



UK Housing and Planning Policies: Evidence from Economic Research

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THE LONDON SCHOOL
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Overview

1. The key policy issue – some stylized facts
2. Features of the British system of land use planning and testable implications
3. Empirical evidence: Impact of planning constraints on house prices
4. Assessment of housing policies in light of existing institutional setting
5. Conclusions

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Stylized fact 1

- **House values in England – particularly in London and SE – are amongst highest in world**

Mean price of single detached house (all transactions in 2008 – in-midst of Great Recession):

- ▶ Kensington: 4.3M £
- ▶ Richmond: 1.2M £ (greenish London suburb)
- ▶ Hackney : 770k £ (rather distressed London borough)
- ▶ Cotswold: 470k £ (rural West of England)

- Buying price per square metre **second highest in the world** (topped only by Monaco)

Sources: Land Registry; Globalpropertyguide.com (last accessed 6/2016)

Stylized fact 2

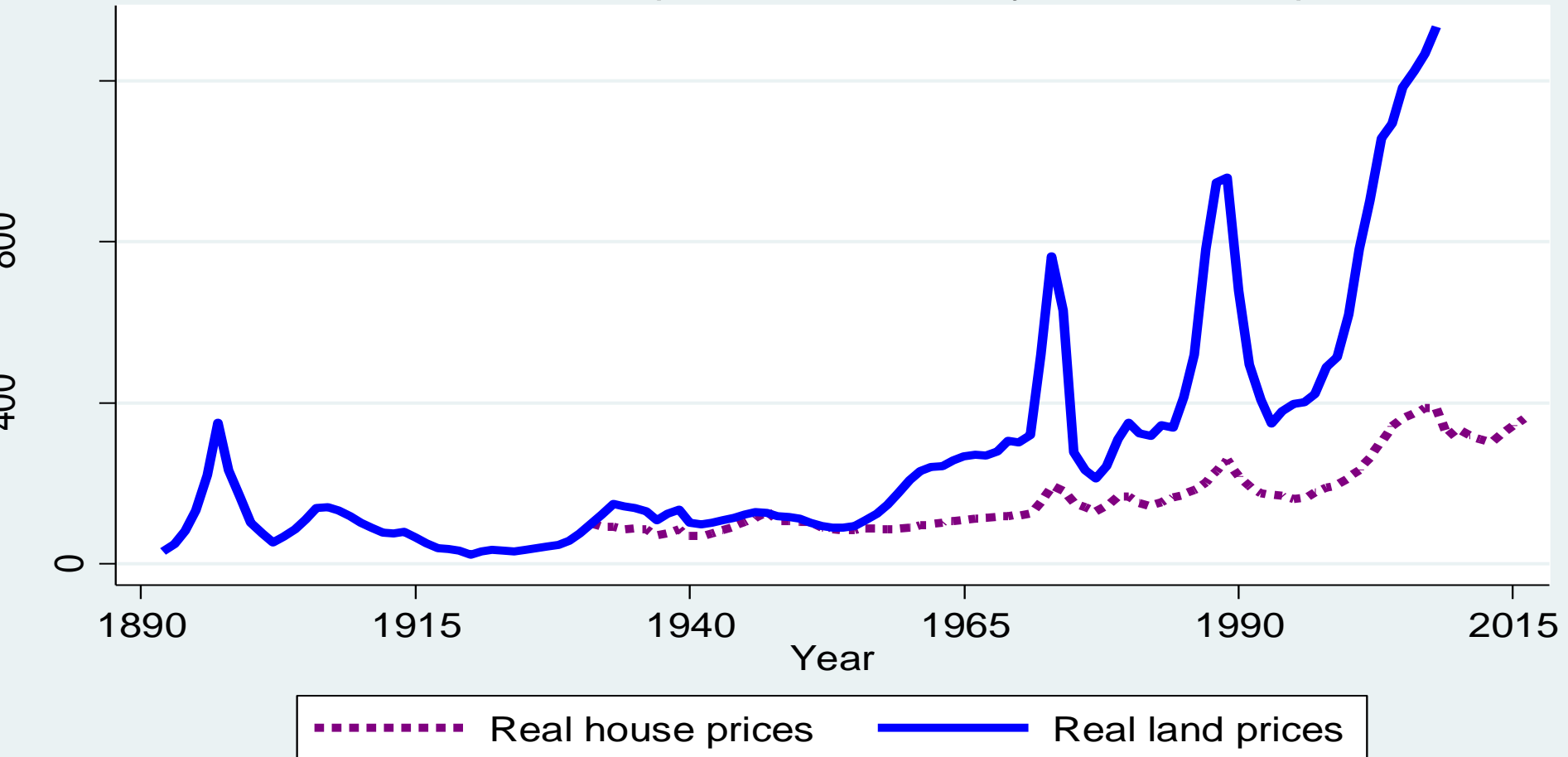
- **House prices in UK (and particularly England) are also extremely volatile**
 - ▶ UK as a whole substantially more volatile than single most volatile market in US
 - ▶ 1980s/90s cycle: boom/bust in real terms
 - **UK: +83% / -38%**
 - Los Angeles: +67% / -33%

Sources: Nationwide; Glaeser et al. (2008)

Volatility has increased in recent decades...

Real land and house price indices (1931=100)

Note: House and land price data for war years are interpolated



Source: Cheshire (2009) and own calculations for 2008 onwards / Land Registry & Nationwide

Volatility has increased in London relative to rest of UK...

