Solving the UK Housing Crisis
An analysis of the investment demand behind the UK’s housing affordability crisis
Daniel Rossall Valentine
About the Author

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Executive summary

This report was written to analyse the problem of the rapid decline in home ownership among young people because of near-continuous house price inflation since the mid-1990s. This report argues that the UK’s widely acknowledged housing affordability crisis is both more serious in its effects than most commentators recognise, and more easily fixed.

The current phenomenon of house price inflation began in 1997 and ran for a decade, until 2007. The answer to the mystery lies in the period 1996-1997. There are only two factors that explain this phenomenon: (1) the growth of owner-occupation demand caused by population growth and (2) the growth of investment demand because of the availability of “buy-to-let”, and a global elite that can buy properties for cash. These two factors have led to a huge growth in the competition for houses, with price escalation as the inevitable result.

The report demonstrates that building more houses, despite being the solution most widely touted, is not the answer to the UK’s housing crisis. In the face of demand from both domestic and overseas investors who see housing as a safe haven for their money, building more houses will have no downward effect on prices. Although expansion of the housing stock has led to price stabilisation (and even decline) in many parts of the UK, in Greater London and the commuter towns of the South East (SE) of England, increasing the supply of houses can have no effect on prices, because of the scale of demand. What differentiates demand in the SE of England from demand in the rest of the UK, is that whilst housing demand in most parts of the UK is local, in London and much of the SE, demand is global. This investment demand is in addition to the steady demand growth caused by the UK population growing by over 3 million in the two decades from 1994 to 2014, a phenomenon which has provoked substantial price inflation in those parts of the UK where the immigration has been focussed. However, although these two factors have often worked in tandem, it is not immigration which is the focus of this report, but the rather more localised issue of investment demand.

The drivers of house price inflation can be grouped into three categories: population, incentivisation and financialisation. Each of these factors has been promoted by government policies, some inflationary effects have been direct and predictable, and others indirect and accidental.

House price inflation is caused by a number of factors including population growth, low interest rates and government schemes to promote house purchase, but the single most important driver of house price growth in the more salubrious parts of London is the investment behaviour of High Net Worth Individuals (HNWIs)\(^1\), both domestic and foreign, who

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\(^1\) HNWIs are usually defined as individuals with a net worth of over $1 million, excluding the value of their first property.
treat housing as an investment for surplus funds. Their impact however is not limited to those areas that they invest in, but ripples out to a much wider geographic area.

The investment demand problem that London and SE England has been experiencing since the mid-1990s is spreading to a number of other areas of the UK. The issue began in central London, and then grew to Greater London and areas of the SE within commutable distance. It now threatens a number of regional cities such as Liverpool and Manchester as prices in London deter even foreign investors, and because of the spread of the property investment idea to a wider range of investors.

Politicians and commentators in the UK have shown a lack of ideas in relation to solving this crisis. Media understanding and analysis of economic and fiscal matters in the UK is very weak, and highly dependent on the press releases of Government and industry bodies. The UK’s powerful housing lobby has stepped into this intellectual vacuum by promoting house-building as the solution. However, this report demonstrates that new houses cannot be the primary solution to this immense problem. It is pure fantasy to think that the global demand for British houses can ever be met. Every town and village in the South of England would be ruined by millions of under-sized and under-quality flats and houses before demand was close to being met from the world’s 15 million strong financial elite, and house prices would still keep on rising. The solution to the UK’s housing crisis lies not in the creation of new housing stock but in changing the usage patterns of existing stock.

This report urges that measures are taken to limit the investment demand for houses. It is investment demand (not the commonly mentioned “shortage of new houses”) that has corrupted the housing market in many areas and pushed average house prices out of the reach of average citizens. The solution to the housing crisis is similar to the solution to the banking crisis of 2007/8. Just as consumers had been damaged because banks had failed to separate high-street banking from an increasingly aggressive and dominant investment banking operation that was driven by an excess of elite money, so the UK housing market needs separating from a global investment market. Since housing has become an investment market, it should be regulated closely like other investment markets. The process of market separation is neither complex nor expensive and it will once again allow British citizens to own a share of their own nation. This report focusses on the international aspect of this problem, the issue of foreign buyers, since their role in price inflation is both substantial and relatively simple to restrict.
Introduction

Dramatic house price booms began in the late 1990s in many countries including Australia, Canada, China, France, India, Ireland, Italy, Korea, Russia, Spain, the United Kingdom, and the United States. There is no prior example of such dramatic housing booms occurring in so many places at the same time.\(^2\) Conventional economics has never been able to explain price bubbles, since economists have been reluctant to incorporate social and psychological factors into their quantitative models. The dominant view of many economists until recently has been that housing prices are driven primarily by construction costs, a hopelessly antiquated view. The UK boom was perpetuated by a number of factors; cheap and easily available mortgages, a flood of elite money (both domestic and international) from High Net Worth Individuals (HNWIs) and a social epidemic of persistent optimism for real estate, encouraged by estate agents, journalists and other commentators. Whilst mortgage approvals have been tightened up, the investment money and epidemic of optimism remain, and it is these factors that this report addresses.

The UK has been experiencing a housing affordability crisis since at least 2001, when the UK’s house price to average household income ratio exceeded a multiple of 4. This crisis has changed the character of the UK housing market and caused immense distress because of the number of people who are now unable to get into the property market.

Britain is no longer a nation of homeowners, with homeownership rates well below the EU average. Despite growth in the number of houses constructed, the number of houses under owner-occupation has been falling since 2003. Home ownership fell from 76 per cent in 2001 to 65 per cent in 2010.\(^3\) Numbers of privately rented households have more than doubled since 1980, to about 4.5 million in 2014. Property agent Savills estimates that rental demand will rise by a further 1.2 million households by the end of 2019.

The cultural significance of home ownership varies considerably between different nations. In the UK, Australia, New Zealand and the USA home ownership is closely associated with the national dream, with the majority of citizens aspiring to ownership. Home ownership in the UK, however has fallen markedly since 2000 as a result of house price inflation, which excludes many people from obtaining a mortgage because the deposit and income requirements of mortgages rises as property prices rise. Britain has become a country divided into two nations, people who are on the property ladder and who are benefiting from property price rises, and those who are not on the ladder and fear never being able to get onto the ladder.

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\(^3\) DCLG, English housing survey and survey of English housing (homeownership trends)
since property prices are rising faster than salaries. This second group face a lifetime living at the parental home or being at the mercy of rolling 12 month tenancies.

Despite the self-serving stories told by the UK’s powerful property lobby, increasing the housing stock will never reduce house prices as prices are driven almost entirely by grossly excessive (and almost infinite) demand. Correcting the prices of UK property so that British people can afford to own property in the UK will not come from building more homes. More homes will only result in a new flood of foreign investors, both immigrants and overseas investors, and the housing crisis will be made worse by the exacerbation of the public sector services crisis that the UK is experiencing because of overpopulation. We argue that it is demand that needs to be corrected by limiting the number of properties sold to non-UK citizens.

As Danny Dorling has commented⁴, the wealthy are effectively engaged in a form of hoarding of a precious commodity, and the only way of preventing the hoarding of a limited resource is by some form of rationing.

This report suggests a number of regulations that will encourage a more intelligent, sustainable and pro-social form of investment, investment that is mutually beneficial for both the investors and the host community which has to live with the consequences. The “laissez-faire” approach has caused great hardship, social division and has damaged our cities, towns and villages. Despite the horrors of the current situation for both renters and potential buyers, swift action to limit investment and speculation could see sanity rapidly restored to the UK housing market. The political party which initiates this action is likely to receive a substantial dose of lasting goodwill from the millions of UK citizens who stand to benefit.

This report argues that it is time for the British government to help British people and reverse the trend for London homes being turned into safety deposit boxes and trophy assets for the super-rich of Asia and the Middle East. The two usual responses given, that “nothing can be done to counteract market forces”, and that the only way to bring down houses prices is to build millions of new houses, are both demonstrated to be false. The only way that price rises can be cut is by putting limits on the otherwise infinite quantity of investment money that is pouring into London in the search of better returns, and that has corrupted the UK housing market, creating a generation of tenants who now despair whether they will ever own a property. It’s time for the British Government to take the side of the British people and prioritise owner-occupiership over investment purchases.

Because of the absence of official data on property ownership, this report is forced to rely on the limited amount of data released by various members of the property industry, principally

⁴ Danny Dorling, All That Is Solid: How the Great Housing Disaster Defines Our Times, and What We Can Do About It (Penguin, 2015)
estate agents. The maintenance of a live property register should be regarded as a priority, so that the public can be informed and so that policy making can be guided by facts.
The UK housing crisis

“The housing crisis” is the common name for the growing realisation by many British people that they are unlikely ever to own a house. The problem is both general throughout the UK, but also particularly severe in the South-East of England. The average house price in England is now 5x the average salary, requiring a long period of waiting whilst a deposit is built up, unless parental assistance can step in. The multiple is over 11 in the SE, since the average salary is £28,400 and the average house price is £337,288. Since the typical salary multiple that a person can get for a mortgage is 3, this would require a deposit of £200,000. As house prices continue to escalate, the required deposit will keep escalating faster than an individual’s ability to save. Most people not already on the ladder will never own a house. This is a crisis and tragedy that neither the public nor the government has yet fully grasped.

Figure 1 – UK and London house prices (Source: Savills Research)

Figure 1 shows two main periods of house price growth, the 1980s and the 2000s. House prices rose consistently from 1996 to 2007, growing by a factor of 3 during this decade of growth.

Whilst the number of new homes continues to grow, the number of homes owned with a mortgage has fallen by almost 800,000 over the past five years, whilst the private rented sector has seen great growth in the same period, up by 57 per cent. Price inflation in housing is turning housing into an investment market and the trend is gathering pace now that institutional
investors have joined private investors. British people face a grim future unless the Government starts to limit the scale of foreign ownership. It’s time to give the British a fair chance to own a house.

Since 2000, the proportion of the public who own their own homes has fallen from 70 per cent to 65 per cent, despite the number of people who aspire to home ownership remaining unchanged.

The UK has been experiencing a period of sustained inflation of property values with serious social consequences. Most people on average wages will never be able to buy a property in their lives. The British Government has largely responded to the housing crisis by adding fuel to its flames. The immigration policies of Tony Blair combined with the mortgage subsidies and low interest rates of David Cameron have contributed to a surge in house prices since 1995 that means that the average house in England and Wales in 2014 cost 8.8 times average household income, and in some areas 20 times local incomes. Much of the price inflation is due to the emergence of a vast number of foreign buyers who now own close to 10% of the UK’s housing stock, but who are affecting prices throughout the whole housing stock. Unchecked, foreign ownership of property could match foreign ownership of UK listed companies, at over 50%.

**Figure 2 – UK house price to earnings ratio** (Source: Nationwide, ONS)

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5 Housing Summary Measures Analysis (ONS, 5 August 2015)
2013 marked a significant year for the London Stock market, it was the year that the majority of the stocks listed (53%) became foreign owned. The foreign takeover of the UK housing market began much later, but already by 2012 the majority of the office space in the city of London was foreign owned. Qatar now owns more of London than the Crown Estate, and all of this has happened in a few years. One need not be a “buy British” protectionist to be troubled by this trend. The unchecked rise in foreign ownership has left the UK’s economy more vulnerable to international economic shocks and its government more willing to listen to foreign investors. The British, still accustomed to think of themselves as owners are, in reality, increasingly a nation of tenants.

Location is key to the value of property and this fact produces highly significant local variations to property prices, but for simplicity this is usually reduced to regional variations. Since 2010, London has been by a new trend, when it broke away from the rest of the UK housing market, a phenomenon that also hit the SE to a lesser extent in 2011. Figure 3 shows the extent of London’s lead in property prices, and also the north-south divide.

