The more the State has withdrawn from housebuilding, the more it has found itself propping up the private market

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There is a paradox in modern housing policy, writes ***Daniel Bentley****. The aim of rolling back the state from housebuilding has turned its role from one of subsidising supply into that of facilitating ever greater amounts of spending power, making housing unaffordable for so many.*

Margaret Thatcher recorded in her memoirs that, by the mid-1980s, 'everything in housing pointed to the need to roll back the existing activities of government'. She also felt that, in terms of building, owning, and managing housing stock, 'the state should be withdrawn from these areas just as far and as fast as possible'.

In truth, the decline of council housebuilding was already under way by the time Mrs Thatcher came to office. But she accelerated a process which saw annual local authority output fall from 154,000 homes in 1967 to the low hundreds during the New Labour years. The consequences of this have been far-reaching, and are at the core of today's housing crisis.

Not only did housing supply go into terminal decline, as is often noted, but the subsequent dependency on private sector housebuilders for new homes encouraged governments to permit – and increasingly to actively promote – the accumulation of purchasing power in the for-sale market. This weakness among policymakers for stimulating effective demand has been disastrous for affordability, and is engendered by the simple fact that private-sector developers are only able to build as many homes as people are ready to buy.

This much is obvious and has always placed a natural limit on private-sector output, which is why for most of the 20th century it was topped up by publicly funded building. It is a straightforward question of market absorption: more buyers means more new homes, fewer buyers means fewer new homes, and in the absence of a major public housebuilding programme, the effects of the cycle are reflected in the ups and downs of total output.

In this context, the answer to an under-supply of new homes appears always to be to increase people's ability to purchase them. But there is a further complication, which is that those new-build homes must also be purchased at or above current market prices. This is a function of the residual land value model, in which the price a developer pays for a site is worked out from how much they think new homes can fetch on the open market (minus building costs and the developer's margin). The result is that developers can never afford to sell their homes below current market prices.

This means that housing supply rarely places any downward pressure on prices, while builders are constantly yearning for more demand in order to keep output going. Governments, desperate to increase supply without funding it directly, have usually been happy to oblige – even as prices have raced away from earnings. The housing market has thus become subject to an enormous increase in effective demand over the past half a century, with little if any effort ever made to contain it.

The process began with the liberalisation of credit, which started in the early 1970s but really took off in the 1990s with the relaxation of loan-to-value multiples and the introduction of buy-to-let mortgages. This last point played a central role in the expansion of the private rented sector as landlords bought three million homes between 1990 and 2015, an entirely new source of demand in a for-sale housing market which was until the late 1980s the preserve almost entirely of owner-occupiers.

Prices soared to unprecedented multiples of household incomes during the early 2000s, from a ratio of 3.54 in 1997 to 7.23 in 2007 (median house price to media earnings), until the 2008 financial crisis threatened to bring them back down. This would have done much to restore affordability in the housing market. But with the majority of banks' lending in the form of residential mortgages, and with about four out of five homes privately owned (by either landlords or occupiers), the consequences of a permanent fall in house prices were too much to contemplate.

The government responded to the crisis by bailing out the banks and the Bank of England slashed interest rates to the lowest levels in its history, bottoming out at 0.5 per cent in 2009. From this level it has still not felt confident enough to raise interest rates – even seven years later. When the vote to leave the EU in June created a ripple of panic in the markets, there was yet a further cut to 0.25 per cent. High house prices were protected once more.

Instead, ministers have dealt with the unaffordability of housing since the crisis with a series of interventions designed to increase households' buying power still further in the new-build market. Chief among them has been Help to Buy, introduced by George Osborne in 2013. This has appeared in various guises, including mortgage guarantees to underwrite loans that banks were otherwise unwilling to make, and ISAs to increase how much buyers are able to save towards a deposit.

But the flagship policy has been the Help to Buy equity loan scheme, under which the government lends up to 20 per cent of the value of a new-build home, mostly to first-time buyers. In just over three years, 91,759 properties have been bought with £4.17bn of government loans. As a proportion of the entire housing market this is not huge, but as a proportion of the new-build market, it is. In the latest quarter (April to June 2016) Help to Buy loans enabled the purchase of 10,721 new homes, more than a third of the 27,910 completions during this period.

As such Help to Buy has become central to housebuilders' output. David Jenkinson, chief executive of Britain's biggest builder Persimmon, told MPs that the withdrawal of Help to Buy was the change that would make 'the biggest difference' to his business. The danger now is that, as with cheap and easy credit, demand subsidies like Help to Buy become difficult to withdraw, even as house prices become increasingly unsustainable. The government has become enmeshed in an endless treadmill of market inflation which only makes housing more expensive.

Far from enabling the state to be rolled back, as Mrs Thatcher envisaged, leaving housing provision to the private sector has merely seen the state's role evolve from one of subsidising supply to one of facilitating ever greater amounts of spending power. This is the paradox of modern housing policy: in persisting with a market-led approach governments have, perversely, found themselves underpinning the very demand that has put the cost of housing beyond the means of so many.

The more the state has withdrawn from housebuilding the more it has found itself propping up the private market. A key test of Theresa May's government, which has identified the housing crisis as a priority, will be whether it finally recognises this for the self-defeating approach it is.

About the Author

Daniel Bentley is Editorial Director of the think tank Civitas and author of ' The Housing Question: Overcoming the shortage of homes' and 'The Future of Private Renting: Shaping a fairer market for tenants and taxpayers'.