

“What’s wrong with the housing market?”

How can we fix it?”

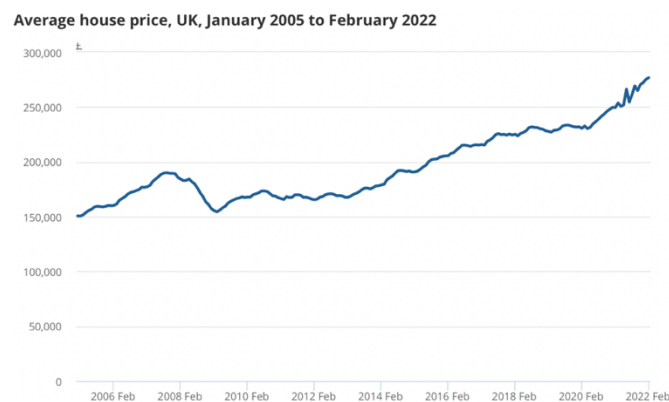
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Section 1: Introduction

As the UK begins to recover from the pandemic, it is becoming increasingly clear the extent of the housing crisis that plagues both the private and rental sectors in the country. In recent decades the cost of buying a home has risen faster than wages (McMullan et al. 2021), pricing out the majority of the population, leading to inequality on several fronts.

Housing prices have been steadily rising for the past decades, as shown in Figure 1. The first wave of home transfers from the government to the private sector began in 1983 with the enactment of the Housing Act. Then, in 2008, the financial crisis caused a spike in mortgage prices, further driving up the price of houses. Due to the Covid-19 pandemic and the escalating demand driven by a 'race for space', periods of lockdown led to increased demand for larger houses with average property prices of completed transactions hitting a record of £282,753 (Michael, 2022). More specifically, between November 2020 and November 2021, housing prices surged by more than 18% in the UK. (Ponnuru, 2022)



Source: HM Land Registry, Registers of Scotland, Land and Property

Figure 1: Average housing prices

Some economists (Gallent, 2019) argue that the primary reason of the housing crisis is excess demand, in which “demand for residential property outstrips market supply”, whilst others (Shanske, 2009) claim that the problem is caused by over-valuation of housing, where "we invested too much in houses that were not worth as much as we thought." The underlying roots and remedies to the housing issue will be examined in further depth in this essay as we look to unpack both the demand and supply sides of the issue.

Section 2: What is the housing problem

It is critical to understand the difference between the two types of housing markets: home ownership and tenancies. There exist both first-time buyers who acquire properties from the government or a developer, as well as second-hand buyers who buy houses from previous owners in the resale market. First-time buyers generally have an advantage over second-hand buyers since they may take benefit of the government's first-home buyer scheme, which offers discounts ranging from 30% to 50% off the original market price. (Gov. UK, 2022)

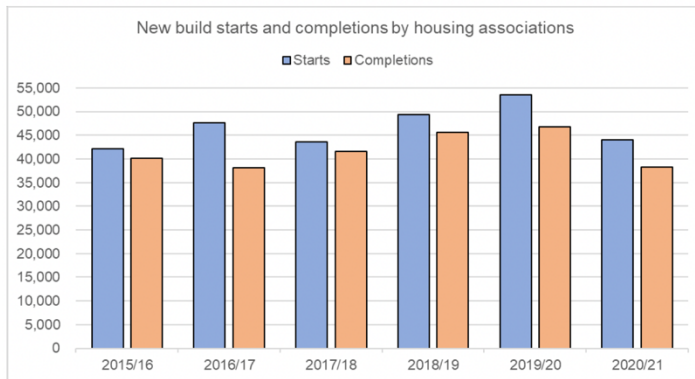


Figure 2: New houses built per year; National Housing Federation, 2022

In a survey conducted by the Lincoln Institute of Land Policy in 2019, it was discovered that 90 percent of the 200 cities surveyed were regarded unaffordable to live in, based on average housing price in relation to median income. (World Finance, 2021)

The new housing supply, on the other hand, is kept at a consistently low level, as shown in Figure 2. In March 2021, only 38,200 homes were built, the lowest number since the Supply Data survey began in 2016 (National Housing Federation, 2021). Insufficient new supply not only prevents homebuyers from accessing new available houses, but it also limits the number of affordable housing units. In a

