Can Housing Help Drive the Economic Recovery?

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Housing and the Economy – the crisis and beyond
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The Starting Point

- Longer run inelasticity of supply has been a major source of concern since the 1970s and especially since 1990
- Housing investment activity added little to economic growth in the period 1999 – 2007 and accounted for perhaps 1.5% of GDP (very low by historic and international standards)
- BUT the decline in residential investment accounted for more than a quarter of the fall in GDP between 2007 and 2009
- Before the economic downturn in 2008, house building accounted for 335,000 jobs and 1.5% of (GDP)
- The construction multiplier is estimated at 2.6. The residential multiplier is probably a little higher because it uses fewer imported materials (although it does employ foreign labour with associated remittances)
- It is calculated that, for every additional job created in the construction industry a further 1.53 jobs are created in the wider economy.
- House building is also a source of funding for Central Government and Local Authorities not just through employment and profits but also transactions and additional Council tax.

Current concerns: output, tenure and housing costs

- Housing completions, which rose to about 170,000 in 2007/8 fell to 107,000 in 2010/11 and have risen little since – although beginning to pick up
- Structure of the industry has become more concentrated – top 4-5 picking up more quickly - concerns re regional and local builders and the need for scale
- The tenure structure has changed rapidly since the early 2000s with owner-occupation in England falling from around 70% to around 65% in 2011/2012. The private rented sector now accounts for 17% of all households very similar to the social rented sector.
- Housing costs: particular concerns in London where prices have risen by nearly a quarter since 2009 and private rents, which are anyway twice those in the country as a whole, have been rising while on average they are constant elsewhere in the country
- Affordability as measured by price/income ratios has continued to worsen in London and hardly improved elsewhere at 8.5 in London and 6.6 across England

Major Drivers for the Economy

- New housing investment and its multiplier effects
- Transactions in the existing market and their impact on white goods, renovation etc
- Impact of house prices (and mortgage availability) on consumption and confidence

BUT

- Impact of economic improvement and government policy on prices, volatility and affordability
- Continued concerns about longer term inelasticity of supply as demographic pressures increase

SO

- Both positive and negative impacts

New Housing Investment

- 2012/13 figures still very poor – in part because of slow start to affordable rents programme, but also because of business decision processes and uncertainties
- Beginning to show signs of improvement
- But depends on sales per site; numbers of sites under construction; speed at which new sites can be brought into play
- Demand and funding - role of pre-sales; role of international investors; role of self funding
- Lack of funding for smaller builders – need for increased activity by regional and local firms
- Continuing concerns about demand finance

Private Sector Initiatives and Concerns

- Only just beginning to speed up bringing new sites into the construction phase
- Large sites particularly difficult – place making/ social infrastructure and speed of sales
- Suggestion that increasing the emphasis on private renting could overcome some of these constraints into the medium term
- Role for institutional finance - but will not normally take development risk
- Continuing concerns about maintaining the pipeline of sites with full planning permission – and costs of process

Extent of Government Involvement

- During the crisis government supported new build to assist developers and economic activity
- Given specific initiatives, S106 and grant aided social housing perhaps 90% of all housing investment in 2009/10 had some government involvement
- Affordable housing led market housing not visa versa
- Coalition government cut grants but introduced some 100 plus initiatives many of which were aimed at new building – notably through changes to planning regime and funding arrangements

