CENTRE for ECONOMIC PERFORMANCE

THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

CEP 2019 ELECTION ANALYSES SERIES

A series of background briefings on the policy issues in the December 2019 UK General Election

Housing

Paul Cheshire
Christian Hilber

#GE2019Economists

Paper EA051

CENTRE *for* ECONOMIC PERFORMANCE

Housing

CEP ELECTION ANALYSIS

Paul Cheshire and Christian Hilber

November 2019

Summary

- Housing in London is the most expensive in any major prime city in the world. Over the last 40 years, the cost of housing in the UK grew faster than in any other OECD country, far outstripping earnings growth.
- Housing affordability deteriorated sharply after 2000 and, with a pause for the global financial crisis, has continued to get worse. The median house price in Greater London is 8.4 times the median income. The average house price across the UK is 4.8 times the average income.
- Home ownership overall rose steadily till 2003, then started to decline. Housing assets have been redistributed to older and richer people and to those whose parents were themselves home owners. Together with increasing regional house price differences, this means that more and more people are not just excluded from valuable assets but priced out of access to better jobs.
- The housing crisis is largely due to a lack of housing. The UK's planning system is the main cause of this. Construction of new homes, especially in higher demand areas, has been decreasing steadily since the 1970s.
- The main constraint on supply is lack of space: Green Belts prevent outward growth, height restrictions stop upward growth. Reform may be politically difficult but there is enough Green Belt land of no environmental or amenity value close to commuter stations in just five city-regions, to build 2 million homes. Coupled with aligning incentives to encourage building this could raise £100 billion of revenues to fund infrastructure and local services.
- Given the constraints on housing supply, the main effect of policies stimulating demand is to increase house prices. In supply-constrained, typically high demand areas, Help-to-Buy actually made housing less affordable. The price increase of newly-built homes outweighed the help to individuals. In these areas house building was static, only profits of registered developers increased.
- Taxation contributes to the problem. Council Tax provides scant incentive for local communities to allow development. Together with the politicised local decision-making in planning, this fuels NIMBYism. Stamp Duty taxes mobility. It discourages downsizing and hampers growing families buying roomier housing.
- A local land tax with annual revaluation and proceeds flowing to local communities would provide incentives for development.

Introduction[1]

'The sense of injustice (Generation rent) feel at being denied a fair chance to buy a property is one of the cardinal political developments of our time… the growing gulf between Britain's 'property- haves' and 'property-have nots'…casts serious doubt on the UK's claim to be a progressive society…the central argument of *Home Truths* is that we must radically reform the supply side…' Liam Halligan, *Home Truths*, 2019

Housing affordability is a key concern of an ever-larger fraction of UK voters who are crammed into artificially limited space. It also underlies the sense of being shut out of prosperity and unable to escape declining local economies. The historical rise in the real price of housing[2] means a lot of wealth is now tied up in housing assets, mainly in land as a financial asset, reflecting its shortage, and there are many vested interests in keeping things this way (such as well-established homeowners and landlords). Substantive reforms could solve the housing crisis, but with a few honourable exceptions, politicians, especially ambitious ones, of all stripes, back away from such reforms out of fear of being demonised by the vested interests. Instead, proposed policies tend to tackle the symptoms – rather than the causes – of the UK's housing crisis; or worse – like the Starter Homes scandal – they are designed just to give the appearance of caring.

This election analysis provides an overview of the key issues and the underlying causes. It discusses the merits and demerits of key policies. It concludes with a discussion of those reforms that ought to be on the policy agenda.

The housing affordability crisis

The central housing policy issue in the UK is the so-called 'affordability crisis' – the fact that housing has become ever more unaffordable, especially for younger households trying to get on the housing ladder.

The homeownership rate for families in the UK rose steadily till 2003.[3] It has then declined until 2015 when the rate stabilised. For younger families under 35 the decline started much earlier, in 1989/90, and it was much more pronounced. The proportion of families with household heads aged between 25-34 years fell from 50.8 in Q4 1989 to 24.5 in 2016. The rate has since stabilised, possibly partly as a consequence of Help to Buy triggering new construction in areas with less unresponsive supply (see below). This evolution of homeownership attainment for the young is in stark contrast to older families. The proportion of home-owning families with household heads aged 65 or older, has been rising throughout the 2000s and 2010s, reaching 75.1 in 2017.

This redistribution of housing assets to the older, as a result of the increasing difficulty of moving into home ownership for the young, is mirrored in the growing importance of the 'bank of mum and dad'. As another CEP Election Analysis shows[4], between 2000 and 2012 a young person's chance of home ownership fell sharply if their parents were not already home owners.

[1] This Election Analysis builds on the CEP Election Analysis on Housing and Planning (Hilber, 2015).
[2] Roughly 5-fold since the mid-1950s. See Cheshire (2014) for more detail.
[3] Housing tenure by age categories have been derived from the Resolution Foundation website: https://www.resolutionfoundation.org/data/housing/ (last accessed on 25/11/2019).
[4] On Social Mobility: http://cep.lse.ac.uk/pubs/download/ea045.pdf

The price of houses includes their value as assets as well as the value of housing services they provide. Since it is real incomes that mainly drive the demand for housing services, rents – their price – have risen less since the financial crisis. But real incomes even now have barely regained pre-crisis levels. Asset yields have remained seriously low so really what has been observed is a process of price adjustment as yields have fallen.