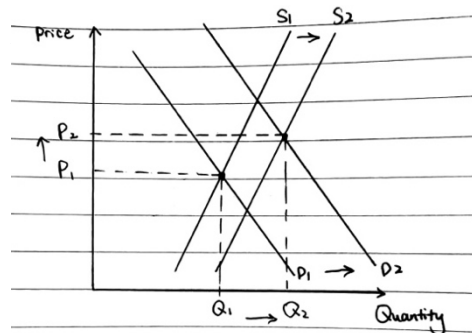
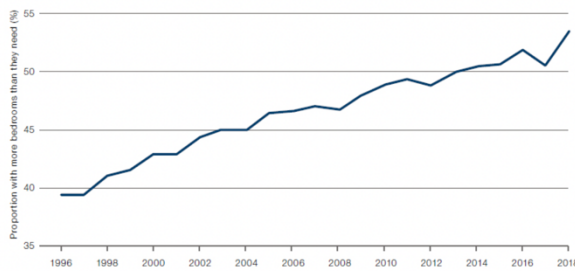


Figure 3: Increase in demand exceeds supply

Most first time buyers are newly wed couples, single occupants moving out of family homes, and immigrants; all subgroups of society that are recently witnessing rapid growth in numbers. For example, one-person households currently account for 22.8% of all households in London; and net migration to the UK from outside the EU has tripled from 2013 to 2022. (Migration Watch UK, 2020) These changes directly contribute to the heightened demand. As seen below, when demand for housing has been expanding faster than supply, the market price is pushed up, changing from P_1 to P_2 in Figure 3.

Furthermore, when the first-hand market is constrained, many people look for homes in the resale market. However, owners are often hesitant to sell their houses because they anticipate they will be able to profit by selling in the future once housing prices go up. Meanwhile, rising demand from investors acquiring numerous housing assets also drives up the price. This may be observed in the rapidly rising number of unoccupied rooms in Figure 4 below, which approximately reached 55% in 2018. This leads to an inequitable situation, where poorer households struggle to squeeze their entire families into a two-room home, while wealthier ones have many spare rooms. Overcrowding currently affects nearly 3.7 million of the population in UK with 2 million children (1 in 5) in England being affected. (NHF, 2021) This generates a welfare issue and a deadweight loss for society as a result of inefficient resource allocation, which harms the poor from a Utilitarian or Rawlsian perspective as neither are we maximising utility nor are we improving the minimum utility the worst off individuals receive.



Source: Ministry of Housing Communities & Local Government, Bloomberg; as of December 2018.

Figure 4: Percentage of UK homeowners with spare bedrooms

There is also a significant welfare concern in the renting market owing to a decrease in household wealth both in the short and long term. Rent is a constant drain in income for the tenants who are unable to afford mortgages and wealthier landlords continue to profit from renting, expanding the wealth disparity. As the cost of housing rises, mortgages become less affordable, and the rental market becomes more crowded. According to Zoopla, only 7.54

percent of rental houses offered in England are affordable to low housing allowance claimants, and worse still only 6.5% for "family-sized" properties in 2019. In the first quarter of 2015, 74 percent of new migrants were in the private rental sector, (NHF, 2019) indicating that pressure from migrants is intensifying. It is apparent that many people are compelled to live in social housing.

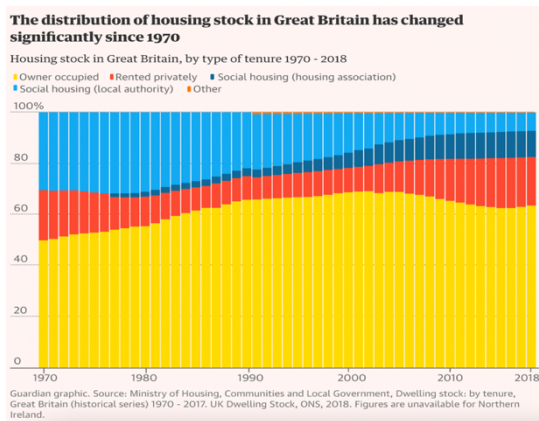


Figure 5: Types of houses in the industry

The paucity of social housing is seen in Figure 5, where social housing makes up a relatively tiny fraction of the total number of houses available. Although social rental housing would be the most appropriate arrangement for 4.2 million persons (1.6 million families) based on affordability, external condition and household size; only 70% of these households have enrolled on the official waiting list for help. (NHF, 2021) Not only has the supply of social housing failed to keep up with demand, but it

is also a drain on government resources, and as the population grows, the government is obliged to offer more and more. As a result, there will be less funding available to invest on other public goods, causing potential for other welfare benefits to be crowded out.

