

# TACKLING HOUSING MARKET VOLATILITY IN THE UK: A PROGRESS REPORT

Volatility has plagued the UK housing market for four decades. The JRF Housing Market Taskforce identified ways to create a more sustainable housing market. This paper presents a progress report, and highlights key priorities for the Government.

## Key points

The Government should:

- Conduct a revaluation of property for Council Tax purposes with a view to gradually transforming it into a national land and property value tax, following full modelling to identify difficulties and to inform its design.
- Ensure the Financial Policy Committee has the power to introduce mortgage credit controls, and that the housing market as a whole is monitored as a threat to wider economic stability.
- Monitor the FSA's new mortgage rules to ensure they do not unnecessarily exclude low risk borrowers from the housing market, collecting the necessary data to do this and formally reviewing the rules after three years.
- Introduce a more effective safety net for home-owners that shares responsibility fairly between home-owners, lenders and government.
- Switch the emphasis of housing subsidies away from a reliance on Housing Benefit towards housing supply, as part of a new model for financing new affordable housing.

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# INTRODUCTION

This paper reviews recent policy developments and provides an assessment of the Government's progress in tackling housing market volatility. It outlines what has been achieved and what remains to be done. Tackling housing market volatility is the key to a socially sustainable housing market in which extreme house price fluctuation is avoided and vulnerable households are less exposed to the consequences of fluctuation.

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The JRF Housing Market Taskforce was established in 2009 to identify credible and robust long-term policy options to address the root causes of instability in the housing market. The Taskforce's work took place over a period marked by rapid policy development and the aftermath of the credit crunch. Since the publication of the Taskforce report there have been several major policy initiatives, notably the national housing strategy and the new national planning framework. Policies in other areas continue to be developed, whilst a steady stream of ideas has flowed from various think tanks.

These are reviewed in the light of the Taskforce's *Tackling housing market volatility* report, published in May 2011. This concluded that housing market volatility could be tackled in four ways:

- In the long run, a sustained (year-on-year) increase in housing supply is needed to bring about a better balance between demand and supply. A shortage in supply creates a predisposition to house price inflation and unsustainable booms.
- Nonetheless, there will be a supply shortage for the foreseeable future, and as an asset market, housing is vulnerable to external shocks that can precipitate booms or busts. It is therefore important to develop instruments such as taxation that can better manage the house-price cycle – tackling housing market volatility in the short run.
- Consumers need better protection against housing market volatility. In the case of home-owners, enhanced financial capability and responsible lending should be combined with an improved safety net that distributes risks and responsibilities equitably between households, lenders and the Government.
- Alternatives to home-ownership should be developed to provide longer-term secure accommodation at affordable prices for those people who do not wish to become home-owners, or who cannot safely do so.

The paper reviews each of these areas in turn.

For more Housing Market Taskforce publications, see [www.jrf.org.uk/work/workarea/housing-market-task-force](http://www.jrf.org.uk/work/workarea/housing-market-task-force)

## Tackling volatility in the long run: housing supply

The long-term failure to produce sufficient new housing on a year-on-year basis is a root cause of housing market volatility. Shortages create underlying upward pressures on house prices, and so help to establish the inflationary expectations that fuel unsustainable house price booms. The Taskforce suggested that radical changes in the planning and land use system might be required to lift output. However, at the time of publication, the short-run impact of the abolition of regional targets was a sharp reduction in planning permissions, while the new social housing model appeared to be optimistic.

## New developments

Since the publication of the Taskforce report, housing supply has continued to fall well below the levels needed to meet underlying demand and the past backlog of unmet demand. Surveys continue to suggest that local authorities have been renegotiating and reducing planned outputs (NHF, 2010) and new supply in the affordable sector continues to fall far behind demand and priority housing needs.

### *New Homes Bonus*

The New Homes Bonus (NHB) was introduced in April 2011 and is an important aspect of the Government's plans to increase supply. It provides financial incentives for local authorities to grant permission for new houses by allowing them to retain resultant additional council tax revenue for six years (see [www.parliament.uk/briefing-papers/SN05724](http://www.parliament.uk/briefing-papers/SN05724) for a valuable background briefing). However it has proved difficult to establish with any clarity what its real impact is (because the data collected is on a different year basis and a different set of sources to conventional housing supply data). The bonus is paid on any new homes being entered on the council tax register minus those removed.

The Year 1 cash payments for the NHB were announced in April 2011 at £199 million. The sums involved per authority are relatively modest – ranging from £200,000 to £4 million (see [www.parliament.uk/briefing-papers/SN05954](http://www.parliament.uk/briefing-papers/SN05954) for further details). The Government has recently announced that the NHB to be paid in 2012/13 will be £431 million, comprising £232 million for housing 'growth' in the period October 2010 to October 2011 and £199 million as the second instalment for Year 1 (DCLG, 2012a). The second year bonus is being paid on the basis of 137,000 new homes and 22,000 long-term empty homes coming back into use. It also included 61,000 new affordable homes (attracting an additional bonus of £21 million).

