IPPR

REPORT

AFFORDABLE CAPITAL?

HOUSING IN LONDON

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ABOUT IPPR

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CONTENTS

GLOSSARY

AR	Affordable Rent (social housing product offered at up to 80 per cent of market rent)
CLG	Department for Communities and Local Government (also DCLG)
CML	Council of Mortgage Lenders
Decent Homes	A standard issued by CLG (2006) to support the target that all social housing should be 'decent' by 2010; the definition applies to all tenures. It includes the following criteria: • current statutory minimum standard for housing (absence of category 1 hazards) • reasonable state of repair • reasonably modern facilities and services (such as kitchen 20 years old or less; bathroom 30 years old or less) • reasonable degree of thermal comfort.
DWP	Department for Work and Pensions
GLA	Greater London Authority
HA	Housing association – used as shorthand for registered social housing providers, including former 'RSLs'
HB	Housing benefit
HCA	Homes and Communities Agency
HMO	House in multiple occupation – includes shared houses, bedsits, self-contained flats, where amenities are shared by more than one household. Large high-risk HMOs must be licensed.
HMR	Housing market renewal
HPI	House prices over incomes
LA	Local authority
LCPC	London Child Poverty Commission
LHA	Local housing allowance
LME	Low to middle earners
LTV	Loan to value (ratio in mortgage finance)
NHB	New Homes Bonus
NDP	Neighbourhood development plan
NLA	National Landlords Association
NPPF	National Planning Policy Framework
OMA	Outer metropolitan area
ONS	Office for National Statistics

Over-accommodation	A definition of the number of rooms that households in receipt of HB will be entitled to according to the 'bedroom standard'. Those with 'spare room' are described as 'over-accommodated'. Sometimes also referred to as 'under-occupying'.
PRS	Private rented sector
RTB	Right to buy
RSL	Registered social landlord – more recently known as registered providers
UC	Universal credit
Under-accommodation	Those households in receipt of HB who are overcrowded, in other words there are not enough bedrooms relative to the family size. The opposite of 'over-accommodation'.
VOA	Valuation Office Agency

EXECUTIVE SUMMARY

This report forms part of a major IPPR research series exploring the key challenges and opportunities for housing in England over the coming decade. The present report focuses on housing in London and specifically explores how we might address the imbalances which exist in both the purchase and rental housing markets in the capital in the immediate future as well as the longer term. We explore why, when it comes to housing, London is unique, and we seek to identify and address key issues of affordability of housing in the wake of the London mayoral election 2012.

The housing challenges facing London are undoubtedly considerable. It is not possible to cover the whole terrain in a single report. Therefore, the particular focus here is on the affordability of housing in London. This includes the affordability of buying a home, the affordability of renting a home, and the potential impact on affordability of the Coalition government's welfare reforms in London. The report explores affordability in respect of all tenures, though the predominant focus in the latter part is on the rapidly growing private rented sector (PRS).

The central argument at the heart of this report is that cost and affordability are the primary challenge for housing in London and that the most effective solution is to increase the supply of new and affordable homes. Chapter 1 sets out why London's housing situation is unique and therefore why it requires bespoke London solutions. Chapter 2 focuses on the question of the cost and affordability of buying a home in London. Chapter 3 then moves on to examine cost and affordability in London's rental housing market. Chapter 4 examines the potential impact of the government's welfare reforms on the affordability of renting a home in London. Chapter 5 then identifies the key areas which require action and sketches the outline of potential solutions. Following our analysis, we call upon the victor in this year's mayoral election to consider our progressive suggestions for London housing policy.

Specifically, we propose the following options for further consideration:

- Increasing the supply of housing in the capital by:
  - exploring novel roles for registered social landlords (RSLs) in the provision of new properties, including in the PRS
  - releasing more public land for development.
- Improving London's welfare reforms by:
  - in the short term, raising the local housing allowance (LHA) caps in London by £10 per week
  - in the longer term, devolving power and responsibility for housing benefit to the mayor.
- Achieving reasonable regulation of the private rented sector by:
  - exploring the idea of maximum base rents in the LHA sub-market of the PRS
  - forming a London Rent Stabilisation Board to check unreasonable rent rises
  - starting an accreditation scheme to codify a new 'something for something' deal with landlords.
- Increasing the taxation of foreign buyers of prime London property by pressing ahead with levying capital gains tax, inheritance tax and a new 'holding tax' on their London properties (on which the government is now consulting).

1. LONDON'S UNIQUE HOUSING SITUATION

1.1 Why housing is such an important issue for London

London's population of 7.9 million people, living in approximately 3.3 million households, is expected to increase by 1.02 million people (12 per cent) over the next 20 years (Gleeson 2011). The Greater London Authority (GLA) estimates that there will be approximately 3.99 million households in London by 2031 (GLA 2009a). This growth in the number of households (equivalent to 20 per cent over the same period) is largely explained by the predicted growth in the number of one-person households, which, it is estimated, will account for 68 per cent of all such growth (Hollis 2010). Growth at this rate would mean that London requires approximately an additional 32,600 homes every year just to keep up with increasing demand, quite apart from dealing with the capital's current unmet housing need.

Housing is one of the biggest challenges facing the mayor of London. Arguably, this challenge will intensify over the course of coming decades, with demographic shifts, economic pressures and major welfare changes all combining to produce problems which will require serious solutions. London's mayoral election in 2012 provides an opportunity to secure a radical shift in emphasis and urgency: to place housing back at the top of London's political agenda.

Given current and projected future levels of housing need, it is perhaps surprising that housing has remained until now a relatively neglected electoral issue in London and elsewhere in England. Ipsos MORI surveys over the last two decades, which have sought to gauge priority issues among voters, have consistently found that housing languishes in political mid-table. Analysis of voter priority surveys between 1995 and 2007 reveal that housing is only listed as important by 15–30 per cent of respondents (the majority of results for housing being in the higher teens and low twenties). This is comparable to the scores for issues such as Europe, but clearly lagging way behind health (47–71 per cent) and education (39–66 per cent). When asked to rank it alongside other policy issues, housing does even worse – between 2 and 9 per cent of respondents identify housing as the most important issue for them (Ipsos MORI 2010). A recent Ipsos MORI poll found that, as of the second quarter of 2011, only 6 per cent of those surveyed recorded housing as an important issue for them – although, admittedly, this was up from 1 per cent in quarter one. In London, the figure was just 5 per cent (Economist/Ipsos MORI 2011).

But there are signs that, this time around, housing may have mattered electorally. In the most recent Ipsos MORI poll for the BBC of 1,001 demographically representative adult Londoners, 38 per cent of respondents identified building affordable homes as one of their most important concerns (BBC/Ipsos MORI 2012). Housing in London, and in particular its affordability, has now emerged as a defining issue.

1.2 Housing demand in London

London's population growth continues to defy trends in other parts of the UK, yet housing supply in London has failed to keep pace. While London's population grew by 8 per cent between 1997 and 2011, the number of actual households created increased by just 4 per cent (MacInnes 2011). It would appear that many potential households, particularly younger people, have yet to realise their goal of independent living, as demand continues to outstrip growth in the supply of available homes.

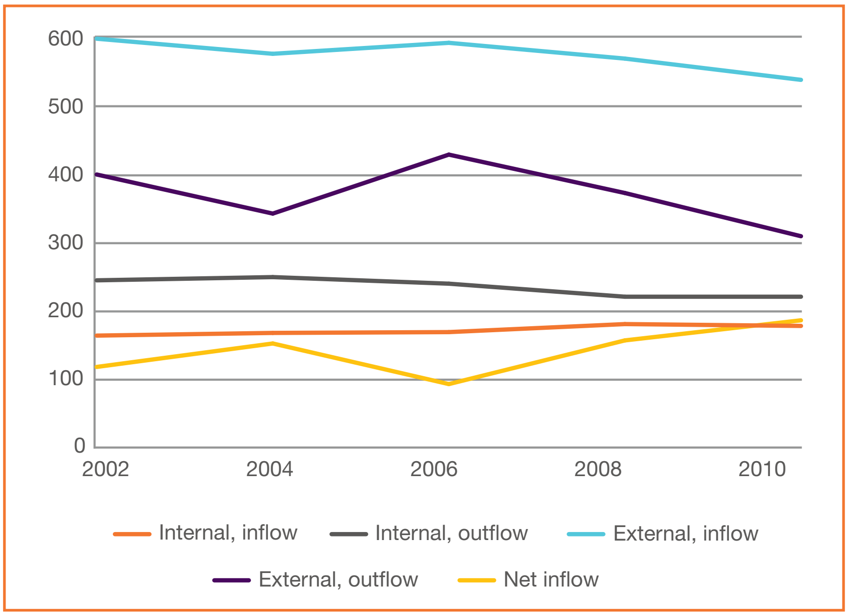
London's population growth can partially be explained by its balance of inward and outward migration (both internal[1] and external[2]) over the course of the last decade and

1 The movement of people within the UK

2 The movement of people into and out of the UK

particularly in the period since the start of the current economic downturn. Using GLA data (GLA 2011a) for internal and external migration flows into and out of London, it is possible to plot how London's population has grown, thus increasing the demand for housing over the course of the decade. As figure 1.1 demonstrates, these population flows have collectively contributed to London's net population growth. While people continue to arrive in London, the number of people leaving has tapered off. This is presumably due to people seeking to ride out the effects of the recession in the UK city which has demonstrated most economic resilience.

Figure 1.1
London migration flows, 2002–2010 ('000s)



Source: GLA 2011a

It is not simply in relation to its population and demography that London is different. Whether measured in terms of cost, tenure type or quality, housing in London differs markedly from that elsewhere in the UK. We now explore in greater detail what makes housing in London unique.

1.3 Nine ways London's housing situation is unique

Economics, geography, existing stock and governance arrangements combine to ensure that London's housing situation is unlike that of any other city in the UK. We have identified nine ways in which housing in London stands out.

1. Housing tenure in London breaks down differently to that in the rest of the UK. Nationally, 66 per cent of households own their own home, with the remainder being almost evenly split between social and privately rented properties (CLG 2012a). In London, the picture is different: 53 per cent of households in the capital own their own home (whether outright or mortgaged), with a greater proportion of households renting from both social and private landlords (Gleeson 2011).

Figure 1.2
Housing tenure breakdown in the UK and London, 2010 (%)

Source: CLG 2012b and Gleeson 2011

London's distinctive age structure and high levels of population mobility mean that the PRS has long had a unique salience in its housing market. The share of the PRS in London has grown significantly over recent years – pre-dating the recession – and now accounts for an almost equal share of the total housing stock as the social sector.

It is true that, nationally, the PRS is the growing sector: the number of households renting in the PRS has grown by more than 1 million between 2005 and 2011, with the total figure now standing at 3.6 million households (CLG 2012b). As Pattison and Devine note: 'If recent trends persist, the private rented sector would be larger than the social rented sector by 2013 and, by the end of the decade, one in five households could be private renters' (Pattison et al 2010).

However, as figure 1.2 shows, in 2010 the PRS already accounted for 22 per cent of London properties. The decline of home ownership in London and the growth of the PRS over the course of recent years underlines the difference between London and elsewhere in the UK. It also suggests the decreasing affordability of housing in London, as fewer people can afford to buy their own home.

2. The cost of housing in London is perhaps the most obvious difference. Given the centrality of London to the UK economy, it is not surprising that there is a significant premium on the price of land and property in London. However, the scale of that premium is what makes London so unique in respect of housing, whether in terms of buying or renting. Average house purchase prices in London rose to £345,298 in December 2011. This represents an increase of 2.8 per cent on the preceding 12 months (Land Registry 2012). The gap between London and the rest of the UK is stark, with the next most expensive region £138,766 adrift in terms of average house purchase price, and London is the only region which saw an increase in property prices in 2011 (Land Registry 2012).

Overall, average house purchase prices are 121 per cent higher in London than nationally (England and Wales). Again, this gap has grown over the course of the current economic downturn, as property prices have fallen across the rest of the country, but have largely held up across London (see further analysis in chapter 2). There is a similarly significant gap in respect of rents, with median social rents 17 per cent higher and private rents 36 per cent higher in London than national averages (Gleeson 2011).

Arguably the biggest single factor in the seemingly inexorable rise in London's house prices, and indeed the biggest obstacle to providing the new housing which London needs, is the cost of land. London's most expensive land is unsurprisingly located in its central boroughs. The average cost of a single square foot of land (0.09 square metres) in Kensington is £1,193, while even London's outer boroughs outpace other areas of England. As we shall see in chapter 2, a half-hectare plot in Ealing costs four times as much as the same size plot in Nottingham. Such disparities, not surprisingly, translate into higher London house prices and rents.

It is worth noting, however, that differences in housing costs between London and the rest of the UK are, to a large extent, driven by differences in average wages. Over the long term, the direction of causality runs from wages to housing costs, not the other way round. Figure 1.3 shows how house prices related to average earnings for London and the UK from 1997 to 2010. The ratio has long been higher in London (partly because of greater earnings inequality) but the change in the ratio is very similar between London and national levels.

Figure 1.3
Ratio of house prices to average earnings, UK and London, 1997– 2010

Source: ONS 2011 and Nationwide 2011

The housing cost differential is thus, to a great extent, the result of shifts in regional comparative economic advantage: any London-specific supply constraints or price bubbles can only be part of the story. The scale of the long-term shift is illustrated in table 1.1, which shows how wages in London have grown compared to national levels since 1979. What is particularly striking is how much of the increase in the London advantage is concentrated in the period since 1997. If the rest of the UK is bewildered by what has been happening to house prices and housing subsidy in London, the rapidity of the change in wage differentials may offer some explanation.

Table 1.1
London/UK ratio of gross weekly earnings of full-time employees, 1979–2010

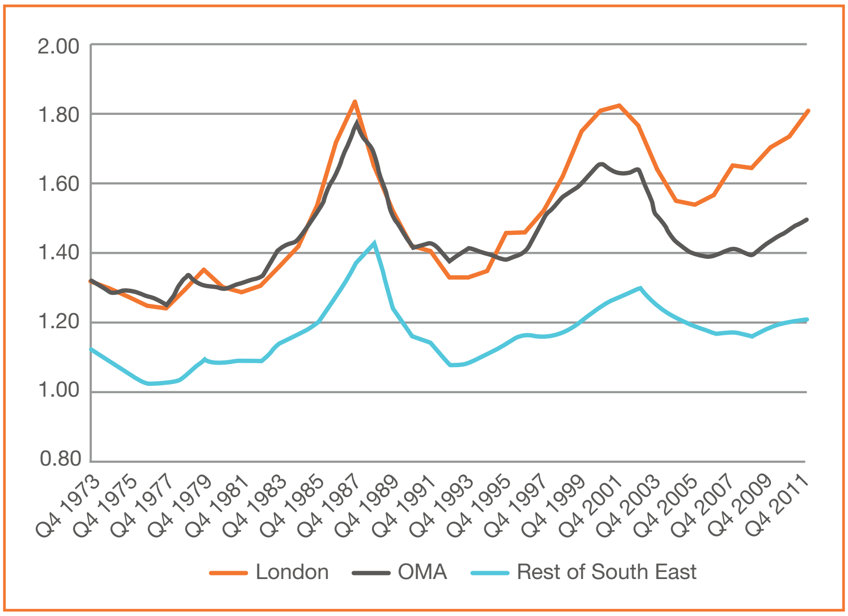
	Men	Women
1979 (median)	1.14	1.16
1997	1.23	1.23
2000	1.25	1.31
2005	1.28	1.30
2010	1.30	1.37

Sources: Buck et al 2002 (1979) and ONS 2012 (1997–)

This does not mean that there are no supply and demand imbalances in the London housing market, but this sort of imbalance is a feature of the UK housing market as a whole, not just of London (Ball 2010). There is some evidence that supply and demand may have been more out of balance in London than the UK roughly from 1995 to 2002. The price to earnings ratio grew rapidly in London during this period, which coincided with rapid population growth and historically low levels of new housing supply. Other evidence, for instance on overcrowding, supports the view that this period saw a general worsening of housing affordability due to undersupply, and we may still be living with the effects of this today (GLA 2010). Observing that wages are the main determinant of the London/UK housing costs differential does not, therefore, mean dismissing other factors.

