Only radical reform can solve the housing crisis

It is time to sweep away the broken planning system and start building for the future, argues Tom Papworth

As the 2015 general election nears it seems likely that the cost of living will be a major area of debate. This surely means that housing will become a key battleground. Housing affordability has been worsening for decades. In the 1940s the average household spent around a tenth of its income on accommodation. By the 21st century that figure had increased to a third of household income. In most English-speaking countries, the average house price tends to be around three times average household incomes; in every region of Britain prices are higher, and in the most popular regions (London and the South East, the West Midlands) the figure is greater than six times.

The number of households in England is projected to grow by over 220,000 households per year. Yet even during the greatest house-price bubble of recent history we only managed to build 160,000 year. The result is an economic, social and human catastrophe. People find it harder to move to take up job opportunities, the cost of the housing benefit bill to the UK taxpayer has spiralled out of control, and we have rising levels of homelessness and families crammed into small, poor-quality housing, for which they are paying vastly inflated costs.

But the much-vaunted 'Housing Crisis' is a symptom of a deeper problem. The real crisis is in planning. England is a "green and pleasant land": 90 per cent of England is classed as Greenspace and Water, four tenths of what is left is domestic gardens, while less than 2 per cent of England is buildings. The figures for the "densely populated" South East are 84.7 per cent Greenspace and Water and just 2 per cent buildings; even London is less than half build-upon.

There is no magic to house prices. They are a function of supply (of land) and demand. For decades the number of households in the UK has been growing faster than the supply of homes. The acute shortage of land for housing is preventing building, and it is driven by our planning system – one of the most resilient pillars of the post-war command-and-control state.

Development decisions are apoliticised, all-or-nothing, winner-takes-all process. There is no requirement to compensate, or incentivize, those who might be adversely affected. Meanwhile, large swathes of undifferentiated land are placed under blanket protection. The system is based upon an unswerving faith in the ability of politicians and planning bureaucracies to achieve better outcomes than individuals trading in a market.

Part of the problem is that local people – those that have the most influence over local decision-makers – bear all of the social cost of a new development and gain little of the benefit. A new housing development will marginally reduce the cost of housing regionally, marginally helping thousands of would-be homeowners. By comparison, the loss of amenity (in the form of local greenspace, population density, etc.) will fall entirely upon a relatively small number of nearby residents. With no need to compensate losers, they have every reason to fight to stop development.

The prices involved are staggering. In the South East, agricultural land sells for just 1 per cent of the price for which land with permission for housing sells: a typical 50 hectare farm worth £1 million could increase in value to £100 million just through the owner getting planning permission. This represents the social value of the thousands of homes that could be fitted on that land and could – if used to (more than) compensate neighbouring property owners – redress the imbalance and encourage them to support development.

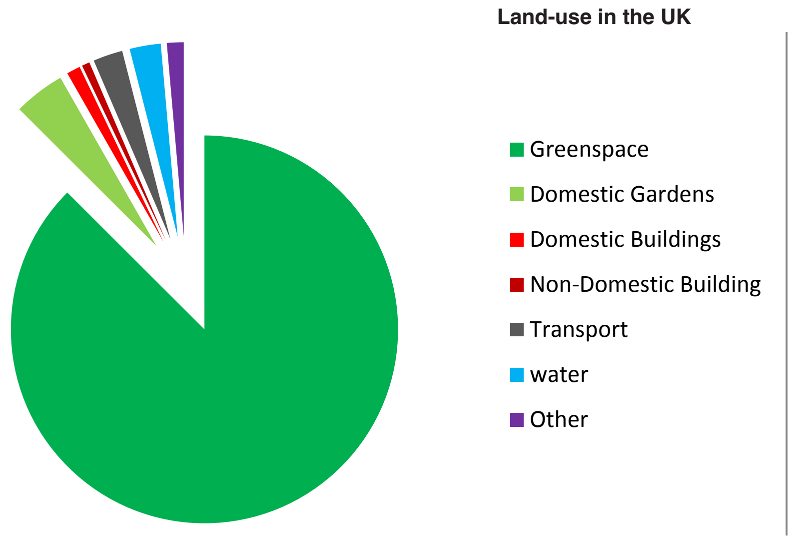
A successful planning system needs to be shaped around people. It should start by being voluntary: top-down targets and solutions are incredibly unpopular and don't work. Planning decisions need to be as devolved as possible – beyond local authorities. It should have no truck with monopoly, which allows developers to over-charge for new, low quality housing: in fact, quality is one of the factors that helps win round local communities. Making it easier to develop land would also bring an end to land-banking: you can't hoard an asset if rivals can make more available.