<table>
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<th>2014</th>
<th>Value £bn</th>
<th>1 year</th>
<th>5 year</th>
</tr>
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<tr>
<td>LONDON</td>
<td>1,485</td>
<td>20%</td>
<td>61%</td>
</tr>
<tr>
<td>SOUTH EAST</td>
<td>1,058</td>
<td>11%</td>
<td>25%</td>
</tr>
<tr>
<td>EAST</td>
<td>584</td>
<td>11%</td>
<td>22%</td>
</tr>
<tr>
<td>SOUTH WEST</td>
<td>519</td>
<td>7%</td>
<td>14%</td>
</tr>
<tr>
<td>NORTH WEST</td>
<td>423</td>
<td>5%</td>
<td>-1%</td>
</tr>
<tr>
<td>WEST MIDS</td>
<td>360</td>
<td>5%</td>
<td>7%</td>
</tr>
<tr>
<td>SCOTLAND</td>
<td>325</td>
<td>7%</td>
<td>1%</td>
</tr>
<tr>
<td>SC &amp; H</td>
<td>310</td>
<td>4%</td>
<td>1%</td>
</tr>
<tr>
<td>EAST MIDS</td>
<td>295</td>
<td>6%</td>
<td>9%</td>
</tr>
<tr>
<td>WALES</td>
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<td>2%</td>
<td>0%</td>
</tr>
<tr>
<td>NORTH EAST</td>
<td>133</td>
<td>4%</td>
<td>-5%</td>
</tr>
<tr>
<td>N IRELAND</td>
<td>78</td>
<td>8%</td>
<td>-19%</td>
</tr>
<tr>
<td><strong>GRAND TOTAL</strong></td>
<td><strong>5,752</strong></td>
<td><strong>10%</strong></td>
<td><strong>20%</strong></td>
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*Figure 3 – Regional house price inflation* (Source: Savills Research)

The SE England housing market is a bubble that’s fuelled by an almost infinite supply of global capital, an investment wave that began in the 1980s in prime central London properties but has long been inflating Greater London and regional cities. Over the last 30 years residential property has outperformed every other investment class which has attracted private investors.
In the last 5 years institutional investors have shown greater interest in residential property, this is likely to sustain the bubble for decades, while homelessness and landlordism increase.

The government under the influence of the property industry has made the bubble much worse, by loosening planning regulations and allowing the building of poor quality housing, by sustaining bizarrely low interest rates which encourage buy to let, by refusing to listen to public concern over immigration (both legal and illegal) and by subsidising buyers (including foreign buyers) through the “Help to Buy” scheme. Each of these policies has further inflated property prices.

Cities need large populations of workers of all economic levels. Families benefit from stability of accommodation, and accommodation of sufficient size. Large numbers of houses in unproductive use are a nuisance. Outside of home ownership, the UK offers little in the way of accommodation stability. Tenants in the UK only have power when they stop paying rent since eviction processes are slow. But law-abiding tenants have very few rights.

The housing crisis has been spun by the property lobby as being a problem of antiquated planning law and narrow minded locals who resent school playing fields, historic buildings and green belt being lost to the growth of more houses. In fact, additional supply of houses will not affect prices. Extra supply simply increases the crisis by adding a population crisis on top of a housing crisis. The single biggest factor in the rise of house prices to their current incredible levels is the growth of a vast foreign buyer segment. This foreign buyer segment is now so large that it has fatally distorted the market and is a serious hazard to British living standards and the British way of life. Foreign buyers are able to target the best quality housing stock, leaving British citizens living in smaller and smaller accommodation, whilst paying such high prices that their disposable income is constrained for the whole term of the mortgage.

In July 2015, a report by accountants PwC suggested that more than half of the under 40s will be renting homes from private landlords in the UK by 2025. The report suggested that house prices will rise at an average of 5% a year, pricing the typical home at £360,000 by 2020. This would equate to a homebuyer needing £64,800 in savings to pay a deposit to get on the property ladder in 2020. The UK housing market will then effectively be the preserve of the wealthy, and the social division between owners and renters will grow.

The Housing Crisis is both more complex and more simple than people think. Whilst many policies exist that could limit both domestic and foreign investment money in the housing market, the complexity is the challenge of getting the UK Government to endorse them, given the power of the property lobby. The British should rightly be angry that politicians have known about this issue long before central London’s median house price was the £1.4 million it is today.
Despite the myths of the property lobby, England is very intensively developed; and highly populated, and the scope for building more homes very limited.

Land is a limited commodity, and therefore increases in demand result in sharp price rises. Almost all governments in the world recognise that a free market in housing will not produce optimal outcomes, and that public policies are required to strike a balance between economic forces and non-economic goals. In a welfare state, the intervention of the government is especially important, since unemployment creates a substantial cost to the public purse.
Social problems caused by house price inflation

Sustained house price inflation creates a number of major social problems including the following:

1. **Growth of the proportion of rental properties** and decline in the proportion of properties that are available for purchase. This is an almost automatic phenomenon caused by house prices going beyond the level that people can borrow, and deposits also escalating. In these conditions, investment buyers become much more powerful in the market, and can use this power to amass large portfolios of homes, which are then offered for rent.

2. **Overcrowding.** Overcrowding is one of the many tangible impacts of the housing crisis on households across the country. Data from the Office for National Statistics shows that homes with six residents are the fastest growing category of household and 3 million people in the UK now live in a home with at least five other individuals. In a period of price inflation, tenants are increasingly forced to sublet communal rooms as bedrooms in order to cover rent inflation.

3. **Delayed home-owning.** Young people trapped in rented properties or parental homes till mid-life; facing delay in starting families and restrictions on the other freedoms associated with security of tenure, such as the ability to entertain guests and the freedom to refurbish living quarters to personal taste. According to PwC, the proportion of young people (aged 20-39) who own a home (or have a mortgaged property) will fall from 38% (2013) to 26% by 2025. As a consequence the number of young people who rent a property is set to rise from 45% (2013) to 59%. The number of people who want to own a house but are unable to get onto the housing ladder (the home-ownership gap) has been estimated at 5 million people. According to the ONS, across England, 2 million adults are still living with their parents. Calling this “delayed” home-owning is rather euphemistic, since unless the problem resolves, most of these people will never be able to own a house. House prices continue to rise faster than wages and so the bar for the deposit will keep moving upwards.

4. **Smaller properties.** The house price crisis encourages builders to construct smaller and smaller properties, in order to create “affordable homes”, and to maximise the profit from the diminishing amount of available land. According to RIBA, the average one-bedroom new-build home is currently 46 sq m, the size of a carriage on London Underground’s Jubilee Line. The average floor space for a property in the UK as a whole

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7 Death of a Dream (HomeOwners Alliance, November 2012)

8 Young adults living with parents (ONS, 2013)
is currently 85 sq metres – making UK homes the smallest in the EU, and less than half the size of average houses in Australia, Canada or the UK.

5. **Residential segregation.** Further segregation of urban areas, with domestic owner-occupiers squeezed out from the well-heeled areas that are most attractive to investors.

6. **“Landlordism”**. Landlordism represents a collection of problems associated with the rental of properties to low-income households, and the unpleasant tactics that landlords use when faced with tenants who have few choices. Landlordism is associated with overcrowding, insecurity of tenure and poor maintenance of property.

7. **Emigration.** Emigration has never been higher than it is now, with many young people realising that the only way of owning a house is to leave the UK. The emigrants tend to be educated above average, and this represents a brain drain.

8. **Escalation of government spend on housing benefit.** One of the stated goals of the 1980 “right to buy” policy was to reduce spend on housing. It was initially successful in this goal, but the rapid rise in housing benefit spend between 1990 and 2012 has negated this cost saving.

9. The further **elimination of parks and playing fields**, as recreational spaces yield to the remorseless activity of property developers urged on by escalating land values. Rising house prices places socially useful land under threat including the preservation of historic buildings.

10. **A reduction in duration of tenure.** Rising prices tend to increase the turnover rate of flats, since landlords will try to increase rents and many tenants will not be able to afford these rent rises and will therefore be forced to “downshift” i.e. locate a cheaper flat. Frequent relocation is disruptive for anyone, but is particularly disorientating for children.

**Prognosis**

The future of UK housing is very grim unless investment money is restricted, because there is an infinite supply of global funds. It is estimated that there are 63 million potential buyers in China alone. Investment from mainstream institutional investors in residential property is growing rapidly, attracted by the consistent growth in value. Whilst institutional investors are likely to be much better landlords than amateur investors and small companies, this trend will help to sustain price inflation, as investment trusts increasingly compete with smaller investors when apartments come onto the market. This will increase the degree to which owner-occupiers are squeezed out of the market.

Other likely effects if the market remains unregulated are:

- Further inflation in regional cities. Price inflation in SE England is putting even wealthy investors off. Investors are now being guided by the leading estate agents into “second-
“tier” global cities such as Manchester, Liverpool and Edinburgh, which are likely to see considerable price inflation as a result.

- The “one generation effect” currently limits the social harm of house price growth, but the effect on the next generation will be much more profound. People who are already on the housing ladder have seen a paper profit on their houses (one they are unlikely ever to realise) and they retain their freedom to relocate, since their appreciating house gives them the ability to tread water in a rising market. Their children however are in a different position, and face a double effect; they need inheritance money more, but their inheritance will come increasingly late in their life due to increased longevity; the average age for inheritance is rising, and is now close to 60.⁹

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⁹ [www.telegraph.co.uk/finance/personalfinance/tax/11144362/Why-inheritance-is-dead-for-a-generation-in-middle-age.html](http://www.telegraph.co.uk/finance/personalfinance/tax/11144362/Why-inheritance-is-dead-for-a-generation-in-middle-age.html)
Causes of house price inflation since 1997

The drivers of house price inflation can be grouped into three categories: population, incentivisation and financialisation.

House price inflation is commonly attributed to shortages in housing supply. Figure 4 shows the growth in English housing stock since 1969 with the UK average price overlaid.

Figure 4 – Dwelling stock by tenure type (England)

Figure 4 shows a continual growth in the size of the housing stock over the whole period, but a change in the mix of housing with a decline of council housing after about 1980, a substantial growth in housing association properties from the mid 1990s, and a rise then fall in owner occupation as private renting first declined and then rose.

Figure 5 shows the additions to the UK housing stock for every year from 1949 to 2013. The rapid decline of council house completions after 1979 is a notable trend, but private completions remained relatively steady from 1980 to 2007.
What is clear from both graphs is that house price inflation since 1996 has not fundamentally been caused by supply-side issues, either by a change in the overall housing stock or a contraction of new construction. The total housing stock has been in continuous growth, and this substantial growth of housing stock since 1998 has failed to check price growth. The contraction in private housing completions did not take place till 2007, indeed this contraction in house completions did not accelerate house price growth, but was accompanied by a rapid decline in house price growth. For the causes of house price growth we have to look elsewhere.

The substantial growth of housing stock since 1998 has failed to check price growth. This fact is used erroneously by the property lobby as an argument for an even greater building programme. A more logical response would be to look elsewhere for the causes of house price inflation.

Figure 5 – House building 1949-2013
Recent UK house price inflation is not driven by supply but by demand. The nine principal demand-side causes are shown in Figure 6 below:

Three of the nine causes of house price growth (shaded purple in figure 6) derive directly from UK Government policy, and relate to property taxes, interest rates and house-buying incentives. Historically the UK has offered exceptionally generous tax treatment to overseas investors in UK property. No tax was due on capital gains realised on sale, rental profits were taxed only at the basic rate of income tax instead of the rather higher corporation tax rate, a lower rate of stamp duty applied on purchases and there were also inheritance tax advantages. Although much of this generosity was removed in April 2013 and April 2015, London still has a large stock of foreign-owned property which dates from this more generous tax regime.

Historically low interest rates of 0.5% since March have fuelled a domestic surge of buy-to-let landlords, who can achieve rental income out of even highly overpriced properties, simply due to the artificially low interest rates.
In addition to mortgage tax relief and low interest rates, schemes of government assistance have targeted those earning too little to obtain a mortgage. The “help-to-buy” scheme is described in a later section. This scheme has promoted continued price inflation by removing the obstacle of the deposit required for a mortgage.

