compass

DIRECTION FOR THE DEMOCRATIC LEFT

thinkpieces

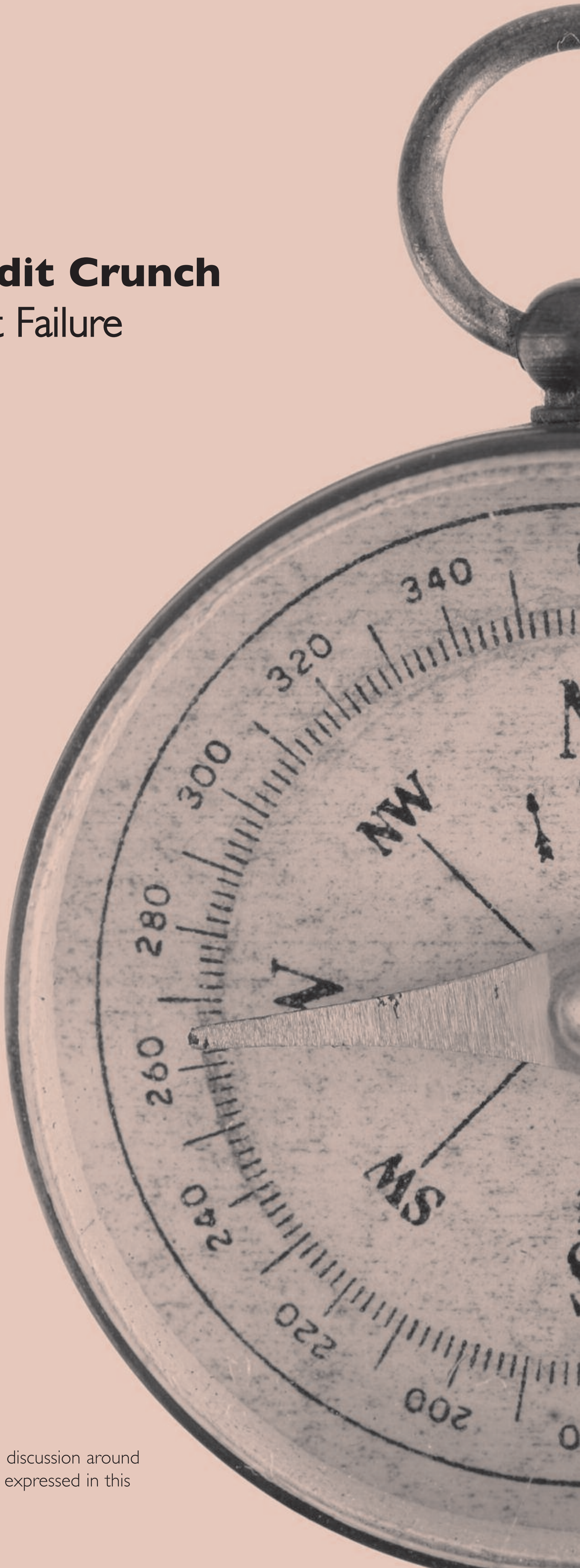
Housing and the Credit Crunch

– Government and Market Failure

By Duncan Bowie

compass

Housing and the Credit Crunch
– Government and Market Failure



> *"The idea of such a crude direct relationship between new building completions and house-price inflation ignored more external economic factors. Well, these external economic factors have now hit. It is not just the housing market which is in disarray, but the government's housing policy as a whole"*

Housing and the Credit Crunch

– Government and Market Failure

The obsession with home ownership

Much of Compass's recent work has focused on the inadequacy of markets to deliver our policy objectives. The current housing credit crunch has highlighted how misguided the Government has been in relying on markets to deliver its housing policy objectives. The case for a fundamental change in the Government's housing policies is now difficult to contest.

In 1997 Tony Blair inherited two fundamental ideological assumptions that had driven government policy on housing from the Thatcher/Major period: that home-ownership was the essential basis of citizenship and should be promoted, and that the market could be relied upon not just to deliver market housing, but also to enable the provision of affordable housing.