House prices in the UK – particularly in London and the South East – are among the highest in the world.[5] In a ranking of the buying price per square metre of a 'comparable flat' in a prime area of a country's prime city, if we ignore the tiny city-state and tax haven of Monaco, the UK prime city, London, is head and shoulders the most expensive in the world. (Globalpropertyguide.com, 2019). Since, other things equal, one would expect the cost of housing space to rise with city size, we should also take population into account in judging a city's relative housing price. In Table 1 all values are relative to London and it shows how expensive London housing is, especially when London's size is taken into account. Tokyo is almost three times the size of London, for example, but housing costs are one half those of London. Since 2014 costs in London have moved even further ahead of the next most expensive city.

Table 1: International comparisons of relative housing costs: prices per square metre

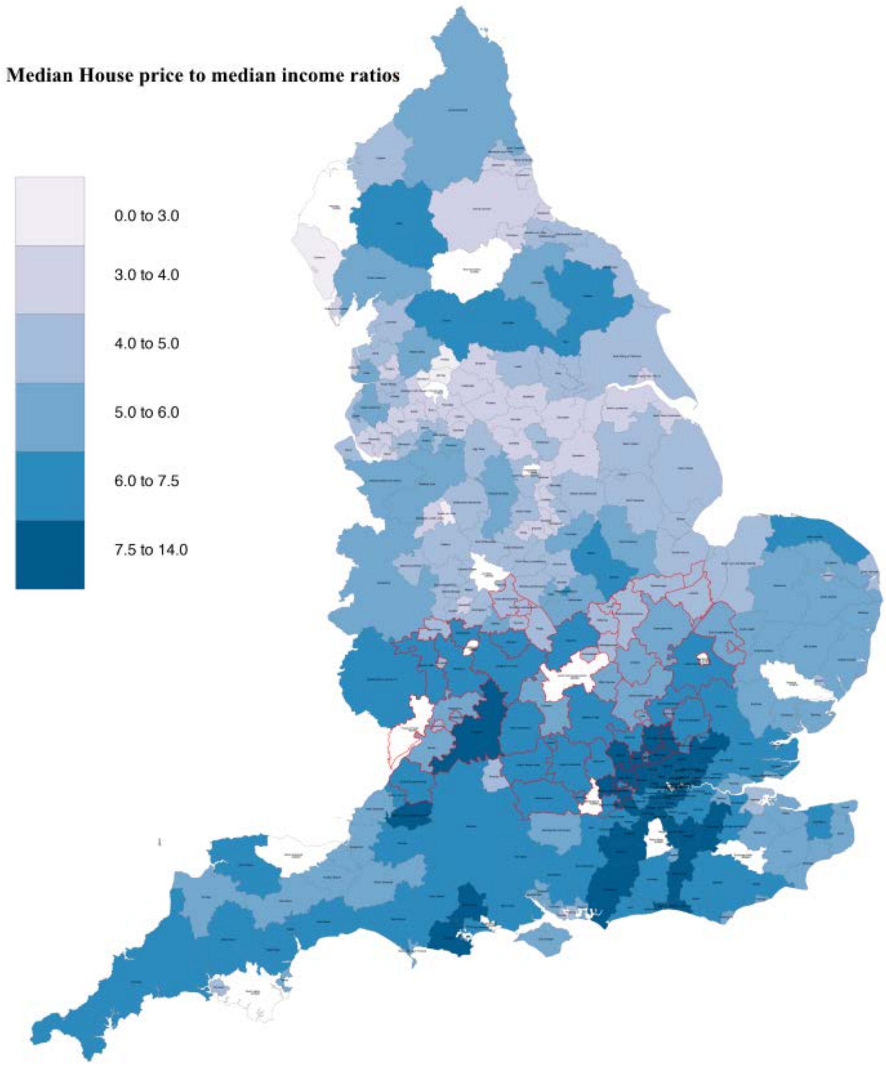
City	2014 House Price m^2 London=100[1]		2019 House price m^2 London=100[1]		2015 Population London=100[2]
London	**100.0**	**(1)**	**100.0**	**(1)**	**100.0**
Hong Kong	66.1	(2)	58.5	(2)	58.9
New York	53.6	(3)	57.9	(3)	134.8
Paris	53.3	(4)	53.5	(5)	97.1
Moscow	46.4	(5)	49.6	(6)	98.9
Geneva	44.2	(6)	48.0	(8)	6.7
Vienna	42.3	(7)	48.3	(7)	22.5
Singapore	44.2	(8)	46.3	(9)	44.6
Mumbai	33.2	(9)	31.4	(12)	177.0
Tokyo	31.2	(10)	55.0	(4)	289.7
Helsinki	24.3	(11)	26.9	(15)	12.1
Toronto	23.9	(12)	35.6	(11)	56.0
Rome	23.2	(13)	27.5	(14)	33.5
Sydney	22.1	(14)	36.1	(10)	39.0
Amsterdam	19.2	(15)	28.8	(13)	19.8
Berlin	15.9	(16)	24.7	(16)	35.5
Copenhagen	16.7	(17)	17.9	(17)	16.3
Bratislava	7.7	(18)	12.9	(18)	5.9

[5] UK house prices are also extremely volatile. Real house price swings in the UK were substantially larger during the last full real estate cycle than those in even the single most volatile metro area in the United States (Cheshire, 2009, and Hilber and Vermeulen, 2016).