Average London house prices compared to average UK house prices

Source: FT

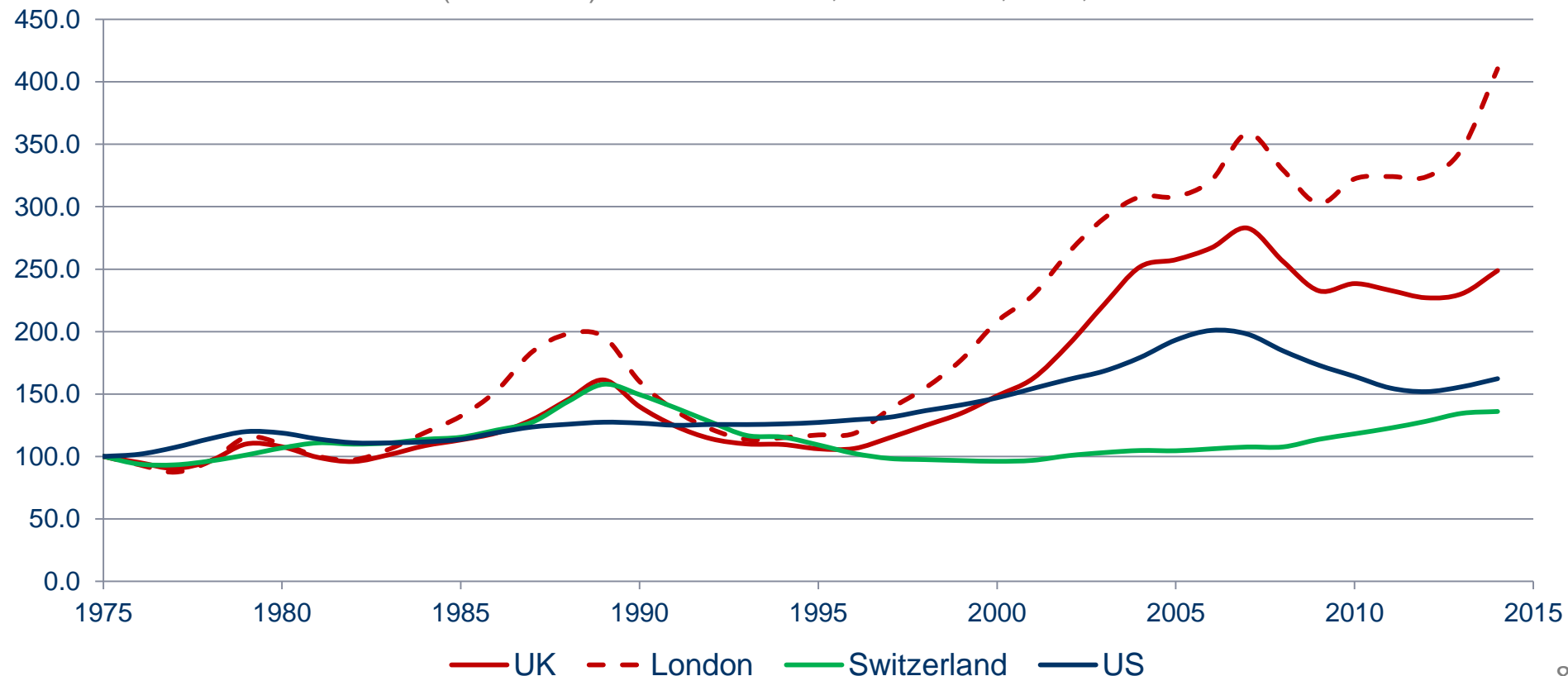


Stylized fact 3

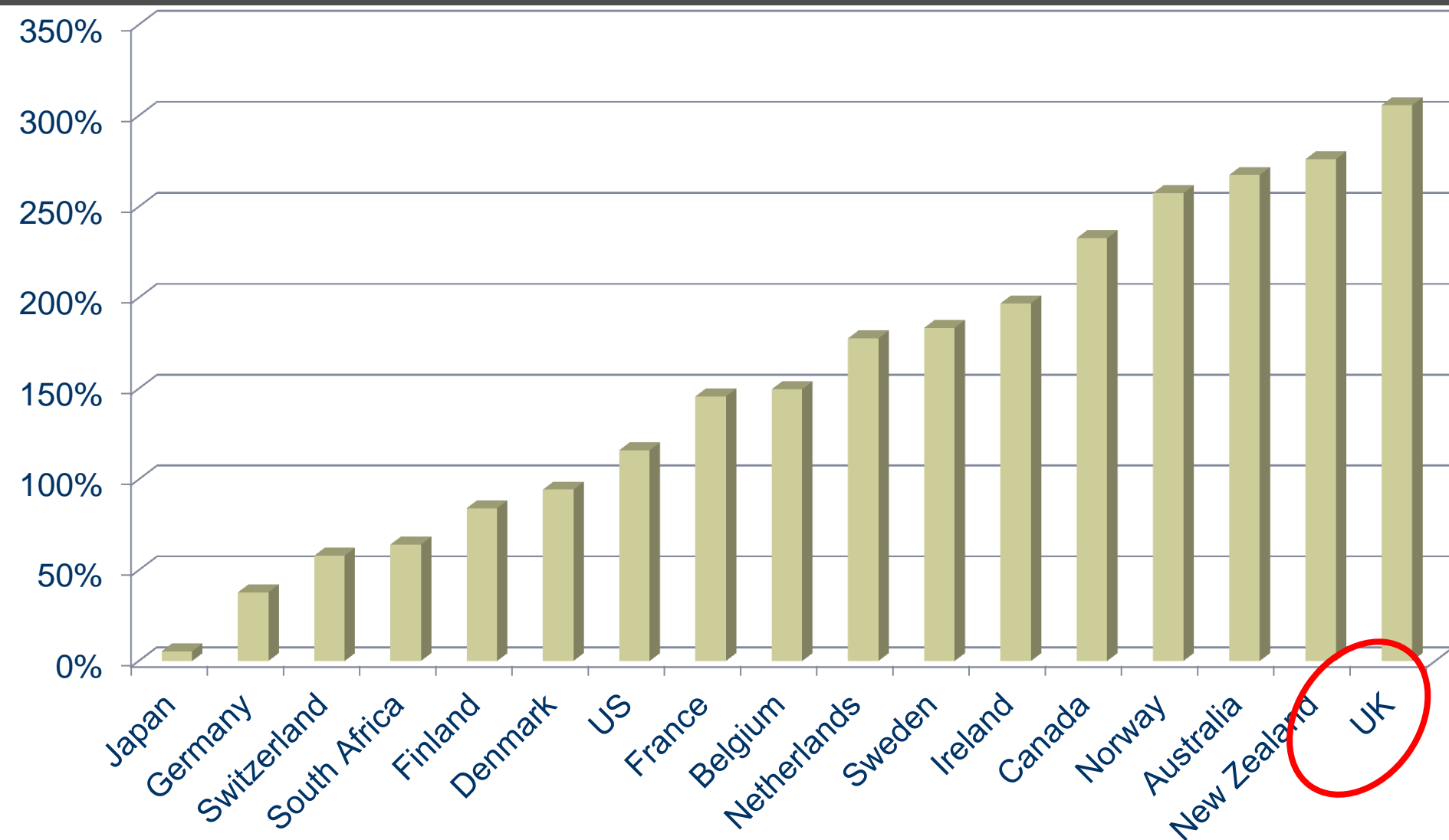
- Real HP growth in UK over last 40 years has been extraordinarily high by international standards...

Real house price growth in UK vs. US & Switzerland

Rebased (1975=100) – Sources: ONS, Nationwide, SNB, St Louis Fed



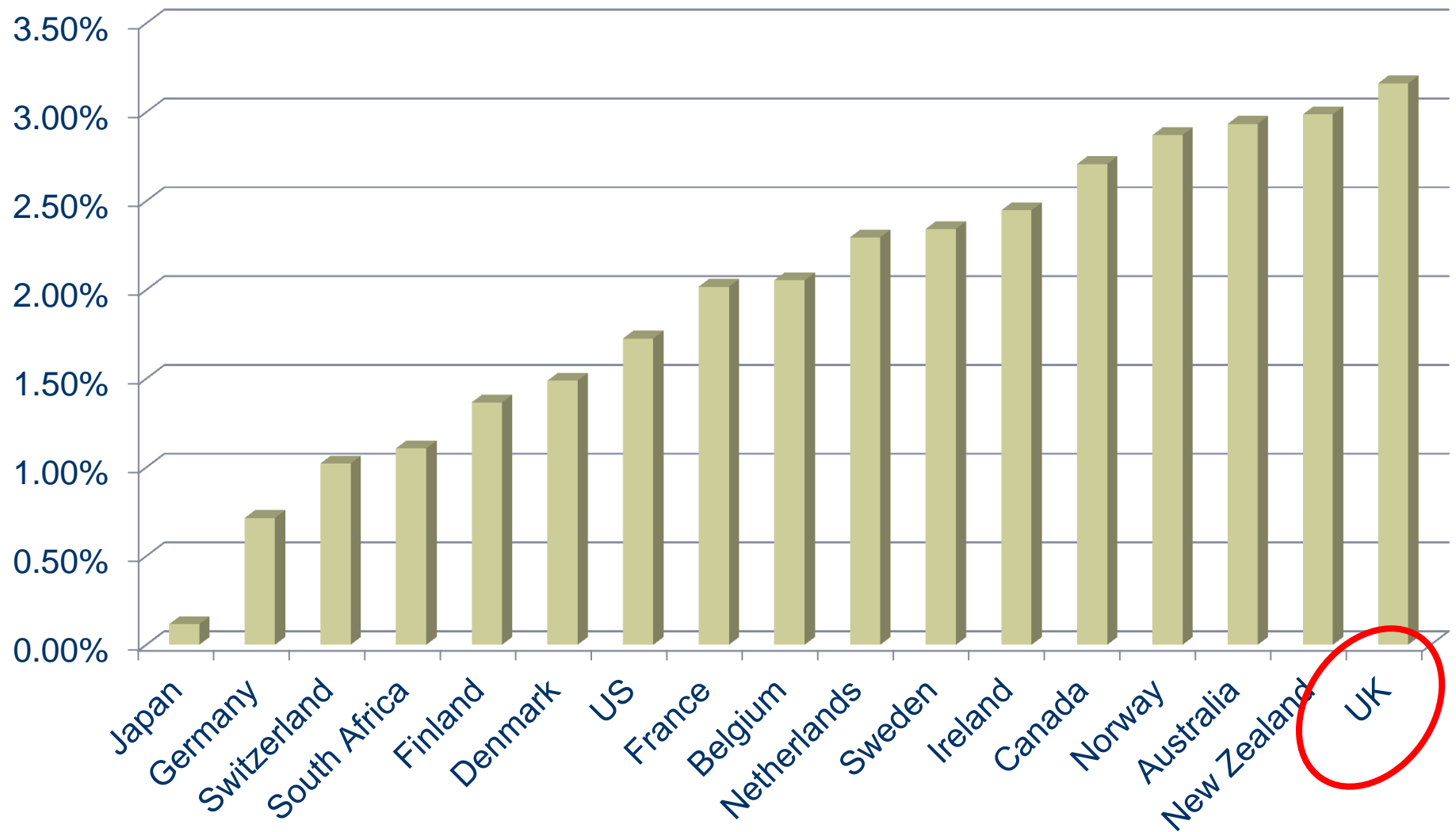
Accumulated real house price growth in % 1970 – 2015 for selected OECD countries



