behind the Barker Review[15] was not the lack of housebuilding per se, but the mounting affordability crisis. By the time Barker's final report was published in March 2006 the proportion of first time buyers had fallen to 31%, the lowest since Nationwide records began in 1983, while the average first-time buyer's price-to-income ratio had reached a record high of 4.8 and the average age of the first-time buyer had risen to 33.5.[16] In the overheated regions of the south of England almost the only people who could afford to enter the housing market at all were either the rich or those who received help from their parents.[17] The Halifax Keyworker survey in 2007 showed that nurses could afford a home in only 1% of UK towns and teachers could afford a home in only 22% of towns.

Market theory assumes that high prices are simply an expression of constrained supply – so the Barker Review put the blame largely on the planning system, and made some rather unrealistic proposals for local reserves of development land that could be released if prices got too high, much as the Bank of England uses currency reserves to manage the price of sterling. The new emphasis on housing supply did result in housing completions finally beginning to rise, but the affordability crisis continued to worsen as house prices took off again from 2006.

The failure of supply side measures to dent house prices, and their subsequent fall despite plummeting supply, reveals a simple truth: house prices are not simply the product of supply and demand equations. New build housing is at best marginal to overall supply to the market, which is dominated by secondhand homes. Even assuming the target of 240,000 homes was reached it would only represent 1% of the total housing stock. We undoubtedly need to build more homes, but the real drivers of house prices are the availability of credit and expectations of future price growth.

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15 Kate Barker, *The Barker Review*, 2006, www.communities.gov.uk/documents/planningandbuilding/pdf/154265.pdf
16 Nationwide House Price Index
17 Council of Mortgage Lenders, *Will the Real First Time Buyers Please Stand Up?*, February 2006

It is now clear that the "responsive and competitive lending market" Barker praised was wildly excessive, lending sums that were far above what long-term asset values or borrowers' incomes could support. While the sub-prime phenomenon is associated with the US, the UK saw plenty of excessive lending by reckless banks driven by the quest for short-term profits and buyers desperate to get on the housing ladder or trade up. The number of borrowers who took out a mortgage with a loan to value of 100% or more doubled in the first nine months of 2007 in comparison to 2006.[18]

House prices do not reflect pure demand, let alone need, but what people can be persuaded to borrow. But we will not borrow that much to buy homes unless we expect house prices to keep rising. People want a secure place to live, but to survive in the housing market they have been forced to make speculative bets on future growth. Security and speculation do not go together. Ignoring this unintentionally speculative dimension of our housing economy has left public policy incapable of understanding, let alone fixing, the social and economic disaster of a bubble economy.

The housing market of the last ten years follows the classic pattern of a financial bubble. From the low point of 1996 – when real house prices were at the same level as in 1979 – low interest rates and steady GDP growth pushed prices up rapidly. By October 2001 the Nationwide average house price index was at £115,000 (adjusted for inflation) – just under the peak of the previous bubble in July 1989. The real bubble took off after then, as interest rates were cut to pre-empt recession in the wake of the September 11 terrorist attacks.

There are two main reasons why this bubble and the subsequent burst have occurred: a self-imposed shortage of economic levers, and political economic expediency on the part of all governments from Thatcher onwards. First, ever since the neoliberal turn under Thatcher, governments have become increasingly wary of interfering with all markets – and the housing market is a very big one to intervene in. As a result, they have lost much of their ability to do so: the finance sector has been deregulated, public sector housebuilding curtailed, and the interest rate handed to the Bank of England, with no remit to worry about asset prices.

The short-term wealth effect created by rising asset values is extremely hard for any elected politician to resist, especially when there is little else to offer your electorate. In the context of an increasingly polarised global economy in which profit rates soared and workers received an ever diminishing share of the spoils, housing wealth became the obvious way to maintain demand. In effect this meant allowing mortgage debt to increase the sum of

18 Mortgage Advice Bureau, www.nowfirsttimebuyer.com/FirstTimeBuyerNews/AlsointheNews/tabid/188/default.aspx?article=First+Time+Buyer+News%20490

money flowing around, creating the temporary illusion of wealth. Mortgage borrowing drove rising prices, which in turn encouraged people to borrow for consumption, fuelling a consumer boom that concealed the declining ability of the majority to benefit from globalised capitalism. In this analysis,[19] debt-laden housing wealth was a substitute for real economic gains for lower and middle income groups whose share of national income has stagnated or fallen since the late 1970s. It is these groups that have experienced the worst effects of the affordability crisis and the lack of social housing.

Figure 2 Shares of total equivalised household income by quintile group[20]

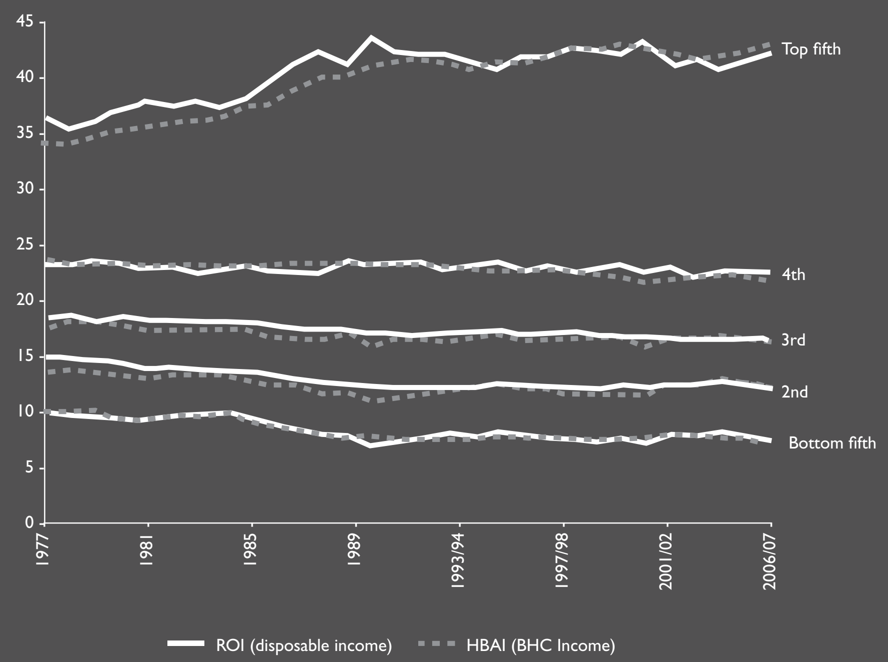


Figure 2 shows that the top fifth of the population has benefited most from the model bequeathed by Thatcherism.

