Housing to 2001: Can Britain Do Better?

Duncan Maclennan
University of Glasgow

Abstract

Demographic and economic changes are likely to be favorable to the U.K. as 2001 approaches. Population pressures are easing, and the economy is recovering sharply. But constraints on public spending will remain. The U.K. housing system is costly and appears to boost prices more than output, reinforcing macroeconomic instabilities. Its key limitation is the lack of an adaptive rental sector—social or private. Policy has been too focused on maximal rather than sustainable homeownership. What Britain needs most is a new vision that encompasses both enhancing economic flexibility and addressing the problems of inequitable income distribution and urban decay.

While emphasizing homeownership and competition as the pillars of U.K. housing policy, the article sets out the importance of producer subsidies and a renewed emphasis on rental housing. Some organizational reforms are proposed. Britain can do better in housing—more thought, not more government money, is the key to progress.

Keywords: Demographics; Homeownership; Rental housing; United Kingdom

Recovery, rethinking, or reemphasis

Recovery

The U.K. economy, since early 1992, has been recovering from its longest and deepest recession in half a century. Against this more optimistic general economic background, there remain severe housing policy concerns of at least three kinds. First, the housing market slump of 1990 to 1993 has left behind negative equity and mortgage arrears concentrated among younger households in southern Britain. These difficulties are likely to be temporary and will unwind as the market recovers, but into 1995, the housing market has remained sluggish in relation to prices and sales volumes despite the recovery in gross domestic product (GDP) per capita. Second, although overall housing progress has been made, since more households live in better homes, persistent housing-related problems have developed over the past two decades. Homelessness acceptance, a measure of those households statutorily defined as homeless, is falling but still near record levels, and social housing investment still runs at less than half of the estimated need. Paying for housing is a pressing issue for low-income earners, and the number of benefit-dependent tenants continues to increase sharply. Although overall housing conditions are improving, there is a growing concentration of poor households in poor neighborhoods.

There is a third concern, although it is much less widely expressed in housing policy debates. For 15 years, U.K. governments have emphasized tenure switch to homeownership, increasing rents in social housing, and effectiveness in social sector development and management. Deregulation of housing finance markets, privatization of public housing, and creation of more competitive provision and management of social rental housing have been the key themes of housing policy. I believe they have all benefited the U.K. housing system, though others disagree. However, beneath the broad rhetoric of changes in policy, there has been little concern about whether successive waves of housing policy innovation have created an economically efficient housing system. Changes have been piecemeal and tenure-oriented, and privatization per se outweighed social cost and benefit as the key policy criterion.

Rethinking the future

In looking to the future, there must be a clearer strategic view, a vision of what British housing systems and policies are intended to achieve. The vision of the 1980s was clear: reduce public housing investment and expand homeownership. Now, when the national and global economies are on the cusp of reinforced competitive economic change, the British vision is still focused on tenure change and reducing housing spending (Department of the Environment 1995). In the face of growing international economic competition, Britain needs a housing system in which the substantial input of public and private resources is used more efficiently. In the short term, in most cities, better stock pricing could reduce coexisting problems of over- and under-occupation of the public stock. Over the medium term, there is a growing public policy recognition that the housing market's relationship to the economy has changed so that housing has a greater capacity to reinforce upswings and downswings. For the long term, it is imperative that U.K. housing output respond more rapidly to demand pressures rather than see economic progress significantly absorbed by rising housing costs. Research has highlighted inefficiencies in the social rental sector (Centre for Housing Research 1989; Maclennan and Kay 1994), cyclical instability (Maclennan 1994; Stephens 1995), and supply sluggishness in the U.K. housing sector (Evans 1988; Malpezzi and Maclennan 1994).

Viewed in an international context, U.K. housing policy debate has been a battleground about distributional issues, often with a focus on tenure means rather than housing ends. At the same time, the consequent system has been high cost (both to individuals and the state), unstable, and inflationary. As the U.K. emerges from the present recession, there has to be a new emphasis on seeking the appropriate mix of owning and renting and of public and private action that will both address housing problems and contribute to economic competitiveness.

The Tri-Country Conference provides an important opportunity to address these longer term issues. In recent months, the U.K. government appears to have set its face against a rational reconsideration of how housing policies could contribute to economic change. With the 1994 budget reducing social housing investment, private rental housing subjected to continuing neglect, and the secretary of state emphasizing the possibility of 80 percent homeownership by the end of the century, policy seems to be reemphasizing the strategies of the 1980s.[1] In the remainder of this article, that strategy will be challenged on economic grounds.

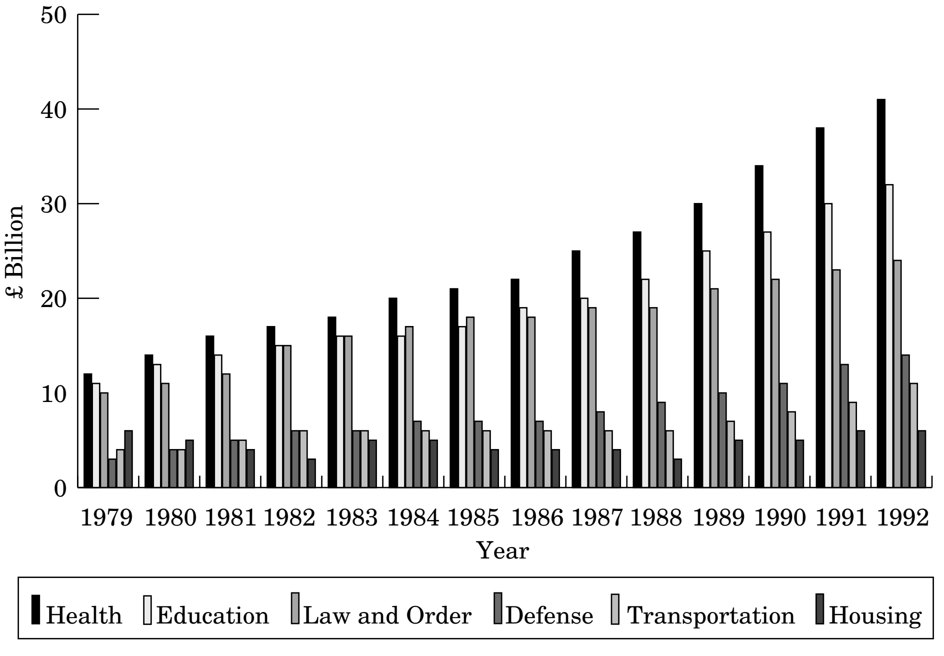
This article does not set out firm forecasts for the U.K. housing sector in 2001, nor does it suggest tablets-of-stone policy plans. Such forecasts can be made only by those who believe that economic factors are unimportant in shaping housing supply and demand. Although this may be the conventional practice in U.K. housing planning, it is not a credible one. Income growth, income distributions, and interest rates matter in housing—indeed they are a more fundamental shaper of outcomes than housing policies. The U.K. economy is, unlike the U.S. economy, markedly and increasingly "open." Forecasts beyond 1997, other than for demographic variables, have little substance. The emphasis of this article is, rather, how the U.K. can begin to create a housing system that adapts to and enhances broader economic flexibility.

[1] In June 1995 a new white paper on housing policy for England was published. It emphasized expanding "sustainable," but rising, homeownership. It also gave new, but limited, support to private renting and discussed further ways of restructuring municipal housing. Future rent increases in the social rental sector are to be moderated. These proposed changes improve on the 1994 position but do not meet the criticisms above.

Economic change and housing policies in the 1980s: Key developments

The 1980s were a decade of expansion and structural change in the U.K. population and economy. Like most advanced economies, the U.K. faced major change in the factors that drive housing systems. U.K. housing demand, as elsewhere, is primarily a function of household formation and real income growth, and the 1980s witnessed U.K. peaks in both these critical variables. At the same time, however, the U.K. government adopted early and strong commitments to deregulation, privatization, and competition policies for housing and housing finance systems. It also advocated, from 1980 on, a long-term commitment to reducing taxation and government expenditure. The latter stance, although it ultimately restrained public expenditure growth rather than delivered absolute cuts (with the critical exception of housing budgets), was central to understanding housing evolution in the U.K. Public spending by program is shown in figure 1.

Figure 1. **Decline of Housing among U.K. Public Expenditure Priorities, 1979 to 1992**



Source: Wilcox (1993, 36).

New times were reinforced by new policies. This section of the article first summarizes the key economic and demographic changes. It then considers how these factors and policy emphases sustained major thrusts of change in the U.K. housing system.