UK housing costs are not only very high in absolute terms and relative to other countries but also relative to incomes. Conventionally measured 'affordability' – median house price to median income – in the Greater London area is now at its worst since data became available, despite the Great Recession. According to Demographia (2019), the price-to-income multiple in the Greater London area in 2018 was 8.3, ranking its affordability at 294th out of 309 housing markets rated. For the entire UK, the median multiple was 4.8 – in their categorisation 'seriously unaffordable'. The Demographia study also notes that housing is particularly unaffordable in those countries that have adopted planning systems similar to the UK's.

The UK's affordability crisis has its epicentre in London (see Figure 1) but extends over most of England and all of the South East. It has been developing slowly since the 1960s accelerating in the early 2000s. Real house prices – but not real incomes – have grown faster in the UK over the last 40 years than in any other OECD country (Hilber and Vermeulen, 2016).

Figure 1: Housing Affordability in England: Median House Price/Median Incomes by Local Authority, 2016



Note: Income data not available for some LAs which are left blank
Source: (Cheshire and Carozzi, 2019).

Who are the losers in this affordability crisis? The obvious answer is young households, but although existing homeowners seemingly benefit from higher asset prices, most of them are also adversely affected. This is because they cannot realise the 'gains' unless they downsize their housing consumption, give up owner-occupation and rent or sell their house to move abroad. In the interim, they have to live in cramped spaces (Hilber and Vermeulen, 2016).

What caused the housing affordability crisis?

Despite rising real incomes and strong population growth, construction of new housing has been decreasing steadily since the 1970s, leading to a substantial housing shortfall.[6] Looking at the data for completions reveals the scale of the problem starkly. In the 30 years 1959-1988, 7,449,160 houses were built in England: in the 30 years 1989-2018, only 3,328,850. That suggests a shortfall of 3,120,310 homes – 104,000 a year – over the last 30 years. All major political parties agree that today there is a serious shortage of housing, that there is not enough housing construction and that housing should be more affordable.

Empirical research points clearly to the UK's planning system – in conjunction with strong demand for housing in some regions, notably the south eastern – as the main cause of this housing affordability crisis (Cheshire, 2009, 2014 and 2018, Cheshire et al, 2014, Hilber and Vermeulen, 2010 and 2016, and Overman, 2012).[7]

This system, which dates back to the Town and Country Planning Act of 1947, is extraordinarily rigid by world standards. The real restrictions came, however, with the Conservative government elected in 1951 which phased out the New Towns Policy and, in 1955, introduced a Green Belt designed not to provide 'green lungs' for city-dwellers but rigidly restrict the outward expansion of London. To this is added strict controls on height, lack of fiscal incentives at the local level to develop and 'not in my backyard' (NIMBY) behaviour empowered by the politically controlled and discretionary planning regime. The British use of so-called 'development control' to decide each significant proposal for development makes all decisions about whether development can go ahead subject to local political calculations and therefore more subject to lobbying and more uncertainty.

Evidence for England suggests that planning constraints magnify the impact of growing housing demand on house prices across the country, but the effects are starkest in London and the South East. Housing is being built where there are the fewest disincentives to permit development rather than where demand is greatest. Demand is for roomier houses in areas close to productive jobs. Instead we have been building relatively more houses where the local economy is slack (but there is lots of brownfield land) and population relatively slow growing. Compare Barnsley and Doncaster with Oxford and Cambridge: population growth and house building, show exactly the reverse pattern to that which logic would suggest: systematically fewer houses built in the more prosperous and faster growing local economies. In the nearly 40 years from 1980 to 2018, 56,340 houses were built in Barnsley and Doncaster combined but

[6] In measuring new supply what matters is house building – completions – not that increasingly popular measure 'net additional dwellings'. This is increasingly popular with politicians because, of course, the greater the shortfall of new supply, the less the incentive to demolish obsolete houses. Instead they are refurbished and sub-divided. Obsolete offices and industrial buildings are converted into substandard housing. So the volume of net additional dwellings rises relative to actual building of new houses – completions - the worse the shortage of houses is.

[7] The effects of the UK's planning system are not confined to housing. Cheshire and Hilber (2008) provide evidence that firmly links regulatory constraints to the extraordinarily expensive price of UK office space. Cheshire et al (2015) demonstrate that 'Town Centre First' policies in England imposed a loss of output of 32% on a typical store opening after the rigorous implementation of the policy in 1996.

only 29,430 in the combined Cambridge and Oxford. The pattern of relative population growth was almost the reverse: a 95,079 increase in Oxbridge against a 29,430 increase in the Barnsley and Doncaster pair (Cheshire and Carozzi, 2019).

Research analysing data for England over recent decades finds that in places with tight regulatory constraints, house prices respond much more strongly to labour demand shocks than in places with less tight constraints (Hilber and Vermeulen, 2016). According to their estimates, house prices would have risen by about 100% less in real terms between 1974 and 2008 if, hypothetically, all regulatory constraints were removed.

Removing all constraints is of course neither practicable nor desirable. Constraints can generate public goods in the form of open spaces, wildlife habitats and scenic land or city-scape. However, pragmatically, if the South East (the most tightly regulated English region) had had the regulatory restrictiveness of the North East of England (less regulated, but still restrictive by world standards), house prices in the South East would have been roughly 25% lower in 2008 and perhaps 30% lower in 2015. Moreover, these are lower bound estimates for several reasons, including the fact that restrictions were already affecting prices in 1974.

