Why Does Britain Have a Housing Crisis? – And What Should be Done About It?

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22 October 2024

The Housing Crisis

The crisis in housing is one of the most significant political problems facing the country and the new Labour government. Labour hopes to build 300,000 houses a year or 1.5m in a 5-year term.

At least, it is a crisis for everyone except baby boomers who have experienced huge untaxed gains in the value of their houses – their worry is whether they will pay inheritance tax.

For young people, it is a major issue. They worry whether they will be able to buy a house: they are only half as likely to own a house by age 30 as baby boomers.

The Institute for Fiscal Studies calculates that in 1995/6, 65 per cent of those aged 25-34 in the middle of the income distribution for their age owned their house; this fell to 27 per cent in 2015/16.

The average age of first purchase was 23 in 1960; it rose to 31 in 2007, and 33 in 2017**.**

Need to save longer for an average deposit: For a typical family in their late 20s and early 30s, it used to take 8 years in the early 1990s; now, 14 years. Deposit needed has increased since GFC – 1989, might be 5 per cent, now 15 per cent. Means reliance on bank of mum and dad: nearly half of first-time buyers have financial support, on average £25,000. Means more rent – usually from baby boomers who own a buy to let property. Or they stay at home, delaying independent adulthood.

Overall, rate of owner occupation started to fall from the mid-2000s.

House building is low and does not respond to higher prices. **The level of residential investment is extremely low.**

An **unusually large rise in house prices compared with income**. Of G7 countries, Britain has had the largest rise in house prices relative to average disposable incomes since 1970, especially since 1997.

Price of housing to second highest of 38 members of the OECD, only behind Finland. Housing takes a larger share of income than in the rest of OECD, and for houses that are becoming smaller.

In 1980, the average family spent 9 per cent of income on housing; 2024 rose to 17 per cent. This is most serious for poorest households: rise from 17 to 34 per cent, whereas richest fell from 5 to 8 per cent.

Poorer and younger households rent; older and better off own. The costs of renting are higher than other tenures. Income inequality was not affected by housing costs in the 1960s and 1970s – from 1979 had a major influence. Between 2002 and 2015 rising house costs were above the gains from income for the bottom 56 per cent of working age households.

Price of land is high – land is a higher share of the overall value of a house than in other OECD countries for which we have data. In the UK, less than 30 per cent of the value of a house is in the building itself, compared with 55 per cent in Germany.

Change in tenure: In the late 1970s, ownership with a mortgage accounted for 25.7 per cent of households and social rent (below market) 26.3 per cent; private rent only 12.7 per cent. Since then, social renting has dropped as a result of Right to Buy and block on using proceeds to build; in 2022.23 only 9,561 social houses built in England, mainly by housing associations – and 24,000 sold. Social rent has been overtaken by private renting where standards are often low; and in 2013, outright owners passed those owning with a mortgage. Now, 35 per cent in England own outright – they benefit from high prices. In half the parliamentary constituencies, outright owners are the largest group by housing tenure – likely to be NIMBYs who are not worried by high rents.

Property tax is regressive, not just between income levels but also between regions which makes levelling up more difficult.

Contribution to inequality:

- Leads to rising levels of inequality of property wealth – unaffordable to some, high gains for others.
- And to income inequality as a result of costs of different forms of tenure with rise in cost of renting relative to incomes, hits those on lower incomes.

Harms productivity and growth: Savings into housing rather than other more productive uses.

So, Britain has an unusual mix of high prices and low levels of building. Why did this happen and what can be done?

The situation has not always been so dire – it dates from the 1980s. Before then, the housing market was delivering more houses at a lower cost to residents through a mix of social rental and owner occupation.

It was a market that took on this shape after the First World War – distinctive, unlike counterparts in Europe where rentals remained more important and owner occupation was at a lower level.

To understand why this market emerged.

The British Housing Market Before 1914

Before the First World War, around 90 per cent of housing was private rental, overwhelmingly owned by small house landlords.

