Chapter 1

‘Building back better’ after Covid: lessons for housing policy from the ‘lost decade’

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In the past 15 years the UK – and the rest of the world – have experienced two seismic shocks to the economy. The global financial crisis (GFC) which began with the credit crunch in 2007 was regarded as a once-in-a-lifetime event, only to be followed by the Covid-19 pandemic in 2020. There are, of course, important differences between the crises. The GFC began within the financial system and induced a severe recession, whereas Covid caused governments to impose lockdowns that restricted economic activity and led to dramatic contractions in the economy. Nonetheless, the severity of the economic contractions, the requirement for governments to take countervailing action in the midst of the crisis, and the widely held belief that a return to the pre-crisis status quo was improbable, all invite comparison. How did policy makers and institutions respond to the crises in the short term? And, in the case of the GFC, how did they do so in the longer term?

This chapter provides an overview of the GFC and its aftermath. It shows that pre-existing problems in the housing system were exacerbated by responses to the GFC and that system-wide coherence in housing policy has been lost. Covid has brought an array of short-term interventions, but the experience of the lost decade that followed the GFC demonstrates that the same mistakes should not be repeated post-Covid. It ends with some suggestions as to how the housing system could be reformed.

It is structured as follows:

- an overview of the global financial crisis and short-term responses to it
- a review of longer-term responses to the GFC, including regulation of mortgage lending, planning, Help to Buy and austerity
- impacts on the housing market, including mortgage lending, housebuilding, house prices and tenure change
- responses to Covid and key areas requiring long-term reform.

The global financial crisis

The global financial crisis grew out of the post-Cold War world which witnessed the growth in global trade, including the opening-up of the Chinese economy, the integration of financial systems, and a consequent shift towards low inflation and lower interest rates. This restructuring of the world economy facilitated a long period of steady economic growth in the west, which in almost all countries was accompanied by a house-price boom and growing mortgage debt. The proceeds of growth were shared unequally. Thomas Picketty noted the reversion to the historic trend of returns from capital outweighing those from labour, much of this attributable to house prices as lower- and middle-range wages lagged.[1] Others argued that this prompted politicians in some countries to support the expansion of homeownership to lower-income households to compensate for stagnant earnings.[2]

The crisis itself was triggered by the rising number of defaults in the US sub-prime mortgage market. Having been financed principally by securitisation, and frequently supported by manifestly unsafe credit ratings, the wholesale markets froze in August 2007 amid a climate of mutual mistrust. This ‘credit crunch’ was the precursor to the GFC. In the UK, the immediate impact was felt by Northern Rock which had adopted an aggressive expansion strategy partly based on securitisation, leading to a liquidity crisis and ultimately the nationalisation of the bank. More broadly, the Bank of England injected liquidity into the banking system in the hope that it would boost lending, whilst three of the largest banks were recapitalised from the market between April and May 2008. A full-blown banking crisis was prompted by the collapse in October 2008 of Lehman Brothers, a US investment bank with substantial holdings of sub-prime mortgages, marking the point at which the credit crunch morphed into the global financial crisis.

Macroeconomic response

Faced with what was then an unprecedent fall in GDP (Figure 1.1.1), the government had no alternative but to increase borrowing to finance government expenditure. Public sector net borrowing rose from under three per cent of GDP in 2006/07 to a peak of just over ten per cent in 2009/10. Indeed, for five successive years, the deficit was higher than in any other year since 1945. Inevitably, public sector net debt followed as annual deficits accumulated, in effect doubling from 40 per cent of GDP to 80 per cent.

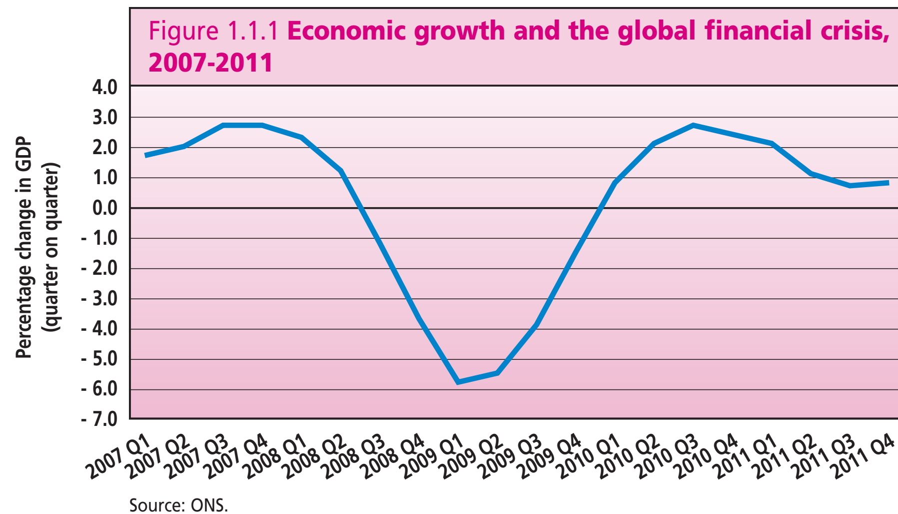


Figure 1.1.1 **Economic growth and the global financial crisis, 2007-2011**

Source: ONS.

The crisis also prompted the Bank of England (BoE) to cut interest rates in stages from 5.75 per cent in 2007 to an historic low of 0.5 per cent in 2008, with a further cut to 0.25 per cent in 2016 in response to the EU referendum result (see Commentary Chapter 1 in the 2020 edition of the *Review*). In common with other central banks, the BoE also ventured into 'unconventional' monetary policy by purchasing government and corporate bonds with the intention of freeing-up bank capital for lending and keeping interest rates low, ostensibly to meet the inflation target. A consequence of such quantitative easing is that it places upward pressure on asset prices, including house prices.[3]

The banking crisis and bank rescues

As bank shares collapsed following the failure of Lehman Brothers, the UK responded with a second round of bank recapitalisation (whereby the government purchased preference shares in eight banks); the injection of liquidity into the banking system (as the central bank issued short-term loans to the banks), and government guarantees for existing bank loans.

Further assistance was granted in January 2009, when an asset protection scheme was introduced. This was aimed at banks' 'toxic' assets, allowing them to pay (with cash or shares) for existing assets to be insured by the government. Limited information is available, but of the £260 billion of assets that one bank (LBG) placed in the scheme, some 28.5 per cent were residential mortgages.

Despite these measures, banking rescues and nationalisations were necessary. In September 2008, the largest mortgage lender, HBOS – with a 20 per cent share of the mortgage market – was taken over by the relatively strong Lloyds to form Lloyds Banking Group (LBG).[4] However, LBG was weakened by the acquisition of HBOS; the government took a minority share in the bank in October 2008 and a majority share in March 2009. HBOS's exposure to the property market was a significant factor in this weakness and in the problems encountered by LBG (see asset protection scheme, above). The government also took a majority share in RBS in October 2008 (though its failure was precipitated by RBS's acquisition of the Dutch insurance company, AIG, at the peak of the market). It fully nationalised Bradford & Bingley (a former building society that had specialised in buy to let lending) in September 2008.

The nationalised banks were managed through a separate agency; the government made it clear that it did not wish to be involved in their operation and has begun the process of privatisation. Meanwhile the Dunfermline Building Society collapsed in March 2009, attributable to its entry into commercial property prior to the crisis. Its core assets were obtained by Nationwide Building Society with government help.