Why are not all areas equally restrictive? In wealthy local authorities with strong demand pressures, homeowners and landlords have most assets to protect so they have the strongest incentives to restrict local development either via voting or lobbying (Hilber and Robert-Nicoud, 2013). Struggling places with weak demand and high unemployment may be more prone to permit commercial development to create local jobs. Even residential development may become palatable since it creates construction jobs and there is a relative abundance of ‘brownfield’ land.

What about physical, geographical and topographical constraints? Constraints due to scarcity of developable land mainly apply to highly urbanised areas (Hilber and Vermeulen, 2016). But in these areas – most pronounced in the Greater London area – the effect is large in the sense that due to scarcity constraints, house prices increase strongly in response to positive demand shocks.

Does Help to Buy create new housing and more homeowners or merely push up prices and profits of developers?

Effects of Help to Buy on house prices and construction volumes

The government’s ‘Help to Buy’ policy stimulated housing demand – which, in theory at least, could have translated into new housing being supplied and higher homeownership. However, to the extent that housing supply is unresponsive to demand shocks, the main effect of the policy may just be to push up house prices.[8]

By far the most popular among the various Help to Buy offers is the Equity Loan scheme. It provides a loan for up to 20% of the house value (or inside London, up to 40%) to buy *new build* properties. Buyers of such properties also do not pay interest for the first five years after purchase.

[8] As a CEP Urban & Spatial Programme Blog entitled ‘Help to Buy’ pointed out immediately after its first introduction: http://spatial-economics.blogspot.com/2013/06/.

Exploiting two spatial discontinuities in the equity loan scheme – at the boundary of the Greater London Authority and at the English/Welsh border – Carozzi et al (2019) explore the effects of the scheme on house prices, construction volumes and developer profits, among other outcome measures.

What they find is that in the Greater London Authority, where housing supply is subject to severe long-run constraints (including a Green Belt three and a quarter times its area surrounding it) and housing is already extremely unaffordable, Help to Buy substantially increased house prices. In fact, their estimates suggest that prices increased more than the present value of the equity loan subsidy.[9] Yet, the policy had no discernible effect on construction volumes or aggregate private mortgage lending.

Help to Buy did increase construction numbers, without significantly affecting prices near the English/Welsh border, an area with relatively flexible supply constraints, virtually no Green Belt constraints, and commensurately affordable housing.

What these findings more broadly imply is that the policy seems completely ineffective in the most unaffordable areas of the country, where the most productive and desirable jobs tend to be concentrated and more housing is most desperately needed, but where young would-be buyers are now in some sense more 'priced out'. The policy only works in more remote areas where it is easier to build but where there are few job opportunities. The consequence is that not only is there a mismatch between local housing supply and local job opportunities, but also, desperate young buyers have to commute ever longer distances (often leapfrogging Green Belts) to get to their jobs.[10]

Effects of Help to Buy on other outcomes (inequality, systemic risks, homeownership)

But Help to Buy is not only a largely ineffective and 'unsustainable' policy, paradoxically, it also further increases inequality. This is partly because the policy pushes up house prices further in already unaffordable areas, thus benefiting longstanding and typically wealthy home owners in these areas as well as owners of undeveloped land. Partly it is because, as the study by Carozzi et al (2019) also shows, the policy helped to push up the profits of developers registered in the Help to Buy business.

Moreover, the scheme may have created a systemic risk in that the government (that is, the taxpayer) assumes most of the risks, with the remaining risk being assumed by marginal – typically financially vulnerable – homebuyers (that is, those who could not obtain loans in the absence of the scheme).

We do not have any direct evidence of Help to Buy on homeownership due to data limitations. However, evidence from the United States (Hilber and Turner, 2014) suggests that there is only a very weak link at best between mortgage subsidies and homeownership rates. In fact, in local markets which were tightly regulated, the subsidies in the US had a *negative* effect on homeownership because the price effect – through increased demand – more than offsets the

[9] Likely this is because the government's equity loan does not only represent a subsidy for (most) buyers, but additionally relaxes credit and liquidity constraints. The latter may explain why the subsidy is more than fully capitalized into higher house prices.

[10] This mismatch between housing supply and job opportunities is further exacerbated by the rigidness of the British planning system. Cheshire et al (2018) show that tight local planning constraints cause local housing vacancy rates and commuting distances (i.e., the distance between an individual's place of residence and her or his job location) to increase.

income effect from the tax deduction. In less regulated markets, subsidies do have a positive effect on homeownership rates, but only for higher income groups.

Reforms for failed property taxes

The trouble with the council tax

One key cause of the lack of residential construction in the UK is the fact that local authorities have virtually no fiscal incentives to permit development. In many countries where planning decisions are taken at the local level, local property and especially local income taxes provide strong incentives to local authorities to permit development (Hilber and Schöni 2016). The only local tax in the UK is the council tax. One key flaw of this tax is the fact that there hasn't been a revaluation since 1992 – postponed by successive governments as being politically too difficult.

This has had two consequences:

- The tax has become increasingly regressive at the top end because of the effective capping of the top rate of tax.
- It bears little relation to underlying property values. Moreover, it has little weight in the tax system compared with other countries (and compared with what it would be under an efficient tax system – see Mirrlees et al, 2011).[11]

In addition, the equalisation system, which redistributes revenues on what is called a 'needs' basis, more or less eliminates any revenue gain in the medium term for local authorities that permit more development relative to those that are more restrictive.

Thus, the council tax in combination with funds to local authorities being allocated primarily on the basis to formulae, defended on the grounds that funds follow needs, provides no effective incentives to local authorities to permit development. The lack of incentives coupled with NIMBY behaviour (facilitated by politicised decision-making in the UK's planning system) contributes substantially to the housing shortage.