The planning system should internalise externalities: negative costs that fall upon third parties should be subject to compensation by, and at the expense of, the developer. It should not allow individuals to prevent development or seek compensation on the grounds that it would cause loss to the value of their property due to the increase in supply. But it is perfectly reasonable to expect to be compensated for loss of amenity: if I wanted to carry out any other economic activity and it caused a direct cost to you, you would be able to seek compensation, if necessary through the courts. Individuals should be able to seek compensation on the grounds of loss of value resulting from a change in circumstances (e.g., a loss of a view or access to a wood or field; increased population density; etc). Crucially, it should encourage the enlightened self-interest of all parties. So on top of compensating local people, it might allow them to reap some of the rewards for permitting development.

The existing planning regime needs root and branch change. One option would be to invest planning powers in "proprietary communities", effectively private companies mutually owned by local property owners. These would need to be far smaller than the vast local authorities we have today. They would generate revenue by auctioning development rights and using the value both to provide local services and to pay dividends to their members. In effect this would be like the Council Tax in reverse: homeowners would get to decide how much money to spend on street lighting and road maintenance and how much to take as dividends

Investing development rights in proprietary communities would ensure that the local community still had a mechanism for determining which areas of their locale were developed and which were not. Auctioning those rights would enable the local community to price the value of that land: rather than assuming that people either do or do not want a certain area built upon, it would let them set a price and so provide a more accurate way for the community to express how much it valued different uses of the land. Revenues from the auction could compensate those adversely affected. Decisions would be depoliticised. And the attractiveness of local areas (and so the prices of homes therein) would reflect how well the community was balancing new development, service provision and dividend payments. Real competition would exist between locales.

In the 1940s most people believed that central planning could create a fairer and more ordered society. The result has been a highly inefficient distribution of development that has also seen housing becoming less and less affordable. This particularly hurts the poor and the young, to the benefit of landowners and those with political influence. We need radical reform if we are even to meet new housing needs, let alone rebalance supply and demand and make housing cheaper and of a higher quality. It is time to sweep away the broken planning system and start building for the future.



Tom Papworth is Associate Director – Economic Policy at CentreForum and a Senior Fellow at the Adam Smith Institute

Tom Papworth is the author of "Planning in a free society: London as a case study for a spontaneously planned future", published by the Adam Smith Institute in 2012. He is also Leader of the Liberal Democrat Group on the London Borough of Bromley and serves on the Development Control Committee and a Plans sub-committee.

Exceptional year for capital values

2013 was an exceptional year in London's residential property market. It began with the spectacular launch of Battersea Power Station in January, which completed 600 sales in four days. By the end of the year, prices for one-bedroom apartments across Midtown, City and Docklands had risen by 20 per cent. This was the strongest annual growth in the London residential market since 2006.

But these price rises were not matched by growth in rental values. Nor indeed is there any reason to expect that they should be. In fact, rental value growth slowed in 2013 to nil or a nominal increase and actually declined in the City. And, since prices have risen strongly and rents have not, yields from residential investments have fallen this year.

In City Midtown and Docklands, 80 per cent of new home purchases (and 33 per cent of all sales) were intended as buy-to-let investments and will find their way into the private rental stock. It is this flow of new supply that is maintaining stability in rental values. We see this trend continuing in 2014.

Looking ahead, any threat to the future of the sales market will come from taxation reform aimed at overseas investors, or steep rises in interest rates. No matter how subtle, the prospect of either of these has the potential to dent confidence. The market has yet to fully absorb the impact of higher rate SDLT introduced in Mrch 2012.

That said, we are not expecting a substantial slowdown in demand or transaction numbers or a major price correction. Owners in our markets are well-funded and we know from experience that when demand falls owners turn in greater numbers to the rental market rather than become forced sellers. This was demonstrated between September 2007 and February 2009 when central London had very few distressed sales and even fewer repossessions.

Pressure for residential property is unlikely to ease as long as London's population continues to expand. Between 2011 and 2012 the number of people living in London grew by 1.3 per cent to 8.3 million and it is forecast to grow by another million before 2021. The Mayor of London has responded by setting ambitious targets of building 400,000 homes in London over the next 10 years. Even if this figure were to be achieved, London would still have a housing shortage. Already, 26 per cent of London's households live in the private rental sector and we expect this proportion to grow.

There are two critical dates looming. The first is the unknown date of an inevitable We do not rule out a small rise towards the end of 2014 provided the wider economy continues to improve.

The second date is the General Election in May 2015. We expect the coalition government to resist introducing any controversial new policies over the next 18 months. The consequent political positioning creates uncertainty which can cause the market to stall in the six-month lead-in.

Our market craves certainty and, from experience, we anticipate a bounce in confidence following the Election whichever party is elected and more buyers in the market from June 2015, which may well fuel further price rises.