Immigration also places a substantial demand on UK housing. British politicians rarely mention the topic of immigration because of the level of public anger on the subject. As Sir Andrew Green of Migration Watch says: "There's been a remarkable silence on the impact of migration on housing demand".\(^\text{10}\) In December 2014, the ONS reported that there were 5.3 million non-British nationals in the UK. It is not known how many of these have purchased properties, but they currently enjoy the same ability to purchase UK property as UK citizens.\(^\text{11}\) To this should be added the ONS’s latest estimate of people living illegally in the UK, which is 430,000, a figure which is likely to be a substantial underestimate. Migration Watch estimate the figure to be 1.1 million, the European Commission estimated that there were 863,000 illegal immigrants living in the UK in 2008.

Figure 7 shows the spikes in 1994, 1998, 2004 and 2014 each of which represented a huge growth in immigration volumes. The spike in 1998 represents the disastrous liberalisation of Tony Blair under pressure from large corporations for a growth in unskilled labour. Changes which included giving immigrants the right to change employer, the abolition of exit checks, a hugely increased allocation of work permits, liberalisation of the family reunification scheme (abandonment of the primary purpose rule), and relaxing the rules on the admission of dependants of work-permit holders. The spike in 2004 represents the accession of Eastern European countries (EU8) to the European Union, and the spike in 2014 represents the accession of Bulgaria and Romania (EU2). House price growth from 1997 correlates closely with the growth in net migration which began in 1998.

An increasing birth rate due to past immigration, increasing longevity, legal and illegal immigration are the four drivers of the UK’s rapid population growth. The signs of over-population in SE England are clear. The UK cannot currently feed its population, a rather clear signal that it may be overpopulated. Public sector services (education, health, transport) are overstretched in SE England and in many towns across the UK, another sign of over-population. The over-population of London and the SE is a further reason why foreign ownership of property should be restrained, because of the twin effects that foreign buyers have; the inflation of house prices and the constriction of supply through leaving properties vacant.

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\(^{10}\) [www.bbc.co.uk/news/magazine-15400477](http://www.bbc.co.uk/news/magazine-15400477)

\(^{11}\) Annual Population Survey (ONS)
The UK’s population has grown by 7 million in the twenty years from 1994 to 2014, from 58 million to 65 million. The housing stock in the same period has grown by 3.3 million from 20.1 million to 23.4 million. This unprecedented and unplanned population growth has led to public services being shared amongst a much larger population. The loss of land to housing has failed to check house price growth which means that the UK is being hit by a triple whammy due to uncontrolled immigration; (1) the permanent loss of land for recreation, public services and agriculture (2) extra pressure on public services and (3) the escalation of house prices.

The form of population growth is also significant. The current population growth is quite different from the population growth of the 1950s and 1960s. That growth was driven by the birth rate, current growth has been driven by immigration since 1994. Migration driven growth results in much greater demand for housing than birth-rate inspired growth since immigrants are usually external to the existing social structure and so create immediate housing demand whereas the housing demand caused by domestic births is delayed and more flexible.
Immigration has an immediate effect, but also a longer term effect, which is the **growth in the UK birth rate**, due to the different social patterns of many immigrants.

**The financialisation of the property market**

Four of the nine factors (shaded grey in Figure 6) are related to the “financialisation” of the UK property market. Financialisation is the process by which markets are converted into financial markets, making products into investments and buyers into investors.\(^{12}\) This financialisation has occurred at a rapid pace; in the 20 years since buy-to-let mortgages were first offered on a large scale in 1996 the number of private landlords has grown to over 2 million. The financialisation of the housing market has divided the UK into property owners who are benefiting from house price inflation, and non-owners who are trapped in rented accommodation or living with parents.\(^{13}\)

Sales of UK homes worth £1m+ reached a new peak of 19,000 in 2014 according to HMRC figures, having tripled in number over the past 10 years. These statistics reflect the level of wealth generated both globally and domestically over the past 10 years. The growth of a new **global economic elite** since the economic liberalisation of Russia that started in 1992 and the liberalisation of China since 1997 has been well documented. Initially, investors from these countries were unsophisticated, but following the growth of professional advice services, these investors are now able to search for investment opportunities world-wide. This new elite of super-rich are taking advantage of lax regulation to pick up luxury property in the world’s premier cities. UK interest rates at 0.5% since March 2009 and political and economic stability have contributed to the view that UK property is a safe haven for overseas investors. The UK has long been a destination of choice for the world’s plutocrats, but this rapidly growing size of this group is producing serious social harm for London’s working population who have already been forced out of many of London’s most pleasant areas; and now face being forced out of London altogether. Overseas investors’ now own a quarter of UK investment property, albeit still some way off their 53% stake in the UK equity market. Overseas investors have become even more dominant in City of London offices, now owning 56% of the invested and owner-occupied stock. They also own a third of the total office stock in the West End and Midtown.\(^{14}\) The “finding shelter” report by Civitas in 2014 reported that 85% of prime London property purchases in 2012 were made with overseas money; with two-thirds of homes bought by people from overseas not purchased for owner-occupation but as investments.\(^{15}\)

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\(^{12}\) More broadly, financialisation denotes the increase in the size and importance of a country’s financial sector relative to its overall economy, the increasing importance of financial markets, institutions and motives and the growing political influence of financiers.

\(^{13}\) In 2005, 59% of 25 to 34 year-olds owned their own home in England – the figure is now just 36%. In 2005, 21% of that age group were renting, the figure is now 48%.

\(^{14}\) The Size and Structure of the UK Property Market 2013 (IPF, 2014)

\(^{15}\) Finding Shelter (Civitas, 2014)
Leading nations that invest in the UK include Russia, the UAE, Hong Kong, China, Malaysia and Singapore, all countries which restrict British citizens from buying properties. The number of Chinese citizens alone who are wealthy enough to afford a property overseas has been estimated at 63 million by Chinese estate agents Juwai. The Chinese 'miracle' has notably not succeeded in creating a country that people choose to live in, when they can choose. Hurun reports that 85% of Chinese millionaires want to educate their children abroad and 67% want to emigrate.

Corruption is rife in many of the countries that invest in the UK, including Ukraine, Russia, Nigeria and China. China has a vast, growing and unsolvable problem with corruption investigations running at 142,893 in 2011; 160,718 in 2012, and more than 182,000 corrupt officials in 2013.

Foreign criminals are using the London housing market to launder billions of pounds, pushing up house prices for domestic buyers according to Donald Toon of the National Crime Agency who said: “I believe the London property market has been skewed by laundered money. Prices are being artificially driven up by overseas criminals who want to sequester their assets here in the UK.” The NCA has identified the UK and crown dependencies as a destination for “billions of pounds of European criminal proceeds”.

According to Transparency International, who analysed data from analysing data from the Land Registry and Metropolitan Police Proceeds of Corruption Unit, 36,342 London properties are held by offshore companies established for tax avoidance. Almost one in ten properties in the City of Westminster (9.3 per cent), 7.3 per cent of properties in Kensington & Chelsea, and 4.5 per cent in the City of London are owned by companies registered in an offshore secrecy jurisdiction.

The UK, Australia, Canada and the US are the most popular destinations for Chinese real estate investment. In London, Chinese buyers accounted for 11 per cent of all property transactions above £1m in 2014, up from 4 per cent in 2012, according to Knight Frank. The comparable figure for Russian buyers, the second-largest group, was 5 per cent — a proportion that has hardly changed for several years. Total value of investment in overseas real estate by Chinese institutional investors has also ballooned from $600m in 2009 to about $15bn in 2014, according to Knight Frank.

Institutional investment interest in residential property is also rising rapidly. Between 2001 and 2011s the performance of UK residential property far surpassed the performance of commercial property, with a total annualised return of 9.6%, versus 6.9%. At close to £6 trillion, residential property is by far the largest asset class in the UK and is worth 3x the total

16 [www.bbc.co.uk/news/uk-33662174](http://www.bbc.co.uk/news/uk-33662174)
18 [www.ft.com/cms/s/0/fcc2d346-bcd3-11e4-9902-00144feab7de.html#axzz3owprrHYI](http://www.ft.com/cms/s/0/fcc2d346-bcd3-11e4-9902-00144feab7de.html#axzz3owprrHYI)
19 Investment Property Databank (IPD) results for the year to 31 December 2011
UK equity market and 8x the value of commercial property\textsuperscript{20}. Over the last 30 years UK residential property has outperformed every other asset class, with an average annual gain of 7%.

In London alone, residential property is valued at £1.5 trillion, more than all the housing stock in Scotland, Wales, Northern Ireland and the North of England combined. London’s two wealthiest boroughs, Westminster and Kensington & Chelsea, have a higher combined value than the whole of Wales. The value of London’s housing stock has risen by 20 per cent over the past year, up by 61 per cent over the last five years.\textsuperscript{21} Added to purchases by wealthy private individuals, this will produce a further escalation of property prices. The value of the UK’s residential stock in mid-2013 is estimated to be £4,615bn, seven times the size of the commercial stock. This value is 51% higher than 2003, compared to the 11% uplift in the commercial stock. Residential has grown faster despite greater expansion in supply.\textsuperscript{22} Institutional investors have long been heavily engaged in the ground rents and student accommodation sub-sectors. This interest has now broadened and a number of investment vehicles are available such as Real Estate Investment Trusts (REITs) and Property Authorised Investment Funds (PAIFS). Aviva Investors, Legal & General and M&G are three institutional investors who have stated that they plan to increase the scale of their investments in private rented-sector homes.

In addition to overseas investors, the UK has a substantial \textbf{domestic elite}, being home to some 550,000 high net worth individuals (HNWIs) according to the 2015 CAP Gemini World Wealth Report.\textsuperscript{23}

The \textbf{buy-to-let} phenomenon turned many ordinary people into property investors. The phenomenon was facilitated by the increase in landlord power in the 1980s including the abolition of rent controls and the introduction of assured shorthold tenure (AST) in 1988, which gave landlords much greater powers of eviction. Mortgage lenders coined the term “buy-to-let” in 1995 and began to promote mortgages for buy-to-let properties. These mortgages had always been available to a minority of trusted property developers but were now promoted to high-street customers. This lead to a growth in the private rental market as ordinary people were now able to become property investors, previously buyers had to pay cash for properties they were intending to let out. The 1996 housing act increased landlord power further by making ASTs the default tenancy offered to private renters. In retrospect the growth of “buy-to-let” has had a very detrimental effect on the availability of housing stock for owner-occupation. More than two million people are now private landlords. The trend did not start

\begin{itemize}
    \item \textsuperscript{20} Zoopla Research December 2012
    \item \textsuperscript{21} Savills Research
    \item \textsuperscript{22} The Size and Structure of the UK Property Market 2013 (IPF, 2014)
    \item \textsuperscript{23} World Wealth Report (CAP Gemini/ Royal Bank of Canada, 2015)
\end{itemize}
immediately in 1996. In 2000, less than two per cent of mortgages in Britain were buy-to-let. The number of buy-to-let mortgages grew most strongly in the years 2005-07. They now account for 15% of all home loans, and the proportion is still growing, since they account for 18% of all new mortgages. Buy-to-let investors have been helped by favourable tax arrangements through tax relief on interest payments on buy-to-let mortgages of up to 45% alongside a 10% wear-and-tear allowance. Between 1999 and 2011, the number of outstanding buy-to-let mortgages grew from 73,200 to 1.39 million, with the value of mortgages outstanding increasing from £5.4 billion to £159 billion in 2011. Government figures show that between 1986 and 2012 about 5 million new homes were built. Of these just over half are now owned by private landlords and let.\(^{24}\) In 2000, Gordon Brown ended the “Mortgage Interest Relief at Source” (MIRAS) scheme. MIRAS had been introduced in 1969 and allowed home buyers to claim tax relief on their mortgage payments, of up to £30,000 per annum per house. The tax-break was ended for owner-occupiers but retained for buy-to-let landlords, giving them a substantial tax advantage when buying a home. In the summer budget of 2015, George Osbourne announced that the tax break for landlords will be cut. From 2017, the amount landlords can claim as relief will be gradually reduced to basic rate of tax – currently 20 per cent, rather than 45%.