Sources: Bank for International Settlements (BIS), World Bank, Bank of England

Real house price growth p.a. in %

Average 1970 – 2015 for selected OECD countries

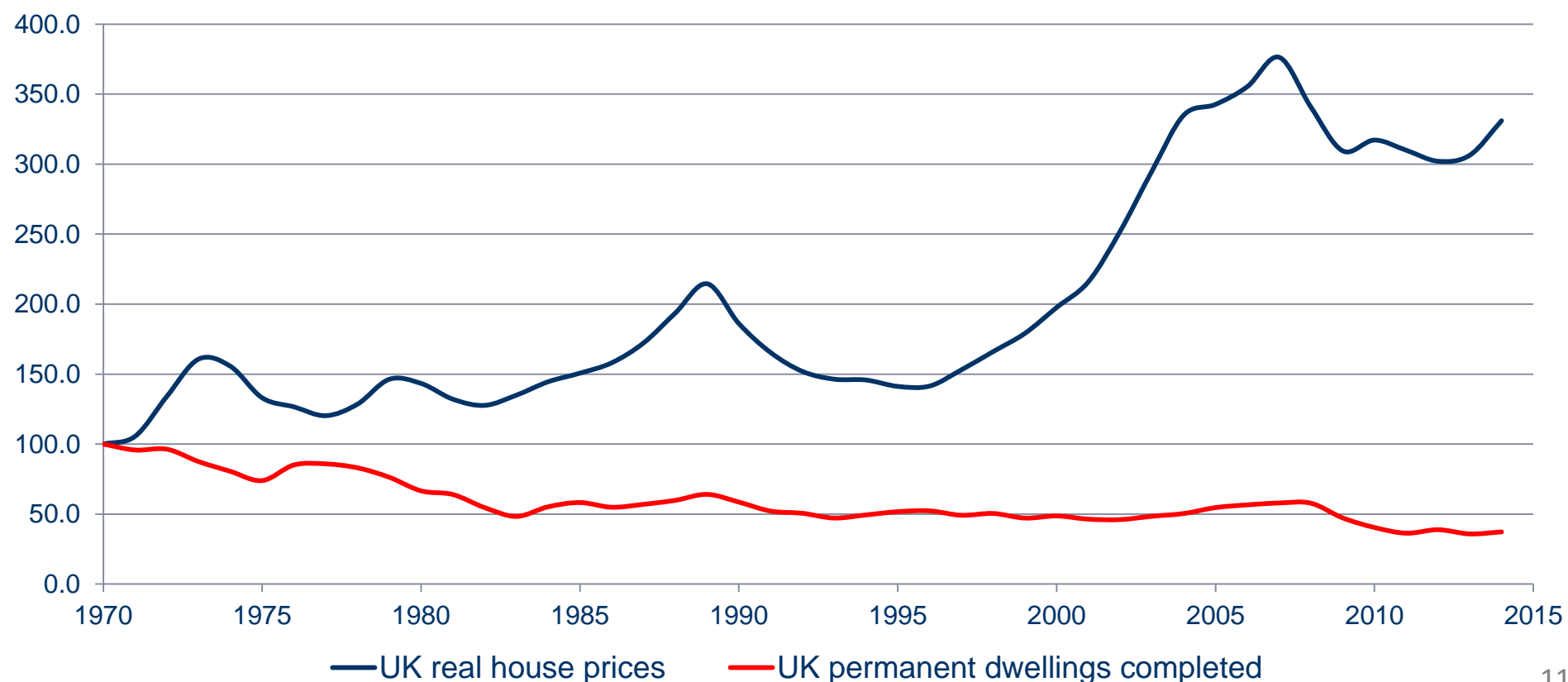


Source: Bank for International Settlements (BIS), World Bank, Bank of England

Stylized fact 4

- **Despite extraordinary price growth since 1970, construction has been in continuous decline...**

UK real house prices vs. UK permanent dwellings completed
Rebased (1970=100) – Source: ONS, DCLG



Stylized fact 5

- **There are not only fewer new-build homes but these are also extremely small by international standards**
(Statistics Sweden 2005)
 - ▶ A new-build house in UK is **38% smaller** than in densely populated Germany and...
 - ▶ **40% smaller** than in the even more densely populated Netherlands
- **...and houses are built in the wrong places: very little construction in the prosperous South**
 - ▶ Very little new housing in e.g. Oxford & Cambridge (compared to say Doncaster or Barnsley)

Derived research questions

- **What factors constrain housing supply** (and thereby cause the corresponding high level and volatility of prices)?
 - ▶ Might the **British system of land use planning** be a – or the main – culprit?

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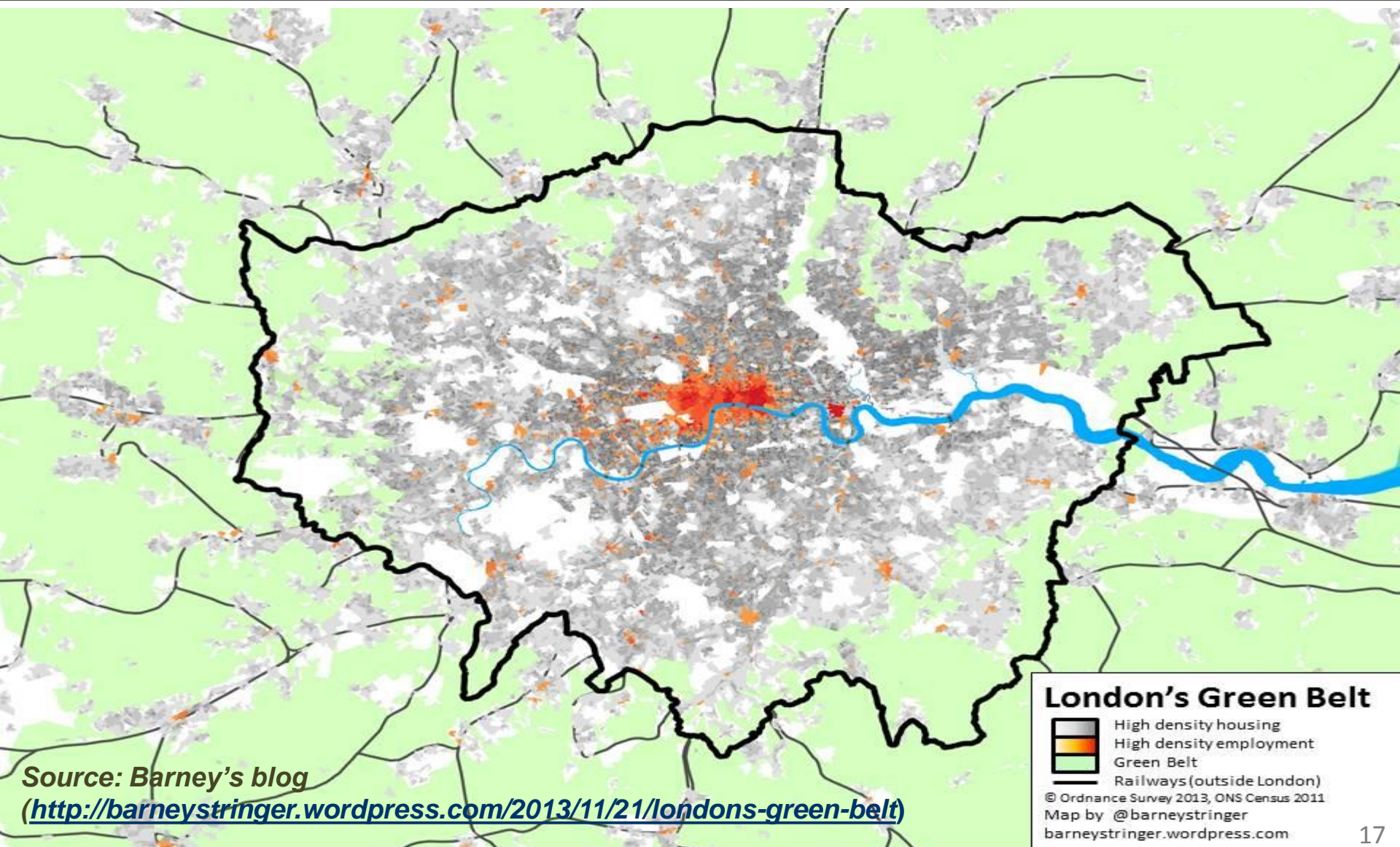
Some background: The British system of land use planning

