



# The Housing Question

Overcoming the shortage of homes

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## Summary

Housebuilding has been failing to keep pace with population growth and household formation for many years. Various reviews have been conducted and numerous initiatives proposed by successive governments in an attempt to increase supply. Despite a modest increase in output over the past few years, however, it remains well below what is felt to be required; the shortfall for England currently stands at more than 100,000 per annum.<sup>1</sup> The argument advanced in this paper is that poor levels of housebuilding are the result of an over-reliance on private-sector output; that private housebuilders have never been able to deliver all of the country's housing needs; that housing shortages have only ever been overcome when private output has been supplemented by substantial public-sector agency and investment; and that there is scant prospect of the current housing shortage being overcome without a similar approach. The paper proposes placing a new statutory obligation on local authorities to acquire sufficient land to top up private-sector housebuilding to the required levels, funded by central government borrowing; new homes could be sold mostly into owner-occupation and the proceeds of sales reinvested into more housebuilding, in perpetuity. It also proposes a new contract between planning authorities and developers in which permission to build residential property is time-limited and granted on a use-it-or-lose-it basis; failure to build out sites within agreed timescales would result in the forfeiture of the land at half its residential use value.

## Introduction

Something has been going wrong in the British housing market for some time now. The problems that have accumulated are manifold – home ownership is falling, social housing waiting lists are growing, overcrowding and homelessness are increasing, to name a few – but the bottom line is that housing has become increasingly expensive for everybody. Too much money has been chasing too few homes, and affordability has worsened dramatically as a consequence.

What is needed is a major step change in approach that will provide a substantial increase in supply, a significant fall in demand, or – preferably – both of those things. Successive governments in recent years have failed to tackle these issues but it is important to remember that we have overcome this challenge before. A century ago, overcrowding and high housing costs had been endemic for many decades. Over the course of the 20<sup>th</sup> century, however, a series of major public-sector housing initiatives substantially overcame what had been known as ‘the housing question’. Between 1921 and 1939, publicly-funded housebuilding averaged about 70,000 a year; between 1948 and 1979, it did not drop below 100,000 a year. Costs were kept in check and home ownership came within reach of the large majority of households.

Since the 1970s, state investment in bricks and mortar has been steadily wound down and the business of housebuilding left almost entirely to the private sector. Council housebuilding has been running at just 2,000-3,000 homes per annum in recent years; housing associations make an important contribution but even they only build in the region of 30,000 per annum.<sup>2</sup> The result has been to expose housing provision to the same dynamics it was subject to prior to the First World War: volatility in prices, volatility in output, increasing scarcity and, finally, rising housing costs and all of its attendant social problems. While conditions today do not bear comparison with those of a century ago, the root cause of the problem is almost identical: the unprofitability to private developers of building sufficient numbers of homes. What principally separates today’s housing model from its Victorian counterpart is the provision of housing benefit as a much-needed safety net in a system that is failing to serve all of the population. The cost of this safety net has spiralled since the 1980s, however, and there will be little to prevent it spiralling still further in the years ahead unless we tackle the imbalance between supply and demand. The shift in the 1970s and 1980s from capital spending to revenue spending – from bricks to benefits – is looking increasingly poor value for money.

It is widely acknowledged that England needs in the region of 250,000 new homes a year to keep pace with the rate of household formation; if we are to start tackling the backlog that has been mounting over many years then we will need to build a lot more homes than that. In the decades after the Second World War, such output levels would have seemed unremarkable: annual housebuilding in England was above 250,000 for most of the 1950s and then above 300,000 for most of the 1960s. Today such numbers seem fantastical: since 2008 annual output has barely been above 100,000 and even before the financial crisis struck it had not been above 200,000 since the 1980s, and then only briefly.<sup>3</sup> Over the last couple of years, housebuilding output has picked up a little, with 2015 witnessing 142,890 completions, and 143,560 starts, in England.<sup>4</sup> But these figures still fall a long way short of what is needed. This paper contains two central points to concentrate the minds of policymakers as they grapple with the housing question that has resurfaced for the 21<sup>st</sup> century.

The first is that the supply of housing has only ever been sufficient when private sector output was topped up by public investment: such was the case in the 1920s and 1930s, and then in the 1950s and 1960s. In both periods, shortages were substantially overcome and the cost of housing in proportion to earnings levelled out or even fell. Central to both periods were major council housebuilding programmes that essentially built those homes the private sector would not. Historically, there has always been a proportion of the population at the lowest end of the income scale for whom building homes is not profitable; either the state builds these homes or they are not built. In addition, housebuilding by the private sector has always been driven in cycles by wider economic conditions, not in strict correspondence with the actual need for housing.

The second is that the interests involved in private housebuilding (encompassing not just developers but landowners too) lack any incentive to guarantee the supply of sufficient homes. Private-sector housebuilders cannot, having purchased land based on projected future values, build so many homes that housing costs fall; to turn a profit on any given project, homes can be released into the local market only as quickly as they can be sold at or above current prices. When prices fall, builders stop building until prices recover. These patterns have been documented in recent decades but they were observable too in the pre-war period, the last time there was a market-centred approach to building. Private-sector housebuilding is essential, but it is not enough on its own.

There are other issues to address in housing other than the need for public investment. The planning system and the rules protecting the green belt in particular are frequently cited as complicating factors; there is no doubt that we

need to bring forward more land for development. But that would be no silver bullet: there are already large numbers of unbuilt planning permissions in place, and the backlog has been growing. A central objective in tackling the housing situation must be to get these planning permissions built at much faster rates. This means overcoming the incentives that currently exist to build out sites slowly. Another major factor that has impacted on housing is the vast expansion in the availability of credit in recent decades, which has increased purchasing power enormously. This has had significant consequences for house prices which may still need addressing even when – or if – housing supply is substantially increased.

Nevertheless, there is no solution to the housing crisis that does not involve a large increase in the rate of housebuilding. The evidence suggests we cannot afford to leave this challenge to the market any more.

# 1: Housebuilding in historical perspective

The history of housing in the 20<sup>th</sup> century demonstrates that building rates – including speculative private-sector building rates – were highest and prices most stable when public-sector housebuilding was highest. When state investment in bricks and mortar declined rapidly from the beginning of the early 1970s, private-sector building failed to pick up the slack (indeed it too went into decline for many years). As total housing output slumped, house prices became much choppier and prone to inflation. The rate of housebuilding is not the only variable to impact on house prices, of course, but a degree of correlation between the two is evident nonetheless.

There were two periods during the 20<sup>th</sup> century, each spanning about two decades, when housebuilding output was sustained at a level higher than any rise in demand and shortages were steadily overcome. Central to both periods was a major state housebuilding programme that topped up private-sector output to ensure that the country's housing needs were met. First, between 1921 and 1939, local authority housebuilding rose from negligible levels in the pre-war era to an average output of about 70,000 a year, with peaks of 121,000 in 1929 and 1939.<sup>5</sup> Combined with even higher levels of private production, by the outbreak of the Second World War there were felt to be enough homes for the number of households.<sup>6</sup> The pre-war housing shortage, worsened by the damage of the First World War, had been largely overcome.

A similar story can be told of the decades following the Second World War, which left Britain short of 750,000 homes in 1945.<sup>7</sup> Between 1948 and 1972, local authority completions never dropped below 100,000 per annum and in 1953 and 1954 they even rose above 200,000. By the 1970s, ministers were able to point to a crude surplus in housing.<sup>8</sup> Once again, the combined efforts of the public and private sectors had ensured that enough homes were built to accommodate the population adequately (although localised shortages remained) and so averting house price inflation.

In both periods – the 1920s and 1930s, and then the 1950s and 1960s – private-sector output was for the most part higher than local authority building. But the council provision was critical. Once the state began to withdraw from housebuilding, a process set in train in the very late 1960s, overall housebuilding levels fell and prices became much more susceptible to speculative bubbles.



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## Pre-1914: 'The housing question'

Before considering the successful housebuilding strategies of the 20<sup>th</sup> century, it is worth reflecting on what had preceded them and how they came about in the first place. The idea of funding housebuilding from the public purse had been altogether out of the question just a few decades before the first exchequer subsidies were introduced in 1919. This was a watershed moment in housing policy, and the war doubtless served as a catalyst for such an approach. But the principle of state finance for the provision of homes had been gaining ground before 1914 as politicians grappled with how to improve the housing conditions of the poor.

Throughout the 19<sup>th</sup> century the business of housing provision had been left entirely to speculative builders, property ownership was the almost exclusive reserve of the small capitalist landlord, and living conditions in Britain's towns and cities were grim if not appalling for much of the working population. The challenges faced in adequately accommodating the new industrial working class was what came to be known as 'the housing question'.<sup>9</sup> A series of legislative advances by the reforming ministries of the late 19<sup>th</sup> century had tackled only the worst excesses of unsanitary conditions and slumdom, and the statutory requirements that were placed on landlords to ensure minimum standards of ventilation and lighting, sewerage and water supply did nothing to improve affordability for those on the lowest wages; if anything they rendered housing more expensive. Working-class households would spend up to 50 per cent of their income on rent.<sup>10</sup>

The result was that overcrowding continued to worsen in the late Victorian period as poorer families crammed into shared properties in order to share the burden of the rent.<sup>11</sup> This was partly the result of huge population growth in towns and cities caused by the Industrial Revolution. The urban dwelling residents of England and Wales grew from 9.9 million in 1851 to 28.5 million in 1911.<sup>12</sup> But the failure to provide anything like enough homes for this population reflected two problems.