People

The 1980s combined and strengthened demographic trends that emerged in the 1970s and are likely to prevail into the next century. The key developments during the 1980s, noted in table 1, were the following:

1. The U.K. population grew by just over 2 percent (around the middle of the range for European Union countries).

2. The population growth was entirely due to net natural increase (a falling death rate); international migration was minimal.

3. The population was aging, with a reduction in the proportion under 16 and an increase in those over 80.

Table 1. **U.K. Population and Age Distribution, 1981 to 2001**

	1981	1991	2001 (Projected)
Age distribution (%)			
Under 16	22.2	20.3	21.3
16 to 39	34.9	35.2	32.6
40 to 64	27.8	28.7	30.5
65 to 79	12.2	12.0	11.4
80 and over	2.8	3.7	4.2
Total population (millions)	56.4	57.6	59.2

Source: Central Statistical Office (1993b, 14).
Note: Percentages may not add to 100 because of rounding.

There were, however, from 1981 to 1991 continuing changes in the transformation of population totals into households requiring housing (see table 2):

1. Average household size fell from 2.71 to 2.48 persons.

2. The total number of households rose by 2.4 percent, with rising rates of new household formation toward the end of the decade; on average, there were 171,000 new households per year.

Table 2. **Changing Household Size in the U.K., 1971 to 1991**

	1971	1981	1991
Household size distribution (%)			
1 person	18	22	26
2 persons	32	32	34
3 persons	19	17	17
4 persons	17	18	16
5 persons	8	7	6
6 or more persons	6	4	2
Average household size (persons)	2.89	2.71	2.48
Number of households (millions)	18.31	19.49	19.96

Source: Central Statistical Office (1993b, 26).
Note: Percentages may not add to 100 because of rounding.

The rising household formation rate reflected not just the baby boom of two decades earlier but changing socioeconomic decisions. For instance, separation and divorce rates were rising steadily, and young people were leaving home earlier. These trends are reflected in the size and structure of households (see table 3):

1. The proportion of single-person households, both under and over pension age, has been increasing rapidly.

2. The share of married couples with dependent children is falling and now forms only a quarter of all households.

3. Lone-parent families with dependent children now form 6 percent of households.

These demographic trends, which will remain largely unaltered to the end of the decade, imply (leaving aside economic circumstances for the moment) (1) a requirement for more homes and (2) a required structural shift from family to single-person or small housing.

Prosperity

Real income per capita grew strongly in the 1980s by U.K. historical standards. This growth occurred largely in the 1984–89 period, when the annual increase exceeded 3.5 percent. Taking 1985 as a base (100), real incomes were 94 in 1981 and 124 in 1991 (falling back from the 1989 peak)—that is, they increased by a third over the decade.

Table 3. **Distribution of Household Types in the U.K., 1971 to 1991 (Percent)**

	1971	1981	1991
One person			
Under pension age	6	8	11
Over pension age	12	14	15
Two or more unrelated adults	4	5	3
One-family households			
Married couples			
No children	27	26	28
1–2 dependent children	26	25	20
3 or more dependent children	9	6	5
Nondependent children only	8	8	8
Lone parent			
Dependent children	3	5	6
Nondependent children only	4	4	4
Two or more families	1	1	1

Source: Central Statistical Office (1993b, 27).
Note: Percentages may not add to 100 because of rounding.

Income growth partly reflected government policy. So did cyclically rising unemployment. In consequence, unemployment and associated labor market changes and shifts in taxation led to a major, regressive shift in the distribution of incomes in the U.K. Changing patterns of housing costs reinforced these growing inequalities. The key changes from 1981 to 1989 are as follows (see table 4):

1. Only the richest fifth of Britons increased their share of national net equivalent income, a measure that seeks to control for differences in household characteristics in order to compare income.

2. Housing costs further reduced the share of net equivalent income accruing to the poorest two-fifths of households but further increased the income share of the richest fifth.

Table 4. **Income Distribution and Real Incomes in the U.K., 1981 and 1988–1989**

	Bottom Fifth	Next-Lowest Fifth	Middle Fifth	Next-Highest Fifth	Top Fifth
Income distribution (net equivalent incomes, %)					
Before housing costs					
1981	9.7	13.9	17.8	22.9	35.7
1988–89	7.9	12.4	17.0	22.7	40.0
After housing costs					
1981	9.0	13.6	17.8	23.1	36.5
1988–89	6.9	12.0	17.0	22.9	41.1
Real net equivalent incomes (1992 prices)					
Before housing costs					
1981	94	128	164	209	298
1988–89	100	147	202	268	402
After housing costs					
1981	78	109	141	182	262
1988–89	81	124	176	234	355

Source: Central Statistical Office (1993b, 77).
Note: Percentages may not add to 100 because of rounding.

3. Real equivalent incomes grew faster for each successively higher fifth.

4. After allowing for housing costs, the net real equivalent incomes of the poorest fifth grew by 4 percent, whereas those of the richest fifth grew by 35 percent.

In brief, Britain became significantly more prosperous, but the income distribution became increasingly unequal. These patterns of income change were quickly reflected in housing choices, particularly tenure patterns. If the annual gross income of homeowners with mortgages is taken as a base (100), two points become clear (table 5):

1. The incomes of all groups of renters fell relative to those of homeowners, with the exception of renters in unfurnished private accommodation.

2. The incomes of outright owners of homes rose relative to those of owners with a mortgage.

A host of commentators have argued that such figures point to an adverse residualization of rental, especially social, housing in the U.K. Another interpretation is that the figures merely reflect household preferences, with growing incomes and more appropriate targeting of social housing toward the poor. Both explanations have some validity. The critical issue for the present is whether the policy regimes that produced such marked income separation between owners and social renters are appropriate now that the separation has occurred.

Table 5. **Intertenure Differences in Gross Incomes and Gross Income Growth in the U.K., 1980 to 1992**

	1980	1984	1988	1992	Gross Income Growth, 1980–92
Homeowners					
With a mortgage*	100	100	100	100	125
No mortgage	57	55	59	61	140
Renters					
Local authority	48	40	35	34	62
Housing associations	46	45	35	37	82
Private renter, unfurnished	42	40	41	47	148
Private renter, furnished	61	46	60	53	95

Source: Central Statistical Office (1993a).
*Owners with a mortgage are taken as the base from which income differences are measured.

Places

National housing system outcomes do not merely reflect overall balances between supply and demand. Rather, the housing system has inevitable and important local and regional dimensions and regional imbalances that shape national economic outcomes.

Between 1981 and 1993, there were two key patterns of regional change corresponding to the boom and bust periods. Population, employment, and income growth were more rapid in the southern half of the country (Coleman and Salt 1992); East Anglia, the Southwest, and the Southeast constitute regions where long-term growth pressures were sustained. Scotland, the North, and the Northwest (although there were important intraregional variations) were locations of slow growth in jobs and population. Internal migration was essentially from north to south.

From 1981 to 1989, regional change in the U.K. largely followed expected patterns. However, in the post-1989 recession, the downturn has been much less pronounced in the North than in the South. The Scottish unemployment rate, at 9.4 percent, now lies below that of the Southeast for the first time in 50 years. When growth resumes, the "normal" pattern is likely to return, but present patterns demonstrate clearly, as discussed below, how potent the housing market has become as a source of regional economic instability.

Within regions or metropolitan areas, changing settlement patterns in the U.K. have displayed tendencies similar to those in other advanced economies. Population growth has been more rapid in small towns and accessible rural areas. Core areas of urban regions have continued to lose population to surrounding suburbs. There are some signs of "edge cities" appearing in southern England. Within core areas, however, there is no simple "inner-city" problem (though the term has been widely and misleadingly used by U.K. policy commentators). The significant scale and geographic spread of social housing, especially in northern Britain, has meant that the unemployment and adverse social trends (rising drug abuse and crime) of the 1980s are as likely to be on peripheral social housing estates as in inner cities. Major state-funded regeneration schemes in central locations (for instance, in Glasgow and Newcastle) have also shaped these patterns through the 1980s and stabilized population in selected inner areas.

Rising population, growing prosperity (albeit with more inequality), and changing places would all have induced significant changes in British housing even without major shifts in housing policy. Homeownership would have grown, renting would have contracted, and the metropolitan edge and the suburbs would have grown relative to city cores. However, policy change reinforced these tendencies in a nonmarginal fashion. In looking to the future, it is critical to understand the kind of housing market created in the 1980s and to consider whether the rental sector as now developed will meet economic flexibility requirements.