Protecting homeowners and supporting the housing market

Fears that there would be a repeat of the mortgage arrears and possessions crisis of the early 1990s led the government to act quickly to protect homeowners.

Earlier attempts to persuade mortgagors to take out private insurance by increasing the waiting time for state support (SMI – support for mortgage interest) to 39 weeks and limiting support to the first £100,000 of a loan had only limited success. The government reduced the waiting period to 13 weeks and increased loan eligibility to £175,000 from April 2009. However, support was time-limited to two years. A pre-action protocol was also introduced which required lenders to

exhaust other options before courts would grant a possession order. Further support included a mortgage guarantee scheme that was intended to facilitate the transfer of borrowers onto interest-only or other more affordable mortgages.

In the event, levels of arrears and possessions were lower than had been feared. Nonetheless, repossessions rose from 19,900 in 2006 to a peak of 44,100 in 2009 before falling to 27,000 in 2012 (see Compendium Table 50), although this was lower than the previous peak in the early 1990s. Undoubtedly, the measures put in place to support borrowers helped. For example, the numbers of recipients of SMI peaked at 241,000 in 2010/11, and this was mostly explained by the rise of claimants in receipt of unemployment-related benefits (see Compendium Table 106b). However, the impact of the recession on unemployment was much less than had been expected, and a crucial difference with the situation in the early 1990s was that mortgage interest rates were lower and reduced further. This not only made interest payments less onerous on mortgagors, it also reduced the cost to lenders of retaining mortgages in arrears on their balance sheets, so facilitating forbearance.

Actions to support the housing market more generally included an expanded affordable homes programme and the increase in the threshold for stamp duty land tax from £125,000 to £175,000 from September 2008 to the end of 2009. This latter measure appears not to have halted the decline in transactions, but did bring them forward as the deadline for withdrawal approached, with the result that they fell again afterwards.[5]

On the supply side, government-sponsored shared-equity schemes such as HomeBuy Direct (introduced in 2010) and FirstBuy (2011) gave way to the much more significant Help to Buy in 2013, which is discussed below. When the *UK Housing Review* first started monitoring overall government support for the private housing market in 2015, it recorded 17 different schemes totalling around £20 billion (mainly in loans and guarantees), intended to revive the sector.

Responses to the GFC

In the decade that followed the GFC, the lack of housing strategy became increasingly clear. Inevitably, the most urgent responses to the GFC focussed on reforming the regulatory framework for banking and mortgage lending. However, as this section demonstrates, austerity drove government policy towards affordable housing and housing benefit, whilst Help to Buy became a sticking plaster.

Regulation of mortgage lending

The GFC highlighted weaknesses in the banking system generally, and especially in the mortgage market, including the regulatory frameworks. Indeed, in the early days of the crisis, a parliamentary enquiry condemned the 'reckless business model' adopted by Northern Rock and concluded that the Financial Services Authority (FSA) had 'systematically failed in its regulatory duty to ensure that the Northern Rock would not pose a systemic risk'.[6] Reforms were introduced following two reviews initiated by the FSA, the Turner Review and the Mortgage Market Review.[7]

The Financial Policy Committee (FPC) is charged with 'protecting and enhancing the resilience of the UK financial system'[8] and particularly to monitor banks' actions in order to remove or limit systemic risks within the aims of economic policy. Consequently, it may recommend or direct the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) to place limits on mortgage lenders' balance sheets. From 2014, it advised the PRA and FCA to ensure that mortgage lenders do not advance more than 15 per cent of their new residential mortgages with loan-to-income ratios at or above 4.5. Powers were initially limited to homeowner mortgages but were later applied to the buy to let sector. Further, the international standards for banks' capital adequacy requirements ('Basel III') were tightened by requiring banks to establish a counter-cyclical buffer.

Meanwhile the rules governing mortgage lending in the UK were strengthened as a result of the Mortgage Market Review. From April 2014, the following assessments have been required:

- all income must be documented
- lending decisions must be made after an assessment of affordability, based on the borrower's net income and major financial commitments
- affordability is subject to an interest-rate stress test, currently set at three per cent

- interest-only mortgages will be allowed, but affordability will be assessed on the basis of a capital and interest mortgage
- sub-prime loans are not banned, but they must be affordable.

The macro-prudential and, in particular, micro-prudential regulations put in place in response to the GFC fundamentally reversed the presumption in favour of deregulation in the mortgage market, accepting that a shift back down the risk curve required more restrictive access to mortgage finance. However, according to the BoE policy statement, this framework is designed to protect the banking system and to a lesser extent safeguard economic growth. It does not have housing policy objectives.[9]

Planning and private housebuilding

Broader housing strategy can be seen as a continuation of the emphasis on increasing the rate of housebuilding for the private market, which emerged following Kate Barker's reviews of housing supply and planning.

After an initial reaction against the regional targets established by the Labour government, the Conservatives have largely adopted the view that the planning system is the main barrier to new development. The Letwin Review, which examined slow build-out rates on sites with planning permission, may have suggested a more critical approach to the housebuilding industry, but this seems to have been an ephemeral concern to government (see discussion in previous editions of the *Review*[10]). Instead, government strategy in England has culminated in the current proposals to shift away from the discretionary planning system to one based on zoning, with nationally set housebuilding targets for each local authority (see Contemporary Issues Chapter 2 in this edition of the *Review*).

Help to Buy

Help to Buy (HtB) grew out of short-term responses to the GFC to become, after housing benefit, the principal government housing initiative in terms of public resources, throughout the post-GFC period. It has functioned as a multi-purpose sticking plaster to compensate housebuyers for the limitations on mortgage credit and high house prices, whilst being of considerable financial assistance to housebuilders.

Introduced in England in 2013, it provides an equity loan for purchasers of properties for homeownership of up to 20 per cent (40 per cent in London) of a property's value, so long as the buyer can put down a deposit of five per cent. Although the scheme is intended in part to address the lack of availability of high loan-to-value ratio mortgages, it is not targeted on first-time buyers, but is restricted to new-build properties. HtB, along with its Welsh and Scottish counterparts, was assessed in detail in last year's *Review* (see Commentary Chapter 6). The *Review* showed that its cost in England is expected to reach almost £30 billion by the time it ends in 2023, that it inflates house prices in high-demand areas, and is a huge support to the housebuilding industry, accounting for between 36 and 48 per cent of total sales of five of the six largest housebuilders. The scheme also gives the state a significant stake in the housing market and potential exposure to falls in house prices. The most recent developments in HtB are examined in Commentary Chapter 3 in this edition of the *Review*.

Austerity and ideology

Otherwise, housing policies were largely influenced by the priority given by the coalition and subsequent Conservative governments to reducing the public sector deficit, generically referred to as 'austerity'.