But if we are to reform the housing economy in a sustainable and equitable direction we need to look beyond the excesses of the last few years. Housing bubbles are nothing new,

19 Graham Turner, *The Credit Crunch: Housing Bubbles, Globalisation and the Worldwide Economic Crisis*, Pluto, June 2008
20 Statistics Commission, *The Distribution of Household Income from 1977 to 2006/07*, December 2008, www.statistics.gov.uk/elmr/12_08/downloads/ELMR_Dec08_Jones.pdf

and have been a feature of the UK economy for at least 40 years. We should not be trying to get back to 2006 – but neither should we be aiming for 1997, or 1979. Ultimately, the bubble economy is just a symptom of a deeper structural problem – the upward trend in house prices.

Rising house prices create an entirely illusory sense of wealth that sustains consumer spending in the short term, but ultimately lead to over indebtedness, price crashes and consumer retrenchment. Much of the additional income secured by the rise in two earner households has simply been capitalised into higher house prices, necessitating higher mortgage outgoings for new owners. Adults in working households with children have been forced to work harder to maintain the same position in the housing market. Rising housing costs are one of the main reasons why people in the UK work longer hours than our European neighbours, and why increasing household incomes have not made us feel any better off. We work harder to borrow more to buy homes in a volatile market, and if the market falls we risk losing the lot. And even if we do well on our own houses, we find that our children then need our help to get a foot on the ladder.

The consequences of rapidly rising house prices are dangerous for our economy, our individual wellbeing, and for society as a whole. Wealth inequality, as measured by the Gini Coefficient, is twice as high as income inequality[21] – and most of that wealth is in the form of housing equity. Housing wealth is poorly distributed to start with, and increases in the value of housing are therefore extremely socially regressive. House prices tripled in the decade after 1997 and housing assets became the main driver of wealth inequality, single-handedly responsible for cancelling out all the progress in reducing income inequality made since 1997.

The implications for future generations are troubling. As inheritance has become the major route into property ownership a new form of urban feudalism has been created, with profound long-term impacts for social mobility and inequality. In a "free" market, all landed property such as housing wealth inevitably becomes more and more concentrated, because land owners effectively hold a monopoly over a limited resource – a basic fact of land markets that Adam Smith observed in the 18th century. This was the economic lesson that the game Monopoly was originally designed to demonstrate: in a conventional property market if you play for long enough all the money will end up with one player.

The most obvious losers in this game are those who do not own and cannot expect to inherit property wealth. As a majority became home owners, those in social or private rented housing were left further and further behind. The right to buy and other subsidies for home

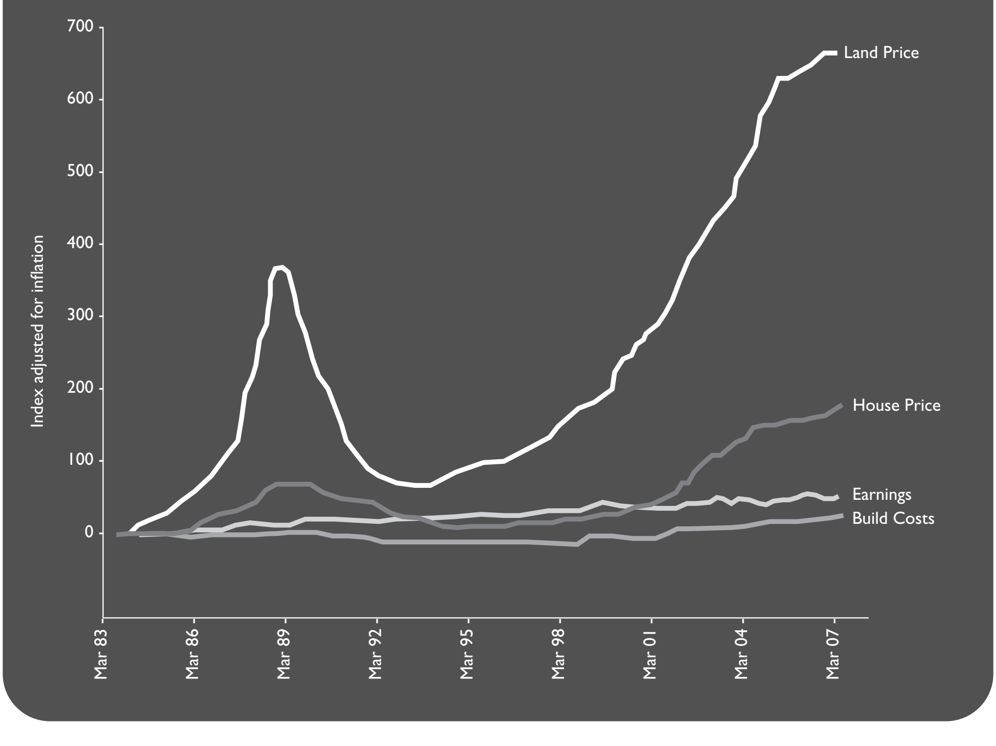
21 *Income, Wealth and Inequality*, House of Commons Research Paper 04/07, www.parliament.uk/commons/lib/research/rp2004/rp04-070.pdf

ownership helped some people move from one side of the widening gap to the other, but in doing so inevitably exposed more marginal home owners to the risk of a bust. By privatising the gains of the housing market we have also individualised the risks to a worrying extent. The biggest losers from the current bust will be those who bought in the last five years, with large mortgages at high multiples of earnings – especially younger, working families without large inheritances. And as the market freezes, no one can move and everyone sits tight waiting for the next bubble to emerge. It is totally dysfunctional.

Macro economic impacts

Rising house prices drive rocketing land prices, the land market being even more volatile than the housing market (figure 3). As house prices tripled during the boom, land prices went up nearly five and half times – and this average figure masks the much higher increases in some locations.[22]

Figure 3 Index of housing market costs 1983–2007[23]



22 Communities and Local Government live tables

23 Team Limited, *Building Barriers*, September 2007

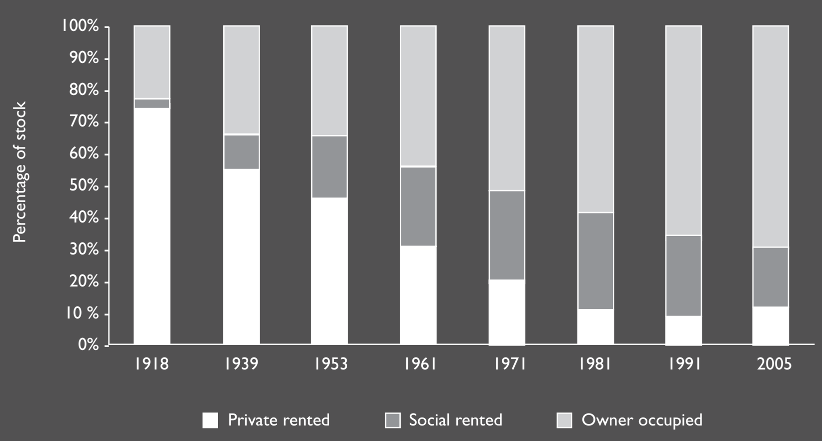
High land prices make development of all kinds ruinously expensive, and place huge pressures on the financial viability of housing projects. In the auction for scarce sites, the winner will be the bidder that believes they can cut build costs the most and squeeze the most out of planning. Most of the value gains of development are therefore capitalised into the land price, reducing the available uplift that could otherwise be captured to provide affordable housing, infrastructure or community services.

