Buying out of the bubble: A bubble-free housing market

GENERATION RENT
The national voice of private renters

Background

A central driver of inequality in the UK is the housing market. The inflating cost of housing, particularly in London and the South East, has driven a wedge between those who own their homes and those who do not, or more accurately, those with access to capital and those without.

People in private rented accommodation face a double assault; increasing house prices that make mortgage deposits ever larger, and increasing rents that suppress the ability to save up for a deposit.

While politicians have broadly agreed on the need for increased housing supply, the truth is that there have been limited successes and none have had the necessary impact on the housing market.

The impact of public policy has potentially been counterproductive with a range of measures designed to stimulate demand rather than improve supply. These measures are all well-meaning and include supported rent and mortgage schemes, but while they may help the individuals who receive the benefit, the true beneficiaries are the property and land owners whose whole portfolio is enhanced in value because of this stimulated demand.

Sadly, some of the recipients of mortgage or rent support are receiving an illusory benefit. Intermediate rent schemes or subsidised mortgages can put quality housing within the reach of people on relatively low (though often still above average) incomes, however, the discount those people are receiving is on the basis of an already inflated price, sustained by excessive and stimulated demand.

It is wrong to say the housing market doesn't work. For landowners and landlords it works very well indeed. But for private rental tenants the housing market has utterly failed. And while, most prominently in London, renters are paying a huge proportion of their incomes on rents, homeowners are deeply wedded to property as an investment that grows in value. Housing costs have long since exceeded any measure of the intrinsic value they provide as a home.

This policy paper outlines a mechanism that allows private renters and home buyers to "buy out" of the housing bubble, creating a self-funded, secondary housing supply where costs are more closely allied to the value of a home rather than the price the housing market will bear.

Money: the rate limiting factor

There are very few limits on the rate at which affordable housing can be built. There's plenty of land, much of which is state owned. Skills in the construction sector are abundant and planning laws are relatively permissive. There is one single limiting factor that inhibits the building of affordable homes and that is money.

The state only has a limited budget for building affordable homes, and while the Homes and Communities Agency's budget of about £1 billion a year sounds like a lot, once divided by an estimated £100,000 cost of building a home, that's only enough to build 10,000 new homes. The fact that the HCA leveraged their funding to support the delivery of more than 20,000 new affordable homes in 2012/13 is commendable, however the definition of "affordable" is an arbitrary figure not necessarily related to the real costs of living.

Once you offset the 3-4,000 homes sold annually through the "right to buy" – homes transferring from "affordable" to "market" – you are left with an insufficient growth in the affordable sector to impact on the market at all, considering a market of 21.7 million households in England and Wales.

In reality, the affordable homes sector is insufficiently large or fluid to impact on the housing market as a whole. People in social housing may have more disposable income than private renters at the same income level but they cannot make the leap to private rents. Equally, private renters suffering hardship cannot access social rents because there is so little availability.

This proposal requires just £1 billion of state funding to stimulate practically unlimited private funding for the affordable homes sector. Furthermore, the £1 billion would, in time, be returned to the Treasury. The first wave of homes would be built for £1 billion but subsequent waves would be funded from the sales receipts of the previous waves. Prices would be capped at 110% of the build cost, creating a fixed price, cost price housing market.

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A bubble-free housing market

The proposal is for the creation of a secondary housing market where purchasers of property have no prospect of benefiting from an inflating house price or from profiteering rental incomes.

All properties would be sold under leasehold and price inflation would be set at a suppressed rate, probably a comparable rate to a bank savings account. Homes could only be sold at the regulated value and rental incomes would be capped at a fair proportion of the regulated value.

This raises the question of why a person might buy such a home. There are several answers to this question.

1. The homes would be cheap. They would be released to the secondary market at cost price plus 10%. In the free market, prices are more like cost price + 200%.
2. Because of the low cost, people on a much lower income would be able to raise a deposit and afford mortgage repayments.
3. People may wish to purchase a low cost home to increase their disposable income after housing costs, choosing to spend that money on a more fulfilling lifestyle.
4. While no-one would get rich from an investment in this secondary market, it would still be a reasonable rate of return, comparable with a savings account.
5. People unable to afford deposits in the free market would be able to get a mortgage in the secondary market, enabling them to build up a capital asset, which they might release as a deposit to buy into the free market at a future time.

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Impact

One immediate challenge is that £1 billion might be better spent on social housing, and to be clear, we are proposing this policy in addition to other affordable housing programmes.

Impact on social renters

If it did involve just a billion pounds then that might make sense, but this doesn't take into account the practically unlimited private funding that this billion leverages.