Investors can have a useful role in the housing market as risk-takers and regenerators. But the vast majority of money coming into UK housing is not from genuine investors but from profiteers who are riding the current trend, rather than innovating, risk taking, and leaving the housing market better than they found it. In addition, much of the foreign money in UK housing is undoubtedly dirty money, i.e. the product of government corruption and organised criminality, since the purchase of housing is a common method of money laundering.

The UK housing market is particularly attractive to foreign buyers because of political stability, the use of the English language, the presence of large diaspora from every nationality on earth and the absence of restrictions on foreign purchase of UK housing stock.

Investment buyers provoke price inflation because they are less price-sensitive, prone to herd behaviour and have considerable buying power. Foreign buyers exacerbate this situation because of their dependence in intermediaries and “experts” who aggressively market UK housing as an investment opportunity. Large blocks of housing are purchased by foreign investment companies and then sold abroad, at inflated prices.

London’s emergence as the second-home capital of the world, does not just affect the prices of high-end properties, but pulls up prices throughout the whole market, as buyers at every level are downgraded to the level below. This effect is nothing new in London, which has been

a market for second homes for over a century, but the scale of the phenomenon is new, with up to 85% of prime property being sold to foreign buyers. In many parts of London, it is the British who are the outsiders.\textsuperscript{25}

The influence of foreign buyers is not limited to London. Price inflation which began in London now affects the market generally, both because the lower end of foreign buyers are now themselves priced out of London and investing in regional cities but also because of the bullish mood that infects the whole UK market, driven by stories of ridiculous prices and ridiculous profits.

A huge marketing operation promotes London properties as investments across the world. Large trade shows do not merely visit New York, Hong Kong or Dubai but now tour former Soviet Republics, the Arab states and South-East Asia, in order to sell apartment blocks. Buyers do not need to even visit the UK to buy a property.

The UK is estimated to have 550,000 of the world’s 15 million HNWIs, putting it in the top five globally behind the US, Japan, Germany and China. Over the past 10 years, the total number of global HNWIs has risen by 77%, and their wealth is forecast to rise by a further 25% over the next three years. These UK HNWIs own an estimated 38% of the UK’s total wealth, and 45% of them live in London.

Figure 8 shows the connections between cause and effect in house price inflation. Price inflation is naturally the result of a growing gulf between demand and supply, but it is principally caused by demand rather than supply, because it is demand which is increasing rather than supply which is shrinking. Although supply is actually increasing, much of this increased supply is not turning into additional houses for owner-occupiership, but being eaten up by foreign and domestic investors who have three other uses for property. This is explored in the next section.

\textsuperscript{25} \url{www.londonlovesbusiness.com/property/residential-property/five-reasons-why-the-london-property-bubble-will-burst/5892.article}
If house supply is increasing quite rapidly why is owner-occupation falling? The answer lies in the investment demand for houses which acts to change the way houses are used and re-deploy owner-occupied houses into two types of investment vehicles. The fourth purpose of houses is second-homes, demand for which is a by-product of the growth of economic elites.

Figure 9 shows the three types of problem behaviour which act to both inflate house prices and reduce the stock of properties for owner-occupation. The number of houses in owner-
occupation has shrunk since 1990 because a growing number of properties are used for these three other functions. First time buyers in particular are disadvantaged at bidding stage because both buy-to-resell and buy-to-let house buyers can negotiate more effectively, can out pay and can typically make an offer more quickly, giving them considerable advantages over owner-occupiers.

![Figure 9 – Four phenomena competing for residential properties](image)

These three types of usage are not wrong in themselves, but in a market with excessive prices and a long queue of perhaps three million people who wish to buy for personal occupation, these three usages take on a very different personality, being causes of major social problems such as homelessness and “near-homelessness” (London now has 75% of all households in temporary accommodation), the growth of “ghost streets” where foreign owners (and vacant properties) dominate, growth of social segregation, prolonged occupation of the parental home which delays family life and limits geographical mobility, prolonged renting which also hampers family life because of the lack of security that UK tenancy law provides, and children forced to buy properties far from the district of their birth because of house prices.

Each of these three phenomena has a long history in the UK, but what is new is the scale, the origin, and the effect. The scale of investment buying both from domestic and foreign buyers is now so great that people on average incomes are now being excluded from owner-occupiership from large parts of the UK. The social nuisance of these three effects is magnified by the growth of foreign buyers because foreign buyers exhibit certain characteristics that make them less socially desirable as buyers and owners:
• Foreign buyers, because of their average wealth, are less price sensitive, which again leads to over-paying.
• Foreign buyers exhibit herd behaviour, relying on market trends rather than product knowledge, which leads to over-paying and price instability
• Foreign buyers have a much greater propensity to leave property vacant, or near-vacant.

Foreign buyers tend to be less knowledgeable about the UK property market, making them more susceptible to marketing “puff” and to paying over the odds. Figure 10 is an example of the misrepresentation that property marketing companies use to investors. The area, Peckham, is described as being the “No.1 London hotspot” but Londoners regularly vote Peckham as being the most dangerous place to live in London.26 This type of misrepresentation would be prohibited in other investment markets such as the equity markets, where very strict standards apply to how products can be marketed and the claims that can be made. The property market, by comparison is the “wild-west” of investment, with inexperienced investors and sharp marketing practices. Property investors might be due little sympathy, but they are not the only ones who suffer. The inflation of property prices to investors pushes up prices for everyone, since they are competing directly with owner-occupiers in the market, and their over-payment results in aggressive rents being charged in order to obtain the expected yields.

Figure 10 – An example of the marketing of property to overseas investors

26 For instance: www.thetoptens.com/most-dangerous-places-london/
According to the government’s Office for National Statistics, from 2001 to 2011 the percentage of home owners in the population fell from 69% to 64%, while the number of renters soared from 1.6 million to 8.3 million. Research from Halifax suggests that even the dream of owning our own home now escapes us. Just four in 10 renters (43 per cent) aged 20 to 45 are saving for a deposit to buy a home, which has declined sharply since last year when the figure was 49 per cent. Three-quarters of UK renters also fear they will never be able to afford to buy their own house and that they will be condemned to a life as a tenant. Those that do get on the ladder have to compromise with less than their ideal homes and may take out extended mortgages. Stretched borrowers are now taking out 30, 35 and even 40-year duration mortgages. Both Halifax and Nationwide allow 40-year terms, and NatWest and Santander 35-year terms.

Non-resident ownership of property creates substantial negative externalities. These three usage categories can be initiated by both domestic and foreign buyers. The problems associate with these usages tend to be exacerbated when they involve foreign buyers who a) tend to be absent for more of the year b) tend to pay higher prices for property because of lack of familiarity with local conditions c) tend to be less attentive landlords because of gaps of distance, language and culture.

These three property uses, each of which has problematic effects in a situation of excess housing demand, plus the ideal property use of owner-occupiership make a total of four property uses. These can be ranked according to their pro-social or anti-social potential as shown in Figure 11 below, ranging from the best use for a house to the least socially useful function of a house.

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We suggest that instead of the UK Government turning a blind eye to residential property prices and uses, that it instead establishes an agency that will monitor property and that can suggest policy changes in order to influence usage outcomes, to prioritise socially useful house use and to experiment with policy options in order to raise the proportion of houses that are owner-occupied.

Figure 11 – A ranking of the different uses of residential property

- 1 UK owner-occupiership
- 2 UK buy-to-let
- 3 UK 2nd homes
- 4 UK buy-to-sell
- 5 Foreign owner-occupiership
- 6 Foreign buy-to-let
- 7 Foreign 2nd homes
- 8 Foreign buy-to-sell
The economics of housing

Housing is a complex field because housing sits at the heart of national life, being influenced by many social, economic and legal factors, and in turn influencing many aspects of economic and social life. Economic analysis can help to analyse a To be useful, economic analysis needs to be grounded in historical analysis, current laws and a sound understanding of the social and psychological effects of different policies. Interdisciplinary work has grown, law and econ

The field of housing economics is very poorly served by both data and analysis. The study of housing has always been on the periphery of economics, and much writing on housing by economists is of poor quality, often because it relies on general market assumptions that are of limited applicability to as unique and localised a market as housing. Non-specialist writers usually fail to understand the complexity of current product offerings such as shared ownership loans, self-build products, offset mortgages, flexible mortgages, lifetime products and reversion products.

Why there can never be a “free market” in housing

Economists may talk about the benefits of “free markets”, but in reality most markets in advanced societies require close regulation to prevent market abuse, criminality and to ensure fair marketing and consumer wellbeing. The notion that markets should be “free” is a recent one, but the phrase “free market” has become a mantra to the extent that many people now confuse capitalism with free markets. The market is a medieval idea and was carefully regulated from inception to limit negative consequences both for the consumer and for wide society. The practice of “exchange” was recognised as both potentially useful and potentially harmful, and many rules were enforced on official markets to ensure that exchange was fair. It is helpful to re-examine the foundations of “free market thinking”; Adam Smith’s own belief in the “invisible hand” (spontaneous order) was very limited. Smith himself asserted that unregulated markets were prone to the rise of monopolies, and would over time degrade unless regulated.

The economics of every market is different. A market is not an abstract entity - something to be mystically mythologised as ‘the market’ in a way that obscures its actual material features. Any actual market must be analysed as a real structure. Economic generalisations such as “increasing the supply will reduce prices” do not apply uniformly to every market; each market needs to be studied individually and regulated in a way which benefits the ultimate consumer. The benefit of other market participants such as producers and intermediaries should always be subordinated to the benefit of the ultimate consumer.

Housing is a market ill-suited to a laissez faire approach. Markets with simple products can self-regulate to a high degree but housing has a few features which means that serious market failures are inevitable. The more expensive the product, the greater the distinctions between
poor and wealthy customers, therefore housing as the most expensive product of all shows the greatest differences between wealth. Laissez-faire inevitably produces highly segregated housing, excellent housing for the wealthy and slum housing for the majority. In some cities in the world up to 80% of the housing is slum housing; this is the natural result of the “free-market” because of the high price of housing and the very limited power that most buyers have in the market. Britain experimented with the laissez faire approach during the industrial revolution. The slums that resulted took nearly a century to clear, and were cleared at huge public expense.

In 1979 the laissez-faire mentality returned to Government. Since then British Governments have persisted in placing great faith in “the market” to solve social problems. It took the 1847 cholera epidemic to shake the Victorian faith in market mechanisms, property rights and “self-help” and produce the first housing regulation in 1848. Since that date, Britain has gradually edged towards building high quality homes and communities but the recent growth in house prices threatens this. A legitimate purpose of public policy is to intervene in markets to prevent market failure and the market failure in housing is now generating serious social costs.

The housing market\(^\text{28}\) is predominantly a second-hand market in which private citizens sell directly to other private citizens without intermediaries such as wholesalers or retailers. Developers buy land, apply for permission to build, construct housing on the land and then sell the housing units either to estate agents or directly to consumers. When consumers wish to sell they are responsible for finding another user who wishes to buy; the developer takes no further role in the property after its first sale. Generally speaking, British housing stock is highly durable, but the durability of different properties probably varies widely; how long many new build properties will last is uncertain.

Housing therefore represents a very specialised asset, and the “market” that has developed around it is also very distinct. Housing economics are very different from the economics of other markets, such as the labour market or the market for consumer goods. In the case of the housing market, the assumption that increasing supply will necessarily reduce prices, although logical, is in practice erroneous. Prices certainly haven’t fallen in response to increases in supply to date. 3 million new properties have been constructed since 1997, and prices in the UK overall have risen by 250%, with prices across Greater London rising by an average of 420%.