What is clear is that the relationship between London and UK house prices is highly cyclical, as is also true for London's surrounding metropolitan area and the rest of the south east. Figure 1.4 (adapted and updated from Buck et al 2002) shows how the ratio of house prices in London, the surrounding outer metropolitan area and the rest of the greater south east to average UK prices has changed over time. London has shown greater volatility upwards, but not downwards, than the outer metropolitan area and greater south east since the late 1990s, in contrast to earlier periods. Inferences based on comparisons of costs are likely to be faulty if changes in the broader economy are not taken into account.

Figure 1.4
Ratio of house prices to UK average for London, outer metropolitan area and greater south east, 1973–2011



Source: Nationwide 2011

The current very high London to UK house price ratio is a case in point: it reflects the differential regional impact of the recession and the policy of maintaining near-zero real interest rates as much as differences in housing supply and demand.

3. The types of homes in London are different to those elsewhere in England too.

Almost 50 per cent of households in London live in flats, compared to 14 per cent elsewhere in England. Similarly, only half of homes in London have three or more bedrooms, compared to two-thirds elsewhere (Gleeson 2011). This inevitably has implications for levels of overcrowding in London. The number of households deemed to be living in overcrowded accommodation amounts to 220,000, representing an increase of 65,000 over the course of the last decade (MacInnes 2011). The result is that London has the most overcrowded households of any region and has one of the lowest levels of under-occupation (Gleeson 2011).

4. The level of acute housing need is another factor which makes housing different in London. The cost of renting and the demand for available social housing in particular mean that affordable homes are beyond the means of a significant number of people. While homelessness in London was, until recently, at its lowest since 1992, in the capital there are still 9,460 homeless and 36,020 living in temporary accommodation (Gleeson 2011). Emerging data suggests that the number of people in acute housing need is starting to increase, with the number of rough sleepers in London increasing in each of the last three years. London accounts for the vast bulk of England's homelessness and temporary accommodation cases, with 75 per cent of households in temporary accommodation being in London (MacInnes 2011).

5. Population change or 'churn' – the levels of population change or 'churn' also mark London out as unique. Ten per cent of households in London have moved within the last 12 months, with the majority of these being in the PRS. It is estimated that, although the PRS accounts for one-fifth of homes, it accounted for two-thirds of moves in 2009–2010 (Gleeson 2011). Churn has profound implications for public services and for community cohesion. A London School of Economics study in 2007 estimated that high population mobility cost London councils more than £100 million per year (Travers et al 2007).

In terms of the housing market, one of the most important differences between London and the rest of the UK is its young age profile and associated household structure. Migration flows between London and the rest of the UK and between London and the rest of the world are the main explanation. London's working-age population is younger and is more likely to live alone or as part of a childless couple. They are extremely mobile, and a large proportion will, at any point in time, have moved on within a few years.

6. Inequality – domestic migration flows are socially selective in terms of income, household type and lifecycle stage, with outflows in particular influenced by the extent to which households have access to the owner-occupied housing market. The concentration of economic and social disadvantage in London largely reflects the long-term effect of these movements (Buck et al 2002). The high percentage of inner London children in lone-parent households, for example, is testimony to the propensity for better placed families to migrate to the outer boroughs as children get older, rather than to distinctive patterns of household formation in inner London.

This serves to make the point that, while geographical segregation by income is not a marked feature of London compared to many other large cities, there is a pattern of segregation by income, household type and lifecycle stage. Children tend to experience less social diversity on average as they get older – although still somewhat more than in other parts of the country. The inherited housing stock – with social tenures concentrated in inner boroughs and family-sized, owner-occupied properties in outer boroughs – underpins the spatial pattern of disadvantage in London.

7. Diversity – London's ethnic diversity is on a scale unparalleled, not only in the UK but in Europe (GLA 2005b). Historically, diversity has been particularly associated with concentrations of first-generation migrant communities in inner London. It is worth noting that large areas of suburban London are now considerably more diverse than virtually any other area in the UK (apart from inner London). And diversity in 21st-century London is not a euphemism for 'not white British' (GLA 2005a): while there are clusters of specific ethnic minority populations across much of Greater London, there are few areas where one group forms the majority of the local population and few where the population is in any way neatly divided between white British and a single minority group.

Clustering of minority groups is far more important than segregation along lines of ethnicity. London's large PRS is important in facilitating both clustering and diversity with a substantial majority of all PRS tenures, accounted for by households of non-UK origin, of which half belong to a black and minority ethnic group (GLA 2007). Clustering tends to bring benefits to areas as well as to minority groups (not least in terms of economic activity), and housing policy, particularly with regard to private renting, needs to be alert to these benefits. Concerns about the impact of the new housing benefit regime on areas of London (as well as on individual households) are therefore understandable. While diversity should not be confounded with economic disadvantage – some minority groups perform better economically than the white British population, in London as well as nationally – we cannot ignore the fact that disadvantage has a strong ethnic dimension in London. One example is that overcrowding rates are more than twice as high for all household sizes among ethnic minorities in London (GLA 2010).

8. London's status as an international city – London is the only city in the UK which can truly lay claim to this title. Its size, population and the location of a major centre of international finance at its heart, gives London a position and pull which are incomparable with any other city in the UK. In the context of housing in London, there are two obvious implications. First, higher levels of both internal and external inward migration (as outlined above), as people from within the UK and elsewhere head to London to seek the employment and cultural opportunities that London provides. Second, the durability of London's housing market has attracted the attention of overseas investors drawn by the promise of high returns and the UK's 'favourable' tax rules. We return to this issue in chapter 5.

9. The office and powers of the mayor of London – while other cities in the UK, and indeed boroughs within London, have directly elected mayors, none has the same level of powers in relation to housing as the mayor of London.

The mayor was given key housing powers by the Greater London Authority Act 2007. This requires the mayor to publish a housing strategy which sets out an assessment of housing conditions in London and proposals for addressing issues of need and quality. Moreover, the mayor was given the power to make recommendations regarding the allocation of funding available to the Homes and Communities Agency and to London boroughs. In addition to new powers under the Localism Act, from 1 April 2012, the mayor has assumed responsibility for housing investment in London. As the mayor's housing strategy notes: 'These new arrangements, governed in partnership with boroughs, will put London in a unique position, with a directly elected mayor bringing together the strategic decision-making and investment on key infrastructure to underpin the development of the homes London needs. It puts in one place the public sector landholdings acquired to promote housing development and the public investment necessary to fund these homes, so that this land can be brought forward to enable housing delivery.' (GLA 2011b)

1.4 Unique, but not altogether detached

House prices in London are driven largely by the same factors that act on national prices, with wages the most important in the long term. Therefore, the London housing cost premium is associated with its wage premium. This contributes to greater volatility in the London owner-occupied market, but peaks and troughs have generally been amplifications of national trends: they do not suggest that the London market is to a great extent detached from the rest of the UK in terms of its fundamental dynamics. New housing supply in London is constrained, but over the last 40 years price movements have tracked national trends (taking account of wage differentials) in most periods, suggesting that London has generally faced similar constraints to the UK as a whole (although the late 1990s may be an exception). There is no strong evidence that Londoners face weaker work incentives due to housing costs, and child poverty rates in London are explained by the same factors as at national level, with the housing costs premium playing no special role.

The evidence, therefore, suggests that London's housing market is strongly integrated with the rest of the UK. Making this point allows us to better contextualise some of the ways in which London is distinctive. Much of this distinctiveness is in fact the other side of integration with national labour and housing markets: to a lesser extent, some aspects reflect the capital's integration with international markets, its 'global city' functions (Sassen 1991), and some reflect the impact of historical and more recent waves of international migration.

1.5 Why do these differences matter?

London's uniqueness matters for two important reasons. First, London's scale and specific economic conditions mean that national housing policies frequently do not fit with the reality of housing in London and have a distorted impact on those who live in the city. Second, London's size and specifically its distinct governance structures mean that we can look for different solutions to London's housing problems. The mayoralty and its strategic role in relation to London's 32 boroughs means that we can explore bespoke solutions for London, which would be unthinkable or unworkable elsewhere in the UK.

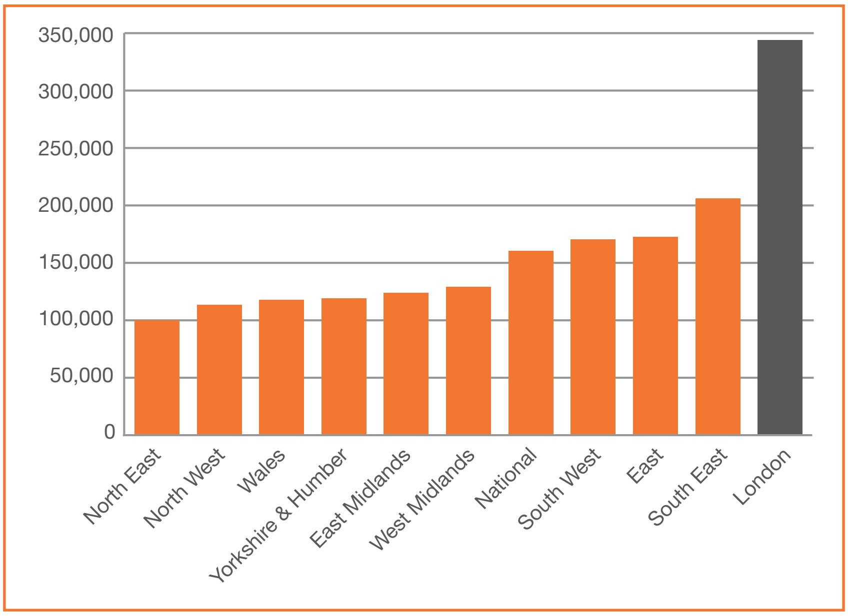
2. AFFORDABILITY IN LONDON – BUYING A HOME

Having established that London is unique, we now probe deeper into one of the most important aspects of housing in London: its lack of affordability. As we established in chapter 1, London is the most expensive region to live in the UK, regardless of whether one wishes to buy or rent a home. As the Organisation for Economic Co-operation and Development (OECD) concludes: 'The price-to-income and price-to-rent ratios are currently around 40 per cent above their long-term averages, suggesting over-valuation' (OECD 2011). This chapter explores in detail the cost and affordability of home-buying in London.

2.1 Buying a home in London

The cost of buying a home in London continues to grow at a rate which outstrips the performance of both the wider UK housing market and, perhaps more significantly, median pay in the capital. Figure 2.1 makes clear the scale of the gap between London and other English and Welsh regions. As noted in chapter 1, the average cost of buying a home in London is £345,298, over £138,000 more than the next most expensive region, and more than three times the cost of the average property in the north west of England (Land Registry 2012).

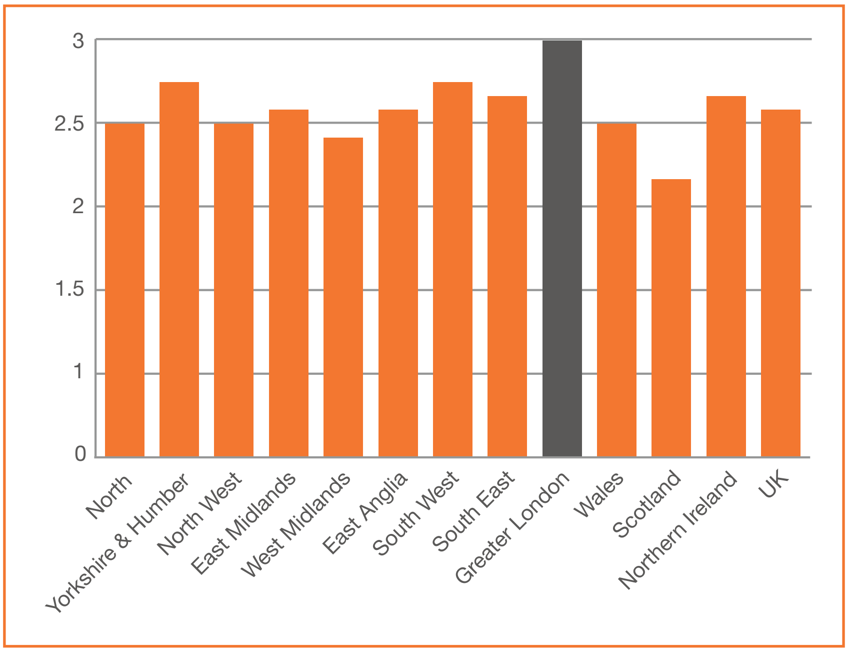
Figure 2.1
Average house prices in England and Wales (£)



Source: Land Registry 2012

If one leaves aside the other London boroughs and compares Land Registry data for Barking and Dagenham (often cited as London's 'cheapest' borough) with all other English and Welsh local authorities, London would still be the 11th most expensive place to live in the country (ibid). To fully appreciate the gap between London and wider UK house prices, one needs to take a historical view. Figure 2.2 sets out the growth of UK house prices over a 40-year period. This shows that London outperforms the next strongest region by an average of 0.3 per cent per year and 0.5 per cent above the national average.

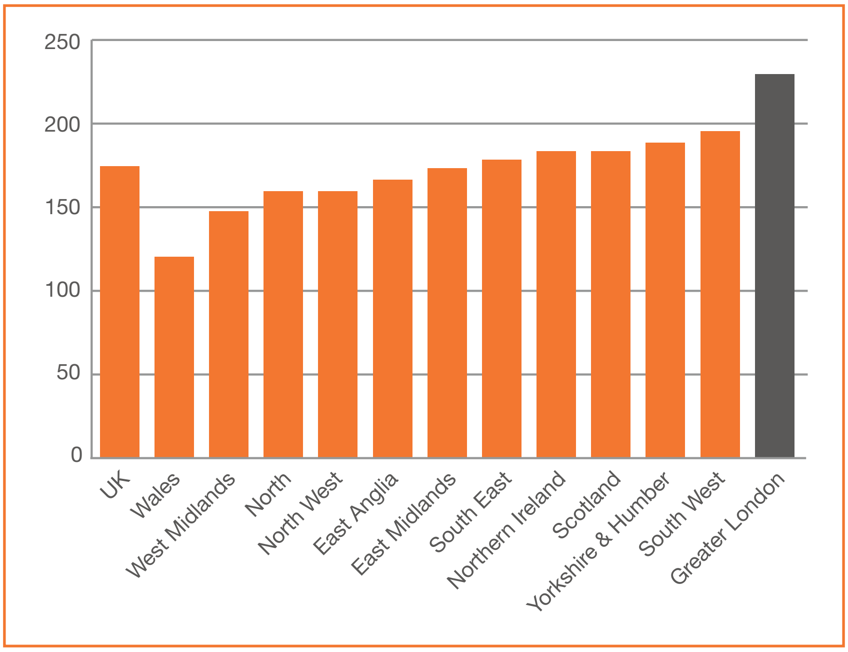
Figure 2.2
Average annual percentage house price rises, 1969–2010



Source: CLG 2011a

Given the different starting points, and the 40-year time span, the cumulative gap is considerable. Figure 2.3 quantifies the extent of this gap.