Policies

Tenure pattern change. By the standards of advanced economies, the U.K. has an unusual tenure structure. Homeownership rates have, since the 1950s, been below those in the United States, Canada, and Australia but above those in the non-Mediterranean European countries. However, in contrast to the non-European countries, social rental housing has dominated rental provision since the 1960s (with three to four social units for every private rental). The developments of the 1980s heightened some of these oddities. Homeownership grew from 56 percent of households in 1980 to 69 percent in 1993. While social renting contracted, from 33 to 22 percent, it did so less rapidly than private rental provision. The middle ground of private rental housing was progressively squeezed as the system polarized into an owned sector driven by the labor market and a social sector, with less than a third of households connected to the labor market, driven by government investment and pricing decisions. Private rental housing in 1994 provided 10 percent of U.K. homes, a small increase over the historical low of 9 percent recorded in 1990.

Growing ownership. Homeownership expansion in the 1980s was in line with broad British household preferences about housing. Research for the U.K. suggests that as real incomes grow, households increase housing expenditures at about the same rate as income growth. The Council of Mortgage Lenders has tracked over time the housing aspirations of U.K. adults. Aspirations for, and expectations of, ownership have consistently run ahead of the actual ownership rate by 6 to 17 percent (table 6). It is unsurprising that, with growing incomes, homeownership rose. But the growth in the absolute scale of ownership by just under a third from 1981 to 1991 also reflected major policy changes.

The single most important policy change was the introduction of the Right to Buy (RTB) in 1980, which gave council and housing association tenants the statutory right to purchase their homes. The financial incentive for more affluent tenants to buy was a powerful one: Assessed sales prices commonly understated market values (by a fifth). Further, purchasers received a proportional discount on assessed values that was related to their length of residence as tenants. On average they paid half the estimated market value to buy their homes (Maclennan, Gibb, and More 1992). Between 1981 and 1991, some 1.33 million social sector homes were purchased in this way, accounting for 36 percent of ownership growth in the decade.

After the initial policy impact, RTB sales fell in the mid-1980s, only to accelerate in the boom and then fall sharply in the recession. The increasingly impoverished nature of tenants and past sales of the better stock mean that sales are unlikely to recover above their present levels and may decline. This conclusion is important because, in turning a perceived sow's ear into a real silk purse, the capital receipts from sales were (in part) used to finance social housing investment, thus reducing housing policy claims on the public sector borrowing requirement. The relevant figures for England are set out in table 7.

Table 6. **Housing Tenure Preferences in the U.K., 1975 to 1993**

	% in Owner Occupation (A)	% Regarding Ownership as Preferred 2 Years Ahead (B)	% Expecting to Own in 10 Years (C)	% Expecting to Own in 10 Years of Those Under 25	Short-Term Gap ($B-A$)	Long-Term Gap ($C-A$)
1975	52	69	62	*	17	10
1983	62	77	78	92	15	16
1986	65	77	80	89	12	15
1989	70	81	83	95	11	13
1991	71	77	84	90	6	13
1993	69	81	85	90	12	16

Source: Council of Mortgage Lenders (1993).
*Not available.

Table 7. **Housing Capital Investment in England, 1979 to 1993 (Million £, 1991–1992 Prices)**

	1979–80	1980–81	1981–82	1982–83	1983–84	1984–85	1985–86	1986–87	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
Local authority investment														
New build	2,704	1,972	1,357	1,226	1,184	1,200	1,011	853	825	962	1,076	582	423	197
+ Housing Revenue Account stock renovation*	1,674	1,310	1,108	1,604	1,828	1,940	1,889	2,118	2,299	2,341	3,409	1,841	1,448	1,477
+ Housing association	438	332	253	223	220	223	173	202	206	158	356	206	162	182
+ Private renovation	526	514	573	916	1,656	1,317	834	723	706	563	565	522	500	566
+ Homeowners	1,448	1,195	1,385	1,383	760	592	397	273	248	369	482	188	157	120
= Total local authority	6,790	5,323	4,676	5,352	5,648	5,272	4,304	4,169	4,284	4,393	5,888	3,339	2,690	2,542
+ New towns	372	323	205	118	135	123	80	55	66	57	45	34	23	16
+ Housing Corporation	926	994	929	1,259	1,168	1,056	1,021	995	992	973	1,080	1,151	1,584	2,228
+ Other (net)	–10	–7	3	7	23	9	4	1	–1	0	1	2	17	28
= Total gross investment	8,078	6,633	5,813	6,736	6,974	6,459	5,409	5,220	5,341	5,423	7,014	4,526	4,314	4,814
– Total capital receipts	1,904	2,092	3,127	4,382	3,742	3,206	2,877	3,147	3,468	4,659	4,216	2,766	1,728	1,550
= Total net capital	6,174	4,541	2,686	2,354	3,232	3,253	2,532	2,073	1,873	764	2,798	1,760	2,586	3,264

Source: Wilcox (1993, 122).
Note: Public expenditure plans, Department of the Environment, adjusted by gross domestic product deflator. Figures may not add to totals because of rounding.
*Stock held by local housing agencies for letting.

In the market sector, fiscal policies to help homeownership weakened in intensity over the 1980s. Homeownership growth probably had much to do with restrictive policies in the rental sector and relatively high inflation rates. The tax treatment of housing in the U.K. favors homeownership, but it has done so less (per individual) over time, at least in relation to mortgage interest tax relief. The key considerations are as follows:

1. Mortgage interest relief may be claimed on only £30,000 of the loan, and that limit has remained fixed and been eroded by inflation throughout the 1980s.

2. Reductions in marginal tax rates reduced the value of Mortgage Interest Relief at Source (MIRAS) tax breaks during the 1980s.

3. In 1991, the government limited tax relief to the standard rate of income tax and then further limited it to 20 percent, then 15 percent, from April 1994 and 1995, respectively.

These 1990s reductions reflect an increasing awareness that MIRAS was regressive, inefficient, and procyclical and, above all, was growing significantly in scale though decreasing in value for individuals (see table 8).

Table 8. **Real Value of Mortgage Interest Tax Relief for Homeowners (MIRAS), 1983–1993**

Year	Exchequer Cost of MIRAS (Billion £, 1993 Prices)	Real Value of Loan Interest Ceiling (Thousand £, 1993 Prices)
1983	3.6	49.9
1984	4.4	47.5
1985	5.3	44.4
1986	6.8	43.1
1987	6.6	41.4
1988	6.4	39.8
1989	6.6	36.9
1990	7.7	33.7
1991	8.1	31.7
1992	6.2	30.4
1993	5.2	30.0

Source: Wilcox (1993, 84).

However, reducing MIRAS has hardly leveled the tax playing field for housing investors. There is no tax on imputed rental income and no capital gains tax for homeowners. Private landlords are taxed on income and on capital gains and receive no asset allowances. The nontaxation of capital gains, combined with transaction costs and taxes that are lower than those in other European countries, underpins the high turnover and trading-up propensity of U.K. homeowners.

Other special measures to promote low-cost homeownership were largely delivered through housing associations, and although they will have growing significance in the 1990s, they were modest in scale. Much more important to ownership growth were progressive financial deregulation and the general background of inflation.

Deregulation and inflation. Financial deregulation has been a complex and changing process since 1979, and it is not described in detail here; for a brief description, see Maclennan (1993). The key consequences of deregulation for ownership expansion were the following:

1. In the early 1980s, competition from banks induced the ending of the building societies' mortgage rate cartel, leading to a market rationing process for lending (rather than queues), albeit at higher margins over base rates.

2. Changes in legislation in 1985 gave societies access to more diverse sources of funds, particularly to quotas of wholesale funds.

3. Building societies had to devise new internal lending or rationing rules in a context of fast-growing demand for loans.

There was surprisingly little innovation in mortgage instruments. In 1989, just under 10 percent of U.K. residents utilized fixed-rate mortgages. The building society variable-rate mortgage dominated provision. "Centralized lenders" entered the U.K. mortgage market from 1986 on, providing loans financed by mortgage-backed securities, but although they initially made 10 to 15 percent of new loans, their significance has declined progressively since 1989. Diamond and Lea (1992) concluded that the U.K. mortgage industry was extremely efficient, relative to five other countries, in raising finance. The lending effectiveness is another matter insofar as 1980s loans were subject to unprecedented default levels in the 1990s (see below).

Persistent inflation, rising again after 1987, helped homeowners and lenders alike. Inflation eroded the real value of mortgage repayments and decreased prospects of default. Mortgage insurance arrangements also generally meant that home values would have to fall £15,000 to £20,000 on default before societies made losses—mortgage insurers bore the brunt of defaults in the post-1989 downturn.