1. Most **housebuilding** was undertaken by small speculative builders. Take one example – Camberwell in south London between 1878 and 80 had 416 builders – 53 per cent of them built no more than 6 houses (12 per cent of the total); 15 large firms built over 60, 31 per cent of total. These speculative builders were prone to periods of boom when supply overshot demand, leading to high vacancies and falling rents.

2. **Finance** was mainly from two sources:
   - Building societies which were mainly local, took household savings and lent out in loans for house purchase – a closed system, did not use the money market.
   - Also, solicitors with access to executors' funds/trust funds – short-term loans, interest only that could be called in when needed, have to remortgage.

3. Ready supply of **land** at a low price:
   - Impact of imports of grain from c1870: agricultural rents fell by around 40 per cent.
   - Lack of planning regulations. There were byelaws on building standards and house layout but not limiting access to land. Aristocratic landowners could provide infrastructure of roads, drains to allow speculative builders to operate – and where they offered 99-year leases, this reduced land costs as well.

Argued by Robert Giffen in 1884 that over the previous 50 years, working-class wages doubled, but rents rose only 150 per cent for a much higher quality of house. GH Wood in 1909 thought that half the increase in rent was accounted for by new features. Housing has become cheaper compared with income.

Also, confidence that housing was more affordable than in other countries. BOT survey around 1910:

- in Germany, weekly wage was 17 per cent lower than England and Wales, and rents 23 per cent higher.
- in France, wages are 25 per cent lower and rents only 2 per cent lower.
- Were large variations within Britain – poor quality in north-east England, and tenements of Scotland were higher rents.

Of course, still slums and overcrowding, but confidence that housing market was working.

Then a **crisis** in Edwardian Britain**:**

- Over supply from 1900 meant rents were sticky as wages rose. High levels of vacancies: figures for Glasgow show vacancies of 2.9 per cent in 1890; then a book, and vacancies of 11 per cent in 1910/11.

This was cyclical, might expect a recovery.

BUT

- Problems of local government finance: rates on house property were regressive and did not increase in line with demands for spending on infrastructure, education, health. Between 1893/4 and 1898/9, rateable value in England and Wales increased by 7.9 per cent and rate income by 23.9 per cent – pressure on rate base. In England, one response was to cut allowance to landlords for collecting rates (legally tenants were liable) in weekly rent – compounding, discount of around 20 per cent if landlord paid. Rates rose, discount fell, and profits squeezed.
- Higher interest rates.
- Stagnant real wages 1900-14.

Taken together, led to a serious fall in property values: Avner Offer found a 40-50 per cent decline in London, based on years' purchase (multiple of rent). See slide for Hampstead and Camberwell. In Glasgow, property values fell 36.2 per cent 1901 to 1912.

- Particular problem in Scotland where lets were longer: in Glasgow in 1905/6, 83.5 per cent of properties with a rental of under £20 a year were held on yearly lets. Serious tensions in landlord-tenant relations:
    - discrepancy between housing and labour markets.
    - between intervals for receiving wages and paying rent.
    - very high levels of eviction and sequestration of goods for non-payment of rent.
    - tenants and landlords both liable for rates – compounding not developed.

Tenants and local authorities pressed to introduce compounding to ease collection – owners hostile, given low discount and fact.

Also linked with a loss of power of sequestration – right to seize property of tenants - and shift to shorter tenancies in legislation in 1911. In compensation, landlords secured greater power of summary eviction. And property was managed by professional house factors who took a rigid approach.

Could these issues have been resolved within the existing tenurial system? Possibly – but then the war blocked this potential. Problem particularly in Scotland, and above all Glasgow.

The shortage of housing was coming to end, and growth in munitions industry – landlords (especially factors) saw opportunity. Led to resistance and rent strikes in Glasgow in 1915. Explosion of the pre war tensions.

What was the government to do, given the threat to the war effort?

Changes in the Housing Market

Immediate solution:

- rent controls: not to increase rents above August 1914

- and also mortgages which could not be called in or increase rate.

Eroded profit of rental sector and hit provision of finance from solicitors/executors (below market rate and could not be called in to secure higher return from government loans).

How to resolve?

If rent controls took off at end of war, rents would rise and provoke more unrest. Allowed an increase at end of war, still below inflation – and extended to higher value properties.