The trouble with the stamp duty

In 2014, the then government eliminated a longstanding anomaly of the Stamp Duty Land Tax (SDLT). Under the old rules, homebuyers had to pay the tax at a single rate on the entire property price leading to large discontinuous jumps in the tax at threshold property prices. For example, a house sold for £250,000 implied a tax liability of £2,500, whereas a house sold for £250,001 implied a liability of £7,500.

Under the new rules, homebuyers only pay the rate of tax on the part of the property price within each tax band – like the income tax. While this reform has been a step in the right direction, it does not address the fundamental problem of the SDLT, namely that it creates a disincentive for people to move house, which has adverse consequences for the functioning of housing and labour markets (Mirrlees et al, 2011).

[11] Another issue with the Council Tax is that it varies hugely across regions and local authorities and depends on which political party is in power locally. To the extent that the Council Tax does provide any incentive to permit development, this further distorts the signals as to where new housing ought to be added.

Research strongly suggests that the adverse effects of the SDLT on housing transactions and household mobility are very large. Whereas Besley et al (2014) find that the 2008-09 stamp duty holiday temporarily increased transactions by 8%, Best and Kleven (2015) estimate the effect of the elimination of the tax on the transaction volume to be 20% in the short run. Hilber and Lyytikäinen (2017a) find that the increase in stamp duty from 1% to 3% at the cut-off of £250,000 reduces the annual rate of mobility by 2 to 3 percentage points or about 30%. This adverse effect is confined to short-distance and non-job-related moves, suggesting a more powerful distortion in the housing than the labour market: the stamp duty discourages downsizing and makes it more difficult for young families to expand their housing consumption.[12]

The stamp duty has been subjected to two other, more recent, reforms. The first is the introduction in 2015 of a stamp duty surcharge of 3% over the standard rate on second homes. This reform is likely to have induced an immediate (one-time) price reduction but has otherwise no incentive effect on second home owners to use their property more intensively (see also Hilber, 2018, and Hilber and Schöni, 2018). In fact, in contrast to a proper property or land value tax, the stamp duty encourages second home investors to hold their property for a longer time period, as the tax only applies at the point of sale. The second reform is the exemption in 2017 of first-time buyers from the stamp duty up to a value of £500,000. The trouble with it is that the effect of the exemption, similar to Help to Buy, is likely to push up house prices further, especially of small (entry-level) homes in tightly supply constrained areas like London, Oxford or Cambridge. This is because the exemption specifically stimulates demand for entry-level housing in those areas.

The key conclusion of all this is that the SDLT is highly inefficient. Some of the recent reforms to SDLT have been sensible (the 2014 reform), others less so (those of 2015 and 2017), but in any case, they do not address the crucial issue of the tax, namely that it constrains household mobility and thereby discourages downsizing by the elderly and upsizing by expanding young families.

Our above reasoning suggests that both the Council Tax and the SDLT are inefficient and further exacerbate the housing affordability crisis. They fail to provide incentives to build more houses and create mismatches in the housing market, further aggravating the housing shortage especially for young expanding families. So, what would be a better alternative?

One proposal, suggested by one of us[13], would be to phase out the SDLT and replace the current Council Tax with a proper local property tax—an annual local tax on the actual house value.[14] This could be achieved in a revenue neutral fashion and in two steps. In a first step, the Council Tax is replaced with a *local tax on property values*, with property values automatically revalued on an annual basis, based on location-specific price changes.

[12] See also Hilber (2017b) for a summary.
[13] Hilber (2016).
[14] An even better alternative might be a local Land Value Tax (LVT). This has the advantage that it cannot be avoided, is non-distortionary, provides an incentive not to sit on more land than is wanted and deters speculative land holding. One difficulty that may explain why the tax is not more widespread is that it is tricky to accurately assess the value of land, especially in areas where there are very few land transactions and most land is already built on. However, statistical estimation using hedonic methods could resolve the valuation issue and there are successful examples, e.g., in Denmark (see https://www.ft.com/content/392c33a6-211f-11e3-8aff-00144feab7de).

In a second step, the SDLT would be phased out over several years[15], while at the same time, the weight of the local property tax in the tax system is gradually increased to maintain revenue neutrality. Local authorities can use the resulting tax revenue to provide and improve local services and infrastructure. It is important that such a reform would also ensure that development-induced increases in the tax revenue base are not equalised away through the central government grant system.[16] Thus, local authorities that are generous in permitting residential development will be able to permanently generate additional resources and will no longer be penalised.

Such a reform has three key advantages over the current system of property taxation:

- First, the newly created local property tax does not affect the decision to move and thus does not distort housing and labour markets.
- Second, such as tax provides stronger incentives to use land or properties more intensively and not to let property stay vacant.
- Third, annual local taxes on the value of property provide greater incentives to permit development (additional tax revenue for the local authority and local taxpayers).

Phasing out the stamp duty and phasing in a proper local property (or land) value tax (that could still be called 'council tax') may not on its own solve the housing affordability crisis, but it would be an important step in the right direction.

Supply-side reforms

Our analysis has, in our judgement, rightly highlighted the pitfalls of existing and proposed housing policies, mainly on the demand side. Following the logic of the evidence, reforms to have a real impact should focus on the supply side and, in particular, on reforms of the tax system (briefly discussed above) and the planning system.