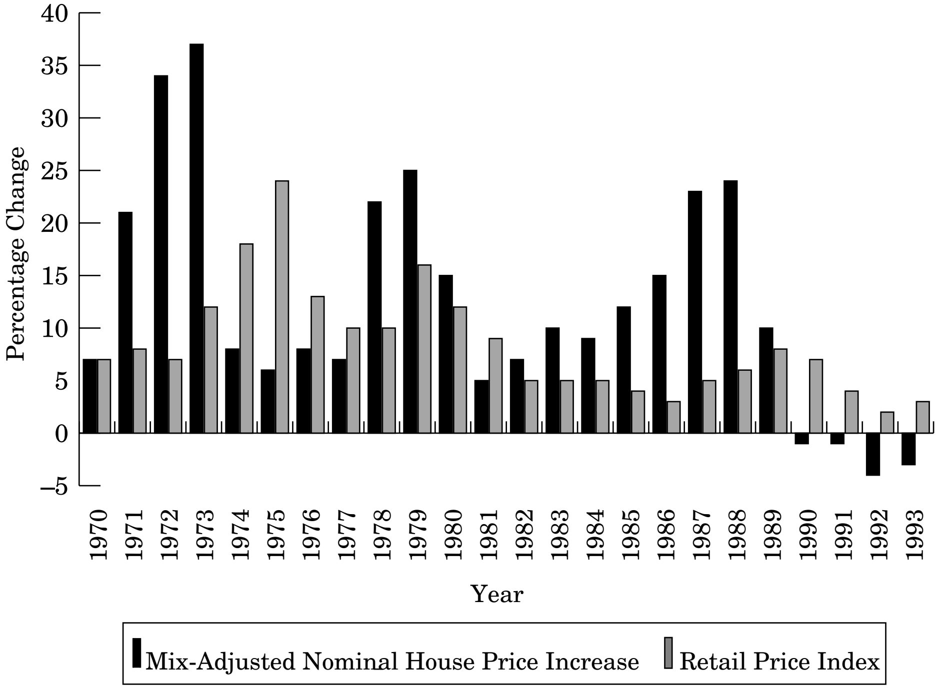
Demand-supply imbalances and prices. Fast demand growth with regional concentrations of expansion impacted on a housing system in which rental supply was heavily constrained by policy (see below) and supply was sluggish. There are few convincing estimates of housing supply elasticities in the U.K. Those that are available suggest a value significantly less than equivalent estimates in North America (Malpezzi and Maclennan 1994).

The fact that so much of the U.K. economic expansion takes place around high-density urban regions (with densities among the highest in the advanced economies) may be part of the explanation. The land-use planning system may also play a role, but the empirical evidence is inconclusive. Some local studies suggest that land-release policies raise land costs and have the adverse effects on housing and the economy claimed by Evans (1988). A recent cross-sectional study by Bramley (1993) disputes this view, although cross-sectional models are an inappropriate way to address such dynamic issues. But land costs, which vary around the regions, represent only 10 to 20 percent of house prices. Much more needs to be understood about why the U.K. housing industry is a high-cost producer, relative to North America.

Whatever the explanation, the U.K. housing system responds only sluggishly to demand pressures, but these demand pressures respond sharply to economic change. The consequence is that house price inflation is a recurrent phenomenon in the U.K.—and it has been so since the early 1970s and not just in the long boom of the 1980s (see figure 2). The typical postwar U.K. house price cycle (see Maclennan 1994) displays rising real and nominal house prices as incomes rise and interest rates fall.

Once a rise was triggered, U.K. house prices then tended to accelerate for a year or two with a frenzy of purchase and trading activity. Prices peaked as interest rate increases induced mortgage rationing and as deposits fell because mortgage rates were sticky. In previous cycles, after the peak of house price inflation, nominal house prices have tended to continue to rise, but real prices have fallen as general inflation rates exceeded house price increases.

Figure 2. **House Prices and the Retail Price Index in the U.K., 1970 to 1993**



Source: Council of Mortgage Lenders (1995).

The 1980s produced a very different boom-bust pattern. Real house prices rose from 1982 to 1989 and after 1986 had major inflationary impacts on the economy (Muellbauer 1990):

1. Interregional differences in house price increases induced wage pressures in southern Britain (see Bover, Muellbauer, and Murphy 1988).

2. The growing gap between housing wealth (which represented a third of personal sector wealth by 1990) and mortgage debt encouraged consumer spending, via equity withdrawal and rising consumer confidence, to grow significantly faster than incomes.

3. The near doubling of transaction volumes from 1984 to 1989 also significantly raised equity-extraction and move-related expenditures.

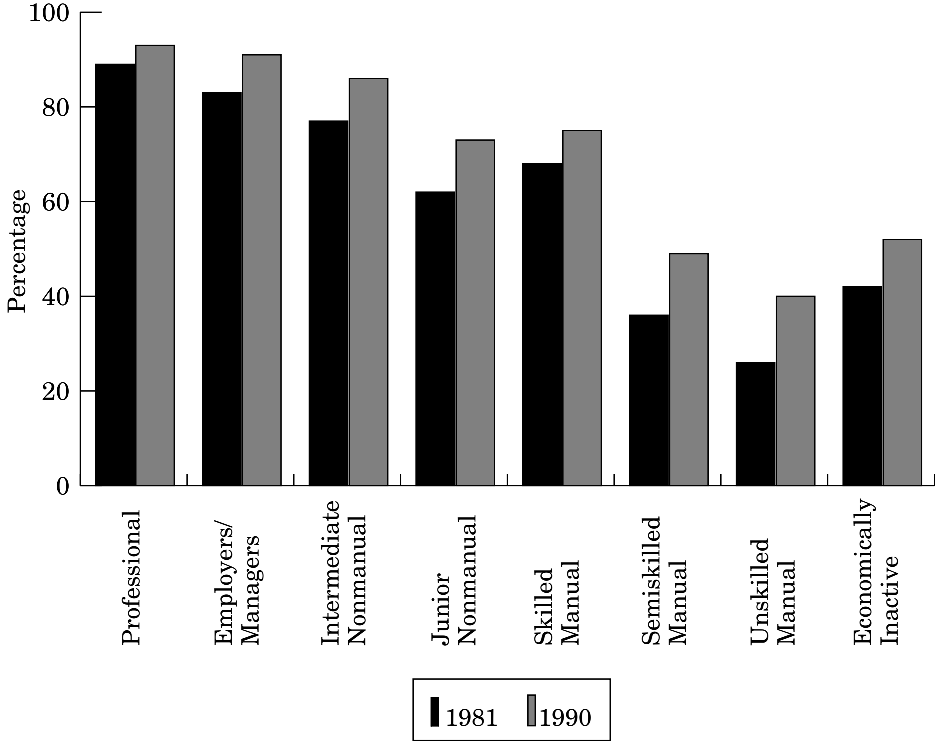
By 1989, the government was compelled to sharply raise interest rates and variable mortgage rates in order to stop the housing-led boom (see McCrone and Stephens 1995). However, it was implementing these macropolicy changes in an expanded and restructured owner-occupied market with several new characteristics:

1. Average loan-to-value ratios exceeded 80 percent for 1980s borrowers, and close to half of first-time buyers had 95 percent or greater loan-to-value ratios.

2. Loan-to-income ratios had reached record highs in the 1981–89 period.

3. Homeownership rates grew more rapidly for lower skill groups (see figure 3), and the sector consequently became more prone to job loss in recession.

Figure 3. **Owner Occupiers by Socioeconomic Group of Head of Household in Great Britain, 1981 and 1990**



Source: Central Statistical Office (1993a).

The consequences of higher interest rate burdens for homeowners (and the ensuing chain of mortgage arrears, home possessions, and falling nominal house prices) for the U.K. housing market in the 1990s are examined in the next section.

Homeownership growth was a policy success in that millions of households fulfilled their aspirations. Rising real house prices, which Prime Minister Thatcher lauded as a sign of economic success, reflected key failures of U.K. housing planning and markets on national and local scales. The ultimate consequences of overgrown owner occupation have been negative for the economy and damaging for particular groups. Implications for the future are examined later; however, it is also critical to understand how rental sector policies contributed to current difficulties.

Rental housing policy to 1989. Policies for the private and social rental sector contrasted sharply with each other and with owner occupation. Until the late 1980s, the government, apart from a few, early, minor liberalizations in relation to short-term tenancies (in 1980), took no purposive action to reform or expand private rental provision (see Kemp 1993). The council sector was, however, the setting for major changes in subsidies and investment controls. These changes have been consummately analyzed by Hills (1991). Only a brief overview of key impacts on the housing system throughout the 1980s is considered here:

1. While an average of 130,000 homes per year were sold under the RTB, associations built only 30,000 units per year and councils 15,500, and the social sector stock contracted sharply (by about a third).