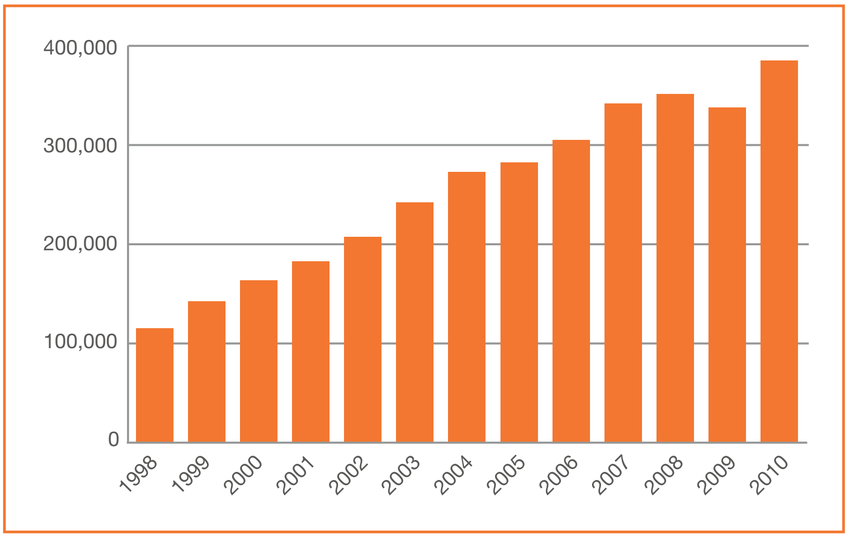
Figure 2.3
Total percentage change in house prices by region, 1969–2010



Source: CLG 2011a

In 2011, the gap extended further, with average prices in London growing by 2.8 per cent, while prices fell in all other regions of England and Wales (Land Registry 2012). It is important to stress that this gap is not simply a historical phenomenon. The scale of recent house price growth in London is made clear by figure 2.4, which details London housing market data between 1998 and 2010.

Figure 2.4
Average London property prices (all dwellings), 1998–2010 (£)



Source: Halifax 2010

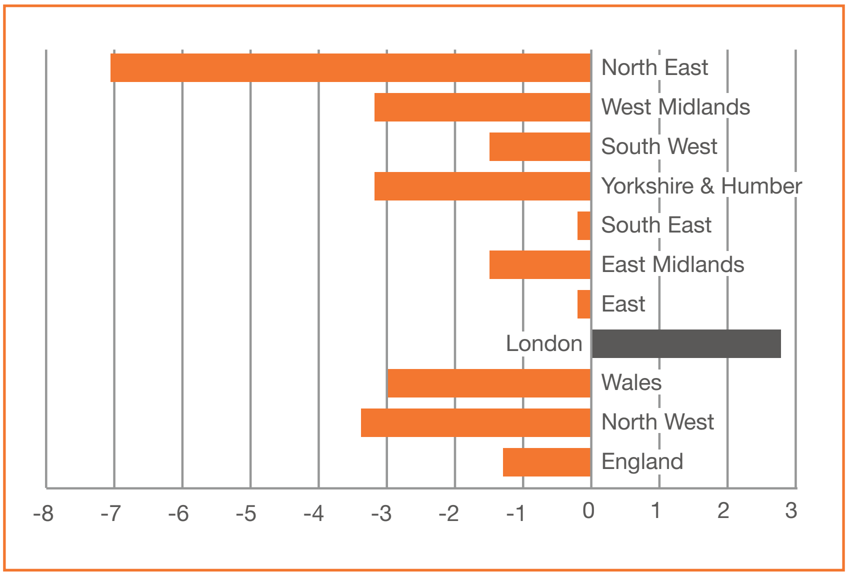
This shows repeated periods of growth in excess of 10 per cent, just one example of a year-on-year decline in house prices (2008 to 2009) and – perhaps most starkly – the average cost of housing doubling in just six years.

London's domination has continued over the course of the last decade. While there are brief periods in which other areas of the country have experienced periods of growth which have outstripped London, these have been short-lived.

London's position has been underscored by what has happened in the period since the current economic crisis began in 2008. The reality is that, like other areas of the UK, London experienced dramatic increases in property prices during the boom years, however London has not, to date, experienced the housing market correction seen in other regions (OECD 2011). London is effectively 'riding out' the worst impacts of the recession, which are biting hard elsewhere. It also means that 'affordable' housing in London remains out of reach for many Londoners. The ongoing 'resilience' of the London housing market is stressed by the fact that in 2011 UK house prices fell by 1.3 per cent, but in London they rose by 2.8 per cent (Land Registry 2012). It is clear that, in these figures for the UK as a whole, the London market is masking far bigger losses elsewhere in the market nationally; for example, during the same period, house prices in the north east of England fell 7.1 per cent (Land Registry 2012).

The continued strength of the housing market in London is underlined by a comparison of the UK housing market in 2011 (Land Registry 2012). London is the only region of the UK which experienced year-on-year growth, amid the continued economic downturn. Figure 2.5 underlines the degree to which London's housing market continues to outperform the wider UK market.

Figure 2.5
Regional house price indices: 12-month percentage change, 2011

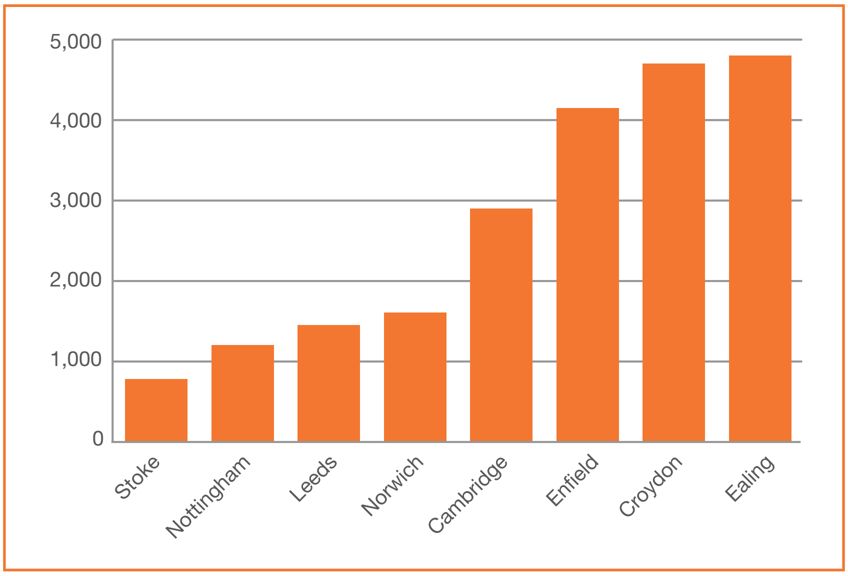


Source: Land Registry 2012

There is little evidence to suggest that the gap between London and other regions of the UK will decrease, at least in the short term.

It is important to note that a major influence on London property prices is the cost of land. As we saw in chapter 1, it is perhaps not surprising that this is most marked in central London's more affluent boroughs, however high land prices are not restricted to Kensington and Chelsea and Westminster, London's most expensive boroughs. This is confirmed by figure 2.6, which offers a comparison of some of London's outer (and therefore less expensive) boroughs and other English and Welsh cities. Half a hectare of residential development land in Ealing costs four times as much as a plot in Nottingham and three times what it costs in Norwich (VOA 2011a).

Figure 2.6
Value of land for residential development (£ per 0.5 hectares), January 2011



Source: VOA 2011a

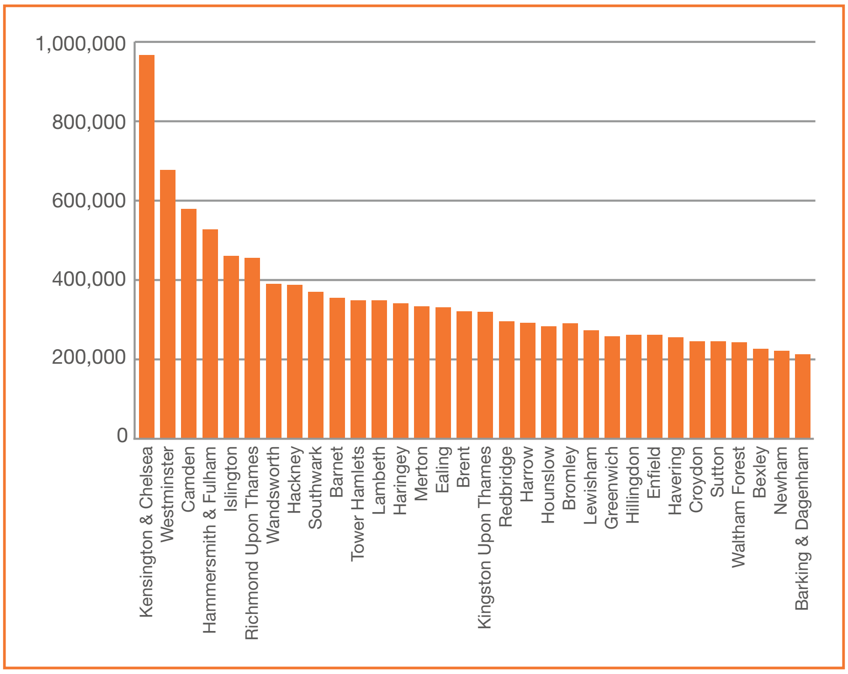
Recent data suggests that the gap between London and elsewhere in England continues to grow. The cost of residential development land in London rose by 12.5 per cent during the six-month period to April 2011, returning to the peak values of 2007 (VOA 2011b). By comparison, the same study found that land values in the north of England had dropped by 71 per cent since 2007 (VOA 2011b).

Having established the degree to which house and land prices in London continue to out-pace the remainder of the UK, it is now important to explore what this means for affordability in London. The focus here is on three areas: the geography of affordability; the relationship between house prices and earnings; and the marginalised position of first-time buyers.

2.1.1 The geography of 'affordability'

Common perceptions of the London housing market as universally expensive mask the considerable variation in the cost of buying a home across London's different boroughs. Before presenting the relevant data, it is worth stating that this variation does not mean that any areas of London are particularly cheap. Figure 2.7 demonstrates the sheer scale of the variation across London's boroughs. It reveals that there are currently no London boroughs in which the average cost of buying a home is less that £212,000. At the extreme ends of the scale, the average cost of buying a home in Barking and Dagenham is £212,166, while in the London Borough of Kensington and Chelsea it is £967,951 (Land Registry 2012).

Figure 2.7
Average property purchase prices in London boroughs 2012 (£)



Source: Land Registry 2012

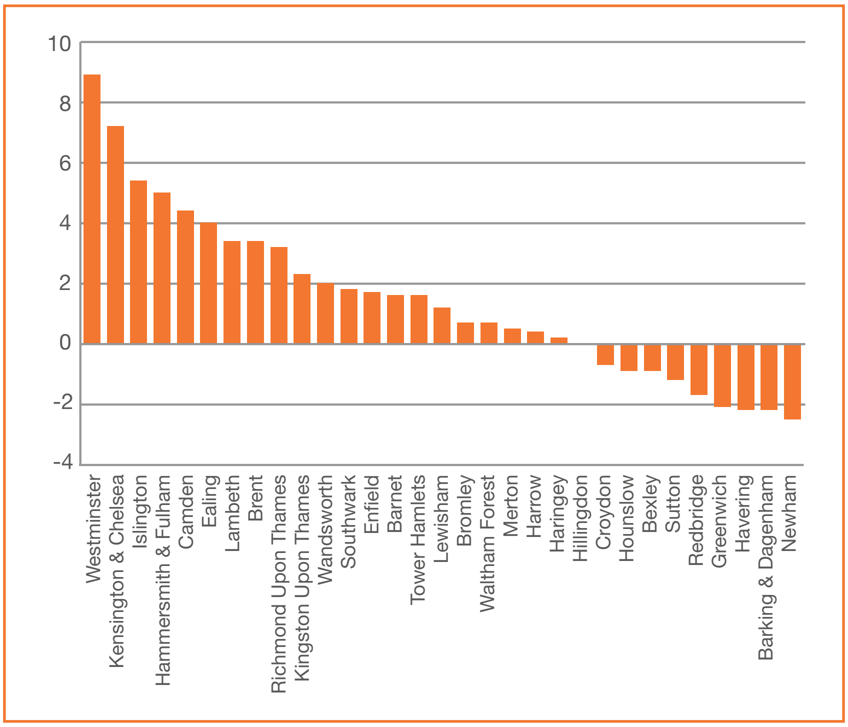
The average price of a property in 26 of London's 32 boroughs (the data excludes the City of London) is under £400,000. This is not to underplay the significance of the sums involved, merely to underline the degree to which we have a two-tier London. The first tier is an inner core of mainly central boroughs, which are characterised by average property prices in excess of £400,000. The second tier comprises those boroughs with average prices between £200,000 and £400,000. When devising and proposing housing solutions for London, policymakers should be mindful of the reality of these two Londons.

It is also important to note that, while property prices in London overall have held up in the economic downturn, and have compensated for falls in other regions, not all areas of London have escaped the effects of the crisis. Figure 2.8 demonstrates the divide.

The five most expensive boroughs listed in figure 2.7 have experienced the largest price increases in 2011, with the highest increases in Westminster and Kensington and Chelsea. The gap between these and the remainder of London has increased.

Compounding the notion of two Londons, just one of the nine boroughs which experienced a drop in property prices in 2010–2011 is an inner London borough (that is Greenwich, which could be experiencing a correction in prices given dramatic increases prior to 2008). The other eight boroughs are all outer London boroughs. These are also among London's 'cheapest' boroughs and, as other recent data suggests, have been hit hardest by the downturn: 'Of the nine boroughs with the lowest average house prices in 2008, seven have seen falls of at least 5 per cent since' (MacInnes 2011). Some may argue that such depreciations improve the affordability of properties in such boroughs. However, it more obviously indicates the very real divide between inner and outer London.

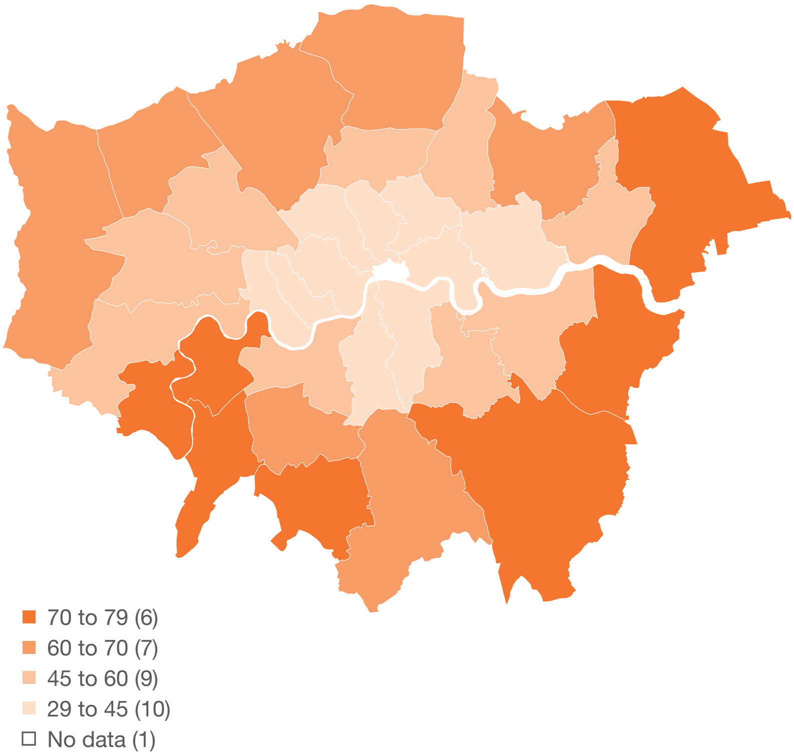
Figure 2.8
Annual property prices changes in London, 2010–2011 (%)



Source: Land Registry 2012

The impact of this considerable variation in the cost of housing between different boroughs translates into equally divergent patterns of home ownership across London. Less than one-third of those living in Westminster and Tower Hamlets own their own homes, while the figures for outer London boroughs such as Bexley and Havering are between 70 and 79 per cent (Gleeson 2011). It appears clear that the cost of buying a home in London plays a significant role in patterns of ownership. Figure 2.9 illustrates the distribution of home ownership by borough, across London.