The drive to get on the housing ladder leaves us saddled with low savings and large debts. And a nation that puts all of its money into bricks and mortar has little capital to invest in its businesses. Our housing obsession therefore plays an important role in the decline of British industry, as it has driven a massive misallocation of investment capital away from jobs and production and into property. Fear of the housing market running out of control has long kept UK interest rates higher than in the Eurozone or the US, damaging Britain’s productive industries by raising both the cost of borrowing and the price of exports. Housing markets are a zero-sum game, and rising house prices do not represent production of value but its reallocation from potentially useful areas.

4. The rise of home ownership

At the start of the 20th century the vast majority of people rented privately, including the urban middle class (figure 4).

Figure 4 Change in tenure mix during the 20th century



During the housebuilding booms of the 1930s and 1960s the rise in home ownership ran parallel to the rise of social housing, with both tenures taking market share from the private landlords. With the introduction of the right to buy the story changed as home ownership directly replaced social tenancy. In the last decade the wheel has come full circle and private renting has started to make a small comeback, at the expense of both social renting and owner occupation.

Home ownership remains the tenure of choice for almost everyone, and for good reasons. Home owners do not have to pay rent, giving them a higher income and greater security than renters. While mortgage payments are often higher than rents, eventually they reduce to zero – around a third of owner occupiers are now mortgage free. Home owners have choices that renters do not – to alter, improve or extend their homes, to let out spare rooms, or to withdraw equity. Home ownership can bring security and a sense of belonging to a community, especially when compared with insecure private renting.

But the biggest reason for the shift in tenure patterns is that for the last 35 years or so home ownership has been promoted as the absolute social and cultural norm.

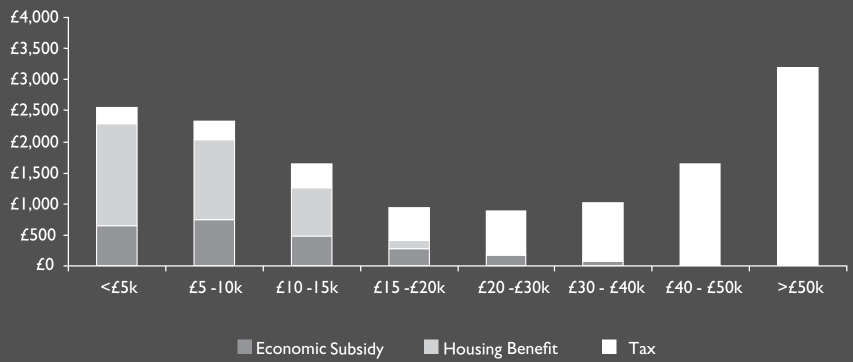
Governments have encouraged this attitude through a range of subsidies and tax breaks for home owners since the 1960s, and which make our homes a highly privileged asset class. Few people now remember Schedule A, though it was part of the income tax regime from the time of the Napoleonic Wars. Under this all home owners paid tax on the value of their homes, based on the 'imputed rent' – the increase in their disposable income that came from not having to pay rent. Between 1960 and 1970 the tax was reduced and then scrapped, and mortgage interest relief (MIRAS) was introduced to subsidise home ownership. This shift marked the beginning of the era of house price booms and busts, and the start of our national fixation on the housing market. It is no coincidence that prior to this point there were no published house price indices to feed the headlines: there are now eleven.

Although New Labour scrapped MIRAS, home owners still receive a unique exemption from capital gains tax, worth about £13 billion in 2007 (although this figure will have been lower for 2008). The shocking fact is that housing wealth is almost entirely untaxed.[24] No other asset class is treated so generously, so it is small wonder that people are prepared to borrow heavily to buy homes, pushing prices up and further boosting the windfall for existing home owners.

24 Stamp duty is a distortionary tax on transactions rather than wealth, which brought in around 1% of housing value growth during the boom years. Inheritance tax captures some of the gains indirectly, but this is widely avoided by the rich – only 6% of estates paid any at all in 2003/04. Joseph Rowntree Foundation, *Attitudes to Inheritance in Britain*, 2005, www.jrf.org.uk/node/1040

The combined effect of economic subsidy (social rents set at a subsidy to market rent), housing benefit and tax breaks is that the richest and the poorest households receive substantial amounts of public housing subsidy, with the most going to the richest. Households with incomes below £5,000 receive an average of £2,500 in subsidy per year from these three sources, whereas those on more than £50,000 receive over £3,000 (figure 5). Those in the middle – which includes most of those suffering the effects of the affordability crisis and the price slump – receive very little at all. In other words, public housing subsidy seems designed to exacerbate rather than reduce inequality.

Figure 5 Housing subsidy by income band, economic subsidy (social rents below market rates), housing benefit and tax breaks for home owners[25]



Home ownership has also had very little competition in recent years. The rights of private renters have been steadily cut back since the days of rent controls, and social housing has been in decline since the Thatcher government of the 1980s as falling supply forced the restriction of allocations policies from favouring those in work and able to pay rent to those in most need. From this point on, social housing ceased to be a universal service that the working and middle classes could benefit from and became increasingly residualised and under funded. In recent years a new intermediate sector, of part or shared ownership, has started to emerge, but this is still very small, and mainly consists of short-term financial products designed to get those who could not otherwise afford it into home ownership.

Conclusion: unsustainable home ownership

The rise of the housing market to its current position at the centre of our national economy has many roots.

25 Communities and Local Government analysis: the true picture is even more regressive than these figures suggest, as ‘economic subsidy’ is a hypothetical concept – in reality, if social housing was put on the market it would not achieve private sector rent levels.

The intrinsically regressive nature of markets, especially those in landed property, was exacerbated by tax breaks and subsidies. Once the shift towards majority home ownership was established it acquired an electoral momentum that was hard to resist.

The withdrawal of the state from housing provision left the field to a dysfunctional private housebuilding sector that had little incentive or ability to improve the number or the quality of new homes. The lack of investment in social housing meant there was no viable alternative tenure to home ownership.

As neoliberal globalisation gathered pace and the distribution of income became ever more polarised, housing wealth offered a short-term palliative to the many whose earning power and pensions were in relative decline. Deregulated credit markets provided the debt finance to support ever rising prices. As affordability worsened, people desperate to buy were encouraged to borrow far too much to get a foot on the ladder, making them more vulnerable to the market. Repeated housing booms and busts exposed more and more ordinary households to extreme financial risks.