The reason for New Labour adopting such basic Thatcherite neo-liberal ideological presumptions still remains difficult to understand, and historians can no doubt ponder whether these principles, though relatively newly established, were adopted by default or by intention. New Labour recognised that Thatcher's policy of council house sales was a popular in winning over the votes of middle income and 'aspirational' working class voters and that any proposal to repeal would be an electoral mistake. New Labour also accepted the simplistic view that as most poor households lived in council housing, it was their housing status that conditioned them to dependency and that home ownership would somehow liberate them from this constraint. The Government argued that they were responding to consumer choice and if surveys showed that 90% of households wanted to be home owners, then it proved home ownership was a good thing and that government in promoting it was doing what the people wanted. Few of the surveys actually asked households whether they could afford to buy a home and whether they thought that they might be able to do so in the foreseeable future.

Nevertheless, the Government focused its policies on encouraging more households to become homeowners, creating a range of routes to homeownership, including a succession of schemes targeted at professional middle- income households providing public services, defined as 'key workers'. This used up increasing amounts of government investment resources to the extent that by 2006/7, Government through the Housing Corporation was funding nearly as many households to buy homes as new rented homes to be available in perpetuity for lower income households.

Government also encouraged, or at least did not use the Bank of England or the Financial Services Authority to in any way discourage, the availability of mortgages to prospective purchasers on terms that were neither sustainable for the borrower nor for the lender. Compared with more traditional arrangements requiring a 5% deposit and lending on 95% of property value assuming a loan of 3.5 household income, with the credit boom, and the widening of mortgage lending beyond the pre-existing Building Societies, loans of 110% of value on multipliers of 5:1 or higher became commonplace. Moreover with the government encouraging shared ownership schemes, initial equity purchases fell from the norm 50% initial share to 25% or even as low of 15% - so marginal home owners could end up paying up to 50% of their net income for a relatively small share of a small flat with little hope of staircasing to a greater share and still paying the rent on the unpurchased equity and the repairs costs – not a very good deal. Yet the government persuaded both itself and these new 'home owners' they were on the home ownership ladder and therefore were good citizens with a 'stake in the country' even if all they actually owned was a debt to a lender in relation to the toilet and possibly kitchenette in a studio flat. Not content with the fact that the proportion of households who were homeowners had increased from 27% in 1918 to 71% in 2003, the Government sought to increase this further to 75%, a target which does not seem to have been based on any assessment of affordability.

Just as successive Ministers, including most recently Ruth Kelly, Yvette Cooper, Hazel Blears and Caroline Flint, have seen promoting home ownership as the first priority of Government housing policy, they have made the achievement of the second and third priorities – the decent homes target and the provision of new social rented housing more and more dependent on private sector finance – i.e. on market profit. The public sector housing renewal programmes have increasingly depended on transfer of stock to housing associations or developers, the private finance initiative and cross-subsidies from profitable private development. We tend to forget that until five or so years ago, there were direct public sector grants for estate renewal – for example the Estates Renewal Challenge Fund, the Single Regeneration Budget and the Capital Challenge programmes. With the end of such programmes, and the Government's continuing rejection of the 'Fourth option' of estate based reinvestment for improvement or replacement by the local authority, tenants now have no alternative to a market led route, generally involving transfer of the ownership of their homes with reduced security. The principle of collectively owned housing and publicly accountable management died a long time ago.

Moving on to the third priority, the Government has increasingly relied on the market to provide affordable housing. Twenty years ago the full capital cost of new council housing and housing association housing was funded by government – the public funding 100% grant route- survived for supported housing into the mid 1990s. As late as 2000, under the mixed finance arrangements introduced under the 1989 Housing Act, family-sized social rented schemes in high cost areas could get 75% of capital costs funded with rent income, under a regulated rent system, and capitalised to cover the remaining 25% of capital cost. The old total cost indicator actually calibrated the grant necessary to meet costs not covered by rent income – with the cost limit driven by real costs in specific areas and uprated if costs went up. Now we have a rent target system, which allows rents to reflect value as well as affordability for tenants; an average grant at between 30% and 50% of capital cost (with many new housing association schemes and in fact whole areas of the country not getting grant at all). The Treasury assumes that, even if build costs go up 5-10% a year, and land costs climb at a much higher rate, that somehow housing associations through 'efficiency savings' can increase output by 7% a year in quantity terms for the same amount of cash - ie without any inflation allowance. Interestingly in Scotland, grant has just been increased in line with cost increases. In England, housing associations are assumed to be 'sweating their assets'. This means not just using up their reserves, but using receipts from a variety of sources including, initial equity sales staircasing of shared ownership homes, development for outright sale, and also where feasible income derived from disposal of existing social rented homes – generally in the highest value areas – or from cutting management and maintenance costs, which happened a few years ago in the case of Peabody Trust. The government and the Housing Corporation also believe that affordable housing can be piggy-backed on the back of private housing and that if only local planning authorities were better negotiators, less public subsidy would be needed as developers would provide much if not all of the affordable housing required from their profits – they would also help fund the roads, train networks, buses, the schools, the health centres, the parks and the public realm as a whole, so the new sustainable communities would be virtually self –financing.