Housing has a range of attributes which make it difficult for markets to work efficiently without regulation. These include:

- Housing is highly price inelastic, since each house requires land. Land is in fixed supply overall and so increasing the supply of land for housing means converting that land from

\(^\text{28}\) The term “market” is not a very accurate metaphor for the processes by which houses are constructed, sold and resold, but in the absence of any other term we will use it here.
another purpose such as agriculture, leisure or public services. There is a fixed quantity of housing units in the market at any one time, and the number of units can only grow at a slow rate. Converting land from other purposes is often time consuming and costly, therefore supply does not rise quickly in response to price rises, allowing prices to escalate rapidly. Therefore a small growth in demand in one locality may cause a substantial price rise.

- Whilst houses are completely immobile, buyers are also relatively immobile since buyers cannot move far from their places of employment. Families with children tend to be even less mobile because children are tied to particular schools.

- Housing is a complex good. A high level of product complexity exists, beyond the ability of most consumers to analyse. Each houses is unique and valuation is complex and subjective.

- Housing is unusual because it is a high price good that is also essential. Put another way, it is a product that society judges to be essential but that almost nobody can afford to buy. “The market” had no interest in solving this problem for most people. Whilst “the market” produced beautiful houses for the wealthy, housing remained unattainable for the majority. It was a mix of charity and cooperative activity that devised the idea of mortgages, which were later given shape by the government. There is no evidence that mortgages would ever develop as commercial products.

- Since the purchase of a house requires a long term loan, the housing market is highly dependent on financial markets. Financial institutions act as gatekeepers to the purchase of a house. There is no “free market” in housing, buyers have to be approved before they can buy. This inevitably means that many of the poorest will not be able to purchase a house. In addition to product complexity, there is also substantial loan complexity. In a period of rising property prices, product complexity tends to increase. Customer exploitation on a large scale is a very real problem.

Housing also has major social significance which makes regulation essential:

- A house is beneficial to its owners but also beneficial to wider society. A house provides its owners with personal autonomy and the base for the raising of a family. A tenant and an owner-occupier might occupy identical houses and might be both paying the same monthly cost, but the owner-occupier extracts more benefit than the tenant. This is the mystical benefit of ownership. In economic language, housing is a “merit good”. Like other merit goods (such as exercise) it is acceptable to subsidise and ration the product in order to facilitate wide distribution, if there is evidence of market failure.

- The loss of land from other purposes in order to build more residential units often has a social cost attached. The social cost of the blitzkrieg of playing fields, parks, police stations and community centres that has taken place over the last twenty years is not easy to quantify, and will not be incorporated into any market mechanism. It is the role
of government to ensure that society performs a wider cost-benefit analysis that looks beyond individual transactions at the potential social impact now and in decades to come.

- The quality of dwellings has implications for health. Overcrowded or insanitary dwellings result in a health hazard for the inhabitants and financial cost for the public purse.
- In a wet climate like the UK, houses need to be very carefully constructed and constantly maintained or will rapidly deteriorate. How houses are maintained has a significant impact on the quality of life of the occupants and also a social effect on the neighbourhood.
- Residential housing is the largest asset class in the economy, therefore house price changes can have a significant impact on national wealth. The failure of a product class or lender can trigger the failure of multiple lenders and cause a general economic crisis. A general economic crisis can set back economic progress by decades and can also jeopardise social order.
- Unwise investments in property can be very harmful, and not just for the investors but also because of the shock that investment collapse can cause within the sector involved. During the 1990s, the belief that owning property is a simple way of making money, and that managing property and tenants is little more than common sense, became widespread. The number of amateur landlords rose sharply after the creation of the buy-to-let mortgage which enabled people to take on multiple mortgages simultaneously. The wider economic risks associated with the housing market means that the Government is justified in regulating the investment market in housing in order to protect the wider economy.
- Housing is closely related to social welfare and the achievement of the British dream. Houses are not just buildings but produce two vital building blocks for society: homes and communities. Security of property tenure is an important contributor to the quality of family life, and carefully planned configurations of housing is an important contributor to the quality of neighbourhood and community life.
- Vacant houses are a social nuisance in places of excess demand. In a period of rising prices, investors will enter the market for the purpose of either arbitrage (purchasing residential property and converting it to rental property in order to sell to landlords at a higher price) or buying property in order to benefit from the appreciation in asset values. These properties will almost always be left vacant to give the owner freedom to make a quick sale, and because letting a property reduces its resale value.

Without strict regulation the housing market will generate substantial negative externalities of crime, ill-health & unemployment. In any society these externalities would be problematic. In a welfare state the cost of these externalities will be incurred by the public at large and so it becomes economic for the nation at large to regulate housing to save the public from the cost
of dealing with the externalities and also rebuilding the housing stock at public expense every half century. Whilst regulation is economic for the nation as a whole, it is in the private interests of landlords and the rest of the property lobby to promote an unregulated market in the short term, in order that tactics of private landlord profiteering can go unchallenged.

Housing is about as far from a “free market” as is possible. Another term should really be found for the activity of exchanging housing. The metaphor of a “market” is far from helpful in the case of housing, because of the very strange characteristics of the exchange e.g. only a tiny percentage of houses are available for purchase at any one time, every “product” is unique, purchase usually takes 25 years, and goods are mostly exchanged directly between users. We advise that people are very careful with the use of the term “market” because many of the associations embedded within the metaphor apply to very few exchange situations in practice.

**Why building more houses will not reduce prices in the SE of England**

Another frequent assertion by the housing lobby is that the rapid price inflation of luxury property has little influence on the mass market. This is also wrong. The magnitude of the investment at the high end raises the prices of houses all the way down the price scale. Foreign buyers distort the entire market. Professor Ley of UBC has been studying the phenomenon of migrant wealth and housing market bubbles around the world for years, including the problem of growing inequality. Prof Ley has demonstrated that tackling high-end properties can reduce prices throughout the market. Prof. Ley has used Citizen and Immigration Canada statistics to estimate that 200,000 people have come to the Vancouver region through wealth-based immigration programs since 1980. An estimated 70,000 millionaire migrants have arrived in the past decade, so there’s been a recent surge in numbers. Their arrival directly correlates with the rise of real estate prices. "If you can cool off the high-end house prices, the top end of the market, which will have ripple effects throughout.”

A “trickle-down” effect is particularly noticeable when an incredibly wealthy group of people buys up houses and redevelops them into bigger, more expensive homes. In doing so, they drive up prices by creating housing stock that is appealing only to other wealthy people, Prof. Markus Moos of the University of Waterloo has shown the impact of wealthy investors. The people who once could afford the west side are now pushed into areas they can afford – the east side. And in turn they are pushing up house prices in those areas. The effect is a lack of affordable houses throughout the region. “There is no firm line between high, medium and low-end, prices are on a continuum. Strong sales in one price range have an impact on adjacent price ranges, and it affects the entire market. It’s the gentrification of everywhere.” Researchers such as Prof Ley and Prof Moos have shown that the magnitude of the investment at the high end has pull up prices throughout the entire market.

Because of the current level of demand in the UK, the building of new houses will not reduce house prices. The construction of new properties may actually accelerate house price inflation because of the following six effects:

1. **The price effect** - New houses are generally sold at above the current average price.

2. **The cost effect** – Much new property is on land that was previously rejected as not cost-efficient.\(^{30}\) As house prices rise, more and more marginal land is converted to residential use, but this results in a rise in average construction costs.

3. **The investment effect** - New properties are intrinsically attractive to investment buyers. Because of their attractiveness to investment buyers, a high proportion of new houses will be used for buy-to-let, second homes or buy-to resell, which means a high proportion of them be left vacant, and many of the rest will be tenanted. The proportion that will be used to satisfy the demand for owner-occupied houses will be limited.

4. **The attraction effect.** House price inflation is self-perpetuating because although it deters owner-occupiers, rising prices attract investors. To an investor price inflation is a sign of a potential investment return and a healthy market, and so many investment buyers will think in the opposite way to “occupation buyers”. Rising prices attract foreign investors, since rising prices are always a sign of high potential investment yields.

5. **The foreign buyer effect** - A significant proportion of new houses are marketed abroad to foreign investment buyers. Foreign buyers are less price sensitive and less able to negotiate on price due to lack of knowledge about local conditions.

6. **The intermediary effect.** New properties in fashionable locations are often sold before being completed; sometimes they are sold before building commences. This leads to price inflation since they tend to be sold in bulk to intermediaries such as investment companies who add a margin to the resell price.

Despite the evident uniqueness of housing, and the weakness of the “free market” model, commentators still push universalistic economic platitudes, asserting that house prices will magically reduce if we pack every available space with more rabbit-hutch flats. The logic is poor, and the evidence elusive, but the argument persists. Zoe Williams from the Guardian has offered one of the few dissenting voices against the house-price orthodoxy:

\(^{30}\) This also results in a “quality effect” since much new property is on land that was previously regarded as unusable because the location is hazardous or is not desirable from a customer perspective. For instance, a 2012 report by the Government’s official climate change adviser, the Climate Change Committee (CCC), found that 13 per cent of all new developments were on floodplains. This affects produces a reduction in average desirability of housing as the housing stick grows.
It is the one point on which all people and parties agree: Britain’s housing problem is one of supply and demand. The solution is to build more homes. It doesn’t matter who owns them: once we have more supply, the normal market – where perfectly equal individuals reach great deals through mutual self-interest – will resume. This orthodoxy on house-building is so ingrained that if you query it you are regarded as a person who doesn’t understand supply and demand.  

Williams concluded that prices are being driven by demand, demand not for homes, but for houses as investments, and that the problem needs to be dealt with at source, by restrictions on foreign investment purchases.

This report suggests that policy making should be informed by the reality of housing economics, the interests of the ultimate consumer and the presence of externalities. Since it is excess demand from investment buyers that has caused the inflation of property prices, the building of more houses is a counter-productive response, which cannot bring down property prices, no matter how many school playing fields or how much green-belt is sacrificed to the developers. In a market that suffers from excess demand and anti-social allocation of resources, market rules need to be introduced that fix these problems.
The politics of housing and the “house price myth”

Lobbyists are paid to create favourable narratives of their clients’ business. Commonly the goal is to prevent regulation by government, by the assurance that market forces, self-regulation and existing law are sufficient to protect consumers and other stakeholders. The Holy Grail for a lobbyist is to generate such a level of sympathy for their clients’ businesses that the government goes further than deregulation and positively supports the industry, as some kind of national treasure. This is now the status of the property industry in the UK. At the same time, lobbyists explain away negative social effects of their clients’ business models, and suggest ways in which public money can help ameliorate these problems. In the case of housing, the inflation of property prices has hugely benefited the property industry. Growth in housing churn and housing value has seen revenues for estate agents, surveyors and lawyers increase substantially.

Figure 12 – The powerful UK property lobby
The property industry is vast and varied as Figure 12 shows. It includes virtually all experts on property. Outside of the property industry there is very little independent expertise on property.

The property industry, whilst benefiting from the hyper-inflation in house prices, recognises the public trauma and the potential for regulatory action and so offers an interpretation of the problem. The problem of price inflation is presented as caused by lack of supply caused by a cumbersome planning system that prevents homebuilders from building on greenfield sites such as parks, lack of land supply, underdevelopment, state planning laws and regulations, local council red tape, and stamp duty. The industry insists that the answer to price inflation is to release green belt land, and to deregulate planning. The housing lobby has persuaded a diverse universe of think-tanks, charities and pressure groups that new-build is the only answer to the house-price crisis, such as Shelter and the Social Market Foundation. Alternative opinions are drowned out by a carefully engineered consensus.

However, the rise in house prices cannot be principally be a problem of supply, since supply has increased consistently since 1997, the year when the house hyper-inflation began. UK house price inflation is almost entirely a demand problem, which can only be solved by restraining demand, and by isolating the housing market from the investment market.