Figure 2.9
Proportion of households that own their own home, by London borough, 2009 (%)



Source: Gleeson 2011

This variation holds particular significance for the current changes to the LHA, an issue which we will return to later, in chapter 4. First, we look at the relationship between the cost of buying a home and earnings in London.

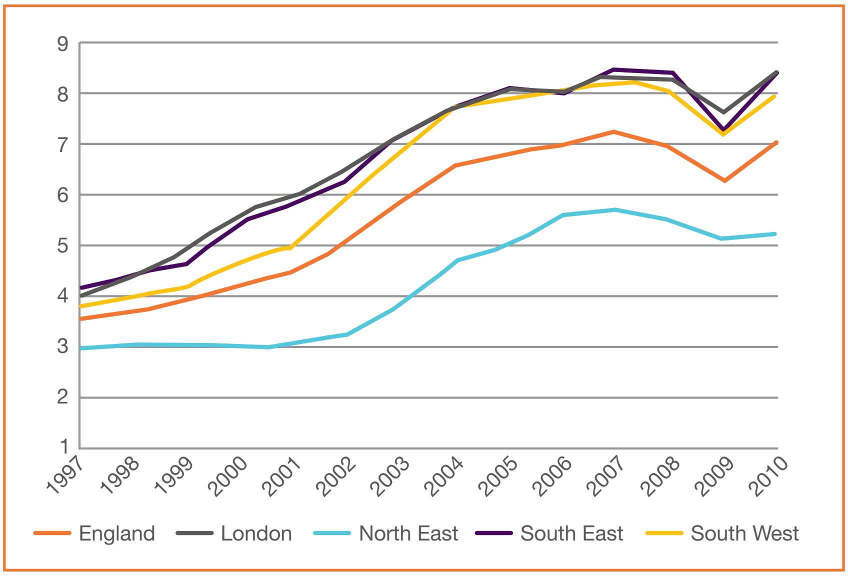
2.1.2 House prices and earnings – an uneven relationship

Property prices continue to outstrip average incomes in London. It is estimated that median property prices are more than eight times median incomes in the capital (OECD 2011). As figure 2.10 (over) shows, the gap between median incomes and median house prices has more than doubled since 1997 (OECD 2011).

Data from the GLA suggests that, in 2010, the ratio of lower-quartile house prices to lower-quartile earnings rose to 9:1 in London (Gleeson 2011). Given rising house prices and stagnant wages across a number of sectors, this pattern is likely to persist.

In 2006, the New Policy Institute calculated that, nationally, 35 per cent of 20- to 39-year-olds were unable to afford to buy even the cheapest home in their area. In London, the figure was 50 per cent (Kenway 2006). Again, given prevailing patterns of house prices and incomes in the intervening period, this figure is likely to have grown. A recent National Housing Federation paper observed that: ‘A person buying the average London home with a 75 per cent mortgage would need to raise over £100,000 for a deposit and to have an income of £87,500’ (National Housing Federation 2011).

Figure 2.10
Ratio of median house prices to median earnings, 1997–2010



Source: OECD 2011

Across London as a whole, just 15 per cent of households have an annual equivalised income of £60,000 or more (Walker 2010). This effectively means that owning one's own home is beyond the financial grasp of the majority of Londoners.

Even if one takes London's most affordable borough – Barking and Dagenham – the gross income needed to be able to buy the average house in the borough is £38,395 (National Housing Federation 2011). To put this into context, the average annual income in the borough in 2011 was £25,968 (Shelter 2012). Such data inevitably shifts the focus onto the tribulations of first-time home buyers.

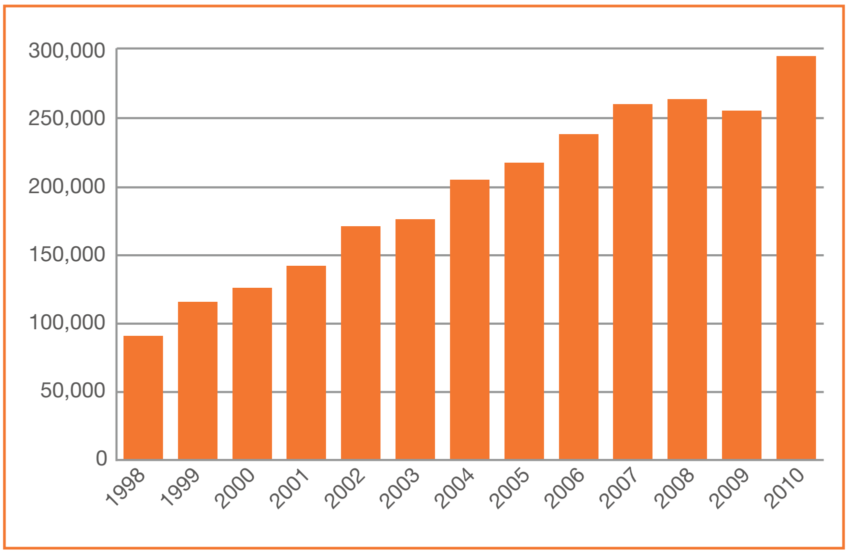
2.1.3 First-time buyers

Issues of cost and finance are particularly relevant to those who aspire to get onto the property ladder for the first time. To consider the position of potential first-time buyers, we can explore data relating to average first-time buyer house prices for London in the period since 1998. As figure 2.11 (over) shows, during this period the average property price for first-time buyers increased from £90,160 in 1998 to £293,594 in 2010.

At a time when mortgage lending is limited and minimum 20 per cent deposits are increasingly the norm, such a figure is clearly way beyond the reach of the vast bulk of London's potential first-time buyers, unless one is lucky enough to be able to call upon what has been termed 'the bank of mum and dad'. This explains why the average age of first-time buyers in London is 43, five years older than the national average (BBC 2011).

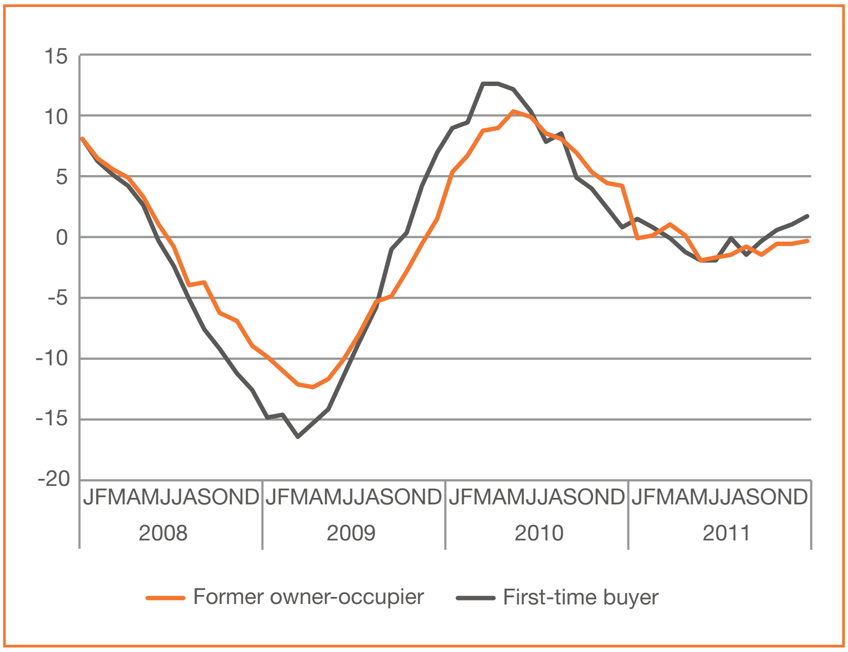
Over recent months, the relative position of potential first-time buyers appears to have worsened, with UK house prices for first-time buyers increasing at a faster rate than those for former owner occupiers (figure 2.12). Given what else we know about London and the UK housing market, it would appear a fair assumption that much of this change is due to what is happening in London. Figure 2.12 also suggests that, over time, house prices for first-time buyers are more volatile than those for existing home owners, thus further underlining the weak position of this group in the contemporary housing market.

Figure 2.11
Average property price for first-time buyers in London (£)



Source: Halifax 2010

Figure 2.12
UK annual house price rates of change by type of buyer (12-month percentage change)



Source: CLG 2012a

As we have seen, there are very real issues of affordability related to buying a home in London. The gap between London and the rest of the UK, and between London boroughs, means that, for most Londoners, the dream of owning one's own home is exactly that – a dream. Affordability in the rental market is, therefore, particularly important in London.

3. AFFORDABILITY IN LONDON – RENTING A HOME

As we established in the previous chapter, London has the highest house purchase prices of any region in the UK. Before we take a look at the London rental market, it is important to underline that the state of the purchase and rental housing markets in London are inextricably connected. Most obviously, the impact of high purchase prices is not restricted to those wishing to get on to the property ladder; rather its impact reaches into the rental sector in two key ways.

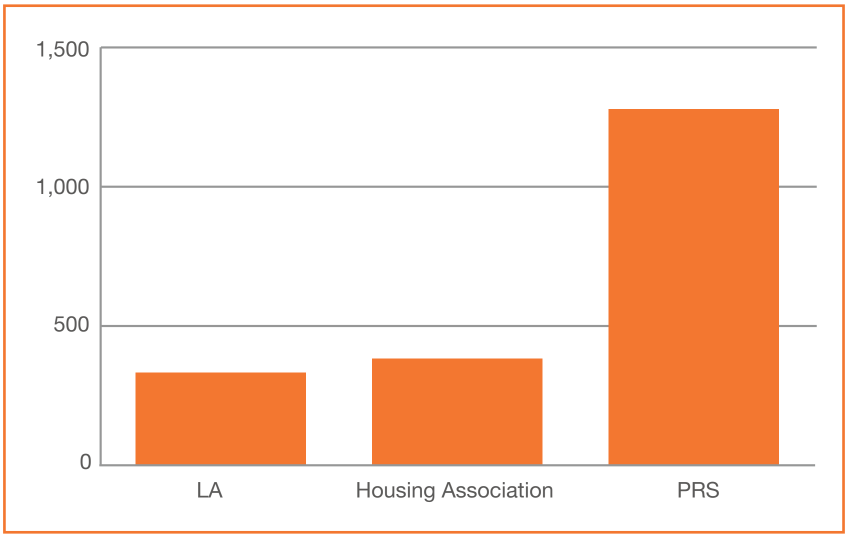
First, high property purchase prices have a knock-on effect in increasing rent levels. It is inevitable, particularly in a market which is dominated by small portfolio landlords, that properties which are expensive to buy will be expensive to rent, as landlords seek yields which cover their own borrowing and ensure an income.

Second, high purchase prices combined with wider demographic pressures (and resulting demand) ensure that there is always likely to be a large number of people who would otherwise wish to get onto the property ladder, but cannot afford to do so. This means that demand outstrips supply and competition for available properties in particular areas drives up rents within the PRS. We explore both of these issues in this chapter.

3.1 The cost of renting a home in London

London continues to have the highest average rents in the UK, across all tenures, whether council, housing association or private. This section considers the detail behind the headline figures. Examining a number of different sources, it is possible to construct a detailed picture of local authority, housing association and private sector rents across London. Figure 3.1 outlines the average rents across the three main rental tenures in 2010. Average rents in London in 2010 were equivalent to £83.40 per week for local authorities (CLG 2010a), £96.05 for housing associations (CLG 2010b), and £320.25 in the private rented sector (VOA 2012). The last of these is equivalent to £1,281 per month.

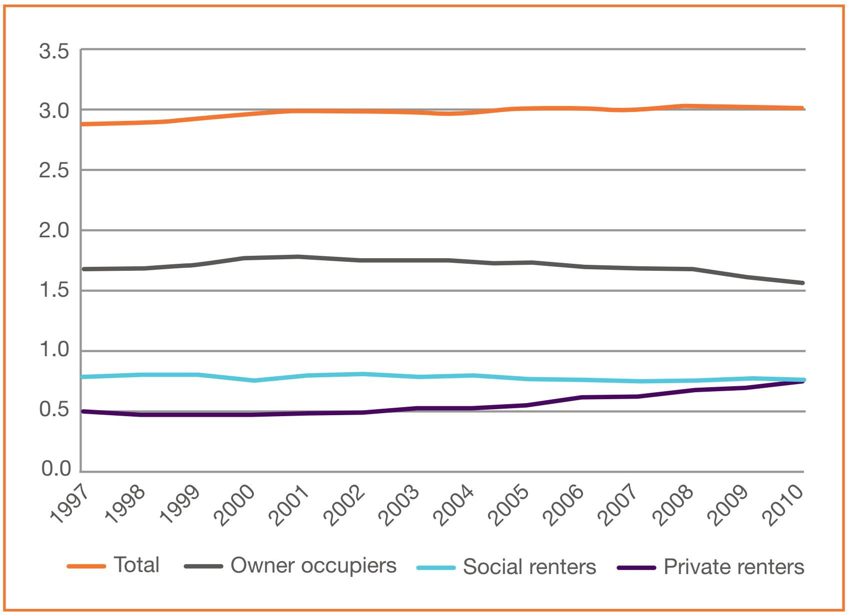
Figure 3.1
Average monthly rents in London across the three rental tenures, 2010 (£)



Source: CLG 2010a, CLG 2010b and VOA 2012

As we saw in chapter 1, the PRS is the growing sector in London's housing market. This reflects the changing shape and balance of the housing market over the course of recent decades. Even in the period since 1998, the number of council homes in London has fallen. This drop has largely been prompted by the last vestiges of the right to buy scheme and stock transfer to registered social landlords. This forms part of a wider shift which has seen a dramatic expansion of the PRS. Almost all new growth in housing has been absorbed by this sector (MacInnes 2011). Figure 3.2 shows the relative growth of the PRS in London since 1997.