Firstly, the housebuilding market was volatile, as were house prices (the two variables each impacting on the other). Building came in cycles, reaching a peak for the Victorian period in 1876, then declining until the mid-1890s, when there was a short-lived rise in output which in turn petered out around 1903, when building activity entered the 'long Edwardian slump' which was not reversed until after the First World War. Concurrent to this, it appears that prices were rising and falling in line with building rates. While house price data from the 19th century remains sketchy, recent research by Luke Samy has documented trends in London during the two decades before the First World War. He finds that there was 'steady house price inflation between 1895 and 1903, followed by rapid deflation from 1903 to

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1914 and stagnation during the First World War'.<sup>13</sup> These building cycles, with construction evolving in long swings influenced by other features of the economy than the need for housing, have been traced back at least as far as the early 18<sup>th</sup> century.<sup>14</sup>

Secondly, it was unprofitable to build homes to cater for those on the lowest wages. Decent housing (by the standards of the time) came at a price that the poor could not afford.<sup>15</sup> *The Sanitary Record* observed in 1884 that 'no practical plan has yet been devised by which dwellings can be built, which... can be let at these low rentals, and prove remunerative to builders'. The London County Council, one of the early pioneers of municipal housing, pointed out that the problem with relying on private enterprise was that it would naturally cater for the better off but would not address the demands which were less profitable:

...there is one serious danger in relying wholly upon private enterprise. The provision of the better rented accommodation suitable for the artisan with a regular income is a more profitable enterprise than building for the poorer section of the working class... there is not much provision made for families which can only afford to pay for two or three rooms.<sup>16</sup>

Attempts by philanthropists and model dwelling companies to provide decent housing and lower than market rents – the forerunners of what we would today call social landlords – made a small but ultimately indecisive impact on the wider situation. They sought to demonstrate it was possible to provide accommodation at rents the working man could afford and still make a modest return. But their rents were still too expensive for the poorest workers and so tended also to accommodate the better off artisan class.<sup>17</sup> Moreover, even these modestly reduced rents rendered them uneconomical as an investment for builders and the associations found themselves outbid for developable land.<sup>18</sup> By 1914, in London they had still provided no more than 100,000 rooms in a city of seven million people.<sup>19</sup>

What finally enabled the major council building programmes of the inter-war and post-war decades to take place was the availability of finance, including central government subsidies but also mechanisms for raising money on the capital markets and the issuance of local bonds. Local authorities had been given the power to build homes in 1851, but there was no compulsion and, crucially, they received no central government funding (the Public Works Loans Commissioners assisted with finance but at non-preferential rates of interest). Consequently, council housebuilding was minimal; by 1914, less than one per cent of the country's housing stock was local authority-owned, perhaps amounting to about 24,000.<sup>20</sup>

Lord Salisbury, later to become prime minister, was in 1883 possibly the earliest front-rank exponent of subsidies for housebuilders; he only advocated preferential rates of interest on loans, but even that was enough to alarm many of his Westminster contemporaries and the press, *The Manchester Guardian* denouncing his plan as 'state socialism pure and simple'.<sup>21</sup> Over the years ahead, however, support for such ideas grew steadily and not just among the new breed of Labour MPs that were winning representation in parliament for the first time. It was a Conservative MP, Arthur Griffith-Boscawen, who took up the cause most vigorously, proposing a series of bills to introduce state aid for local authorities in the years before the First World War.<sup>22</sup> In 1913, a Conservative Party pamphlet expressed the practical rationale of such an approach:

If a certain number of houses are not built at a non-economic rent, the present housing evil is irremediable and the problem must be given up in despair. If, on the other hand, those houses are to be built, it seems clear from experience that some state encouragement to local authorities will have to be given.<sup>23</sup>

In the same year, a Land Enquiry Committee set up by David Lloyd George recommended that local authorities should have a statutory duty 'to see that adequate and sanitary housing accommodation is provided for the working-class population' and suggested Treasury grants as one way of ensuring this.<sup>24</sup>

### **1919-1970: Building for the needs which only the state can meet**

The first large-scale exchequer subsidies for municipal housebuilding were introduced under the 1919 Housing and Town Planning Act (the 'Addison Act'), as Lloyd George sought to deliver on his promise of 'homes fit for heroes'.<sup>25</sup> The Act required local authorities to survey the needs of their areas for houses, and then to make and carry out plans for the provision of those houses, subject to approval by the Ministry of Health. All substantial losses would be borne by the Treasury.<sup>26</sup> In addition, the subsequent Housing (Additional Powers) Act offered lump-sum subsidies to private-sector builders for the construction of homes not exceeding a certain size, but which could be for sale or rent.<sup>27</sup>

This legislation was the culmination of a gradually rising acceptance that private builders alone would never cater to the housing needs of all of the population; while they would respond to demand in those parts of the housing market that were profitable, there would always be a substantial section of the working-class population for whom the provision of decent accommodation could not be provided profitably at the levels of rent they could afford. On the eve of the First World War, Lloyd George, then chancellor of the exchequer, told the House of Commons:

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You cannot provide houses in this country by private enterprise. I do not care what party is in power, whatever party it may be I predict it will have to realise the fundamental fact that the builder for years has gradually been passing out of the field in the building of houses [for the poor] — he has been passing on to something which he finds more profitable.<sup>28</sup>

It was this understanding that underpinned support for the introduction of state-funded housebuilding; not ideological fervour for statist solutions but a pragmatic acknowledgement among those instinctively against such approaches that private enterprise alone would not build all of the homes the country needed.

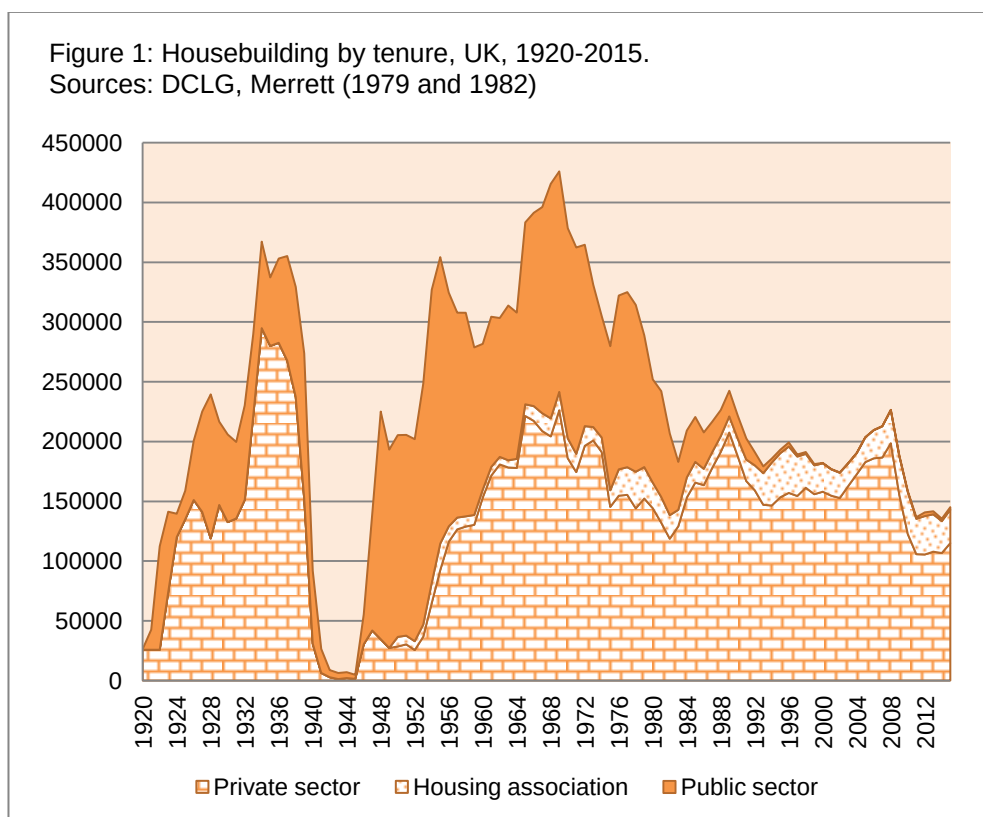
This had been the view of Griffith-Boscawen, who felt that private housebuilding would still need to provide the bulk of new homes,<sup>29</sup> and was later echoed by the industrialist Sir Alfred Mond, minister for health (with responsibility for housing) from 1921. Mond, a Liberal MP who later crossed the floor to take the Conservative whip, made clear he would not have supported state housebuilding if an alternative had been on offer:

If I saw any real prospect of any general resumption of the building of true working-class houses by private enterprise, I should not consider any prolongation of state assistance... We have, however, to face the fact that private enterprise did not nearly solve this problem before the war and will not solve it in the near future...<sup>30</sup>

Whitehall guidance was at pains to stress in the years ahead that the state should not fulfil any functions that the market would conduct itself. The first annual report by the Ministry of Health indicated that the 1919 Act required local authorities to determine the housing needs of their areas after 'deducting houses likely to be built by other agencies';<sup>31</sup> councils would only build the difference between what was needed and what the speculative private developers would build. Section 6 of the 1923 Housing Act stipulated that local authorities would only be allowed to build if they could convince the minister that it would be better than leaving it to private enterprise.<sup>32</sup> In 1929 the tenth annual report of the Ministry of Health reiterated that council housebuilding activities had to be 'cooperating but not competing with private enterprise'.<sup>33</sup> What the speculative private developers did not build, the state would.

Little of this output had been for the very poorest families, however. Council housing during this period catered by and large for the better off working-class household, the clerks, tradesmen and semi-skilled workers, usually on an above-average wage;<sup>34</sup> meanwhile, private-sector building for owner-occupation catered for the growing middle class. It was not until the 1930s that slum clearance projects were set in train and even by 1939 only 245,000 slum houses had been demolished, replaced by 255,000 new houses or flats.<sup>35</sup>

Nevertheless, housebuilding output in the inter-war period reached levels higher than at any previous time in the country's history. Some 3,998,000 homes were built in the 20 years before the outbreak of the Second World War, an average of almost 200,000 a year. Of those, 1,112,000 were built by local authorities, although another 430,000 of the homes built by the private sector also benefited from public subsidies, so just over a third of the output had been aided by the state.<sup>36</sup> Prices, meanwhile, settled down after a period of rapid growth: in London, for instance, after real-terms inflation of 127.6 per cent in the 1920s, they then fell by 3.2 per cent in the 1930s.<sup>37</sup> The ratio between average earnings and average house prices also went into decline during the 1930s (see Figure 4 below).



In the immediate aftermath of the Second World War, facing materials and labour shortages as well as a renewed shortage in housing, the principle of using local authority output merely to top up private-sector output was breached for a short while by Clement Attlee's 1945 Labour government. With the concept of central planning in vogue, housebuilding was to be coordinated principally around local authority output - only one-fifth was to be private enterprise. The same government introduced for the first time, under the Town and Country Planning Act 1947, the requirement for new developments to have planning permission from the council.<sup>38</sup>

The planning regime from this period remains with us to this day (and is the focus of some debate, as will be discussed in the following section), but the focus on

local authority building did not last. And while construction rose impressively in the years immediately following the Second World War, from just a few thousand in 1945 to more than 200,000 in 1948,<sup>39</sup> Britain's peak housebuilding years came a little later and only once the Conservative government in the 1950s began to unleash private enterprise construction once again. The 1953 white paper, 'Houses: the next step', marked a decisive return to the principle that local authority housebuilding was only to build that which the private sector did not; at this point using the government's new 300,000 annual target as the threshold.<sup>40</sup> It was a target which was hit, more or less, for the next decade. Local authority output dipped, but nevertheless remained well above 100,000 per annum.

The 1961 white paper, 'Housing in England and Wales', spelt out again that, while the government's aim was that there would be houses built 'in sufficient numbers to keep pace with rising demand', the role of the local authorities was to 'build for the needs which only they can meet'.<sup>41</sup> When Labour returned to power in 1964 they adopted the same approach, that council building was to cater for those that the private sector failed to reach.

By now, however, policymakers were beginning to look forward to a time when there would not be a shortage of habitable homes. Correspondingly, a 1965 white paper envisaged a point at which council housing provision would be wound down:

...once the country has overcome its huge social problem of slumdom and obsolescence, and met the need of the great cities for more houses let at moderate rents, the programme of subsidised council housing should decrease.<sup>42</sup>

A few years later, in 1968, the government started to do just that, announcing that public-sector housing would be reduced.