At the peak in late 2007, the value of homes in the UK had risen 15-fold in 30 years. Once the market had run out of control there was little anyone could do to rein it in, and policy makers were left hoping that keeping interest rates up and exhorting private industry to produce more would stave off the bust for a while longer. We are now reaping the rewards of a 40-year socio-economic experiment with housing wealth.

The principles for a new housing economy

Housing is a highly complex area in which the motives behind policy are often confused, and in which every intervention can have multiple consequences, intended or otherwise. To reform the housing economy and the policies that shape it we need to state clearly the aims of our actions and the principles we are acting on.

1. Universality

- **Access to decent, appropriate and affordable housing for everyone**
  A decent home is a basic human right that no-one should be denied.
- **A social housing sector that ensures no-one is left homeless or in sub standard housing**
  To ensure needs are met there will always be a need for a strong social housing sector, supported by taxation if necessary.
- **A system of income support that enables people on low incomes, whether in work or not, to afford a decent home that meets their needs**
- **A sufficient supply of homes to meet the needs of existing and future populations**
  Adequate supply of new homes in all tenures is essential to meet needs. Public, private and non-profit sectors all can and should contribute to housing supply.

2. Choice

- **Genuine choices between different tenures and housing types for everyone, including good-quality, affordable rental housing**
  Tenure choice should not be restricted to those with higher incomes. A wider range of affordable tenures, including social rent, intermediate, co-operative and specialist needs housing, is essential. Different housing types and sizes should be available in all tenures.
- **A sustainable model of home ownership**
  Home ownership that is affordable for median wage earners to access, without being reliant on inherited wealth, excessive debt, or public subsidy. Homes should be bought and sold easily in a transparent market that cannot be exploited by agents and lenders for their own ends.
- **A diverse and flexible housing system that enables people to move easily as and when necessary**
  Moving between tenures and withdrawing equity should be as straightforward and transparent as possible.

3. Equality

- **Between tenures**
  The tenure bias and the accompanying social stigmas must be removed.
- **Equalisation of life chances between tenures**
  Tenure should not determine economic, health, education or other social outcomes.
- **Homes that meet people’s needs**
  An inclusive society requires that housing provision reflects social diversity and takes account of the needs that flow from gender disability, ethnicity, age and sexual orientation.
- **Homes as places to live, not speculative investments**
  Our homes and neighbourhoods should be treated as the centre of our social lives, not expressions of our economic power. Home ownership is a privilege and should not be unduly rewarded by public subsidy or become a source of unearned, untaxed wealth.
- **Stable house prices**
  We must avoid repeating the cycle of house price booms and busts. House prices should rise no faster than average earnings.

4. Quality and environmental sustainability

- **Raising standards of design and environmental performance in new housing**
  New homes must contribute to reducing our national carbon footprint. Rigorous standards for environmental performance, size and design quality of homes should be enforced equally across all tenures.
- **Raising the standards of the construction industry**
  Improved labour standards and training in construction are necessary conditions that must be met in order to allow the achievement of high-quality sustainable housing.
- **Investment in the existing stock to raise and maintain quality**
  An improved Decent Homes standard in all homes, public and private, to make existing homes more environmentally efficient and maintain them for the future.

To reform the housing economy and the policies that shape it we need to state clearly the aims of our actions and the principles we are acting on

The solutions: homes to live in

If security and not speculation is to be the basis of houses fit to live in then we need two things: mixed supply and mixed tenure. The last 30 years bet everything on the market and the individual. Now we need a better balance. Market failure requires public intervention, taxation and regulation.

1. A mixed economy in housing supply

Public investment in housing and infrastructure

The market has not delivered the numbers or the quality that we need during the boom years, despite returning huge profits to shareholders. While there is still a place for Section 106 in securing affordable housing and other public benefits, we must not depend on the speculative gains of a bubble economy to replace proper public investment.

After years of under investment in the physical fabric of society we need an explicit recognition that homes, infrastructure and places require public investment, just as education and health do – and are valid reasons for public borrowing. There is no contradiction between public investment and private provision – the high point of private housebuilding was also the high point of the council-housebuilding programme. Treasury appraisal systems and the rules governing local authority spending need to be changed to take proper account of the holistic benefits that investment in homes and places can create, and of the costs of not doing so. The rules on council borrowing must be revised to bring the UK in line with other European countries to enable them to invest in housing development and regeneration.[26]

The vulnerability of an oligopolistic housebuilding industry to market shocks is now apparent, with potentially disastrous implications for housing supply and employment. Investment in housing construction is urgently needed to prevent massive loss of skills and capacity in the industry. Fortunately housebuilding is one area of the economy in which counter cyclical public investment is effective and quick to implement. Rapid public intervention now could unlock new supply while preserving and creating employment and training opportunities. We must meet the 2020 Group's challenge for £6.35 billion of public investment in new affordable housing, and heed its warning that without intervention 447,000 construction workers may lose their jobs.[27] If no action is taken to stimulate housing then a similar number of jobs could be lost across these other industries.[28]

26 Steve Wilcox, *UK Housing Review* 2008/09, December 2008
27 *Financial Times*, 23 February 2009, www.ft.com/cms/s/0/b6add3c0-013a-11de-8f6e-000077b07658.html
28 There is a range of estimates for construction multiplier effects, but according to the Trades Union Congress the multiplier is likely to be at least 1.8.

Reforming the development market

Renewed public investment must not simply reflate the bubble or preserve the pre-crunch development industry. Bold public intervention at this crucial moment could transform the dysfunctional market and help make it serve the needs of people. First, the various emergency programmes run by the Homes and Communities Agency must be careful not to bail out a failed business model for its own sake: any homes bought under the National Clearing House for unsold private development must be of the right type and at the right price for public benefit.

Land ownership is the simplest and most effective way to influence the outcome of development. The policy of selling public land and property assets for maximum value (or 'best consideration') should be reversed – the presumption should be in favour of long-term public retention of land or its free transfer into permanent community or non-profit ownership. Public land should only be sold where there is a sound case based on long-term quality of outcomes rather than short-term cash return. This will require central government to recognise that agencies across the public sector will not be able to support their core functions with cash returns from land assets on their books, and to compensate them for this.

Retaining public development land will bring returns over the long term, but we need models of public finance that more accurately value the future rental income and capital growth generated by quality development and infrastructure. By retaining land and employing the right financing tools, such as a land value tax, public infrastructure provision will pay for itself many times over.

At this point in the market cycle when prices are plummeting, land acquisition is a smart use of public money. The Homes and Communities Agency should be empowered to divert funds from short-term packages to acquire land for long-term transformation. The danger of the current market is that developers and landowners will mothball their sites and wait for the market to return. This not only blights communities with dereliction, it prevents the land market from properly adjusting to a new base and reduces the opportunities for either market- or state-led innovation.