The Government has been cautious about regulating the property market for decades, scared both of the possible economic impact and the electoral consequences of upsetting homeowners. This fear has resulted in a long period of regulatory paralysis. The growth of housing wealth has exacerbated this paralysis, with the UK’s economy now over dependent on housing wealth. Total housing wealth was estimated at £4,768 billion in 2014, an increase of 8% in the last year. Savills’ estimate is even higher, at £5.75 trillion. It is a sign of how much the UK Government fears damaging property prices that UK properties have not been valued for tax purposes since 1991, and the top band remains at £320,000, a figure which is well below the average property price in London.

The housing lobby have helped with this regulatory paralysis by creating a narrative that has sent concerned politicians and commentators down the wrong path, the path of increasing supply. Increasing housing supply can never bring down prices, no matter how much public land and green-belt is turned into flats because the demand for investment returns is almost infinite. The UK has already seen the spoliation of many of its most beautiful and historic towns in the name of bringing down prices, and the destruction has been entirely in vain. The only

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32 It was fear of the electoral impact of property revaluation that led the Thatcher Government to eliminate the link between property valuations and local taxation by introducing the disastrous “poll tax” in 1989.
34 [www.savills.co.uk/blog/article/185397/residential-property/uk-housing-market-rises-to-5-75-trillion.aspx](http://www.savills.co.uk/blog/article/185397/residential-property/uk-housing-market-rises-to-5-75-trillion.aspx)
groups that have benefitted are the professional groups who profit from land sales and house sales.

The lobbyists of the housing industry have done their jobs well. They have created a fantasy housing market where prices are driven by supply, and the only possible solution is the building of millions of more flats and houses.

The property lobby have weaved a sophisticated self-serving narrative which consists of at least nine connected falsehoods which together present an alternative reality and push government into responses that benefit the members of the property lobby. The “house price myth” looks something like this:

1. The super-rich only affect the prices of luxury property. The excessive prices they pay does not affect prices in the mass market.
2. The number of sales to foreigners is small despite the publicity that many of the sales receive.
3. Wealthy foreigners bring many benefits to a country that counteract any negative effect on the property market.
4. The UK can easily accommodate millions more houses. Pro-development think tanks circulate the statistic that 7% of UK land is urban, suggesting that 93% of land is therefore still available.
5. The building of new houses will bring house prices down
6. The UK has a terrible planning system which blocks supply growth
7. Buyers want small properties, such as high density blocks of flats, and the building industry are providing what customers want when they reduce the sizes of flats.
8. Economic growth depends on rising house prices.
9. Introducing restrictions on foreign purchases will jeopardise economic growth.

Each element of the lobbyists’ house price myth can be refuted as follows:

1. The buying habits of the super-rich distort the whole market. (see “economics of the housing market” section)
2. The number of houses owned by foreign buyers is now substantial. In 2014, foreign buyers purchased 75% of new properties in central London. According to estate agent Knight Frank foreign buyers purchased 49% of all properties worth more than £1m in central London over the same period (new homes account for 20% of all transactions.)\(^{35}\) There is currently no data on the number of foreign-owned homes in the UK, but no one doubts that it is increasing rapidly.

3. For some people, the mental image persists of the super-rich person as a talented entrepreneur such as Steve Jobs who contributes employment, and brings real benefits to the country in which he resides. The reality is very different. The wealthy of Russia, China, Africa and the Middle East are very rarely entrepreneurs and few bring employment or establish productive businesses in the UK. Much of the money has come from government, and there is a real worry about corruption. Foreign buyers as a group perform no positive function, but rather generate anti-social consequences. They are not improving the housing stock or urban communities. They are not developing the many UK towns that could benefit from investment. They are simply cherry picking and colonising areas of the UK (predominantly in London) that are already gentrified and making the over-pricing effect much worse. Their role is profiteering, segregation and the exclusion of ordinary working people from the homes that are rightfully theirs. Many people who work in London cannot afford to live there, even in the cheapest areas, but instead commute from towns outside London such as Slough, Basildon and Dartford. Foreign buyers are, inadvertently, a great social problem that has already caused great damage to British families, and there is no sign that this problem will do anything other than grow without regulatory action.

4. Land in the UK that it is economic to build on is now almost entirely used up, new houses will be built on increasingly uneconomic land, or land that will be taken from other social functions.

5. The assertion that building more houses will reduce house price may seem like basic economics but the idea is not borne out by experience or housing economics. The building of new houses has no effect on prices under current conditions due to the almost infinite demand. (see “economics of the housing market” section)

6. UK planning is a democratic and devolved system that carefully regulates new developments by people who know best i.e. local residents. Local politicians have the duty to balance conflicting pressures, but often rightly decide that development is unnecessary.

7. The reducing size of houses is not driven by consumer demand but by the profiteering of developers, who try to pack as many properties into the space they have, leading to the shrinkage of gardens and floor space.

8. Economic growth does not derive from house prices. Rising house prices gives the appearance of wealth to owners, but this is money that most owners will never be able to spend. Studies have shown that increases in property prices tend to have a positive impact on real GDP\textsuperscript{36}. This pattern becomes stronger as a population ages and becomes more concentrated in the old homeowners group. With an aging population, aggregate consumption may become more responsive to house price movements. However, at the

same time as being paper-millionaires, many owners of expensive houses have little disposable income due to mortgage payments. Over inflated house prices do carry significant risk and can skew policy making. Residential investment is a volatile component of GDP in the U.K and it has had a highly significant relation to the business cycle Politicians will protect the bubble for fear of voter displeasure if it bursts and generates widespread negative equity, as well as the potential hazard to the wider economy if asset prices fall and home defaults start to rise.

9. There are numerous simple defences to protect housing markets from profiteering. Many countries such as Australia, Jersey, Denmark, Singapore, Hong Kong, China and Switzerland already use them, and it is merely laissez-faire dogma and lobbyist influence that prevents the UK Government from introducing policies to restrain demand.
The UK Government’s response to the crisis since 2010

“Help-to-buy” was a package of measures introduced by the UK Government in 2013. The scheme aims not to restrict demand, but rather on further inflating demand, through subsidising both low income buyers and institutions that lend to low-income buyers. The “help to buy” scheme is actually two very different schemes, an equity loan scheme and a mortgage guarantee scheme.

The equity loan scheme was launched in April 2013. Here the Government underwrites mortgages with by offering loans of up to 20% of the price of a house (up to £120,000, since the most expensive eligible house will be £600,000), interest free for five years, and at below-market rates afterwards.

The mortgage guarantee scheme was launched in October 2013. Here, the government offers cut price insurance to lenders, sharing some of the risk if mortgages go into arrears. Because of this support, lenders taking part are able to offer home buyers more high-loan-to-value mortgages, up to 95%.

Critics said that the mortgage guarantee could create a housing bubble in the UK. Business Secretary Vince Cable warned at the time that it would lead to “serious inflationary pressures”. Help to Buy” was a blessing for the construction industry as it helped prevent a price correction and maintain inflated prices. It encouraged young buyers to rush into house buying, despite high market prices. The two schemes saw the government take a punt with billions of pounds of taxpayer money.

The Government has also promoted the growth of “shared ownership”; a scheme that gives the impression of ownership, but not the reality of ownership. Shared ownership is not the panacea that it is often presented as. Owners have many of the disadvantages of ownership (such as immobility and responsibility for property maintenance) without the knowledge that they will one day own the property outright.

The “mansion tax” proposed by Labour in the 2015 election campaign on homes worth over £2m was a moderate property tax by international standards but had an impact in supressing the market at the top end. The Government estimated that the tax would have increased the tax on wealthy households to £36,000 a year. Since the defeat of Labour and the mansion tax, foreign demand for British housing has surged, and house prices are starting to soar further.

On a positive note, two welcome (if belated) tax changes were introduced in the 2013 Finance Act, the introduction of capital gains tax for foreign buyers, and the annual tax on enveloped dwellings (ATED). ATED was introduced as part of a package of measures aimed at making it less attractive to hold high-value UK residential property indirectly, eg through a company, in
order to avoid or minimise taxes such as stamp duty land tax (SDLT) on a subsequent disposal of the property. It applies to all properties acquired by corporations. When ATED was initially introduced, the taxable value threshold was set at £2m or above. It was announced in Budget 2014 that the threshold for the application of ATED would be reduced to £1m or above with effect from 1 April 2015 and further reduced to £500,000 or above with effect from 1 April 2016. The Government also introduced an extension to the capital gains tax (CGT) regime by introducing a CGT charge on disposals on or after 6 April 2013 of property by both resident and non-resident non-natural persons. This change marked a departure from the long standing position that companies are subject only to corporation tax on chargeable gains and are not subject to CGT.

Further reforms were made in 2015 with the reduction of mortgage interest tax relief. Tax relief on interest payments on their buy-to-let mortgages will be reduced from 45% to 20% over a four-year period, and the removal of the 10% wear-and-tear allowance are both welcome. This will put pressure on many of Britain’s two million landlords. This will create a more level playing field between first time buyers and investors. However landlords investing through limited companies will avoid this new tax increase. However, given the scale of price increases that UK property has delivered over the past 30 years, such small increases in tax are unlikely to deter any investors.

Regular revaluations of housing for the calculation of fair property taxes are essential. These should be taken nationwide at least every five years, and in areas of exceptional price movement (such as London) should be taken more frequently than this. It is a sign of how much the UK Government fears damaging property prices that UK properties have not been valued since 1991, and the top band is still £320,000.
International responses to the foreign ownership problem

Regulation often has side effects. It may produce evasive behaviour or generate harmful side effects which are as bad as the original problem. But this is not a justification for regulatory paralysis. One benefit of the UK’s regulatory sloth in this field is the ability to learn from the actions of other nations who have already started to tackle this problem. Investors are particularly hard to regulate because they are well served by professional advisors, and so simple regulations tend to work best, accompanied by substantial penalties for abuse. Many well-tested simple defences to protect the housing market now exist, and numerous countries such as Australia, Jersey, Denmark, Singapore, Hong Kong, China and Switzerland already use them. Further details on the experiences of selected nations are provided below:

Switzerland

Switzerland was one of the first nations to identify the problem. Switzerland has had a long problem with German investors buying chalets as 2nd homes, and Switzerland implemented restrictions in 1961 to limit this, with a limit of 1500 property sales for foreigner per year. The regulations were enshrined in law in 1983 (the Koller Law) and modified later. A government proposal to abolish the rules was rejected by parliament in 2008 and 2012. In 2012 the Lex Weber law was passed in order to stop the proliferation of holiday homes, protect the natural environment and limit property speculation and house price inflation. The law limits the number of secondary residences in any municipality to 20%.

Australia

Australia’s problem is similar to the UK’s own, the rapid growth of investment which has produced rapid price escalation in Sydney, preventing Australian citizens from home ownership. Huge increases in property prices in Sydney and Melbourne have been linked to foreign money from Asian countries such as China, Hong Kong and Singapore. In 2009 the Labour Government of Kevin Rudd loosened the rules of foreign home ownership to allow people on student visas to buy properties. On moving back overseas, they did not have to sell the property. The real estate market was, in effect, opened to the parents of hundreds of thousands of foreign students in Australia.
In 2010, following a surge in property prices that made housing increasingly unaffordable, especially in major cities like Sydney and Melbourne, the Conservative government of Tony Abbott restricted the rights of foreigners to buy property. The visa changes of 2009 were reversed so that temporary visa holders were required, once again, to sell the property on leaving Australia. By 2013, up to 80% of new properties in some parts of Sydney were being sold to Chinese buyers, encouraged by record low interest rates. In December 2015 Australia will introduce further rules surrounding the purchase of Australian real estate. After that date, foreign non-residents (FNR) may not own any share of an established property except in very limited circumstances. FNRs will be restricted to the purchase of vacant land and new dwellings that have never been owned, so long as no more than half the dwellings in a development are sold to foreign persons. FNRs temporarily residing in Australia can apply to buy one piece of existing property to use as a residence provided they sell it when they leave Australia. FNRs also have to pay a $5,000 application fee to buy a residential property under $1m, and for properties over $1m, it will be $10,000 for every extra million dollars in the purchase price. Anyone breaking the law will be fined up to 25% of the value of the property and forced to sell it. The fees go to the cost of enforcement and to the maintenance of a new national property register. High net worth individuals can bypass the process. The federal government offers a 'premium investor visa' to immigrants that invest $15 million or more in the country. From 1 July 2015, ‘foreign purchasers’ of residential property will be subject to a 3 per cent surcharge over the standard duty rates. This will result in a combined duty rate of up to 8.5 per cent.
Singapore

Ownership of properties by foreigners in Singapore is restricted to people who have permanent residency and who make “adequate economic contribution to Singapore”. Only small flats may be purchased by foreigners; houses are for ownership by citizens only, and the land area of the property must not exceed 15,000 sq feet. A 15% tax surcharge is applied to all foreign purchases of property.