2. The overall contraction rate tended to be greatest in southern Britain, where 1981 stocks of council housing (housing managed and funded by local housing authorities), inner London excepted, were already significantly less than in the North, thus making contraction greatest in the regions experiencing the fastest growth.

3. For much of the decade, annual real investment in council housing ran at about £1 billion, or about a third of the 1979 level (see table 7).

4. From 1982 until 1990, the rents of council houses rose faster than inflation and at just below the index for average earnings; as the council sector incomes were becoming poorer relative to average incomes, the gross rent-to-income ratio

was rising. Research for the Joseph Rowntree Foundation indicated that the gross rent-to-income ratio lay in the 25 to 30 percent range for social sector tenants (Maclennan, Gibb, and More 1991).

5. Rents rose in all sectors as a consequence of a deliberate policy of switching subsidies away from landlords and dwellings toward tenants, and Housing Benefit—a tenant-based, income-related rent rebate program—quadrupled during the 1980s, with 3.4 million tenants (just over 70 percent of tenants) receiving Housing Benefit or Income Support by the end of the decade.

6. The average net rent burden (after Housing Benefit) in the council sector was about 13 percent of incomes in 1989; however, the emerging subsidy pattern meant that those above the benefit cutoff now received lower subsidies in social renting than they would in owning.

7. A significant poverty trap existed for those on Housing Benefit, since income-related housing subsidy was withdrawn in absolute amounts almost equal to any increases in tenants' earnings (see Hirsch 1995).

Lettings and homelessness. Arguably the pricing and subsidy effects of these policy changes have been more important than declining stock opportunities, though both undoubtedly boosted the growth of homeownership. Most RTB purchasers were tenants who otherwise had no intention of rapid movement out of council housing, and many were long-term tenants in preferred stock types and areas. In consequence, until now, RTB sales are likely to have had a minimal effect on the volume or pattern of council stock available for letting. This effect is likely to become much greater toward the end of the century, when death rates of RTB purchasers will be rising. Further, reflecting the previous history of council housing development, re-let rates for the existing stock rose from 4.6 percent in 1980–81 to 6.3 percent a decade later. Indeed, while stock fell by a quarter, annual lettings of council housing in England fluctuated around 245,000 new tenants. With the housing association sector expanding new lettings after 1984–85, the number of social housing tenancies created each year did not decline at all in England (Maclennan and Kay 1994).

What did change over the decade, with major implications for the next century, was the composition of all lettings. The proportion of gross lettings to existing tenants making moves within council housing fell throughout the latter half of the period, reflecting increased difficulties of matching households to existing housing stock. In relation to new tenancies, statutory homeless entrants progressively displaced waiting list applicants. Lettings by the homeless constituted 16 percent of lettings in 1981 but 39 percent by 1991–92.

Street homelessness, according to the 1991 census, affected 2,852 people in Britain (Office of Population Censuses and Surveys 1992), though the housing charity Shelter has claimed that the number of "rough sleepers" was 10 times that. Homelessness on the streets is not the critical issue that it is in the United States, for instance. It is also important to recognize that the U.K. defines homelessness in a very specific fashion.

Homelessness, as defined in the Homeless Persons Act of 1978, refers to households that do not make themselves intentionally homeless and that are deemed by councils to meet priority need requirements (see table 9). Low income, overcrowding as families grow up, and relationship breakdown underpin the vast bulk of homeless applications and acceptances. Homeless acceptances grew by 113 percent from 1981 to 1991, and they grew most rapidly in the regions of Britain with fast growth or declining stock. In London, by 1991–92, 65 percent of new leasings were to homeless applicants, compared with just over 25 percent in northern Britain.

Table 9. **Homelessness: Category of Priority Need, 1992 (Percent)**

Category	Greater London	Metropolitan Districts	Other Districts	England
Dependent children	58	56	69	62
Pregnant member	17	10	14	13
Vulnerable member				
Domestic violence	2	10	2	5
Old age	5	3	6	4
Physical handicap	6	3	3	4
Mental illness	6	4	3	4
Young	1	7	2	3
Other	4	5	2	4
Homeless in emergency	1	1	1	1

Source: Wilcox (1993, 152).
Note: Percentages may not add to 100 because of rounding.

Rental supply too restricted? Two key statistics suggest that homeownership growth has displaced social housing by too great a margin:

1. In England, the number of homeless households in temporary accommodation (the bulk now leased from private sector landlords) grew 12-fold from 1981 to 1991, with 60,000 households affected by 1991.

2. In the housing market downturn of 1989 to 1994, some 300,000 households had their homes repossessed.

A variety of national housing needs assessments have been undertaken for England, most recently by the Housing Corporation. They all suggest that a program of 100,000 units per year is required, whereas actual programs generate only half that number. Such studies have their limitations, but there is clearly an underprovision of affordable homes in southern Britain. In the North, the issues are primarily about stock quality (also a problem in the South) rather than overall supply. In consequence, in the 1980s, government policy tightened rental housing supply the most in the areas of rapid growth and high real house price inflation, thus exacerbating the negative economic consequences of market instability.

From 1982–83 until 1989–90, the government steadily expanded the volume of renovation investment within council housing (see table 7). And as the decade progressed, new financing mechanisms and more integrated approaches to estate renewal were adopted. Indeed, better estate management, tenant participation, and effectiveness in housing management were important themes widely advocated by the Department of the Environment before they commanded significant support from councils. It is, however, not unfair to say that modernization expenditure was inadequate in relation to stock deterioration and, even worse, the growing concentration of poor and sometimes problematic households in particular estates. British academics have generally and stoutly dismissed the notion of an underclass. But with changes in the housing system and the labor market, there are more instances of three generations of the same family, all under 50, living in close proximity with no active labor market connections. Violence, crime, and alcohol, drug, and solvent abuse are acute problems in such localities, and health and educational standards are often low.

Is it just that the housing policy changes of the 1980s have more sharply sorted out income groups into different niches? Or do spatial concentrations of poor housing and poverty-trapping benefit systems reinforce the difficulties? There are no clear answers to these questions—revitalization programs have yet to be evaluated over adequate periods. But the answers are now vital if British cities are to remain civilized.

These issues were forcibly recognized at the end of the 1980s. After almost 10 years of a purely negative view on rental housing, new legislation was promoted in 1988. That legislation was rooted in government's opinion that Britain needed a more robust rental sector, without any new reliance on councils. The emphasis was to be on the promotion of the independent rented sector, a label embracing both housing associations and private landlords. At the same time, the market boom of 1986 to 1989 turned sharply downward. The most recent five-year period, from 1989 to 1994, has generated a new context for assessing the adequacy of U.K. housing policy.

Dawn's early light or twilight's last gleaming?

Reforming rental housing

After the 1987 general election, there were the beginnings of a reappraisal of U.K. housing policy. While ownership growth was to remain the principal objective of housing policy, there was a new awareness of the run-down condition of estates in the council sector and a recognition that not all households could afford homeownership. Since the government still regarded councils with some disfavor as managers (and councils were increasingly encouraged to adopt the role of enablers), other channels for investment in affordable housing had to be opened.

The thrust of legislative change and policy after 1988 was to essentially create a pluralistic and competitive or contestable social housing sector. Housing associations were chosen to lead this process because they were regarded as having a number of advantages:

1. They were not councils.

2. They were often locally based.

3. Many involved tenants in management.

4. They had a reputation for good, but often expensive, service provision.

Associations are grant funded and are supervised and monitored by the Housing Corporation in England, by Scottish Homes in Scotland, and by Tai Cymru in Wales. For the first time in the history of U.K. housing policy, associations dominated new investment in affordable housing from 1989 to 1993.

Although new lettings in the private rental sector were deregulated in January 1989, that sector was essentially rejected as a major alternative vehicle for providing low-income housing. Except in Scotland, where private landlords could receive capital grants of up to a third of costs, there were no new rental investment incentives outside of the Business Expansion Scheme, which gave deep tax-sheltered subsidies (of about half of capital costs) that attracted more than £1 billion of investment during its five-year life span and provided around 40,000 units for generally above-average-income households (see Kemp 1993). But, as with so much of the 1988 Housing Act, grand ideas for a different kind of rental housing sector have not been fulfilled because of the inadequate design and level of government support for the key fiscal instruments (see Crook, Hughes, and Kemp 1995).

The net effect is that through the 1990s downturn, homeownership has continued to grow, housing association funding rose and then fell, council investment has been as severely restrained as in the 1980s, and there have been few signs of the creation of a new commercial rental sector, though private rental provision appears to have increased since 1989.