More immediately, the Homes and Communities Agency should be prepared to use its compulsory purchase powers to acquire mothballed sites and kick-start development; this would send a message to the industry that the public sector intends to make the most of its buying power, and would force the land market to rebase rapidly, enabling the industry to emerge from the slump sooner. Local authorities should also be given greater powers and resources to bring under-used property to development.

Need for public sector leadership and an improved private sector

The market has failed to deliver: the public sector must take on more leadership of development and regeneration, especially in terms of land assembly, master planning and infrastructure provision. This does not mean micromanagement – it means powerful public agencies, whether local authorities, regional government or area specific agencies like the old and successful New Town Development Corporations taking strategic control and responsibility for major developments. Once the overall plan is set and enabling infrastructure is in place, land parcels can be handed on to delivery partners on the ground, whether these are retained in public ownership, leased under licence, gifted or sold. Smaller land parcels will help increase overall build out rates by preventing monopoly providers from constraining supply to keep prices up, and enabling different developers to build and sell into different sub-markets.

An enabling public sector must change the incentive structures of the market so that private investment prioritises long-term returns on quality development rather than short-term capital gains

This approach – which is successful in other European countries[29] – will require the public sector to take its fair share of both the risks and rewards of development, and to have the confidence to make and shape the market where necessary. Publicly owned regional development banks should be established on the Dutch model, to provide long-term finance for infrastructure and housing growth backed by bonds.[30] This model is similar to that which built the New Towns – the powerful New Town Development Corporations purchased land at agricultural prices and provided infrastructure with Treasury bond finance, issued planning permissions and used the resulting uplift in land value to repay the loans. These examples from our European neighbours and our own history should inform all large-scale developments such as the proposed eco-towns.

A mixed economy also requires a stronger and more sustainable private sector. An enabling public sector must change the incentive structures of the market so that private investment prioritises long-term returns on quality development rather than short-term capital gains. There is good practice in the private sector, but it is the job of the public sector to make this the norm.

29 PRP, URBED and Design for Homes, *Beyond Eco-towns: Applying the Lessons from Europe*, 2008, www.prparchitects.co.uk/research-development/research-publications/2008/beyond-eco-towns.html

30 Nicholas Falk, *Making Eco-towns Work: Developing Vathorst*, Amersfoort NL, URBED, www.prparchitects.co.uk/assets/pdf/5.pdf

Attracting institutional investors such as pension funds to invest in housing development could help stimulate the growth of more long-term developer business models. Strong, public sector plan making and infrastructure provision would go a long way towards derisking development and creating opportunities for 'patient capital' investment, but there are also specific barriers that need to be overcome. Stamp duty should be reformed to remove the penalty on large portfolio transactions that disadvantages large-scale investors compared with conventional housebuilders selling to the buy to let market.[31] Incentivising long-term private investment should be a central aim of any future changes to tax, planning and subsidy policies.

A robust and diverse housebuilding sector

A diverse, mixed economy would encourage innovation and make the housebuilding sector more resilient to economic shocks to maintain output and jobs during downturns. We need a wider base of suppliers from all sources – going beyond the stale dichotomy of state vs market to include non-profit and community sectors and new models. We need to recognise the contribution already made by housing associations; building a new mixed economy and a larger proportion of rental housing will require their essential development and housing management expertise. We also need to recognise the positive role that a vibrant public sector building maintenance and construction sector can play.

But there is scope for housing to be built, owned and run by a much wider range of organisations than at present, including community land trusts, local community groups, self-builders and ALMOs, and for emerging models like co-operative land banks.[32] These alternative providers could help democratise development, and break the vicious cycle of disempowered communities, poor-quality development and NIMBY (not in my back yard) resistance to new homes. Having a diversity of suppliers is a worthy end in itself, and public-sector-led development should seek to encourage new market entrants and innovation wherever possible. The "balance sheet barrier" – when public agencies deny potential partners access to sites unless they can show a large corporate balance sheet – should be scrapped.

To encourage diversity, large sites in public control could be divided into small plots, some of which should be sold, leased or transferred under license to housing associations, community providers and smaller housebuilding firms as well as a proportion being held back for local authorities to develop. Self-builders have long been a neglected part of the housing sector – but they build up to 20,000 homes per year, more than even the largest

31 The Smith Institute, *The Future of the Private Rented Sector*, 2008, www.smith-institute.org.uk/download-pages/download_private_rented.htm
32 Shann Turnbull, *Democratising the Wealth of Nations*, International Institute for Self Governance, 2000

firms.[33] They generally build to higher-quality standards than commercial developers, and are far less prone to cyclical economic pressures as they are typically developing homes for occupation rather than sale. We should recognise their contribution and encourage the growth of the sector – especially in the form of medium-scale community self-build projects.[34] These have great potential to improve supply rates and overcome resistance to development by engaging and empowering communities.

Communities are also best placed to spot under-used land assets in their areas and to identify the best potential use for them. A community right to buy should be enacted, drawing on the experience in Scotland. The Land Reform (Scotland) Act 2003 gives local communities the first right to buy land they have registered or can demonstrate an interest in, and provides some public funding to help them do so. While it has been successful in empowering some communities to take collective ownership of their land, especially in rural areas, the Scottish system leaves it up to landlords as to when they wish to sell. A more empowered approach would be to give communities a further right to compulsorily purchase land that is under used, mismanaged or where the pattern of land ownership is overly concentrated in a few hands.

A renewed role for local government in housing provision

As the best placed agency to understand and interpret local needs, local government has a key role to play in the new mixed economy and must be empowered to play this role again after decades of increasing centralisation. Enabling a new era of municipalism to flourish will require the political courage to allow experimentation and diversity. This will undoubtedly bring risks, but centralisation has clearly not worked: we need to give local authorities the powers, the resources and the time to rediscover their leadership and development skills.

Recent moves towards lifting some of the restrictions that have prevented councils from building are welcome and must be followed through.[35] If retaining 100% of right to buy receipts is to be the norm, new funding will be needed where housing need is greatest and there must be a condition that the receipts are reinvested in new homes or in improving the existing council stock. But we should go further and empower councils to provide new homes directly: local authorities must receive social housing grants directly, enabling a new generation of council housebuilding to get under way. But we should not be dogmatic about council housing, nor replace a failed market monoculture with a municipal

33 National Self Build Association, *Self build as a Volume Housing Solution*, 2008, www.nasba.org.uk
34 *Enabled Self Procurement*, www.esp-sim.org
35 Communities and Local Government, *Changes to the Revenue and Capital Rules for New Council Housing: Consultation on Excluding New Council Housing from Housing Revenue Account Subsidy and Pooling*, 21 January 2009

monoculture. Councils should be empowered and prepared to provide homes in all tenures, not just social housing, and councils should not prevent the full range of housing providers from contributing what they can.