Figure 3.2
Housing tenure in London, 1997–2010 (millions of households)

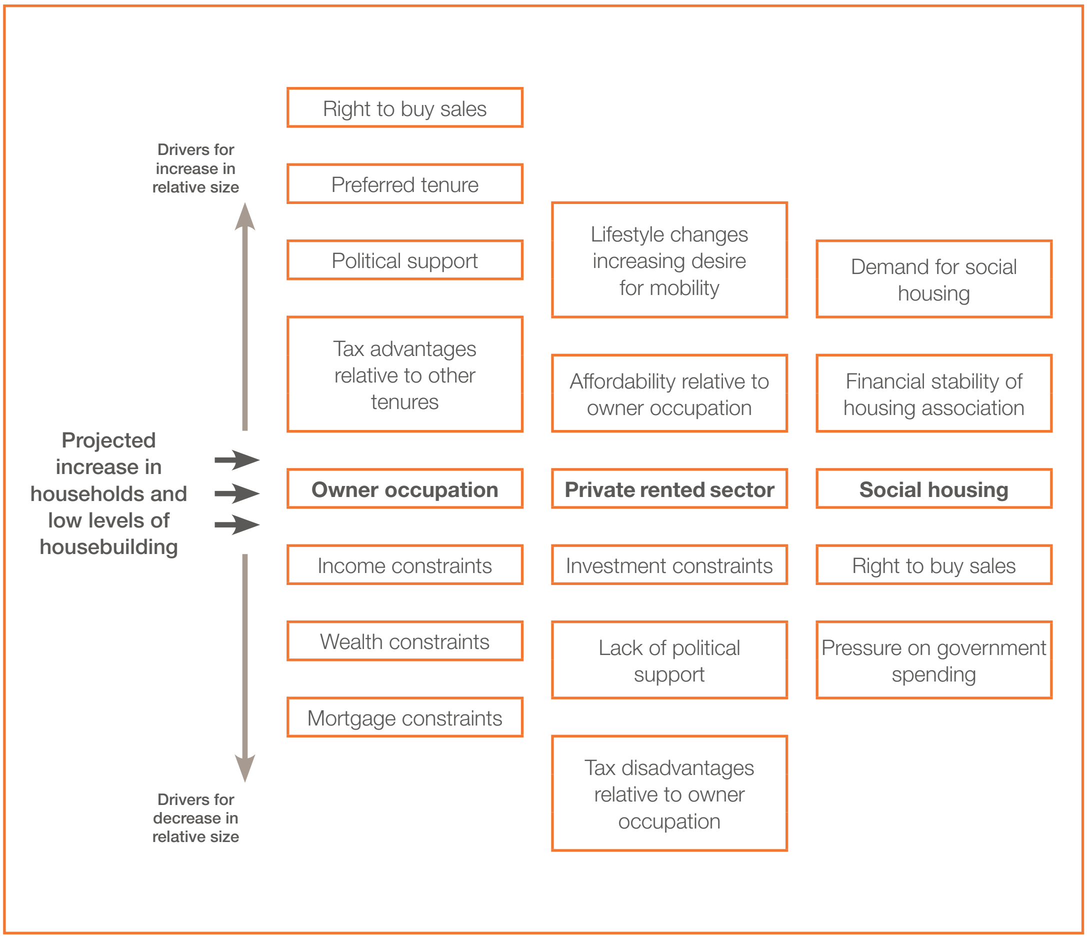


Source: MacInnes 2011

This growth has, in large part, been driven by the availability of credit for those seeking to enter the buy-to-let market. A fuller explanation of the various factors at work in the relative growth and decline of different parts of the housing market is provided in figure 3.3 (over). As a result of these shifts, the number of people who own their own home in London has fallen by 6 per cent since 2000 (Gleeson 2011) and the proportion of households in the PRS continues to grow. Nationally 'the number of households in the PRS increased by 1 million between 2005 and 2009' (Pattison et al 2010). The number of households in the PRS appears set to surpass the number in the social rented sector within the next few years.

Consequently, the focus of our analysis is on the PRS. This focus allows us to acknowledge a number of the realities of the London housing market. It is in the PRS that the highest rents and most obvious levels of unaffordability are to be found. Social rents (local authority and housing association rents) are only marginally above the commonly used affordability formula of 30-35 per cent of income. Research by the London School of Economics and the G15 group of London housing associations recently identified the ratio of social rents to income as 0.37 (Whitehead 2011). The real disparities in London are in the PRS. There are boroughs in London where the median rents are equivalent to more than 65 per cent of median incomes.

Figure 3.3
Key drivers of recent changes in tenure mix



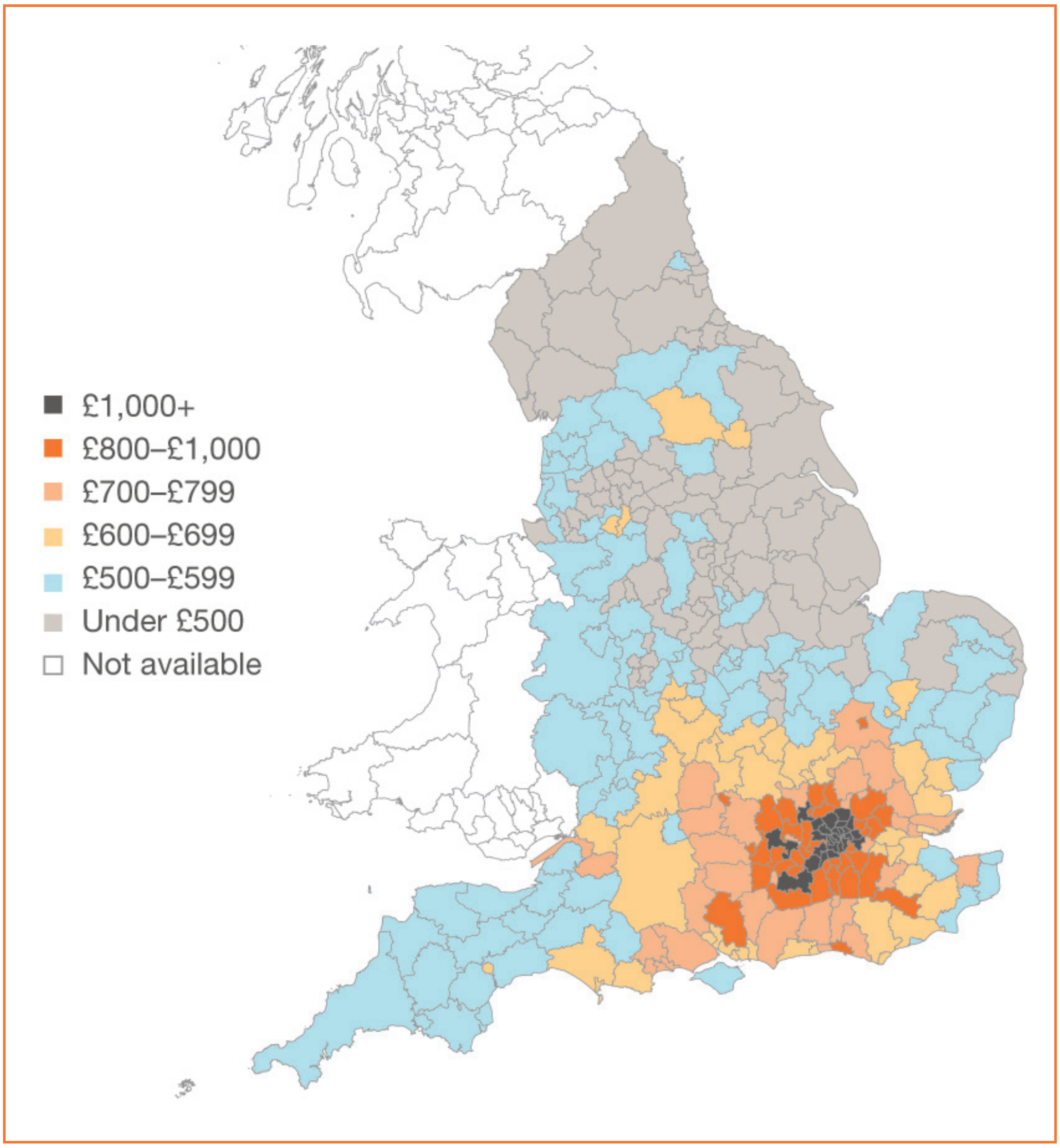
Source: Reproduced from Pattison et al 2010

3.2 The cost of renting a home – London's place within the UK

In 22 of the 32 London boroughs, the average private sector rents are in excess of £1,000 per month; in nine of the boroughs, average rents are between £800–999 per month; and in just one borough these rents are between £700–799 per month (Shelter 2011). This means that there are currently no London boroughs in which the average rents are below £700 per month. This obviously does not mean that there are no private sector properties available below this average figure; it does, however, present the key affordability issue in the PRS in London.

By way of comparison, in no region other than London does the proportion of rents exceeding £1,000 per month go above 4 per cent, compared to 69 per cent in London. There are five regions in which average rents do not exceed £699 per month. The regions with higher average rents are noticeably located in the south of England and neighbour London, suggesting that the London effect radiates out into neighbouring regions. What is perhaps clearer is evidence of the north–south divide in property prices. The regional distribution of rents is graphically depicted in figure 3.4 (over). This also shows the degree to which high rents in London radiate out into outer London and beyond in the south east.

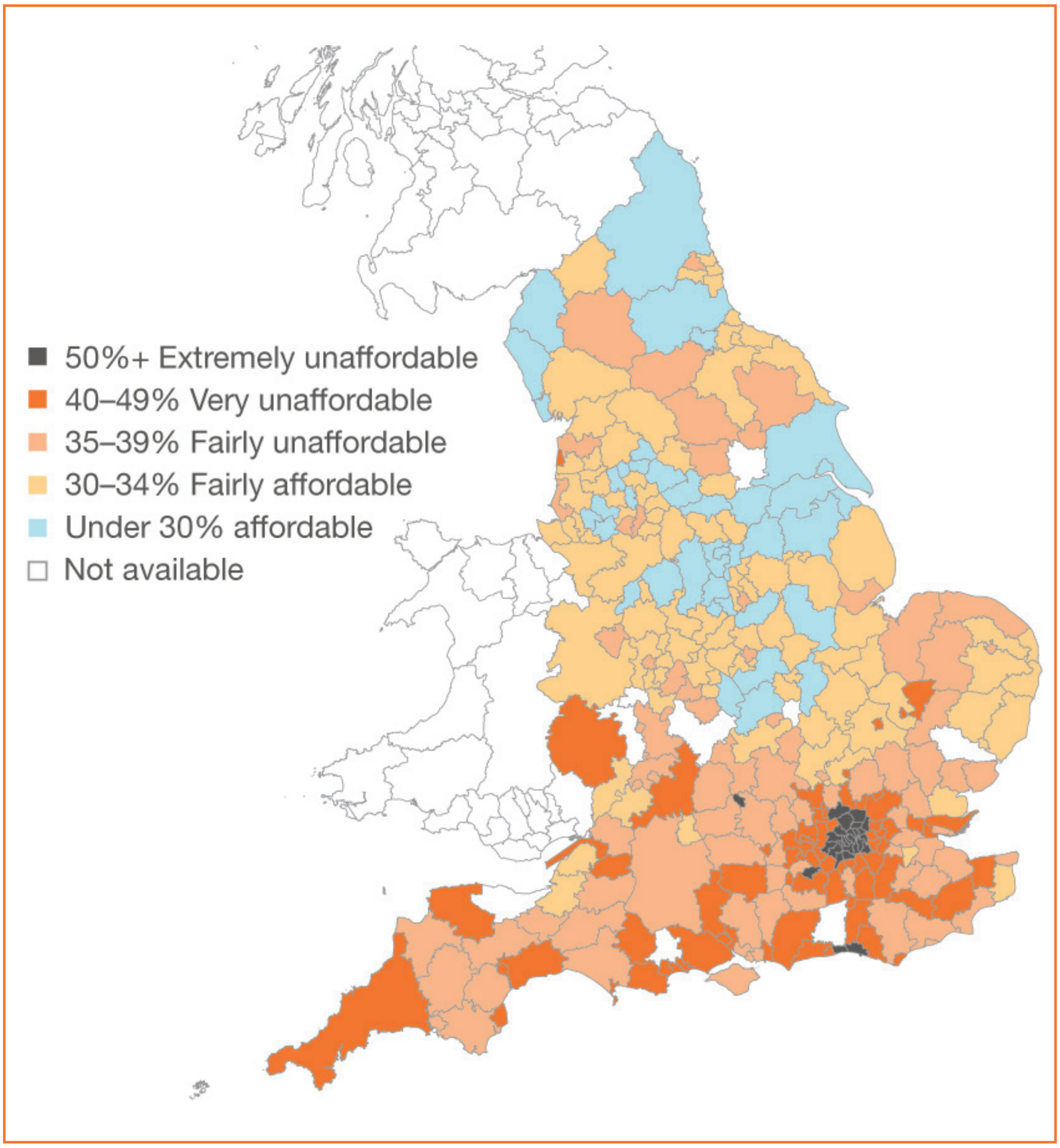
Figure 3.4
Average private rents per month for two-bedroom homes, England



Source: Shelter 2011

The other measure of London's challenge here, besides outright cost, is the question of affordability, specifically measured by calculating median rents as a proportion of median incomes. This analysis reveals the extent of affordability – or rather unaffordability – of renting in London. A list of the 30 least affordable places to live in England is dominated by London boroughs. The top 16 local authority areas and all but five of the top 30 are in London. While it is perhaps not surprising that Kensington and Chelsea tops this list, with median rents at 89 per cent of local median pay, it is perhaps more telling that Barking and Dagenham – London's 'cheapest borough' – registers on this same list at 49 per cent (VOA 2011a). Figure 3.5 (over) provides a graphic representation of London's position as the least affordable place to rent privately in England.

Figure 3.5
Private rents on two-bedroom homes as a proportion of local full-time, take-home earnings



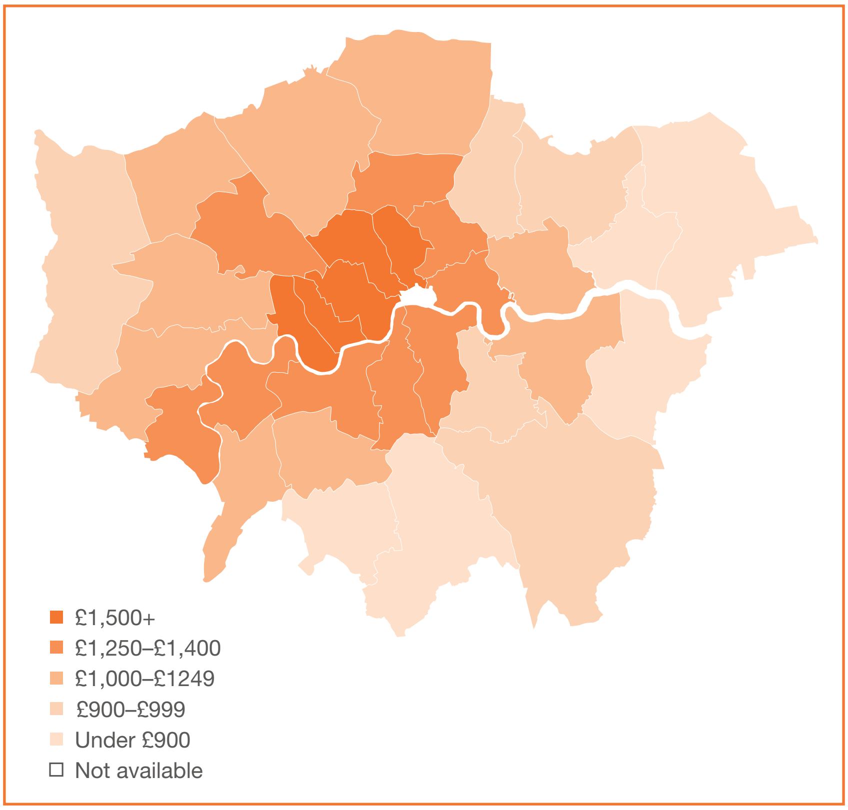
Source: Shelter 2011

It is important to record that the gap between London and the UK in terms of private rents has continued to grow during the course of the current economic downturn. Private sector rents have continued to rise strongly in London, with estimates for 2011 suggesting an annual rise of 6.4 per cent (Brown 2012b). The *Guardian* recently quoted a London-based property company which claimed that for every rental property vacancy in the capital there were five prospective tenants (Osborne 2011). Having established London's status as the most expensive and least affordable region in England, it is now important to explore the differences in rents and levels of affordability *within* London.