Public expenditure support for affordable housing, which had been increased during the GFC, was cut back (see Compendium Table 66) and higher rents (consistently referred to in the *Review* as Affordable Rents) were introduced in England, predicated on lower grant subsidies for new build.[11] The sector continued to decline in England as the right to buy was 'enhanced'. There was also an ideological shift culminating in the controversial 2016 Housing and Planning Act that included measures that would have led to the sector to become (in the words of Lord Kerslake), a form of 'temporary welfare provision'.[12] These included obligatory fixed-term tenancies and a 'pay-to-stay' policy for higher-income social renters. In the event, these and other measures were abandoned or not enacted (see Contemporary Issues Chapter 2 of the 2019 edition of the *Review*), whilst the Homelessness Prevention Act increased local authorities' obligations towards non-priority need homeless people. Different priorities have been followed in the devolved nations, with right to buy ended in Scotland and Wales, and bigger affordable housing programmes introduced.

Social security was targeted for savings, including the housing benefit bill which had grown to more than £20 billion annually – making it by far the largest expenditure subsidy to housing. In the private rented sector, savings included reducing the local housing allowance limit from the median of the broad rental market area to 30 per cent, uprating this first only by inflation and then freezing it (see Commentary Chapter 6). The age where the shared accommodation rate applies was increased from 25 to 35. The 'abolition of the spare room subsidy' (commonly known as the 'bedroom tax') was introduced in the social sector. Broader limitations on eligibility through the two-child limit and benefit caps also reduced the cost of housing assistance. The system that had largely guaranteed a minimum level of income for households after paying their rent has been transformed: tenants are increasingly expected to contribute to rent from already inadequate levels of non-housing benefits. Although of relatively little importance to public expenditure, support for mortgage interest has been replaced by a loan scheme, which has greatly reduced the numbers of homeowners receiving support.[13] Not surprisingly the period of austerity has seen a rise in destitution, manifested in an increase in rough sleeping and in dependence on foodbanks.

Although the private rented sector grew and in England overtook the social rented sector, strengthening of tenure security was promised but not enacted by the time Covid struck. The sector was reformed in Scotland in 2017, where tenure security was greatly increased on new tenancies. However, regulation and policy have impacted on the private rented sector in other ways. The Prudential Regulation Authority extended the same underwriting standards to private landlords as to homebuyers in 2017, so affordability assessments and interest-rate stress tests were employed. This reduced the advantage that landlords had enjoyed in terms of access to interest-only mortgages. The tax treatment of rental income also changed from 2017/18, for example phasing out interest deduction at anything other than the basic rate of tax. Meanwhile a surcharge was introduced on stamp duty land tax (and equivalents in Scotland and Wales) in 2017/18, whilst most first-time buyers were exempted.

Impacts on the housing market

In the decade between the GFC and the pandemic the housing system operated in a new context of slow economic growth, weak earnings, fiscal austerity, low inflation and very low interest rates. As the previous sections showed, the mortgage industry was subject to a more restrictive regulatory environment, whilst housebuilding was given continued government support through planning concessions and Help to Buy.

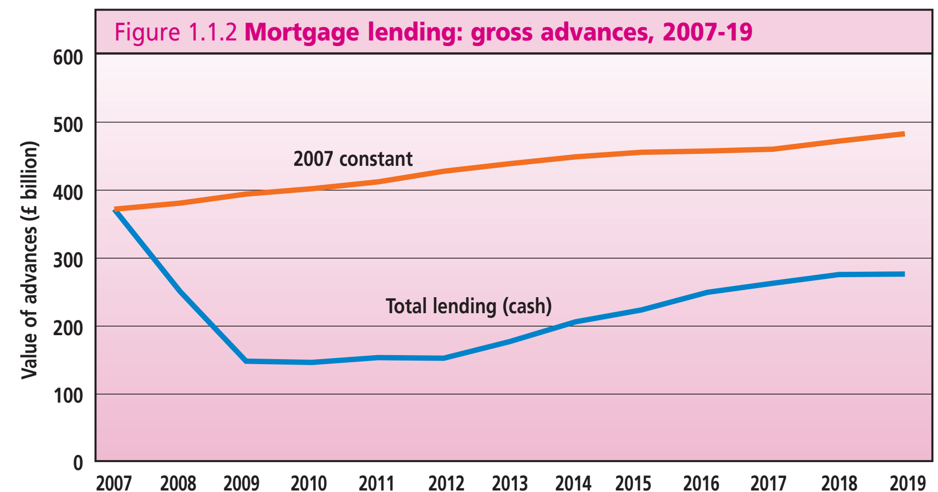
This section examines how these changes affected the housing market and wider housing system.

Mortgage lending

The key factors that influenced the level and pattern of mortgage lending were the new regulatory environment combined with very low interest rates that made borrowing attractive. Overall lending recovered, but not to the levels seen before the GFC. And the uptake of lending between different groups also varied.

The value of mortgage lending collapsed from £372 billion in 2007 to £146 billion in 2010, and only really recovered after 2012, rising to £276 billion in 2019 (Figure 1.1.2). In cash terms this was 75 per cent of the 2007 level, but in real terms it was only 57 per cent of the 2007 value of lending. Further, the rate of recovery had slowed towards the end of the period.

Figure 1.1.2 **Mortgage lending: gross advances, 2007-19**



Source: Calculated from Bank of England/ FCA MLAR tables; ONS.
Note: '2007 constant' is 2007 lending uprated by inflation.

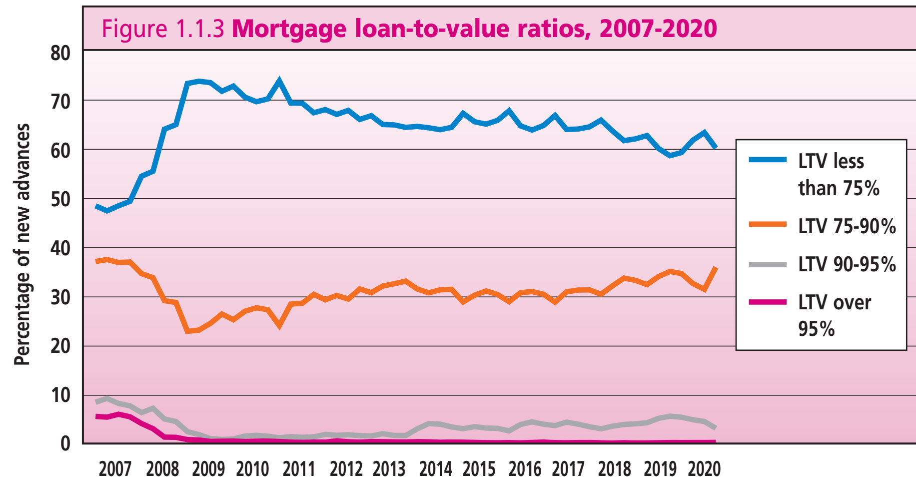


Figure 1.1.3 **Mortgage loan-to-value ratios, 2007-2020**

Source: Bank of England/FCA MLAR tables.

The size of loans in relation to property value reflect greater caution on the part of lenders as well as regulatory change (Figure 1.1.3). The proportion of loans advanced at less than 75 per cent of property value (under 75% LTV) rose from half to 70 per cent, and then drifted down to around 60 per cent. Those between 75-90% LTV fell from almost 40 per cent to almost 20 per cent of loans, before recovering to just over 30 per cent. However, mortgages between 90-95% LTV, which had accounted for ten per cent of the total before the crisis, fell sharply in numbers and on the eve of Covid made up around five per cent of the market. Those above 95% LTV, which accounted for about six per cent of loans before the crisis, have almost disappeared. The numbers of mortgages advanced to existing owner-occupiers moving house and to first-time buyers fell dramatically during the GFC (Figure 1.1.4). In the case of existing owners, the recovery has been very muted and the number has been relatively flat for five years, reaching only 57 per cent of the 2007 level in 2018. As the chart shows, the numbers of loans to moving owners was already lower in 2007 than it had been in 2001, although there was some volatility.