- Today's planning system established in 1947 through **Town and Country Planning Act**
- Key features
 - ▶ Expropriated development rights of land owners
 - ▶ Designated 'use' classes, whereas any change of 'use' requires **development control permission** (granted at local level)
 - ▶ Aim is 'development control' or 'containment'

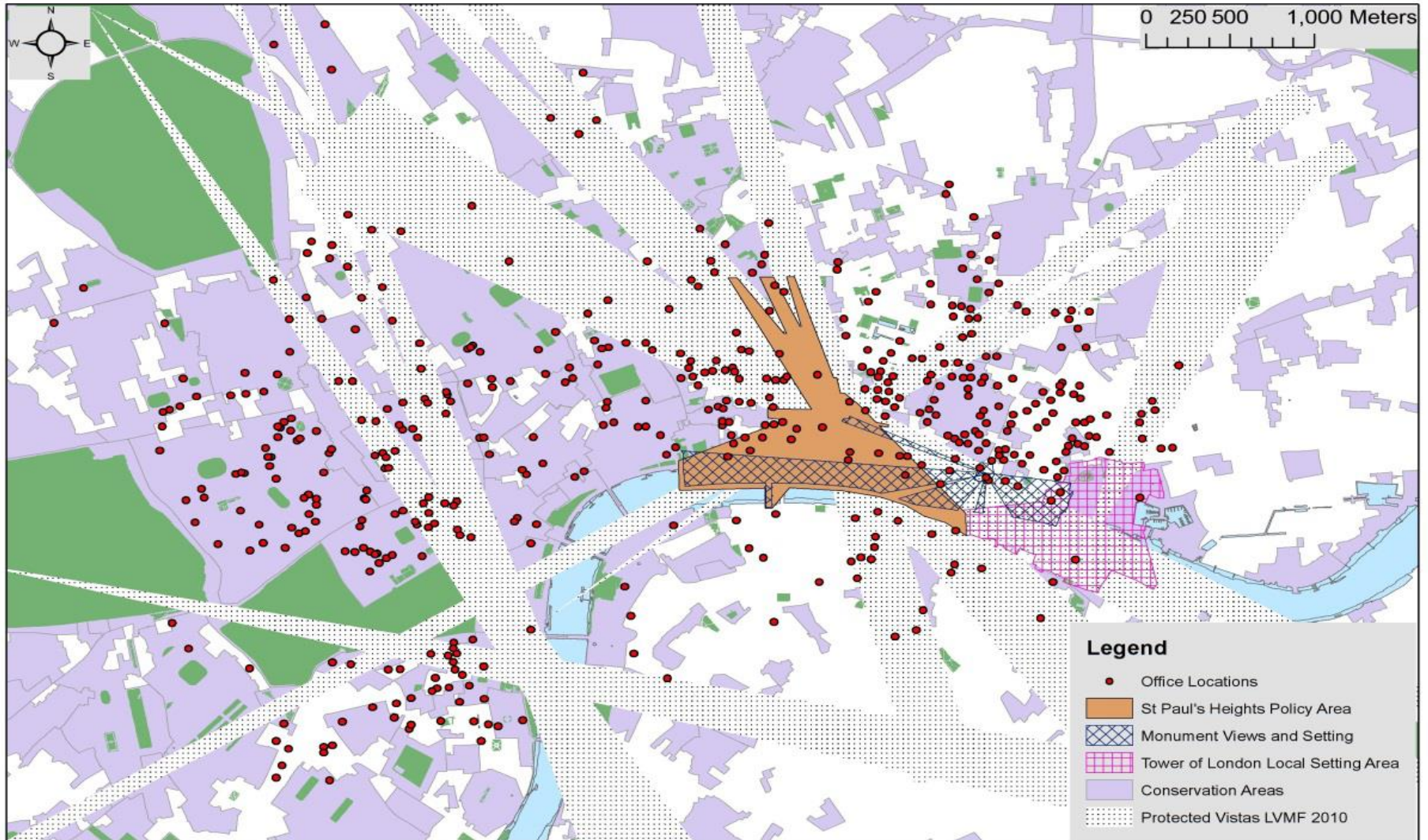
What green belt containment looks like...



And in London...

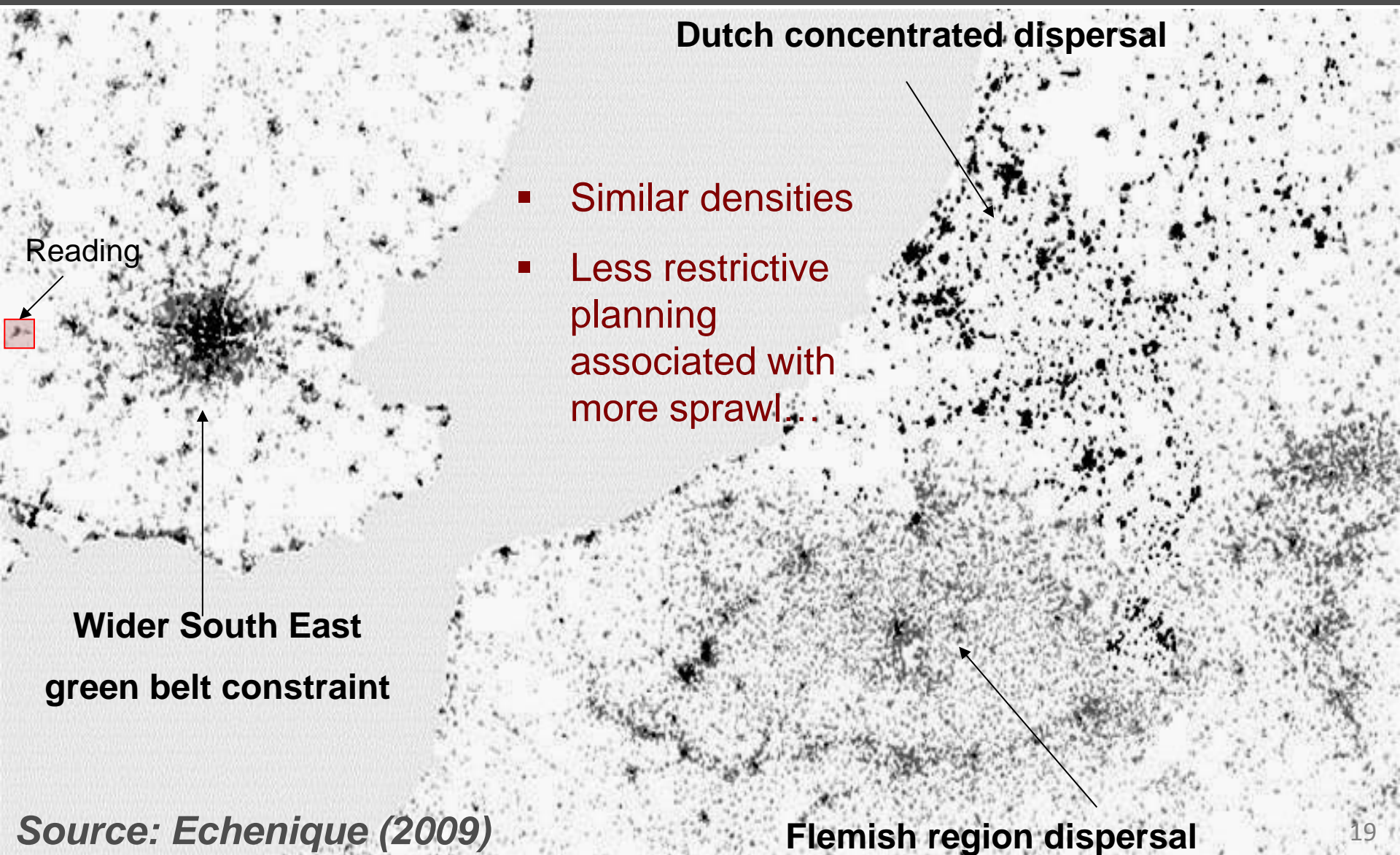


But not just green belt containment – many other planning constraints...