Denmark

Despite the assumptions of many politicians and journalists, EU member states can restrict the purchase of housing by citizens of other EU states. Finland and Denmark both applied for this right, and both obtained it, due to their problematic experience with foreign purchase of 2nd homes. Denmark experienced rapid house price inflation between 2000 and 2006, with prices tripling in that five year period. From 2007, the bubble burst and prices fell substantially. EU citizens can purchase any type of real estate except vacation properties without prior authorization from the authorities. Non EU citizens must have lived in Denmark for five years. There are tough restrictions on certain areas, particularly summer holiday homes on the coast. The laws restrict these properties to be mainly occupied by Danish people. Buyers must prove that they either have family there or have a strong connection to a particular property to overcome this.
A British solution

The British have traditionally welcomed foreign investors. The free-trade movement originated in the UK in the 1830s and Britain still clings to the belief that it benefits from unrestricted flows of investment capital and people, having not yet adjusted to the reality that the UK is now more often the prey rather than the predator. The last 35 years has seen the steady sale of hundreds of major UK companies. The sale of such iconic British brands such as The Times (1981) Harrods (1985), Rowntree (1988), Jaguar (1989), Walkers Crisps (1989), Land Rover (1994), Rolls-Royce (1998) Boddingtons (2000), Debenhams (2003), Sarsons (2005), Manchester United (2005), P&O (2006), Heathrow Airport (2006), Boots (2006), ICI (2008) and Cadbury (2010) shows that there appears to be no limit to the degree of foreign ownership that the British Government will accept. According to Alex Brummer, by 2012 more than half of British originated firms were foreign owned37.

Like British business, prime British housing is also being gradually transferred into the hands of foreign investors. We suggest that the only measures that will directly tackle house price growth, without substantial side effects, are measures to regulate the investment demand for houses that emerged in the mid-1990s, and to separate this investment demand from the owner-occupier demand. If investment demand is not regulated it will continue to grow and will eventually swallow up owner-occupier demand until the housing situation of the 1920s is restored. Owner-occupier demand cannot compete with investment demand, because of the advantages that investors (both private and institutional) have when buying properties in the market place. The number of houses classified as “investment grade” will continue to grow. The growth of institutional investors will increasingly push private investors into the sub-prime market, and the horrors of “landlordism” will return. The difference this time will be that many of the landlords will be overseas investors.

Limiting the scale of the financialisation of the UK housing market would not only deflate the housing market and release more properties for owner-occupiership but also make the UK more impervious to financial shock. It was a crisis in a small sector of the US mortgage market in 2007 that caused a global banking crisis. Separating the owner-occupier market from the investment market would protect owner-occupiers from both the price hikes and the price crashes that are an inescapable feature of investor activity.

Although regulatory reform receives little interest in the UK press, Australia has recently introduced controls on the foreign purchase of property and several countries are currently considering controls such as South Africa and Canada.

37 Alex Brummer, Britain For Sale: British Companies In Foreign Hands (Random House, 2012)
The main obstacles to reform in the UK are 1) the laissez-faire mentality to housing that prevails in the British Government (whichever party is in power) 2) the strength of the UK’s property lobby which has been very effective at promoting the growth of the UK’s housing stock, and 3) the number of UK citizens who own overpriced properties who might feel committed to supporting current prices. As the economics editor of Channel 4 has noted, “Housing is the only basic human need for which rapid price rises are met with celebration rather than protest.”

If the obstacles of the lack of will of the British Government, and the power of the property lobby can be overcome, the housing crisis can be solved. The solution to the housing crisis is to separate investment activity from the buying activity of ordinary home-buyers, and create two distinct markets, one market for the purchase of homes for living in, and the other market for property for investment purposes. Restrictions on property are very common internationally. Most nations which experience house price inflation respond with restrictions on foreign buyers.

\[\text{Figure 14 – The concept of two property markets}\]

Foreign buyers are the low hanging fruit from both ethical and practical perspectives, which is why this report focusses on them. The British people have no moral duty to enrich foreign millionaires, and the identification of foreign citizens is relatively simple. Therefore the regulation of foreign ownership is a sensible first step. There are ways in which restrictions on foreign buying can be overcome, but the most straightforward of these loopholes can easily be closed, and significant penalties attached to breaches of the rules to deter malfeasance.

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38 [www.theguardian.com/books/2013/aug/18/default-line-extract-faisal-islam-housing](http://www.theguardian.com/books/2013/aug/18/default-line-extract-faisal-islam-housing)
To prevent the continued blockage of government action by lobbyists, it is advisable to create a government agency to oversee the new regime. This new “Foreign Investment Agency” (FIA) would review applications for foreign ownership, monitor levels of foreign ownership and recommend adjustment of the rules periodically to Parliament to ensure that foreign ownership remains vibrant. Foreign ownership can be very helpful or highly detrimental depending on the economic cycle, the relationship between demand and supply, and the intentions of the investor.

The companies that benefit from excessive property prices assert that demand cannot be influenced and that demand regulations are either unworkable, illegal under EU law, or could provoke a price crash and trigger a recession. In fact, regulation is common internationally and a wide range of regulatory options exists. There are a variety if policy options available, which can be used in combination in order to produce the right effect. The fifteen options shown in Figure 15 below are a sample of possible measures.

<table>
<thead>
<tr>
<th>Zoning</th>
<th>Property size restrictions</th>
<th>Vacancy surcharge</th>
<th>Foreign ownership surcharge</th>
<th>Reciprocity principle</th>
</tr>
</thead>
<tbody>
<tr>
<td>Penalties for quick sales</td>
<td>Ban ownership by foreign companies</td>
<td>One property per foreign family</td>
<td>Annual cap on foreign sales</td>
<td>Monitoring of foreign ownership</td>
</tr>
<tr>
<td>Residency requirements</td>
<td>Regular revaluations</td>
<td>Foreign purchase tax</td>
<td>Foreign ownership concentration cap</td>
<td>Second home concentration cap</td>
</tr>
</tbody>
</table>

**Figure 15 – A portfolio of solutions to the housing crisis**

Figure 16 presents a greater range of options to restrain housing demand, each of these options is currently in use by one or more national government.
<table>
<thead>
<tr>
<th><strong>Policy</strong></th>
<th><strong>In use by</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Data collection on the nationality of all UK property (including diplomatic, sovereign and corporate property) and maintenance of a property register which publishes statistics on foreign ownership</td>
<td>USA, DNK, FRA, MEX, JPN, TUR, SGP, ZAF, AUS</td>
</tr>
<tr>
<td>Tax surcharge for foreign buyers</td>
<td>AUS, HKG, SGP, ITA</td>
</tr>
<tr>
<td>Request permission to buy.</td>
<td>AUS, CHE, SGP, DNK</td>
</tr>
<tr>
<td>Foreign buyers must arrange mortgages with a UK bank</td>
<td>CAN</td>
</tr>
<tr>
<td>Ban on buying existing homes; only new properties can be purchased by foreigners.</td>
<td>AUS, DNK, CHE, SGP, THA</td>
</tr>
<tr>
<td>A non-development penalty for land that is still undeveloped after 2 years. After this period a much higher rate of tax applies.</td>
<td>SAU</td>
</tr>
<tr>
<td>Limit the number of properties per year that can be sold to foreigners.</td>
<td>CHE</td>
</tr>
<tr>
<td>Property zoning to geographically restrict foreign ownership (for instance foreign ownership only allowed in areas of insufficient demand such as on the outskirts of towns, or foreigners prevented from owning properties in the most prime locations such as high streets or waterfront)</td>
<td>DNK, CHE, TUR, NZL</td>
</tr>
<tr>
<td>Reciprocity principle. Foreign nationals are only allowed to buy in the UK if their home country permits UK citizens to buy property there.</td>
<td>TUR, HUN</td>
</tr>
<tr>
<td>A restriction of one foreign property per foreign family</td>
<td>CHE, CHN</td>
</tr>
<tr>
<td>Banning ownership of property by foreign companies</td>
<td>URY</td>
</tr>
<tr>
<td>Banning the exclusive marketing of properties overseas</td>
<td>AUS</td>
</tr>
<tr>
<td>Foreigners buying property to use as a home must use it as their main residence.</td>
<td>CHE</td>
</tr>
<tr>
<td>Non-residence penalty on vacant properties.</td>
<td>FR, GBR</td>
</tr>
<tr>
<td>Prohibition on buyers having criminal records</td>
<td>USA</td>
</tr>
<tr>
<td>Limit “flipping” by penalising short ownership tenure through a time-graduated CGT. Properties that are resold shortly after being purchased attract a higher tax charge.</td>
<td>MYS</td>
</tr>
<tr>
<td>Prior residence requirements (e.g. 1 year continuous residence)</td>
<td>DNK, CHN</td>
</tr>
<tr>
<td>Foreigners temporarily residing in the UK can apply to buy one piece of existing property to use as a residence provided they sell it when they leave the UK.</td>
<td>AUS</td>
</tr>
<tr>
<td>Ongoing residence requirements (e.g. no more than 120 days abroad per year)</td>
<td>TUR</td>
</tr>
<tr>
<td>Limit the % of homes in any area that can be foreign owned to prevent the development of ghettos (e.g. 20%) If an area exceeds the limit then all sales must be to citizens, until the area falls below the limit.</td>
<td>DNK, CHE</td>
</tr>
<tr>
<td>Limit the % of flats in any block that can be owned by foreigners (e.g. 49%)</td>
<td>THA</td>
</tr>
<tr>
<td>Limit the % of homes in any area that can be used as secondary residences</td>
<td>CHE</td>
</tr>
<tr>
<td>Restrict resale within a fixed period (e.g. 5 years)</td>
<td>CHE</td>
</tr>
<tr>
<td>Revalue properties for council tax purposes every five years, and create new bands for high value properties to ensure that all properties pay their fair share in tax.</td>
<td>DNK, AUS</td>
</tr>
<tr>
<td>Size (or value) limits; foreigners prohibited (or require special permission) to buy properties over a certain size or value (e.g. 100sqm)</td>
<td>NZL, CHE</td>
</tr>
</tbody>
</table>

**Figure 16 – Policies used internationally to solve the problem of excess foreign ownership**
Recommendations

We recommend:

- That the British Government establishes the principle of preference for UK owner-occupiers within the UK property market.
- That the Government tasks the Treasury and Bank of England with maintaining average UK house prices at no more than 4x average household income.
- The monitoring of property ownership. A full survey and map of property ownership, starting in London, which will be published annually. This will allow analysis of the housing market including more formal economic analysis, which is currently impossible due to lack of data.
- The creation of a foreign investment monitoring and review agency, along the lines of Australia’s FIRB, with Parliamentary oversight from a new Select Committee. This agency would administer all of the restrictions listed below as well as monitoring property ownership, demand, prices, and vacancy nationwide. The agency would also be responsible for designating areas of low demand and high demand where special purchase rules would apply.
- As recommended by Transparency International, transparency should be established over who owns the offshore companies that own 36,342 London properties, through making such transparency a Land Registry requirement.
- The registration of all property owners including fingerprint biometrics to ensure that UK housing is not purchased with the proceeds of crime, whether foreign or domestic. Two registers would be maintained, one for owners and one for properties, in much the same way that vehicles and vehicle owners are registered. This would enable the UK to prevent property being sold to foreign buyers with criminal records, and would enable property to be more easily confiscated when tracing the proceeds of crime.
- A foreign-buyer surcharge of 5% of asset value, in order to fund the new agency.
- The restriction of property auctions to people resident in the UK, to limit the price inflation and property vacancy associated with the auction process. Auction sales to overseas buyers are often sold “unseen” and subsequently left vacant.
- The implementation of the “new only” rule, to limit non-resident buyers to new properties, and to prohibit them from buying “landed property” such as detached or terraced houses, in order to prevent the “ghosting” of UK town centres, and to encourage vibrant neighbourhoods.
- A surcharge of 5% of asset value for any foreign buyer who sells a UK property within 5 years, in order to protect the UK market (and UK tenants) from overseas economic turbulence.
• A ban on UK property being advertised exclusively abroad, with all sales needing to be conducted within the UK.
• All buildings of multiple residences must be over 50% owned by UK citizens.
• A cap on the proportion of homes in any post code area that can be foreign owned of 30% (with higher caps for areas of low property demand).
• The statutory removal of the council tax discount for properties left empty, in order to discourage vacancy (with exceptions for areas of low property demand).