### **The 1970s to the present: the decline of housebuilding**

After the 1969 Housing Act, public-sector housebuilding went into steep decline for the first time since the Second World War. The number of local authority housebuilding completions almost halved from 196,180 in 1967 (public-sector land purchases peaked in the first quarter of this year)<sup>43</sup> to 101,430 in 1973, the lowest annual public-sector output since the 1940s.

Crucially, this decline in state housebuilding translated almost directly into a decline in overall housebuilding levels. As Figure 1 illustrates, while local authority housebuilding dropped off, private enterprise output continued more or less along the same trajectory it had been on. As a result, the total number of new homes fell

from 415,460 in 1967 to 304,640 in 1973, and while there was also a fall in private output during that time, that accounted for only 13,000 of the drop-off.<sup>44</sup>

These are still large numbers by today's standards, and yet a quarter of the UK's housing output had been lost in the space of six years. Given that the goal of housing policy for most of the period since 1918 had been to build those homes the private sector would not this is hardly surprising. But by the 1970s it was felt that there was a surplus of houses for the needs of the population. Indeed, the 1976 'Housing Policy' white paper claimed there were 500,000 more homes than households.<sup>45</sup> Despite a modest revival in council building output in the late 1970s, it continued on its downward trajectory thereafter, falling by more than 100,000 per annum in a decade, from 175,550 in 1969/70 to 67,450 in 1979/80.<sup>46</sup>

Margaret Thatcher equated council housing with the 'socialism' she was trying to eradicate from Britain and saw no need for the state to invest in bricks and mortar any more.<sup>47</sup> She noted in her memoirs:

By the mid-1980s everything in housing pointed to the need to roll back the existing activities of government. Although the country's housing stock needed refurbishment and adaptation, there was no pressing need now - as arguably there had been after the war - for massive new housebuilding by the state... as regards the traditional post-war role of government in housing - that is building, ownership, management, and regulation - the state should be withdrawn from these areas just as far and as fast as possible.<sup>48</sup>

Thus her government reformed council housing funding arrangements, introducing ring-fenced housing accounts designed to force local authorities to put up rents and dispose of their stock. By the time she left office in 1990, Thatcher recorded approvingly, 'councils had almost completely stopped building new houses' and nine had already disposed of their entire stock.<sup>49</sup>

Annual local authority completions were in the low hundreds during the last Labour government (1997-2010). Housing associations became the preferred recipients of state funding for social housing in the 1980s, because as private providers their borrowing would not count towards the public-sector net debt. They have been building about 20-30,000 a year for the past decade, but this is well short of the levels that councils reached half a century ago.<sup>50</sup>

With the dramatic decline in council output, total annual housebuilding has struggled to reach 200,000 per annum in recent decades. Since the financial crisis in 2008, new homes figures have languished in the low 100,000s – lower than at any time since the Second World War. Consequently a shortage has re-emerged and is worsening now with each passing year.

More than a decade ago, in 2004, the Barker Review of Housing Supply recommended the building of 245,000 private-sector homes a year, in England, to keep house price inflation at the European average of 1.1 per cent per annum (it also suggested 17,000 new social housing units were required to keep up with demand, and possibly another 9,000 on top of that to make inroads into the backlog that existed even then).<sup>51</sup> The Town and Country Planning Association calculated in 2013 that England needed 240,000 to 245,000 new homes per year.<sup>52</sup> The 2014 Lyons Review suggested that by that point a backlog of one million homes had built up and that up to 260,000 homes a year would be needed as the population continues to grow.<sup>53</sup> Kate Barker, the former Bank of England policymaker who conducted the 2004 review, has recently suggested that this figure may now need revising upwards to 300,000 homes a year.<sup>54</sup> The Royal Institute for British Architects has also called for 300,000 homes a year.<sup>55</sup> The government's official forecast is for 220,000 households to be formed every year in England (not the UK) between 2012 and 2022.<sup>56</sup> However, those figures are based on the population projections of the Office for National Statistics, which frequently underestimates future immigration levels.<sup>57</sup>

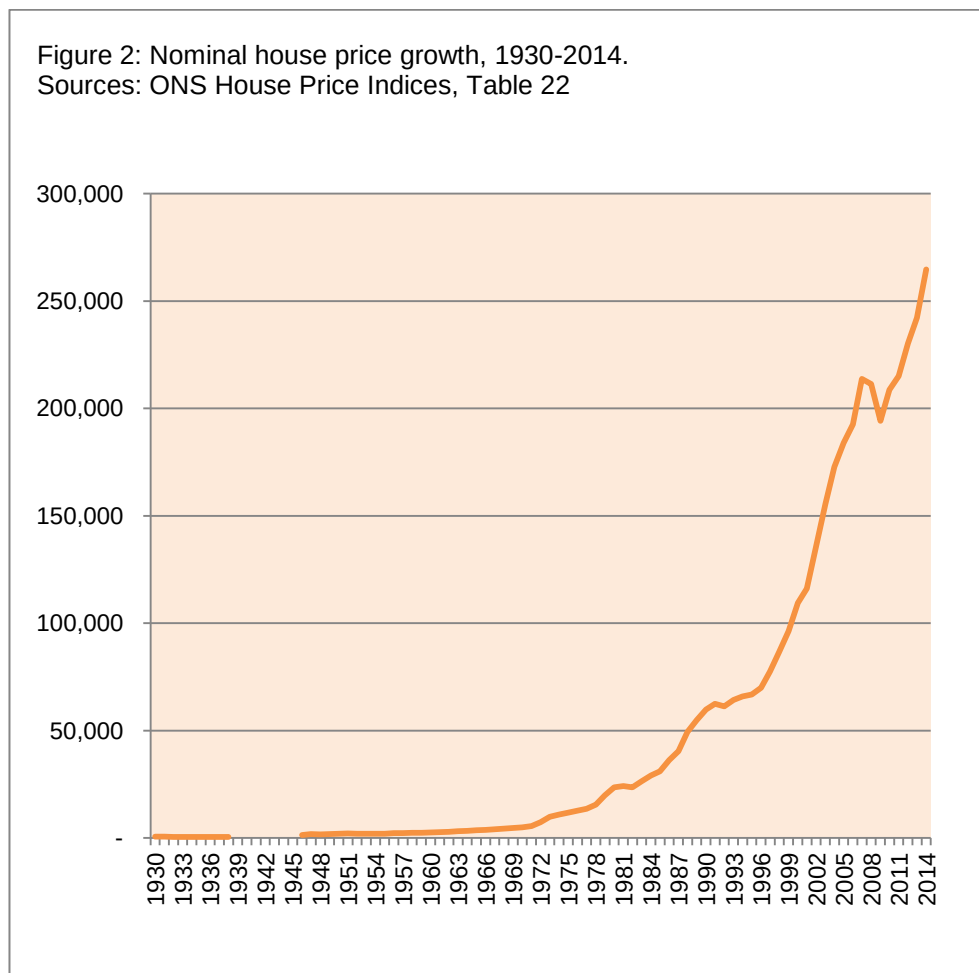
## Conclusion

Public-sector housebuilding was introduced out of the acknowledgement that speculative private-sector builders had not and would not construct all of the homes the country needed. It came in the aftermath of the First World War, when the need to take care of returning soldiers and their families was high on the political agenda, but the argument had been taking hold for several years prior to 1914. If living standards among the working class were to be held above a certain threshold, then the economical, profit-making side of housing provision would need to be supplemented by less lucrative, perhaps loss-making, housing provision by the public sector. In effect, the state would be simply topping up private output – not taking over housebuilding but making up the gap that was left by private firms. Since the 1970s, and the decline of public-sector housebuilding, the same shortage of housing supply, and many of the same associated problems, have begun to re-emerge.



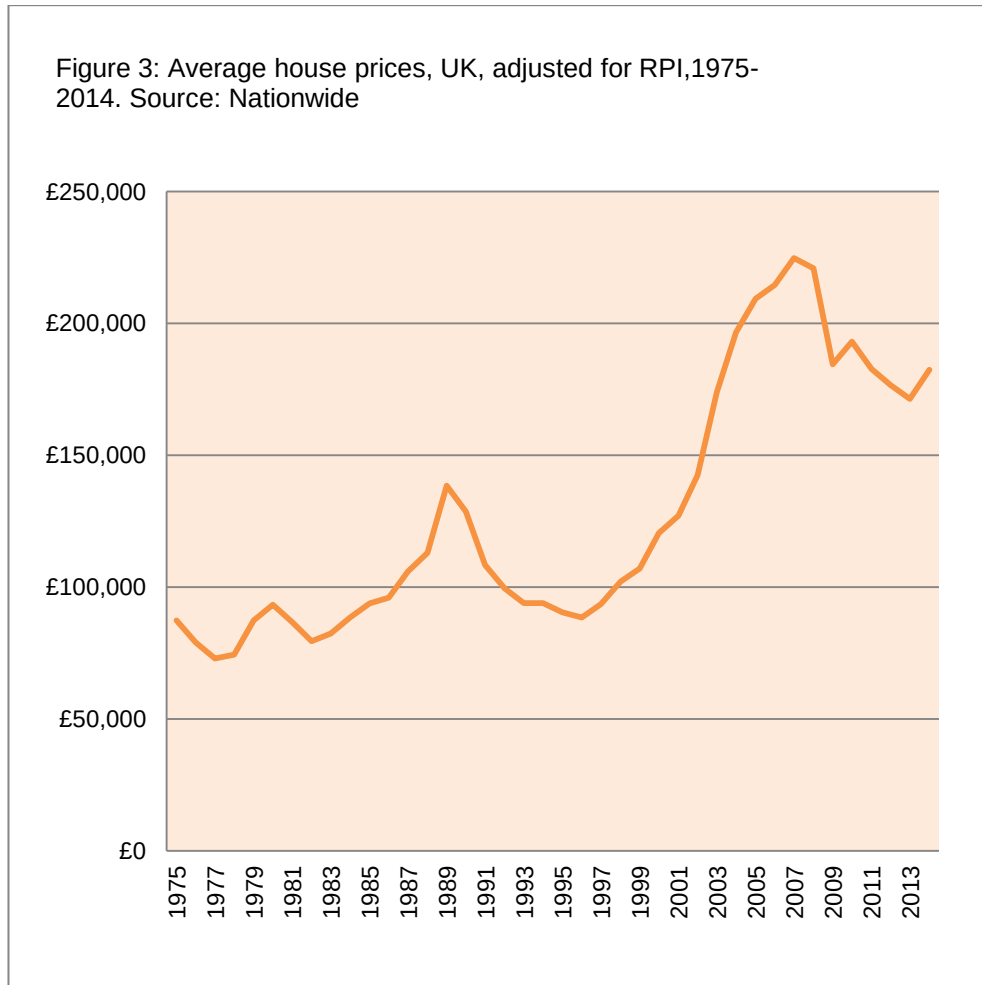
## 2: The property boom and its consequences

The first sign of the late 20<sup>th</sup> century property boom came at the beginning of the 1970s, at the same time that public-sector building went into decline. An official Whitehall study from 1974 recorded with a mixture of consternation and perplexity that house price inflation in England and Wales averaged 19 per cent a year between 1969 and 1973, and 29 per cent a year for the period 1971-73. Residential land prices were rising at up to 48 per cent.<sup>58</sup> The study noted, perhaps optimistically, that there was 'no historical precedent for such a price movement being maintained'.<sup>59</sup> In fact, however, Britain was moving into a new era of house price inflation, as Figure 2 shows.



