The demand for housing as an investment

Drivers, outcomes and policy interventions to enhance housing affordability in the UK

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Professor in Economics and Finance
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IIPP Policy Report — October 2024

Institute for Innovation and Public Purpose

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Written by

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About this report

As part of the previous UK government's interest in engaging with the wider housing policy debate, the Ministry of Housing Communities and Local Government (the Department of Levelling Up, Housing and Communities) contracted Professor Josh Ryan-Collins to undertake an independent report on the financialisation of the UK housing market.

The analysis and recommendations included in this paper are the author's own, and the department's funding does not constitute policy endorsement by the previous or current government.

About the author

Josh Ryan-Collins is Professor of Economics and Finance at the UCL IIPP. His research focus is on the economics of land and housing, money and banking, and macroeconomic policy. His books include *Rethinking the Economics of Land and Housing* (Zed 2017) (co-authored), *Why Can't You Afford a Home* (Polity 2018) and *Where Does Money Come From* (2012 NEF) (co-authored). His work on the interaction between the financial sector and housing markets in high-income economies has received international recognition and he has provided advisory support to the European Commission and UK government on housing affordability issues.

Table of Contents

Executive Summary **7**

1. Introduction **11**

2. Key drivers of the financialisation of UK housing **16**

2.1 Mortgage credit liberalisation 16

2.2 Financial innovation, the globalisation of mortgage financing and wealth-driven housing investment 23

2.3 Falling interest rates and quantitative easing programmes 26

2.4 Shifts in government policy and the financialisation of the rental sector 28

3. The impacts of financialisation on housing-related inequalities **35**

3.1 Wealth inequality 35

3.2 Tenure inequality 35

3.3 Housing space consumption inequality 37

4. Policy recommendations **41**

4.1 Planning and housing policy 41

4.2 Reforms to the UK mortgage market 44

4.3 Reforms to property taxation 48

5. Conclusion **51**

References **53**

Table of Figures

Figure 1:	Standardised UK house price-to-rent and house price-to-income ratios (100 = long run average)	**14**
Figure 2:	Bank loans outstanding and % of GDP and real house price index, (Right hand scale)	**18**
Figure 3:	Gross mortgage lending for house purchase and housing affordability	**18**
Figure 4:	Disaggregated credit and house prices (Right hand scale) averaged across 14 high-income economies, 1950–2016	**20**
Figure 5:	Annual buy-to-let mortgage advances for house purchase by value (£m) and as % of all mortgage loans by value, 2000–2021 (Right hand scale), annual data	**21**
Figure 6:	Quarterly residential mortgage advances (gross flows) by purpose of loan, 2007–2022	**22**
Figure 7:	Number of housing market transactions by buyer type	**24**
Figure 8:	Key UK interest rates	**26**
Figure 9:	Trends in tenure in the UK (%)	**29**
Figure 10:	Quarterly total Stamp Duty Land Tax transactions and Higher Rate on Additional Dwellings (HRAD) transactions since 2016	**32**
Figure 11:	Feedback cycles influencing the financialisation of housing	**34**
Figure 12:	Distribution of underoccupied households (with two or more spare bedrooms) by tenure (England)	**38**
Figure 13:	Distribution of underoccupied households by age and household type	**38**
Figure 14:	Spread between 75% and 95% LTV two-year fixed rate mortgages, 1995–2023	**45**

Executive summary

Housing has two economic functions. It is a consumption good – it provides shelter – but also an investment. In relation to the latter, it can be a financial asset providing realised and unrealised capital gains and rental returns; a source of collateral to support borrowing; and an efficient store of wealth. The demand for housing as an investment can impinge on its function as a consumption good given an inherently limited supply of housing and land in desirable areas.

This report examines the role of investment demand for residential property in the UK – also described as the ‘financialisation’ of housing – and its contribution to worsening affordability over the past 40 years.

A key driver of financialisation in the UK has been the liberalisation of mortgage credit markets since the 1980s. Together with historically low real interest rates and financial innovations which enabled capital market investors to enter the mortgage market, by the time of the global financial crisis this had led to a quadrupling of mortgage credit from around 20% of GDP to 80%. This growth rate far exceeds any feasible increase in the construction of new homes. The vast majority of mortgaged purchases were for existing homes and during this period real house prices increased five-fold. Since the mid-1990s house prices have decoupled from their long-run relationship with incomes and rents; rising mortgage credit and lower interest rates are the only feasible explanation for this shift.

Although the growth rate of mortgage credit has fallen since the global financial crisis in 2008, cash buyers and capital market investors have maintained investment demand for UK property. Property in major cities, in particular, have become a highly desirable global asset as real interest rates on other safe assets, such as government bonds, reached historic lows.

Government policy on housing in the UK since the 1960s has involved a steady shift away from subsidising the provision of affordable housing, mainly in the form of social rented accommodation but also regulation of the private rented sector (PRS), and towards subsidising the demand for homeownership and a liberalised private rented sector. The current property tax regime favours home ownership both as a form of tenure and as a financial asset.

The commercial mortgage market favours lower risk borrowers. This means that existing homeowners and investors have a major advantage in purchasing

property, given their existing collateral and wealth. Legislation to liberalise the private rented sector introduced in the 1980s and 1990s, together with the introduction of buy-to-let (BtL) mortgages in 1996, has led to a major increase in the purchase of additional homes (second homes and buy to let) as existing homeowners have out-competed first-time buyers, even with the erosion of tax breaks for investors since 2016. More than 50% of second homes and two-thirds of rental properties are owned by the richest fifth of households.

These developments have contributed to major shifts in tenure away from the stated policy goal of successive governments to increase homeownership. Since the early 2000s, mortgaged homeownership has fallen drastically from 45% to 30%, mirrored by the private rented sector (PRS) share doubling from 10% to 20%. Private landlords now own around one in five homes in Britain whilst four in ten adults own no property at all. Millennials (born between 1981 and 1996) today are only half as likely to own their home at age 30 as the baby-boomer generation (born between 1946 and 1964) were at the same age. Younger families have seen their homeownership rate halve to 25% since 1989. The share of families with children that live in the PRS has almost tripled since the 1990s.

The increasing demand for housing as an investment has contributed to growing housing-related inequalities across age, wealth and income, and by tenure. Renters face considerably higher housing costs than homeowners on average and are more likely to have lower living standards across a range of measures. Together, a decline in housing benefit for renters relative to costs and the erosion of the social rented sector have left many younger and middle- and lower income households and families in the rental sector facing serious affordability problems.

The financialisation of housing has also contributed to rising inequalities across tenure and age in terms of the consumption of housing space. Relative inequality in housing space consumption improved for most of the 20th century, but since the 1980s it has notably deteriorated. Today 90% of underoccupied households – where there are two or more spare bedrooms – are owner-occupiers. This compares to just 6% of private renters and 4% of social renters. Over 50% of under-occupied households are occupied by people over the age of 60 (4.8 million out of 8.8 million). Couples or lone parents with dependents, meanwhile, have just a 10% share of underoccupied households, even though they account for more than 25% of total households.

The recent rise in interest rates has discouraged some types of investor, in particularly mortgaged buy-to-let landlords. However, there is little evidence of an overall decline in investment demand for UK properties, with evidence instead of cash buyers and asset managers buying up housing, including, potentially, foreign buyers. Wealthier investors may view property in cities such as London and Manchester as good long-term investments and be less sensitive to small price changes caused by either rising interest rates or tax reforms (for example, the higher rate of Stamp Duty Land Tax (SDLT) on additional homes introduced in 2016).

Policy solutions

The UK housing market is characterised by a housing-finance feedback cycle, whereby increasing financial flows into housing generate rising prices and expectations of future rises, which in turn generate more speculative demand for housing as an investment, and so on. Policy makers need to carefully consider what types of interventions can break this powerful dynamic. Marginal reforms in discrete policy spheres are unlikely to do so.

For many years policy has focused on new construction to increase supply. Whilst this may be effective in reducing housing costs in certain areas, more emphasis should be focused on repressing investment demand for housing with the aim of releasing a portion of the existing stock for either first-time buyers or conversion to social rent where housing need is greatest. Such supply can be bought onto the market much more quickly than new build.

Local authorities (LAs) could be given powers to limit use or tenure change that would mitigate against affordability, for example the conversion of primary residences or long-term PRS lets to second homes or short lets. They and other social landlords or community housing associations could also be given right-of-first refusal to buy and, where needed, renovate PRS properties that stressed BtL investors may choose to sell or where landlords are unwilling to upgrade rental properties to Decent Homes Standards. LAs could also be given new compulsory purchase powers to purchase early-stage private sector developments, that have been delayed due to the housing downturn, at prices that would render the existing permission viable at minimal profit margins and convert these to social rented housing. These interventions will require financial support from government – Homes England could consider raising the 10% acquisitions cap on the Affordable Homes Programme (AHP) – and, in the longer term, the creation of a public housing corporation/bank.

Compulsory and permanent mortgage insurance and longer term fixed-rate mortgages for first-time buyers should be introduced to bring down the cost of higher loan to value (LTV) ratios for first-time buyer mortgages. Alongside this, HMT and the Bank of England/FCA should consider lowering LTV ratios for BtL

mortgages to reduce the volatility of the mortgage and housing market, and repress speculative demand during upturns or when interest rates are low.

An annual property tax could be introduced, replacing Council Tax and Stamp Duty, that would considerably reduce investor demand for housing and free up potentially hundreds of thousands of properties to better meet housing needs. If this is not feasible in the short term, SDLT and Capital Gains Tax on additional homes should be significantly raised.

Further research on the demand for housing as an investment could be undertaken to examine in more depth the role of individual cash-buyers and capital market actors in buying residential property as investments, in particular since 2008, and their sensitivity to interest rate changes; the efficiency of the use of existing housing units (for example, excess bedrooms, under-occupation); and the extent to which landlords pass on increases in costs (including those due to interest rate rises and tax rises) to tenants and/or exit the PRS.

1. Introduction

The UK's housing affordability crisis is characterised by rising house prices and rents relative to incomes, falling rates of homeownership amongst younger cohorts, rising private renting, and high levels of homelessness and households in temporary accommodation. There are major inequalities in terms of space and quality of housing provision, and the distribution of housing wealth between tenures and across age and income cohorts.[1] The post-pandemic period has seen further deterioration in affordability with sharp rises in interest rates pricing out first-time buyers, despite house price falls, leading to increased demand for rental accommodation. This has contributed to both rents and homelessness reaching record highs.

Housing has two economic functions. It is both a consumption good – it provides shelter – but also an investment good. In relation to the latter, residential property can be:

- a financial asset providing realised and unrealised capital gains, and actual and imputed rental returns;
- a source of collateral that can enable borrowing and increase purchasing power, including to acquire additional property;
- a store, and means of passing on, wealth; and
- a hedge against rental risk.

It is important for housing policy makers to understand the impact of both types of demand to ensure the efficacy of interventions aimed at enhancing housing affordability. The demand for housing as a consumption good can be understood as a universal need that the state has an obligation to provide for at a basic minimum level.

Primary residences can be viewed as being both consumption and investment goods at the same time for their owners. However, the latter function can impinge on the former given an inherently limited and inelastic supply of housing and land in desirable areas. This report focuses on the demand for housing as an investment, its drivers over the past 40 years in the UK and policy interventions that could reduce this type of demand in a sustainable fashion and potentially enhance the provision of affordable housing.

In UK policy circles, explanations of the affordability crisis have focused more on supply-side explanations. Multiple reviews of the UK's housing market have

concluded the reason for high prices is due to inadequate provision of new homes relative to rising demand driven by rising incomes, increasing household formation (people living in smaller households) and rising immigration. Government interventions have also focused on supply-side reforms.