Registered Social Landlords and Local Authorities would be free to purchase properties in this market and rent them to social tenants. However, were the tenant to purchase the property under the Right to Buy scheme, they would be buying into the bubble-free, secondary market. This would mean that they would have an affordable home, but they wouldn't profit from its subsequent resale in the manner that they would have done if selling onto the free market. In short, these are permanently affordable homes regardless of transfers of ownership.

However, this constant, privately-funded growth in the number of affordable homes for ownership and rent would have a fundamental impact on social renters.

Currently, social renters simply have no other realistic housing options and desperately cling to social rents. Moving to private tenancy represents a huge loss of security, often a deepening dependence on Housing Benefit and exposure to landlords with a very different culture from social landlords.

The inescapability of social tenancy creates a fixed group of people who are defined as socially dependent, a culture that impacts on the opportunities of children raised in social tenancy. Furthermore, the rarity of social renters leaving the sector (except through Right to Buy, where they take the home with them) means that too few properties ever become available for people suffering hardship but without access to social rents.

A growing availability of truly affordable market rents and homes to buy would begin to create a fluid social housing sector, giving social renters more options over where to live and how to define themselves. As an example, a single parent might no longer remain in a council estate but could potentially find a home nearer a preferred school or within commuting distance of a suitable job opportunity. The freedom to leave social tenancy then releases that property to someone on the waiting list.

Impact on benefits spending

This new, dynamic release of social tenancies, together with truly affordable rents available privately would create a significant saving for benefit paying agencies. The poorest people are not in social tenancies, they are in expensive Bed & Breakfast accommodation or in private tenancy with landlords in receipt of Housing Benefit, broadly at free market rates. As an example, the £1,250 per month cap on Housing Benefit for a two-bedroom home is already considered a devastating cut for HB recipients in London, and is often set lower by local authorities.

This policy would shift people from these two forms of housing into newly available social tenancies or directly into the new, truly affordable private tenancies, radically reducing costs to benefit payers.

As an example, the £1,250 per month cap on Housing Benefit for a two-bedroom home is already considered a devastating cut for HB recipients in London. However, were such a claimant to move to a home sold at near-cost price and with a regulated rent cap, they would be looking at a monthly rent bill more like £500 per month. Not only would this be a huge reduction in the cost of Housing Benefit but significant numbers of claimants would be taken out of dependency altogether.

The costs of B&B accommodation are significantly more expensive even than the highest Housing Benefit claims. This policy would not only provide stable, affordable accommodation for families in B&B but it would save the taxpayer money.

This represents a direct transfer of money from private landlords and B&B proprietors back to taxpayers.

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Impact on the private rented sector

Private landlords dependent on Housing Benefit receipts would be the losers in this policy, yet they would not be destitute. With the gradual loss of benefit claiming tenants, they would have to win other tenants. The growth of a truly-affordable housing supply would mean the free market supply would have to start competing on price, quality and customer service, driving a rise in standards among landlords and letting agents in the free market.

This wouldn't happen overnight; the impact would be limited to the rate at which new homes under the secondary market scheme could be brought to market. Landlords and letting agents wouldn't go out of business overnight but would instead see a growing pressure year on year, ultimately ending their ability to profiteer at the expense of their tenants' quality of life.

Impact on house prices

Again, there would be no overnight impact, but in the medium-term there would be a gradual reduction in the number of potential buyers in the free market. However, this would not be a one-way effect. While many people would sensibly forego purchasing in the free market in favour of a low cost home, these homes would be available to people on much lower incomes.

Over time, there would be a body of people who had accrued capital that could be spent subsequently as a deposit on a free market home that they would never have otherwise been able to afford. This would become a driver for social mobility and, in time, increase the number of people able to afford to buy property.

This should be explored further but you would expect the "heat" to be slowly taken out of the free market, to be replaced with a more sustainable growth in the number of potential free market home buyers. This might provide the gentle course correction in the free market that could evade a more dramatic housing market collapse of the type experienced in the past.

Impact on the economy

Almost any rule of economics seems to be disprovable by real world examples, which may be because of the complexity of an economy and the inability to model it sufficiently well. However, it is general agreed that money being spent and circulated supports growth in an economy better than money being hoarded.

While there is a "luxury" private rental market, most private renters are generally younger than average and at a relatively early stage in their careers. They are mostly people just struggling to get by. The rent they pay generally goes to landlords and agents building property portfolios or to the banks lending money to those landlords. In short, this money is not particularly active in the economy. There is not a directly proportionate increase in the number of banking or letting staff employed on the basis of this income.

Conversely, giving every private rental household an additional £500 per month for example would result in a split between savings and spending on lifestyle. The lifestyle spending increase would support a range of sectors and jobs in a manner that would cycle around the economy far more effectively than putting it in the hands of a small number of landlords.