Government has believed that all they needed to do was set higher housing targets, make councils grant more planning permissions and the new homes would be built. The more homes built, the more affordable they would be, through more social rented and shared ownership homes provided. When the housing figures did not go up, and prices come down as the government's macroeconomic model said they should, government blamed councils for not allocating enough land for housing and not granting enough planning permissions, overlooking the fact that consents had increased. For example in London there was nearly four years worth of planning consents in the development pipeline. This was when the market was positive and demand, at least for market homes, was strong. This was the case even in the Northern cities where the Government pathfinders programme was planning to demolish homes to reduce supply in order to increase house-prices – always a rather bizarre strategy, prices were going up anyway.

The idea of such a crude direct relationship between new building completions and house-price inflation ignored more external economic factors. Well, these external economic factors have now hit. It is not just the housing market which is in disarray, but the government's housing policy as a whole. It has been caught in the contradiction of its own policies – if house prices fall, existing home owners are unhappy, terrified of negative equity and potential default, if house prices go up faster than the rate of income, fewer households can afford to buy. In effect Treasury policy was to try to defend the status quo – to try to link the rate of house price inflation to the rate of wage inflation – unfortunately the market does not work quite like this. With the 'Credit Crunch', the government has got the worst of both worlds – house price falls with negative equity panic. This will lose them some votes, but with the 'Credit Crunch' and restrictions on lending, homes only become more affordable in theory, as less households can afford to buy. A 10% fall in prices is not much use to marginal homeowners if their purchasing power has reduced by 35%.

The end result

So where has this policy led us?

1. A social rented programme, which depends on both private developers wanting to build and housing associations being able to borrow – two conditions that now look highly questionable.

2. New developments with no funding for social infrastructure, which further increases the risk of developers being unable to market completed units, and therefore generating a further disincentive to additional private investment. The growth areas programme will come to a standstill, and the Government target of 240,000 homes a year is unachievable. In England housing starts are likely to fall below 100,000 a year from the 2007/8 figure of 156,437 (of which interestingly although less than 10% - 15,540, were starts by housing associations; they would be completing 13% of homes).

3. Estate regeneration schemes, which are no longer viable as the cross subsidy from market led development no longer exists.

4. Short-term market demand has generally produced housing, which is not appropriate to meeting long term housing needs. We now have an overhang of completed market homes , mainly small units in higher rise developments, which cannot be sold but are too small or otherwise inappropriate, in terms of location and/or build form for use for social housing. Developers have been building for a market, which no longer exists, especially with the decline of investors in ' buy to let'. This means that some developers will go bust and new homes will be left empty. There is a risk that some half built developments will be mothballed.

5. Households who have bought homes, or shares of homes, who could not really afford to, will now have difficulty selling and paying back the mortgage if they want to move, which is not very good for labour mobility. These households will be at risk of mortgage default if their income falls, and if the 'Credit Crunch' has a wider negative impact on the economy. This could happen.

6. Increasing affordability issues with social rented homes as the combination of target rents and service charges means that those households not on benefit are paying higher proportions of their

income on housing costs. We know that this acts as a disincentive to seek employment – a point rather misunderstood by Caroline Flint in her comment "get a job or lose your 'subsidised' home" This also ignores the point that for many councils, rent income covers costs and therefore generates a surplus, which either keeps the council tax down or is clawed back by the Treasury.

7. The tax-payers money has been used, not to help those in housing need, not to stimulate housebuilding, or even to stimulate the housing market but to support one lender by taking on the risk of a private company, Northern Rock.