However, since the 1980s, successive governments have been unable to materially increase the rate of housebuilding, which has averaged around 150,000 new units per year.[2] The UK housing development sector is dominated by private sector developers, who may lack incentives to build out at a rate that would reduce house prices in local areas where they operate.[3–5]

Moreover, evidence suggests that expansion of the housing stock may have a limited effect on housing affordability in aggregate. Estimates of the sensitivity of UK house prices to increases in housing stock consistently show that a 1% increase in housing stock delivers a 1.5–2% reduction in house prices.[6,7] Taking into account the growing surplus of housing stock relative to number of households, this implies that, all else equal, expanding the housing stock by 20% (approximately 5 million homes) over the next 20 years roughly in line with government projections might bring down prices by around 10%.[7] This contrasts with a 306% increase in mean nominal English house prices since January 2000 (from £75,219 to £305,370).[8]

Furthermore, new build makes up just 1% of the total of new housing supply that comes onto the market each year, with the vast majority coming from existing properties being sold or rented out.[9] To achieve more material increases in affordability in the short to medium term, policy makers also need to consider how to reduce types of demand – specifically investment demand – that might free up *existing* stock for those in housing need, as well as ensuring the most efficient use of any new supply.

The term 'financialisation of housing' has been used to describe a shift towards treating housing as an investment above and beyond its role as a consumption good or to favour its market value over its use value; and, more generally, an increasing role for the financial sector in the housing market.[10] Indicators of financialisation commonly noted in the academic literature include:

- the liberalisation and expansion of mortgage credit so that it grows at a faster rate than incomes (debt-driven investment);
- an increase in cash purchases and new forms of capital market investment flowing into residential real estate (wealth-driven investment);
- growth in the size of the private rented sector (or 'landlordism') *vis a vis* homeownership and increasing market power for investors *vis a vis* would-be homeowners and tenants; and
- increasing concentration of housing wealth in higher income and older cohorts.

The impact of these finance-related developments on house prices is also determined by a range of other contributing factors. These include changes in interest rates and policy decisions across housing, planning, financial regulation and fiscal policy spheres, and related institutional developments. Taking into account these wider policy dynamics, other terms than 'financialisation' have been used to describe the way in which housing has become prioritised as an investment good. These include the 'commodification of housing'[11] and the 'rentierisation of housing'[12]. This broader conceptualisation of financialisation will be used in this report.

Previous booms in house prices in the UK in the 1970s and 1980s saw busts that returned house prices to their long run ratio with rents and incomes (Figure 1). But since the 2000s, house prices have decoupled from incomes and rents. Similar dynamics have been observed in other high-income economies.[13] Since rent prices should reflect, in a relatively pure sense, the demand for housing as a consumption good, the explanation for the discrepancy is likely to be related to a rise in the investment demand for housing, enabled in significant part through non-wage-related capital flows (i.e. flows of credit and/or accumulated wealth).

Figure 1: *Standardised UK house price-to-rent and house price-to-income ratios (100 = long run average)*

Source: OECD analytical house price indicators

Rising house prices in the UK and other high-income economies have mainly been driven by rising land values, with the cost of housing structures tracking consumer price inflation.[13] Land underlying dwellings in the UK has increased in nominal value almost eight-fold since 1995, from £0.7 trillion in 1995 to £5.4 trillion.[14] This is equivalent to an increase from 82% to 252% of GDP.

From an economic theory perspective, capital gains and rental income from property are normally considered as economic rents – income derived from control over a scarce asset (land) needed for production – rather than normal profit derived from productive investment in a competitive market. Land has unique properties differentiating it from other commodities, including being inherently scarce, fixed and irreproducible, which means its owners are able to extract economic rents if permitted to do so.[15,16] Increased financial flows into unproductive assets like land and property increase such rents and can be viewed as an inefficient allocation of capital, with negative consequences for economic growth and wealth inequality.[17,18]

The focus of this report will be mainly on the UK housing market, but with some comparative analysis of other high-income economies. Section 2 focusses on the drivers of financialisation, including mortgage market liberalisation, financial innovations and the role of institutional capital, monetary policy and government policies. Section 3 examines the inequalities financialisation has contributed to and section 4 discusses potential policy interventions.

2. Key drivers of the financialisation of UK housing

The combination of four major factors has led to an increased demand for housing as an investment good in the UK and other high-income economies since the 1980s, resulting in house prices rising at a faster rate than incomes:

- developments in mortgage credit markets;
- financial innovation;
- low interest rates; and
- government policies favouring owner occupier and investor housing.

2.1 Mortgage credit liberalisation

The majority of housing transactions in the UK are for existing rather than new residential property. Even with substantial increases in supply – such as those targeted by the UK housing ministry – this would continue to be the case given the size of the population. First-time buyers, existing homeowners, and large and smaller investors compete to buy the same stock of mainly existing residential property.

The availability to these groups of mortgage credit and other sources of investment will determine their purchasing power rather than incomes alone. Relaxations in credit conditions due to financial liberalisation, and/or increases in available disposable income and wealth, can lead to an increase in financial flows into housing, resulting in higher prices relative to incomes.[19–21] Much policy focus and economic modelling of house prices has focused on the elasticity of the supply of housing, and changes in incomes and the user cost of housing on the demand side, but neglected the role of credit constraints and how speculative (non-rational) expectations of future price rises may drive demand for housing.[22,16,23]

With most economic commodities, rising prices will lead to *falling* demand. In contrast, rising house prices relative to income creates more demand for mortgage credit as: 1) affordability worsens meaning larger loans are required for house purchase; and 2) expectations of future house price rises increase the attractiveness of housing as a financial asset (see Figure 11).

At the same time, rising house prices support an increase in the supply of mortgage credit because banks collateralise their lending against the value of the house (and land) they are lending against. Rising collateral values de-risk larger mortgage loans. This is often described as the 'collateral channel' in the economics literature.[24]

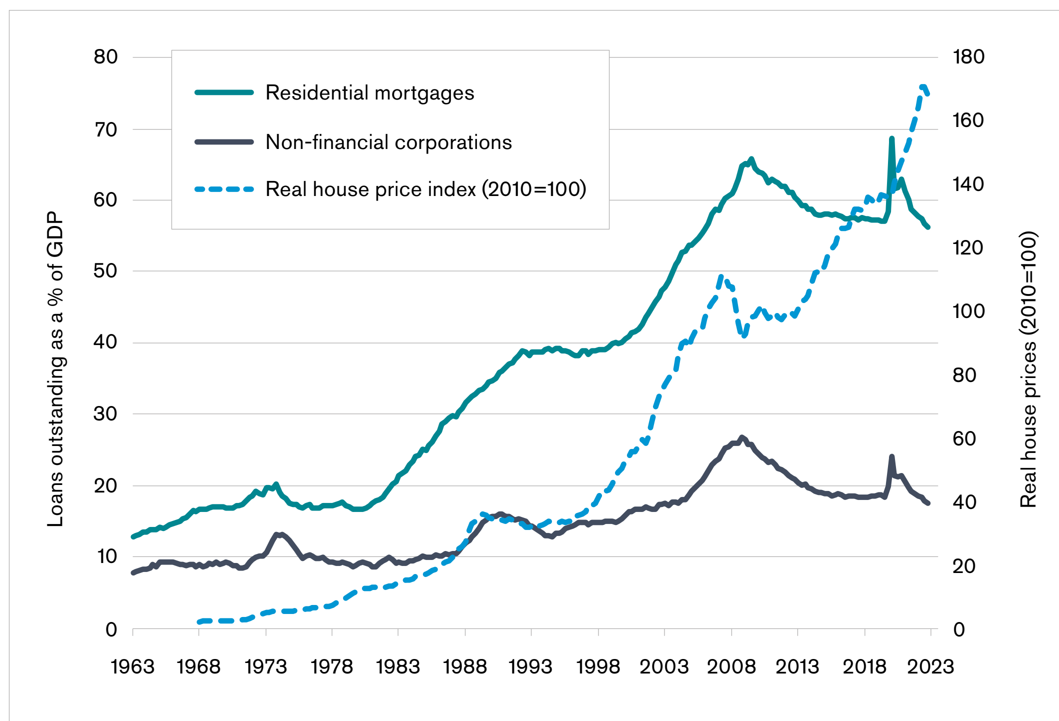
In this sense, increasing the supply of mortgage credit – through financial liberalisation – creates its own demand for further mortgage credit. These dynamics create a 'housing-finance feedback cycle',[25] which can be challenging to break out of without negative repercussions for house prices, financial stability and the wider economy. The self-reinforcing dynamics of mortgage credit and house price expectations are key to understanding the volatile nature of UK house prices since the 1980s.[22,23,26]

The deregulation and liberalisation of mortgage credit the 1970s, 1980s and 1990s in the UK involved:

- the abolition of regulations that prevented banks from competing with building societies and other established housing finance institutions in the provision of mortgage credit, such as limits on interest rate charges and tax disadvantages;
- the removal of other sectoral credit controls on mortgage credit; and
- the removal of foreign exchange controls also made banks less dependent on domestic deposits for their funding, de-linking domestic incomes from mortgage credit growth.

These reforms aimed to increase levels of homeownership. However, they resulted in a huge expansion of mortgage credit, which helps explain the rapid rise in UK house prices from the 1980s.[16,20,27] As shown in Figure 2, outstanding residential mortgage credit (for all types of secured lending) was below 20% of GDP for the 1960–1980 period, but then quadrupled to around 60% of GDP prior to the financial crisis. During this period real house prices increased five-fold. As a comparison, lending to non-financial firms (the grey line) rose from 10% of GDP to only 20%.

Figure 2: *Bank loans outstanding and % of GDP and real house price index, (Right hand scale)*



Source: Bank of England statistical database, series LPQ, break adjustments by author; house prices: BIS
Note: The Covid pandemic in 2020 resulted in a sharp fall in GDP, which reflects the spike in credit outstanding/GDP

Figure 3: *Gross mortgage lending for house purchase and housing affordability*

Source: Refinitiv Datastream; Bank of England; Nationwide

Figure 3 shows gross mortgage lending specifically for home purchase, excluding other forms of secured lending, such as re-mortgaging or business loans secured against property, and the Nationwide house price to earnings ratio on the right-hand scale (red line). There is a correlation between the rising mortgage credit flows and the house price to earnings ratio from the mid-1990s up to the financial crisis.

However, after the financial crisis, mortgage lending slowed, but, after a short period of falling, house prices continued to increase at a more rapid rate than incomes. The financial drivers of house prices in the post-financial crisis period may have had more to do with 'wealth-driven' investment,[28] explored further below.

A further development contributing to expanding mortgage credit in high-income economies in the 1980s was the emergence of a new international regulatory framework – the Basel Accords. These introduced minimum capital requirements for all banks related to the type of assets they held. Loans secured by mortgages on residential properties only carried half the risk weight (50%) of loans to non-financial firms in the original Basel Accord. The effect of these reforms was to allow banks to earn fees and net interest margins on holding 2.5 times more credit risk in real estate than they had before, without any increase in their capital requirements.[29]

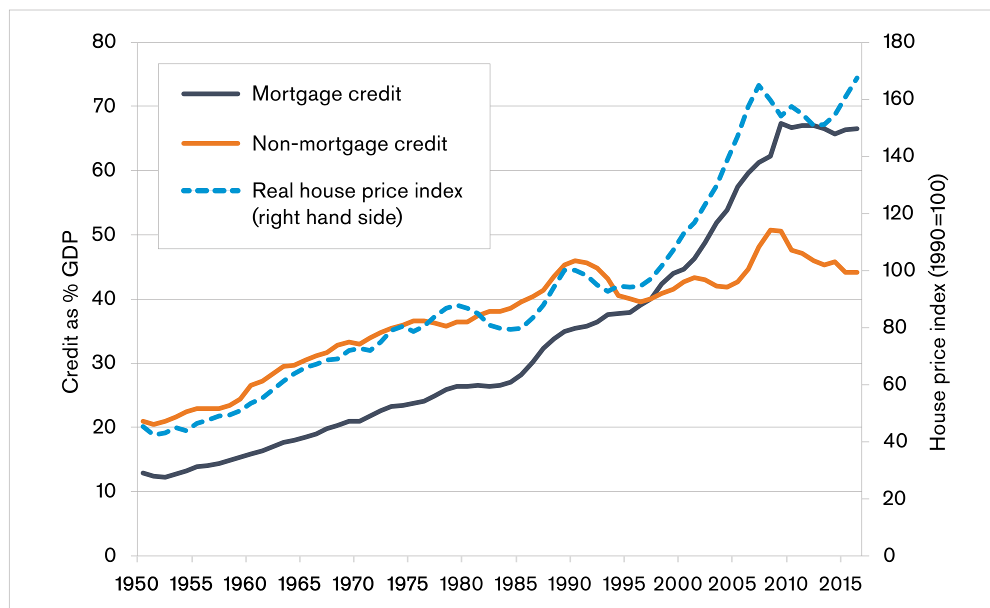
One concern with the view that increases in mortgage debt drive up house prices is that causation may run the other way: rising house prices (caused by some other factor, for example, inelastic supply or rising incomes) lead to greater demand for mortgage credit. However, there are reasons to be skeptical of this view.