One obvious reform would be to abandon the almost entirely discretionary mechanisms of decision-making the British planning system clings to. Both whether a proposed development will be approved and what 'Planning Obligations'[17] to impose as a condition of approval, are entirely discretionary. This is highly damaging because it injects uncertainty into the development process. Development is already a risky business because it has to be based on estimated future costs and revenues but increasing uncertainty increases risk, so requires a higher return – a bigger risk premium. In turn that means a proportion of development ceases to be viable, so less gets built. It is also reasonable to argue that Planning Obligations, in particular, are one of the factors which have increased the monopolisation of development over the last 30 years. They, like the complexity of navigating our planning system, act as barriers to entry.

[15] Phasing out the SDLT over several years, rather than in one go, slows down and reduces redistribution that is inevitable when reforming the tax system. Abolishing the SDLT in one go may lead to unacceptable levels of redistribution e.g. between those who have just bought a house and those who will by a house after a radical tax reform.

[16] Helping the disadvantaged and equalisation based on 'needs' is important, but it should be done at the individual level rather than via trying to address 'local need'. This is important because LSE research (Hilber et al 2011) has shown that central government grants are essentially fully capitalised into property values, thus help home owners and landlords rather than the poorest and most disadvantaged who typically rent.

[17] Section 106 Agreements now mainly to provide allegedly affordable housing as a quid *pro quo* for getting permission.

The Master Planning system of Continental Europe and, to a lesser extent, the Zoning system of the US, lead to clear-cut and predictable decisions. The plan, once democratically adopted by the local community, defines what developers can do. This may be parcel by parcel or it may be framed in terms of rules applying to large zones. Either way the extra risk premium our discretionary system imposes is avoided and, since 'rule-based' systems are less complex, barriers to entry are lower. Another significant source of uncertainty and barrier to entry could be eliminated by replacing the existing discretionary, bargained 'Planning Obligations' with a transparent tax, levied on the realised sales value of all new development. This would be a far more efficient mechanism for extracting value increase resulting from planning approval.[18]

Any reforms to increase land supply should take into account problems of market failure endemic in land markets because of both their contribution to land-derived public goods, such as open space, and problems of external costs stemming from the reality that the value of every parcel of land is influenced by activities on neighbouring parcels. Unregulated markets would not supply enough land for urban open space, recreation, wild life habitats, National Parks, Areas of Outstanding Natural Beauty, and historic districts in cities or heritage buildings. There is a strong case for safeguarding such land. However Green Belts not only cover about 1.4 times as much land as all urban areas – the London Green Belt stretches from the North Sea to the edge of Aylesbury and covers 22 percent the area of the GLA itself – but they do not protect land on the basis of its social or environmental value. They exist uniquely to prevent development: in the jargon to 'prevent settlements merging'.

There have been several proposals over the past five years to release some low amenity value Green Belt land[19] close to stations. In practical terms, this would imply re-designating some land that is in high intensity agricultural use or perhaps used for private golf courses or derelict and near current or planned transport routes or access points.

One of us published a more detailed report (Cheshire and Buyuklieva, 2019) showing how, if rigid planning rules were relaxed, some 2 million new homes could be built close to train stations serving major employment centres at no cost to government at all and at considerable gain to the local communities where they were built. This did two things. The first was to identify how much environmentally valueless land there was within 800 metres of 'commuter stations' – defined as providing a service to the major employment centre within 45 minutes. The second was to suggest specific measures designed to realign incentives so that local communities would welcome new development, the scope for NIMBYism would be much reduced, developers would invest in rail-based development with low carbon footprints, land value uplift would be diverted to fund both social housing and need local infrastructure as well as support commuter rail services. At the same time people could commute shorter distances and be able to access well paid, productive jobs.

In brief the proposal was that the owners of the stations (like Transport for London or Network Rail) should set up development companies run on commercial criteria and that these new

[18] The value increase is very large indeed and represents an extraordinary price distortion revealing how severely land for housing is restricted at present. According to https://www.gov.uk/government/publications/land-value-estimates-for-policy-appraisal-2017 in the absence of planning obligations, land for housing is commonly worth £3 to £7 million per hectare in southern England and, on the northern fringes of London, £17 to £25 million. This compares with an agricultural price of some £20,000: so up to a 1,000 fold increase in price.

[19] Barney Stringer of QUOD https://barneystringer.wordpress.com/2014/06/17/is-the-green-belt-sustainable/ and Paul Cheshire of LSE http://spatial-economics.blogspot.co.uk/2014/07/building-on-greenbelt-land-so-where.html or LondonFirst (2015).

development companies should be given the sole right to develop all the land identified as 'buildable' within 800 metres of commuter stations. As sole buyers they could buy land cheaply – for not much more than agricultural prices instead of the £3.5 million a hectare minimum that currently has to be paid for housing land anywhere in southern England. If developing the land around stations was incentivised by tapering off subsidies to commuter rail and co-ordinated by a newly created Development Corporation (along the lines of New Town Development Corporations created to address the housing crisis of the 1950s), it would ensure the land was built out speedily but according to rail capacity. At the same time the Development Corporation could ensure the new homes were built out in rail and cycle friendly fashion so current car-oriented developments were replaced by low carbon, rail-oriented ones.

In addition, it was proposed that current and extraordinarily inefficient negotiated Planning Obligations (Section 106 Agreements) and the Community Infrastructure Levy would be abolished for this land and replaced by a transparent tax on the sale price of all the new construction. This would produce proper funding to pay for enhanced services and infrastructure for the local communities receiving the development – place-making infrastructure – and proper funding for truly affordable housing in the social sector. Aside from some financing to bridge cost and revenue flows, government would not have to pay a penny. All this could be funded from land value uplift.