This depiction of nominal house price growth does not tell the full story, however: once general price inflation is factored in, the picture is slightly less dramatic but also much choppier. There are marked peaks and troughs, each more pronounced than the last. This is illustrated in Figure 3 which takes a close-up view of how prices have evolved, adjusted for inflation, since the 1970s.

Figure 3: Average house prices, UK, adjusted for RPI, 1975-2014. Source: Nationwide

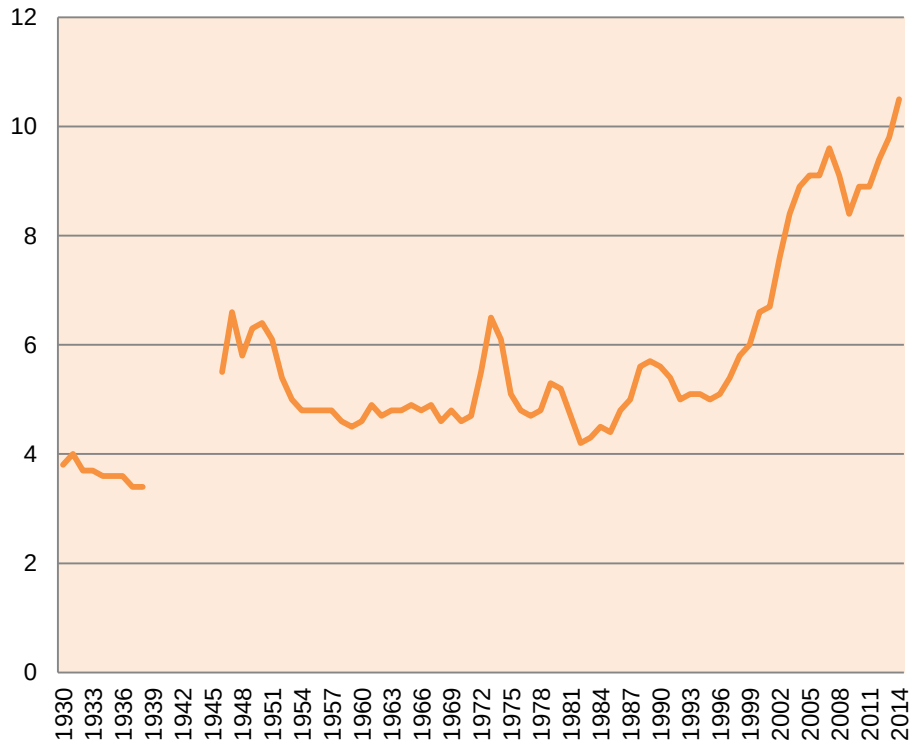


But the most telling representation of house price growth, and what is most pertinent to any consideration of the affordability of housing, is to view it in relation to wages.

Figure 4 plots the ratio between average annual nominal earnings and average house prices since 1930 (there is a gap for the years of the Second World War, for which there is no data). What this demonstrates quite vividly is that the affordability of housing had, in response to the heightened output of the inter-war period, begun to improve by the 1930s (prices in London had peaked in 1926).<sup>60</sup> This progress was disrupted by the Second World War, by the end of which a major shortage had re-emerged, but by the 1950s, as construction levels reached new heights, house prices once again stabilised, and for a while rose more slowly than earnings.

All of this changed at the start of the 1970s, when public sector housebuilding began to be drawn down. Since then, we have witnessed a return to the peaks and troughs in house prices that were experienced during the 18<sup>th</sup> and 19<sup>th</sup> centuries (discussed earlier) and which had been, for a few decades of the 20<sup>th</sup> century, levelled out somewhat.

Figure 4: Ratio between average annual earnings and average house prices, UK, 1930-2014. Sources: ONS, Measuringworth.com



Since the mid-1990s, the affordability of housing has steadily worsened and has shown no sign of returning to the level it was at throughout the post-war period, even allowing for a small improvement in the ratio between prices and earnings following the 2008 financial crisis.<sup>61</sup>

It is important to note that this rise in property prices consists mainly of a rise in land prices. It is not the bricks and mortar which is worth very much more than it was, it is the land on which the home stands. Among the advanced economies it is estimated that 80 per cent of the inflation in property prices since 1950 has consisted of increases in land values.<sup>62</sup> In the UK, residential land with outline planning permission doubled in value between 1994 and 2000, and by the eve of the financial crisis in 2008 it had reached five and a half times its 2004 value.<sup>63</sup> In the UK, the difference in value now between agricultural land and residential land is staggering. In 2015, a hectare of agricultural land was worth an average of £21,000; with planning permission for residential development, a hectare was worth £1,958,000 – roughly 93 times as much. That figure excludes London, however, where residential land prices are many, many times higher still: in Bromley, an outer borough, a hectare would have cost just over £10 million; in

Westminster, where demand is highest in the centre of the capital, it would have been £93 million.<sup>64</sup>

We have discussed at some length already the progress of housebuilding and its decline since the 1970s, which has clearly been a significant factor in house price growth. But there have been other factors at play as well – principally restrictions on the supply of land on the one hand and, on the other, vastly inflated demand.

### Planning controls

Planning controls as we know them today were introduced (by and large) under the Town and Country Planning Act in 1947, which allowed local authorities to veto development and determine how urban areas were able to expand. Until this point there was little check on the use of land for residential development; after it, the developable land was effectively rationed by local authorities. This planning system was introduced in response to the rapid and haphazard expansion of Britain's towns and cities during the inter-war period; this sprawl – while it helped improve housing costs – was not the most efficient use of land and unlikely to prove sustainable through another period of rapid housebuilding.<sup>65</sup>

A less well-remembered provision of the 1947 Act, however, was the introduction of a charge equal to the development value of the land; this development charge meant that the landowner was not able to profit from the uplift in value that planning permission conferred.<sup>66</sup> This was an important but contentious component of the new planning system, effectively cancelling out (for the landowner) the planning gain created by the new artificial scarcity of developable land. The development charge was a controversial measure, however, causing resentment among landowners, who were subjected to compulsory purchase orders with little by way of recompense. It was abolished for private-sector land purchases in 1953 and for public-sector purchases too in 1959.

Land prices have been rising ever since.<sup>67</sup> There is a large body of literature which has described the effect of planning controls on land prices in various localities around the world.<sup>68</sup> We will return to the availability of planning permissions and the extent to which they are responsible for restricting development in the following section. But in terms of blaming high land prices on the planning system, it should be considered that land values did start rising in the 1950s but they did so only modestly at first; it was only around 1970 that real land prices became especially prone to dramatic price spikes.<sup>69</sup> It is the volatility of land prices which dates from this point – reminiscent of the house price cycles and building cycles of the 18th and 19th centuries discussed previously – which has done most to limit private-sector housebuilding, as will be explored below. It is unclear then that the

imposition of planning controls, while undoubtedly a factor, is the principle driver behind land values of the levels we see today. More significant, I would argue, is the decline of housebuilding that occurred at the beginning of the 1970s, which rendered housing – and so the land on which it could be built – more expensive. Broadly in tandem with this, however, came a further development that would contribute to high house prices: the expansion of credit.

### The expansion of credit

The other side of the price equation to the restricted availability of housing and land is the vast increase in demand – or purchasing power – over the same period. Since the early 1970s, financial liberalisation has led to an enormous increase in the amount of money, or credit, chasing a finite number of homes. UK financial services, which grew more slowly than GDP between 1914 and 1970, have since that period grown twice as fast as national income.<sup>70</sup> A significant staging post in that process was the 1971 Competition and Credit Control Act which relaxed curbs on lending and led to the major commercial banks weighing in to the mortgage market, previously the preserve of building societies. The 'Big Bang' of 1986 further liberalised the financial services industry and the deregulated free market in credit.<sup>71</sup>

These reforms led to a vast increase in private credit, particularly in the form of mortgages on property, which to banks often appeared the easiest and safest way of lending money and increasing their market share. Household debt grew from 15 per cent of GDP in 1964 to 95 per cent in 2007.<sup>72</sup> Most of this was spent on housing. Among advanced economies, lending on property increased as a share of all bank lending from 35 per cent in 1970 to almost 60 per cent in 2007; in the UK, residential mortgages comprised 65 per cent of all bank lending in 2012.<sup>73</sup> The availability – and cheapness – of this credit has increased enormously the amount of money people have been able to spend on housing, with inevitable consequences for prices.

As Adair Turner, the former head of the Financial Services Authority, has described, the growth of finance has had a vicious circle effect on asset prices, including housing:

Before the mid-twentieth century, banks in several advanced economies were restricted or at least discouraged from entering real estate lending markets... Once the constraints were removed, these institutions increasingly became real estate lenders. But lending against real estate – and in particular against existing real estate whose supply cannot be easily

increased – generates self-reinforcing cycles of credit supply, credit demand, and asset prices.<sup>74</sup>

### New class of investors

The resulting frenzy was not confined to owner-occupiers. As housing has come to be seen (rightly or wrongly) as a one-way bet, it has attracted large numbers of new investors. The gap between prices and earnings that opened up in the mid-1990s coincided with the sudden and rapid expansion of the private rented sector. This had been made possible by the deregulation of private rentals under the Housing Act 1988, but the boom in landlordism did not take place until buy-to-let mortgages were introduced in 1996. By 2011 there were 1.39 million buy-to-let mortgages outstanding, worth a combined £159 billion; 20 years earlier these mortgages did not even exist.