First, a number of recent empirical studies using careful statistical identification strategies, such as using financial deregulation as an instrument exogeneous to demand, suggest that house price rises are more likely to be a *response* to credit supply expansion rather than a cause.[30–33] For example, Favara and Imbs (2015) examined the impacts of the passing of a 1994 US-wide branch banking deregulation law in the US.[31] Because some states chose to limit the level of regulation and others did not, the authors were able to isolate the extent to which credit liberalisation was exogeneous to demand in impacting mortgage credit expansion and associated house price increases. This study found that between 1994 and 2005, deregulation explained between one half and two-thirds of the observed increase in mortgage loans, and between one third and one half of the increase in house prices.

Second, other studies have found credit constraints to be the most important factor in explaining cross-country differences in house prices,[19,21,34] which helps to explain different house price responses to the same shifts in interest rates.

Third, the UK was not alone in seeing rapid expansions in mortgage credit correlated with rising house prices. For example, one study found that across 16 high-income economies, on average, mortgage credit rose from 40% of GDP in the mid-1990s to 70% by 2007, with house prices doubling over the same period[35] (see Figure 4). Given significant differences in other potential explanatory variables in such a large sample of countries, such as the elasticity of housing supply or changes in income, expansion in mortgage debt, which occurred nearly everywhere in the 1990s, is the most convincing intuitive explanation.

Figure 4: *Disaggregated credit and house prices (Right hand scale) averaged across 14 high-income economies, 1950–2016*



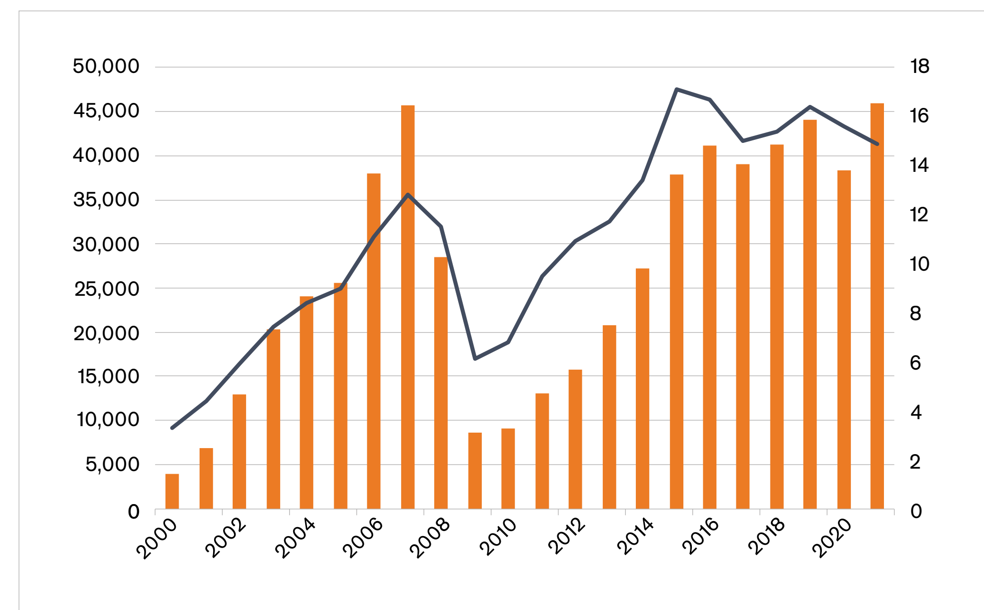
Source: Adapted from Jorda-Schularick-Taylor macrohistory database: www.macrohistory.net;

Indeed, recent cross-country empirical research shows liberalising mortgage credit has actually led to *lower* levels of home ownership as affordability has worsened across many advanced economies.[36] Furthermore, rising mortgage debt and credit liberalisation are not associated with increased construction of new homes, as is often claimed.[37]

Alongside rising affordability problems for first-time buyers, there are other explanations for these dynamics. One is that once homeowners become a majority voting constituency, they act to limit the construction of new homes in the areas where they live via influencing planning decisions and housing policy – the so called 'homevoter hypothesis'.[38] Another (complementary) explanation is that countries with liberalised mortgage markets are more likely to have mainly market-based provision of housing and that commercial home builders lack incentives to build out at a rate that would reduce house prices, even if more mortgage credit is being made available to theoretically support more construction. As a result, more credit flows into competition for existing homes, further inflating house prices and developer profits.

Another important trend in UK mortgage lending since the 2000s has been the growth of the buy-to-let (BtL) sector since the introduction of BtL mortgages in 1996 (discussed further below). As shown in Figure 5, BtL lending has been highly cyclical. It expanded by £40 billion in the run-up to the global financial crisis and then collapsed, before recovering sharply and then stabilising after the introduction of higher taxes on BtL properties in 2016. However, since 2015, BtL mortgage advances have averaged around 15% of the value of all advances in the residential mortgage sector, notably higher than the 12% reached at the peak of the global financial crisis.

Figure 5: *Annual buy-to-let mortgage advances for house purchase by value (£m) and as % of all mortgage loans by value, 2000–2021 (Right hand scale), annual data*

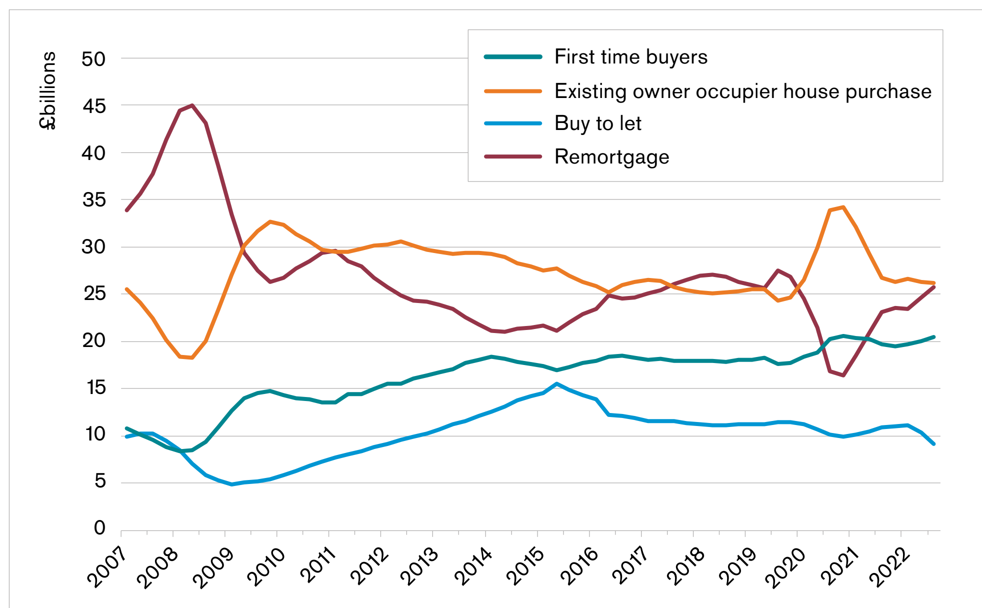


Source: UK Finance, Table MM17

More detailed mortgage lending-by-purpose data, including first-time buyer data, has been gathered since 2007 by the Bank of England/FCA and is shown in Figure 6 (note: this shows quarterly rather than annual data). Notable is the fall

in existing owner house purchase and re-mortgage lending from 80% to 60% of the total share in the six years following the financial crisis (£70 billion at peak to around £55 billion per quarter). First-time buyer mortgage advances have increased from around 10% to 20% of total (and £10 billion to £20 billion in monetary terms) since 2007. The Stamp Duty holiday introduced during the Covid-19 pandemic saw a major, but temporary, expansion in mortgage credit for existing homeowners in 2020; there was a more muted increase for first-time buyers.

Figure 6: *Quarterly residential mortgage advances (gross flows) by purpose of loan, 2007–2022*



Source: Bank of England/FCA Mortgage and lending administration return (MLAR), Table 1.33.; data seasonally adjusted by author

The most recent data on mortgage advances suggests the higher interest rates in place since 2022 have now begun to materially reduce mortgage lending. Total advances fell to just below £60 billion in 2023 Q2, a 25% reduction on a year previously. The share of advances for buy-to-let purposes was 8.1% in 2023 Q2, a fall of 1.7 percentage points on the previous quarter and a fall of 5.5 percentage points from 2022 Q2. This was the lowest observed since 2010 Q4. However, transactions for additional dwellings (attracting the new higher rate of Stamp Duty Land Tax (SDLT)) have not declined, suggesting more cash-buyers have entered the BtL/second home market and that demand for investor property has not declined.

2.2 Financial innovation, the globalisation of mortgage financing and wealth-driven housing investment

Financial innovation, in particular the emergence of residential mortgage-backed securitisation (RMBS) from the 1990s onwards, allowed new sources of institutional capital (for example, from pension funds and insurance companies), to enter the housing market. RMBS involves the packaging up of many mortgage titles into a security that pays a specific yield depending on the relative riskiness of the portfolio of mortgages contained within it. By selling RMBS, banks could remove these loans from their balance sheets, enabling them to reduce their regulatory capital requirements and then further expand their lending. The fees from selling on such loans helped banks make up profits lost due to lower interest rates.

Securitised mortgages were initially viewed as more liquid and thus less risky than mortgages by regulators, and thus only carried a 20% risk weight in the international Basel rules. RMBS were highly attractive to capital markets as an alternative to lower yielding government bonds, in particular in the run-up to the financial crisis of 2007–08. RMBS transformed a geographically fixed and illiquid asset – a traditional 25-year fixed-rate mortgage loan – into a liquid and transparent financial asset which can be bought and sold almost anywhere in the world.[39] By opening housing finance to a vast global investment sector, RMBS broke down previous national and local institutional barriers over the funding of home purchase.

RMBS played a key role in the rapid increase in mortgage credit in the UK in the lead up to the 2008–09 financial crisis. Securitisation enabled mortgage issuers to offer a wider range of mortgage products, to offer mortgages at lower rates of interest and offer them at higher loan to value (LTV) ratios. This in turn enabled larger numbers of people to access home ownership at higher price to income and mortgage-debt to income ratios. The UK's house price-earnings ratio more than doubled between 1997 and the peak of the boom in summer 2007 (see Figure 2).