The difficulty would be a political one. The policy would allow building on Green Belt land – but only so long as that land had no environmental or amenity value. There is a remarkable quantity of such land. A worked example for five city-regions, Birmingham, Bristol, London, Manchester and Newcastle revealed 47,000 hectares of 'buildable land'. Reserving 10% for new publicly accessible green space and wild life habitat still provided enough land to accommodate 2 million additional homes – 15-years of building at recent rates. If the new development levy was set at 20% it would produce some £100 billion of revenue over time to pay for the place-building infrastructure and new social housing.

In the longer term, one could revert to protecting all land only on the basis of its environmental or amenity value taking account of infrastructure costs and the carbon footprint of development. This could be done by increasing the areas of outstanding natural beauty so that there were substantial green spaces within reach of all major cities ('green fingers' more than 'green belts'), retaining all habitat or national park protection but using land price differentials as price signals to let planners know where or when land would be more usefully transferred to some other use.

If the price of land, if it were developed in some alternative use, exceeded its value in its current use by more than some fixed amount (a 'threshold' acting largely as a greenfield development tax) and it could be shown that that price differential was not justified by the environmental or amenity benefits associated with the land in its present use, then there would be a presumption in favour of development (Cheshire and Sheppard, 2005). In fact, the Guidance to the National Planning Policy Framework (NPPF) issued in 2019 incorporates something close to this idea as an affordability formula to gauge demand to guide where to release land locally for housing.

Other supply-side reforms could work via altering fiscal incentives at the local level as discussed in the section dealing with tax reforms above. These are 'supply-side' measures since they could greatly reduce the existing incentive for local communities to prevent development.[20] The 2010 coalition government made tentative moves in this direction with the New Homes Bonus but this was ineffective since the fiscal incentive was only temporary (for three years) and was far too timid to offset the local authority's costs associated with residential development.

More fundamental reforms would be necessary to provide sufficient incentives to local authorities to change their ways. In an ideal world, this would work via replacing the council tax and the stamp duty land tax with a proper annual local property tax, ideally based on land values, with automatic annual revaluation based on neighbourhood specific price changes. This could be designed to be revenue neutral. Such a reform is politically difficult but it would help to address various housing-related issues in one go. To this could be added the Land Development Charge (LDC), mentioned above, charged on the sale value of all new development and replacing both Planning Obligations and the Community Infrastructure Levy (an arbitrary tax on development imposed by only a minority of Local Authorities with no safeguards that revenues are applied to providing 'community infrastructure'). Proceeds from the LDC would go to Local Authorities and be ring-fenced from funding equalisation. Local Authorities in turn would be required to spend the revenues on supporting infrastructure and transparently funded social housing. One advantage of the LDC, apart from its transparency and predictability is that its cost would be negatively capitalised into land prices.

Conclusions

The evidence shows there really is a crisis of housing affordability and the effects of this crisis are spreading far beyond just housing. They are severely handicapping economic productivity, reducing social welfare and having a severely detrimental impact on the distribution of wealth both between the young and the old and between the high price regions of the south and the low price regions of the north. Housing may be affordable in our declining local economies but that often traps people in hopelessness.

Empirical research points clearly to the UK's rigid planning system as the main cause of the housing affordability crisis. Demand-side policies such as Help-to-Buy don't work in this setting because they merely increase house prices.

The current property-related taxes are inefficient, especially the council tax and the stamp duty. The former is regressive and does not provide sufficient incentives to permit development at the local level, the latter hampers household mobility and generates distortions in the housing markets. Importantly, it discourages downsizing of the elderly and impedes the upsizing of expanding young families.

This Election Analysis presents a set of more supply-side friendly policies. The obstacles to moving to such policies must not be underestimated since they are likely to antagonise vested interests and would change the structure and distribution of financial assets. But the long-run

[20] That disincentives restrict supply was shown in Cheshire and Hilber (2008). Even the change from locally administered Business Rates to the central government Uniform Business Rate in 1990 had a significant disincentive effect on the willingness of local authorities to allow office development and, as a direct result, over time increased costs of office space more than any conceivable level of the previous local Business Rates. This was a small change in incentives since, because of the policy of funding local expenditures largely on the basis of a needs-based formula, there was already a minimal real incentive from local Business Rates. Over the medium term extra revenues from a higher local rate of tax would be dissipated. All the Uniform Business Rate did was to make this lack of incentive transparent and immediate. The revenues never passed through local hands at all.

consequences of just symbolic action and promises which cannot be implemented are likely ultimately to prove socially explosive and economically traumatic.

November 2019

Further reading

Besley, T, N Meads and P Surico (2014) 'The Incidence of Transaction Taxes: Evidence from a Stamp Duty Holiday', *Journal of Public Economics* 119: 61-70.

Best, MC and HJ Kleven (2015) 'Housing Market Responses to Transaction Taxes: Evidence from Notches and Stimulus in the UK', *Review of Economic Studies* 85(1), 157-193.

Carozzi, F., CAL Hilber and X Yu (2019) 'The Economic Impacts of Help to Buy', LSE mimeo, November.

Cheshire, P (2009) 'Urban Containment, Housing Affordability and Price Stability – Irreconcilable Goals', SERC Policy Paper No. 4, September

(http://www.spatialeconomics. ac.uk/textonly/SERC/publications/download/sercpp004.pdf).