On the face of it, the figures suggest an increase in output, but given the concerns about whether the new system is being 'gamed' to secure the NHB bonus, as distinct from new homes, it is hard to be sure (see note 1). Certainly, there remains a mismatch between the numbers generated via NHB and the Department for Communities and Local Government's completions data. Annual housing completions at the end of September 2011 stood at 106,000, i.e. roughly in line with the October to October count for NHB, which is given as 137,000 homes. It has not been possible to reconcile these two sets of figures to date, and it would be helpful if DCLG clarified them.

However, it is clear that the output as measured by completions is some 50,000 units below the long-term average. On these trends, affordability will decline further and pressures on house prices will grow, so risking yet another damaging house price cycle.

### *Planning reform*

There has been Government recognition of the need to increase supply in the long run. The planning system emerged as an inhibitor of economic growth in the Government's growth review. The National Planning Policy Framework (NPPF) is intended to increase supply in the long run.

The NPPF centres on a presumption in favour of sustainable growth, whilst aiming to simplify planning guidance. The proposals have, unsurprisingly, proved to be controversial but the final policy published on 27 March was generally welcomed, at least initially (DCLG, 2012b). Nonetheless, strong concerns remain around the brevity of the new planning regulations and whether replacing 1,000 pages with 70 will mean complex legal wrangles over the meaning of the new brief version and thus similar delays and uncertainty. The presumption in favour of sustainable development and how it might be defined and applied has been one of the most contentious areas, and it is not clear the new version is enough to stop numerous appeals. A greater emphasis is placed on the priority use of brownfield land in the final version, along with protection of the green belt and urban open spaces. Importantly, local authorities are under a duty to properly assess housing need and demand, though this will be subject to ongoing interpretation. It will take some time to see if the NPPF results in more homes.

### *Housing strategy*

Meanwhile, the evidence from the house building industry's housing pipeline reports is that supply remains 'extremely weak' (HBF, 2011). Although builders have reported a strong end to 2011, there are still over 69,000 units on stalled sites (Housebuilder, 2012). It is therefore unsurprising that the

Government's Housing Strategy published in November 2011 unveiled a second set of initiatives directed at reviving the depressed housing and construction market:

- A £500 million growth fund for dealing with infrastructure for housing projects.
- A £420 million Get Britain Building investment fund to help provide finance for medium and small builders (increased to £570 million in the 2012 Budget).
- A Mortgage Indemnity Insurance scheme to help underpin mortgages for first-time and other buyers of new homes (100,000 new home purchases to be assisted).
- The Build Now, Pay Later scheme on public sector land (100,000 homes to be built).
- A reformed and enhanced Right to Buy with receipts being put back into new building (100,000 new homes to be funded).
- A £30 million fund for self build.
- Plus all the elements related to the NPPF and the New Homes Bonus and the reform of business rates.

Most of the measures relate directly or indirectly to increasing supply (and hence the construction industry), though none alone will transform the supply of housing. The Housing Minister has suggested that these measures will result in an additional 300,000 homes being built alongside the 170,000 homes likely to be achieved under the 'affordable rent' programme to 2015. This would be a significant contribution if it is achieved, but more than 750,000 homes would be needed to achieve unmet demand based on household projections (DCLG, 2010).

#### *'Affordable rent' programme*

Evidence is also emerging on the impact of the Government's policies for new social and affordable housing. Despite a 60 per cent cut for housing in the Comprehensive Spending Review, the Government is confident that it will deliver 170,000 affordable/social homes through the National Affordable Homes Programme (NAHP) over the next three years. This relies on stretching Government subsidy over more units by charging near (i.e. up to 80 per cent) market rents on new social lets and a proportion of re-lets, leveraging a much higher proportion of development costs in from the private sector and expecting housing associations to contribute by running down their balance sheets.

It is uncertain whether the 'affordable rent' regime is viable beyond the current spending period. First, the differential between social housing and affordable housing rents varies considerably across England. In some areas social housing rents are at or even above market rents and thus there is little potential for creating an 'affordable' rental market. Elsewhere there are considerable differentials between social and market rents and this creates a space for 'affordable' rental products, with and without housing benefit subsidy. However, there are emerging concerns about the affordability of these higher rents to those prioritised for affordable housing, particularly once the welfare reforms come fully into effect in 2013. Second, some associations are close to their borrowing limits and although higher rents ought to increase their borrowing capacity there is still limited borrowing available. Third, the big gain is in converting existing social housing units to 'affordable' rents but this is constrained by the rate of turnover. It can also only happen once. Taken together, this suggests the outcome will vary considerably between associations and areas.