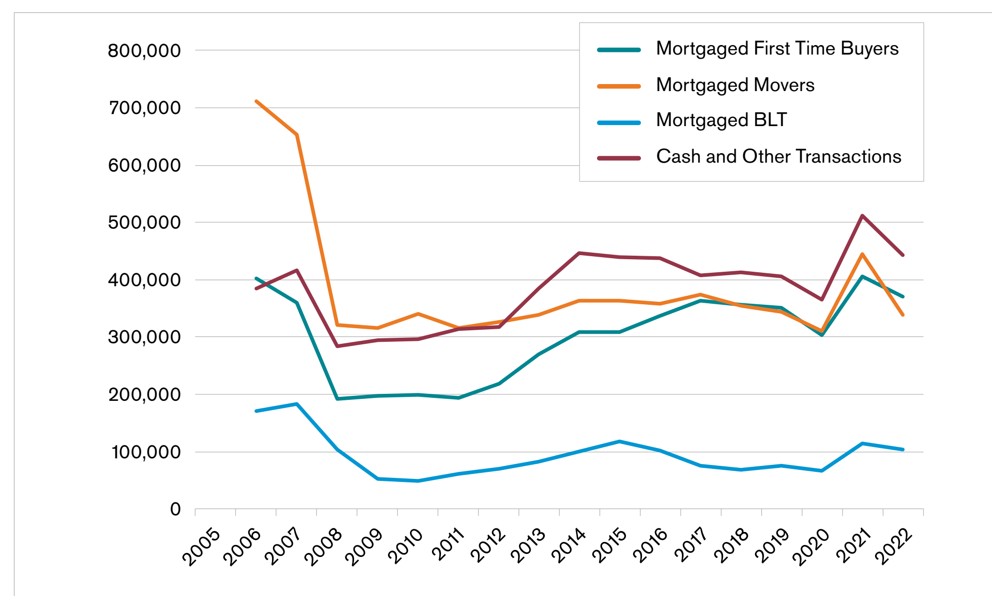
Traditionally, UK banks have funded their mortgage lending using retail deposits. This maintained a link between the growth of mortgage credit and the wider economy. However, in the run-up to the financial crisis, the UK's top ten mortgage lenders reduced their funding from retail deposits from 72% cent to 55%, while overall mortgage lending tripled to £346 billion.[40] Instead they borrowed on short-term money markets, rolling over the loans with further RMBS sales. When the market for RMBS collapsed with the sub-prime crisis, many UK banks

suddenly found their short-term wholesale funding also dried up. Of the top ten mortgage lenders in 2007 (who represented 78% of the market), those with the highest reliance on RMBS (and representing a third of the market) had all been bankrupted, nationalised or taken over by autumn 2008.[40]

Following the financial crisis, the RMBS market collapsed and mortgage lending stagnated in the UK and other high-income economies (Figures 2 and 3). Given this, the growth of *wealth-driven* (as opposed to *credit-driven*) housing investment plays an important role in explaining the growth in house prices in the UK since the global financial crisis.[28]

Detailed data on non-bank private and institutional investment into the housing market in the UK is limited. This is an area where more transparency, disclosures and research is needed. However, Figure 7 shows a significant rise in cash purchases of residential property (data on type of purchase is not available) in the UK since 2007, with cash transactions overtaking mortgaged purchases by existing homeowners for the first time in 2012. Research suggests 34% of homes sold in 2023 were bought by a cash buyer, the highest since 2017 and 4% greater than 2021 when mortgage rates were considerably lower.[41] Furthermore, a record 78% of cash buyers across Great Britain in 2023 didn't fund the purchase via selling a home, the highest share since 2009 when the series began.

Figure 7: *Number of housing market transactions by buyer type*



Source: UK Finance; HMRC Land Registry

The UK saw direct overseas investment in residential real estate rise considerably in the post-crisis period. Between 2014 and 2016, for example, 13% of all homes purchased in London were bought by overseas investors and around half of these were of housing valued at less than £500,000.[42] A recent study estimated that foreign property buyers have pushed up house prices in Britain by 17% over the last two decades.[43] Some overseas investors make use of aggressive tax avoidance schemes. For example, between 2009 and 2015 complex corporate structures mostly registered in offshore tax havens purchased nearly 28,000 London properties and land parcels at an estimated value of £100 billion.[44]

One of the first reports on non-bank portfolio investment flows into European residential real estate estimated that such investors had captured €27.7 billion worth of housing assets in London by 2021, the second largest of any city in Europe after Berlin (on €42 billion).[45] In the same year, the UK was home to 200 residential real estate funds, by far the most in Europe and only slightly behind the US.[45] London is the most important city for portfolio investment, but there has also been significant investment into Birmingham and Manchester.

The UK's build to rent (BtR) sector has rapidly expanded in recent years. It now stands at over 88,000 completions, with a further 50,000 homes under construction and investment of almost £4.5 billion in 2022.[46] BtR may increase the supply of housing, in particular in cities, and potentially bring down rental costs.

However, given the area of greatest housing need in the UK is for those on lower incomes, it can be questioned whether the current policy focus on supporting BtR as the main strategy for increasing supply in the PRS is appropriate. For example, a recent comprehensive study of housing development, BtR and build to sell (BtS) investment in Greater Manchester between 2012 and 2020 found just 471 affordable homes built in the city centre (of which 192 were with developers via section 106 and 279 built by the council) out of 45,069 units in total, or 1% of the sample over this eight-year period.[47] Greater Manchester councils significantly relaxed affordable housing requirements to attract in BtR and BtS investors, as well as offering a range of other subsidies. Similar dynamics have been found in other UK cities.[48,49] Furthermore, rising interest rates may make BtR programmes less attractive to investors as rental yields compare less favourably to other safe assets (such as government bonds), making such schemes higher risk than, for example, direct public investment in social housing.

2.3 Falling interest rates and quantitative easing programmes

When it comes to demand for residential property as an investment, key determinants are the rates of return that could be earned on wealth held in forms other than housing and, for buyers requiring mortgages, the cost of borrowing. These constitute an important element of the 'user cost of housing' that is often viewed as determining long-run house prices in economic models.

A standard proxy for alternative assets is the rate of return on government bonds, which are considered the safest form of asset. This is sometimes described as the 'risk-free' rate and is a benchmark used by financial markets to assess the risk of other assets. Historically, property has been seen as riskier than government bonds.

Figure 8 shows the steady decline in the yield (interest rate) on ten-year government bonds since the 1990s. Inflation-linked government bonds that track consumer price inflation can be seen as an even safer asset, thus attracting a lower yield. The yield on inflation-linked ten-year bonds has been negative for most of the period since the global financial crisis, meaning that investors buying these assets would be paying the government money to hold these kinds of liabilities.

Figure 8: *Key UK interest rates*

Source: Refinitiv Datastream

With regard to mortgage costs, from the mid-1990s to 2022, steadily falling mortgage interest rates (Figure 8) have increased the affordability of residential property purchase by reducing debt service to income ratios for both households and investors.

In the aftermath of the financial crisis, the Bank of England reduced the base rate to the zero-lower bound and commenced quantitative easing (QE) to push down medium- and longer-term rates by purchasing government bonds from capital markets on a vast scale. In theory this would lead investors to invest in more risky real economy investments, such as debt and equity issued by companies, and boost corporate investment. But evidence suggests that investors shifted much of the newly created money in their accounts (which replaced the government bonds) into financial and real estate assets, resulting in the inflation of these assets.[50–52]

Bank of England research has estimated that real house prices in 2014 would have been 22% lower respectively than they actually were in the absence of loose monetary policy (i.e. lower interest rates and QE).[50] The wealth gains from monetary policy were not evenly distributed, however. The paper estimated that the least wealthy 10% of households saw an increase of £3000 in their measured real wealth (mainly made up of housing and pension assets) between 2006–08 and 2012–14, compared to £350,000 for the wealthiest 10%.

QE programmes were undertaken by nearly all major central banks during the global financial crisis, creating a 'wall of liquidity' that catalysed a global search for higher yielding but safe assets.[10] Landed property, particularly in rich global cities, proved to be one of the most attractive assets for investors with global reach. Property prices in global cities synchronised, with price dynamics closer to each other than with cities in their respective domestic hinterlands.[53] Even where international investors target 'prime' (very expensive) properties, this has a trickle-down effect, raising prices across different market segments and contributing to a generalised worsening of affordability.

Some economists have argued that the decline in the real risk-free rate is the main explanation for rising house prices in the UK since the 1990s. For example, using a user-cost based equilibrium model of the UK housing market, Miles and Monro[54] estimate that the nearly 6 percentage point decrease in the yield on inflation-linked UK government debt between 1985 and 2018 may have caused a doubling of average UK real house prices across the period. They also find that even major improvements in the elasticity of housing supply during the period of falling interest rates would have made little difference to affordability given these very large, long and unanticipated falls in the risk-free rate.

However, the impact of low interest rates on the demand for housing as an investment and rising house prices relative to incomes will be mediated by other factors. In particular, more regulated mortgage markets will constrain lending even with low rates. Also, the attractiveness of homeownership *vis-à-vis* other tenures and other financial assets will play a role. The latter will be affected by government policies in a range of spheres, discussed further below.

As a counter example to the interest-rates-drive-house prices hypothesis, Germany also experienced falling real interest rates for the majority of the 1990-2020 period. However, house prices actually fell relative to incomes, even though the German stock market index (DE40) rapidly increased.[52] Germany, however, did not liberalise its mortgage credit regime in the 1980s, nor enact demand-side subsidies for homeowners and investors, or liberalise its rental market, which remains much more regulated in favour of renters than that of the UK.

2.4 Shifts in government policy and the financialisation of the rental sector

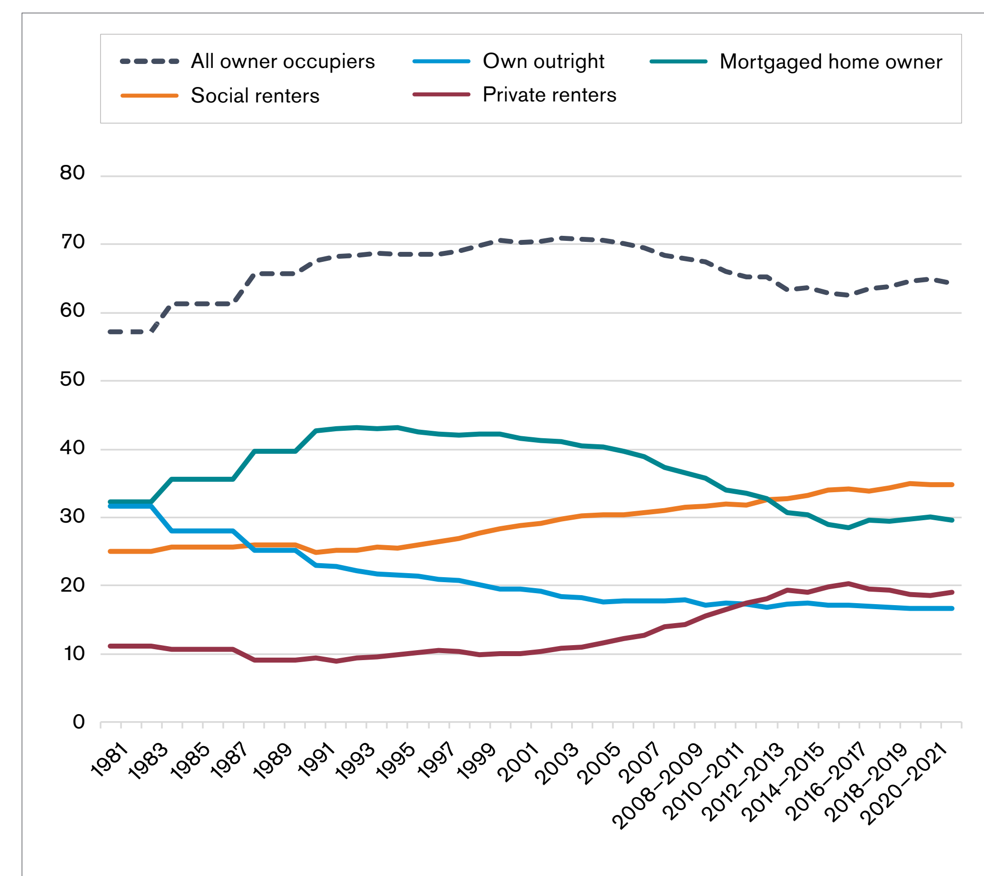
UK housing policy since the 1960s has involved a steady shift away from providing and subsidising affordable housing, mainly in the form of social rented accommodation, and towards subsidising the demand for homeownership and a liberalised private rented sector. In 1975 more than 80% of housing subsidies were supply-side subsidies, intended to promote the construction of social homes. By 2000 more than 85% of housing subsidies were on the demand side, aimed at helping individuals with the cost of mainly market-provided housing, in particular housing benefit.[55]

Although housing benefits have increased in line with rising rents, total housing subsidies, also incorporating the provision of social housing and rent controls, have fallen from 16.5% of the total day-to-day cost of housing services in the national accounts in 1979 to 11.5% in 2019–20.[56] This has been the major contributor to the rising cost of rents as a share of tenants' incomes.