Government Objectives

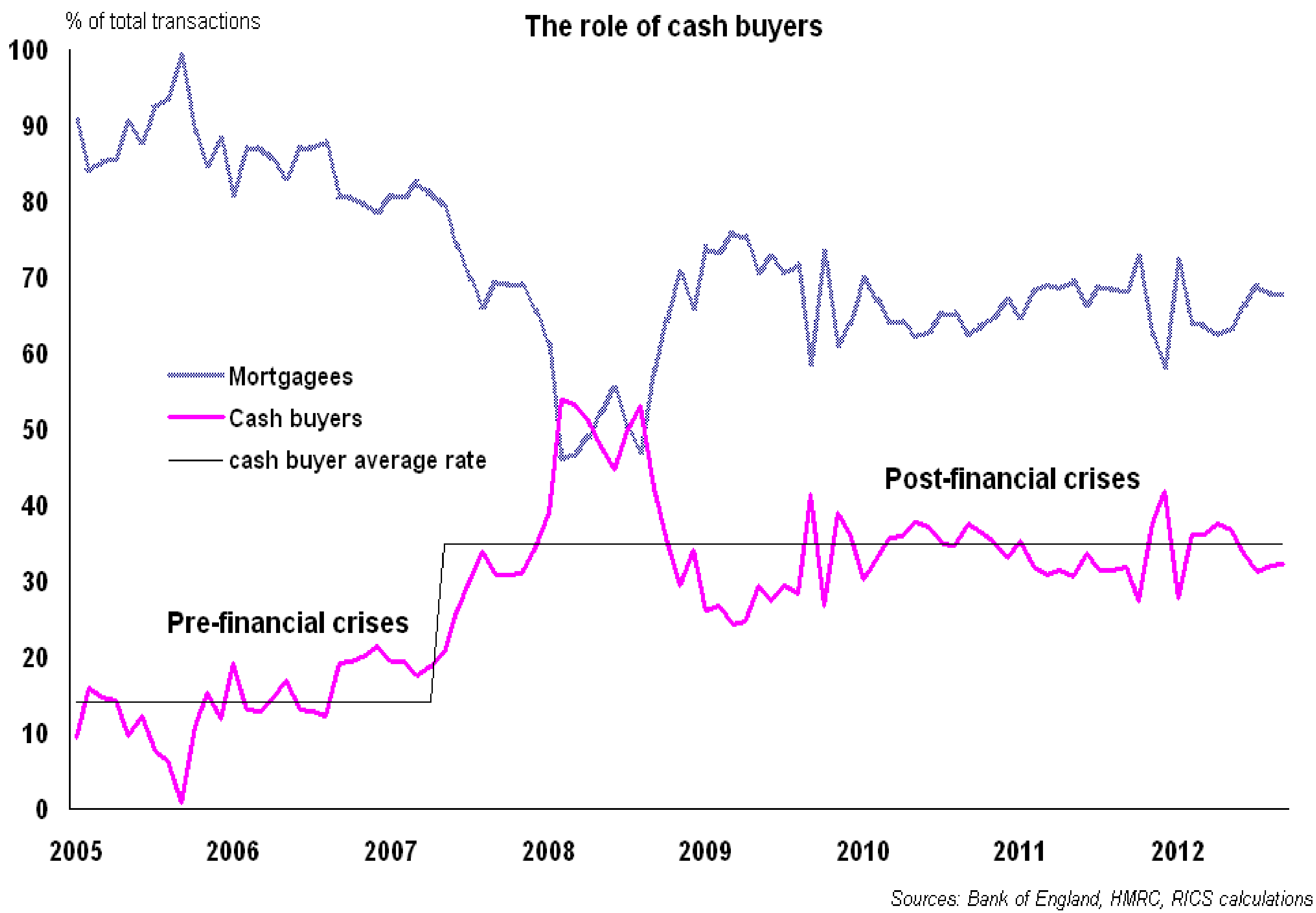
- Vast majority of initiatives so far have been around new building
- Problems for second time buyers and other moving up market – or just moving. Impact – partly growth of private rented sector but also atrophied mortgage and housing markets
- Initiatives for existing market only put in place in 2013 and 2014

Funding for Affordable and Rented Housing

- Affordable rents programme – based on increased rents; higher benefit payments and greater borrowing power – currently estimated at 170,000 to 2015 with some additional grant
- Guarantee for housing associations and other RPs which it is argued could cut borrowing costs by up to 1.5% to around 3% - independent allocator/aggregator
- Guarantees for private sector for build to rent - £3.5 bn – initially to be assessed and allocated in-house
- Build to Rent scheme to support new build in the private rented sector – up to £1bn – although issues re revival of owner-occupation

Demand Finance

Figure 1: The role of cash buyers 2005 to 2012



Government Involvement in Demand Finance

- The Bank and HM Treasury launched the Funding for Lending Scheme (FLS) on 13 July 2012 and extended it in 2013. It provides funding to banks and building societies for an extended period to boost their lending to the UK real economy, with both the price and quantity of funding provided linked to their lending performance.
  - Significant impact on mortgage lending
  - But also reduces incentive for more mainstream mechanisms such as vanilla securitisation
- Help to Buy Equity Loan scheme for new build: 5% deposit and 20% government equity loan with interest charge from year 6. Current allocation £3.5 bn – priced at zero because expected to pay for itself from capital increases
  - Modification of earlier schemes which have generally been successful
- Help to Buy Mortgage Guarantee Scheme: starts in 2014 and runs for 3 years; covers homes up to £600,000 both new and existing; government guarantees 15% of value of mortgage. Guarantee priced at market rates - state aid issues
  - Concerns that will cause 'house price bubble' and distort the market into the longer term but also evidence from other countries is that few institutions may take it up

Future Pressures

- Already signs of pressure on certain materials and skills because of impact of crisis on capacity.
- Similar concerns about planning process and flow of sites
- Longer term demographic pressures: lower household formation but higher population growth rates – projected requirements over 240,000 per annum until 2031
- Also ‘backlog’ of unformed households? - if incomes, access to funding and confidence improves
- However hard we try there is going to be a continuing shortfall and therefore pressures on prices and affordability
- Concern must be that cannot move forward on an upward trajectory because of these pressures
- Similar patterns of rising prices at least in growth areas in many other countries – including the USA and Ireland

Conclusions

- Housing investment only around 1.5% of GDP in mid 2000s - would need to expand to much higher levels if to make major contribution
- However it is a lead indicator and helps build confidence
- Value to the economy of mobility and transactions –impact on related industries and on housing improvement investment
- So an obvious driver of the economy – but relatively limited
- Also major short term pressures as a result of the link between economic growth and house prices – likely impact greater volatility rather than a stable trajectory to higher and sustainable residential investment
- Whatever needs a massive restructuring of the delivery process if to achieve the levels of output projected to be required to improve affordability and housing standards
- Part of an alternative is to reduce demand by changes in tax and subsidy – but this would not help the recovery at least in the short term?