Section 3: How can we fix it?

3.1 Diffusing the Oligopolistic Housing Market

To begin, it is necessary to acknowledge the presence of an oligopoly in the UK housing sector, the top three companies take up approximately 18% of the market share. Since these profit-maximizing enterprises with moderate market power have an incentive to keep prices high, the number of houses available will be lower than the socially optimal level, as indicated in Figure 6 below.

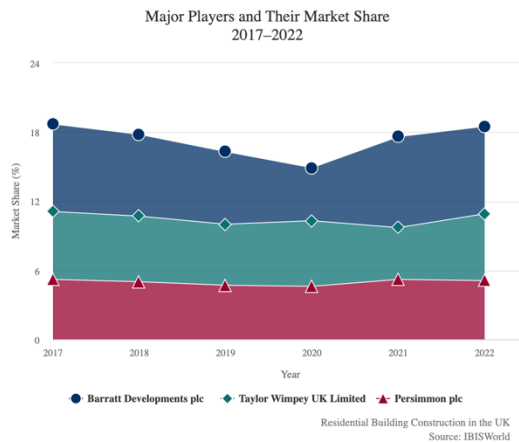


Figure 6: Market share

observed. Secondly, authorities can incentivize new market entries by giving tax breaks or other forms of financial assistance. By enhancing competitiveness in the market, these measures would result in equilibrium pricing that are closer to socially optimal levels of housing provision and eliminate the deadweight loss shown in Figure 7.

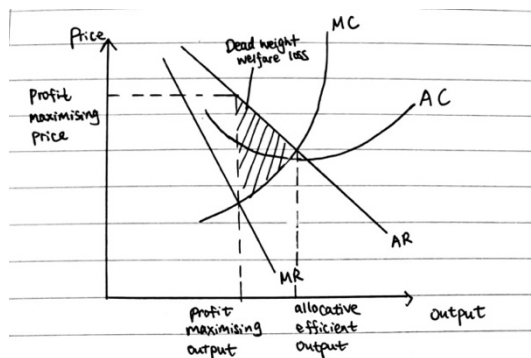


Figure 7: Profit maximizing firms

Competition authorities could intervene in this market to break up oligopolies and prevent collusion thereby restoring prices closer to the socially optimal level. This may be achieved in two ways. Firstly, oligopolies' market dominance can be weakened by fining them when they engage in monopoly behaviour, such as misleading leasehold properties buyers and charging exorbitant fees. If not for explicit fines, authorities could consider including double blind tender processes which invite more competitive bids and a return to Bertrand Nash equilibriums as compared to the collusive case that is currently

Moreover, an affordable housing plan must be established to minimise the cost of housing through faster construction and lower prices. This may be accomplished by providing support to firms who develop lower-cost homes, as well as increasing government investment directly. The National Housing Federation, which represents housing associations across England, has plans to improve building methods and advance technology such as

constructing using ‘timber frames’ which would make it possible to build up to four times as many homes with the same amount of on-site labour. (Osborne et al., 2021) The goal of such designs is to lower the cost of producing houses with shortened time period, leading to higher productivity and market efficiency. If the firm building houses is a profit maximizing firm, then as drawn below, the original marginal cost would equal the marginal revenue. As technology advances, there will be decreasing marginal cost from Old MC to New MC, leading to either an increase in quantity supplied or maintaining the quantity to achieve higher profit, the author of this essay believes that it is more likely that the quantity will increase as indicated in Figure 8. This is because through increasing supply, the firm will be able to gain larger market share leading to more market power.