The right-to-buy policy of the Conservative government of the 1980s saw one of the largest transfers of socially rented homes to the owner-occupier sector in history. This contributed to the shrinkage of the social rented sector from 31% to 17% of the English housing stock between 1979 and 2010 (Figure 9); during the same period, social rents moved from around half to two-thirds of market levels.[56]

These policies, together with mortgage liberalisation and the financial innovations discussed above, significantly increased mortgaged homeownership amongst lower and middle-income groups in the 1980s (Figure 9). However, since the early 2000s, homeownership in aggregate has been falling (from 70% to around 65%). Mortgaged homeownership has fallen drastically from 45% to 30%, outweighing an increase in outright homeownership from 25% to 35%. Since the early 2000s, the private rented sector share has doubled from 10% to 20%, mirroring the decline in mortgaged homeownership.

Figure 9: *Trends in tenure in the UK (%)*



Source: ONS Trends in Tenure (note: data unavailable for multiple years in 1980s)

Homeownership as an asset class also receives favourable tax treatment. According to an assessment by the OECD, in 2020 the UK spent 1.3% of GDP on tax relief for homeowners, the highest rate of the 18 countries surveyed[57] and far above the average of 0.3% (mainly captured by the relief on Capital Gains for primary residences).

The most notable reliefs are on imputed rent (removed in 1963 as part of 'Schedule A' reforms), full relief on Capital Gains Tax for primary residences and the failure to revalue Council Tax. Council Tax was introduced in 1991 to replace rates. Council Tax is based partially on local authority services and partially on property value, with progressive bands relating to the value of the property. The bands have not been revalued since the tax was introduced. As a result, millions of homes that have seen their value increase between four and five times since the early 1990s have not seen any proportionate increase in property tax, creating a huge implicit tax break for homeowners *vis-à-vis* other tenures and *vis-à-vis* other financial assets. This has created major regional inequalities in the property tax burden as homes in the south east have risen in value much faster than elsewhere in the country. As an example, currently a property in Bolton worth £150,000 pays £2,719 in Council Tax a year, whereas an £8 million mansion in Westminster pays just £1,655.58

A range of mortgage subsidies were also introduced, including the ability to offset taxation against interest payments on investment properties (abolished in the early 2000s) and schemes supporting first-time buyers, notably Help-to-Buy equity loans. Evidence suggests these latter schemes had the perverse effect of increasing house prices as the increasing demand was capitalised into house prices.[59]

Stamp Duty Land Tax (SDLT) is the largest property tax in the UK and has been made more progressive via recent reforms with higher rates for higher value properties and additional dwellings. However, SDLT is a transaction tax that discourages households from moving home and/or downsizing, reducing the effective supply of homes available at any time and the efficiency of the housing market.[60]

Government policy has also created incentives for the purchase of investment properties. Most notably, the 1988 Housing Act made private renting more attractive for investors by phasing out rent controls, which had been in place to some degree in the UK since 1915. These reforms strengthened landlords' grounds for repossession, abolished fair rent appeals and reduced the minimum notice period of eviction from one year to six months.[61] The Renters (Reform) Bill will abolish no-fault evictions and bring in other policies to strengthen renters' rights.

Buy-to-let (BtL) mortgages were introduced in 1996 creating a new source of credit flows into the housing market. BtL mortgages allow landlords to leverage not only against their existing property, but also expected future rental flows from their rental property, a feature that does not apply to other types of mortgages. BtL proved extremely popular, with lending expanding from zero to 16.5% of all mortgage advances by 2015[62] – a level it has remained at since (Figure 5). One study estimated that its introduction led to a 7% increase in house prices between 1996 and 2007.[63]

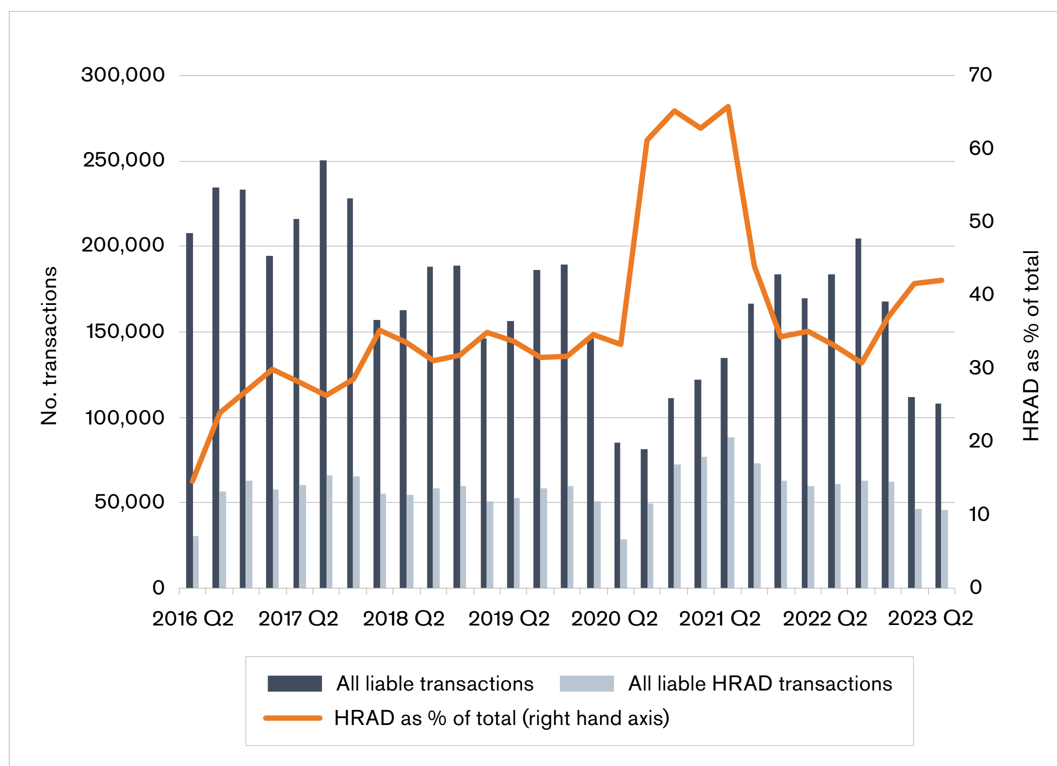
Research suggests investors also pay considerably less for similar properties than purchasers of primary residences, with one estimate putting the discount between 1.6–12%.[64] This may be due to investors being able to extract discounts in exchange for quicker transactions, either because they are cash buyers or because they do not need to sell property themselves to purchase, or because homeowners value some properties more than investors due to rental risk hedging benefits.

A 3% increase in SDLT for purchases of additional dwellings (second homes or BtL mortgages) was introduced in April 2016 and the amount of Income Tax relief available on finance costs for let residential property has been progressively reduced to the basic rate of tax. This may have contributed to the decline in BtL mortgages since 2016 (see Figure 6).

However, as shown in Figure 10, the number of transactions attracting the Higher Rate on Additional Dwellings (HRAD) has remained around 60,000 per quarter since its introduction and actually increased as a percentage of total SDLT transactions from around 10% to 40% in the most recent period (provisional figures).[65] The SLDT data demonstrates a rapid rise in HRAD transactions at the time of the Government's Stamp Duty holiday. Home purchases liable for HRAD hit a record high of 84,700 in the second quarter of 2021, making up 65% of total transactions during this period.

Given the decline in BtL mortgage credit since 2016 (see Figure 6), this suggests more cash buyers have been entering the UK market to purchase additional dwellings. Overall, it would appear that HRAD has not rebalanced the housing the market in favour of first-time buyers *vis-a-vis* existing homeowners and investors.

Figure 10: *Quarterly total Stamp Duty Land Tax transactions and Higher Rate on Additional Dwellings (HRAD) transactions since 2016*



Source: ONS quarterly Stamp Duty Land Tax (SDLT) statistics

Furthermore, there remain other tax breaks and benefits for landlords. In particular, corporate landlords can continue to offset corporation tax against mortgage interest payments on their properties and pay profits from dividends, which attract a lower tax rate than cash payments.

These developments helped drive a large increase in the proportion of BtL properties. Private landlords now own around one out of five homes in Britain (see Figure 9). Whilst 5.5 million people own a second home, four in ten adults own no property at all.[66] There was net increase of 2.8 million homes built or transferred into the private rented sector between 1990 and 2022 according to the English Housing Survey.[67] The share of families with children that live in the PRS has almost tripled since the 1990s.[68]

Further exacerbating the crisis in the PRS has been the shift in recent years towards the purchase of second homes and landlords using their properties for short-term lets. The number of London-based buyers who purchased a second home outside the capital increased by 309% in 2020 compared with 2019, according to Knight Frank.[69] The number of holiday lets in England rose by 40% in three years to 2022, according to data from 152 councils collected by the BBC,[70] with tourist areas particularly effected.

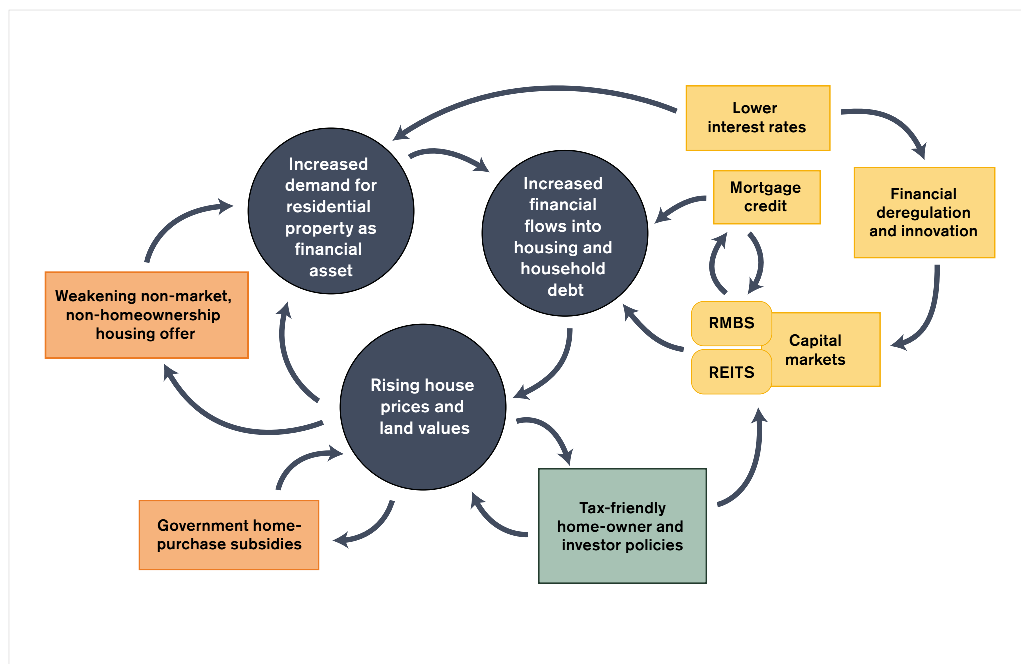
There is a growing body of evidence suggesting that the shift towards converting properties to short-term lets reduces effective supply of housing in cities and tourist areas, driving up housing costs.[71–74] A recent study, based on 2018 data, estimated that more than 2% of all properties in London, and up to 7% in some local areas, are being misused (i.e. breaking regulations applying to holiday rentals, for example, around number of days a property is available) through Airbnb as short-term holiday rentals. This same study estimated that a 100% increase in the proportion of Airbnb owned versus rented properties would be associated with a rental price increase of about 16%.[75]

Compounding effects of financialisation drivers: the housing-finance feedback cycle

Housing markets are best understood as complex systems characterised by feedback loops, accumulations, delays, emergent properties, path-dependency and nonlinearities, which are key in shaping their behaviour over time.[76,77,26]

The above mentioned four drivers of the financialisation of housing interact with each other via multiple feedback cycles. These amplify and reinforce rising house prices and expectations of further price rises (see Figure 11). For example, the liberalisation of mortgage credit in the 1980s and 1990s might not have led to such a flood of credit into the housing market had it not coincided with a tax regime that enabled homeowners to capture most of the capital gains from their primary residences and the selling-off of social housing through right to buy. Historically low interest rates since the mid-1990s have also encouraged borrowing and stimulated financial innovations like residential mortgage-backed securitisation as banks have sought new ways of increasing profits; this in turn has enabled domestic and global institutional investors to invest in the housing market. Government subsidies for first-time buyers have further enhanced demand for homeownership and pushed up prices.