Source: Cheshire & Dericks (2014)

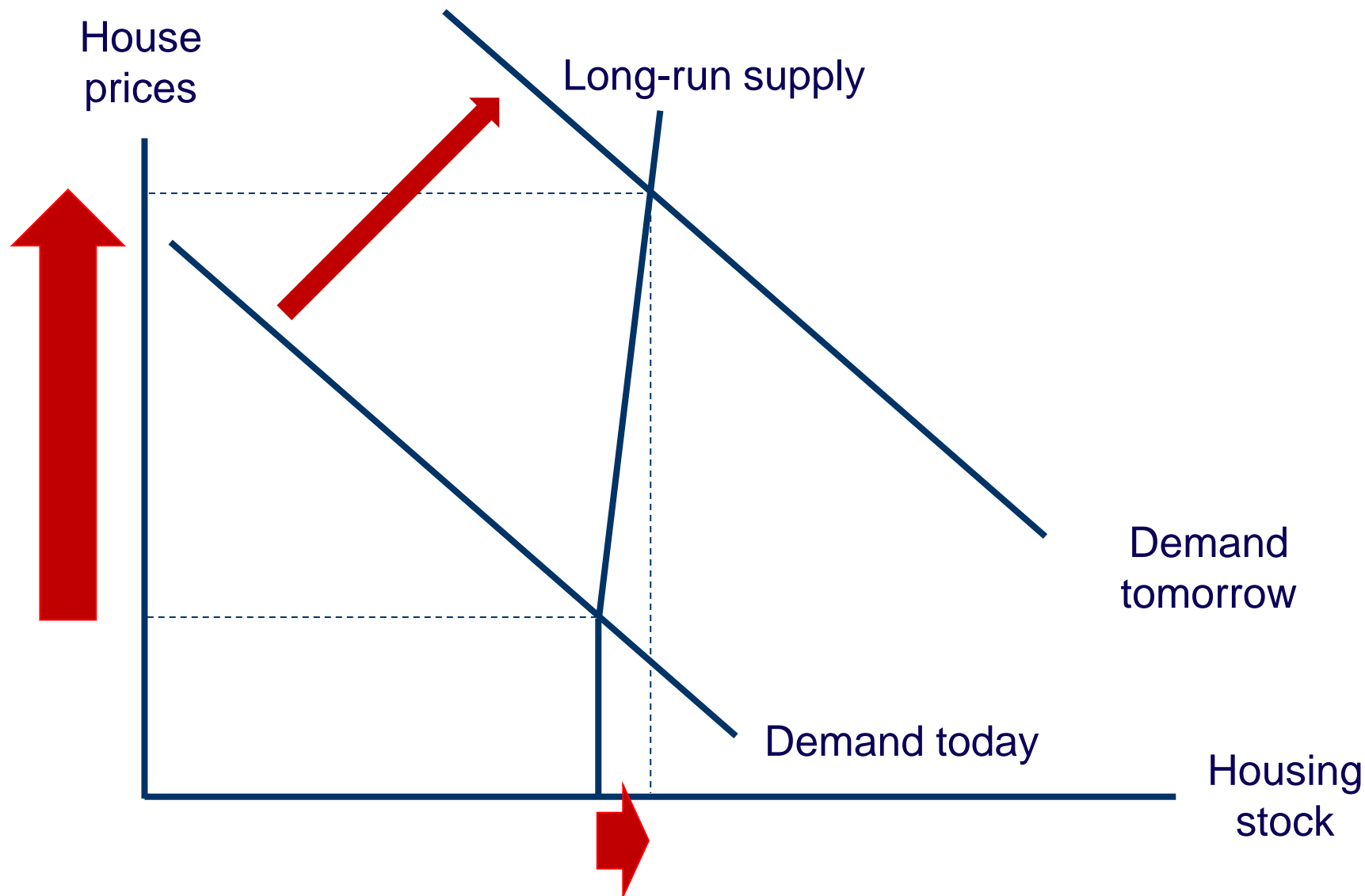
The planning system does affect urban form...



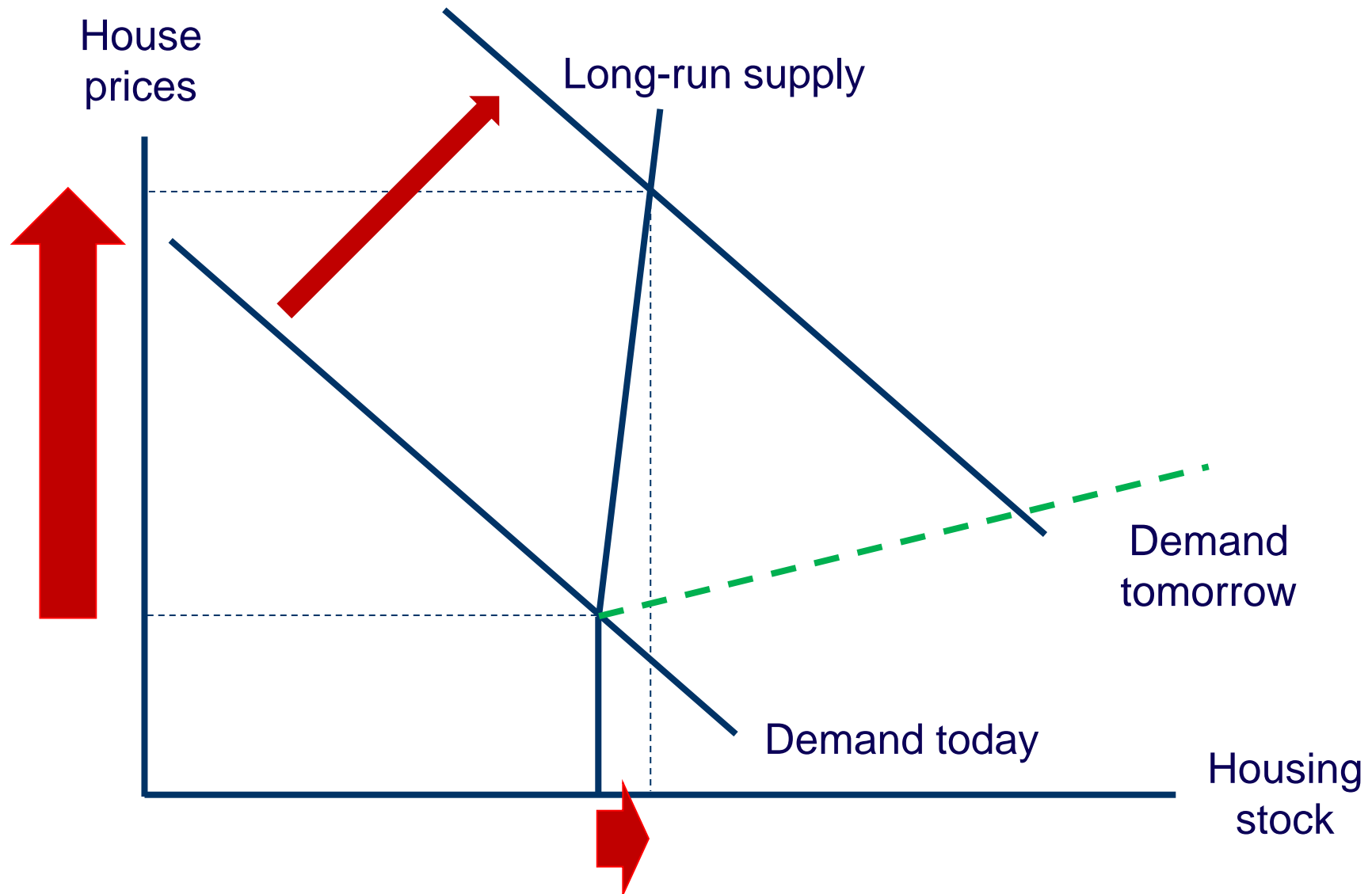
Who decides in UK?