Between 2001 and 2014/15 the number of homes owned by private landlords in England more than doubled from 1.9 million to 4.3 million.<sup>75</sup> It is estimated by Savills, the estate agency, that homes in the private rented sector (across the UK) were by 2015 worth almost £1.3 trillion – just over a fifth of the value of the total housing stock at £6.17 trillion.<sup>76</sup> Not all of this stock was debt-financed, however: while buy-to-let mortgages opened the floodgates to this kind of investor in the 1990s, latest research by Shelter suggests almost half (45 per cent) of private landlords today have no mortgage on any of their properties; only nine per cent have a loan-to-value ratio across their properties of more than 75 per cent, so they are on the whole remarkably asset-rich and unleveraged – quite unlike the average first-time buyer.<sup>77</sup>

The expansion of the private rented sector has been underpinned by housing benefit, which was adopted in the 1980s as the preferred way of supporting lower-income households when the government began to wind down the provision of council housing. This, in a more modest way, further contributed to demand. Instead of subsidising supply, via the building of new homes, the government effectively began to subsidise demand, by topping up what people could afford to pay in rent to private landlords. This marked a major reversal in housing policy which would have significant consequences for the public purse after the government abolished rent controls in 1989 as part of the deregulation of the private rented sector. In the years ahead, the cost of housing benefit would balloon, from £3.2 billion in 1979/80 (in 2015/16 prices) to £24.7 billion in 2015/16.<sup>78</sup> This was the result not just of spiralling housing costs but also the much larger number of people coming to live in rented accommodation. The number of households in need of housing benefit more than doubled in a decade from

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777,000 in 2004/5 to 1.6 million in 2014/15.<sup>79</sup> Today, 25 per cent of private renters are in receipt of housing benefit, at a cost of £9.2 billion a year - state funding that is effectively underwriting rent demands, thus contributing to rent inflation and so the attractiveness of the sector to existing and potential private investors (as discussed in greater detail in a previous Civitas report).<sup>80</sup>

### Declining home ownership

As prices have risen, to the delight of many existing homeowners, it has become increasingly difficult for first-time buyers to get on to the property ladder themselves and owner-occupation has fallen from a high-water mark of about 71 per cent in 2003 to 64 per cent in 2014/15 (in England).<sup>81</sup> But these figures disguise more dramatic falls among certain groups, particularly the young and the least affluent. Among low to middle earners under the age of 35, home ownership has fallen from 57 per cent in 2000 to 25 per cent in 2014.<sup>82</sup> Increasingly families have little choice but to rent in the private sector, where there is rarely any security of tenure of more than six or 12 months. The number of households with children renting from private landlords has increased by one million in a decade.<sup>83</sup> Concerns about the high costs of renting, the lack of security and poor conditions have begun to proliferate.

These developments have been most pronounced in the South East and especially London, which since the 1970s has established itself as a global hub of finance and culture that is providing immensely attractive to people not just from the rest of the UK but the rest of the world. Now absorbing almost half of net migration to the UK, London's population has increased from its post-war low of 6.7 million in 1988 to 8.6 million today.<sup>84</sup> As a result, London has experienced a disproportionate rise in house prices relative to the rest of the country. Savills calculates that 51 per cent of the increase in value of UK housing stock since 2009 has occurred in London and 42 per cent in the south of England.<sup>85</sup> Owner-occupation in the capital was in 2015 down to 50 per cent of households, with 27 per cent renting privately (as opposed to 18 per cent elsewhere),<sup>86</sup> while rates of overcrowding have almost doubled from seven per cent to 13 per cent between 2003/4 and 2012/13.<sup>87</sup> Here more than anywhere else buy-to-let landlords – and to a lesser extent rich overseas investors – have ridden the wave and as a result become increasingly central to the viability of new developers' calculations: in 2013 only 32 per cent of new-build London homes were sold to owner-occupiers; 61 per cent went to investors of one description or another.<sup>88</sup>

This has led many estate agents and developers to claim that the investments of domestic landlords and overseas non-residents are a vital prerequisite for new

developments to get off the ground. But this is only true to the extent that landowners have come to take inflated residential land prices for granted: if this demand were not there then they would have to trim those expectations. The trouble with relying on investment money to build future homes is that it only maintains supply to the extent that it also increases demand. It is a strategy built around maximising house prices and not one that could ever reduce the cost of housing.

## Conclusion

By the turn of the 21<sup>st</sup> century, almost entirely dependent once again on the output of private-sector builders, the housing market was in certain ways beginning to resemble that of the turn of the 20<sup>th</sup> century. A steadily worsening shortage of homes was helping to drive up housing costs proportionate to incomes and property ownership was becoming concentrated once more in the hands of a small number of landlords. As the Oxford historian Harold Carter has noted:

The two tenurial groups – small capitalist landlords buying houses on borrowed money, and tenants with limited security of tenure – would have been familiar one hundred years earlier. What was different this time around was that the government was paying the rent, for one in four of the new tenants. This was essential if they were to be able to have anywhere to live... In effect, the government became the guarantor of a new generation of slum landlords.<sup>89</sup>

That the housing market has become very much more exposed to the ups and downs of economic cycles is the result of entrusting housebuilding almost entirely in the hands of profit-maximising private interests. But the *extent* to which it has been buffeted must be connected to changes in the wider economy – particularly the explosion in private credit. It is impossible to know precisely how much the relaxed credit regime of recent years has contributed to house price growth as opposed to inadequate supply. But one estimate suggests that low mortgage rates and the rise in loan-to-income multiples has accounted for about 60 per cent of house price growth between 1994 and 2014.<sup>90</sup> So while increasing housebuilding to keep track of demand is essential, and the focus here, it may only provide part of the solution to reducing the cost of housing.



### 3: The barriers to housebuilding today

Having considered how private-sector housebuilding has failed to keep up with demand, the consequences arising from it and certain factors that have compounded the situation, the question that remains is 'why?' As the government withdrew from the business of building homes why did the private sector not make up the difference?

A multitude of explanations are proffered from various quarters for the present housing shortage and a multitude of methods for overcoming it are proposed. The argument I will advance here is that while there are many obstacles to higher levels of housebuilding, the most fundamental problem is an over-reliance on private-sector development, in which those with the ability to increase supply also have much to lose from doing so. This has been made worse by very high land prices – a consequence of those factors considered in the last section – which has meant that developers have even more to lose.

#### Shortage of planning permissions

Much of the present debate about housebuilding focuses on the planning system and the utilisation of land. On one side are those calling for either the relaxation of planning laws or incentives for communities to approve planning applications; on the other are those, often labelled nimbys ('not in my back yard'), who want to resist residential development encroaching into the green belt or even greenfield sites.

The impact of the planning regime on housing costs was discussed briefly in the previous section, and we will come back to the importance of land prices further on in this section. But there are also concerns that the planning system simply does not yield adequate amounts of land for development. Developers complain that the planning process, overseen by under-resourced councils, is too slow and holds up development.<sup>91</sup>

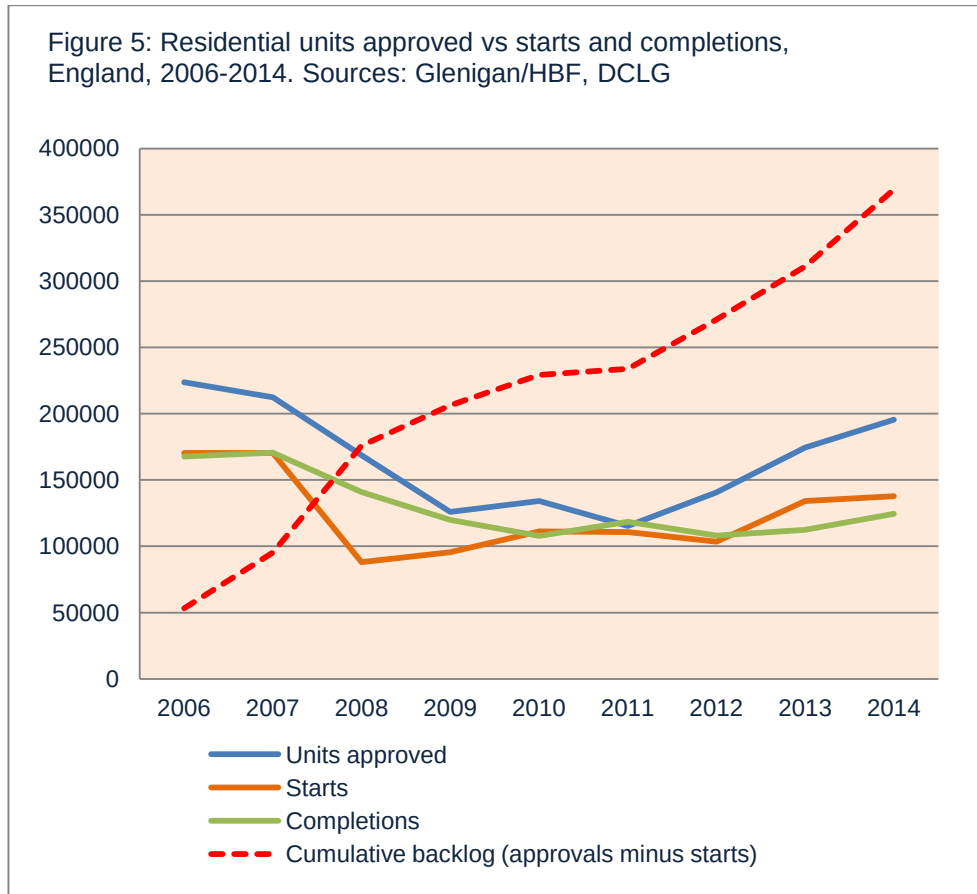
The Institute of Economic Affairs points to an 'anti-development bias' arising from the fact that local residents, to whom councils are accountable, 'face the disadvantages of development, but not the gains'.<sup>92</sup> If the community saw more of the financial benefits of development, it is argued, then more planning permissions would be granted. There is also much criticism of the green belt, which artificially restricts the growth of towns and cities to prevent urban sprawl. The Adam Smith Institute has calculated that a million homes could be built on just the 3.7 per cent of the London green belt that is within walking distance of a train station.<sup>93</sup> There is

much to be said for these analyses, and some degree of liberalisation of the planning system and/or incentives for local communities to accept development would be worth pursuing.

However, the problems lie deeper than simply the availability of planning permits and developable land, which should be evident for various reasons. First, the planning system we have today is much the same one that was in place during the most productive period of housebuilding in Britain's history, during the 1960s. By the same token, 19<sup>th</sup> century builders failed to construct enough homes even in the absence of anything like a modern planning system. More importantly, there is not actually a shortage of planning permits today.

There are many more unbuilt housing units with planning permission than there are starts in any given year – and the gap has been growing. In early 2014, for example, planning permissions were outstanding in London on 172,000 unbuilt private-sector homes, across 766 sites.<sup>94</sup> Yet over the ensuing year, there were only 15,790 starts by private developers.<sup>95</sup> That means that less than 10 per cent of the homes with planning permission were even in the process of being built a year later. Each year about 50,000 units are awarded planning permission in the capital (which is a good figure: London is thought to need 49,000 new homes a year to keep pace with demand), but only 21,370 were built in 2014/15.<sup>96</sup> A backlog of unbuilt planning permissions is growing annually; as of summer 2015, it had reached about 260,000 units waiting to be constructed in London alone.<sup>97</sup>

There is a similar story nationally. In the year to March 2015, planning permissions for 261,000 new homes were granted in England,<sup>98</sup> but work only started on 137,740 new homes during the same period (it was 143,560 across the 2015 calendar year).<sup>99</sup> A degree of timelag between permission being granted and work starting is reasonable and to be expected. Housebuilders suggest there is a two- to three-year lag between approval being granted and homes coming on to the market.<sup>100</sup> But the gap between residential units granted planning permission and the number of homes even being started has widened in recent years. Figure 5 shows how a pronounced upswing in planning approvals since 2011 has corresponded with only a much smaller increase in starts and an even more modest rise in completions. The broken red line charts the backlog in planning permissions that has accumulated since just 2006 (the statistics used for this figure can be found in Appendix One).