Therefore, retain controls and end shortage by council housing. When shortage removed, local authorities could retreat and return to status quo ante.

But not able to build enough after war – high costs of material and labour, as well as landowners seeing opportunity to secure high prices. Built around 170,000 out of 500,000 needed.

Rent controls therefore retained. In 1931, 69.1 per cent of housing in England and Wales still had controls. Some liberalisations in 1933 before extended during the war – remained after the war and tightened in 1963 and 1974.

- More council housing later in 1920s – and in 1930s large slum clearance schemes. Tensions between respectable tenants of general-purpose housing and slum clearance. Improved access to land with agricultural depression
- Shift of building societies to owner occupation:
    - funds increased as became more national, bringing savings to expanding areas.
    - cheap money after left gold standard.
    - fall in costs.
    - reduced deposits, extended time to buy.

Tenure

In England and Wales, between the wars only 19.4 per cent of additional housing was provided by private landlords – 31.5 per cent by local authorities and 49.1 per cent owner-occupied.

Although some older houses were sold by landlords to owner occupiers, private rental remained the largest sector: in 1938, 34.9 per cent of houses in England and Wales were owner-occupied, 11.2 per cent public rental and 53.9 per cent private rental.

What we have in the interwar period and continuing after 1945, under both Labour and Conservative governments, is

- Owner occupied housing financed by building societies – use value rather than expecting a real gain in asset.
- Local authority housing since First World War funded from local taxation/borrowing and government grants.

Note change with green belt and planning controls: Town and County Planning Act, 1947. Created value for development land – but also taxed by a 100 per cent development charge; abolished by Conservatives; Labour reintroduced a betterment levy of 40 per cent in 1967, abolished 1970; Labour again introduced a development and tax in 1976, abolished in 1985.

Both Labour and the Conservatives met the need for housing, with no serious hose price inflation. In 1950, the Conservatives pledged to build 300,000 houses a year – Harold Macmillan delivered.

This housing market was overturned by financial liberalisation and Right to Buy in the 1980s. That is the origin of the crisis – and there is nothing preordained. John Muellbauer of University of Oxford points out that a comparison with Germany shows the crisis in Britain was self-inflicted – going back to my opening point on the rise in house prices in Britain with average disposable income, the level in Germany fell from 1970 to 2010. Why was Britain different?

What Went Wrong in Britain? A Comparison with Germany

Difference in housing investment and supply

In Britain, about half the rise in house prices since 1997 was the result of inadequate residential investment which did not match the growth of population or income.

In Germany, residential investment more than kept pace with growth of population and income.

After permission to build is granted, most houses in Germany are built: Permission to build 261,000 and 86 per cent were built.

unlike in the UK. In 2014/15, permission was granted to build 261,900 houses in England of which only 155,080 or 48 per cent were built. Why build and reduce prices?

The issue is not hold up in planning as often claimed by government – it is failure to build what is allowed. Issue is more about forcing builders to actually build – Richard Clewer, Conservative leader of Wiltshire County council complains builders game the system: they get permission and then avoid large developments with tougher section 106 requirements for schools roads. Councils need to maintain a give year pipe of projects – if not, presumption in favour of approving residential developments which allows developers to do as please. He complains the result is piecemeal developments rather than larger better-planned projects.

Differences in land market

In Britain, the landowner takes virtually all the planning gain from permission to develop – can by 200-fold increase in price. Take Cambridge and the surrounding area of South Cambridgeshire: in 2017, the government's valuation office put a value on land after development permission was granted of £5,955,000 and £5,300,000; without permission, probably worth around £20,000 a hectare as agricultural land. Report by the Centre for Progressive Policy claims the uplift from agricultural to residential use is 275 times.

There is a section 106 requirement to provide some public benefit – a school, leisure centre, road improvement - and to build some affordable houses which can be reduced on grounds of viability.

British developers are mainly land speculators who make profits from land banks. Their management efforts go into the complicated process of finding land and securing permission, making a capital gain rather than improving productivity and quality of what they build. They incur more debt and hence risk.

