National Institute of Economic and Social Research


# Housing the Economy

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## 1. Troublesome Trinity

Housing outcomes are increasingly problematic in the UK and the OECD. A troubling trinity of rising homelessness, growing queues and high payment burdens in rental housing, and difficulties in entering homeownership are widespread (Maclennan et al., 2019; OECD, 2023).

Adverse outcomes, evolved over decades, reflect both socio-economic changes and persistent failures in the governance of housing systems. Governments fail to grasp how housing outcomes frustrate goals for stability, higher growth and productivity, fairer distributions of wealth and residual incomes, and progress towards net zero. Ubiquitously macro- and sector-specific policies overwhelm the effects of 'palliative' expenditures of Housing Ministries.

Governments need to disrupt policy approaches and rethink what housing is, how the system functions, what outcomes do for the economy, society, and environment, and what 'housing' policy is. They must reach beyond the mantras of meeting needs, making housing affordable, and expanding homeownership. Housing policy must be redefined as the whole of government actions that manage the overall housing system to deliver outcomes that best achieve wider missions (Bowman et al., 2021; Marsh, et al. 2024; Maclennan, 2023). Economic policy must shape a better-functioning housing system that delivers improved wealth and productivity effects (Maclennan and Long, 2024).

Current difficulties partly reflect short-term policy mismanagement. The UK, like similar economies, has experienced a decade of pressures in rental markets exacerbated by high immigration rates, growing numbers of overseas student, and potential homeowners frustrated by high downpayments, stress tests and, more recently, higher mortgage rates. Despite the 'supply side' rhetoric of policy, 'demand mismanagement' has been recognised, policy adjusted and rent rises are easing. However, two longer-term 'meta' processes have driven the current crises. First, real housing prices have risen ahead of incomes; between 1992 and 2022 average house prices rose by 377 per cent and median household disposable income by only 51 per cent (Marsh, et al, 2024). Second, the distributions of income and wealth have shifted against the poorest three deciles. The first trend suggests a system dysfunction problem, and the second a growing 'merit' good provision moral challenge. Are there signs that there is a new government understanding, and not just new urgency, for policy progress?

## 2. Merit Goods and Aspirations

### Remaking Rental

The government acknowledge the significant shortfall in merit provision. In her first speech as Chancellor of the Exchequer, Rachel Reeves stressed the economic significance of housing, announced 'the biggest increase in social and affordable housebuilding in a generation' to meet 'needs'. She also recognised system limitations and, embracing a 'supply-side' emphasis, announced plans for 1.5 million new homes, in England, by 2030. This near doubling of housing starts is to be primarily driven by restoring, with £100million of Treasury support, local planning competences, structures, and processes to shape faster, flexible planning. These intentions were welcomed by market and non-market housing providers. Now, despite the reinforcement of the 'supply' message by senior Ministers, there are emerging concerns that the policy goals are both unachievable and too limited to stop housing outcomes deteriorating.

In relation to 'needs', additional funds for municipal homelessness schemes and net zero housing, and reform of the Right to Buy to prevent social stock loss are obvious gains. The split of limited additional (£750million) resources for the Affordable Housing Programme (AHP) between low- and middle-income housing is opaque, but it is clear that attaining the implied increase for the poorest quintile will require increased spending that is difficult to reconcile with public spending targets. The scale and distribution of the 'needs' alleviation programmes will remain unclear, buffeted by the macroeconomic storms of this winter, until the conclusion of the Public Spending Review in mid-2025.

The redefinition, in the restated fiscal rules, of public debt control in net terms (recognising that some investments create assets as well debts) are pro-investment in housing. However, there also needs to be a reduction in the short term subsidy controls used by HM Treasury that have derailed long term investment programming (Lloyd and Grayston (2023). Housing spending also includes resource budgeted spending on acute services e.g. homelessness, and this will remain tightly controlled in the foreseeable fiscal environment.

A decade of centrally imposed rent restrictions and requirements to meet quality standards, have depleted the revenues and subsidy leveraging capacity of social landlords. The Deputy Prime Minister has committed to a more stable and less restrictive rent regime for non-profits and the Chancellor has questioned whether the prudential lending regime is now too restrictive. These regulatory constraints need to be relaxed if expanded links between non-profits and pension funds and new possibilities for blending debt finance, guarantees, property value uplifts, public land, and planning gain developed to leverage limited grant funding with private capital. Unless the government raises AHP spending and re-energises innovation in non-profit housing finance it could complete a year in office without increasing non-profit starts.