At this stage it is difficult to provide any precise estimate of the long-term effect of the new regime. Suffice to say work is proceeding in Whitehall to find alternative funding models such as the reformed Real Estate Investment Trusts.

#### *Real Estate Investment Trusts*

The 2012 Budget set out the new Real Estate Investment Trust (REIT) regime aimed at attracting investors to full market and 'affordable' rental housing. It is accepted that there may need to be

further modifications to create a REIT suitable for funding social housing; not least around issues such as trading property and transferring vacant social rental homes. As announced in the Budget, the Government has now published its consultation document ([www.hm-treasury.gov.uk/d/condoc\\_reforms\\_to\\_reit.pdf](http://www.hm-treasury.gov.uk/d/condoc_reforms_to_reit.pdf))

The scale of the new 'affordable' rent regime assumes a continued supply of private finance at a time when both the volume of funding and the cost and terms of the loans are in question, with the likelihood that there will be greater reliance in the medium term on capital markets rather than bank lending. The move to 'affordable' rents will also diminish the supply of traditional social housing at social housing rents (and tenants moving to the new regime will have less security of tenure). There remain serious concerns about the impact on Housing Benefit of the new regime and how it will interact with the welfare reforms currently being progressed by the Government, in particular the Housing Benefit and overall social security caps. There are early signs that investors and ratings agencies are playing ever closer attention to the impact of the new welfare arrangements on housing association cash flows.

Given that part of the rationale for the Department of Communities and Local Government is the administration and delivery of public subsidy, there are grounds for believing that grant will continue to be available on a selective basis for mixed-funded schemes. Reduction does not mean elimination, not least because it is recognised by officials that there are many circumstances where grant is needed to make schemes work. However, it may become a residual input into a viability calculation, rather than the starting point.

### Tackling volatility in the long run: conclusions

The Government has set considerable store by the New Homes Bonus and the reformed planning system. The first is not proven, and the second has only recently come into force. The number of starts under the new Affordable Rent programme is modest but even if the full 170,000 new homes forecast are delivered, current and backlog demand cannot be met with a programme on this scale. Housing statistics also need to be more closely aligned in order to assess fully the impact of these initiatives. The serious shortfall in housing supply has worsened, exacerbating our exposure to housing market cycles, with all the consequences this has for households, communities and the economy.

### Tackling housing market volatility in the short run

Improving the underlying balance between demand and supply is the key to reducing underlying inflationary pressures in the housing market. However, it is clear that this will not be achieved in the near future. In any case short-term volatility may also arise from macroeconomic volatility or changes in financial conditions. Consequently, counter-cyclical policies are also required to tackle volatility. The most plausible instruments identified by the Taskforce were mortgage credit controls, as an instrument of macro-prudential policy (see note 2), and a move towards a more effective, reformed system of property taxation.

### New developments

There was a welcome debate on the role of property taxation in the run-up to the 2012 budget, and some speculation that a 'mansion tax' might be introduced on expensive properties. In the event a higher rate of Stamp Duty on properties sold for more than £2 million was introduced. The lack of action on recurrent property value taxation was disappointing. The Taskforce report outlined how the Council Tax could be transformed into a counter-cyclical land and property value tax in stages, beginning with revaluation, moving towards a point-value tax system and in time to full property value tax. This remains an area worthy of serious consideration.

The failure of the 'tripartite' regulatory system to identify and tackle 'systemic' risks to the whole financial system (rather than to individual banks) has been identified as a significant contributory factor in the financial crisis (HM Treasury, 2011). A key part of the Government's reform of the regulatory system is the proposed creation of the Financial Policy Committee (FPC) within the Bank of England. The Financial Services Bill that will lead to its creation is working its way through Parliament. The FPC is intended to contribute to financial stability by monitoring and taking action to remove or

reduce systemic risks (Financial Services Bill). An interim Financial Policy Committee was established in February 2011 and has now met. The interim FPC has been asked to advise the Government on the macro-prudential instruments that might be placed at its disposal once legislation has been passed. The Bank of England has issued a discussion paper that solicits responses on this question (Bank of England, 2011), and the Committee's advice to the Government followed its meeting in March 2012 (IFPC, 2012).