The need for intervention

The basic Keynesian analysis is that when the market slows down, the state needs to intervene. The one intervention we have had is perhaps not the best way of meeting long-term policy objectives. An expensive intervention to bail out one company does not reassure a sensitive market. Clearly, the Government cannot afford to bail out any other lender, nor will it be able to bail out a major developer who gets into financial difficulty. There are several major housebuilders which are seriously over-exposed – the names are all over the financial pages. Any public sector resources need to be focused on output rather than protecting individual companies and their shareholders from the consequences of their own actions. We need to distinguish between short- term actions and longer-term options. The basic message is that government could not really have got it much more wrong. The belief that house prices would go on rising, that somehow this was good for everybody and would somehow provide more affordable housing was not just based on the wrong ideology but based on a complete lack of logic or analysis. The Treasury's belief, encouraged by Kate Barker, that deregulation and the abolition of planning and public sector led frameworks for development was the solution was always naïve. Equally naïve are the beliefs that a new tax, the Community Infrastructure Levy, would fund sustainable communities, and that local authorities, or other public bodies, or private developers would come to the rescue of affordable housing by providing free land to housing associations. All these initiatives were always just a diversion from, or an excuse for not facing up to, the fundamental dangers of market dependence.

The options available to the Government are not cheap ones:

The Government should buy as many private homes from developers as possible for housing associations – but only those which meet Housing Corporation standards and are appropriate for social housing use. This means that housing associations should not buy small flats in high-rise schemes and that the Housing Corporation should not waive its standards just to help out developers. Government money should not be used to protect developers' profit margins. Housing associations should buy selectively and buy at a discount on market price, given that for some schemes there is no effective market. Housing associations should not buy flats for shared ownership. There is already an oversupply of shared ownership flats in some locations, and the 'Credit Crunch' will hit shared- owners' borrowing capacity as well as the capacity of market purchasers. The Housing Corporation should revive the intermediate rent programme, because such homes can be converted to full social rent in the longer term or alternatively sold back on to the market once it revives and that would generate receipts to fund more appropriate social rent housing in the longer term. If the Housing Corporation is facing a short term under spend problem, as funded schemes don't get completed, then resources would be better switched to buying second hand family sized street properties, than buying inappropriate newly built flats.

Developers should be encouraged to redesign schemes to make them more marketable – to focus on lower and medium density schemes, which are attractive to prospective home-owners. This will mean a lower unit output than has planning consent in many schemes, but will lead to more sustainable developments. Where developers seek to renew unimplemented planning consents, after the two-year validity runs out, applications should be rejected if they do not meet policy requirements on bedroom size mix or affordable housing proportions, forcing developers to work up 'implementable' and policy compliant schemes. Such schemes could attract Housing Corporation finance and might actually be more viable for a developer than the consented scheme.

The government needs to increase levels of grant to housing associations to develop and acquire completed homes. Given the end of cross-subsidy from developers, cheap lending, housing associations' ability to support development from shared ownership receipts, an increase in build costs (which will not ease off just because of a market slowdown), the need to focus on larger, lower density homes and the need to meet climate change policy requirements, grant per unit will need to increase dramatically. – In London this could mean an average grant per unit of closer to £200,000 a unit than the current £95,000 to £105.000– not a cheap option.

The government will have to fund transport and social infrastructure directly. Community Infrastructure Levy will need to be deferred. Any planning gain mechanisms will need to relate to longer term asset appreciation – short term gain is dead, at least as far as most brownfield sites are concerned, premium locations are different as the top of the market for multi-millionaires only, will still hold up given the government's 'liberal attitude' to tax avoidance by the very rich.

The government will need to put more money into estate regeneration. This may mean increasing the affordable housing output in terms of homes and providing fewer new market units, given that demand for them is limited. This will probably be a better solution in terms of the development of sustainable communities –concentrations of small buy to let units are not the best way to create a sustainable community.

The government should avoid the temptation to introduce short term financial incentives to prop up the market – so don't reduce stamp duty or provide more subsidies to home-buyers – this just creates a false market. Similarly, a new batch of untested part ownership initiatives will not be very helpful.

It would be more useful for government to release surplus land direct to housing associations for social rented housing on a discounted if not free basis.This means that government has to assume that targets for receipts from land and property disposals won't be met.As there is no market demand for brownfield land the receipts wont be realised anyway. So it's far better to give the land to housing associations, which means social rented housing might actually be built and homeless households housed.We need to forget the obsession with getting tenure mix on every site – the large sites won't build out until the market revives, so the Housing Corporation should switch its investment to small sites, where the infrastructure exists and new homes can be built fairly quickly. Small associations, with assets but not overstreched borrowing can make their contribution.This is the time for small builders and the smaller architecture firms.