Will investment in the private rental sector (PRS) expand? Evidence reviews suggest (Gibb et al., 2022) markets cannot be assumed to be textbook competitive and that regulation of the PRS, if carefully constructed, well informed and flexible, does not necessarily inhibit long-term investment. The King's Speech proposed regulations to improve the PRS by promoting building to rent (BTR), good landlord practice, and ending no fault evictions. The UK government have resisted demands for rent controls, learning from the Scottish experience where poorly constructed measures have deterred investment. A likely expansion in BTR will, however, address middle and upper income rental demands rather than low income needs.

Surprisingly, the Government has not made expenditure proposals to reset the Local Housing Allowance (LHA), the benefit cap, the 'bedroom tax', and the two-child benefit cap that are all required to alleviate housing aspects of poverty and homelessness (Bramley, 2024). The 'bedroom tax' disproportionately affects disabled, working age, social tenants whilst the major source of under-occupation is older owner occupiers resisting downsizing to maximise bequests, which could be mitigated to an extent by exempting over 65s from stamp duty land tax (Whitehead and Crook, 2023).

**Facing Up to Falling Ownership**

UK governments have long advocated expanding 'affordable' homeownership, creating a new 'merit' expectation. Homeownership rates rose until 2001 (71 per cent of households) as growing longevity of existing owners offset the already falling home-ownership rates for the under-35's. By 2024 the overall ownership rate had fallen to 65pc primarily because the rate for the 25-35 age cohort fell from almost 60 to 40 per cent as a consequence of post GFC mortgage re-regulation, slow income growth and low entry-level wage rates. Governments have failed, for almost three decades, to address the processes that disadvantage successive younger generations. First time buyer policies, like Help to Buy, have been piecemeal, expensive, limited in impact, and raised prices for the next wave of market entrants.

A major rethink of homeownership policy aims, means and effects is required. Economic growth is likely to boost ownership only if it does not raise house prices so that ending the near certainty that UK growth drives higher house prices, in effect addressing system functioning, is essential to meeting the merit 'aspiration'. Central banks, and finance ministries, in the UK, Canada and Australia, have been happy to highlight municipal planning system inflexibilities as the key driver of housing unaffordability. The Government's 'supply' stance leans in that direction too.

Planning effects on housing affordability cannot be dismissed, nor should they be exaggerated. UK house prices and homeownership patterns are also shaped by the scale and availability of mortgages and deposits, high and low interest rates and prudential regulation and stress tests (Miles and Monro, 2020; Lewis and Cumming, 2019). There is a plausible counter to the 'supply' failure view, namely that monetary and prudential policies, allied to tax policy settings for housing capital gains, shape patterns of house price inflation (Mulherin, 2019). Ignoring these effects leaves and obsolescent understanding of homeownership processes and outcomes underpinning policy decisions, whilst homeownership transforms from a savings, wealth spreading system to a speculation system reinforcing wealth imbalances. The housing market has become increasingly driven by family wealth and less by income and mortgage lending to the bottom half of the income distribution is shrinking.

Disruptive innovation in housing planning is unlikely to be enough to secure more affordable outcomes and there is an urgent need to reappraise the roles of fiscal, prudential, and monetary policies in shaping adverse housing outcomes. The Chancellor, in looking beyond a supply side approach, has questioned whether prudential regulations (that have shifted financial risk to younger and poorer households) now unduly limit the ability of mortgage lenders to balance risk and return.

She might also ask if:

- the Bank should have more focus on the productivity effects of sustained increases in the price of housing.
- there is scope to further develop long-term fixed rate mortgages (Miles, 2004; Mulherin, 2019).

With four out of five of first-time buyers requiring family gifts to make loan deposits the housing market now erodes social mobility and exacerbates unequal wealth patterns. Recreating affordable ownership choices for younger, poorer households also has to be set beside the additional up-front capital costs, albeit with longer term net income gains, of installing low carbon domestic energy systems (and a costly parallel retrofit effort in the rental sectors will also be required).

Failing to 'own-up' to why ownership is down is no longer an option for the UK. Sustained rentier gains for existing owners and landowners are not consistent with current government missions to simultaneously raise productivity, more equally distribute wealth and attain net zero. Future governments, by 2040, will have to face the consequences of declining home-ownership rates for pensions, housing benefit, social care and health costs. The government must revert the nation's most widespread speculation system back to the steady savings-low inflation housing system prevailing before April 1972. The silence on substantive policy debate for the sector is deafening.