The target market

Another challenge for policymakers is how to restrict access to these homes to those people who really need them. As an approach, this would be an error as it presumes the benefit derives from the £1 billion of seed funding from the state.

Who would buy these homes?

In truth, it is the leveraged private funding that creates the success of this programme, far outweighing the seed funding in impact. So you would want to make these homes as widely available as possible.

It is also vital that these homes are built to a high standard that raises the average housing quality in a given area, adding to their attractiveness and reducing any stigma associated with "non-profit" housing. Doing this would start to re-establish the image of subsidised housing as a mainstream, positive and important housing choice.

1. RSLs and Councils would be encouraged to buy these homes for social tenancy, in the knowledge that Right to Buy would only mean the right to buy in the secondary, bubble-free market. State bodies could provide their own land for building such homes, receiving a ground rent from the purchaser in addition to the sale price.

2. With decent homes available, potentially for under £100,000, banks could be underwritten to provide 100% mortgages for people on low incomes, making home ownership a reality for people earning less than £25,000 per year. This would be low risk for bankers because these permanently affordable homes would be in high demand. They would also be sellable only at a regulated price so even if a buyer were unable to keep up with mortgage payments (though at these prices that would be unlikely), there would be no real risk of negative equity.

3. Private landlords would not be able to profiteer from rents in these homes, capped as they would be from a market price to a fair, regulated proportion of the regulated value. That said, every potential landlord would be able to business plan their income and expenditure with a high degree of security.

   A further bonus could be paid to landlords whose tenants were previously Housing Benefit claimants or families in B&B accommodation, as a proportion of the saving to the Council

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or Benefit Agency. This would provide an incentive to make such homes available to people who really need them, without restricting who can pay for the capital purchase of the home.

4. Philanthropic investors could choose to invest in these properties, knowing they are delivering social good without requiring them to actually lose money. Tax breaks equivalent to Gift Aid could be offered as an incentive.

It is crucial that these homes are made available in a fair manner. Part of the 10% "profit" made on the sale of these homes should be spent on a centralised system of allocation by a lottery of all those wishing to buy a given home and to audit rental tenancies. This would be essential to prevent opportunities for system abuse.

Who would build these homes?

1. As a government policy the first tranches of homes should be built on state owned land with commissioned property development teams. In London alone, there is an estimated 600 hectares of state owned land on which housing could be built. Developers would be paid a reasonable fee and costs rather than the profits they would expect when using their own investment funds and land banks.

2. With proper legislative backing, Councils and RSLs could transfer their housing stock to this secondary market, ensuring any Right to Buy sales were subject to the bubble-free regime. Conversely, it may be necessary to pledge outright not to do so if it were assessed that this would cause a significant boost in the number of Right to Buy applications in order to beat a deadline of transfer.

3. Private developers could designate a portion of their developments to the secondary market in order to meet affordable housing quotas. Interestingly, this might lead to some relatively expensive properties becoming part of the secondary housing stock, however, even these properties would be subject only to the regulated rate of appreciation and sale by lottery rather than to the highest (or first) bidder. This would require some policing to ensure such properties adhered to the "cost price + 10%" rule for this programme, however, it would serve to destigmatise the whole programme if it were not exclusively low-price housing.

An important factor is scale. Too few homes built would fail to have an impact, too many would stretch the availability of skills and supplies, driving up build costs. The £1 billion should target the release of 10,000 homes but thereafter the replacement of those sold homes is funded by the receipts of` previous waves. The billion gets spent many times.

Conclusion

As a policy, this proposal is ideologically ill-defined. A left winger might see it as a market solution, baulking at the lack of focus on the truly needy and a right winger might see it as a market intervention, upsetting the profitability of the free market.

In truth it is a common sense solution to a problem that is only growing, providing stability and a more fluid housing market that supports social mobility rather than impeding it.

For this reason we're calling this a homes policy rather than a housing policy. It's not just about ensuring a place to live for everyone in need, but also underpinning an improved quality of life for people under pressure.

It is true there are losers in this policy, principally the recipients of Housing Benefit. By that, we don't mean the claimant but the landlord who receives the money. Reducing Housing Benefit and B&B spend has to be a priority for any serious policy maker, but we hope we have shown here how it can be done more effectively and more humanely than with an arbitrary benefits cap.

There is a challenge to politicians to adopt this policy despite their pro or anti market concerns and in spite of its failure to sit neatly into an ideological pigeonhole. The scale and impact of this proposal is such that it begs to be implemented. Because no policy and no rhetoric about the cost of living means a thing without a radical approach to the housing market.

And we know that people aren't forced to use food banks because of the cost of food. They are forced to use food banks because of the cost of housing.

If you would like to discuss further any of the policies outlined in this document, please contact Generation Rent at alexhilton@generationrent.org

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