Land costs are a high proportion of the overall costs of a new house.

Large firms have become more dominant: decline in small and medium firms from 12,000 in 1988 to 3,000 around 2018, only build 25 per cent of houses. Of course, they deny they engage in land banking – Competition and Markets Authority found they hold more land that good for a well-functioning market but driven by uncertainty around planning. Perhaps – planning has become more complex. But could be more power of compulsory purchase and capture of values.

In Germany, local authorities capped land values at the price at the time permission was granted. It was easier to acquire land for infrastructure and to capture part of the increase in value from planning gain.

Small and medium firms build about half of houses, management focuses on quality and efficiency – land costs are a lower share, and materials and labour costs a higher share which are more easily financed without incurring debt.

Differences in mortgage credit market

A substantial part of the increase in the ratio between house prices and income in the 1980s came from financial liberalisation that increased the mortgage stock. It moved from below the German level to considerably above.

Liberalisation of mortgage credit in the 1980s and again after 1997.

- 1979 end of exchange controls, closer links with global capital markets.
- 1980 end of 'corset' – a penalty on banks that increased interest-bearing deposits above a set limit - allowed banks to enter domestic mortgage market for the first time.

- Building societies had more freedom, formalised in Building Societies Act, 1986.
- Banks entered the mortgage market – brought in more funding, easier credit terms for borrowers. Both the loan to value ratio and loan to income ratio of first-time buyers became more generous during the 1980s – though fell back in the 1990s, it then reached a new peak. In the 1980s, the average loan to value ratio for first time buyers reached 85 per cent, with a sizeable minority on 100 per cent. This high level of gearing increased the rate of return.

In the UK in the 1970s, the real cost of mortgage borrowing for standard rate taxpayers averaged minus 5 per cent because the nominal interest rate was below inflation. This transferred resources to mortgage borrowers.

House prices rose relative to interest and with high gearing, the return from housing could at times exceed 60 per cent a year. The return was usually higher than liquid saving. Although transaction costs were high, in Britain there was no capital gains tax on sale of the main residence unlike in Germany where CGT was levied if sold within 10 years which discourages speculative selling, trading up. British house purchase had a large speculative element – explains the obsession with owner occupation and TV shows such as *Location, Location* and *Love It or List It*.

In Germany, no mortgage market liberalisation in the 1980s, and lending remained conservative with loan to value rates pegged at 80 per cent, strict income taxes, and fixed rates reduces the ability to withdraw equity by remortgaging. Like building societies, the Bausparkasse provided mortgages from the funds paid in by small savers, but they maintained a closer link between saver and home purchase.

The Bausparkassen would agree a contract with the saver, and when 40 to 50 percent of the sum had been accumulated, the saver could borrow the balance to buy a house after a delay of one or two years which ensured the system remained in balance. Saving received low interest, but also paid below market rates on the mortgage. Gearing was lower – and because of the need to save a deposit, first-time borrowers were older, in their late 30s or 40s.

Interest rates in Germany were never negative. Unlike Britain, returns on house purchase were negative for most of the 1980s and were never especially high.

Difference in the mortgage markets in Germany, France, and Britain in table.

In Britain, mortgages were floating or fixed for short period; in Germany fixed for long term.

As a result, changes in interest rates have a quicker impact in Britain. In Germany, larger liquid assets above household debt means that higher interest increases consumer spending.

Different attitudes to housing

John Muellbauer of Oxford University: ‘Germans buy houses primarily as places to live while for the British, the portfolio investment motive is a very important consideration’.

The ratio of illiquid wealth in housing to income reached an all-time high – money went into housing rather than into liquid savings. But this illiquid wealth was then used as collateral. Financial liberalisation meant it could be cashed in by borrowing for consumption. Housing was more collaterised.

Not apply before 1980 – then increased with higher credit supply which led to more ‘spendability’ of housing wealth. Applied to Thatcher 1979-92 and Blair 1997-2007 – been called ‘privatised Keynesianism’. Since the global financial crisis, collapsed – paid off more of mortgages, but borrowing rising on unsecured short-term lending.