Now for the longer- term options and the paradigm shift -

A Labour government should not be promoting home ownership as the ideal tenure. It should not be criticising social housing and social housing tenants. It should not be implying that they are second-class citizens who do not make an adequate contribution to society and dependent on the state.

The government should stop promoting and 'incentivising' unsustainable home ownership. Government subsidy should not be used to support individual capital gain.The government should therefore not provide financial assistance to home- owners or to households wishing to buy on the open market.This just inflates houseprices, as well as breaching the fundamental socialist principle that public money raised from taxation should not be used to fund private profit.Any form of government investment in privately provided development should be in the form of an equity stake where the public sector benefits from any appreciation of value.

Government investment in housing provision should focus on social rented provision for households in housing need, where the ownership and appreciation in value remain with an accountable public sector body or a non-profit making agency, such as a housing association, subject to public regulation.The government should support sub-market housing for middle income households unable to access the market, on the basis of the ownership and management of the housing remaining with a public sector agency or regulated non-profit making body. It is neither necessary nor cost effective to use a profit making body as landlord or managing agent for intermediate housing as this increases the costs to the occupant. Furthermore, the Government should investigate mechanisms by which a regulated and rent controlled private rented sector could provide housing for households in housing need with housing benefit used to cover costs, which cannot be met by the tenant.This should be on the basis that the quality of housing and security of tenure is at least equivalent to that provided by local authorities and housing associations.

The government should provide sufficient funding to local authorities to enable them to meet the decent homes standard and to improve or replace unfit estates without recourse to cross-subsidy from private developers and private finance other than borrowing, which can be supported by existing rent income.

The current system of planning obligations should be replaced by a regime which taxes value appreciation over time, rather than just at the time of planning consent.This can be used by the local planning authority being granted a share in value appreciation at the time of planning consent, with contributions being levied either on an annual basis linked to revaluation or from receipts on onward disposal.

The value of existing private property should be taxed, either through modifications to the existing tax system or through the reintroduction of income tax schedule A. Inheritance tax should be increased, which would both limit house price inflation as it would reduce effective demand as well as limiting the transference of wealth between generations, which is one the key sources of inequality in our society. Under-occupation should be discouraged through a modification to the council tax regime, which related the tax levied to the relationship between dwelling size and dwelling occupation.This would apply more severely to second homes.

Council and housing association homes should be made affordable to tenants through the removal of the value element from the target rent system.Tenants should not pay for the value of their home as they do not benefit financially from value appreciation. Service charges should also be subject to regulation.

In order to support the development of new affordable housing, local authorities and other public bodies should be encouraged to make land available on a subsidised basis to housing associations. In the case of local authorities this could be in exchange for a higher than norm level of nomination rights. Local authorities should however also be encouraged to develop surplus land directly on the basis that all homes developed would be available to households in housing need.

Local authority planning powers need to be used more effectively to ensure an appropriate range of housing is provided, including social rent and intermediate provision.This will in most locations mean low and medium density schemes rather than high density schemes, and an increased proportion of houses, maisonettes and lower rise flats than in the current development programme.The Government should introduce national quality standards to include internal space and external amenity and play space standards.

Government needs to insure the planning of new homes is supported by the planning and funding of transport and social infrastructure, including the provision of education, health and leisure facilities. These need to be appropriate to the needs of new communities and where supported by private finance need to managed by accountable public sector agencies.

Conclusion

The fundamental change of policy required – the paradigm shift – is that a Labour government must promote collective ownership over home ownership, and must ensure that the provision of public investment or revenue support is condition on democratic public control, regulation of standards and access to housing on the basis of housing need. These basic socialist principles need to be reasserted if we are to move away from the market led ideology which has been disastrous both for the Labour government and for millions of households across the country. In the current context of the credit crunch, this radical shift in policy is now necessary as well as being right in principle.

Duncan Bowie

> Compass is the democratic left pressure group, whose goal is to debate and develop the ideas for a more equal and democratic world, then campaign and organise to help ensure they become reality.

Join today and you can help change the world of tomorrow - www.compassonline.org.uk/join.asp

compass

Southbank House, Black Prince Road, London SE1 7SJ
T: +44 (0) 207 463 0633 M: +44 (0) 7900 195591 gavin@compassonline.org.uk
www.compassonline.org.uk