The remit of the FPC will include the control of systemic risks arising from unsustainable levels of leverage debt or credit growth (Financial Services Bill 9C(3)(c)). This relates directly to the potential to employ mortgage credit controls. The JRF Taskforce was attracted to the use of counter-cyclical mortgage credit controls, in the form of maximum loan-to-value (LTV) ratios. Unlike interest rates, they are sector specific, and in contrast to capital adequacy rules they are much more difficult to avoid by overseas lenders. Enforcement could be achieved by limiting security to loans that fall within a certain LTV limit at origination. Since the security of a mortgage relies upon national legal systems, erosion by foreign banks would therefore be limited (see note 3).

The interim FPC stopped short of recommending that it should be given powers to impose credit controls in this way. The Bank of England discussion paper raises some pertinent 'cons' of credit controls, as follows:

*The principal draw-back to the use of credit controls, such as maximum LTVs, is that they would limit lending to some households that could afford a high LTV mortgage. As the discussion paper observes, it may be difficult to 'ensure an appropriate trade-off between financial stability benefits, economic activity and societal preferences for home-ownership' (p. 25).*

The Taskforce also considered micro-prudential regulation of individual mortgage lending decisions, and broadly supported the structure proposed by the Financial Services Authority in its mortgage market review (though urged a full impact assessment before details were finalised). Assessing affordability is a more robust approach to assessing risks for individuals than the application of crude lending limits. The Taskforce therefore rejected the use of maximum LTV or loan-to-income (LTI) ratios in the context of micro-prudential regulation.

However, credit controls are worth serious consideration in the context of macro-prudential regulation, and this might over-ride judgements at an individual level. This approach can be justified in two ways:

- A more stable housing market is of general societal benefit, and therefore can 'trump' the desirability of allowing access to credit to all those who appear able to repay it.
- Reducing volatility can be expected to improve access to home-ownership. This is because volatility has been associated with a long-term rise in house prices in relation to incomes. Home-ownership rates, particularly among younger age groups, began to fall at the same time as the mortgage market was at its most liberal in the mid-2000s.

While the Taskforce considered LTVs as the obvious means through which controls would be applied, there are alternatives, such as the requirement for high LTV mortgages to be backed by higher levels of regulatory capital. This implies a 'softer' and less direct form of control; lenders would have greater discretion to allow high LTV loans. The principal downside of relying on regulatory capital is that overseas banks immediately fall outside the remit. This would place British lenders at a competitive disadvantage as well as weakening the effectiveness of the measure.

The Bank of England discussion paper also moots the use of maximum loan-to-income ratios (LTI) as a tool of macro-prudential regulation. These would appear less attractive than maximum LTV for two reasons:

- Maximum LTIs seem likely to be more far more complex to enforce than maximum LTVs, which have a direct relationship with a mortgage contract in the UK.

- High LTVs are more strongly correlated to mortgage arrears than high LTIs (FSA, 2011), and are an unavoidable factor in driving negative equity.

There is therefore a stronger case for the use of limits on LTVs than for LTIs.

There is clearly support for the use of LTVs as an instrument of macro-prudential policy on the Interim Financial Policy Committee, but the sensitivities concerning their impact on individual borrowers meant the Committee did not advise that it be given powers of direction over such tools at present. However, the issue remains alive since the Interim FPC also noted that 'these tools may be appropriate after further analysis, reflection and public debate' (IFPC, 2012, para. 31).

### Tackling housing market volatility in the short run: conclusions

There is strong evidence to support the view that the FPC should be given powers to employ quantitative controls on mortgage credit, as a means of securing financial stability. While the Interim FPC did not recommend that it should yet be granted such powers, it has kept the debate alive, and this is an important advance. We believe that this measure could play an important role in containing short-run housing market volatility, although it would be unwise to see it as providing a complete solution. In reforming the structures of financial regulation, the Government is attempting to ensure that risk in the financial system is managed at different levels, notably at the micro and macro levels.

However, the risk remains that key sectors with great destabilising potential are neglected. The housing market is one such sector, as the Interim Financial Policy Committee clearly accepts. It is therefore crucial that government and regulators take a sector-wide – rather than instrument specific – approach to stability, and that a full range of instruments is kept available. The continued neglect of the role that property taxation might play is an obvious concern. The Taskforce report showed how the Council Tax could evolve into a national property tax. By neglecting the management of the housing market as a whole there is a danger that it will reveal the next hole in the system of regulation.

### Protecting home-owners from the consequences of volatility

Home-owners are more exposed to the consequences of housing market volatility than other people, although the combination of Housing Benefit cuts and the benefit cap means that tenants are less protected than they have been. Some 840,000 home-owners experienced repossession of their homes in the three decades following 1980. Government strategy since the mid-1990s was to shift responsibility for meeting mortgage interest payments in a crisis to individuals. However, this did not work and large-scale Government intervention was needed after 2008 to limit repossessions. The situation has been helped considerably by the Bank of England's continued policy of very low interest rates, as well as lender forbearance encouraged by the pre-action protocol. The Taskforce concluded that there is a need for a three-tier system, based on the principle of shared responsibility between mortgagors, mortgagees and government.