3.3 Renting: disparities within London

Given its size and diversity, it is not surprising that there is a considerable degree of variation in rents and affordability between inner and outer London and between individual boroughs. The variation in rent levels across different boroughs is represented in figure 3.6, which details the average cost of renting in each of London's 32 boroughs. While Kensington and Chelsea clearly stands out, it is important to note that in boroughs such as Camden, Islington and Hammersmith and Fulham the average rents exceed £1,500 per month. Figure 3.6 clearly illustrates that the highest rent levels are in the inner London boroughs, with a partial, affluent outer ring of boroughs including Richmond upon Thames, Wandsworth, Hackney and Haringey. While average PRS rents in Hillingdon were equivalent to £242 per week in 2011, average weekly rents in Kensington and Chelsea were £679 (Shelter 2011).

Figure 3.6
Private rents per month by London borough, two-bedroom homes, 2011



Source: Shelter 2011

While high average rents suggest the unaffordability of renting in London, it is important to consider the relationship between rent levels and average incomes.

3.4 Rent levels and incomes – the real measure of affordability

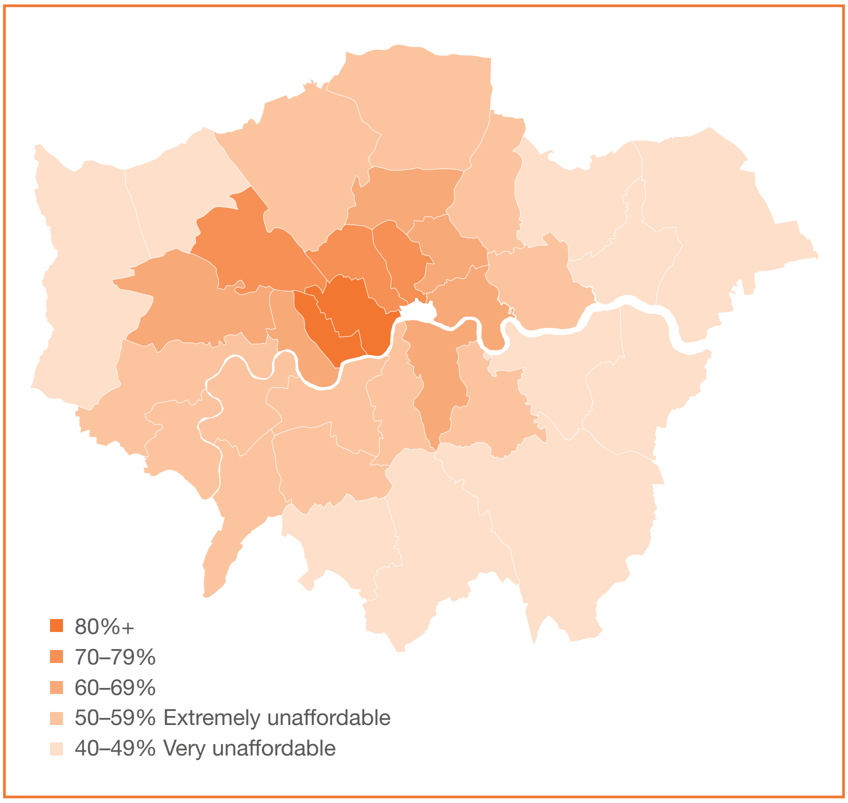
Arguably the best measure of affordability in London is to compare the cost of rents with incomes in the capital. There is no formal definition of what constitutes affordability but a common rule of thumb is that housing costs should account for no more than 30–35 per cent of household income.

Analysis by Shelter underlines the unaffordability of London: 'The most unaffordable local authorities are concentrated in London: the majority (22) of London boroughs have median rents that cost more than 50 per cent of median local full-time earnings. All boroughs have a median private rent for a two-bedroom home which costs more than 35 per cent of median take-home pay in that area' (Shelter 2011).

Shelter designate 69 per cent of London as 'extremely unaffordable' – those areas in which 'median London rents for two bedroom homes take up 60 per cent of a Londoner's median take-home pay' – with the remaining 31 per cent still 'very unaffordable' (Shelter 2011).

In nine London boroughs, the average PRS rent is 65 per cent or more of the median take-home pay. While boroughs such as Kensington and Chelsea (89 per cent), Camden (77 per cent) and Islington (77 per cent) clearly stand out, it is perhaps more concerning to note that outer London boroughs such as Hillingdon and Barking and Dagenham barely scrape in under the 50 per cent mark (Shelter, 2011).

Figure 3.7
Private rent as a proportion of median full-time, take-home pay, two-bedroom homes, London



Source: Shelter, 2011

As a footnote to this discussion, it is important to warn that, on occasions, the argument regarding the relationship between rents and pay has been overstated. For example, one newspaper carried the headline 'Renting in the capital tops average take-home pay', which, while factually correct, was comparing private sector rents in London with average net pay in Britain (Bar-Hillel 2011). There is, however, no escaping the fact that rents in London are significantly out of kilter with average levels of pay. Analysis by Shelter and Cambridge University concludes that it is only a matter of time before 'parts of every borough will become "unaffordable" to private renters' (Fenton 2010).

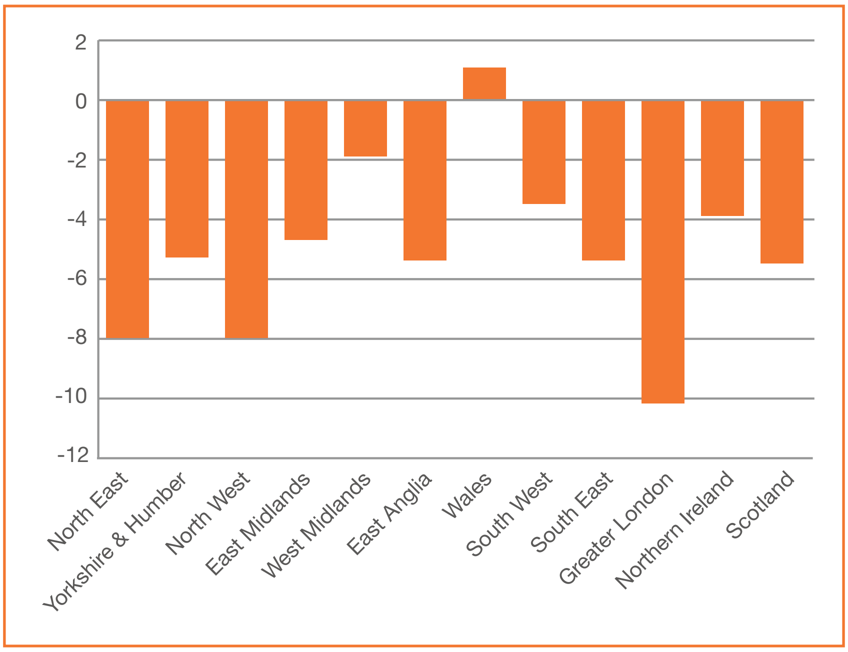
3.5 Why does this matter?

It is clear that high rents and lack of affordability within the PRS in London is important for a number of reasons. First, people in London have to live somewhere. Ensuring the availability of affordable rental properties is essential to ensuring the continued growth and prosperity of London as a major world city. Second, the London economy, particularly central London's service industries, require people to work in shops, cafés, theatres, gyms and restaurants. If people cannot afford to live within commutable distances, then they will not be able to afford to take up and retain jobs which pay the minimum wage or London living wage. Such work greases London's wheels. Finally, one of the things which sets London out from other world cities such as Paris and New York is its mixed, cohesive communities. The availability of affordable housing is essential if London is to avoid drifting into economic and ethnically segregated neighbourhoods and boroughs.

3.6 Comparative cost of renting and buying a home

Renting is now more expensive than purchasing a home. Analysis by the Halifax in January 2012 identified that buying 'is more affordable than renting' in England, Scotland and Wales. It calculated that, nationally, buying was 16 per cent cheaper than renting. In London, the gap was 10.2 per cent – average monthly mortgage repayments of £1,089 compared to £1,212 for average monthly rents. Reference to data for 2011 from the same source suggests that this gap is growing (all Halifax 2012). Figure 3.8 sets out the regional data for 2012.

Figure 3.8
Relative costs of buying compared with renting UK, 2012 (%)



Source: Halifax 2012

Such data points to the continuing, strong performance of the rental market, and in particular the resilience of the PRS, even during a time of economic constraint.

3.7 Strengthening rentals market

It would appear that the gap between London and the remainder of the UK is likely to have widened since April 2011, as recent media reports suggest that rent levels in the PRS appear to be on an inexorable rise (Brown 2012a). 'Strong' PRS performance is underlined by the fact that nationally the number of buy-to-let mortgages being approved has started to grow again. The growth of the buy-to-let market (2000–06) saw 500,000 such properties added to the PRS (OECD 2011). In the third quarter of 2011, new buy-to-let loans increased by 16 per cent, a further indication of confidence in the PRS and the prospects for rental yields. Overall, 84,000 new properties were added to the buy-to-let market in 2011 (CML 2012).

While the burgeoning PRS and its increasing rents are clearly good news for those who are landlords in London, the news is less good for Londoners as a whole.

3.8 A PRS crisis

As we have seen, the PRS in London is currently characterised by high rents and an imbalance between supply and demand. The nature of the PRS in London poses fundamental challenges to two of the Coalition government's flagship policies: its welfare reform programme; and its recently published national housing strategy. The uniqueness of London's housing market means that these national solutions do not provide answers which are appropriate for London.

For a significant proportion of households in London the issue of affordability is poised to become an even more pressing one. Changes to the local housing allowance and housing benefit systems will have a major impact for households across the capital.

4. AFFORDABILITY IN LONDON – IMPACT OF WELFARE REFORMS

The cost of housing benefit remains one of the most complex and intractable welfare problems faced by successive governments. The tendency has been for politicians to heavily criticise inactivity in opposition, but ultimately to fail to tackle this issue once in government. The case for reform appears clear. Department for Work and Pensions (DWP) data shows that the cost of housing benefit has doubled from £11 billion in 1999–2000 to £22 billion in 2010–2011 (DWP 2010).

Our starting point for this chapter is that reform of the broad housing benefit system is essential. The Coalition government is right that the status quo is no longer sustainable. Given the current economic crisis, we would expect the number of people claiming a range of means-tested benefits to rise. This will inevitably put considerable pressure on an already stretched system at a time of major reform. While welfare reforms inevitably mean that some people will be worse off, this should not dissuade discussion and it certainly should not prevent actual reform.

4.1 Housing benefit

Official DWP data (July 2011) shows that 4.89 million people receive housing benefit: three-quarters are under the age of 65; and 68 per cent are tenants of social landlords. The remainder (approximately one-third of the total) are PRS tenants (Walker and Niner 2010). Of those receiving housing benefit, 3.87 million are single, with 'almost two-thirds of these being female'. 1.68 million recipients have at least one dependent child.

Approximately one-third of housing benefit claimants do not receive a 'passported benefit', which includes income support, jobseekers' allowance, employment and support allowance and pension credit (DWP 2010). One-quarter of these claimants are in employment. The significance of housing benefit as an in-work benefit is one which must not be overlooked (Crisis 2010).

4.2 Housing welfare reforms

As part of its emergency budget in June 2010, the Coalition government announced a series of major changes to LHA and housing benefit. We summarise the main changes here.

Welfare reforms – summary of major changes to LHA and HB

- Removal of LHA rate for five-bedroom properties (maximum now four-bedroom)
- Caps on LHA of
  - £250 for a one-bedroom property
  - £290 for a two-bedroom property
  - £340 for a three-bedroom property
  - £400 for a four-bedroom property
- Abolition of 'single room rate' for under-35 year-olds
- LHA rates to be set at the 30th percentile of rents in each broad rental market area rather than the median
- Abolition of the £15 weekly 'housing benefit excess'
- Additional bedroom 'offer' for disabled people
- £26,000 per family total benefits cap

Source: IPPR summary

4.3 The rationale for welfare reform

The government has established a clear rationale for its reforms.

First, it has identified the specific problems associated with the cost of funding benefits for larger properties in London (DWP 2010). The government is interested in tackling what it perceives to be the excessive burden placed on the system by high rental costs in London (DWP 2011a). As the DWP's official impact assessment states, 'in London some rates are excessively high. For example, Local Housing Allowance rates for five-bedroom properties in central London have risen as high as £2,000 per week. However, even rates for two-bedroom properties can exceed £300 per week in some London areas' (DWP 2010). As an earlier report in this IPPR series noted, 'by 2009/10, London accounted for 26 per cent of all housing benefit expenditure' (Hull et al 2011).

The scale of housing subsidy in the capital compared to other regions (while it reflects longstanding differences in housing costs) is the object of incredulity in other regions. In the PRS in London, LHA is costing £1.6 billion a year, or 28 per cent of the nation's entire bill for this allowance. A simple comparison of payments can all too easily be interpreted as excessive generosity in London. But this level of subsidy is intended to deliver identical living standards in London and other areas. And there is reason to think that housing standards for LHA claimants are, if anything, somewhat lower in London.

London faces a new sort of housing crisis arising from the rest of the UK's reluctance to fund this area of social spending in the capital at current levels. That reluctance could be exacerbated by the tendency of politicians and commentators to seek out groups to blame for current fiscal difficulties – from 'greedy' private sector landlords to 'work-shy' Londoners supposedly enjoying living standards most working families could not dream of. Other criticisms suggest that high rents in London can be attributed to other undesirable factors such as asset price bubbles or supply–demand imbalances. It is tempting to hope that addressing these problems would bring London rents down to a more affordable level. This demands further assessment.

4.3.1 The London differential

Discussions of expenditure on housing subsidy in London, and problems of affordability, need to take account of long-term, inter-regional differences in housing costs. Ironically, the average level of housing benefit in the PRS in London is lower than the long-term growth in housing costs, simply because rents in London have been much more stable than house prices (GLA 2011b). This was, at least in part, due to a steep rise in PRS supply, perhaps an indicator of the extent to which London house prices have moved beyond the reach of younger Londoners. There is little reason, therefore, to see rents and the cost of subsidising rents in London as generally excessive. The long-term differentials in housing costs seem convincingly grounded in comparative economic advantage.

It is sometimes asserted that housing subsidy allows households reliant on benefits to rent properties which would be out of their reach if they were in work, suggesting that it is not London housing costs which are the problem but claimants renting expensive properties. The general hypothesis (not confined to London) has been researched in two separate studies commissioned by the DWP; both have shown that out-of-work LHA claimants are accessing properties of similar cost, and somewhat lower quality, than low-income working households (McKay 2010, Walker and Niner 2010). The notion that claimants are living in excessively expensive properties is sometimes supported by showing claimants in higher-cost central London areas, but these locations account for a disproportionately high share of the entire London PRS and a disproportionately low share of claimants. Analysis taking account of rents and the distribution of PRS stock indicates that the strong deterrent effect of higher rents is offset by the geographical constraint on supply, at least for smaller households in one- or two-bedroom properties (Gaffney 2012).