Councils should also be ready to intervene in their local housing markets where necessary, for example to provide mortgage rescue for distressed home owners or to reprofile the existing private stock. Some councils are already taking the lead in this area – Birmingham and Liverpool are both seeking to establish municipal banks to support local economic development. These initiatives should be supported and successful models rolled out across the country.[36]

Key to achieving this will be a significant expansion of housing functions within local authorities. This should involve an urgent national housing skills audit to identify where councils have to increase capacity through immediate appointments and improving skills for the longer term through apprenticeships and training opportunities. Housing and planning delivery grant should be expanded to ensure that local authorities can put in place the skills and capacity necessary to deliver a renewed housing function.

2. Mixed tenure

Sustainable home ownership

Most people can currently choose only one or two tenures at best, and tenure is far too big a factor in determining life chances. While home ownership will remain the tenure of choice for most people, we need to rebalance the risks and rewards in the housing economy and move beyond the dependency on housing wealth that many have been forced into. This will mean providing decent investment alternatives and secure pensions, so that ordinary people do not have to gamble on the housing market to pay for their retirement or rely on it to fund their care in old age.

It must also be part of a more fundamental shift towards an economy in which incomes are more fairly distributed and maintained at a level that prevents the need to supplement income with excessive levels of debt.

The individualisation of housing market risk has exposed many marginal home owners to the risk of negative equity, and rising unemployment threatens to push them into repossession. Mortgage support and rescue schemes have to strike a delicate balance between allowing the housing market to correct downwards and minimising the harm

36 Anthony Brand, *Capital Ideas: Financing Future Local Economic Development*, New Local Government Network

caused by the correction, especially to the most vulnerable. The buy to let boom has left many investors and amateur landlords exposed to the risk of negative equity. While investors should not be bailed out, the banks must be prevented from evicting good, rent-paying tenants when their landlords default on their mortgages.

Irresponsibly encouraging marginal owner occupation can place individual families at unnecessary risk and create costs to the community. So a common framework of responsible support for all potential first time buyers is required that replaces the various homebuy schemes and discounts available under the right to buy and the right to acquire.

Looking beyond the immediate crisis, we need to resocialise both the risks and the rewards that markets create, and to foster a fundamental shift from an economy built on speculation on capital growth to one based on fair income from the productive use of property. For home ownership to be truly sustainable we need a fairer housing market and an end to house price booms and busts. We need viable alternatives to debt-laden home ownership and a level playing field between tenures.

Reforming the housing market

A sustainable model of home ownership requires a housing market that works properly, in which information is clear and freely available and transactions can flow smoothly and easily. The existing system for buying and selling homes is a parody of a true market. Buyers have poor access to information about what they are buying, and the little information that does exist is not standardised. Most home owners buy a home only a few times in their lives, making them inexpert consumers and allowing unregulated middle men to extract huge fees from the process. Lengthy chains that can break down at any time make home buying a misery.

Estate agents must be properly regulated to protect the interests of both buyers and sellers

Home Information Packs (HIPs) were a step in the right direction towards a clearer and more honest housing market. The decision to drop the Home Condition Report element in the face of massive media opposition was regrettable and should be rectified by replacing HIPs with Housing Log Books. Estate agents must be properly regulated to protect the interests of both buyers and sellers, and information in advertisements should be standardised– at present they do not even have to include a square meterage. Free and independent advice should be provided for all prospective buyers and sellers. If this had been in place many of the worst excesses of recent years might have been avoided.

But to improve the workings of this dysfunctional market radically we should consider establishing a public clearing house for homes: a series of non-profit regional agencies exempt from stamp duty, to which sellers could sell their homes without waiting for a chain of transactions to be in place. Prospective buyers would then have a large pool of properties to choose from, available from a properly scrutinised public agency. The opportunity to buy and sell chain free would command a small premium; with the stamp duty exemption this would make the clearing house self-funding over the long term. Reasonable reserves would need to be held to ride out the market cycles, although along with the other measures proposed this would help reduce the volume and speed of market fluctuations by enabling the market to clear more easily. This would also provide a large, constantly recycling pool of properties in public ownership, creating a powerful new lever for influencing local housing markets or acquiring homes for affordable housing.

Preventing housing booms and busts

Crucially, we also need to tackle the underlying economic drivers of unsustainable home ownership, not to punish home owners or discourage those who seek to own their home, but to put all tenures on an equal footing, and to make home ownership more sustainable over the long term. Achieving this will require a careful look at the taxation system – at the least, a progressive housing tax could help pay for free housing advice and regulation. But raising revenue is only one purpose of taxation: it can also help balance and regulate markets, steer the flow of private investment, incentivise or discourage different behaviours, and redistribute windfall gains that would otherwise be privatised. The right housing tax reform could potentially achieve all of these goals.

While acknowledging that any changes to the tax system require a high level of political courage, in the context of the current crisis there has never been a better opportunity to build a consensus for change. The principles that should lie behind a recasting of the tax system should be that successful speculation should be taxed and that a share of any unearned windfall profit should be shared with the community.

Social justice demands that the gains in land value be shared more equitably with the community than at present, and a tax system that could stabilise the housing market and reduce the chances of booms and busts is in everyone's interest. Possibly, the most effective fiscal policy means of achieving this would be to replace the unpopular and regressive council tax and the system of business rates with an annual land value tax (LVT). All land would face an annual charge for the benefits received as a consequence of being a landowner on the basis of the unimproved site value of the land, which would be revalued for tax purposes annually. This could be structured so that it eventually provided a similar level of overall public revenue to council tax and business rates (currently £25.6 billion and £19.6 billion respectively). It is important to be clear here – we are not talking about a tax on property values. If people improve or develop their home then the benefits would still accrue to them. We are just talking about the value of the land their home sits on, which is therefore the most public and social asset there can be.

By using tax thresholds, the tax burden on lower and middle income groups can be further reduced and we should follow the example of Denmark and allow pensioners to postpone some or all of their charge until their home is sold.

The percentage tax rate would be set locally by the council within a range determined nationally by central government. This would ensure local discretion in tax raising and help reinvigorate local government.

Replacing council tax and business rates with LVT on this model could be highly progressive. The main winners would be those who rent, pensioners and those who live in a local authority area with relatively low property values and relatively high council tax.

The losers would be those with relatively low council tax and relatively high property values, and those with second homes or investment property portfolios.

By taxing landowners on their unearned gains rather than taxing their tenants, LVT would be a highly progressive tax change, with positive impacts for social justice and economic equality.

It could also have other macroeconomic benefits. Where public investment in transport infrastructure, schools or other services improved the value of nearby property, tax revenue would increase, making such investment self-financing and helping to support housing growth.

LVT could play a major role in the financing of infrastructure, especially public transport, so that over time it would be the beneficiaries of the investment who would pay. For example, the Crossrail project – a rail-link between Maidenhead, Heathrow Airport and central London, through to Shenfield, east of London, and Abbey Wood in south-east London, could have been financed by borrowing on the basis of the additional revenue from LVT that would be collected due to the higher value of the land in the vicinity of Crossrail, after completion of the project.