Figure 17 summarises the situation, placing all potential buyers into three categories, UK citizens, foreign residents and foreign non-residents.

<table>
<thead>
<tr>
<th>CURRENT PROPERTY RIGHTS</th>
<th>PROPOSED PROPERTY RIGHTS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UK CITIZENS</strong></td>
<td>Unlimited</td>
</tr>
<tr>
<td><strong>DUAL CITIZENS</strong></td>
<td>Unlimited</td>
</tr>
<tr>
<td><strong>RESIDENT EU/EEA CITIZENS</strong></td>
<td>Unlimited</td>
</tr>
<tr>
<td><strong>INDEFINITE LEAVE TO REMAIN / PERMANENT RESIDENT</strong></td>
<td>Unlimited</td>
</tr>
<tr>
<td><strong>NON-RESIDENT EU/EEA CITIZENS</strong></td>
<td>Unlimited</td>
</tr>
<tr>
<td><strong>FOREIGN NON-RESIDENTS (FNRS)</strong></td>
<td>Unlimited</td>
</tr>
</tbody>
</table>

**Figure 17 - A new spectrum of property rights**

We estimate that these moderate actions will cut foreign demand for housing by over 70% and begin to re-orientate the UK housing market towards owner-occupation rather than as a haven for foreign investment. The best quality of foreign investment (long term, sustainable and intelligent investment) will remain, but the rest will choose to invest in other asset classes or in other locations.
Conclusion

The UK housing market is at present grossly unbalanced between powerful investors and weak owner-occupiers. The future for British people who are not already on the housing market is grim and getting worse as British housing increasingly becomes the preferred global haven for wealthy foreigners to invest their money. This report argues that the UK market is now rigged against owner-occupiership, with the result that many British people not currently on the housing ladder are condemned to never being able to buy a house in their own country.

The building of more houses under conditions of excess demand will have no effect on price. Current house prices are a demand phenomenon. If the government persists in its neglect of demand-side issues, the proportion of British housing that is owned by landlords will keep increasing, and an ever increasing proportion of British people will find themselves as permanent tenants, or unable to move out from parental homes, locked out of a secure home for their family and a chance of leaving property to their children.

A safe, secure, home is the cornerstone on which individuals and families build a better quality of life, develop relationships and gain independence. Given the evidence for the value of owner-occupiership to the quality of life, the fact that successive UK Government have refused to prioritise owner-occupiership over various forms of investment ownership is both bizarre and socially harmful. Gross inequality eventually becomes a problem for everyone, not just the poor. Everyone who believes in the “one nation” tradition should reflect on current housing trends and whether the practical and incremental reforms suggested in this report would help the citizens of Britain buy a home of their own. The political party which solves the problem of housing affordability and helps British people achieve their ownership dream can expect a substantial reward of gratitude.

This report has suggested that the UK housing market is failing the nation, and the negative effects are likely to grow as prices rise and the scale of investment activity grows in response. Without restrictions on foreign ownership of UK property, UK citizens face a future as tenants to foreign landlords as an unending supply of money from the wealthy of Russia, China and the Middle East spreads out from London to affect many other parts of the UK. The British dream of owning a house will be over simply because of the neglect of British politicians. Property is not just a national dream; according to the UN declaration on human settlement, 1976, a decent home at an affordable price is a universal right. It is a matter of some regret that the UK, despite its wealth, is failing to deliver on this right.

Of course owner-occupiership is not for everyone; doubtless some people do not have the ability to manage all of the details that property ownership entails, others will find tenancy more suitable for their employment arrangements; but owner-occupiership is what the overwhelming majority of the UK population aspire to, and it is Government’s role to remove as many barriers as possible that obstruct the achievement of this goal.
Problems do not solve themselves; it will take government action to restore progress towards the British dream of owner-occupation, and we hope that this report will help initiate a debate that will provoke government action.\textsuperscript{41}

\textsuperscript{41} Since investment markets are highly sensitive to rumour, the mere discussion of restrictions on foreign buyers is likely to fuel a fear of the growth of “regulatory sentiment” and start a useful “price correction”. This pre-regulatory price correction would provide useful data on the likely effects of regulatory action.
Appendix 1 - Q & A

1. Does the UK have the legal power to prioritise British citizens over EU citizens?
   Firstly, town planning is governed by national law not EU law, and member states are entitled to restrict property ownership in particular areas where there is good reason. Secondly, the EU has allowed member states exemptions from the principles of the free movement of capital, in relation to property ownership, where the member state has made a case under the category of the “overriding requirements of the general interest” To date, Denmark, Finland and Malta have retained the ability to limit the acquisition of second homes by non-nationals.42

2. Won’t a reduction in demand cause prices to fall?
   Yes, prices will fall because current prices are inflated. It is excess house prices which is the main reason for the housing crisis in the UK. A price correction will occur in time anyway, when Chinese money dries up, so it is better for the correction to occur sooner than later, and it is better for the correction to be controlled by UK Government policy rather than global economic pressure.

3. Doesn’t foreign money have a good effect?
   Foreign money may be beneficial when demand is lacking, but will be harmful when there is a condition of excess demand. Foreign demand for property is in any case qualitatively different from domestic demand, since it is usually for investment purposes, is accompanied by a much higher state of non-occupancy and is generally much more inclined to over pay. Foreign demand therefore provoke much greater price inflation than domestic demand. Whilst some foreign owners are responsible, and rent their properties out to UK citizens and maintain the properties well, there is no requirement to act responsibly, and much foreign property is left vacant or is managed remotely by absentee landlords. Additionally, much foreign money is of dubious origin, because the majority of it flows from mega-rich elites of countries with high levels of corruption such as Russia, Ukraine, Nigeria and China. Reliance on foreign demand also makes the UK economy increasingly vulnerable to foreign shocks. Foreign money would be highly beneficial in some areas of the UK, such as in some sea side resorts or industrial towns that suffer from excess housing stock. Unfortunately, the UK’s experience of foreign investment in property is that it is overwhelmingly directed into areas already experiencing high demand, due to the “herd behaviour” of foreign investors. The new foreign investment agency through monitoring of demand will be able to designate areas where foreign investment will be encouraged.

4. Surely increasing the supply of housing stock will reduce prices?
   This has not been the experience in the UK. The building industry has been busy erecting flats and miniature houses on increasingly marginal land whilst prices continue to soar.

42 See http://ec.europa.eu/finance/capital/faqs/index_en.htm for further details
Prices respond to demand much more than supply, and demand in London seems almost infinite. Price rises attract further demand because of the investment yields that rising prices imply.

5. **Why haven’t any politicians in the UK promoted these ideas in the last 20 years?**
   The building lobby has been very successful at promoting its own “solutions” i.e. planning deregulation, sale of playing fields and the use of green belt. It is remarkable that the housing crisis is always talked about as a problem of supply, and demand is never mentioned. Partly this is due to sensitivity over questions of immigration and over-population.

6. **Why are you picking on foreign buyers when there are many domestic property investors?**
   Foreign buyers are the most natural group to restrict first. They are relatively straightforward to identify, have no moral claim to British property, have no electoral power and their influence is almost entirely negative in the current inflated market.

7. **Won’t other nations retaliate if the UK implements restrictions on foreign buyers?**
   This is unlikely. There is very little reciprocation at present. For instance British citizens find it very hard to buy properties in the UAE and Switzerland, but the UK places no restrictions on citizens of these countries buying property in the UK. Each country does what it thinks best with little regard for what other countries do.

8. **Isn’t building more new houses the answer?**
   The supply of housing is a minor factor in the overall cost of housing in the UK. The building of new houses can actually push prices up because new houses tend to have higher average prices than existing houses. In a market with excess demand, small increases in supply will not exert downward pressure on prices. Much of the new housing constructed in the UK is not offered for sale in the UK, and is sold long before it is completed due to foreign buyers being less price-sensitive. Of the new housing, much of it is built on land which was previously rejected by builders because of its isolation or other problems, such as being located on a flood plain. The small average size of new houses in the UK (76 sq metres) means that they are unlikely to perform well as family homes. The single largest argument against new building is that the demand for UK housing is infinite and that no amount of new housing will satisfy it, or being down prices, it will merely feed the demand for new investment opportunities.

9. **Can’t the free market sort this out?**
   Lack of regulation has brought the UK to its current crisis. This report demonstrates that for foreign buyers, houses are not homes but investments, and should therefore be regulated like investments. All financial products have been heavily regulated throughout the EU and USA for many years. The market for financial products is highly regulated because of product complexity, the history of mis-selling, individual risk to buyers and the wider macro-economic hazard of financial products being mis-sold. Another aspect is that
many foreigners are buying houses with the intent of keeping them vacant. In any market with fixed capacity this sort of anti-social behaviour will cause problems for other buyers. It is the foreign buyers who are abusing the freedom of the market, and therefore a process of rationing and regulation is a logical response.

10. How can you be sure that the policy options you suggest will have the desired effect?
The UK Government has dragged its feet on regulation for two decades and it will need to go through a process of learning. Just as the regulation of financial markets has evolved and involved many changes and reversals, so the regulation of the housing market is a new world and there is a need for the testing of policy options, for experimentation, for detailed monitoring and periodic review. Housing market regulation needs to be flexible, not static as it must adapt to economic cycles and emerging social problems. The current laissez-faire approach has produced a crisis for UK citizens and the negative social consequences will continue to spread unless parliamentarians and others increase the pressure on the Government to act.
Appendix 2 - The campaign & petition

This report will not be liked by the property lobby and will not be attractive to the Government, who have already demonstrated their caution in property regulation.

However, the British political system is very sensitive to genuine public opinion and if pressure can be maintained on MPs, there is a prospect of change.

We have started a campaign called “Campaign for House Price Sanity” which will promote the policy ideas of this report.

How can you help?

1. Sign our petition
2. Share the link for the petition on social media
   www.facebook.com/housepricesanity
3. Contact your MP and encourage them to support the campaign
4. If you can help our campaign in any way (e.g. if you have expertise in economics, statistics, publicity or housing policy) and want to help build the case for intelligent regulation, please email housepricesanity@outlook.com with your details.

We urge all readers of this report to sign the petition below and to share the link, so that a Parliamentary debate will be scheduled on this matter; which will awaken a wider public consciousness of the current crisis and the policies which would help alleviate it.

PETITION TO UK PARLIAMENT

We call on the UK Government to follow Australia, Denmark, Singapore, Switzerland and many other countries by introducing restrictions on foreign purchases of UK homes.

https://petition.parliament.uk/petitions/110560/