The movers figures reflect the fall in transactions (Figure 1.1.5). From a pre-crisis peak of 1.7 million in 2006/07 they fell to half this figure in 2011/12. The numbers of transactions have since risen but have stagnated at around 1.2 million over the past few years, representing less than 70 per cent of the pre-crisis peak.

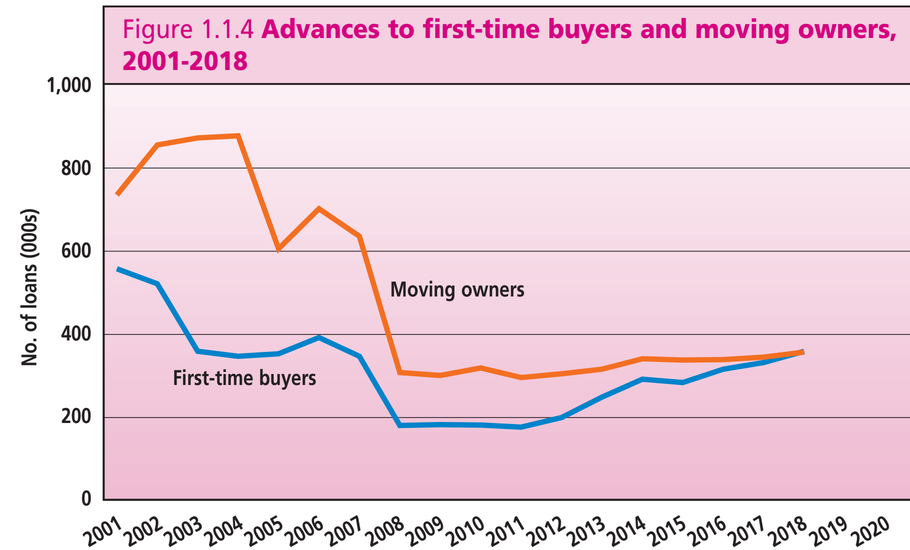


Figure 1.1.4 **Advances to first-time buyers and moving owners, 2001-2018**

Source: Compendium Tables 43a and 43c.

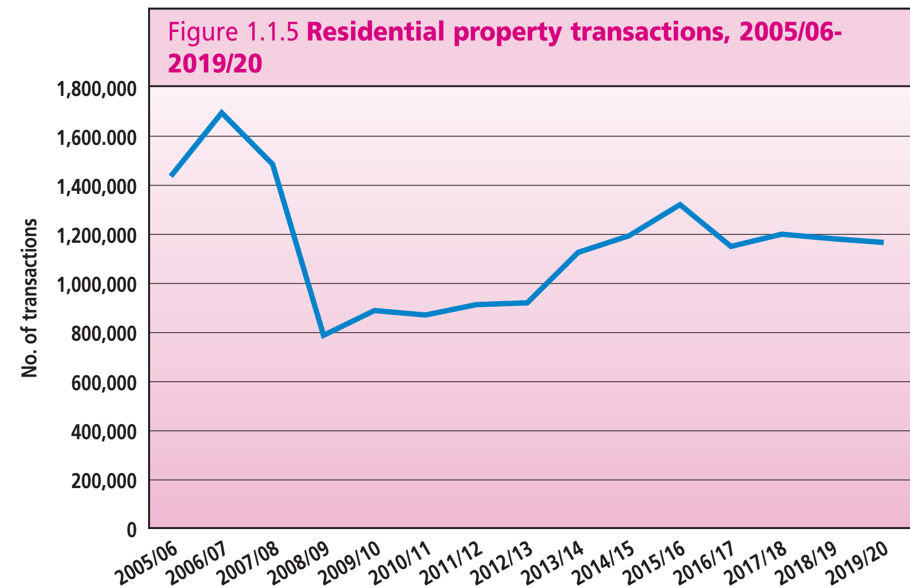


Figure 1.1.5 **Residential property transactions, 2005/06-2019/20**

Source: HMRC. Note: Does not include small transactions (under £40,000).

This is consistent with the maturing of the owner-occupier market as the average age of owners rises and fewer people trade up, although reforms to transaction taxes, which have become more progressive, may have also had a role in deterring mobility.

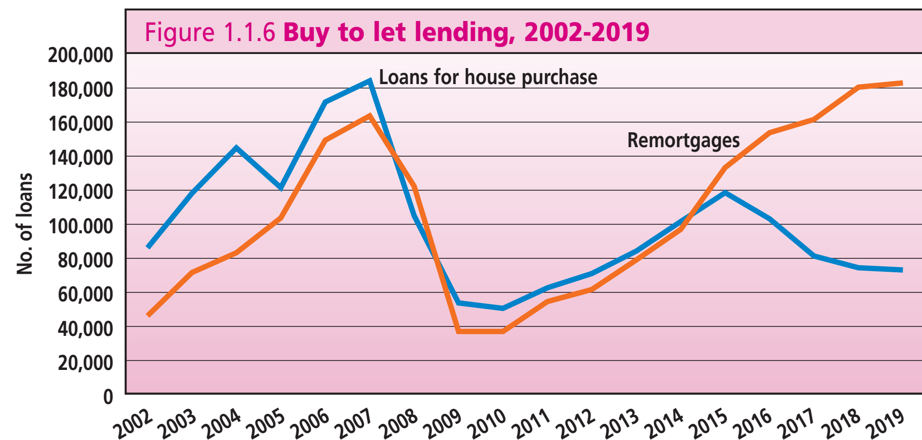
The numbers of first-time buyers also fell during the GFC but has caught up with the smaller number of movers (Figure 1.1.4). However, there has been a longer-term fall in the numbers of first-time buyers which were over 500,000 at the turn of the millennium. The figure of 370,000 in 2018 was comparable to the 2007 figure, but it should be remembered that this was insufficient to prevent homeownership from falling, particularly in younger age-groups.

Lending to the buy to let (BTL) sector experienced a precipitous decline due to the GFC, but also recovered strongly before lending for house purchase fell again after 2015, whilst re-mortgaging activity continued to grow (Figure 1.1.6). The initial recovery is consistent with landlords being well placed to put down deposits in order to secure relatively cheap finance, which at this point they could still obtain on an interest-only basis (in contrast to owner-occupiers). Some policy changes were intended to tilt the playing field in favour of homeowners, particularly first-time buyers, and regulatory changes had the same effect. However, the number of BTL loans for house purchase had begun to decline before the tax and regulatory changes began to take effect in 2017, suggesting that the market may have peaked in any case.