Between 2006 and the end of 2014, there were 369,000 more planning permissions awarded than there were starts. It is notable that between 2008 and 2011 completions ran at a similar level to planning approvals; but that would appear to have been a temporary alignment in the aftermath of the financial crisis which effectively put many developments on hiatus until prices bounced back. Nevertheless, we can see that in 2006 and 2007 – the high-water mark of housebuilding before the crash – the same gap was present that we are returning to now.

Housebuilders hold very much more land than these figures suggest, however. An analysis by *The Guardian* found that Britain's nine biggest builders owned or had the option to build on more than 600,000 plots; yet the builders had only constructed 66,881 between them in the most recent financial year.<sup>101</sup> These figures included land which did not yet have planning permission. Many developers complain about the slow progress their applications make through town hall planning departments. But what of that land that has already got planning permission - why is that not built out more quickly? This is the crucial question now.

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## Skills shortages

Housebuilders and ministers point to a lack of skills holding up development. This skills shortage in the construction industry is described as ‘the number one challenge for housebuilders’ by David Thomas, chief executive of Barratt Developments, Britain’s biggest builder. There are gaps among bricklayers, plumbers and chartered surveyors, for instance.<sup>102</sup> This means labour costs have risen; the Royal Institution of Chartered Surveyors (RICS) says construction wages have risen by more than 6 per cent in the past year. The housing minister, Brandon Lewis, also regards the shortage of skills as the biggest challenge in housebuilding. ‘If I had all the money I want for housing and all the land I want, I would still have a shortage of skills,’ he said recently.<sup>103</sup> This shortage has been exacerbated by the downturn after 2008, when many skilled construction workers left the industry; they have yet to be attracted back in sufficient numbers. While the number of bricklayers required to meet demand between 2013 and 2015 increased by 15,600, the annual award of construction qualifications has fallen by 10,000 a year. This situation is likely to improve in time, however. RICS chief economist Simon Rubinsohn points out that as wages become more attractive skilled workers and school leavers should be enticed into the construction industry in greater numbers.<sup>104</sup>

There are good proposals already for dealing with this problem, if the government was inclined to tackle it. Frank Field MP, in a recent Civitas pamphlet, has called for the creation of a series of skills academies to provide the numbers of bricklayers and other construction workers to sustain housebuilding at the necessary levels. This could be achieved by scaling up the work of private training providers who are already training bricklayers, plasterers, carpenters, roofers, electricians and plumbers in just 10 weeks, who could then begin work for an ‘improvement year’, after which they would be awarded certification by government-backed inspectors.<sup>105</sup> Lord Baker’s university technical colleges (UTCs) are also pioneering a new vocational approach to secondary education which holds out the prospect of very many more school-leavers entering the workplace with training in areas including construction.<sup>106</sup>

The apparent skills shortage provides ministers and builders with an easy explanation for the under-supply of housing, but in doing so they divert attention from more fundamental problems that need to be resolved. Even if the skills gap were plugged, not enough homes would be built, for reasons which we will turn to now.

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## Landbanking

Housebuilders frequently and vociferously deny that they hoard land, notwithstanding the huge amounts that they hold in their possession.<sup>107</sup> They stress that they need a guaranteed pipeline of land for their business model. Developers also cite obstacles in the conditions attached to planning permissions.

But the question of landbanking is not confined to builders. In fact, many of those planning permissions cited above are not yet in the hands of builders and so the first and most obvious challenge is to ensure that they are. Many are held by non-building organisations like investment funds, historic landowners or the public sector, who presumably intend to dispose of the land to a building company at some indeterminate point in the future. In 2012, almost half (45 per cent) of London's unbuilt planning permissions were attached to land held by non-builders.<sup>108</sup> By 2014 this had fallen to 32 per cent, which represented good progress but still meant almost a third of the land in London that had been approved for new homes was not owned by a company that can build them. A report for the Greater London Assembly in 2012 went so far as to say:

Unlocking London development sites is not about helping builders build, but more to do with changing the ownership of sites controlled by non-builders, i.e. getting them into the hands of firms that build.<sup>109</sup>

Why would anybody hold on to their land like this? Landbanking – whether by developers or non-developers – is fuelled by the expectation that land prices will continue to rise. This is compounded by the fact that, research shows, landowners usually sell for financial reasons, not out of necessity – that means they can usually hold on for a bit longer if it would lead to a higher return. The Office of Fair Trading observed in 2008 that if prices are expected to rise in the years ahead then landowners were likely to hold on to their land:

If landowners anticipate that land values will be higher at some point in the future, they may delay selling land they own. One of the key features of the planning system is that it grants planning permissions rather than obligations. The effect of these two features is that, in practice, a landowner may not be inclined to sell land as soon as it achieves planning permission.<sup>110</sup>

The effect here is one of a positive feedback loop, whereby land price appreciation encourages landbanking, which further promotes land price appreciation. This has become a significant issue as residential land prices have – as discussed already – increased rapidly in recent decades. Of course, this dynamic does not just apply to land with planning permission: the owner of any land that has the prospect of

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residential development at some point in the future has little prospect to sell sooner rather than later if prices are expected to continue rising.

Landbanking is not the preserve of the profit-making private sector either, but can be observed across the public sector. In 2012, government bodies (by definition non-builders) retained ownership of 31 of the capital's 524 planning permissions for residential development.<sup>111</sup> One of the problems encountered by the 2010 Coalition government in its drive to sell off surplus public-sector land was that individual departments, under tight budgetary pressures, were unwilling to accept lower valuations for sites than they had been hoping for.<sup>112</sup> Progress by NHS Trusts in particular was initially very slow, despite the encouragement of the Department of Health. It turned out that 'many of the trusts wanted to retain land because they considered that it would increase in value over the next four years'.<sup>113</sup> As taxpayers, we might be pleased that NHS managers were seeking to maximise the returns on public assets – but the effect is to restrict the supply of land for new homes.

### Absorption rates

Even if we accept that developers do not hoard land, it is also the case that they do not build it out as quickly as is physically possible. Studies show that developers usually build out any one individual scheme at a rate of no more than 100 homes a year, irrespective of the number of permissioned units on the site they are developing. The average is approximately 50 a year.<sup>114</sup> An academic analysis of build-out rates in 2008 (before the crisis, so in good economic conditions) described how the typical housebuilder aimed to build and sell one unit per week; their business plans were based on this scenario from the outset of a project.<sup>115</sup> This was the same for any site – whether it had permission for 50 homes or 500, the annual release of new homes into the market would be around 50. There was a slightly better average of 68 starts per site in London in 2011, and even 85 in 2013; but in a best case scenario a site of 500 homes would take at least five years to build out.<sup>116</sup>

These figures reflect what housebuilders call absorption rates – how quickly the local market can absorb the new properties. The Home Builders Federation describes it like this: 'Housebuilders can only build at the rate a local market will support. You cannot build out a site for 5,000 houses instantly or indeed put them up for sale in a local market at once.'<sup>117</sup> Jennie Daly, UK land director at Taylor Wimpey, giving evidence to the Lords Economic Affairs Committee recently, explained the situation in greater detail. Asked whether her firm – if it wanted to –

could double its rate of housebuilding if the skills and materials were available, she said:

There are a number of elements that would restrict our ability to double our contribution, or build. You alluded to skills and production limitations, materials and other elements. It would be inappropriate to ignore the fact that we also sell into a market where we don't know our customer and so we have to look to market absorption. Some areas in robust market areas could be capable of increases, if skills and commodities were available. Other areas where there just isn't the depth of market then there would be concerns about the over provision into the market and the fact that that would have a distorting effect on the local market, and that would be of concern both to the local market property owners and to ourselves.<sup>118</sup>

What is meant by this is that builders cannot afford to flood the local market in such a way that it reduces prices. This is a function of the housebuilders' exposure to the land market. In order to purchase land on which to build, a developer must submit the highest bid. This winning bid must be predicated on selling houses at the current market level or higher – any lower and a rival developer would bid higher and take the land. Thus current house prices in the local vicinity determine how much the developer must sell their houses for if they are to turn a profit.<sup>119</sup> For this reason the developer can never release so many homes into the local market that prices fall, and it is virtually impossible for a developer to adopt a price-cutting strategy. A developer who tried to sell homes more quickly and/or more cheaply would either turn a loss (on the price of the land) or fail to secure the land in the first place.

This dynamic was described by the Office of Fair Trading in a report published in 2008. It wanted to know why, in the years up to 2007, a period of significant growth, rising land and house prices, strong demand and easy credit there was not a corresponding increase in the number of homes being built by homebuilders. Initially suspicious that anti-competitive practices were at play, the OFT concluded in fact that the housebuilding process was working as was to be expected.<sup>120</sup> That is to say, developers were building homes as quickly as it was economically viable to do so:

...the homebuilder will build at a rate which will satisfy the demand in the local market *at or above the existing price levels*... inevitably a homebuilder attempting to offer cheaper homes will be outbid for land by a homebuilder selling homes at the prevailing market price. It is for this reason that build out rates, or absorption rates as they are known... are dictated by local market conditions and not by the maximum technical speed at which homes can be built. *Homebuilders deliver new homes as fast as they can sell them, not as fast as they can build them.*<sup>121</sup> (my italics)

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So when housebuilders talk about building rates being based on ‘the depth of market’ they mean that they are based on the ability of the local market to maintain current price levels even when there is an increase in supply. Houses are built and sold into the market as quickly as people can buy them *at or above current prices*.

Another study, by academics David Adams and Chris Leishman of the University of Glasgow, suggested that build-out rates were designed into a project from the start and would not increase even if demand turned out to be greater than anticipated. If the sales environment exceeded expectations, ‘prices are quickly increased or incentives dropped to bring the sales rate back on target’; no developer would simply increase the construction rate.<sup>122</sup> If a developer calculated that prices would continue to rise, staggering sales over a longer period would yield greater profits.

...the release of houses is managed on a site-by-site basis by builders themselves to achieve the target sales rates underpinning earlier bids for land... Developers with cautious build-rate assumptions will benefit from an advantage in terms of the price they can offer landowners assuming that house prices are rising faster than construction costs and the cost of borrowing.<sup>123</sup>

If, on the other hand, demand turns out to be worse than expected, prices would only be cut ‘as a last resort’.<sup>124</sup> If market conditions deteriorated and a development was not yet started it was more likely, Adams and Leishman found, to be delayed or suspended.<sup>125</sup> (It is important to note that this is not a happy scenario for developers either: not only is their investment in abeyance, but if interest rates rise then they will be highly exposed on any finance they have used to fund the development.)