Why did so little change, at least at the aggregate level? Are the priorities and mechanisms of the 1988 reforms likely to lead to a better U.K. housing system if left in place to the end of the century? The rest of this section considers the intents, strengths, and weaknesses of the policy measures in the council, association, and private rental sectors.

Council sector

Legislative change at the end of the decade imposed new and tighter controls on capital spending and subsidies for local housing authorities in England and Wales. (In this important area, as in others, Scottish housing policy diverged from that of the rest of the U.K.)

In the earlier part of the 1980s, the geographic pattern of council house sales receipts did not closely match patterns of investment needs, and the government (except in Scotland) required councils to retain and not spend significant volumes of receipts. By 1988, councils had around £5 billion of unspent receipts. After 1990, each authority received capital spending limits that contained essentially three components: a permission to borrow, a level of sales receipts that could be spent, and spending from rental surpluses. This system enhanced geographic equity, since the borrowing entitlement was calculated allowing for expected sales receipts. Surplus receipts, with the exception of the deep recession year of 1992–93, were largely to be used to repay outstanding housing debts. Control was still tight, though markedly fairer.

Subsidy arrangements were also changed, arguably to tighten control and enhance fairness. Before 1990, as councils followed guideline rent increases, those authorities with lower costs (usually because they had older stock and lower debt repayments) had generated surpluses on their historical cost accounts. In other locations, council housing accounts were still subsidized from local taxation. To make this pattern more rational, the government sensibly “ring-fenced” housing accounts—where ledgers had to be balanced on the basis of rental income and the declining total of central government support for local authorities. Authorities were also required to use surpluses to offset Housing Benefit bills.

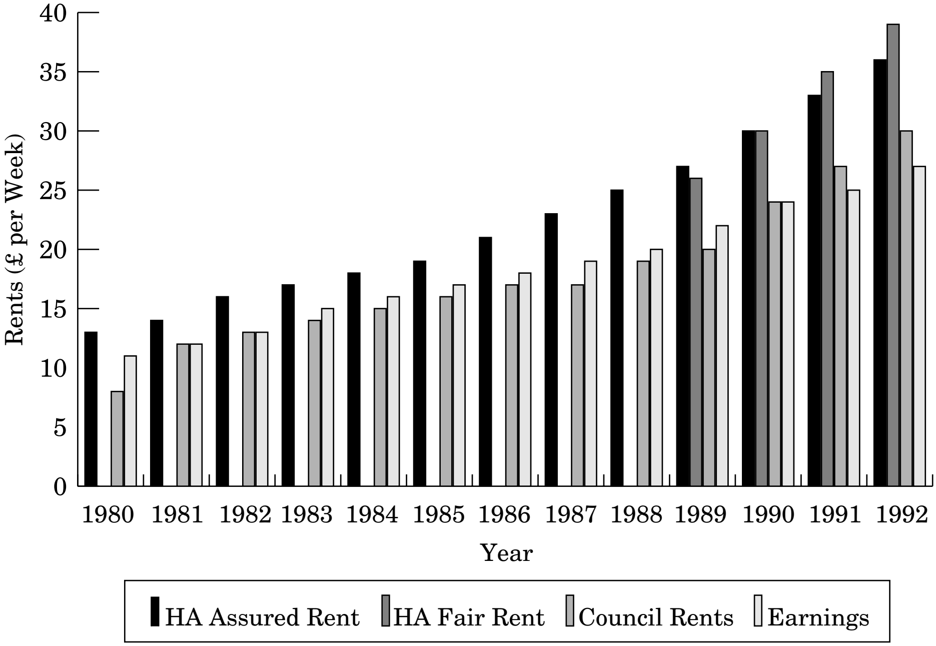
The reform also, and again sensibly, addressed the haphazard pattern of average rents across different local authority areas. Guideline, or notional, rents were calculated for each authority by assuming that a notional rate of return (around 2 percent) could be earned on the council stock. The basis for this calculation was the value of council stock being sold. The formula was implemented on a gradual basis, but rents nonetheless rose faster in the pressured South than in the North, adding impetus to ownership growth in the long-term pressured regions.

This major policy change involved an important sin of commission and a critical sin of omission. The key error was in selecting council house disposals as a basis for valuation. The sales involved a biased sample of better homes, and these houses were bought by a selection of more affluent households; even then, they were only sold with a 50 percent discount. Clearly, such values seriously overstate what the remaining tenants would pay for their homes in a market. Indeed, recent research for the Joseph Rowntree Foundation (Maclennan 1994) suggests that in some areas of southern Britain, council rents are now above appropriately defined market values. Further, large-scale voluntary transfers (LSVTs) have involved unit valuations of less than half of RTB sales prices.

The essential omission involved the failure to ensure consistent rent setting within authorities. Local authorities select their own pricing schemes. In 1989, rents within authorities were usually set by flat structures, and rents were not closely related to dwelling quality (Maclennan, Gibb, and More 1992). In consequence, rents play a minimal signaling role within authorities and, even worse, may lead to a significant waste of Housing Benefit.

These intracouncil rent-setting issues will become even more important in the decade ahead. Since 1989, council rents have risen faster than average earnings (see figure 4) as tenants have become poorer and as house prices have fallen. In southern England, council rents rose by 60 percent as house prices fell by half that amount. Arguably, council rents had to rise for the independent rental sector (associations and private landlords) to invest without growing public subsidies.

Figure 4. **Rise of Social Housing Rents and Earnings in England, 1980 to 1992**



Source: Wilcox (1993, 112).

Transfers and competition. The 1989 reforms were not focused solely on rents and capital spending controls. New routes were created to facilitate tenant and stock transfer out of council housing. Tenants, as individuals, were given the right to transfer their dwellings to other landlords. Collectively, they were also encouraged to seek transfer of council stock in the areas in which they lived to alternative landlords—through the LSVT process. Few tenants have exercised their individual right to transfer, and it is now a forgotten element of change. On the other hand, by 1994, 33 councils had curtailed their direct provision role through LSVT. Most were smaller, semirural, and southern councils. Two powerful financial incentives drive transfers. First, a rent surplus authority can transfer stock to an association with the association, unlike the council, making no contribution to local Housing Benefit bills. Second, associations may have access to higher flows of capital spending—including grant aid from councils with a net receipt from LSVT.

Since 1991, LSVT flow has been limited by the Department of the Environment or, more probably, the Treasury. A wider use of LSVT could see investment rates and Housing Benefit bills in social housing increase. Fiscal stringency has overruled the desire for landlord pluralism. But it is also increasingly debatable, in relation to both LSVT and association growth in other areas, whether pluralism equates with competition or contestability. As long as social housing is under demand pressure, it is not at all clear how pluralism enhances competition—in effect, one rationed monopolist replaces another in the eyes of tenants. Pluralism may have created competition for investment funding at regional and national levels, but locally little has changed in the U.K. housing system.

Progress. If pricing and pluralism have involved both positive and negative developments, there have also been some unambiguously positive changes in council housing in the past five years:

1. Central government has continued to promote tenant involvement, information, and training, and many local authorities have also sought their own innovations in effectiveness.

2. Housing modernization schemes are now usually public-private partnerships and increasingly embrace strategic and integrated approaches linking housing change to initiatives in employment, crime, and other areas.

3. The organization of housing management has changed markedly for the better, and performance monitoring has become the norm rather than the exception.

These observations are important for the future. Council housing in 1994 is no longer the system that was so vigorously attacked from 1980 on. The client group is now almost universally poor. Modernization is increasingly imaginative and often cheaper than associations (which are undertaking declining amounts of rehabilitation in England). The performance culture has spread in management; it will be reinforced by compulsory competitive tendering for management services after 1995. From then on, local authorities will be required to offer up a range of management services for open competition, usually in the form of three-year service contracts. Council management costs still lie well below those of associations (Bines et al. 1993). The real issue now is whether policy, by achieving all these changes (which would not have occurred widely without central government action), has created a new council sector that should be allowed to compete for a larger share of investment funds and on the same terms as housing associations.

It is probably more likely that government will encourage and endorse the formation of local housing companies—that is, companies that would operate at arm's length from councils and involve a minority council representation on boards. The threat of compulsory competitive tendering, for staff as well as councilors, may assist this change, as may the critical consideration that such companies would, in part, invest outside the limits of the U.K. definition of public expenditure. With falling RTB sales, there is also the prospect that the disposal of stock to such companies would generate badly needed housing capital receipts to the U.K. Treasury.

All this suggests potential new challenges to the favored public funding position of housing associations. It is now pertinent to consider how the policy position of associations gained such prominence in 1989 but is now increasingly challenged.

Housing associations: New dawn?