- Local Planning Authorities (LPAs) grant or reject planning applications
 - ▶ Problem: Since 1947 virtually **no fiscal incentives** at local level to permit development (costs far exceed benefits)
 - Underlying causes?
 - ▶ UK = highly centralized country, virtually no fiscal power at local level
 - ▶ Political power tilted towards homeowners (NIMBYs)
- ⇒ Local long-run supply curve nearly vertical...

Theoretical prediction...



Theoretical prediction...



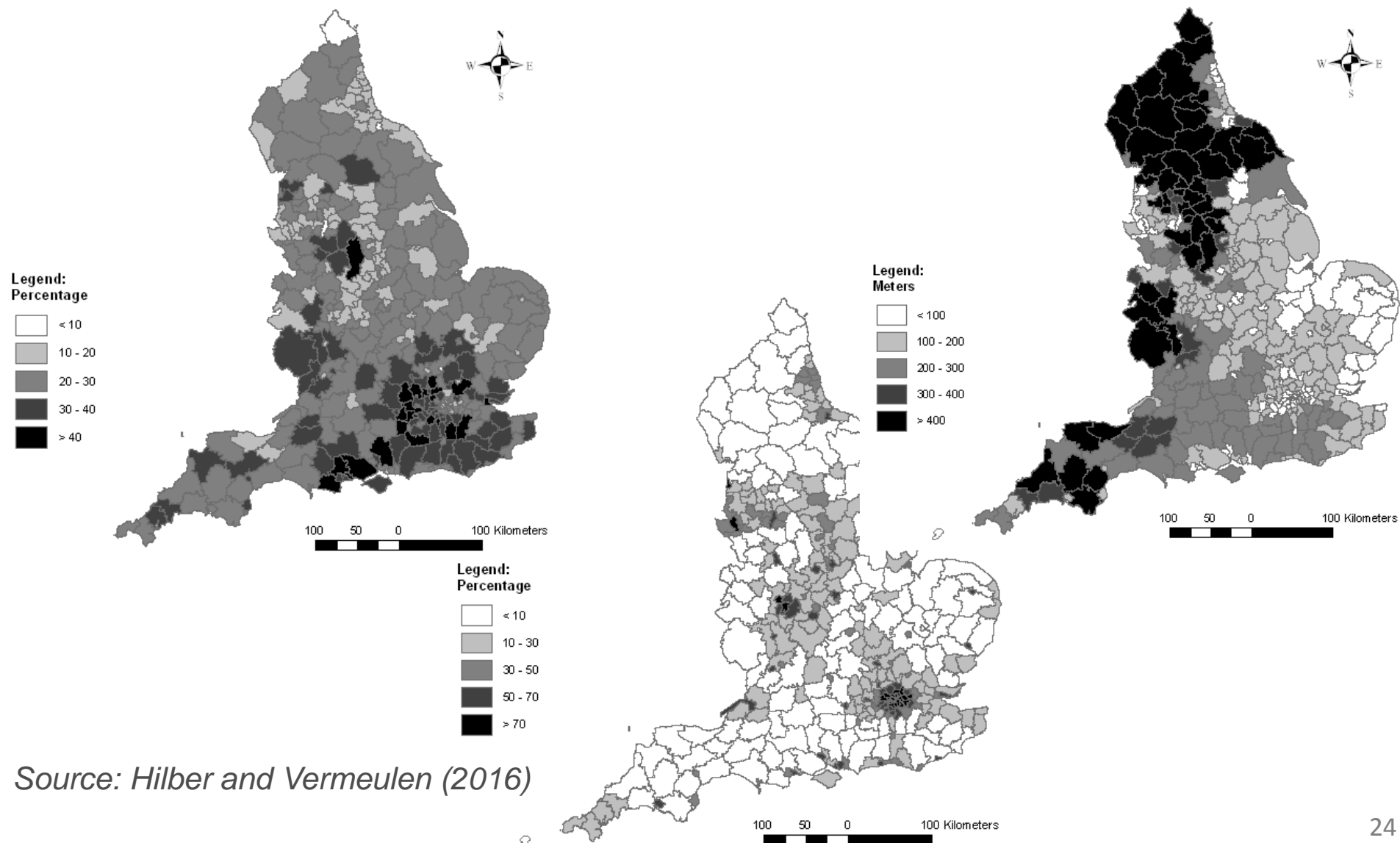
How to test?

- Hilber and Vermeulen (2016)
 - ▶ Exploit spatial variation in three different types of supply constraints: **regulatory, scarcity of developable land and topography**
 - ▶ Interact supply constraints with demand shifters (local earnings; labour demand shock)
 - ▶ Use instrumental variable technique to identify **causal effect** of local supply constraints measures on local house prices

Average refusal rate
(major residential
projects) 1979-2008

Share developable
land developed,
1990

Elevation range



Source: Hilber and Vermeulen (2016)

Main findings

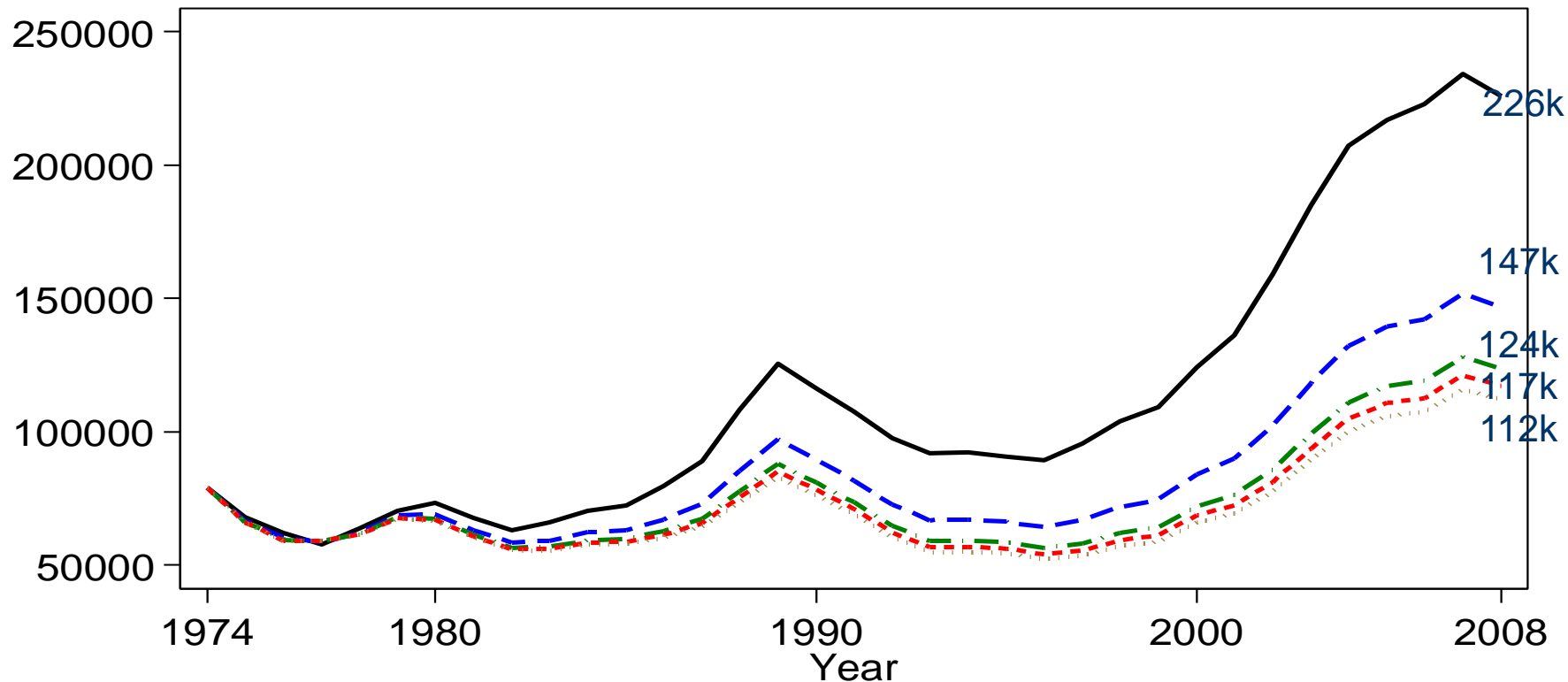
- **Tight local planning constraints** in parts of England (in conjunction with strong demand) are to a large extent responsible for extraordinarily high house prices
- **Local scarcity of developable land** matters but very non-linearly (only in most developed locations)
- **Topography** matters in statistical sense but very little in economic (quantitative) sense...