Since the 1970s, housing output has become much more sensitive to prices once more. Stephen Merrett, writing in 1982, observed that in the previous 15 years downward shifts in demand had never brought an annual country-wide fall in house prices. This was because ‘when demand conditions turn sour builders prefer to reduce their output flow, and selling buyers hold their homes off the market where this is feasible’.<sup>126</sup> A graphic example of this can be seen at the end of the house price boom of the early 1970s. When prices began to fall sharply in 1973 (compounded by the global stock market downturn and then the oil crisis which began in October), builders reduced output abruptly, from 216,000 in 1973 to 106,000 in 1974, the largest peace-time fall in private housing output in British history.<sup>127</sup> Similarly when the 2008 financial crisis hit, and house prices slumped, housebuilding went into a decline from which it is still yet to fully recover.

This feature of the private housebuilding industry is not just a contemporary phenomenon. It is a major reason why, as we have seen, housebuilding fluctuated



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so markedly in the 19<sup>th</sup> century: speculation would take hold for a while, then confidence would fall and builders would cut output. Peter Kemp, describing how Victorian housebuilding output was subject to ‘cyclical fluctuations, with periodic gluts and shortages’, writes of how:

...larger speculative builders took into account in their profit calculations the likely effect that their addition to the supply of dwellings in a particular locality would have on the level of rents that could be charged and hence on the amount that landlords would be prepared to pay for the dwellings...<sup>128</sup>

The process of peaks and troughs in 19<sup>th</sup> century housebuilding culminated ultimately in a crash which began in 1903 and from which it still had not recovered by the outbreak of war in 1914.<sup>129</sup> The ‘long Edwardian slump’ saw an enormous 70 per cent decline in output, to the lowest levels for 60 years, alongside a 40 per cent decline in values.<sup>130</sup>

Building and selling properties quickly rarely makes any sense; flooding the local market with new homes would be entirely inimical to the developers’ business model because it would bring down prices. Supply is calibrated on a site-by-site basis to hold up prices. It would not be fair to blame developers for creating this scenario, however, as it is they who have most to lose if the market turns sour. Conservative build-out rates reflect the extraordinary fragility of the market. This framework has major implications for any ambitions to reduce housing costs while also relying principally on the private sector to build the homes we need. It suggests that, without some kind of overriding incentive or intervention, private-sector developers will never build so many homes that prices will fall.

## Land prices

As discussed already, land prices have grown enormously since the 1950s, but particularly over the past couple of decades – much faster than labour and materials costs. This has meant that the cost of residential land has risen significantly as a *proportion* of the build costs of every property built. One estimate suggests it has risen from just over a quarter to more than two-thirds over the past half a century.<sup>131</sup> This exacerbates the tendency towards conservative build-out rates because it means so much of the developer’s profit margin is now determined by the price they have paid for the land, while the higher it is, the more developers have to lose if prices fall. As well as causing developers to build more slowly, as a hedge, high land values create a barrier to entry into the housebuilding market. This has had the effect of keeping out many SME builders who lack the assets needed to enter the market.<sup>132</sup>

Even among those larger developers who can compete, however, such is the frenzy for residential land in some hotspots that sites can be purchased at prices that are initially unprofitable, the purchaser gambling on the likelihood that the land will become economical to build on at some point in the future. This can be another reason why land, ripe for residential development, in fact stands idle for too long. As the consultants Molior reported to the GLA:

...the industry feels that vendor price aspirations definitely lead to sites lying dormant – when the vendor wants too much for their site either the site does not sell, or the site is sold but then does not get developed.<sup>133</sup>

This strong correlation between high land values and low construction rates is not peculiar to Britain but has been observed internationally.<sup>134</sup> Fundamentally, very high land values deter rapid housebuilding because they leave developers so much more exposed to price fluctuations, and so the enterprise is much more perilous financially.

## Conclusion

There is not, strictly speaking, a shortage of land on which to build. Over the past few years, developers increasingly have been sitting on large numbers of planning permissions. This does not mean that they are 'hoarding' land per se. There are various factors that reduce the rate of housebuilding. Some of these might be overcome: it is quite conceivable that skills shortages for example, significant though they are right now, can be addressed if there is the will to do so.

What is less easy to overcome, however, is the need for the private-sector housebuilder to release homes into the market only at a rate which will not cause house prices to fall. This is fundamentally at odds with any strategy to reduce housing costs. Though not the only factor to have driven house price inflation since the 1970s, it is the one which will prove most difficult to surmount.

None of this is to say that planning rules do not need streamlining or liberalising. Clearly there are not enough planning permissions in place already to meet all of the country's housing needs in perpetuity and we need a plentiful supply of developable land. There can be little doubt that the planning system, essential though it is, has increased residential land prices by raising scarcity. But land prices are influenced too by the availability of credit. And, even as more land is brought forward for development, the private sector will not build it out at such a rate that prices would fall.

This is illustrated well by recent disclosures about the painfully slow rate of progress on ex-public sector brownfield land released for housing by the Coalition

government between 2011 and 2015. An analysis of 100 of those sites, with capacity for 9,100 new homes, found that by January 2016 still only 200 homes had been completed. Work had started on just 2,400 – about a quarter – despite another 2,100 having full planning permission.<sup>135</sup> This sample suggests that of the more than 100,000 homes that could have been built on land like this that was released by the last government, only a few thousand have so far been built.

Overcoming the understandable tendency to build out developable land so conservatively represents a major challenge to any effort to raise building levels to the necessary rates and reduce housing costs.

## Conclusion: What should be done?

The present Conservative government, aware that high house prices and the consequent decline in owner-occupation is becoming a particularly damaging issue politically, has identified housebuilding as a priority for the current parliament. The housing minister, Brandon Lewis, has defined 'success' as 1 million new homes built over the course of the government's five-year term.<sup>136</sup> At 200,000 homes a year, this is not an especially impressive target, and output is already running behind that ambition. But new initiatives are yet to work their way through. In his November 2015 spending review, George Osborne announced plans to deliver 400,000 'affordable' new homes in England by 2020/21 in what he called 'the biggest housebuilding programme by any government since the 1970s'. These homes would be delivered via a series of initiatives funded by a doubling of the housing budget to £2 billion a year from 2018/19. 'We are the builders,' the chancellor told the Commons.

The rhetoric, especially as trailed to the media on the morning of the review, sounded promising. But the initiatives involved are unlikely to create much additional housing that would not have been built anyway, and certainly nothing like 400,000 extra units (over five years); instead the government's Starter Homes initiative will enable more of those that are built to be sold at a discount to first-time buyers. In this respect, it was in much the same vein as initiatives during the Coalition government: helping a relatively small number of first-time buyers get on to the housing ladder via various subsidies without doing anything to actually reduce the cost of housing. The effect of this has been and continues to be to make things worse rather than better, as it further supports demand without improving supply. There have been other initiatives announced in or since the spending review and reaffirmed in the March 2016 Budget which should be welcomed, including the release of public-sector land for 160,000 homes, streamlining the planning system and providing £1.2 billion for the remediation of brownfield land. Improving the availability of land on which to build is an important component of the housebuilding strategy the country needs.

None of these initiatives amounts to the actual building of homes, however, and there is no sign that anybody seriously expects a glut of new properties to flood the market. Certainly the Office for Budget Responsibility does not anticipate that any of the government's plans will change much. In its outlook for the next five years, the OBR forecasts house price inflation to 'persist at rates somewhat above earnings growth', amounting to 26.4 per cent by the beginning of 2021. It made no mention of the chancellor's '400,000' homes in the context of house prices.<sup>137</sup>

One recent initiative that showed promise was the government's decision to directly commission the building of 13,000 homes on publicly-owned land. It was described by David Cameron as 'a huge shift in government policy', which would be a fair assessment but for the extremely limited extent of its ambition. Another promising but currently small-scale initiative involves the use of 'housing zones', in which councils receive funding to work with private developers in order to deliver homes more quickly; in other words, subsidising development and involving local authorities in getting homes built. However, the scale of this too is tiny. Just £6 million has been committed so far, assisting the construction of up to 45,000 homes.<sup>138</sup> Involving public-sector money and agency like this is the right sort of approach but it needs to be scaled up, and on a very large scale.

### Some principles for a new approach

In the absence of a committed public-sector building programme, the supply of new homes has been, and continues to be, inadequate: the market has failed to deliver. Upwards of 240,000 homes are needed in England each year: not only has private enterprise failed to hit this figure in the past few decades but it has *never* come near.<sup>139</sup> It may be time now to relearn the lessons of the early 20<sup>th</sup> century and accept that it is unrealistic to expect the market alone (supplemented by a relatively small number of housing association properties) to provide all of the homes that the country needs. We need to ensure once again that those homes the private sector does not build are provided by the public sector: this will require significant public funds and the direct commissioning of housebuilding by the state, whether by central government, regional bodies or councils.

Allied to this is the need to increase the amount of land that is made available for development and ensuring developers build it out at the rate that homes are needed, rather than the rate at which the highest returns can be obtained. This is of profound importance to the housing question which goes to the heart of why mounting unmet demand is resulting in higher prices rather than higher output. Tackling it will involve addressing the lack of incentives for landowners to release land more quickly or for developers to build out sites more quickly. We need to break the dynamic which means that residential land and the homes that are built on it are drip-fed into the market at a rate that holds and pushes up house prices. The answer must involve imposing a new set of incentives, on both landowners and developers, which ensures that housebuilding keeps up in future with evolving need.

## Proposals

There are various ways in which the above principles might be put into practice. Here are some proposals for a national housebuilding strategy which would meet these objectives:

1. Give local authorities a statutory duty not only to survey housing need (existing and future) and identify sufficient land suitable for development, but also to ensure the delivery of those homes within appropriate timeframes. Crucially they should be empowered and required where necessary to step in and directly commission construction work where the private sector fails to meet the needs identified in the given local area.
2. Establish a National Housebuilding Fund on which local authorities can draw for the financing of construction work. The assumption should be that these homes are sold into owner-occupation on the open market, with the proceeds of sales reinvested into the fund and used for future housebuilding, in perpetuity. But there should also be access to this fund for housing associations to build homes for social rent and repay the amount out of future rental income over the years ahead. The capital for this fund could be raised via the issue of central government bonds, taking advantage of the currently very low cost of borrowing.
3. Grant planning permissions in future on the basis that they are completed within a given timeframe, corresponding with the existing and future needs that the local authority has identified. Build-out rates would effectively be determined by local planners according to the area's needs. Where sites are not built out as planned, the local authority should be able to impose charges, and/or (as appropriate) acquire the land at less than its residential use value (probably 50 per cent) and directly commission building firms to complete the work. These sanctions are meant as a last resort – the goal being not to punish developers but to introduce new incentives powerful enough to change current behaviour. A less severe approach – if it elicited the necessary response – might be to charge annual business rates on the capital value of undeveloped sites.
4. Give local authorities the power to acquire non-planning permissioned land at less than residential use value in certain limited circumstances, these being where the pipeline of developable local land has run low, and where the land in question is deemed strategically important to meeting local housing need. This too is meant as an action of last resort, designed to

encourage the owners of developable land to strike deals early with private developers.