Housing associations involved in providing affordable homes are essentially not-for-profit organizations registered (in England) with the Housing Corporation for subsidy purposes. There are more than 2,000 associations in England alone, ranging in size from 25 to 25,000 units. Some work in a single neighborhood and others throughout the country; some specialize in meeting particular special needs, and others provide general family housing. The sector in Scotland (supervised by Scottish Homes) is composed predominantly of community-based associations undertaking area rehabilitation. The Welsh sector (supervised by Tai Cymru) is more like that in England, but still different from it.

At the end of the 1980s, associations housed just over 3 percent of British households (in contrast to councils' 26 percent). However, associations' preferred position in public funding was such that in England in 1992, associations completed 20,000 new rental units and councils 1,400. The new rental priorities of the late 1980s resulted in a near doubling of association output between 1989 and 1992. Output is now set to fall. Why?

The 1988 Housing Act created a new funding framework for associations that included several key points:

1. It was accepted that the private loan component of development would, regardless of how much it was underpinned by grant aid (known as Housing Association Grant [HAG]), be regarded as private rather than public spending. This favored associations as conduits of public investment.

2. HAG assistance limits were to be preset (in England and Wales but not in Scotland) by area and scheme type and not determined as a residual. Previously, in-contract cost increases inevitably fed into higher HAG per house.

3. Housing association tenancies were now to be "assured" (acquired through the private market) rather than "secure" (obtained as of right), and rents were to be set by associations, bearing in mind affordability, rather than by government rent officers.

It would be unfair to conclude, for England, anything other than that housing associations responded rationally and extensively to the new regime. Some of the consequences are unambiguously positive, but others are questionable and essentially reflect flaws in policy design. Key changes have included the following:

1. Significant internal reorganization of associations, particularly larger ones, has put a new emphasis on finance in association decision making. However, the same changes have, in some places, reduced tenant influence on management committees and created tensions between informed officers and voluntary members inexperienced in financial

affairs. In consequence, is voluntarism being squeezed out, and are associations becoming expert and development led? Are they becoming more like councils?

2. Associations in Britain are now using close to £1 billion of private investment finance, much of it raised on conventional loan instruments from building societies and banks, as well as some borrowing from the capital market via the Housing Finance Corporation, though equity investment routes have not been developed. But is this funding really efficient? Have funding institutions, which often have little expertise in social housing and sometimes little interest, really enhanced efficiency? Recent experience in the housing market casts doubt on the efficacy of the industry in assessing lending opportunities.

3. HAG rates in England and Wales (but not in Scotland) have fallen below 70 percent and are set to fall below 60 percent. These reductions have been facilitated by recent low interest rates and falling land costs in southern Britain. There are signs of other cost reductions in development, including standardized designs, buying in the marketplace, and larger scale developments. But there are concerns that dwelling sizes and standards are falling and that larger association estates are becoming dominated by Housing Benefit recipients. Are associations becoming more like councils?

4. Association rents on assured tenancies rose even faster than council rents between 1989 and 1992—by 55 percent in comparison with 31 percent. There has been a long and imprecise debate on affordability in the U.K., and, unlike the governments in Canada and the United States, the U.K. government has been unwilling to specify appropriate ratios (or, better, residual incomes—that is, net equivalent income minus housing costs). But the net effect has been to significantly raise payment burdens for tenants not receiving Housing Benefit. Are associations becoming more like councils?

It was argued above that pluralism per se does not create competition in housing service provision, though it has increased competition in securing public funds and in some parts of the development process. After five years of the new regime, it is apparent that policy changes have created an association sector that is complementary to, rather than competitive with, council housing. In preparing local housing plans and funding bids, councils now, largely, strive to maximize association funding inflows into their areas. In turn, councils have sought and used increasing rights to nominate their waiting list clients for around half of association tenancies. There are advantages from this pluralism in decision making, but equally there must be planning and management disadvantages in larger councils forming liaisons with and coordinating the actions of up to 40 local associations. A coherent framework for local integration must be developed to cope effectively with the new pluralism, and this issue is raised in the final section.

Turning again. Prospects for the association sector now seem somewhat less rosy. Recent expenditure plans (see table 10) have proposed a reduction in HAG rates and development programs with a significant switch from social renting to association provision of low-cost homeownership. A further tightening of affordable rental provision in southern Britain now seems inevitable.

Table 10. **Housing Corporation Approved Development Program, 1994 to 1997 (Million £)**

	1993–94	1994–95	1995–96	1996–97
Rental housing				
Mixed funding	1,267.5	1,080.3	859.1	818.0
Public funding	146.7	55.9	103.1	117.7
Short life housing	12.1	19.6	19.0	18.0
Miscellaneous works	93.4	74.5	77.5	79.7
Total	1,519.7	1,230.3	1,058.7	1,033.4
Incentives and sales				
Tenants' incentive scheme	75.0	81.6	93.2	100.9
Do It Yourself Shared Ownership	130.0	92.8	170.2	204.2
Shared ownership	101.7	98.3	104.2	112.4
Total incentives and sales	306.7	272.7	367.6	417.5
Other expenditure	2.0	12.0	52.0	52.0
Total gross expenditure	1,828.4	1,515.0	1,478.3	1,502.9
Receipts	50.0	58.0	58.0	58.0
Total net expenditure	1,778.4	1,457.0	1,420.3	1,444.9

Source: Wilcox (1994, 143).
Note: Figures for 1993–94 are estimated outturns, those for 1994–95 are planned, and those for 1995–96 and 1996–97 are indicative. Figures exclude the Rough Sleepers initiative and City Challenge funding, apart from £324.4 million included in 1993–94.

But why is government now shifting away from the emphasis developed in 1989? The shift does not seem to be based on a reasoned review of association progress since 1989; rather, it appears to be politically driven. The Housing Market Rescue Package of 1992 often led associations to purchase larger volumes of homes on homeowner estates, but the rent levels meant that houses were let to Housing Benefit recipients. The political backlash has been considerable within the Conservative Party. And perhaps there is a wider recognition that associations, like any other provider, require deep public subsidies to adequately house the poor.

These are essentially negative reasons for review of association progress. There are also legitimate reasons that have received little attention. As new potential providers of affordable housing emerge, including local housing companies and private landlords, and as councils have improved their performance, there is an urgent need for government to review the provision of affordable rental housing in Britain. Critical issues concern dropping tenure as an issue and considering appropriate roles and competition overlaps for different providers. Equally, there has to be a review of the balance of producer and benefit subsidies given the benefit-dependent status of all low-income tenants, regardless of their tenure.

In all these post-1989 changes in the rental sector, the dog that didn't bark was commercial investment in private letting. Recent revised statistics have indicated that the sector has expanded since 1990, and more detailed local studies have indicated a positive response to the 1989 deregulation, albeit on a small scale (Gibb 1994). The Business Expansion Scheme, terminated at the end of 1993, also had a positive effect on supply. However, much of the sector increase may be attributable to moving owners unwilling to sell homes in falling housing markets. Housing market recovery could remove this rental stock and, if prices rise, begin to reinforce the yield gap between homeownership and rental housing provision. The U.K. government has failed to learn the lesson from the United States and European countries that deregulation is not enough to encourage large-scale investment in rental housing. The potential importance of an expanded near-market sector for Britain is better understood if the bust experience of the U.K. housing market from 1989 to 1993 is considered.

Homeowners in trouble

The downturn of the U.K. housing market and its wider economic effects are discussed in Maclennan (1994). A brief summary of the key arguments follows.

The sharp increase in interest rates to cool the housing-led boom in 1989 had rapid contractionary effects on the economy. Builders, who are highly dependent on bank finance, quickly reduced housing starts and completions in the market. Starts fell from 280,000 in 1988 to 120,000 in 1992. Existing homeowners seeking to move quickly withdrew from the market, and transaction volumes halved within two years. The number of first-time buyers also fell. Further, nonmovers faced with sharply increased mortgage rates interacting with high, variable-rate mortgages reduced equity withdrawal and general consumption. Younger households and recent purchasers (post-1987), especially in southern Britain, quickly ran into housing payment difficulties.

The consequences of the economic contraction were felt disproportionately in the more debt-exposed southern regions. And in these regions, with their smaller social rental sectors, unemployment following contraction was quickly reflected in the owner-occupied sector—this critical feedback loop was much less important in the North and Scotland. Downward pressure on house prices was most apparent in the South (between 1990 and 1993, nominal house prices fell by a third in the Southeast but not at all in Scotland).

Falling house prices reinforced the downturn. Payment arrears quickly matured into possessions, and by 1994, 250,000 owners had lost their homes and 150,000 households still had arrears exceeding 12 months. Possession sales further fed house price drops, and negative equity affected an estimated 1.5 million owners.