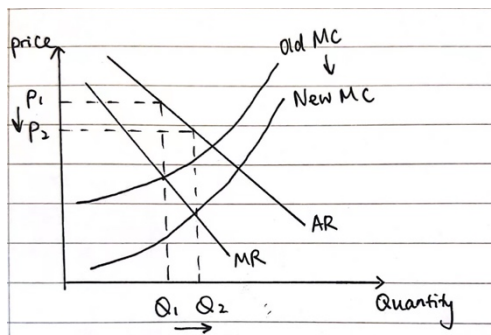


Figure 8: Marginal cost decrease

Furthermore, it is also feasible that the government can deregulate in order to authorise land use for home construction and allow more private owners to restructure. As a result, suburban regions can be developed to allow for the building of low-cost housing. This was largely facilitated by government amendments in 2017 that removed the constitutional consents regime and the disposals consent regime, making it easier for providers to sell and restructure social housing (Gov. UK, 2017).

3.2 Increase supply without building new houses

Building new houses is not the sole option; there are other efficient ways to increase supply. The government can consider imposing taxes on homeowners, such as taxes for individuals who own a house but do not live in it and do not actively sell or rent their homes. A similar policy known as the Bedroom tax was introduced in 2013 which was targeted at tenants living in social housing, reducing their housing benefit when they live in under-occupied accommodation. This tax could be further extended to all groups. (Shelter, 2019) This will help to prevent vacant homes and boost supply. Alternatively, the government could consider imposing taxes on homeowners who own more than one property. Currently in the UK, basic-rate taxpayers pay 18%, while higher and additional-rate taxpayers pay 28% on any gains made from selling an investment or second property - such schemes could be further adopted to disincentivise the owning of houses as mere investment assets. (Green, 2019)

The Stamp Duty Land Tax (SDLT) and the council tax are currently enforced on all owners; these taxes are successful in tackling inequality since the residential property rate for SDLT increases when you own multiple properties, and the council tax is based on the size of your owned house. However, the government would be able to improve welfare by increasing the tax

rate further, and introducing a new levy to prohibit unoccupied properties, including further distinguishing people who own many housing assets.

Finally, regulations can be implemented to enhance labour mobility and connectivity. At the moment, housing crises are concentrated in large cities such as London. To avoid situations like this, the government should consider developing new business centres and upgrading transit connections. High Speed 2 is an example of new transport that links London to Manchester, Birmingham and Leeds, minimizing travel time and increasing efficiency (HS2, 2022). Such ideas would increase the radius of available living space, resulting in a greater supply of residences and alternative places for people to live in, thereby partially alleviating demand in key areas, thereby reducing pressure on house prices.

3.3 Decreasing the cost of renting

Thus far the possible ways of reducing market price of houses have been discussed and the attention is now turned to how the housing crisis can be combated in the rental sector. There are currently a few policies in play such as the Local Housing Allowance (LHA) which was increased in March 2020 to cover the bottom 30% of rents, but it was frozen again in April 2021, thereby ending the help for the low-income households. This is a severe issue since these households may have not fully recovered from the pandemic's impact on their income.

Not only is cost a concern, but the government can also provide better support by reforming the private tenancies regulations. This is because, during the pandemic, many tenants are forced out of their homes after their one-year rental tenancy agreements expire, leaving them with little confidence that they will be able to locate in a suitable long-term residence. The National Residential Landlords Association also suggests that the government should provide 'either a financial bridging facility or a deposit builder ISA to make it easier for tenants to move home without needing to find money for a fresh deposit' (Osborne et al., 2021) in order to improve the living standards of these households. The government can also establish authorised public rental platforms that are easily accessible, lowering administrative costs and improving the reliability of the residences provided.

Section 4: Conclusion

In sum, this essay covered three aspects: the housing issue, different housing sectors' demand discrepancies, and various remedies to the housing conundrum.

While demand and supply side issues has been discussed, the housing crisis does not affect every individual homogeneously. It is believed that fundamentally there need to be more policies targeting the low-income households as this group is the one that suffers the most from the intensified demand issue. However, problems also exist within the market structure as there are lack of regulations to discourage anti competitive behaviour and prevent speculators from buying several houses. The best approach would be to consider the time horizon of the policies implemented. In the short term, the most urgent problem is the shortage of supply. To solve this, the government could plan to increase efficiency of building houses and build targeted smaller houses for married couples and single occupants. By further ramping up the use of advanced technology, the marginal costs can be lowered and time taken to implement will be shorter.

Nevertheless, while this may sound plausible in economic theory, the true solution lies in better navigating the politics of the real world. Therefore, it would be necessary to address the powerful developer lobbies so as to best introduce welfare improving schemes.

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