The pandemic led to increased demand for bigger homes and gardens. With housing supply limited by strict UK planning regulations and the market propped up by a stamp duty waiver and the furlough scheme, prices of detached houses have risen. Paul Cheshire, Christian Hilber and Olivier Schöni find that they rose most in areas close to the centre of London.

UK house prices in Covid-19 times

The British care deeply about what happens in housing markets. Older house owners care because so much of their personal assets are tied up in housing; the young care because they feel left behind and are increasingly desperate to be able to afford decent homes. So there has been plenty of speculation about the effects the pandemic would have on the housing market – some of which has proved to be wide of the mark.

At the start of the pandemic, we anticipated that office closures and the fear of packed commuting would lead to an increase in the demand for home-working, with clear implications for space within the home (Cheshire and Hilber, 2020).

Like most, we thought that in the short term, this would lead to falling prices in central areas and a change in demand away from packed cities towards suburban areas – perhaps with an increase in relative demand for very small living spaces in central cities, to support two or three days a week in the office. This implied increasing long distance moves, jumping the Green Belt, and longer, less frequent commutes. It also implied a fall in demand for centrally located, smaller houses compared with larger houses in the outer suburbs.

Although this has become a kind of conventional wisdom, with headlines describing a 'race for space' and rising demand for large country houses, further reflection, and now evidence of what has actually happened in the housing market over the past year, has caused our judgements to evolve.

Partly these changes have been driven by government actions to prop up the housing market, delaying the downward correction in prices, personal incomes and the economy. But this change in emphasis is also partly because in the UK, it is never possible to underestimate the impact of planning policies on house prices.

The most striking result of the onset

of the pandemic was an almost total halt to activity in newly constructed houses: housing completions fell from 46,000 in the second quarter of 2019 to 16,000 in the corresponding quarter of 2020. After a brief but abrupt fall, transaction prices of detached and semi-detached houses quickly recovered after the immediate Covid-19 shock and were above all previous highs by late 2020.

Although prices for the smaller house types did recover somewhat, this was far less pronounced, and prices for flats and maisonettes never got back to their pre-Covid-19 levels at all.

It may be the case that the prices of a few large country houses increased. But the really large price increases in 2020 compared with 2019 were for the few detached houses as close as possible to the centre of London, and not for remote locations. That the increase was confined to detached houses is no surprise, and there were increases for large houses up to 25 miles outside central London. But the fact that the price increases in the later part of 2020 were so large in both absolute and relative terms in central areas is wholly against conventional wisdom.

The ability to translate an increase in preferences into purchases is constrained by incomes. London has an exceptionally unequal income distribution and the evidence is that the pandemic has made the rich (and old) even richer relative to the rest of society. Moreover, the ability to buy the most sought after housing is controlled by people's incomes relative to those of others competing in the market, not by their absolute incomes (Cheshire and Sheppard, 2004).

So a post-pandemic widening of the income distribution gave even more market power to the richest households in London. They seem to have concentrated that power on escaping the effects of the worst impacts of lockdown and the increasing demand for home-working by wanting to buy larger, more central houses.

A larger house in a central location not only allows more space to work at home, but also makes it easier to avoid public transport, to walk or cycle about the city and to the office when that is necessary. It might also reflect a bet on the longer-term bounce-back of cities in general and London in particular. But it is important to note that relative to the total market, the number of detached houses transacted in central areas is small, and they are likely to be bought by the seriously rich.

What we seem to observe in the data is a trend, long predating the pandemic, towards the construction of more detached houses with larger gardens beyond London's Green Belt. This is subject to the caveat that at present we only know about garden sizes and prices in detail for houses inside the Greater London authority.

This trend appears to reflect an increase in preferences for more living space and larger garden sizes. Detached houses are built further and further out, because more central locations are simply no longer affordable. This is a consequence of strong demand in conjunction with a dysfunctional planning system limiting supply (Hilber and Vermeulen, 2016).

Second, the main short-term effect of Covid-19 has been to slow down housing construction, including construction of detached houses. Put differently, housing supply during 2020 was even more inflexible with respect to price than in the normally inflexible state of the UK's housing market. As a consequence, the location and form of houses to accommodate the change in tastes for space simply could not adapt, at least not in the short term.

Covid-19 may have induced stronger preferences for more living space and access to gardens for most people. But the available stock of such houses has roughly remained unchanged in the short term – hence the scarcity-driven increase in their prices.

A post-pandemic widening of the income distribution has given even more market power to the richest households in London

Demand for housing is most importantly determined by incomes. The Chancellor's actions early in the pandemic to support incomes – the furlough scheme, the scheme for the self-employed and support for businesses – effectively supported personal incomes very substantially.

In addition, there were specific measures directed at supporting activity in the housing market and house prices. The Stamp Duty Land Tax holiday scheme, which started in July 2020, was originally due to end on 31 March 2021 but has been extended to 30 June 2021. This was worth up to £15,000 on a £500,000 house, with bigger discounts for more expensive houses up to the ceiling of £500,000.

There were other measures too – aside from the extraordinarily low interest rates – such as potential mortgage payment holidays for six months to those who had lost income from Covid-19. These measures prevented a downturn in the housing market and added further pressure to the pent-up demand for larger, more expensive houses.

There is now a significant risk of policy trying to prop up house price inflation. These policies are costly to the government and eventually are likely to be reversed. If this coincides with an economic downturn and rising interest rates, there is a significant risk that the policy ends up helping to trigger a disruptively abrupt housing market downturn: a sharp reduction in transactions, an increase in properties' 'time-on-the-market' and eventually a downward adjustment of real prices.

In principle, of course, the British obsession with booming housing markets as a symptom of economic health is absurd. As we have frequently argued, housing is seriously unaffordable in the UK. The problem is the reasons for price reductions and the context. In a context of falling disposable personal incomes, a fall in house prices may not make housing any more affordable.

In the longer term, we expect cities to reassert their pull. They have survived far worse crises than the pandemic – think of the two years 1665 and 1666: first the plague, killing 15-20% of London's population, then the Great Fire destroying most of the city and a good chunk of its suburbs. But London was back and booming within 20 years.

As cities and incomes recover, a rising cost of space looks likely in the long term, especially if the UK planning system is as restrictive as it has been over the past 75 years. Our system of property taxes and local government finance adds to this problem, since it continues to penalise local authorities that permit residential development. Without radical reform, space in housing and gardens – even just houses – will increasingly become the privilege of the rich.

Housing in the UK remains seriously unaffordable

This article summarises 'The Pandemic and the Housing Market: A British Story' by Paul Cheshire, Christian Hilber and Olivier Schöni, CEP Covid-19 Analysis No. 20 (https://cep.lse.ac.uk/pubs/download/cepcovid-19-020.pdf).

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Without radical reform, space in houses and gardens will increasingly become the privilege of the rich

Further reading

Paul Cheshire and Christian Hilber (2020) 'Covid-19: Crashing the Economy so what will it do for the Housing Market?', CEP Urban and Spatial Programme Blog, April (http://spatial-economics.blogspot.com/2020/04/covid-19-crashing-economy-so-what-will.html).

Paul Cheshire and Stephen Sheppard (2004) 'Introduction to Feature: The Price of Access to Better Neighbourhoods', *Economic Journal* 114(499): 391-96.

Christian Hilber and Wouter Vermeulen (2016) 'The Impact of Supply Constraints on House Prices in England', *Economic Journal* 126 (591): 358-405 (earlier version available as CEP Urban and Spatial Programme Discussion Paper No. 119: http://www.spatialeconomics.ac.uk/textonly/SERC/publications/download/sercdp0119.pdf).