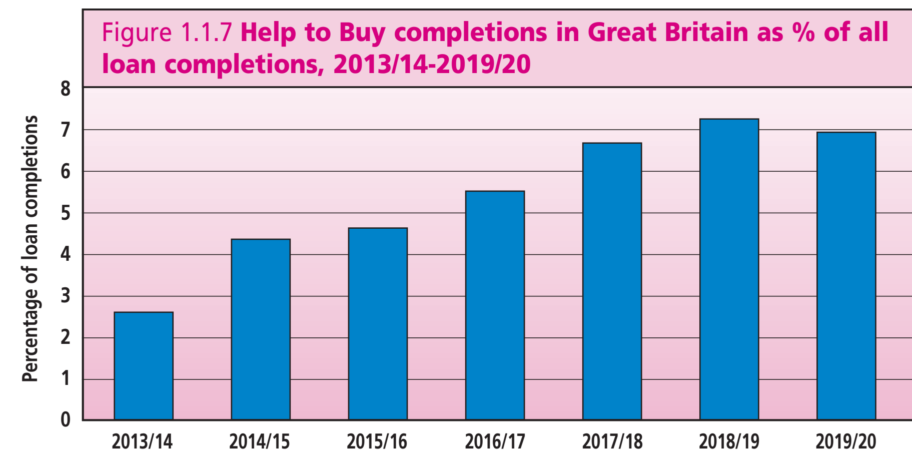
Help to Buy

Given the recovery in lending to first-time buyers, combined with reduced availability of high LTV mortgages, Help to Buy became an important element in the post-GFC housing system. Since its introduction in 2013 the HtB shared-equity scheme, which is restricted to new dwellings, has acted as a lubricant for both the mortgage and housebuilding sectors. From a purchaser's perspective, it eases the restrictions imposed by mortgage regulation that have reduced their access to high LTV mortgages. However, these were already effectively restricted by high house prices: the affordability constraint became binding before the LTV constraint. Since its introduction in England in 2013, HtB has been taken up by approaching 280,000 households, with perhaps another 22,000 from Wales and Scotland. Although not limited to first-time buyers, they are the dominant users, accounting for more than 80 per cent of the total.

Between 2013 and 2020, HtB in Great Britain accounted for about 5.4 per cent of mortgages approved for house purchase (by number). Other shared-equity schemes would nudge the figure over 5.5 per cent. But as Figure 1.1.7 shows, the proportion grew from 2.6 per cent in 2013/14 to 7.3 per cent in 2018/19, before falling back to 6.9 per cent in 2019/2020. We estimate that Help to Buy loans for first-time buyers were associated with 10-13 per cent of mortgages for first-time buyers.



Source: Compendium Table 56.



Source: Bank of England and Compendium Table 105a.

Housebuilding

The housebuilding industry was also badly hit by the GFC, and consequently continued its long-term tendency to become more concentrated. Housebuilding was examined in last year's *Review* (Contemporary Issues Chapter 1), which established that growing concentration of the sector coincided with average output (in England) declining over the decades from 300,000 units annually in the 1960s to 130,500 in the 2010s, falling far short of the 340,000 units required.

The industry's priority in the GFC and its immediate aftermath was to maximise cash flow to avoid liquidation. Thereafter they prioritised profit over volume by adopting 'de-risking' strategies, notably focussing on greenfield sites with straightforward infrastructure requirements and where uncomplex standardised houses could be built, areas where planning permission was likely to be relatively easily obtained and areas where they could rely on rising house prices.[14] This strategy reflects housebuilders' business model that requires land to be purchased some years in advance of sales being made, which is inherently uncertain. Their strategy also appeared to rely increasingly on buying more large sites that could each be built out at a rate that would not depress prices and threaten profitability. The industry also benefited from Help to Buy, which now accounts for between 36-48 per cent of total sales of five of the six largest housebuilders (as pointed out in last year's *Review*).

House prices and affordability

This section examines trends in the house prices and affordability of owner-occupied housing. Table 1.1.1 presents house-price levels and trends using the long-running Nationwide price index. It shows how prices have changed across the nations and regions between the third quarter of 2007 when prices peaked nationally, and the most recently available figures in the last quarter of 2020. Further, since prices use an index whereby the first quarter of 1993 is 100, we can also compare prices in 2007 and 2020 with 1993, which was around the beginning of the cycle that peaked in 2007. The table also shows if and when prices returned to their Q3 2007 peak.

By the time nominal and real prices peaked in the third quarter of 2007, mortgaged ownership was already falling as people were being priced out of it. Across the UK as a whole, cash prices were 3.67 times higher than in 1993 in the third quarter of 2007. The greatest increase was in Northern Ireland where cash prices were 6.6 times their 1993 level (due to the 2005-07 spike), followed by London where they were 4.5 times higher. The smallest increase was in the North where they rose by 2.8 times. In real terms, house prices were 3.4 times higher across the UK.

After 2007, prices fell everywhere, but the recovery began in London where cash prices returned to their pre-crisis peak as soon as the first quarter of 2013.

Table 1.1.1 **Nominal and real house prices, 2007 and 2020**

	North	Yorks and The Humber	North West	East Midlands	West Midlands	East Anglia	Outer South East	Outer Metropolitan	London	South	Wales	Scotland	Northern Ireland	UK
Nominal (Q1 1993 = 100)														
Q3 2007	**294.5**	**318.6**	**307.8**	**346.1**	**316.6**	**363.2**	**395.5**	**373.2**	**451.8**	**378.9**	**317.3**	**290.6**	**659.4**	**367.3**
Q4 2020	**301.0**	**351.0**	**342.4**	**443.2**	**398.2**	**479.8**	**544.1**	**545.0**	**726.8**	**490.3**	**350.8**	**298.8**	**432.1**	**458.5**
% change	**2.2**	**10.2**	**11.2**	**28.1**	**25.7**	**32.1**	**37.6**	**46.0**	**60.9**	**29.4**	**10.5**	**2.8**	**- 34.5**	**24.8**
When reached Q3 2007	**Q4 20**	**Q3 2018**	**Q2 2018**	**Q3 2014**	**Q2 2015**	**Q2 2014**	**Q1 2014**	**Q3 2013**	**Q1 2013**	**Q2 2014**	**Q2 2018**	**Q2 2020**	**N/A**	**Q2 2014**
Real (Q1 1993 = 100)														
Q3 2007	**268.7**	**292.8**	**282.0**	**320.3**	**290.8**	**337.4**	**369.7**	**347.4**	**426.0**	**353.1**	**291.5**	**264.8**	**633.6**	**341.5**
Q4 2020	**246.2**	**296.2**	**287.6**	**388.4**	**343.4**	**425.0**	**489.3**	**490.2**	**672.0**	**435.5**	**296.0**	**244.0**	**377.3**	**403.7**
% change	**- 8.3**	**1.2**	**2.0**	**21.3**	**18.1**	**26.0**	**32.4**	**41.1**	**57.7**	**23.3**	**1.5**	**- 7.9**	**- 40.5**	**18.2**
When reached Q3 2007	**N/A**	**Q4 2020**	**Q4 2020**	**Q2 2016**	**Q2 2017**	**Q3 2014**	**Q2 2014**	**Q4 2013**	**Q1 2013**	**Q3 2015**	**Q4 2020**	**N/A**	**N/A**	**Q3 2015**

Source: Calculated from Nationwide index.

Broadly, the recovery in house prices spread out from London. Cash prices reached their pre-crisis levels in the South West, Outer South East, and East Midlands in 2014, and the West Midlands followed in 2015. However, this did not occur in Wales, the North West and Yorkshire & Humberside until 2018; and until the last quarter of 2020 for Scotland and the North. House prices in Northern Ireland remain substantially below their 2007 peak.

