London's Housing Crisis

A perspective based on the role of financial markets and the UK's economic growth model

Kaveh Dianati, Nici Zimmermann, Mike Davies
University College London

In London, the gap between house prices and incomes has been continuously widening over the past few decades. Median house prices are now ten to sixteen times median incomes, the worst affordability level since data became available (Figure 1). This, chief among various other statistics, has brought observers to virtually unanimous agreement that England is facing a housing crisis, centred on and particularly severe in London.

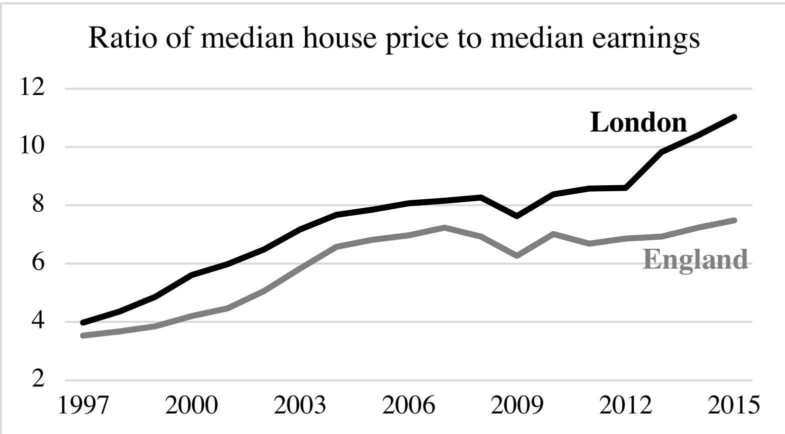

Figure 1 - Declining affordability of housing in London and in England

In the vast literature on this topic, most of the attention is directed towards the supply side, with the 'supply shortage' discourse completely dominating discussion on the housing crisis. Relatively little attention has been paid to the demand side, and in particular, the role of unregulated investment demand. The current 'supply fetish' comes in a bundle with a relaxed attitude to external demand pressures and, until recently, generous tax relief for those investing in buy-to-let property. However, housing supply is necessarily finite and inelastic, while, because of globalisation of trade, housing demand is not spatially bounded. Therefore, theoretically, measures suggested by proponents of accelerating supply, such as land-use deregulation, seem unlikely to enable supply to catch up with the hyper-inflated – domestic as well as international – investment demand. In addition to that, the private construction industry seems incapable as well as unwilling to increase supply so much as to catch up with demand, as their business models are traditionally based on increasing profit margins rather than output in times of great demand. Since housebuilding in the UK follows a speculative model, there is an underlying rationale for builders to trickle supply onto the market and release it when market conditions are most favourable - increasing profit at the expense of construction volumes.

Ironically, almost all government housing policies are currently adding fuel to the fire by further feeding demand. Chief among such policies is the recent *Help to Buy* scheme aimed to 'boost housing supply' via stimulating demand through an equity loan scheme for first-time buyers and a mortgage guarantee scheme which applies to existing housing as well. We argue that investment demand, which is further fuelled by the mortgage market, is implicitly encouraged by government policies, as a growth model for the UK economy through housing equity withdrawal, and as a privatised pension provision strategy.

Throughout the past four decades, the government has gradually reduced its involvement on the supply side of housing, and policy has switched its focus to the promotion of homeownership through demand-side subsidies. This is a textbook example of *policy resistance*, since these very policies have led to a situation where the growth in owner-occupation has gradually slowed-down, peaked, and started declining since 2008, as seen in Figure 2, with more and more households being priced out into private rental accommodation.

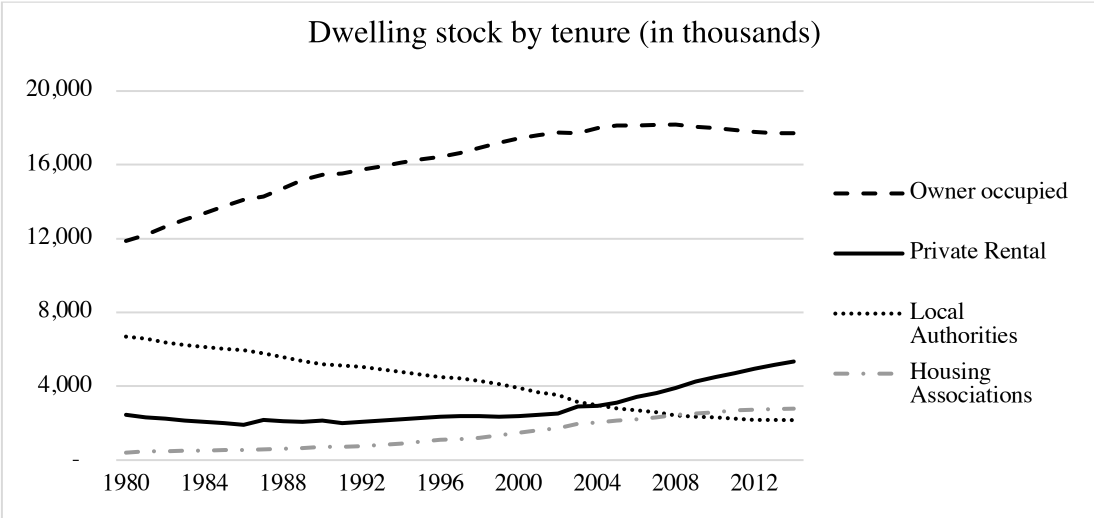

Figure 2 - Developments in housing tenure, London

In sum, policies implemented during recent decades in the housing domain seem to have only helped to make matters worse in terms of affordability. Surprisingly, however, no political party has so far addressed what increasingly seems to be at the root of the crisis, namely the financialisation and virtually unbounded flow of money into housing.

In this paper, we present an initial model built on existing literature and statistical data that serves as a first step towards an integrated model of London's house price dynamics since 1980, with a particular focus on the role of the financial markets. The model, even though at an early stage, shows promise in endogenously replicating past trends in some variables key to the current housing crisis. A more comprehensive qualitative model is also presented in the form of a causal loop diagram, which will be the basis of further refinement of the formal quantitative model.

This paper presents work that is very much in progress at present, with the formal model only beginning to take shape. However, there are certain implications already made clear at this early stage. Chief among those is that the described theory of London's housing crisis demonstrates above all that disparate measures taken here and there, aimed at incremental increases in the supply of new build or the provision of affordable housing, do not address the underlying dynamics central to the emergence of the crisis, and are therefore unlikely to solve the crisis in the long-term. We argue that London's housing crisis goes beyond the housing domain and is rooted in the prevailing paradigm of political economics in the UK, the country's implicitly envisioned model of economic growth, and its neo-liberal system of asset-based welfare. Therefore, the conversation on the housing crisis, whether on the media or in the social sciences circles, needs to fundamentally shift from an exclusive 'supply-side fetish' and an emphasis on 'making more affordable housing' towards the more fundamental quandary of 'making housing more affordable'. The literature supporting this view suggests this could be done through a broader framing of the problem encompassing practically infinite investment demand, the free rein of commercial banks in creating and allocating money, and the UK's unsustainable model of debt-based economic growth and private asset-based model of welfare provision.