Figure 11: *Feedback cycles influencing the financialisation of housing*



Source: Author

Policy interventions, to be further examined in section 4, need to consider where they will be capable of breaking or reversing these feedback cycles. Marginal interventions to single policy spheres may be less likely to alter powerful reinforcing dynamics, as suggested by the apparent failure of the more punitive tax regime on additional dwellings, introduced since 2016, to reduce the purchase of such dwellings.

3. The impacts of financialisation on housing-related inequalities

The financialisation of housing markets contributes to and exacerbates housing-related inequalities. This has multiple and overlapping dimensions across tenure, age, income, wealth and quality of housing provision, including the distribution of housing space.

3.1 Wealth inequality

With regard to wealth inequality, house prices have increased by around 86% on average since the post-crisis trough of 2008,[78] whilst real incomes have barely increased. This means existing homeowners have seen enormous and very lightly taxed increases in their wealth relative to non-homeowners (whose incomes are on average also lower than homeowners).

Rising prices relative to incomes also exclude lower income earners from home ownership and the opportunity to attain a valuable financial asset. Millennials (born between 1981 and 1996) today are only half as likely to own their home at age 30 as the baby-boomer generation (born between 1946 and 1964) were at the same age.[79] Younger families, headed by an adult aged between 25 and 34, have seen their homeownership rate half to 25% since 1989.[79]

The rise in second home homeownership and landlordism corresponds with greater concentration of wealth. The proportion of adults living in families with additional property wealth (i.e. second homes or BtL properties) rose from 8% in 2000–2002 to 11% in 2014–16. At the same time, the proportion without any property wealth fell from 66% to 60%.[66] More than 50% of second homes and two-thirds of rental properties are owned by the richest fifth of households.[66]

3.2 Tenure inequality

Renters face considerably higher costs than homeowners on average and are more likely to have lower living standards on a variety of measures. Whilst up until the 1980s renters spent about 10% of their income on housing costs, similar to the average across other tenures, by the mid-1990s this had tripled to 33%, in contrast to other tenures where it had only doubled to 20%.[68] This discrepancy has remained in place since the 1990s, depressing renters' living standards in the process. The 1980s liberalisation of the rental market in favour of landlords and reductions in housing benefits helped drive this process.

The lowest income quintile of renters spend 60% of their income on housing costs,[68] and social and private renters have poverty rates of 46% and 34% respectively, compared with 12% for owner-occupiers,[80] a situation made considerably worse by the freezing of local housing allowances in April 2020.

Housing costs facing renters in the UK are near record highs at the present time. Rents for new commercial tenancies increased by 10–12% over the year to summer 2022, following the Covid pandemic, as there was a large increase in demand as people returned to work.[68]

Rising rents have led to large increases in housing benefit being paid out to lower-income renters, which amounts to a significant government subsidy for landlords. At present, housing benefit costs approximately £10 billion every year.[81] This is currently around four times more than the government spends to build new homes through the Affordable Homes Programme. Since the vast majority of landlords come from the top 20% of the income distribution[82], these dynamics further increase housing and earnings inequality.

Existing homeowners can also secure larger mortgage loans at lower interest rates by virtue of already having a source of desirable collateral, out-competing first-time buyers for new property that come onto the market. In doing so, the effect is to push up the price of housing beyond that which it may have reached had only owner-occupiers been competing.

Housing market downturns may not reverse this process. Indeed, there is evidence that the process of existing homeowners outcompeting first-time buyers was amplified following the global financial crisis of 2007–08. In the aftermath of the crisis, banks lowered loan to value and loan to income ratios, requiring larger deposits. This shut out first-time buyers from the market and led to the phenomenon of 'accidental landlords'. This is where first-time homeowners who are moving up the housing ladder are unable to find (first-time) buyers for their homes and instead rent them out and leverage against them to access sufficient mortgage credit to purchase more expensive homes.[83] This phenomenon drove a change in the composition of housing sales in the post-crisis period: sales of lower quality houses made up a smaller fraction of the total when down payment requirements increased.[83] Similar dynamics are likely also taking place today with mortgage interest rates having risen considerably since 2021.

3.3 Housing space consumption inequality

In the UK, the government has defined a 'bedroom standard', which determines the adequate number of bedrooms in a home depending on the composition of a household.[i] Households with two or more spare bedrooms are classified as being under-occupied and households with less than the bedroom standard overcrowded.[84] One recent study using the English Housing Survey found that 37% of households in the UK – around 8.8 million households – were under-occupied. This compares to 4% households who had less than one bedroom and were classified as overcrowded (equivalent to about 1 million households).[85] It follows that policy interventions that incentivise just a small percentage of under-occupying households to move to a more efficiently occupied property could potentially free up significant homes for those in most need.

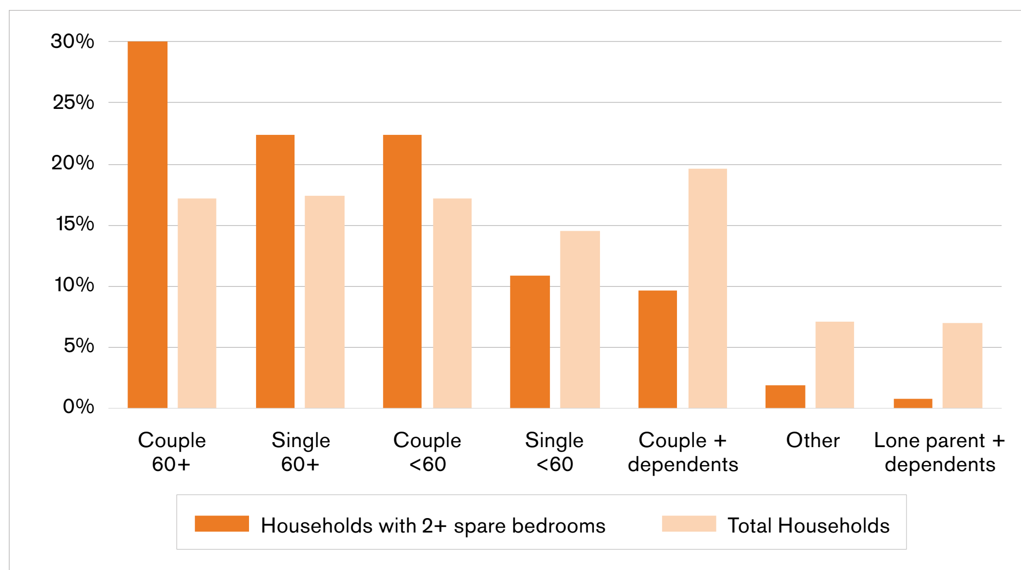
Figures 12 and 13 show the distribution of under-occupied households in England by tenure and age cohort, based on analysis of the English Housing Survey.[85] 90% of underoccupied households are owner-occupiers, of which 60% are outright owners without a mortgage. This compares to just 6% of private renters and 4% of social renters. Furthermore, over 50% of under-occupied households are over the age of 60 (4.8 million out of 8.8 million).[i] Meanwhile, couples or lone parents with dependents have just a 10% share of underoccupied households, even though they account for more than 25% of total households.

i The standard requires that a separate bedroom should be provided to the following persons: 1) couples of adults, 2) a person aged 21 years or over; 3) pairs of same-sex persons aged between 10 to 20 years; 4) people aged 10 to 20 years who are paired with a person aged under 10 years of the same sex; 5) pairs of children aged under 10 years, regardless of their sex; and 6) people aged under 21 years who cannot be paired with someone in 3), 4) or 5).

Figure 12: *Distribution of underoccupied households (with two or more spare bedrooms) by tenure (England)*

Source: Based on analysis of the English Housing Survey in Gough I, Horn S, Rogers C and Tunstall R (2024), Fair decarbonising of housing in the UK: A sufficiency approach. CASE Working paper. London: Centre for Analysis of Social Exclusion. London School of Economics

Figure 13: *Distribution of underoccupied households by age and household type*



Source: As above

To some extent these stark inequalities in housing space consumption can be attributed to the 'baby-boomer' generation, born before the mid-1960s, reaching retirement, with children leaving home and having paid off their mortgages: the 'empty-nester' phenomenon. However, if we look more closely at the history of housing space inequalities it becomes clear that the financialisation dynamics described in section 2 have played a role in these trends.

Housing and land has a high-income-elasticity of demand: as incomes rise households spend more of their income on housing relative to other goods.[86] One estimate across two UK cities found that a 10% increase in incomes leads people to spend about 20% more on space in houses and gardens, with homeowners having a higher income elasticity of demand than renters.[86] This means that rising income inequality, amplified by unequal access to mortgage finance, will likely translate through to rising inequality in terms of the consumption of housing space in the absence of other policy interventions.

An analysis of census data by Professor Becky Tunstall from the London School of Economics found that all deciles of the UK population saw gradual increases in space (as measured by number of rooms per person) between 1921 and 1981, including the least well housed decile.[87] However, between the 1981 and 2011 census, relative housing space inequality significantly increased.[ii] The most generously housed decile saw an increase in rooms per person from three to five, whilst the least well housed decile saw no change at all, maintaining just one room per person on average. When measuring the ratio between the bottom and top deciles, the overall effect was to wipe out a century's worth of reduction in relative housing space consumption.

Recent data also show declines in space available to renters and, in particular, young people. Analysis by the Resolution Foundation found that between 1996–2001 and 2017–2019, the average floor space per person across all English dwellings increased from 44m^2 to 47m^2.[68] But this was entirely driven by increasing space for homeowners. In contrast, average floor space per person in the PRS declined by 16% from 43 m^2 to 36 m^2 per person. Low-income private renters have experienced the greatest decrease in space, losing three times more than high-income renters (21% compared to 7%).

These dynamics can be explained by rising income inequality which markedly increased in the 1980s,[88] but also by the shift in government policy towards favouring market-supplied homeownership and, unintentionally, private renting as

ii Data is only available to 2011 since the ONS stopped collecting data on rooms per person in the 2021 census.

a form of tenure. Social rented housing allocations policies aimed to match home sizes to household sizes at first letting. This contrasts to market-provided housing, which is driven by consumer preference and profit maximisation. As discussed, following the introduction of right to buy, the social rented sector almost halved, from housing 30% of all people in England and Wales, to 17% by the 2010s. Thus, a smaller proportion of the national housing stock was allocated according to housing need.