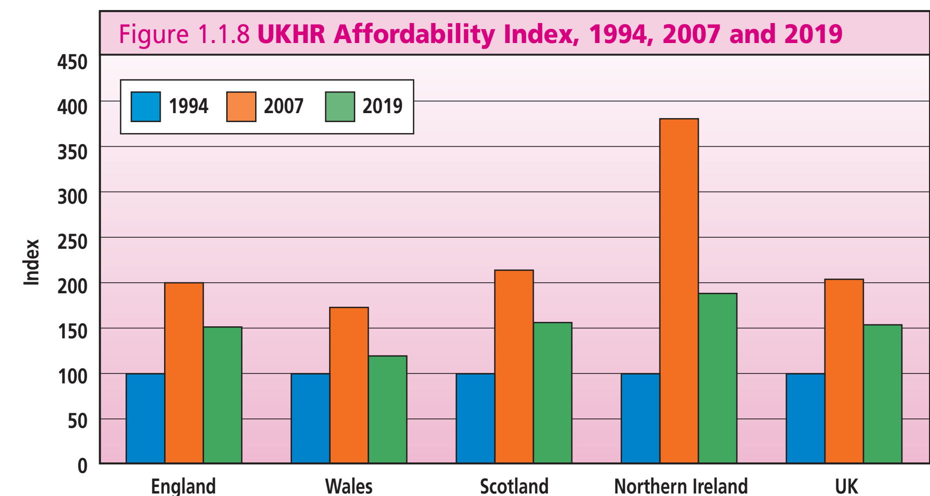
Obviously, it often took longer for real prices to reach 2007 levels. Across the UK as a whole this occurred in the third quarter of 2015, but there have been marked national and regional variations. Whilst UK real prices have grown by approaching one-fifth since 2007, in London they are 58 per cent higher now than in 2007 and they are a third higher in the Outer South East. In contrast, they are lower now in Scotland and the North (by about eight per cent) and in Northern Ireland (by 40.5 percent); they are only very marginally higher in Yorkshire and The Humber, the North West and Wales.

House prices compared to 2007 therefore tell a complex story, yet a perception remains that housing is expensive. Part of the answer may lie in the 'money illusion' – mistaking cash rises for real ones. But what remains true across the whole of the UK is that real house prices are substantially higher now than in the early 1990s. They are four times higher across the UK as a whole – and even in Northern Ireland 3.8 times higher. There is, of course, more to housing affordability than prices (incomes, interest rates and mortgage availability matter, too). But we might question whether the housing market 'corrected' as fully as was necessary to restore affordability after the GFC. This is illustrated very clearly by the Nationwide house-price-to-earnings ratios. Again, we emphasise these are not a complete guide to affordability overall, but they illustrate both the regional/national divergence following the GFC and also the higher 'floor' beneath which prices did not fall anywhere after the GFC, in contrast to the boom and bust of the late 1980s and early 1990s.

High house prices in relation to incomes place a break on access to owner-occupied housing, but the affordability constraint is weakened if servicing costs are reduced by lower interest rates or rising incomes. Real earnings were lower in 2018/19 than in 2007/08,[15] but interest rates have fallen as part of macroeconomic policy. The *UK Housing Review* Affordability Index seeks to capture the three vital elements that determine the ease of entry into homeownership: house prices, interest rates and incomes (Figure 1.1.8). For these purposes, the index is based on the simple average price of housing in each nation or region, the cost of a 25-year repayment mortgage at average prevailing mortgage interest rates and the long-term average LTV of 82 per cent, and the average gross income of one person in full-time employment. We caution that this is only a guide to affordability. Not only are figures averages, but the index assumes a single full-time income, whereas there are in reality a very wide range of employment types within households, including dual full-time earners, people on zero-hours contracts, people who are self-employed, etc.

Nonetheless, it captures the essence of what has been going on. In every nation (and indeed English region), affordability improved between 2007 and 2019. However, homeownership was falling in 2007. When 1994 – the start of the long period of house-price growth that preceded the GFC – is used as a benchmark, homeownership was less accessible in 2019.

Figure 1.1.8 **UKHR Affordability Index, 1994, 2007 and 2019**



Source: UKHR Affordability Index, Compendium Table 45a.
Note: 1994 = 100; the higher the index, the less affordable is homeownership.

The housing system on the eve of Covid

The period between the GFC and Covid largely witnessed the continuation of trends that were established before the GFC (Figure 1.1.9).

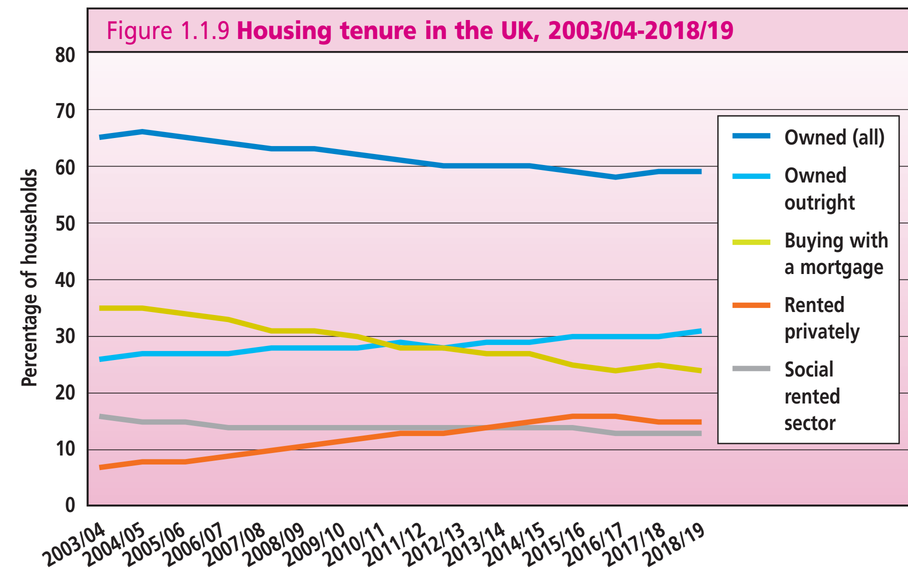
The tenure breakdowns are based on households and are derived from the Family Resources Survey. A change in a single year should be treated with some caution, but the trends over time are clear. The pattern over the 2003/04 to 2018/19 period features declining homeownership overall (from 69 down to 63 per cent), which disguises the fall in mortgaged ownership (from 39 per cent to 28 per cent), outweighing a rise in outright ownership (from 30 up to 35 per cent). Private renting grew rapidly (from 11 to 19 per cent) and overtook social renting which declined gradually (from 20 down to 17 per cent). However, a picture emerges towards the end of the period of some stabilisation in levels of mortgaged ownership and of private renting.

Figure 1.1.10 provides an age profile of mortgaged homeowners as this is suggestive of future trends in homeownership. Mortgage ownership declined in every age band (overall by 12 percentage points over 2002/03 to 2019/20). However, the largest fall was in the prime 25-34 age band: the drop was a full 24 percentage points from 59 per cent to 35 per cent. The 35-44 age band shows a decline from two-thirds to one half, and the 16-24 band from one-fifth to five per cent (although this figure is volatile due to the small sample). As with the overall figure there does appear to be some bottoming out in the latter part of the period.