The groups and places that had been most involved in the 1980s boom were also those who lost most in the downturn. The housing market slump deepened and prolonged the recession. It also gave credence to a view that British housing policy needed to be radically rethought to pursue sustainable rather than maximal homeownership, and that growing labor market flexibility made such rethinking all the more essential.

An alternative view, which stems from ideological wishful thinking rather than sound economic analysis, is that policy change is not required because individuals and institutions will have learned new rules of the game. But even if that were true, what choices do U.K. households actually have in the near future? Social renting is tightening, and private renting is stagnant. Newly wary households still have a fiscal advantage in buying, even if it is reduced. But the clinching argument is that government has recommitted itself to further expanding ownership—an appropriate measure for Scotland and the North but a commitment that, if fulfilled, will increase instabilities in the southern housing market. Government needs to face the competitive economic challenges of the times rather than tilt at windmills demolished in the 1980s.

Challenges for the future

Easier times?

The future demography of Britain to 2001 is hardly a daunting one by international standards. Population and household numbers will be growing, but at a lower rate than in the last decade. The population and the labor force will be maturing, but that maturation will largely be in the preretirement age groups (though there will be longer term increases in rates of dependence). This implies that there will be reduced pressures on entry routes into the housing system but more concern about careers and quality within it. In the social sector, the impoverished nature of 1980s entrants means that few will exit the sector or buy their homes. There will be new concerns about how households move through a smaller and more fragmented social housing sector. In the market sector, households that are already relatively affluent will be earning higher incomes and receiving inheritances, largely in the form of houses. More high-quality and high-value homes will be needed, and urban centers must respond to that challenge if suburbanization is not to be exacerbated.

Specific economic forecasts are much less firm. The only certainties will be growing competition in the world economy and the need for economies to be flexible in the face of rapid change. U.K. economic policy is, in that context, heading in the right direction. GDP growth forecasts for the next few years are about 2 to 3 percent per year. The real economic issues relate to the labor market. Labor market flexibility is already apparent in the current upturn: Short-term contracts, part-time jobs, and higher female economic activity rates are replacing long-term male jobs. This change calls into question the wisdom of increasing homeownership rates for young households. There is also a concern that growth will be relatively jobless—this is the European Union's expectation, but it is belied by recent U.K. experience. If U.K. cities are to remain civilized and the poorer areas to be truly regenerated, then more purposive action will be required to reduce unemployment. Housing Benefit policy runs counter to that objective, and there must be a concern that the U.K.'s £2 billion-plus housing-led regeneration projects will not achieve sustainable regeneration.

Public expenditure to support social transfers and public investment is likely to remain heavily circumscribed. The record U.K. public sector deficit is falling but is structurally as well as cyclically driven. Taxation is more likely to decrease than increase toward the 1997 election, and international competition will limit single-nation tax increases. In the housing context, there would be much merit in removing as much housing spending from the budget as possible (in relation to investment). But with whatever budget is available, the U.K. could do better and create a more effective housing system. Three key areas of housing policy challenge exist now: sustainable owner occupation, efficient pricing and contestable subsidies in rental housing, and a new governance framework for local housing policies.

Sustainable owner occupation

The U.K. has to put in place an owner-occupied housing market that, in the context of growing labor market flexibility, is more stable in relation to the general economic cycle. A housing market system is also required that more effectively translates growing incomes into increased housing output and not into rising real prices.

There are a number of measures that could assist in that regard. Government should drop aspirational targets for homeownership and concentrate on forecasting and facilitating regional targets of numbers of homeowners that can be maintained through cyclical downswings in the economy. Reductions in MIRAS have reduced the yield gap between owning and market renting, and white paper proposals in 1995, if implemented, will further reduce that gap. By mid-1995, private rental housing investment may be held back by political uncertainty (about what a possible Labour government after 1997 would do to private renting) rather than tax and demand-side influences.

Looking to the longer term, government has to develop a housing market rather than a housing tenure policy. Consumer information, valuation, and sales systems should be scrutinized. On the supply side, there must be renewed efforts to increase production sector productivity and to secure the elusive goal of land supply policies that do not inflate housing costs but at the same time meet environmental objectives. This is a particular dilemma because market-led economic growth will be concentrated in southern Britain.

At the macropolicy level, it is unlikely that monetary and fiscal policies will foster national real house price increases at anything like 1980s levels. The most likely scenario to 2001 is that nominal U.K. house prices will move much as general prices do. Unearned housing capital gains will play a lesser role in the U.K. economy.

Efficient pricing and contestable subsidies in rental housing

The policies of the past decade have restricted social housing investment and substituted Housing Benefit for producer subsidies. An overtight rental housing system with unsystematic pricing rules merely fuels overgrowth of low-income owner occupation and wastes Housing Benefit, which may trap households in dependence.

Government, at the end of 1994, decided to restrain future rent increases in the social rental sector, recognizing that rising rents (via benefit and other claims) now led to a net increase in public expenditure. This implies a growing significance for producer subsidies if social investment is to expand. It is also possible that transfer of municipal stock to companies outside the public sector—an idea being discussed in different forms by government and opposition—could generate new sales receipts to fund subsidies.

If local housing companies and housing associations do progressively capture the municipal stock, then U.K. social housing will have an ownership structure more similar to that of West European countries. The peculiarly British “municipal monopoly” will have ended. And there are also signs that the present government now intends to make producer subsidies for the production of low-income housing available to the private sector as well as housing associations.

Whether or not structural change takes place in social rental housing, the U.K. government will have to develop more explicit affordability policies and consistent rent-setting approaches. The disorder in rent levels and rent increases that occurs across the different administered sectors is unusual by West European standards and is unnecessary. Private financing of not-for-profit housing, or regulated rental sectors, does not require a complete absence of central government control over rent setting; it does require regulation to offer adequate security and returns to investors.

More orderly rents would mean a more efficient use of Housing Benefit. The key issue facing rental housing policy in the U.K. will be to redesign the Housing Benefit system. It is clearly absurd to spend billions on housing support that discourages many tenants from work while they reside in areas of poor or deteriorating service provision. There is no easy answer to this issue, and it will not be resolved by marginal tinkering with the parameters of the benefit system.

A new governance framework for local housing policies

In the future, there will be a pluralistic provision of housing to meet needs. Further, there will be a growing reliance on helping low-income households fulfill their requirements in the housing market. Policy requires a new conception of needs, assisted demands, and general demands at the local or regional level. Attention must be given to how the new diversity of means can be effectively integrated to meet housing policy ends. At the same time, there must be a wider effort to locally integrate housing with urban, environmental, and local economic policy objectives.

The government has already begun to address some of these issues. In the future, borrowing permissions for local authorities and allocations of Housing Corporation funds to support housing associations will be made on a consistent basis. Since 1994, the creation of a single urban regeneration budget has resulted in local authorities submitting integrated bids, embracing housing and other components, for regeneration funds. That process gives a new impetus to local vision formation, public-private partnership, and cross-departmental cooperation within the public sector.

However, the implied governance pattern is rather confused. Local authorities, because of their cross-sector role and immediate local accountability, should be given the key role of vision former and enabler. The Housing Corporation, since it operates regionally, should be given a key role in forming, with local authorities, metropolitan-area-wide housing strategies (in Scotland the equivalent organizations are already developing such a planning process along with the central government). The Housing Corporation, or a new national body, should be given supervisory and monitoring powers to scrutinize the effectiveness of all subsidized providers of low-income rental housing and not restrict its focus to housing associations.

Tenant and community involvement has evolved rather slowly and in patches in the U.K. More widespread involvement could be promoted. Most commentators agree that tenants should have some role on the boards of housing associations and local housing companies. But there is also scope for a more Scandinavian approach, wherein there is a tenants' council associated with each landlord.

Making the case for housing

Arguably too much of U.K. housing policy expenditure is wasted on national ideological priorities and, at the local level, in allocating cash to deal with symptoms rather than causes. At the national level, a new vision is needed of what housing does, good or bad, for the economy and what bad housing means for public spending on crime, health, and the environment. This requires an honest assessment by government of housing's role in the economy and society and a better argued case from housing lobbies.

At the local level, vision is also required. Cities have to ask what estates and neighborhoods are for. And in asking that question, a more holistic view of the local role of good and bad housing must emerge. Clear visions, competitive resource allocation, and real public-private partnerships—not just rhetoric—will be required to create a housing system that uses markets and social providers to meet individual and societal aspirations. Britain can do better.

Author

Duncan Maclennan is Director of the Centre for Housing Research and Urban Studies at the University of Glasgow.

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