The rapid appreciation in house prices relative to other assets driven by financialisation, alongside the high transaction costs from Stamp Duty, has also had the effect of discouraging the baby-boomer empty-nesters from downsizing. Rather, the incentives created by policies since the 1980s were to encourage existing homeowners to buy second homes or leverage against their existing homes to help their offspring buy their first homes, further establishing intergenerational inequalities.

4. Policy recommendations

In general terms, government policy should aim to reshape the housing market to prioritise housing need over its function as an investment good. This will involve repressing investment demand, with the aim of freeing up the existing housing stock for first-time buyers and renters, including social renters. The aim would be to reverse the tenure dynamics seen since the early 2000s (see Figure 9), encouraging more mortgaged homeownership and social renting in particular.

This is not to say that increasing supply – the long-held focus of successive governments – is not still needed and in particular locations it may enhance affordability, especially if such new supply is genuinely affordable. However, given the scale of the affordability crisis, both supply and demand-side approaches now need to be embraced.

Three main policy spheres can be employed to reduce the demand for housing as an investment: 1) planning and housing policy; 2) mortgage regulation; and 3) property taxation.

4.1 Planning and housing policy

For many decades in the UK, the emphasis in planning reform has been on simplifying, liberalising and deregulating the planning process to enable the private sector to build more homes for owner occupation in line with increased demand. 'Demand' itself is usually assumed to come from rising incomes, smaller household formation and immigration, with little attempt to distinguish investment demand from housing need.

However, the planning regime could be reformed to prioritise housing need. One option would be to introduce new planning use classes and give control to local authorities over decisions to change these uses. For example, an owner-occupier who wished to sell their primary residence to an investor or landlord, or who wished to convert from owner-occupation or long-term letting to short-term letting, could have to apply for planning permission to do so in designated 'higher pressure zones', as proposed in a recent report by the Joseph Rowntree Foundation.[89] Local authorities could reject such applications in areas with affordability issues.

The previous UK government consulted on introducing a new use class for short-term lets.[90] The Welsh government has also taken steps in this direction.[91] They

have introduced three planning use classes – primary home, secondary home and short-term holiday accommodation.[iii] Local planning authorities, where they have evidence, are able to make amendments to the planning system to require planning permission for change of use from one class to another. Local authorities are also being given the ability to control the number of second homes and holiday lets in any community.

The more challenging interest rate environment also creates opportunities for use change in favour of housing need. Higher rates may be increasing stress on BtL investors with interest-only mortgages in particular and potentially professional investors with high levels of leverage. The passing of the Renters (Reform) Bill may also lead to some landlords considering leaving the BtL market.

A temporary relief on Capital Gains Tax could be offered to owners wishing to sell, for example, on condition they were to sell either to first-time buyers or social landlords (the latter perhaps supported by the government within a restricted time period). This could enable a large one-off shift in the use of the existing stock towards housing need that could make a material difference to affordability.

Local authorities (LAs) could also be given the right to first refusal to purchase BtL or owner-occupier properties from owners seeking to exit the market in areas of housing pressure, and, where needed, upgrade them and make them available for social rent. Such policies are being undertaken in other European cities, including in Paris and Barcelona. In Barcelona, the city has so far acquired 1600 existing housing units by investing €190 million via city-wide right of first refusal powers introduced in 2016 as part of a wider 'right to housing' plan.[95]

Government could also empower public authorities and social landlords to acquire via compulsory purchase early-stage private sector developments that have been delayed, at prices that would render the existing permission viable at minimal profit margins, and to convert these to social rented housing.[89] This will require a reform of compulsory purchase to ensure the compensation paid reflects the current planning status of the site rather than the putative hope value. The Labour Manifesto commits to further reform of compulsory purchase compensation rules to improve land assembly, speed up site delivery, and deliver housing, infrastructure, amenity and transport benefits in the public interest.

Similarly, LAs could be empowered to acquire properties from landlords who are unable or unwilling to let their properties to required standards, be it in relation

iii See https://www.gov.wales/written-statement-changes-planning-legislation-and-policy-second-homes-and-short-term-lets for legislative details on the changes.

to energy efficiency ratings, the Decent Homes Standards – which is due to be extended to the PRS – or other forms of regulatory non-compliance.[96] This would incentivise landlords to invest in higher quality, greener homes and encourage LAs to acquire them at a reduced price where standards are not met.

The above use conversion policies will only occur at scale with significant financial support from government to enable LAs and social landlords to both purchase and renovate properties where required. Housing acquisitions by LAs and social landlords have dropped from 50,000 in the early 1990s to less than 10,000 in 2021–22, due to cuts to the Affordable Homes Programme (AHP). In the short-term, Housing England could consider raising the 10% acquisitions cap on the AHP.

In the longer term, the government could consider the establishment of a national affordable housing fund/bank, or housing corporation, that would support such conversions and potentially also buy up land for new development under enhanced compulsory purchase rules. These types of organisations are common in many countries with more strategic and effective affordable housing strategies, for example Singapore and South Korea, where they have played important counter-cyclical roles during housing downturns by building out when private sector development slows.

A public housing bank could access funding from several sources. First, the government could capitalise the bank by issuing government bonds which would attract triple A credit rating. Second, the bank could borrow directly from capital markets. It should be an attractive proposition for institutional investors seeking long-term secure assets to match long-term liabilities (for example, pension funds).

Alongside acquisition policies, the supply of socially rented housing stock could also be increased by reforms to right to buy (RtB). In theory, LAs' receipts from RtB should enable them to build new socially rented stock, but in the ten years between 2012–13 and 2021–22, sales under RtB were greater than the increase in homes for social rent in all but one year.[97] This resulted in 23,000 fewer homes for social rent than at the outset. Recent government reforms now allow LAs to use 100% of the receipts from the sale of RtB homes to fund new build, which may help to improve the situation. Nevertheless, there is a case for abolishing or at least pausing RtB given the affordability crisis facing the country.

However, given its political popularity, other reforms could be considered. As with the planning use reforms mentioned above, covenants could be applied to RtB homes giving LAs first refusal on homes that are sold, maintaining the

30% discount in perpetuity to prevent the public subsidy being privatised and ensuring the home could only be sold to a household who qualifies for affordable housing.97 This would bring homes sold under RtB in line with wider affordable home-ownership products on offer, such as the First Homes scheme.[98]

Restrictions on overseas buyers of UK housing could also be implemented, given the evidence that foreign purchasers have pushed up house prices in cities and put pressure on rents, including in an environment of high interest rates where domestic BtL landlords may leave the market. The register of overseas entities gives the government a better understanding of the holding of UK property by companies owned abroad and off-shore.

Such restrictions are coming into force in other countries. For example, in 2018, as part of a policy to curb rising house prices, New Zealand banned the sale of homes to many foreign purchasers and Switzerland has had restrictions on such purchases for many years. Australia has rules preventing non-residents buying existing dwellings for residential purposes.

4.2 Reforms to the UK mortgage market

Reforms to support first-time buyers

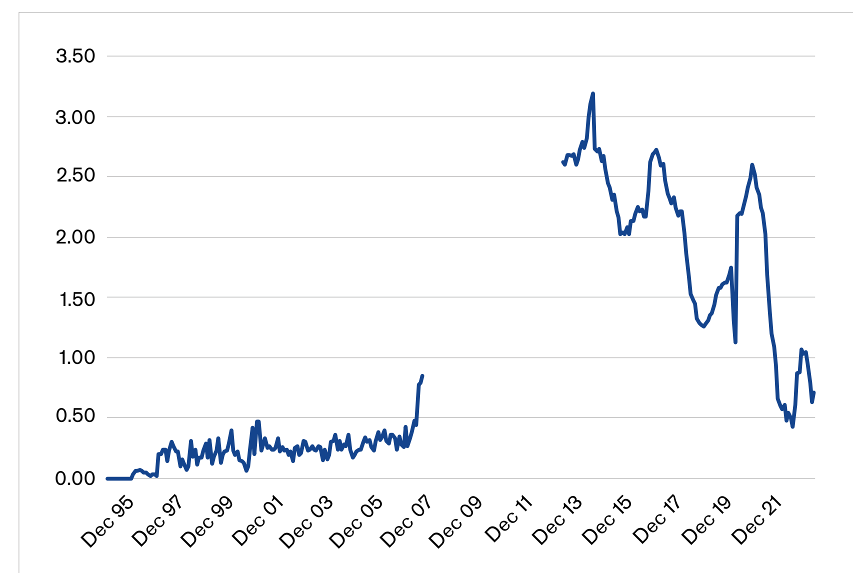
As mentioned in section 2, the UK mortgage market is biased in favour of existing homeowners and investors over first-time buyers (FTBs) who may have greater housing need. Prudential regulation introduced since 2008, following the global financial crisis, has worsened the situation for FTBs by forcing banks to hold more capital against mortgage loans. Mortgage lending to FTBs almost halved between 2007 and 2008 (see Figure 6) and did not recover until around 2014. This was reflected in a sudden drop in the median loan to value ratio for new FTB loans, from 90% in 2007 to 75% in 2009.

The UK mortgage market is dominated by short-term fixed-rate mortgages of two to five years. This places a high level of interest rate- and credit-risk on individual households and in particular FTBs, who usually require larger loans relative to income or house price value. In the US, Canada and much of Europe, much longer-term fixed-rate mortgages of 20–25 years are the norm and mortgage insurance is also more common.

The government has introduced mortgage guarantee schemes, but the take-up has been low. The Help to Buy mortgage guarantee, offered between 2013 and 2017, averaged 10% take up.[99] The more recent Mortgage Guarantee scheme (MGS), in place since April 2021, has had just 5% take up on average in terms of the overall value of FTB loans.[iv]

The spread between interest rates offered to borrowers on 75% LTV vs 95% LTV has been much larger since LTVs were re-introduced in 2013 than in the pre-financial crisis period (see Figure 14). There is evidence of an overall fall in the spread over the period since the MGS schemes were introduced, although it remains elevated compared to the pre-crisis period. However, the spread is highly cyclical, suggesting banks are regularly revising their view of the riskiness of high LTV products, making planning ahead for FTBs challenging. Overall, continued risk-aversion from lenders appears to have outweighed the impact of the MGS schemes.

Figure 14: *Spread between 75% and 95% LTV two-year fixed rate mortgages, 1995-2023*



Source: Bank of England interactive database, codes IUM2WT and IUMBV34; 95% mortgages were prohibited between 2008–2013

Under the current scheme, which is revenue neutral, banks pay a one-off fee equivalent to 90 basis points of the loan and in theory can claim relief on the amount of capital they have to hold against the insured loan. However, the mortgage guarantee is classified as a securitisation and is subject to the complicated European Credit Risk Mitigation framework. Anecdotal evidence suggests lenders are not applying for the MGS due to the onerous nature of the application.[99]

iv This calculation is based on the FCA's MLAR table 133 to calculate total FTB loans and HM Treasury's 'Official Statistics on the mortgage guarantee scheme' (accessed 23 September 2023).

A recent reform proposal by the Tony Blair Institute for Global Change argues that by making mortgage insurance compulsory and permanent, rather than voluntary, and simplifying the credit risk mitigation framework, it should be possible to lower the cost of higher LTVs, as is the norm in other countries.[99] The report estimates that the cost of a 95% LTV mortgage could be reduced by around 20 basis points with such reforms and proposes insurance on all mortgages of above 80% LTV. It estimates the cost of the scheme would be around 0.4% relative to a 75% LTV mortgage, so the fee charged to banks for participating could be lowered from its current 0.9%. Banks might pass on these costs to borrowers, but this could be spread across a range of borrowers.

To introduce more long-term fixed rate mortgages, adjustments would be required to the current regulatory frameworks, which are focused on shorter term mortgages. In particular, loan to income regulations need to be relaxed from the current 4.5 ratio to income for borrowers choosing long-term fixed rate mortgages, given they will no longer be subject to interest-rate risk.