Summary: the lost decade

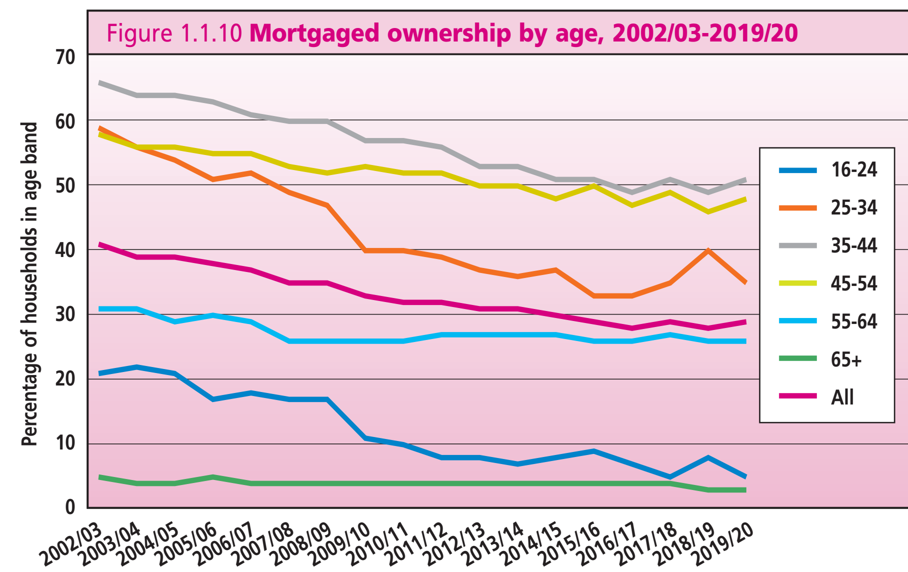
In summary, the housing system on the eve of Covid lacked any overall coherence and in retrospect the period bookended by the GFC and Covid resembles a lost decade. Monetary policy created conditions of very cheap money, and an incentive to invest in housing, but the regulatory priority to ensure prudence in the financial system created uneven access to cheap finance. Fiscal policy weakened state safety nets and continued to reduce investment in and access to social rented housing, whilst earnings remained weak. In these conditions private renting continued to grow, but (at least in England) remains on a highly insecure basis that makes it unsuitable for the long-term housing of many of the households who now depend

Figure 1.1.9 **Housing tenure in the UK, 2003/04-2018/19**



Source: Family Resources Survey.

Figure 1.1.10 **Mortgaged ownership by age, 2002/03-2019/20**



Source: Family Resources Survey.

on it. The government's long-term strategy remained that of creating the conditions to restore the supply of market housing, whilst doing nothing to reform the industry whose business model is predicated on controlling build-out rates in order to prevent prices falling. In the interim, a series of ad hoc measures have been deployed: taxing private renting less favourably to tilt the playing field towards homeowners and the state becoming an investor in new build properties, both to make up for the lack of mortgages at high LTVs and to support the housebuilders.

Responding to Covid

This section examines, first, the short-term responses to Covid, and then the longer-term responses that are needed to tackle underlying issues in the housing system that were not addressed following the GFC.

Short-term responses to Covid-19

The government's short-term response to Covid has mirrored some of the actions taken in response to the GFC. In the short term, the government has borrowed heavily – even more so than after 2008 – to support incomes and businesses effectively prevented from operating by lockdown measures. The Bank of England cut the base rate, but of course did so from a much lower starting point (0.75 per cent) than was the case in 2008 (5.5 per cent), and it now stands at a new historic low of 0.1 per cent, firmly in negative real interest-rate territory. The quantitative easing programme was also expanded by £450 billion from March to November 2020, doubling the extent it had developed over the previous decade (see Commentary Chapter 1).

The private market has been supported principally by recent stamp duty 'holidays' designed by different administrations. These mirror the 2008-10 'holiday' introduced during the GFC, which had the effect of bringing forward transactions to escape the re-introduction of the tax. The easing of the first lockdown in July 2020 led to a sharp bounce-back in the housing market, with transactions in December 2020 being the highest for that month in more than a decade.[16] The Scottish Government has already announced that the stamp duty holiday will finish at the end of March 2021, and it seems that the UK government will follow. However, in contrast to the GFC, there has been no boost to investment in affordable housing, perhaps because the housebuilders have not (yet) experienced the severe collapse in demand and finance they experienced during the GFC.

Individuals have also been protected, primarily through income-support schemes such as furlough. Whilst the LHA rate has been restored to 30 per cent of the local median rent, there has been no enhancement of the loan scheme that replaced support for mortgage interest. Instead, in both rental and homeowner sectors, blanket forbearance policies have been adopted, with the expectation that landlords and mortgage lenders will absorb cash-flow disruption (at the minimum) and possibly losses.

There is, however, no exit strategy and a series of cliff-edges as income-support schemes come to an end and forbearance unwinds. Managing this transition will be a major challenge.

Long-term responses to Covid

Whilst the exit strategy from Covid presents challenges, the crisis has also exposed huge weaknesses in social infrastructure after a decade of austerity. It has especially highlighted the low level at which social security benefits are paid. Particularly in the early weeks of the first lockdown, when there were unusually high levels of social cohesion, there was much discussion about how the country could 'build back better' across the economy and social policy, including in housing.[17]

However, there is also a strong temptation to muddle through and return to 'normal'. If mortgage lenders and private landlords continue to be able to exercise forbearance and to exit from this requirement without causing mass homelessness, and if the housebuilding industry continues to be able to sell its houses profitably, even as Help to Buy is replaced, then there will be a feeling in government that all is well, and they can sit back and wait for the proposed planning reforms to take effect.

This would be a mistake.

This chapter's examination of the decade that was bookended by the GFC and Covid has demonstrated the lack of strategy. Covid provides the imperative for government to reconsider the housing system as a whole and develop a strategy that has been lacking at least since the Treasury commissioned the Barker and Miles reviews, and since it thought carefully about monetary policy and housing in the context of potential membership of the euro in the 2000s.

This chapter ends with some suggestions as to what such a strategy might look like, that are intended to prompt discussion.

The context of monetary policy and housing supply demand the reform of land and property taxation

The move towards ultra-low interest rates supported by QE that occurred as a result of the GFC has intensified as a consequence of Covid-19 and is likely to continue, particularly as the boundaries between monetary and fiscal policy become less clear. The resultant supply of cheap credit and the negative real interest rates on government bonds will encourage upward movements in asset prices, including house prices.

It has been widely accepted since the Barker review that an increase in long-term housing supply is required to improve affordability in the housing market. However, even if housing supply were to be improved (see below), it would take decades before it would have a marked effect on affordability. This is because new supply is only a small part of total supply.

To date, the government approach has been to seek to address affordability problems with demand-side solutions, such as Help to Buy and stamp duty concessions, which do not address the underlying problem, but do contribute to maintaining high prices. A counterbalance to house-price inflation is therefore required in the shape of reforms to land and property taxation. They are needed to counter speculative expectations on both demand and supply sides, and to encourage more efficient use of stock. One of the key reasons for long-term rising prices is the tendency for demand for housing to rise disproportionately with incomes.[18]

The current mix of taxes are a mess, and reform would be beneficial, even without wider benefits. The council tax was designed to be regressive and is still based on 1991 values in England and Scotland. Stamp duty land tax and its equivalents discourage mobility. Ideally, a form of recurrent land-value taxation is desirable as a non-distortionary tax that could replace existing taxes. Transitioning to such a system could begin with the adaptation of the council tax into a proportionate property tax through the step-by-step alteration to the band multipliers, as was begun in Scotland in 2017. Experience shows that reform is possible: revaluation took place in Wales in 2005, and in Northern Ireland a new system of local taxation based on capital values replaced the old rates system in 2007.