The London Underground Jubilee Line extension, which cost taxpayers £3.5 billion, could have been financed in this way. It has been estimated that as a result of the extension, land values in the vicinity of just two of the stations, Canary Wharf and Southwark, increased by £2.8 billion, and over the whole extension by some £13 billion. In other words, had LVT already been established, the public as a whole would have been the beneficiaries from the higher land values created, instead of the private landowners in those areas, who had contributed nothing to the project.

LVT would promote new capital investment rather than sterile land speculation

Similarly, where development reduced house values the owners would be automatically compensated by lower taxes. Because it is levied on the value of the land, not the buildings on it, LVT would incentivise owners to improve their property, as any such increase in value would increase their home’s value but not their tax bill. By taxing all land, including vacant business property, it would encourage owners to bring such assets into use, improving the land supply and creating jobs.

LVT would promote new capital investment rather than sterile land speculation as it would encourage a shift of private investment from land speculation (which creates no extra land but only higher land prices) to productive enterprises. Inner city areas would be opened up and regenerated.

LVT could not be avoided. Unlike income tax and business taxes where tax avoidance experts are in great demand and the ‘shadow economy’ flourishes to evade taxes. Land cannot be hidden or concealed.

While it could initially just replace council tax and business rates, moving to LVT could begin to shift the entire tax base from work and production to wealth and resource consumption. In future years it could be increased to allow reductions in income tax, especially for lower wage workers. By removing the main speculative driver of house price growth, LVT would reduce and stabilise property prices, making both renting and owning homes cheaper for everyone, reducing the economic gulf between different tenures and placing the entire economy on a more robust and equitable footing.[37] Most importantly, it would alter the dynamics of the property market, smoothing out the peaks and troughs and preventing housing market bubbles from developing in future and making home ownership more sustainable in the long term.

37 Fred Harrison, *Boom and Bust*, 2006

The practicalities of switching to LVT are not difficult. Land revaluation can be carried out using map-based data, and is far simpler than the revaluation of individual homes which the old rates system required – and which has so far been avoided for the council tax regime in England and Scotland. It is carried out routinely by local governments around the world, including parts of the US, Australia and Denmark, all of which tax land value to a varying extent. Jurisdictions that use LVT have found it reduces property market volatility, encourages more sustainable investment in existing town centres and boosts local economies.[38]

A tax on land and unearned windfall profits would be the basis to get back to the socialisation of risk and reward. In a globalised economy we are putting impossible demands on individuals. We cannot cope alone. We must share the risks and rewards. We can do this by earning enough in real and deferred wages to replace our dependence on rising house prices – which we cannot guarantee and which have all kinds of other damaging economic and social impacts.

We do not underestimate the opposition from those with a vested interest in the unequal and ineffective outcomes of the market as it is currently structured, but as Churchill said, "It is not enough that we do our best; sometimes we have to do what is required." Taxing unearned land value increases is not just necessary but desirable and feasible.

Decent alternatives to home ownership

Putting home ownership on a sustainable footing must be matched by ensuring that there are also good alternatives in the form of social housing, private renting and intermediate tenures. Even in a more stable, more affordable housing market there will always be a need to provide enough social housing for those who cannot afford to house themselves.

Lower land prices resulting from public control of development and LVT would mean that the existing budget for affordable housing provision would go a lot further – but given the huge backlog of unmet need there will still be a need to continue the recent increases in funding for affordable housing for the immediate future, especially as the supply of cross subsidy from the private market has dried up. The 2020 Group's call to build 100,000 new social homes over the next two years, including a £750 million infrastructure fund to pump-prime new developments, is an ambitious but necessary first step.

Tenants need rights if renting is to be a viable and attractive long-term option, but there is a huge gap between the rights enjoyed by social and private tenants. In countries with more balanced tenure mixes, like Germany, private tenants have much greater protection

38 Jerry Jones, *Land Value for Public Benefit*, Labour Land Campaign

than in the UK. Tougher regulation of landlords, greater security of tenure, longer contracts and the simple right to redecorate one's own home would improve the quality of the private rented sector dramatically. Security of tenure also requires some controls over rent increases, perhaps linked to inflation. Local authorities need to be resourced to enforce regulation, and bad landlords who mismanage property and exploit tenants should be punished with immediate confiscation of their stock.

Increasing large-scale institutional investment will both require and stimulate the creation of new models of private rental-led residential development, which could improve the quality of the sector as well as boosting supply. In contrast, with the assumptions of market fundamentalists, greater tenant protection will actually help the emergence of these 'build to let' models, as long-term, institutional investors want steady, predictable incomes and need to protect their reputations.

Reducing polarisation to create a sustainable and balanced housing economy requires a far greater intermediate market – options for those who can afford more than a social rent but cannot or do not wish to access home ownership. Most intermediate options to date have been focused on helping people into home ownership. While this has its place, what is really needed is a permanent intermediate sector that would help meet the needs and extend the choices of a huge section of society and reduce the intense pressure on the limited supply of social housing. The recent move towards intermediate rent should be encouraged – though policy clarity around the definition of this tenure and clear affordability standards are needed. Quality rented accommodation available at a range of prices between social and market rents would be a major step towards a balanced and flexible housing economy.

As well as providing homes and choices for millions of households, a fully developed intermediate housing sector would have positive systemic impacts. Housing equity will become easier to trade in smaller chunks, reducing the frictional inefficiencies of the housing market and giving owners of housing equity greater flexibility to buy and sell housing equity as their situation demands. The ultimate goal should be a system of truly flexible equity in which people can acquire small amounts of debt free equity as a form of saving, build up their stake over time and release it steadily in retirement. This would improve the position of both younger people wanting to own their home and older home owners wanting to release value without having to move, while reducing their dependence on unsustainable debt or predatory equity release schemes.

Co-operative models such as mutual home ownership and community land trusts[39] offer a truly sustainable vision of the housing economy, in which people across the income

39 CDS Co-operatives and New Economics Foundation, *Common Ground – For Mutual Home Ownership*, 2004

spectrums could acquire housing equity at a level affordable for their income. Mutual home ownership would create a new, sustainable form of asset wealth that would support individuals and communities, and could be traded on secondary markets, providing opportunities for pension fund investment.

Now that land prices are falling and the policy agenda of recent years has broken down it is the perfect moment to enable these alternatives to contribute towards a better tenure mix and a fairer housing economy: public land and affordable housing grant should be made available to such innovative models and community-led projects immediately.