### New developments

#### *Mortgage Market Review*

Since the Taskforce report was published the Financial Services Authority (FSA) has brought forward another set of proposals as part of the Mortgage Market Review (FSA 2011a). Following consultation the FSA expected to publish a set of final rules in summer 2012, although it does not envisage implementing them until summer 2013.

The three core aspects of the proposal for responsible lending are:

- An assessment of affordability should be based on net verified income being sufficient to meet mortgage payments after committed expenditure and basic household expenditure is taken into account.
- That the assessment be subject to an interest rate stress test, based on market expectations of future interest rate increases.

- Whilst interest-only mortgages would not be banned, the affordability assessment would assume that a capital and repayment mortgage were in place.

The proposed requirement for an additional 'buffer' in the case of credit-impaired borrowers has been dropped.

However, the Taskforce cautioned that much better information than that presented in the previous set of FSA proposals was required before a decision can be reached on the implementation of these principles. The FSA has produced another extensive impact assessment (FSA, 2011a, Annex I; and FSA, 2011b), and has changed the basis for some of its calculations. However, they are still based on data that is insufficient to produce a robust assessment of affordability as it does not include sufficiently rigorous income data. So, whilst the 'responsible lending requirements' are described having the 'most significant impacts' of the Mortgage Market Review as a whole (FSA, 2011, p. A1:3), '[it] is extremely difficult to identify exactly how the responsible lending requirements will change borrowing in the market or the likely scale of this' (ibid.).

The FSA also suggests that a less prescriptive approach than previously advocated be adopted in relation to the assessment of affordability. It suggests that lenders be required to 'take explicit account of' committed expenditure and basic essential expenditure (FSA, 2011, p. 19). While it is clearly right that there is a balance to be struck in assessing affordability (FSA, 2011, pp. 80-88), some concern remains that there will be scope for a return to overly-optimistic affordability assessments should market conditions turn upwards once again. Much the same problem might arise from discretion given in the application of the interest rate test.

Taken together these concerns justify:

- Significantly enhanced data collection by the FSA and successor bodies so that it can monitor the impact of the Mortgage Market Review and properly track affordability assessments.
- Pilot affordability assessments running alongside actual lending decisions before the final rules are implemented. These should employ a variety of affordability methodologies.
- An initial review of the impact of the new rules after three (rather than five) years. This should be used to refine the affordability methodology.

#### *Support for Mortgage Interest*

The Department for Work and Pensions issued a call for evidence on the reform of Support for Mortgage Interest (SMI) in December (DWP, 2011a). The paper sets out the Government's view of the role that state assistance should play in meeting home-owners' mortgage interest costs; that 'it should provide short-term help to people at a time of personal crisis such as loss of employment or relationship breakdown and incentivise work' and that 'taxpayers should not in effect be helping people to acquire personal assets through any potential long-term rises in house prices' (DWP, 2011a, p. 4).

The Taskforce's suggestion that the Sustainable Home-ownership Partnership (SHOP) might form the basis of a better safety net is consistent with this approach. SHOP is based on the principle of a partnership between borrowers, lenders and the Government, each making a contribution to a pooled fund (see note 4). The fund would be used to purchase 'block' insurance from the private sector. Block insurance is much cheaper than individually purchased (retail) insurance as the fees/up-front costs are much reduced. In the event of a designated risk (loss of employment, self-employment, accident or sickness) borrowers would be entitled to a fixed period (e.g. 12 months) of non-means-tested assistance that would cover both interest and capital payments, after a short period of lender forbearance.

This would be a marked improvement over current arrangements, as capital payments are a greater proportion of overall mortgage and interest costs in a period of low interest rates. Caps would not be needed, as contributions are proportionate to payments. Moreover, eligibility would not be lost through the means-testing of a partner's earnings. The system would be compulsory on new mortgages (including re-mortgages) so would be phased in. SHOP does not cover all risks – notably

relationship breakdown which is an uninsurable risk, so SMI (or equivalent) would need to run in parallel, but could be wound down and primarily aimed at people with long-term needs. This would dovetail neatly with the Government's proposals for longer-term support. The creation of the NewBuy scheme, where Government, builders and lenders have combined to underwrite the risk of higher LTV mortgages is useful here, with Government acting as guarantor behind the scheme.