As a result, household savings dropped – Britain has one of the lowest levels in the OECD which affects investment and growth.

Differences in rental market

In Germany, the private rental market remained larger, with a balanced age structure compared with Britain where there was a bias towards younger renters.

Private rent was a viable alternative to owner occupation.

In Germany, the landlord was able to fix the rent in a new contract and then further increases were restricted.

Contracts were long – an average of around 11 years,

In Britain, private rental was not so popular or stable. British rental contracts are shorter than German – an average of around 2.5 years.

In Britain, rent controls were more rigid and tightened in 1965 and 1974, until largely repealed in 1988. No fault eviction is now a serious political issue.

What to do?

Serious consequences

- Low saving rate in Britain.
- Wider intergenerational inequality.
- Impact on productivity and growth.
- Housing shortages, poor quality and high cost for many.

Solution

The focus on planning is only a small part of the answer – an easy non-solution. Need more thorough-going reforms.

- Refocus savings to productive investment and away from property which leads to inequality.
- Land value tax to replace or supplement the council tax: tried by Lloyd George before the First World War. Does work in some places: Denmark has municipal taxes based on and values plus a 1 per cent state tax on property, rising to 3 per cent. In Australia, a land value tax used in Queensland and New South Wales, though exempt primary residences. Even found in US – some local authorities in Pennsylvania have a form of LVT since 1913.
- Public sector land bank to purchase and sell or develop land. This would give local authorities a share of planning gain. Found in Korea – Korean Land Corporation set up in 1975, one reason for the decline in the ratio of house prices to income unlike in Britain. Similarly in Singapore – something not mentioned by those who want London to be a Singapore on Thames. Here, the New Town Development Corporations captured land value.
- Public sector housing.
- Change in mortgage finance so not inflate prices; impose CGT on sales if not used for buying a main residence.
- Regulation of rental sector with longer contracts.

Is any of this possible? To some commentators, no – blocked by winners (early movers) who dominate the electorate, and power of financial interests, landowners. NIMBYS block development.

But is this too pessimistic? Have had major changes before – radical shifts in tenure around First World War and 1980s. And not just take opposition for granted – needs politicians in favour of reform to construct a story, not just react to focus groups. Concern for infrastructure – schools, GPS, hospitals. Notion of unearned wealth that central to pre-1914 Liberals – Lloyd George and Churchill. We have the data – what we need is to present a compelling case.

Further Reading

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WAGES AND RENT LEVELS, C1910

	Weekly Money Wages	Net Rent ex tax	Ratio
England and Wales	100	100	1.0
US	230	207	1.1
France	75	98	0.8
Germany	83	123	0.7

Source: Daunton, *House and Home*, table 4.5, 80.

THE EDWARDIAN PROPERTY SLUMP: YEARS PURCHASE OF LEASEHOLD PROPERTY IN LONDON, 1892-1912

	Hampstead	**Camberwell**
1892	11.65	7.68
1897	9.98	7.75
1902	9.98	8.37
1907	8.80	6.46
1912	5.27	5.12

Source: Offer, *Property and Politics*, table 17.3, 270.

HOUSING TENURE IN ENGLAND AND WALES, 1938

		Houses built		
		Before 1914	**Inter-war**	**all**
Owner-occupied		27.1	49.1	34.9
Public rental		-	31.5	11.2
Private rental:	*Controlled*	*41.3*	*nil*	*26.6*
	Not controlled	*31.6*	*19.4*	*27.3*
	All	72.9	19.4	53.9
Total		100.0	100.0	100.0

Source: Daunton, *Property Owning Democracy*, table 1, 4.

MORTGAGE MARKET STRUCTURE, 2013

	UK	**Germany**	**France**
Interest rate adjustment	Variable	Fixed	Fixed
Equity withdrawal	Yes	No	No
Average LTV ratio on new loans %	80-90	70	75
Mortgage to GDP ratio %	74	43	26
Mortgage-backed securitisation	Yes	Limited	Limited
Owner occupation %	70	42	56

Source: Ryan-Collins, Lloyd ad Macfarlane, *Rethinking the Economics of Land and Housing*, table 5.1, 156.