It is important to recognise that expenditure on housing subsidy in London largely reflects differences in economic fundamentals. The double bind is that increasing economic disparities between areas of the UK – which the recession has reinforced – both drive variation in spending levels and make legitimating spending in London very challenging.

4.3.2 The link with work incentives

The government has expressed concern that current levels of benefits 'create disincentives to work and are not sustainable' (DWP 2010). It is widely assumed that high housing costs in London translate into weaker work incentives and unemployment traps due to higher housing benefit payments. But the benefits system is designed to avoid such effects, and a series of analyses of London's non-working population consistently shows that standard variables explain most of the employment gap between London and the rest of the UK, with the important exception of lone parents (McKay 2010, Meadows 2006, LCPC 2007). If housing costs were creating an unemployment trap in London, we would expect to see impacts across household types, so again housing costs seem to be being given an exaggerated role.

The low, but rising, employment rate for lone parents in London presumably reflects other factors – possibly an interaction between the availability of part-time work and flexible childcare (2008). Whether housing benefit in London has an effect on how people progress in work, through high marginal deduction rates which reduce the value of increases in earnings, is a different matter; but it is now generally accepted that marginal deduction rates have little effect on individuals' decisions whether to work at all (Brewer et al 2007).

One area where the benefit system can fall down in terms of work incentives is for the partners of low-wage workers in areas of high private rented housing costs. This is because the withdrawal of tax credits and housing benefits when the partner enters employment can offset the gain in earnings to the point where the family is no better off (creating a marginal deduction rate problem at household rather than individual level). It is not clear that this is happening in London, and the combination of circumstances required to eliminate gains to employment may be statistically rare (both partners would have to have hourly earnings which would be low by London standards). But it is the case that mothers in couple families with children in London have low employment rates compared to other areas (LCPC 2007), and there has been a striking rise in the percentage of single-earner couples in outer London, predating the recession.[3] There has also been a significant rise in child poverty in outer London which is consistent with higher poverty risks for single earner couples with children (while rates have been falling in inner London) (DWP 2011b). It is possible that there has been a shift in labour market outcomes for couples reflecting higher housing costs, with more of an impact in outer London due to the relatively low share of families in social rented accommodation. However, any effect of housing costs is likely to be small compared to other factors, and the shortfall in employment rates for mothers in couples in London is largely explained by standard variables.

3 Author's analysis of Annual Population Survey household data, available at https://www.nomisweb.co.uk

4.3.3 The question of fairness

The new welfare arrangements are said to be based on 'fairness', making 'housing that is beyond those in work, beyond the reach of those on housing benefit' (DWP 2011a). In particular, the DWP's impact assessment states that the 'removal of the five bedroom rate will bring the housing choices of larger families more in line with those who do not claim housing benefit' (DWP 2010). The logic is that the bulk of 'working families' in London cannot afford to live in inner London, so why should the state continue to heavily subsidise those on housing benefit to do so?

4.3.4 Improving affordability

The government argues that its approach will help improve the affordability of housing by reducing 'the levels of rent met by housing benefit in expensive areas and apply downward pressure on expenditure more generally.' It concludes that 'reducing all rates to the 30th percentile rather than the median will bear down generally on the rental values being met through housing benefit' (DWP 2010).

Arguably, the overriding motivation for the government is a financial one. At a time of fiscal constraint these changes are intended to reduce expenditure in a key area of public policy. The government estimates that the reforms will 'save £1 billion by 2014–15' (DWP 2010). The central question now is: how will the reforms play out and what will the impact be for housing in London?

4.4 Measuring the impact of the changes in London

There is almost universal agreement that these welfare reforms will most heavily impact on London. Analysis of the official DWP data (table 4.1 over) underlines the scale of the differentials between London and elsewhere. This suggests that the average loss experienced by those losing out in London will be £23 per week, which is equivalent to £92 per month or £1,196 per year. No other region's 'losers' are projected to lose more than £9 per week (DWP 2010).

Alternatively, if one focuses on average rent shortfall (table 4.2), the differentials are equally stark. No more than 4 per cent of households in any other region will lose more than £15–20 per week and no more than one per cent of LHA recipients in any other region outside London will lose more than £20–30 per week. In London, 19 per cent of households will experience a shortfall of £20 or more per week. The proportion of households in London which will lose £15 or more is 21 per cent. This means that more than one-fifth of households in London will have losses which equate to at least £60 per month. At the starkest level, 5 per cent of households in London which claim LHA will incur losses of £40 or more per week. This is the equivalent of an annual shortfall of £2,080 or more (DWP 2010).

The official DWP impact assessment notes that 'in around 80 per cent of cases the shortfall will be less than £10 per week' (DWP 2010). This is, however, equivalent to up to £520 per year – a substantial sum for any low-income household. The impact assessment also notes that 'just' 4 per cent nationally will be £20 per week worse off. However, in London this figure rises to 19 per cent of all of those on housing benefit (DWP 2010). It is clear that, despite the government's overt commitment to 'fairness', these measures disproportionately hit households in London and inevitably these are among the poorest households. Official data records that average losses as a result of the LHA changes in London are almost twice those of the next worst affected region – the south east. Households in London will lose an average of £22 per week. This equates to average annual losses of £1,144 (DWP 2010).

Table 4.1
Impact of welfare reforms (excluding the removal of the £15 excess)

	LHA caseload	Average maximum HB (March 2010)	Estimated number of losers	Estimated percentage of losers	Average loss per loser
	Households	£/week	Households	%	£/week
National	939,220	121	642,160	68	-10
Breakdown by size					
0-shared room	74,690	67	58,760	79	-6
1-bedroom	387,740	101	243,090	63	-8
2-bedroom	328,250	134	248,530	76	-10
3-bedroom	112,550	158	76,580	68	-13
4-bedroom	27,900	190	10,340	37	-28
5-bedroom	8,100	248	4,870	60	-74
Breakdown by region					
East Midlands	59,100	95	42,260	71	-7
East of England	71,010	119	50,520	71	-7
London	**159,370**	**197**	**103,570**	**65**	**-23**
North East	45,160	92	32,640	72	-7
North West	131,180	97	89,620	68	-7
Scotland	51,060	101	28,620	56	-7
South East	123,000	132	81,520	66	-9
South West	83,180	112	58,910	71	-7
Wales	48,710	91	35,220	72	-7
West Midlands	80,140	102	55,370	69	-7
Yorkshire and the Humber	87,310	88	63,910	73	-6

Source: DWP 2010

Table 4.2
Average rent shortfalls, following welfare reforms

	Not losing	Losses of £0–5	Losses of £5–10	Losses of £10–15	Losses of £15–20	Losses of £20–30	Losses of £30–40	Losses of over £40
National								
LHA caseload (households)	297,050	155,960	292,710	143,590	12,890	19,440	7,800	9,760
Avg max HB, Mar 2010 (£/week)	104	102	111	144	178	243	292	422
Percentage of caseload	32	17	31	15	1	2	1	1
Average loss per loser (£/week)		-3	-7	-11	-17	-24	-36	-130
Percentage of LHA recipients by region								
East Midlands	29	26	30	11	4	0	0	0
East of England	29	19	33	17	1	1	0	0
London	**35**	**7**	**20**	**17**	**2**	**10**	**4**	**5**
North East	28	19	43	10	0	0	0	0
North West	32	23	28	16	1	0	0	0
Scotland	44	13	33	8	1	1	0	0
South East	34	10	29	22	3	1	0	0
South West	29	15	40	14	1	1	0	0
Wales	28	24	34	14	0	0	0	0
West Midlands	31	19	33	16	0	0	0	0
Yorkshire and the Humber	27	21	39	12	0	0	0	0

Source: DWP (2010)

4.4.1 How reform affects different parts of London

Having established the likely relative impact on London overall, it is important to look at how the reforms affect different parts of London. The London Poverty Profile provides a useful analysis of those households which it estimates will be affected by the reforms, providing a borough-level analysis (MacInnes 2011). Geographically, the households most heavily affected will be in inner London. As the profile records: 'Households in the Inner West of London stand to lose the most money as a result of changes to LHA. This is true for all household sizes. In fact, the average loss for a one bedroom rental in the Inner West of £35 per week (around £150 per month) is greater than the average loss for a three-bedroom rental anywhere else (up to £20 per week or £85 per month in the Inner East and South).'

The government's welfare reforms are clearly a national policy which is designed to address distortions and excesses within the current system. However, as we have seen, London is at the forefront of the government's thinking in introducing these reforms. The fact that the most expensive properties are located in inner London mean that it is not surprising that a significant proportion of these changes will be felt there most of all.

Since the announcement in the emergency budget in June 2010, there has been a steady stream of analyses which have attempted to quantify how many households and individuals will be affected. The London Poverty Profile estimates that there are 104,000 households in London 'whose local housing allowance will not fully cover their rent following the changes' (MacInnes 2011). London Councils recently suggested that 159,000 will see a reduction in the benefits they receive and that 10,000 households will have to 'relocate' (Gleeson 2011). The official estimate simply suggests that 17,400 households in London could be 'affected' (DWP 2010).

Perhaps the most headline-grabbing estimates are those relating to the individuals and households who will have to move home as a result of the changes. Shelter estimates that 68,000 to 134,000 households will have to move nationally; the GLA puts the London figure at 9,000, of which it estimates that 6,800 are families (DWP 2010).

Estimates regarding the likely responses of individual households should be treated with caution. The reality is that no one, whether the government, GLA or other key stakeholders can predict what will happen once the reforms come into full effect. This is arguably one of the most disturbing aspects of the current situation. As the DWP's own impact assessment for the policy makes clear, the full likely impact of the changes are unknown (ibid).

4.4.2 Welfare reforms and affordability

This chapter does not seek to provide a detailed analysis of the broader impacts of the housing benefit changes for London. This has been provided by authors elsewhere. Rather, this section specifically focuses on the impact of reforms on the affordability of renting homes in London.

The reforms are predicated on the assumption that, when faced with shortfalls in their rent, individuals and households will be able to renegotiate their rents with their landlords or move home, to keep their rents in line with the new maximum levels permitted under the changes.

In the case of London, both of these assumptions may be flawed. As we saw in chapter 3, existing demand within the PRS outstrips supply considerably. Even prior to these changes, a landlord in London with a vacant property is likely to be able to let that property immediately and have a choice of potential tenants. Such disparities do not naturally lend themselves to equitable adjustments in the market. The buoyant market means it is likely that a landlord will be able to let a vacant property at the same rent or higher.

Competition for vacant properties explains why London's rents remain on an upward trajectory. This makes the notion that tenants will be able to negotiate lower rents with their landlords unlikely. This logic might work in other parts of the country where there is a pool of vacant properties available. This is clearly not the situation in London. Indeed, if the reforms lead to a significant number of households moving, whether 'voluntarily' or as a result of evictions, we could perversely see further increases in rent levels across different parts of London, as landlords drive up prices amid increased competition for properties. If this were to happen, it would be the opposite of what the government intended.

Emerging evidence suggests that only a small proportion of landlords with LHA tenants would consider reducing existing rents. In 2010, a London Councils survey found that 60 per cent of landlords in London would not consider cutting rents in response to the changes (London Councils 2010). One survey suggested that 88 per cent of landlords in London say they cannot afford to reduce rents (Hill 2011). Perhaps most disturbingly, a recent National Landlords Association (NLA) survey found that 77 per cent of landlords with LHA tenants were 'either considering or have already begun reducing their involvement with the LHA market' (Wellman 2011). Unfortunately, if such sentiments become a reality, there is a chance that we could see a contraction of the LHA PRS sub-market in London. Recent reports suggest that 59 per cent of landlords already refuse to take on benefit claimants, thus further restricting the options for those affected by the changes (ibid). Surprisingly, DWP's impact assessment finds that there will be 'no direct burdens on landlords'. This would appear to run counter to the observation that the government is expecting landlords to accept lower rents as a result of the introduction of these measures. However, the impact assessment goes on to suggest that landlords 'could experience' the following:

- greater number of tenants in arrears
- some landlords may choose not to take on housing benefit tenants
- landlords may accept less in rents (but then do less to maintain the property)
- risk that landlords might flee the market.

As a precaution, the DWP has set aside a contingency budget to deal with any fall-out. This discretionary housing budget was set at £10 million for the first year and £40 million in successive years (ibid).

4.5 Housing supply in London

Now we turn to the second potential response to the changes – that households will be able to find new homes. The overriding issue here is supply and demand. This will be crucial in determining whether the reforms will result in significant movement, whether within boroughs or, more likely, an outward movement of households from inner to outer London.

It seems clear that those households affected by the reforms in inner London boroughs are unlikely to be able to afford new homes within the PRS in their borough. The situation for those living in boroughs such as Kensington and Chelsea and Westminster is particularly acute. However, this is a problem which affects all London boroughs, both inner and outer.

So, if individuals cannot afford to find new homes in their existing neighbourhoods and boroughs, will they move to outer boroughs which are traditionally thought more affordable? Again, there may be significant barriers. Even if households wish to move from inner to outer London, it is unlikely that the conditions in the wider housing market in London would facilitate it. There are simply not the properties available in what are frequently referred to as London's more affordable boroughs. This is largely because demand in these boroughs already outstrips the supply of properties within the PRS.

A significant contributory factor is the balance between the different housing sectors across different parts of London. There is a greater proportion of PRS properties in the more expensive inner London boroughs, such as Kensington and Chelsea, Camden and Hammersmith and Fulham. As figure 2.9 showed, outer London boroughs have among the highest levels of home ownership. This imbalance, coupled with existing demand, means there will simply not be the spare capacity within outer London boroughs' PRS to absorb any outflow from inner London boroughs.

Looking slightly ahead, the London Poverty Profile suggests that 'by 2015 … two-thirds of London's neighbourhoods will be hard to afford for LHA claimants' (MacInnes 2011). In exploring the likely impact of the changes it is important to differentiate between those who are forced to move, either by eviction or because of the large scale of their rent shortfall, and the greater number of households who are likely to experience smaller shortfalls in the region of up to £10 per week. These households will be faced with a dilemma – to move and uproot their families or try to stay in their current homes and absorb the shortfall by reducing other outgoings. For many of these individuals, their choice will be determined by a combination of economics and the social impacts of the decisions that they make.

While there have been a number of rather alarmist figures regarding likely mass evictions and an unprecedented migration of inner London households to outer London, it is more likely that a significant proportion of those households affected will have no choice but to stay in their current homes and reduce other outgoings in order to meet the shortfall in their rents.

A substantial proportion of those who claim LHA are in low-paid work. Crisis estimates that 26 per cent of housing benefit claimants (279,000 people) are in employment. If a significant proportion of these people moved home, there could be quite serious consequences for unemployment figures in London and the burden on the wider benefits system. It would be a further perverse unintended consequence of the reforms if they were to lead to an increase in 'worklessness' and an 'uprating' of the benefits bill. As a further cautionary note, Walker and Niner highlight that there is considerable fluidity between different groups of housing benefit/local housing allowance claims: 'A clear message from the in-depth interviews is that it would be a mistake to see "HB claimants" and "low income working families" [LIWH] as totally distinct categories. Many interviewees had moved between these categories, sometimes several times, so the same household could one day be a LIWH and the next a claimant. Further, where HB is claimed as an in-work benefit, households are essentially both low income working households and claimants at the same time' (Walker and Niner 2010).