This revised framework would not only, by involving the public sector, provide a backstop to ensure the homes that are needed are built irrespective of private-sector output. It would also exert a new downward pressure on prices. Developers would no longer be able to restrict supply in order to maximise prices; instead, they would have to design business models, including pricing strategies, based on releasing homes into the market at the rate they are *needed*, as stipulated by the local authority. This would inevitably require them to be sold at lower prices than at present, which would mean, in turn, purchasing land at much lower prices than are customary at present. The losers, ultimately, would be landowners – they would still stand to profit from the sale of land for residential development, but they would not be able to command the prices they do at the moment. Developers, who have built landbanks at current land prices, would also be placed in an extremely vulnerable position.

There might be a danger, with the introduction of ‘use-it-or-lose-it’ planning permits, that landowners or developers are reluctant to obtain planning consent (if the clock is then ticking as soon as it is granted). The purpose of the local authority’s power to compulsorily purchase land at less than its residential use value would be to overcome this likelihood (councils already have the power to acquire land compulsorily but the owner is legally entitled to any development gain that arises within 10 years).<sup>140</sup> Empowering councils to purchase land at 50 per cent of the residential use value in certain circumstances would mark a partial return to the development tax that was a feature of the 1947 Town and Country Planning Act. Rather than being applied to all land purchases, however, it would only be used as a last resort as a disincentive to landowners holding land to profit from inflation. Landowners in areas of high housing need, with plans at some point to cash in on residential use values, would run the risk of losing much of that windfall if they did not strike a deal with a developer and get their sites in the pipeline sooner rather than later. The power should only be available to the local authority, subject to review by the secretary of state, if the existing pipeline for homes is running so low that the necessary rate of development is at risk. All other land purchases by councils should be made on the open market.

This framework would maintain market mechanisms and fair pricing, but it would remove the ability of landowners and developers to manipulate those prices by controlling the supply of new homes. Crucially, it would drive residential land values down because, if homes have to be sold more quickly and therefore cheaply into the market, then the land will be worth less to the developer – and

landowners can only command prices that developers are prepared to pay. By using the public sector to top up private-sector output, it would also remove one of the principal drivers of high house prices at present, which is the year-after-year shortfall in the building of new homes.

In terms of who should deliver public-sector housebuilding, I would argue that councils remain best placed to fulfil this function given that they are locally accountable. The difficulty in some places at the moment is that this local accountability gives voice to nimbyism, which holds back planning approval for certain developments. This nimbyism must not be allowed to override national imperatives, which would be the point of placing a new statutory duty on local authorities to ensure sufficient homes are built. The alternative might be to have a central government quango in charge of such commissioning, or regional bodies (the Northern Powerhouse initiative would seem to offer scope in that part of the country, for example); but the more remote from town halls the decision-making, the more resentment there is likely to be about new developments.

The new council-built homes would not need to be maintained in the social sector; on the scale envisaged this would raise the prospect of a new generation of council estates. This is likely to be politically unpalatable but would also entrench poverty and welfare dependency; there is much evidence that spatially segregated social housing has served not only to concentrate poverty in particular areas but to perpetuate unemployment among those who live in it too.<sup>141</sup> Selling new properties directly into owner-occupation would in some ways represent the logical extension of right-to-buy. The crucial difference with the 1980s manifestation of right-to-buy, however, would be that the proceeds of sales would be reinvested in more homes. A similar strategy was pursued in the late 20<sup>th</sup> century by Singapore, where the large majority of homes are both public-sector built and privately owned.<sup>142</sup>

Increasing access to home ownership would be one attractive outcome of the plan, but that is not the fundamental objective, which is simply to increase the supply of homes and so reduce housing costs across *all* tenures. This may alleviate some of the demand for social housing; however, the proposed new fund for building should also be made available to housing associations to the extent that local authorities identify social housing need in their areas.

Finally, councils should, wherever possible, be encouraged to parcel up land for their own developments into chunks manageable by SME builders. This would encourage greater competition in the building industry and break the stranglehold of the biggest high-volume builders.



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## Costs

How much money for public-sector housebuilding should be made available via the National Housebuilding Fund? This would depend on how the private sector reacts to the reforms outlined here, and so how many public-sector homes were needed. It would also depend on what kind of homes were needed where. But if we assumed, for the sake of argument, that there was no improvement in private sector housebuilding above current levels, we would be looking to councils to oversee the building of about 100,000 homes a year, including about 25,000 in London. If, say, half were two-bedroom flats and half were three-bedroom houses, and all were built in London and the south of England, this could be achieved for £15-20 billion, based on estimates of 2015/16 building costs calculated by the consultancy Capital Economics (a breakdown of this figure can be found in Appendix Two).

This would represent the highest end of the cost spectrum, because these figures are calculated using today's building costs, including today's land prices (as well as assuming that all of the homes would be in the more expensive south). If homes were sold into the market in much greater numbers and more quickly than they are at present, then prices would be depressed and land values would fall, reducing the cost of building future homes – for the public and the private sectors. In addition, if the private sector stepped up housebuilding in response to the proposed planning reforms, then the demands on the public sector would be correspondingly less. If private (and housing association) output reached 200,000, for example, that would leave roughly 50,000 homes a year to be built out of the National Housebuilding Fund – costing at most £10 billion.

This would be a one-off upfront capital investment – as homes were sold into the market, the money would be reinvested year after year. These sums should be viewed in the context of the current cost of housing benefit, which is roughly £25 billion every year - none of which finds its way back to the taxpayer, and is a direct consequence of the failure to build enough homes. The investment in new homes, on the other hand, would yield significant returns for the taxpayer: reducing housing costs would reduce housing benefit liabilities, now and in the future. In addition to that, money spent on construction would contribute to GDP growth. The value of this has been estimated at a £2.84 increase in GDP for every £1 spent.<sup>143</sup> The Lyons Review calculated that increasing annual housebuilding to just 200,000 a year by 2020 could create 230,000 new jobs and add 1.2 per cent to GDP.<sup>144</sup>

Still, the initial outlay would be large and would be likely to meet significant political opposition. The climate at Westminster is currently hostile to big spending initiatives, however efficient a use of resources this might be in the long term. It

might reasonably be argued though that the recent period of belt-tightening since 2010 and the prospect of a budget surplus within the next few years might allow a little breathing space for the contemplation of long-term infrastructure investment such as this. Government borrowing costs have recently reached all-time low levels, 10-year gilts now costing the government well under 2 per cent.<sup>145</sup> Borrowing to invest should not be ruled out in areas of national importance. Without it, as I have tried to show in this paper, the under-supply of new housing is unlikely to be resolved.

## Postscript

There is an elephant in the room in the housing debate which is that, actually, very many people do not want housing costs – or, more precisely, the price of their own home – to fall at all. Most homeowners (which still, for now, means most households) have gained and continue to gain from rapid house price growth. Many may be concerned about their children or grandchildren's limited prospects of becoming homeowners; they may be horrified by the kind of prices that many younger people must pay today just to rent. Even so, there is little obvious desire for a fall in house prices, which would leave millions of homeowners out of pocket. Few, if any, politicians will stand up and say that house prices need to be reduced. In fact, most seem content to go along with initiatives from this and the previous government to buoy the market by effectively subsidising purchases. And yet the only way of reducing housing costs for everybody is to get on top of demand, increase supply and depress house prices. The present generation of owner-occupiers is not the only vested interest presenting an obstacle to the government doing the right thing. There are large landowning interests who stand to lose out from any change to the status quo, and there are vocal campaigns against housing developments on environmental and heritage grounds, for instance.

For the past decade or more, we have lacked the will as a country to do what is necessary. House-price appreciation has been too enticing, for too many people, to do much about. But even if the public mood changed and we were determined to tackle the issue along the lines suggested above, there would be potentially enormous economic consequences arising from any strategy to reduce house prices. Recent homebuyers would be placed in negative equity, consumer confidence would probably fall, a recession may well ensue. If land prices were to fall – as intended – the current generation of developers who are sitting on expensive landbanks will be highly exposed. More frightening still perhaps, the financial sector that has facilitated the current levels of house prices would be plunged into crisis as those prices fall; as noted above, about two-thirds of UK bank lending is in the form of residential mortgages. Martin Wolf of the *Financial Times*, a critic of measures that keep housing expensive, nevertheless warns: 'A deregulated and dynamic housing supply could spell financial and political Armageddon.'<sup>146</sup>

I have tried to offer some answers here as to why we do not build sufficient homes and what must be done to rectify the situation. How house prices can be negotiated downwards sensibly, without creating mass panic and an economic crash, is a challenge worthy of an entire study of its own. These are big questions

beyond the scope of this paper, but they require serious and honest discussion of the kind that has not been had so far. The question may reasonably be asked, can we afford to bring down housing costs? It may also be asked, can we afford not to?

## Appendix One

Table of statistics for Figure 5:

Year	Units approved	Starts	Completions	Approvals minus starts	Cumulative backlog
2006	223694	170,320	167,680	53,374	53,374
2007	212467	170,440	170,610	42,027	95,401
2008	168559	88,010	140,990	80,459	175,860
2009	126010	95,560	119,910	30,450	206,310
2010	134143	111,150	107,870	22,993	229,303
2011	115412	110,820	118,510	4,592	233,895
2012	140555	103,520	107,980	37,035	270,930
2013	174353	134,110	112,330	40,243	311,173
2014	195569	137,740	124,490	57,829	369,002

## Appendix Two

It is impossible to be precise about how many homes would be needed, of what type and where, as part of any public sector housebuilding programme. This table is intended to provide an illustration of what would be possible with a one-off capital investment in the region of £15-£20 billion. It is based on building cost estimates for 2015/16 calculated by the consultancy Capital Economics.<sup>147</sup> It includes the building of 100,000 homes – half as two-bedroom flats, the other half as three-bedroom houses. These include 25,000 units in London – with the flats in inner London, and the houses in outer London. All of these units are built in the south; of course, many would likely be built in the north, where the cost would be cheaper. The scenario envisaged here comes to a total cost of £16.6 billion.

	2 bed flats	Cost per unit (£)	Total (£billion)	3 bed houses	Cost per unit (£)	Total (£billion)
Inner London	12,500	142,000	1.8			
Outer London				12,500	229,000	2.9
Home counties	12,500	134,000	1.7	12,500	223,000	2.8
South urban	12,500	119,000	1.5	12,500	185,000	2.3
South rural	12,500	125,000	1.6	12,500	160,000	2
			6.6			10

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