Quantitative effects (based on IV with *all* instruments)

- If planning were completely relaxed in *average LPA*:
 - ▶ House prices in *average LPA*: -35%
- *and* developable land were abundant:
 - ▶ House prices in *average LPA*: -45% ($\Delta = -10\%$)
- *and* LPA were completely flat:
 - ▶ House prices in *average LPA*: -48% ($\Delta = -3\%$)

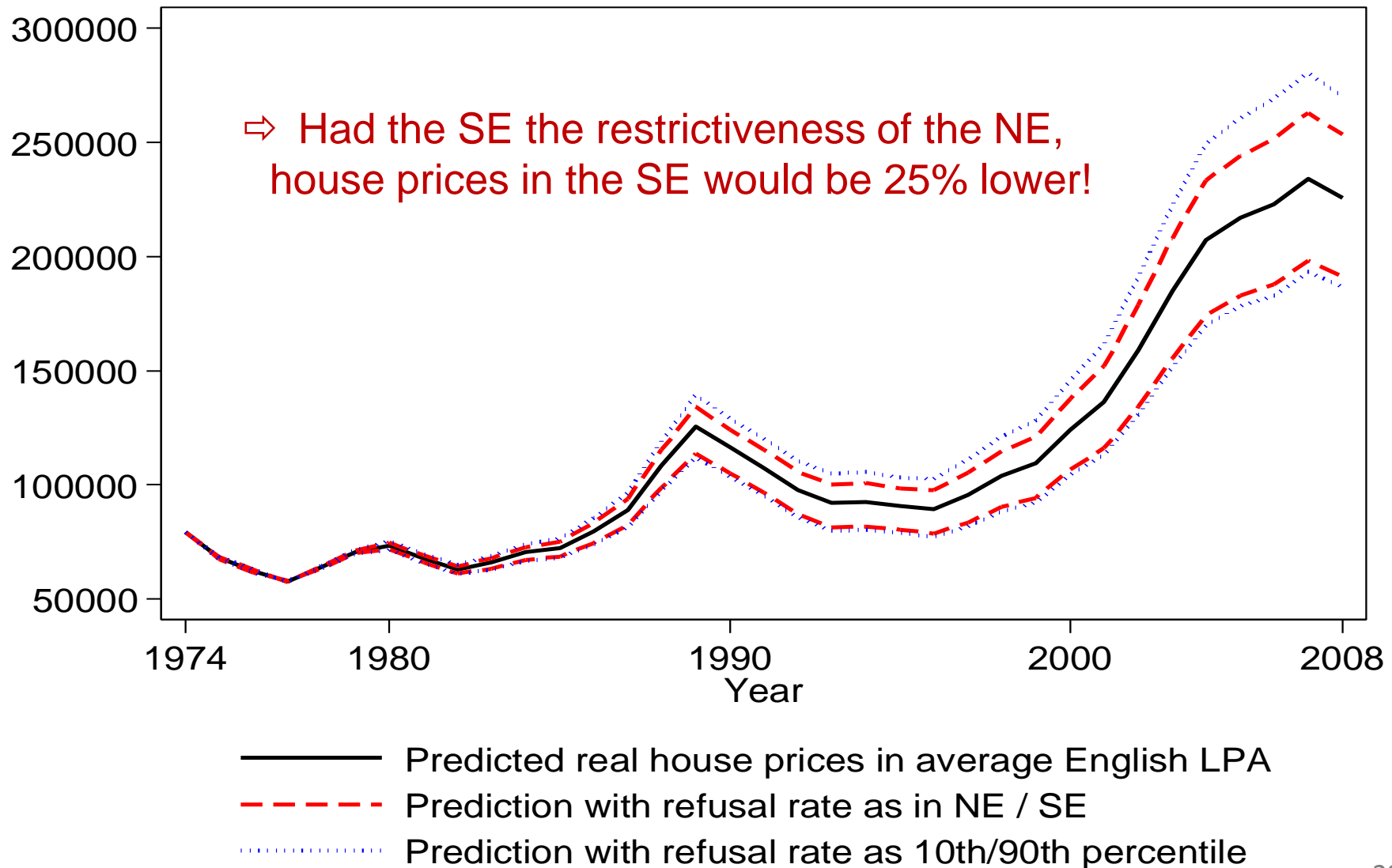
*Note: These are likely lower bound estimates for a number of reasons
(see Hilber and Vermeulen, 2016, for details)*

What would house prices in average English LPA be if...

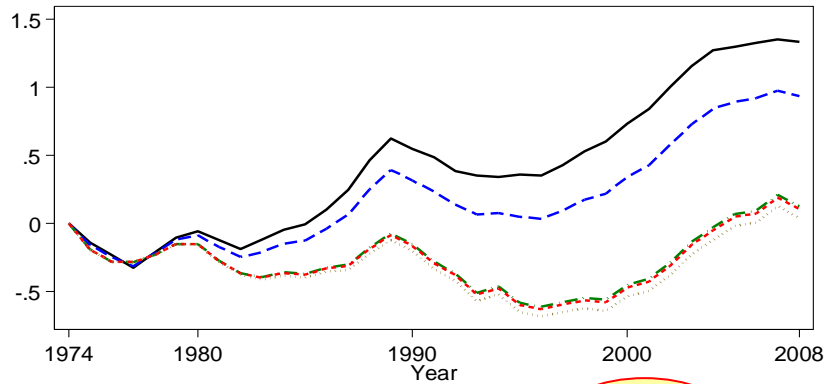


- Predicted real house prices in average English LPA
- - - Prediction with refusal rate set to zero
- . - - and share developed set to zero
- - - - and elevation range set to zero
- and earnings assumed constant

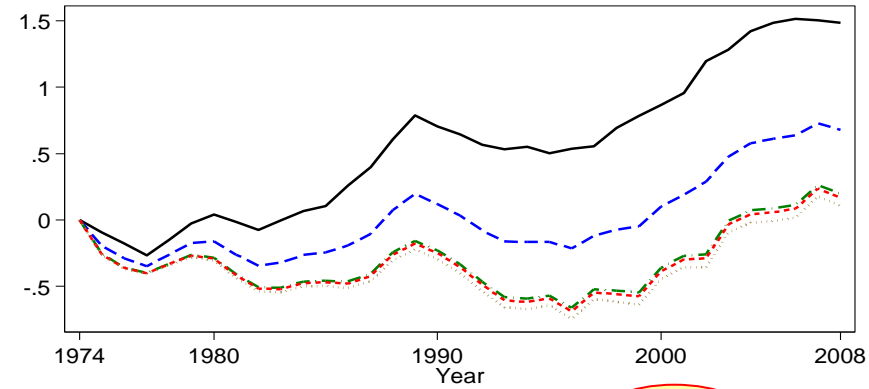
North East vs. South East & 90th vs. 10th percentile



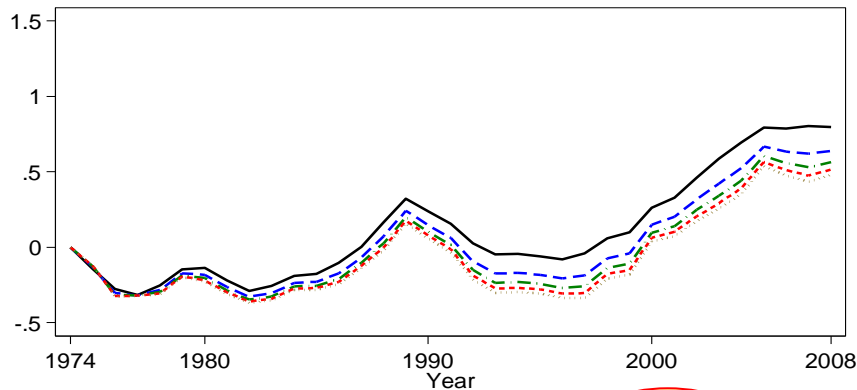
But large variation across locations...