The DWP consultation paper seeks views on whether longer-term recipients of Support for Mortgage Interest (SMI) might be subject to a charge being placed on their property, perhaps after two years. The charge would take the form of interest paid and an administrative fee, which would be redeemed on sale or death. The DWP notes that relatively few (10 per cent) of people receiving SMI through Jobseeker's Allowance do so for more than two years (DWP, 2011b). However, the majority (80 per cent) of those receiving SMI through Pension Credit and Income Support do so for more than two years (*ibid.*). In 2010/11, fewer than one-fifth of SMI recipients received JSA, while around half received Pension Credit. Consideration should be given to the impact of people being moved from Employment Support Allowance and Income Support, as employment conditionality is extended as part of wider social security reform.

The Taskforce supported the principle of shared responsibility, and this principle is reflected in the proposal. But the proposal might also have unintended consequences for people in relatively low-value properties in depressed markets, who would be most likely to become 'trapped' in negative equity by accumulated interest being added to the charge. The DWP would be wise to consider the possibility of allowing owners to roll-over the charge on to other properties so as not to discourage mobility or trading down.

The introduction of Universal Credit provides further opportunities for the reform of support for home-owners. SMI would be rolled up into the Universal Credit. In principle it should be easier for home-owners undertaking low-paid work to retain eligibility for support for housing costs within the Universal Credit. However, the removal of earnings disregards for housing costs could make some people worse off by taking low-paid work, which runs contrary to the objective of 'making work pay' (Wilcox, 2012). Wilcox has proposed that SHOP could be incorporated into the Universal Credit, bringing together in and out of work means-tested elements (*ibid.*). He suggests that this would allow the issues of time limits and charges for longer-term claimants to be considered 'within a more constructive context' (*ibid.*, p.31).

### Protecting home-owners from the consequences of volatility: conclusions

The current system of safety nets for home-owners is inadequate. The broad consensus that has emerged that supports a strategy of responsible borrowing, prudent lending and an effective safety net is welcome. However, behind these principles much work needs to be done. A much more robust evidence base is required before the changes envisaged by the Mortgage Market Review can be assessed, whilst it is important that discretion given to lenders in assessing affordability does not facilitate a return to any irresponsible lending. Safety nets continue to play a crucial role in limiting repossessions, and while the Government's emphasis on shared responsibility is one shared by the Taskforce, it must ensure that there is an effective safety net. In short, a rethink is required to find a solution that improves security for home-owners faced with reductions in income, whilst also meeting the Government's objective of making work pay.

### Developing alternatives to ownership

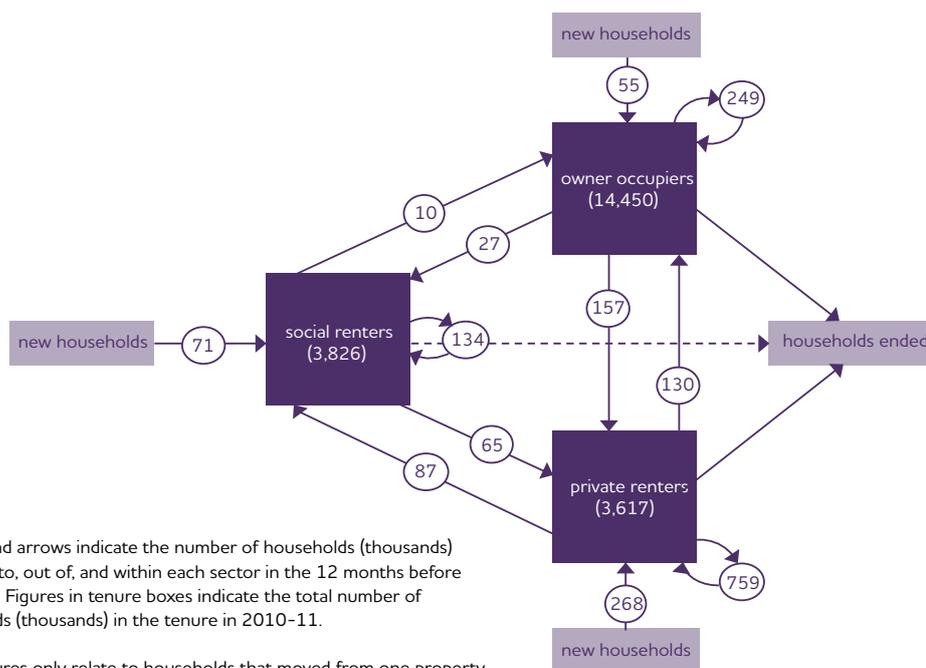
With access to home-ownership limited, and in decline, the need to identify suitable alternatives is clear. The problem is that there are no widely available alternatives to home-ownership that provide security. Social rented housing continues to play this role for many households, but supply is limited and being undermined as Government treats it more like a temporary safety net. Low-cost home-ownership is unlikely to appeal to more than a small minority, leaving the chronically insecure private rented sector as the only alternative to ownership for most people.