The state should take a more active role in housing supply

The current policy of reforming the planning system whilst leaving the housebuilding industry unreformed is unlikely to produce the levels of long-term housing supply required to improve affordability. Limiting supply through build-out rates is an accepted part of housebuilders' business model, along with lack of diversity of product and location. Homes England seeks to address some of these problems, but focuses on the release of publicly owned land.

Part of the problem arises from housebuilders' aversion to building on brownfield sites and in lower-value areas. The state could play a vital role in increasing the supply and diversity of housing by purchasing privately owned land, putting in infrastructure and selling it for development. By carrying some risk, this should widen the availability of sites deemed viable by volume builders by shortening the time between purchase of land and sales, and by removing risk from otherwise uncertain infrastructure costs. It would also facilitate a greater diversity of housebuilder, and allow experimentation with different ownership models (such as community land trusts and self-build) and building techniques (e.g. 3-D design, and modern methods of construction). If land acquisition were to occur at or close to agricultural values (for example through compulsory purchase), it would also create a mechanism for land-value capture that can be used to support affordable housing, or could be recycled into the purchase of other sites.

Rethinking the role of rental housing
The UK government has displayed an erratic approach towards social rented and other forms of affordable housing. The Cameron government sought to marginalise it by turning it into a form of temporary welfare support or 'ambulance service'. The May government rowed back from that, but there is little indication that the Johnson government has a clear view of its purpose. If it continues to decline, as it is in England, then – particularly as demand rises – there is a high risk that the Cameron agenda will be resurrected. This would leave much need unmet, worsen affordability and create greater insecurity.

A long-term strategy for social renting might first begin with strengthening the sector's ability to provide a safety net for people who are unlikely to be able to secure housing of sufficient size and quality in the private sector. If supply increases sufficiently, then its function can broaden into a wider affordability role for a broader section of the community. Particularly in lower-demand areas, where the differences in rents between social and private rental are smaller, then social rented housing can begin to exert pressure on the private sector in terms of rents and standards.

The tenure shift towards private renting has played a significant role in raising poverty rates after housing costs. The rising cost of housing benefit prompted a series of cuts that have weakened this safety net (see below). There is a strong case for shifting subsidy back to the supply-side and to widen access to affordable housing. The ending of right to buy in England, which has happened already in Scotland and Wales, is overdue. Investment in social renting can help to contain poverty, and to reduce housing benefit costs – a form of preventative expenditure. Thinking about expenditure in the round is key to establishing a meaningful rental strategy.

Meantime, private renting is ripe for reform, as it remains largely unchanged outside Scotland. The Scottish example demonstrates that security of tenure can be greatly enhanced, although change has not been as rapid as anticipated.[19] International evidence (and indeed the UK's own experience over the twentieth century) would caution against rent caps, but would support workable rent pressure zones that limit rent increases for existing tenants and sometimes also when tenancies change. The requirements for RPZs in the current Scottish system are too onerous and should be reformed. Whilst it is important to recognise the limits of what regulation alone can achieve, there is an urgent need to increase tenants' security as a first and essential step towards modernising private renting.

Mending the income safety net
A constant theme in the *Review* has been the hardship caused by benefit cuts after 2010. The cuts to housing benefit (and equivalent support in universal credit) have been especially pernicious. The UK social security system was always designed around the assumption that mainstream benefits do not allow for the payment of housing costs. The pandemic has revealed quite how low UK benefit rates are – to the extent that the UK's furlough scheme actually resembles the generosity of a north-west European social insurance scheme – meeting 80 per cent of former earnings up to a limit. If there were a single set of changes that would make a real difference in the short term, they would be the retention of the £20 enhancement to universal credit and the maintenance of the local housing allowance rate at 30 per cent of median rents.

But in the long term, an enhancement of working-age benefit rates is greatly desirable and is supported by the Joseph Rowntree Foundation's Minimum Income Standard, which establishes the budget required for a household to purchase those goods and services (excluding housing) that most people believe everyone should enjoy. UK governments recognised that the state pension was too low and have systematically increased its real value over time. The same approach – which would require a step change in attitudes to social security, public expenditure and taxation to match – would be needed to raise the incomes of the working-age population and their children.

Ending homelessness
As is described in Commentary Chapter 5, the pandemic prompted sweeping changes to homelessness policy, as governments across the UK adopted 'Everyone In' policies to rapidly accommodate people sleeping rough and end the use of communal night shelters. Groups often not given full protection, notably single people and those who have no resource to public funds, were fully included, at least in the early stages.

There is an opportunity to build on such initiatives to aim to end homelessness. Progress has been made across the UK on improving homelessness prevention. There is a need to act rapidly where homelessness occurs in order to limit harm, and the pandemic has highlighted the desirability of ending the use of congregate accommodation such as night shelters and instead move towards rapid rehousing approaches (including Housing First) that prioritise swift access to mainstream accommodation with appropriate support within the wider community. It has also demonstrated the need to tackle the wider 'core homelessness' discussed in Commentary Chapter 5, including the ending of rules which deny certain groups access to help, which were quite correctly suspended during the pandemic.

Conclusion

The housing system has experienced two massive shocks in the past 15 years. The global financial crisis spurred emergency actions to protect the housing market, market institutions and homeowners. But subsequent policy, and the context in which it operated, failed to address underlying problems in the market. Instead of a strategic overview of the housing system, and its interconnections with the wider macro-economic framework and wider social system, housing entered a lost decade. Covid has prompted other emergency and short-term actions to protect the housing market, homeowners and tenants. Yet a key lesson of the GFC, repeated during the pandemic, is the need to regain strategic oversight of the housing system as a whole. This chapter has outlined ways that could contribute to this process.

Acknowledgement and notes

This chapter includes work undertaken for the UK Collaborative Centre on Housing Evidence project on housing systems, their institutions and their resilience: https://housingevidence.ac.uk/our-work/research-projects/housing-systems-their-institutions-and-their-resilience/

The chapter has also been informed by the author's experience as a member of the Scottish Government Coronavirus (Covid-19) Housing System Policy Circle: https://www.gov.scot/groups/coronavirus-covid-19-housing-system-policy-circle/

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14 Payne, S. (2015) 'Exploring the impact of the recession on British volume housebuilders: a behavioural analysis', in *Built Environment*, Vol. 41, No. 2, pp.271-288.

15 Calculated from DWP (2020) Household Below Average Earnings, Table 2a.

16 HMRC Monthly property transactions completed in the UK with value of £40,000 or above.

17 The Scottish Government established a Social Renewal Advisory Board to plan for the post-pandemic period, supported by a series of policy circles including the Coronavirus (Covid-19) Housing System Policy Circle. The main SRAB report along with the housing report (under 'supporting files') are here: www.gov.scot/publications/not-now-social-renewal-advisory-board-report-january-2021/

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