



Understanding Affordability

The Economics of Housing Markets

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Aims and Structure

- Housing affordability remains a central social and economic problem, but it is not new. Over the long term, housing conditions for the majority of the population have improved very considerably, but some groups have been left behind, notably those on low incomes and younger cohorts.
- Problems of affordability have become increasingly important – but in the UK the government has seen the solution mainly in terms of new building.
- There is a remarkable degree of agreement among economists across the UK and comparable countries on a range of required reforms around property taxation; planning and land release, including funding infrastructure and social housing; regulation of the private rented sector; income-related subsidy; and financial market reforms. But economics is only part of the argument.
- Our book is divided into two main parts. The first provides the analytical basis for understanding changes in affordability. The second considers the policy options in the light of the analysis. This stresses the interactions between different parts of the housing market and with the economy more generally (and is already out-of-date!).

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On Simple Solutions to Complex Problems

- Economic analysis suggests that changes in affordability arise from a number of key sources:
- Changes in household income relative to the stock of housing services. Since the late 1960s the former has grown faster than changes in the latter and this is the case for a supply expansion. However, avoiding this mismatch through supply expansion alone is a massive task.
- The cost of capital, which includes not just the relative returns from housing as an asset but also the effects of credit restrictions and housing taxation.
- On the demand side affordability worsens if, as is the case in the UK, the income elasticity of housing demand is greater than the price elasticity. A possible explanation is that a high income response is influenced by social norms of behavior as well as financial incentives.

Therefore, concentrating on just one side of the market limits the effectiveness of housing policy. In the 1960s and 1970s there was more emphasis on the demand side relationships but particularly since the turn of the century

But this emphasis reflects political and macroeconomic priorities and diverse responsibilities rather than inherent problems in solving housing problems.

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Affordability Indicators in Land Use Planning

- The centrally defined common methodology places too much emphasis on (i) projections of household growth; and (ii) an affordability indicator based on the median house price to workplace earnings ratio (why workplace?).
- The use of the price earnings ratio and a value of 4 - said to be based on mortgage requirements. But repayments as a proportion of incomes have not risen since around 2000 and the constraints are mainly around deposits and stress tests.
- An important change is the introduction of the housing stock into the formula where new construction is to be the maximum of the household projections or a half percent of the housing stock. This compares the growth of one variable with the level of the other.
- In practice it also means that stock will come to dominate and total numbers required will also grow. Further it means those who do build will have to go on building more – those who do not will be less pressured.
- A “better” measure would be the ratio of local population to the housing stock weighted by average earnings. As a by-product, this abolishes the need for household projections. The problem is that the spatial distribution of building would be different from current plans.
- The 2 measures are correlated but by no means the same.

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Lessons around Planning Reform

- Our planning system is at one end of the spectrum from individual planning permission to full scale zoning and the grass always looks greener on the other side. Building in local plans from 1990 added to the complexity rather than providing transparency and speed. There is also a lack of regional strategic planning – making the levelling up agenda particularly difficult.
- But change does not necessarily make things better – or speed things up. Rules based systems are often difficult to adjust to changing circumstances – so eg Toronto, which 000s of pages of extremely detailed zoning rules, has ended up with opportunity zones where developers suggest uses (as planning permission). Especially in the current environment flexibility would seem to be at a premium).
- Also how do we get from one system to the other – especially if we wish to continue to give local authorities responsibility? The Consultation which closes on October 1st hardly provides a clear pathway – but is it more important than the Vision in the glossy?
- The government’s immediate answer appears to be allow much larger sites not to provide affordable housing ‘to support small and medium sized developers’; to enable much more permitted development – especially to address the issues around retail and office decline; and to require unrealistic numbers of new units through a system that even developers appear to dislike.
- Given the current economic environment we will need more than this to maintain both output and affordability.