3. Regulating for quality and sustainability

The events of the last 18 months should dispel any lingering belief that house prices simply reflect supply and demand. The workings of the credit market are integral to our housing economy and the economics of land mean that house prices are particularly prone to booms and busts. Proper regulation of all financial markets is essential, and especially of mortgage lending. The dangerous practices of lending many times a borrower's salary, or 125% of the home value, are gone for now – regulation must ensure they do not return. Very high loan to value rates are not a means of enabling poorer households to achieve sustainable home ownership. They simply entice more vulnerable buyers to take on dangerous levels of debt and fuel house price rises, excluding more people from owning in the long run.

Regulating the banks is part of the solution, but the crisis also demonstrates how much we need a stable, sustainable mortgage market, offering reasonable loans to ordinary people, of the kind that building societies used to provide. Not one of the building societies that demutualised to become private banks in the 1980s and 1990s has survived the recent wave of takeovers and bankruptcies. More than two centuries of sustainable, co-operative enterprise has been destroyed in a decade.

Now that the high-risk, bonus-fuelled culture of commercial banking is collapsing we urgently need to rediscover and expand sustainable, mutual models of housing finance. Building societies, credit unions and community development finance institutions should all be supported and enabled to grow. Local and regional public banks could provide safe, stable mortgages as they have done successfully in the past. The campaign to turn the existing Post Office network into a Post Bank, providing affordable finance to local people and businesses, is a welcome addition to the sustainable finance movement.

Regulation is the only way to improve the quality and environmental performance of new homes built. But the number of new homes built will always be tiny compared with those already there. Repairing and improving the existing stock is vital to improving the lives of millions of people, especially the most vulnerable, and to reducing our national carbon emissions.

> Universal quality requirements must be set high and drive standards upwards, rather than being a common denominator of minimum decency

The current discrepancies between what is required for market and affordable housing reduces the quality of the overall housing stock, and gives private developers an unfair market advantage over non-profit and public sector providers. It also makes it difficult to move stock from one tenure to another, as developers are now discovering as they attempt to convert unsold private flats into affordable housing. Most homes exist for many decades, and few are likely between tenures during their lifetime. For a sustainable mixed economy to flourish, builders, managers and residents of all types need a level regulatory playing field. Universal quality requirements must be set high and drive standards upwards, rather than being a common denominator of minimum decency. These must include proper space standards again – in their absence private sector homes have been shrinking in size, seriously undermining the long-term sustainability of many recent housing developments.

The Code for Sustainable Homes is a strong step forward, which must not be allowed to succumb to pressure from developers. The push from some parts of the market to reduce standards on grounds of financial viability must be resisted as a short-term false economy. Firmer standards applied across the board would benefit the housebuilders by setting the size and quality of homes achievable on a site, reducing their risk and the price they must pay for land.

The bursting of the bubble market is a unique opportunity to set a new base line for housing quality across the board, which will enable all types of provider to compete equally rather than pursue another race to the bottom.

The housebuilding sector has all too often been plagued by bad employment practices such as casual working, excessively long contracting chains, bogus self-employment and even illegally 'black-listing' trade union members.[40] Labour standards and training must be improved if the industry is to deliver high-quality sustainable housing.

40 Alex Hawkes March 2009 www.cnplus.co.uk/hot-topics/legal/revealed-the-comments-on-the-construction-blacklist/1994749.article

The skills that will be developed during the process of building sustainable homes and the proposed eco-towns will need to be generalised, and this must be reflected in the continued development of a strong apprenticeship programme.

There is a continual need to maintain, repair and improve the housing stock, especially if we are to meet the challenge of climate change. Green homes investment in the affordable housing stock would make a major contribution to reducing energy consumption, carbon emissions and fuel poverty, while improving the health and quality of life for millions of people.

Thirty years ago the housing market was restructured for a whole generation. That model has failed. It is time to try again.

Conclusion

When our homes have become part of the problem we are clearly in trouble, because housing shapes the world around us, literally. Homes are the major factor in determining the built environment, our ecological footprint, patterns of social interaction, even educational and health outcomes. Most of all, housing has become the sclerotic, stuttering heart of our national economy – and is in danger of serious cardiac arrest.

In the midst of a housing-led recession we have the best opportunity in a generation to rethink our troubled relationship with housing, to avoid the economic and social mistakes of the past, and to get the political economy of housing right for once. We must not allow the crisis to distract us from this longer-term prize, nor seek to return to the world of poor supply, house prices booms and busts, and permanent social housing shortages.

The good society must have a clear sense of what homes are for – to provide people with decent places to live in vibrant neighbourhoods and sustainable communities. Homes should primarily be secure bases in which to live, raise a family and share in the life of our communities. As the great Labour housing minister Nye Bevan said of the welfare state he helped found, our housing system should provide us with serenity.

This simple vision runs directly contrary to the received wisdom of recent decades, which held that homes were primarily investments, substitutes for wages and pensions. The basic tension is between housing as assets and housing as homes. If we are to get housing right we will have to tackle some of these deep seated issues, including making tough choices around taxes and the preferential treatment of house price speculation. We need to pour less debt into buying existing homes, and invest more in building new ones and the infrastructure needed to support them. We need to nurture a diverse, mixed economy in both supply and demand that can raise the game in terms of quantity, quality and environmental performance. We need a genuine range of affordable choices for everyone – including decent housing support for those who need it most.

In the midst of a housing-led recession we have the best opportunity in a generation to rethink our troubled relationship with housing

But most of all we need a fair and sustainable housing economy, which means reforming the basic economic structures that lie behind the current crisis. Our homes cannot be left at the centre of an unsustainable market economy – they are just too important for that.

We can have a functioning housing market that works in the interests of the many not the few. Thirty years ago the housing market was restructured for a whole generation. That model has failed. It is time to try again.

About Compass

Compass is the democratic left pressure group whose goal is both to debate and develop the ideas for a more equal and democratic society, then campaign and organise to help ensure they become reality. We organise regular events and conferences that provide real space to discuss policy, we produce thought-provoking pamphlets, and we encourage debate through online discussions on our website. We campaign, take positions and lead the debate on key issues facing the democratic left. We're developing a coherent and strong voice for those that believe in greater equality and democracy as the means to achieve radical social change.

We are:

- An umbrella grouping of the progressive left whose sum is greater than its parts.
- A strategic political voice – unlike thinktanks and single-issue pressure groups Compass can develop a politically coherent position based on the values of equality and democracy.
- An organising force – Compass recognises that ideas need to be organised for, and will seek to recruit, mobilise and encourage to be active a membership across the UK to work in pursuit of greater equality and democracy.
- A pressure group focused on changing Labour – but Compass recognises that energy and ideas can come from outside the party, not least from the 200,000 who have left since 1997.
- The central belief of Compass is that things will only change when people believe they can and must make a difference themselves. In the words of Gandhi, 'Be the change you wish to see in the world'.

Compass
FREEPOST LON15823
London
E9 5BR
t: 020 7463 0633
e: info@compassonline.org.uk
w: www.compassonline.org.uk

compass

DIRECTION FOR THE DEMOCRATIC LEFT

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