In addition, it will be necessary to attract investors with longer time horizons into the mortgage market. UK banks rely heavily on short-term deposits to fund mortgages, which biases them in favour of shorter-term mortgage loans to avoid excessive maturity mismatch. This contrasts with other high-income economies, where it is common practice for mortgages to be securitised and purchased by institutional investors with long-term liabilities, who seek matching longer-term assets, such as insurance companies and pension funds.[100] Such covered bond models have proven to be quite resilient to economic shocks, including during the global financial crisis, in countries such as Germany and Denmark.[101]

One potential barrier to such institutional investment is the risk of borrowers pre-paying their mortgages. Reforms to Solvency II regulations to enable assets with prepayment to qualify for the discount available when the term structure of assets matched liabilities if additional capital was held against such risk could be introduced to address this problem.[99]

Attracting institutional investment into long-term, low-risk mortgages may make better use of such capital from an affordability and increasing homeownership perspective than having such capital flow into real estate funds or real estate investment trusts. The latter is currently the dominant model in the UK, but these vehicles are focused on short-term, high-yield returns rather than housing need and may be more sensitive to economic shocks such as interest rate shifts.

Macroprudential policies to restrict buy-to-let purchases

However, the risk with subsidising mortgage lending via insurance or introducing new loan products is that it may lead to an overall increase of mortgage debt flowing into the housing market, further driving up aggregate house prices, as evidence suggests previous help-to-buy schemes have done. To prevent this, the government needs to correspondingly reduce the investment demand for housing. This is why simultaneous reforms to taxation, planning and the mortgage market are also important.

Since the financial crisis, central banks and financial supervisors in many countries have implemented forms of macroprudential policy, which aims to repress the flow of credit to specific sectors of the economy deemed to pose systemic financial risks. The real estate sector has been favoured as a sector for such policies, typically involving lowering loan to value or loan to income ratios for mortgages. Evidence suggests these interventions have been effective in slowing mortgage credit and house price growth.[102,103]

However, evidence also suggests that such policies lead to a transfer of credit from low- to higher-income borrowers (including investors), who have larger deposits.[104] Thus, whilst such policies may reduce systemic financial risk, they may mitigate against homeownership for lower income groups. This certainly appears to be the case in the UK.[99]

There is then a strong case for introducing more restrictive macroprudential limits specifically on investor BtL mortgages alongside reforms to support FTBs, as discussed above. Several countries have introduced investor-specific macroprudential regulation on mortgages, including Hong Kong, Israel, Malaysia, Ireland, New Zealand and Singapore, with caps on ratios ranging from 70% (New Zealand, Ireland) to 20% (for non-individuals in Singapore with one or more outstanding loans).[102]

In 2016, HM Treasury granted the Financial Policy Committee (FPC) powers to direct the Prudential Regulation Authority to implement limits on BtL mortgages specifically via LTV and interest coverage ratios (ICR), bringing it into line with regulatory powers in the owner-occupier sector implemented in 2014.[105] However, as yet such powers have not been implemented in either tenure.

The Bank of England and FPC may be in favour of stronger limits on BtL mortgages, given they have argued the sector is more procyclical than the owner-occupier market and may amplify mortgage credit cycles.[106] A recent

study employing agent-based modelling of the UK housing market estimated that a reduction of the LTV cap for BtL borrowers by 20 percentage points in the UK would lead to a significant reduction in aggregate debt to income ratios (-19 percentage points), as well as a reduction in total net wealth inequality (-2 percentage points) and in consumption volatility (-23%).[107]

Currently such decisions are at the discretion of the independent FPC, so a letter from HM Treasury may be required at a minimum, if not new legislation, to enact new limits aimed at rebalancing the mortgage market away from its bias towards investors.

Given recent interest rate rises and declines in BtL lending, but little change in BtL transactions, current demand for investor property is more likely coming from cash buyers than investors requiring credit. Macroprudential regulation may then have limited impact at the present time, but might be more useful during housing upturns.

4.3 Reforms to property taxation

Given that increases in land value are economic rents, there is a strong economic argument for the imposition of a holding tax on property value to socialise such rents. If the tax was set at a high enough level, it should substantially reduce speculative mortgage lending and cash investment into housing, with other assets more attractive, even under conditions of very low interest rates. This could potentially release more existing supply for those in housing need, as well as reducing prices.

There is now a consensus amongst economists that property taxation in the UK requires reform, given the regressive and inefficient nature of the current regime, as outlined in section 2.4. There have been several major commissions and reviews which have proposed reforms of property tax as a means to stabilise the housing market and dampen speculation, as well generating funds for the public purse.[108–111]

Property taxation is a politically sensitive area. However, given the outdated and highly regressive nature of Council Tax and the widely recognised inefficiency of SDLT, there is a case for a major one-off reform that would align tax more closely to the rental and capital values of property (net housing in wealth in the UK has increased by 700% since the early 2000s, whilst taxation on property has remained around 4% of GDP). In doing so, such a reform would redistribute the property tax burden from poorer to wealthier areas and enable a more efficient distribution of the housing stock aligned more with housing need.

One recent proposal is to replace Council Tax and Stamp Duty with a flat 0.48% annual property tax on the current market value of a property, with a surcharge for empty and second homes, and homes owned by non-UK residents.[112] The incidence of the tax would fall on landowners rather than tenants, in contrast to Council Tax, and homes under a certain value could be exempted.

Modelling of the policy, which would be fiscally neutral at the 0.48% rate, suggests 75% of households would be better off as a result, in particular poorer areas of the country outside the South East that have not seen rapid growth in house prices.[113] The modelling assumes that landlords pass on 66% of the additional costs from the reform to tenants. Similar types of proportional property or land value tax have been proposed by the Resolution Foundation,[110] the IPPR[114] and Bright Blue[111] think tanks, and Professor John Muellbauer[115] for the OECD in recent years.

The new tax liabilities would be partly or wholly capitalised into house prices.[116] This would result in prices falling in expensive areas and rising in cheaper areas. This would likely benefit FTBs in London and the South East, and could make housing less affordable for buyers in poorer areas. However, since in these latter areas supply may be less restricted, lower tax bills may make housebuilding more profitable and so induce higher levels of construction in response, instead of fully capitalising into higher house prices.[116]

An annual proportional property tax would increase the incentives to use property efficiently, increasing the effective housing supply – this may also go some way towards offsetting any increase in house prices in poorer regions. Higher house prices would, of course, also benefit the owners of those houses and could see wealth inequality between regions fall. Modelling of the 0.48% proposal suggests the policy would make available between 167,000 and 600,000 homes over five years.[113] For the 600,000 estimate, around 315,000 homes would be released through increased housing market activity due to the SDLT being removed, with another 280,000 from turning empty, second and unbuilt homes into primary residences.[113]

One objection to such reforms is that cash-poor households living in high-value housing would be unable to pay a proportional property tax. However, such households could be permitted to defer payment until they sell their property and tax increases could be capped. Discounts could also be provided for enhancing the energy efficiency of properties in line with the UK's decarbonisation targets.[111,117]

The tax could be collected by councils, with a suitable national level equalisation mechanism to ensure fair funding for all local authorities, despite differential property values in different regions.

If a major structural reform is not politically feasible, more marginal reforms to existing property taxes could still have a material impact on dampening investor demand. As discussed in section 2.4, the increase in SLDT on additional properties and reduction in tax relief in place since 2016 do not appear to have materially reduced the demand for investment properties. Wealthy cash investors may be less sensitive to changes in the tax burden, attracted by the long-term growth potential of UK property (in terms of capital gains) and overseas purchasers may particularly view property in the UK as a 'safe haven'. Given this, there is a case for progressively raising HRAD to a level which leads to a material decline in demand from investors (including cash buyers), just as the Council Tax premium on second homes has been progressively raised in some areas.

Additionally, Capital Gains Tax rates on additional property (as well as other assets) could be equalised with income, as proposed by the Office of Tax Simplification,[118] and landlords' exemption from National Insurance Contributions could also be removed. A one-off capital gains exemption could also be provided to investors on a temporary basis, before the above-mentioned tax rises were introduced, on condition they sell to a first-time buyer or social landlord.

Local authorities could also be granted powers to raise Council Tax significantly on investor properties, particularly those used for second homes or short-term holiday lets, as is being done in Wales; this could complement or be an alternative to the reforms to planning policy outlined above. Stamp Duty on foreign purchases could also be raised to a more punitive level.

Tax could also be used to prevent developers mothballing sites or engaging in landbanking activities to speed up build out rates. LAs could be empowered to levy Council Tax and business rates on sites with planning permission as if the property had been built and occupied, allowing a suitable grace period for construction, for example, 18 months.[89]

5. Conclusion

This report has examined the role of investment demand for residential property in the UK – also described as the 'financialisation' of housing – and its contribution to worsening affordability over the past 40 years. Key drivers of investment demand include the liberalisation of mortgage credit, financial innovation, historically low interest rates, policy shifts in favour of homeownership and investor properties, and neglect of the provision of an affordable and high-quality private and social rental sector. Housing's function as an investment and financial asset has been prioritised over its role as a consumption good and housing need more generally.

Since the 2000s, these developments have resulted in huge increases in credit and wealth (the latter, in particular, since the global financial crisis) flowing into the UK housing market, decoupling house prices from their historic relationship with incomes; a rate of increase far exceeding any feasible increase in new construction of homes.

The nature of the mortgage market means that existing homeowners and cash-buying investors have a major advantage in purchasing property, given their existing collateral and wealth. Favourable legislation to liberalise the PRS introduced in the 1980s and 1990s, together with the introduction of BtL mortgages and declining interest rates, has led to a major increase in the purchase of additional homes (second homes and BtL) as existing homeowners have out-competed first-time buyers, even with the erosion of tax breaks for investors since 2016.

Together with a decline in housing benefit for renters relative to costs and the erosion of the social rented sector, this has left many younger and middle- and lower-income households and families facing serious affordability problems in the rental sector.

The UK housing market is characterised by a housing-finance feedback cycle, whereby increasing capital flows in housing generates rising prices and expectations of future rises, which in turn generate more speculative demand for housing as an investment and so on. Policy makers need to carefully consider what types of interventions can break this powerful dynamic. Marginal reforms in discrete policy spheres are unlikely to do so.

The recent rise in interest rates has discouraged some types of investor, in particularly mortgaged BtL landlords. However, there is little evidence of an overall

decline in investment demand for UK properties, with evidence instead of cash buyers and asset managers buying up housing, including, potentially, foreign buyers. Wealthier investors may view property in cities such as London and Manchester as very good long-term investments and be relatively insensitive to increases in (short-term) costs.

Given the scale of the crisis, structural reforms across multiple policy spheres are required. Policies that support the conversion of existing investment properties into long-term, high-quality private or social rented sector housing, as well as supporting first-time buyers into homeownership, should be prioritised.

Local authorities could be given powers to limit use change that would mitigate against affordability, whilst being supported to buy and, where needed, renovate PRS properties that stressed BtL investors may choose to sell. An annual property tax should be introduced, replacing Council Tax and Stamp Duty, that would considerably reduce investor demand for housing and free up potentially hundreds of thousands of properties. Mortgage insurance and longer term fixed-rate mortgages for first-time buyers should be introduced, alongside lower LTV ratios for BtL mortgages. Such tax and mortgage reforms would have the added benefit of reducing the volatility of UK house prices.

Further research on the demand for housing as an investment could be undertaken, analysing:

- the role of individual cash-buyers and capital market actors in buying residential property as investments, particularly since 2008, and their sensitivity to interest rate changes;
- the efficiency of the use of existing housing units (for example, excess bedrooms, under-occupation), particularly by owner-occupiers; and
- the extent to which landlords pass on increases in costs (including due to interest rate rises and tax rises) to tenants and/or exit the PRS.

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