## 3. What About the System Governance Issues?

The government's 'needs' policy is a fairer, more expensive, version of recent British housing 'business as usual'. Yet it is unlikely to stem deepening housing difficulties. Policy tinkering will not work. Housing system governance needs to change. This starts with disrupting the conventional meanings of 'housing' and 'housing policies'. Housing is more than a short run activity (such as building) with multiplier effects. It is a stock of attributes that are infrastructures central to the economic behaviours of households and, of course, an asset. Policy is not best thought of numbers of needs and starts but as stocks of capability enhancing attributes with multiple outcomes, including productivity and growth. These choices are driven nor just by income and wealth but by a wide range of sectoral and macro policies.

Adopting that non-reductionist notion of housing requires a shift to a housing system management policy approach (Maclennan, 2023; Marsh et al 2024). It requires a whole of government approach, across all policy silos and orders of government, to collaboratively manage the housing system to meet core missions. This involves, at each level of government, an integrated view of how all policies support or frustrate Housing Ministry actions for better outcomes. The Deputy Prime Minister is well placed to lead cross Departmental policy integration, and the Chancellor should have on her desk evidenced briefs on what housing does not just for inclusion and the environment but for productivity and the economy too (Maclennan, 2024). Put bluntly, (and the same observations can be made in Ottawa and Canberra) the government needs to get its housing act together.

The same observations can be made of town halls and devolved administrations too. With housing-relevant resources and autonomies distributed across all levels of government, housing policy requires effective collaboration mechanisms across all orders of government (Scottish housing outcomes are a stark example of how absent such behaviours are in the UK). The devolution of powers to regional/metropolitan levels now proposed for England by the UK government, aligned with a return to strategic spatial housing planning and 'new towns' thinking', could constitute the beginning of more effective sub-national policy collaborations if they are collaboratively resourced and locally led. At that regional-metropolitan scale new understandings of how real housing and land markets function and fail, and of the limitations of non-market delivery systems could be developed and underpin action for more relevant understanding of housing-economy interactions. More housing rights and more public resources will not, in a business as usual approach, significantly alleviate the UK's housing problems. New ideas and collaborative governance might.

## 4. Much Done, Much Still To Do!

The Chancellor of the Exchequer has raised investment to meet 'needs', initiated a changed perspective by recognising the economic growth roles of housing, emphasised the disruption of planning processes to accelerate supply, and also changed fiscal rules and advocated prudential regulation changes that are pro-housing. Five major strands of further change are required for housing outcomes to substantially improve.

i. British economic and housing policies have fostered the 'rentier' rather than the 'entrepreneurial' economy. The Treasury view of 'housing' has to change and recognise that homes are spatially fixed stocks of multiple capital attributes, produced in imperfectly functioning systems, that shape the consumption and production patterns of people and places, and that impact capital allocation in the economy with higher housing costs reducing investment in other forms of growth-inducing capital.

ii. Speeding up planning will be insufficient to deliver the supply increases envisaged. Housing supply chains are complex with currently high interest rates, severe shortages of skilled labour, materials, and critical infrastructures. Firm strategies within the development industries also matter and the Government should absorb the Letwin Review observation that meeting supply targets requires incentives to deliver affordable homes whilst faster planning may grow stocks of unused permissions. The return of mandatory local housing targets should include a requirement both to develop regional housing market modelling and housing supply chain audits with costed measures to remove barriers.

iii. 'Levelling-Up' rhetoric has ended, but it is imperative that devolution drives strategic, collaborative, multi-order housing investment strategies, that will require better strategic planning, to be a central mechanism in policy delivery, and link housing and infrastructure investments to economic, inclusion and environment goals, for instance in transport-oriented developments and shaping well served neighbourhoods.

iv. Long-term housing tax reform should start now. The British housing culture, fostered by successive governments, that capital gains are an untaxable entitlement of homeowners, must end. Housing is dominated by stocks and changes only slowly, so policy needs to have consistent direction over long horizons (Marsh et al, 2024). MHCLG are now developing an explicit long term housing strategy for England, and it cannot credibly ignore housing taxation questions. Housing tax change will be politically difficult, slow, but essential if Britain is to be both a nation of homeowners and a dynamic economy. Problematic housing outcomes have risen towards the top of national political agendas in the 2020's and there is growing evidence that housing difficulties have played key roles in driving up votes for 'populist' parties. Poor housing outcomes are changing politics. Politics might now have to change how it thinks and acts on housing.

v. Governments have to change their structures and behaviours to cope with modern housing systems. Improved governance, at national and sub-national scales, which emphasises what housing means, how real housing systems function and how their outcomes feed into broader, high-level goals will be essential. That approach also calls for new structures for managing policies, as noted above, that facilitate integrated, collaborative actions within and across governments. Otherwise, business as usual, fiscally feasible palliative housing budgets will fail to stem wider 'big policy' effects that deepen housing difficulties.

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