## New developments

Since the publication of the Taskforce report, the evidence suggesting a downward trend in home-ownership has strengthened. The contraction of home-ownership, the growth of private renting and the slow decline of social housing has continued, even though regional and local patterns are quite varied (Pawson and Wilcox, 2012). Research published in mid-2011 by the National Housing Federation (NHF, 2011) suggested that in England home-ownership would shrink to around 65 per cent of households by 2025 and this is further supported by research by Cambridge University (CCHPR, 2012). Private renting has grown across all income cohorts, with the largest increases being in the middle and upper quartiles and it is estimated that by 2014 the sector will be larger than the social rented sector (Pawson, 2012). Low-cost home-ownership provision remains very small scale, currently 1 per cent of households according to the English Housing Survey, and although more funds have been channelled through housebuilders to support FirstBuy, overall numbers via funded programmes have not increased – rather the focus has shifted to new build.

In reality the alternatives to home-ownership are quite restricted. Access to social housing and low-cost home-ownership is limited by the rules and funding in place thus placing the private rented sector (PRS) alongside home-ownership as a relatively accessible point of entry. The figure below from the 2009/10 English Housing Survey underlines this. Some 210,000 new households entered the PRS in 2009/10, compared to 48,000 into social housing and 40,000 into home-ownership.

**Figure 1: Number of households moving into and out of sectors, 2010-11**



Figures and arrows indicate the number of households (thousands) moving into, out of, and within each sector in the 12 months before interview. Figures in tenure boxes indicate the total number of households (thousands) in the tenure in 2010-11.

These figures only relate to households that moved from one property to another. They do not include sitting tenant purchasers.

Base: all households resident less than 1 year

Note: excludes a small number of cases where previous landlord type was unknown.

Source: DCLG English Housing Survey, full household sample

### *Institutional investment in private renting*

Searching for ways to attract institutional investment into rental housing has been something of a 'holy grail' (Stephens, 2011), its most recent appearance being in the CLG select committee report on housing supply (CLG Committee, 2012). Institutional investment is often seen as being the key to transforming the PRS into an accessible and secure alternative to home-ownership. The Government has recognised this and has moved to try to build new momentum behind institutional investment in the sector with a view to ensuring a step change in supply (not least given a degree of uncertainty

as to whether the Buy to Let market could fund the required expansion). Real Estate Investment Trusts (REITs) are the Government's preferred mechanism. The UK has tried to create a REIT regime over a number of years and HM Treasury recently undertook an informal consultation of further proposals set out in the March 2011 Budget (HM Treasury, 2011) with a view to incorporating them in the Finance Bill 2012. These included: the abolition of the 2 per cent entry charge for companies; allowing cash to be included in the business assets test; widening eligibility for a spread of investors; giving the three-year 'grace' period for setting up new REITs and relaxing the listings requirement (see note 5); all of which were seen as bringing the rules into line with investor expectations (BDO, 2012). The Treasury has now set out a revised regime taking these proposals forward and details have been published by HMRC (see note 6).

The Montague review (Montague, 2012) of barriers to institutional investment into the private rented sector suggested that developers' obligations to provide affordable housing under Section 106 agreements might be waived, or at least reduced. This would represent a de facto subsidy to the investors. This might be justified if it were to increase supply and was conditional on the housing remaining in the rental sector for a minimum period (as Montague suggests), and on improvements in the security offered to tenants compared to the normal insecure tenancies that are offered by small-scale landlords. This latter point is especially important, and would sit well beside the requirement for housing to remain rented for a minimum period. If such a distortion were to be created, it should also be viewed as being a temporary pump-primer to create a market that scarcely exists – in the way the Business Expansion Scheme did for the private rented sector in general 20 years ago.

Clearly there is continuing momentum inside Government reflecting the growing concerns about the capacity to fund new housing supply. Whether REITs are the answer is a more open question. Recent research on a number of countries has confirmed that REITs and institutional investors currently play only a modest role in the PRS in a market dominated by small investors (Scanlon and Kochan, eds, 2011).

#### *Security of tenure*

Even if REITs do stimulate supply, questions around demand and security of tenure remain. In expanding the role of private renting as an alternative to ownership there is the question as to whether it can meet the needs of all the different types of households that will need to be housed. The Government has rejected any further reforms to security of tenure in the PRS, taking the view it will inhibit investment. However there is a conundrum if it means the sector is not able to properly support those who need long-term secure residence reflecting jobs, schooling or other family requirements. This remains an unresolved tension, and we may have to explore the role that subsidies or the tax regime might play in coaxing landlords into providing greater security and/or lower rents.