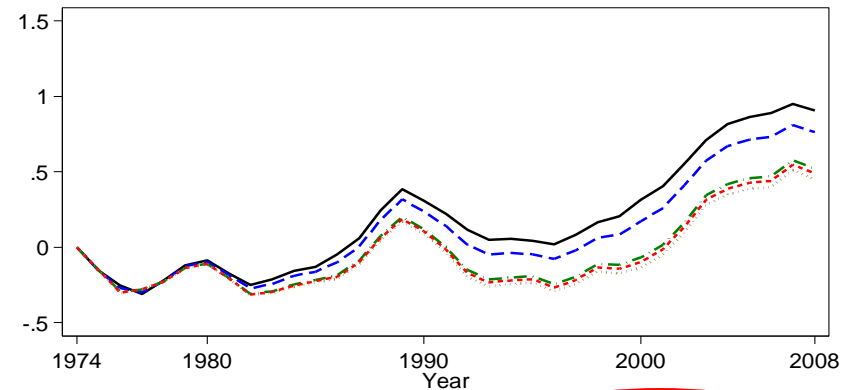
- Predicted log real house prices in Westminster
- - - Prediction with refusal rate set to zero
- . - . - and share developed set to zero
- . - . - and elevation range set to zero
- - and earnings assumed constant



- Predicted log real house prices in Reading
- - - Prediction with refusal rate set to zero
- . - . - and share developed set to zero
- . - . - and elevation range set to zero
- - and earnings assumed constant



- Predicted log real house prices in Darlington
- - - Prediction with refusal rate set to zero
- . - . - and share developed set to zero
- . - . - and elevation range set to zero
- - and earnings assumed constant



- Predicted log real house prices in Newcastle upon Tyne
- - - Prediction with refusal rate set to zero
- . - . - and share developed set to zero
- . - . - and elevation range set to zero
- - and earnings assumed constant

Preliminary conclusions:

There are two fundamental issues...

1. Planning system effectively assigns development rights to local policy makers, planners & NIMBYs
 - ▶ In contrast: In most other countries, development is rule based – if land is zoned as residential, presumption is in favour of development
 2. Lack of fiscal incentives to develop at local level
 - ▶ Discourages local authorities to permit development (most costs – little benefits!) – NIMBYism reinforces
 - ▶ Creates incentives to impose horizontal restrictions (Green Belt) and vertical ones (height restrictions)
- ⇒ **1. + 2. jointly cause affordability crisis!**

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Some existing and proposed policies...

1. Housing construction targets
2. Help-to-Buy and other demand subsidies
3. Devolving fiscal power by abolishing uniform business rate (*Chancellor announcement in Oct.*)
4. Increase in stamp duty on buy-to-let properties & second homes (*Autumn Statement*)
5. Limit on increase of rents for social tenants (*Chancellor announcement*)
6. Allowing local authorities to build starter homes on Green Belt (*DCLG consultation document*)
7. Expansion of Right-to-Buy (*Autumn Statement*)

1. Housing construction targets

- **Idea:** Announce housing construction targets to encourage development
- **Problem:** Targets alone neither tilt development rights in favour of development nor do they provide fiscal incentives

⇒ **Expected effect: Nil!**

⇒ **Evidence:** Construction in decline since 1970 despite ever increasing targets by all parties and consecutive governments of different colours

2. Help-to-Buy & other subsidies to homebuyers

- **Idea:** Subsidise demand for owner-occupied housing
- **Problem:** Local supply extremely price inelastic, in particular in London & South East
- ⇒ **Expected effect:** Policy raises prices but does not spur development
- ⇒ **Evidence:**
 - ▶ House prices in London rose by 25.8% b/w 2013Q2 and 2014Q4 & there was no housing boom!
 - ▶ Evidence from US: In tightly regulated cities demand subsidies are counterproductive (Hilber & Turner 2014)

3. Devolving fiscal power by abolishing uniform business rate

- **Idea:** Devolve fiscal power to tax businesses to local authorities (LAs)

⇒ **Expected effects:**

- ▶ If LAs can keep revenue should provide more incentive to permit commercial development on brownfield land, **great but...**
- ▶ **Problem:** May divert brownfield land away from housing (substitution effect) so probably even less new housing!

(If central government grants were to fully offset business rate revenue: then no effect at all)

4. Increase in stamp duty on buy-to-let properties & second homes

- **Idea:** Discourage buy-to-let & second homes
- ⇒ **Expected effects:** Makes buy-to-let and second homes less attractive compared to owner-occupation
 - ▶ **Buy-to-let:** Increase in stamp duty will reduce supply of private rental homes ⇒ Increase in private rents & possibly slight reduction in price of owner-occupied homes
 - ▶ **Second homes:** Might increase supply of primary homes in short-run and slightly reduce house prices (good!) but may provide even fewer incentives to add new housing (bad!)
- **Overall:** Likely zero sum; private rental will become less affordable and owner-occupied housing slightly more affordable

5. Limit on increase of rents for social tenants

- **Idea:** Make social housing more affordable by limiting social rent increase (to e.g. 1% p.a.)
- **Problem:** Reduces book value of social rented housing stock ⇒ reduces ability of housing associations to finance additional social housing development
- ⇒ **Expected effects:** Less new social housing ⇒ few lucky social tenants but even greater affordability crisis for all other young and low income households

6. Allowing local authorities to build starter homes on Green Belt

- **Idea:** Relax (somewhat) constraints to build starter homes at edge of green belts & on brown-field land within green belts

⇒ **Expected effects:**

- ▶ Tiny fraction of green belt is brownfield
 - ▶ Only possible if local authority wants it!
- **Problem:** Local authorities still have no fiscal incentives to develop, especially not in green belt, so at best ‘a drop on a hot stone’.
 - ▶ **But** does send signal that low-amenity-value land in green belts *may no longer be sacrosanct*!

7. Expansion of Right-to-Buy

- **Idea:** Expand RTB to housing association tenants

⇒ **Expected effects:**

- ▶ Incentivises owner-occupation – *may or may not be welfare increasing*
- ▶ But in any case: at huge cost to taxpayer because housing associations must be compensated for losses
- ▶ **IF** they are not: Policy will endanger ability of associations to finance new homes, *so may reduce new construction*
- ▶ Also creates more ‘homevoter’ NIMBYs, which in turn *may further reduce new housing construction!*

Conclusions

- Planning serves important purpose - in principle it can improve welfare through correcting market failure such as externalities and public goods
- But British planning and tax systems have serious “design flaws”:
 - ▶ ‘Development control’ blindly favours containment and generates great degree of uncertainty
 - ▶ Lack of local fiscal incentives reinforces problem
- Existing and proposed policies do not tackle these flaws – policies are, at best, ineffective but often counterproductive

So what ought policy makers do?

Some guiding principles...

- Radical reforms needed that simultaneously address flaws of **planning and tax system**
- Planning system ought to...
 1. **Focus on correcting market failures:** Designate parks, areas of natural beauty, historic buildings etc. that are off hands from (re-)development *and*
 2. **Change to rule based zoning system:** Introduce presumption in favour of development in areas that are not protected

So what ought policy makers do?

Some guiding principles...

- Tax system ought to...
 1. **Align fiscal incentives to develop:** Local residents & neighbours who bear costs also ought to be able to reap benefits
 2. **Move** away from stamp duty & demand subsidies **towards impact fees** (reflecting marginal social costs) and **genuine local property tax or LVT**
 3. **Consider** permitting **private compensation payments**

Q & A

Thank you!

*Presentation with references & hyperlinks
will be downloadable from:*

<http://personal.lse.ac.uk/hilber/>

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