Cheshire, P (2014) 'Turning Houses into Gold: The Failure of British Planning', *CentrePiece* 19:1 (http://cep.lse.ac.uk/pubs/download/cp421.pdf).

Cheshire, P (2018) 'Broken market or broken policy? The unintended consequences of restrictive planning', *National Institute Economic Review*, **245**, R9-19. http://eprints.lse.ac.uk/90240/

Cheshire P and B Buyuklieva (2019) 'Homes on the right tracks. Greening the Green Belt to solve the housing crisis', September, Centre for Cities.

Cheshire, P and F Carozzi (2019) 'Housing Sprint: land report. Housing Sprint. Oxford Future of Real Estate Initiative, Oxford, UK.

Cheshire, P and CAL Hilber (2008) 'Office Space Supply Restrictions in Britain: The Political Economy of Market Revenge', *Economic Journal* 118(529): F185-221.

Cheshire, P, CAL Hilber and I Kaplanis (2015) 'Land Use Regulation and Productivity – Land Matters: Evidence from a Supermarket Chain', *Journal of Economic Geography* 15(1): 43-73.

Cheshire, P, CAL Hilber and HRA Koster (2018) 'Empty homes, longer commutes: The unintended consequences of more restrictive local planning', Journal of Public Economics 158: 126-151.

Cheshire, P, M Nathan and H Overman (2014) *Urban Economics and Urban Policy: Challenging Conventional Policy Wisdom*, Edward Elgar.

Cheshire, P and S Sheppard (2005) 'The Introduction of Price Signals into Land Use Planning Decision-making: A Proposal', *Urban Studies* 42(4): 647-63.

Demographia (2019) *15th Annual Demographia International Housing Affordability Survey: 2019, Ratings for Metropolitan Markets* (http://www.demographia.com/dhi.pdf).

Globalpropertyguide.com (2019) *World's Most Expensive Cities*, available from: http://www.globalpropertyguide.com/most-expensive-cities [22 November 2019].

Halligan L (2019) *Home Truth. The UK's Chronic Housing Shortage.* London: Biteback Publishing.

Hilber, CAL (2015) 'UK Housing and Planning Policies: The evidence from economic research', *CEP Election Analysis Series*, Paper EA033.

Hilber, CAL (2016) 'The UK planning system – proposals for reform', *Planning and Building Control Today*, July.

Hilber, CAL (2018) 'Second home investments', *CentrePiece* 23(3), 25-28.

Hilber, CAL and T Lyytikäinen (2017a) 'Housing Transfer Taxes and Household Mobility: Distortion on the Housing or Labour Market?', *Journal of Urban Economics* 101, 57-73.

Hilber, CAL and T Lyytikäinen (2017b) 'Stamp duty, mobility and the UK housing crisis', *CentrePiece* 22(3), 17-20.

Hilber, CAL, T Lyytikäinen and W Vermeulen (2011) 'Capitalization of Central Government Grants into Local House Prices: Panel Data Evidence from England', *Regional Science and Urban Economics* 41(4), 394-406.

Hilber, CAL and F Robert-Nicoud (2013) 'On the Origins of Land Use Regulations: Theory and Evidence from US Metro Areas', *Journal of Urban Economics* 75(1): 29-43.

Hilber, CAL and O Schöni (2016) 'Housing Policies in the United Kingdom, Switzerland and the United States: Lessons Learned', *Cityscape* 18(3), 291-332.

Hilber, CAL and O Schöni (2018) 'The Economic Impacts of Constraining Second Home Investments', CEP Discussion Paper No. 1556, July 2018.

Hilber, CAL and TM Turner (2014) 'The Mortgage Interest Deduction and its Impact on Homeownership Decisions', *Review of Economics and Statistics* 96(4): 618-37.

Hilber, CAL and W Vermeulen (2010) 'The Impacts of Restricting Housing Supply on House Prices and Affordability – Final Report', London: Department for Communities and Local Government.

Hilber, CAL and W Vermeulen (2016) 'The Impact of Supply Constraints on House Prices in England', *Economic Journal* 126(591), 358-405.

Mirrlees, J, S Adam, T Besley, R Blundell, S Bond, R Chote, M Gammie, P Johnson, G Myles and J Poterba (2011) *Tax by Design: The Mirrlees Review*, Oxford University Press.

Overman, H (2012) 'The UK's Housing Crises', *CentrePiece* 17:3, (http://cep.lse.ac.uk/pubs/download/cp382.pdf).

Stringer, B (2014) 'Barney's Blog: Is the Green Belt Sustainable?' (https://barneystringer.wordpress.com/2014/06/17/is-the-green-belt-sustainable/).

Authors

Paul Cheshire is Emeritus Professor of Economic Geography at the London School of Economics and an associate of the Centre for Economic Performance.

Christian Hilber is Professor of Economic Geography at the London School of Economics and an associate of the Centre for Economic Performance.

For further information, contact:

Paul Cheshire: 0207 955 7586, p.cheshire@lse.ac.uk
Christian Hilber: 0207 107 5016, c.hilber@lse.ac.uk
Helen Ward: 07970 254872, h.ward1@lse.ac.uk
Romesh Vaitilingam: romesh@vaitilingam.com

CEP
2019
ELECTION
ANALYSES
SERIES

CEP
2019
ELECTION
ANALYSES
SERIES

CEP
2019
ELECTION
ANALYSES
SERIES

#GE2019Economists