#### *Welfare reform*

Investment is driven by returns, making the Government's planned reforms of welfare benefits critically important. The Housing Benefit costs associated with the PRS have risen sharply in recent years, encouraging Government to argue that rents under the Local Housing Allowance (LHA) regime in the sector have become benefit-led, a viewpoint others have challenged (Lister, et al., 2011). LHA eligible rents are now capped at between £250 and £400 a week according to property size and set at the 30th percentile of local market rents compared to the previous median. Subsequent uplifts will be calculated using consumer price inflation rather than actual rents, where this gives a lower increase. Additional restrictions include the raising of the age of the single room rent from 25 to 35, and the introduction of an overall benefits cap from April 2013. The latter makes the 'affordable rent' regime even more problematic in high-cost areas.

With continuing shortages of supply and other reforms such as the spare room restrictions being proposed to deal with under-occupation, a new limited security of tenure provision alongside the benefits cap and a revived Right to Buy scheme, there is little to suggest that the social rented sector is being made any more attractive to prospective tenants.

### *Low-cost home-ownership*

Having briefly explored the alternatives being generated by the rented sector we conclude by looking again at low-cost home-ownership and schemes being put in place to enhance access to the sector. As suggested at the start of this section, the Government-backed LCHO regime is now very focussed on funding new build. A number of private equity loan schemes, such as those by Asset Trust, Mill Group and Castle Trust, are on the market or about to launch, but volumes remain small. Housebuilders also have their own schemes, partly as a consequence of the mortgage shortage, but it is not clear whether these are part of a long-term plan. The Bank of England's new Funding for Lending scheme (£80 billion) is intended to bring lower-cost finance into both the small business and residential lending markets. This may help ease some of the constraints borrowers face – access to funds and cost of funds but the support is phased over 18 months and across a number of markets.

### Developing alternatives to ownership: conclusions

The downward trend in home-ownership may be hardening into a structural change, so highlighting the need to identify alternatives. The Government's efforts have focused on identifying ways to attract institutional investment into the private rental sector, which even if successful, does not address the chronic insecurity that prevails there. Moreover, the Housing Benefit cuts will serve to make tenants less, rather than more, secure. With low-cost home-ownership always likely to be a minority tenure and with the security that is traditionally associated with social renting being diluted, this is an area where we are rapidly moving backwards. A key challenge remains to find ways to make private renting more secure without prompting mass landlord exits from the sector.

## Overall conclusions

It is widely accepted that housing market volatility is deeply damaging to many households and to the wider economy. But this progress report shows that in some ways we are moving further away from this goal. The Government has demonstrated that it is prepared to take tough decisions, but it continues to be too timid concerning actions that are needed to bring about greater housing market stability.

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## About this paper

This paper follows up on the work of the JRF Housing Market Taskforce and reports on the progress made since its final report was published in May 2011. It was written by Mark Stephens and Peter Williams. Mark Stephens is Professor of Public Policy at the Institute for Housing, Urban and Real Estate Research, Heriot-Watt University. He was Academic Adviser to the Taskforce and author of its report. Peter Williams is Director of the Cambridge Centre for Housing and Planning Research, and was a member of the Taskforce.

## Notes

- 1 This uncertainty is reflected in the interpretation of figures from Kensington and Chelsea that suggested that the New Homes Bonus is being paid on Houses in Multiple Occupation that have been re-classified as self-contained units. A very high proportion of the new homes attracting NHB in Kensington and Chelsea were in Band A, which seems to be very unlikely given the area (Hansard, 30 January: Column 542). This was denied by the Government on the basis that they mostly represented conversions and other 'substantive material changes to properties' (Hansard, 27 February: Column 37W).
- 2 Macro-prudential regulation is aimed at containing systemic risks, as opposed to micro-prudential regulation, which is aimed at containing risks in individual banks.
- 3 The separate Scottish legal system would, however, be a consideration.
- 4 This principle of partnership is also reflected in the Government's NewBuy scheme where it is underwriting the risk of lenders making losses on 95 per cent LTV loans to selected buyers. Here the partnership is between government, builders and lenders with a 5 per cent contribution from borrowers.
- 5 [http://www.bpf.org.uk/en/files/reita/reita\\_org\\_documents/analysis/deloitte/Deloitte\\_REITs\\_-\\_Summary\\_of\\_the\\_regime\\_Dec\\_2011.pdf](http://www.bpf.org.uk/en/files/reita/reita_org_documents/analysis/deloitte/Deloitte_REITs_-_Summary_of_the_regime_Dec_2011.pdf)
- 6 See <http://www.hmrc.gov.uk/tiin/tiin664.pdf>

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## FOR FURTHER INFORMATION

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