Housing benefit represents a vital mechanism for ensuring that thousands of people can play an active part in the work force. Given wider economic conditions and rising unemployment, there is a significant risk that the proportion of households in London claiming housing benefit could increase over the coming months and years.

4.6 The potential social impact if people move

While partially heeding the DWP's warning that it is not possible to predict people's behaviour, it is important to consider the consequences of welfare reform. The DWP has set out a number of potential results. These specifically focus on the impact of any 'resulting population movement' for schools, health services and homeless services in those areas of outer London which it is presumed will be the destination for those who move (DWP 2010). It includes apparently extreme remedial measures such as the need to 'build temporary classrooms' and providing transport for pupils who are about to sit examinations (DWP 2010).

Focusing specifically on the potential for increased numbers of homeless households, the impact assessment proposes two mitigations. The first suggests that the transitional period 'gives people time to plan' (DWP 2010). And London boroughs have recently put contingency plans in place. Second, CLG has switched £10 million of its existing homelessness budget to help with the transition period (DWP 2010). It is not clear what impact this will have but it would appear to acknowledge the possibility of wider homelessness. The DWP also suggests that 48 per cent of affected households (450,000 households) are families with dependent children (DWP 2010). The impact assessment lists a series of potentially negative impacts for children, including those relating to housing, health, education and anti-social behaviour. The assessment warns, for instance, that the Welsh assembly government's ability to deliver the '13 broad aims for its children poverty strategy' will be significantly impact by these welfare reforms (DWP 2010).

Similarly, the impact assessment notes the potential impact for teenage mothers. This includes 'losing contact with Connexions and teenage pregnancy support'. It notes: 'This type of support tends to be less well resourced in outer London boroughs and adjoining counties'. It cautions: 'Even if their re-housing is managed so they do not become homeless, teenage mothers affected are at risk of mental problems as a result of their isolation in their new location and poorer outcomes for their children' (all ibid). It is perhaps most concerning that none of the key stakeholders have been able to model more definitively the impact of these changes which witness a faltering step into the unknown for DWP, local authorities and the households affected.

4.7 A clash with the Affordable Rent policy?

A further problem is posed, particularly in London, by the new Affordable Rent policy and its interaction with the new universal benefits cap on out-of-work (but not working poor) families. Under this policy, RSLs can charge up to 80 per cent of market rents in new properties and re-lets, which will not be affordable to families requiring three-bedroom or larger properties if they are out of work – which means they will not be affordable if there is a risk of being out of work. RSLs in London are clear that this is the major problem with Affordable Rents (London Assembly 2011a).

This brings out an issue which is easily overlooked when we consider aggregate housing supply and average prices: is London building the right kind of accommodation? Much new housing development in London consists of one- or two-bedroom flats suitable for young, childless and mobile households: these properties offer advantages to developers and to public servants with targets to deliver specified numbers of units, but they do little to address the problems of overcrowding and council waiting lists associated with unmet demand from families. In recognition of this fact, both of London's mayors to date have sought to increase the priority placed on larger properties in development, with some limited success (GLA 2011b). Boris Johnson wanted the proportion of family-sized homes in new social supply to rise to 42 per cent in the next round of investment: the message from RSLs is that they will 'be lucky to hit 20 per cent' (London Assembly 2011a). The risk is that one effect of the combination of Affordable Rent and new overall benefit caps is that new supply will not only be inadequate in volume terms but will revert to a bias in favour of smaller units which the regional tier has sought to reverse over the last 10 years.

This presents London's newly re-elected mayor with a dilemma to add to the conundrum of maintaining new supply under straitened fiscal circumstances: there is a trade-off between the volume of new units (which recent experience suggests has an impact on average housing cost growth) and meeting the most pressing housing need.

Moreover, unless we see major change in allocations policy to accompany the introduction of Affordable Rent, its effect will be to increase overall housing benefit expenditure. As things stand, as properties at new Affordable Rents go to those in greatest need, that is, those who are most likely to be on housing benefit, their benefits will have to increase to pay those higher rents.

The current welfare reforms underline the importance of affordable supply of property in London. The reforms may be undermined by the lack of alternative accommodation for affected families within the London housing market. Families who find themselves living with a shortfall in their rent as a result of these changes are likely to struggle to find affordable alternatives because of the high cost of renting in London, the buoyancy of the PRS, and the failure to ensure that housing supply, across all tenures, has kept up with increasing demands from London's growing population.

5. DEVELOPING SOLUTIONS FOR LONDON

Having identified what makes housing in London unique (chapter 1) and established the centrality of the affordability question for home ownership (chapter 2), rented markets (chapter 3) and the Coalition government's welfare reforms (chapter 4), we now explore potential solutions to London's housing challenges.

London's housing problems were not created yesterday and will not be solved tomorrow. It will take many years to address the imbalances and inequalities which have built up over recent decades. It is important to consider short-term and longer-term solutions.

This chapter suggests solutions to help address the fundamental problems which currently beset London's housing. We signpost a series of complementary and interconnected directions which could serve as a road map for the mayor of London. Together they could provide the basis for a holistic solution to London's housing problems. A number of the proposed actions need further work to determine the detail and maximise their impact. And it is essential that any potential solutions are rooted in the specifics of London's housing markets.

In developing bespoke housing solutions, we must ensure that London takes full advantage of its unique governance arrangements. The role of the mayor of London is fundamental to tackling London's current housing problems and specifically addressing London's affordability challenge. In some instances, the recommendations mean an increase in the mayor's powers; in others, they place new responsibilities on the officeholder.

5.1 Increase housing supply

Affordability – or rather unaffordability – is the key issue cutting across all aspects of London housing, from the cost of buying and renting a home, through to the potential consequences of the government's welfare reforms. So, what can London do to address its growing affordability challenge?

The overarching solution to this problem is to increase the number of affordable homes available to buy and rent across different parts of London. Dealing with supply will also help deal with the housing benefits conundrum, and address issues such as overcrowding within London's existing housing stock. Ultimately, it would create a downward pressure on both purchase prices and rents.

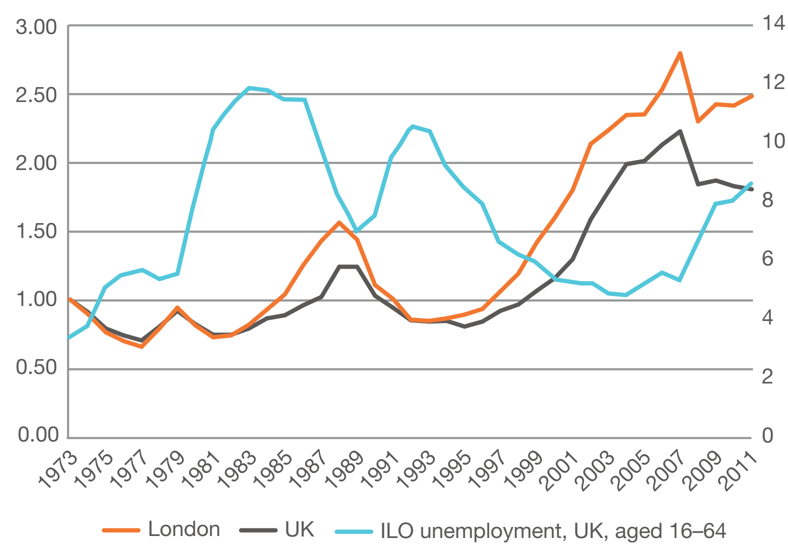
While it is important to acknowledge that insufficient supply is not simply an issue for London – annual increases in housing supply across England have dropped significantly since the economic crisis began in 2008 – it is clear that this problem is magnified in London. London has seen the largest reduction in the number of new homes in England, decreasing from 24,340 in 2009–10 to 17,830 in 2010–11 (CLG 2011b).

There is no single policy solution for London's housing problems. However, addressing and remedying the current chronic under-supply will go a long way towards rebalancing London housing markets. But it will not be easy.

House prices in the UK have risen more than incomes over the post-war period, indicating that supply is outstripped by demand at national level. As we have seen, London seems to have shown a similar trajectory to the UK as a whole over recent years, once wage differentials are taken into account. In fact the long-term picture shows house price growth in real terms following very similar trajectories in London and the UK but with a growing gap in the late 1990s and first years of this century (see figure 5.1). We have also seen that the price-to-earnings ratio in London rose more rapidly during this period, so this is not simply a reflection of faster earnings growth in London. There are many possible explanations for this, the most obvious being that this was a period when population growth was more rapid in London than nationally, while housing supply was growing very little.

The lesson is that even temporary shortfalls in new supply relative to demand can have long-term impact on housing costs in London relative to the rest of the UK. While the rate of house price growth in the UK caught up with London by about 2002, the gap which emerged in earlier years has shown no signs of narrowing.

Figure 5.1
Index of house prices in real terms and unemployment*, 1973–2011



Sources: Nationwide 2011, Treasury (gross domestic product deflator), ONS 2011
* International Labour Organization standard definition of unemployment

Reductions in housing grant mean that RSLs envisage new supply being at about half previously planned levels. There is little hope of the private sector expanding to the scale required to meet the GLA's target of 32,600 units a year. The historical record shows private housing development averaging around 12,000 units a year in London since the mid-1980s, with big cyclical peaks and troughs (GLA 2011b). The current trough is somewhat shallower than in previous cycles (falling from about 18,000 units to about 12,000). Nevertheless, it would be rash to assume that the overall scale of new private sector delivery will be dramatically different to previous decades. The peaks of private supply have only exceeded 15,000 units a year on one occasion since 1961 (in 2005–06). It may even be the case that the reduction in social sector development will have a negative impact on the private sector: CLG notes in its impact assessment for the Affordable Rent policy that: 'statistical evidence suggests a positive relationship between social housing supply and private completions in recent years' (CLG 2011c).

We suggest ways to turn this situation around and get more homes built in London.

5.1.1 New roles for RSLs

For credit constrained families seeking secure accommodation and predictable rents, a better range of options in the PRS is desirable. One option for London's regional and local tiers of government is to explore partnerships with RSLs (operating outside their charitable function) or developers for new private tenure options which would offer security (contracts for three years plus) and stabilised market rents (rising only by consumer price index inflation for duration of the tenure). Local authorities could take equity stakes in the properties, which would need to be restricted to rental use for some multiple of the minimum contract period offered (15 years, for example). Subsidy should not be necessary as returns to investors can be factored into the initial rent as typically happens in regulated private tenancies: if authorities want to keep rents below this level, they have the option of offering subsidy through discounted land or rent guarantees. This option would seem particularly suited to some of the new sources of finance (pension and insurance funds) currently being explored by RSLs (Hilditch 2011). So there is a potential role for institutional investors in the PRS. There is no reason why investment in this sort of property should not be open to small landlords (buying off-plan) as well. This may be desirable, as competition from small landlords will tend to drive down yields and therefore rents (as they tend to be more focused on the value of the property on disposal than on yields).

The government's decision to introduce a nine-month 'grace period' before workless households are affected by the benefit cap provides significant protection for working families with high housing costs. In general, the majority of people who make a claim for out-of-work benefits do not go on to become long-term claimants, even at times of weak labour demand (as at present). This is evidenced by the scale of flows on to and off housing benefit in London: about 200,000 claims begin and end in most years. It would be perverse to force households facing temporary unemployment into unnecessary moves, and this is presumably what the grace period is intended to prevent.

Households where someone is usually in work should not be affected by the cap. However, landlords, including RSLs, do not have information on the work situation or future prospects for individual tenants, and tenants can not be sure how quickly they will be able to get back to work. There is an obvious role for insurance here: if the risk of an employed tenant falling foul of the cap (that is, being out of work for more than nine months) is low, as we believe it is, it would make sense to spread it over all RSLs who are offering new family-size, affordable accommodation. RSLs could be covered for the costs of arrears or eviction, or for the cost of reducing rents temporarily for tenants who have been out of work for more than nine months until alternative accommodation can be found.

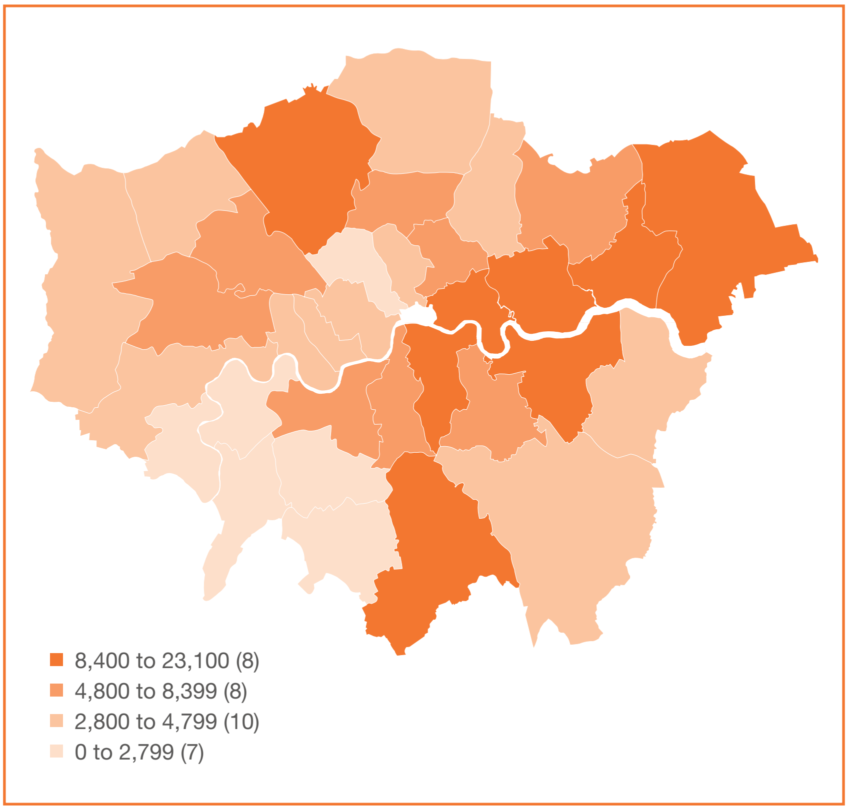
This opens up the possibility of increasing the new supply of affordable units of this size, above what is currently achievable, as RSLs, the mayor and the London Assembly wish to do. Some larger RSLs might be able to insure themselves against these risks using their existing assets, but the wider the risks are spread the lower the overall social cost will be. So, there is a clear role for the regional tier in promoting and perhaps administering such a scheme.

5.1.2 Make more public land available for residential development

Nationally, local authorities own land equivalent to the size of Leicestershire (CLG 2011d). A CLG report in 2011 noted that much of this land is able to be developed and could make a substantial contribution to meeting housing need: 'A significant proportion of existing sites that are suitable for development are sitting in public land banks – there are over 16,000 hectares of previously developed land owned by councils and public bodies, and on central government land alone there is enough capacity to build 60,000 new homes over the next 10 years' (CLG 2011e).

So how much 'available' land is held by public authorities in London? A strategic housing land study commissioned by the GLA in 2009 noted that public authorities in London hold a significant amount of land which is available and suitable for house-building. As figure 5.2 shows, there are a substantial number of 'large sites' available across London boroughs, with 'a clear concentration in eastern boroughs, particularly Tower Hamlets, Greenwich, Newham and Redbridge'. Eight boroughs have between 8,400 and 23,100 large sites which are appropriate for development. The total capacity of London's large sites is estimated at 234,266 dwellings (all GLA 2009b).

Figure 5.2
Large site capacity by London borough

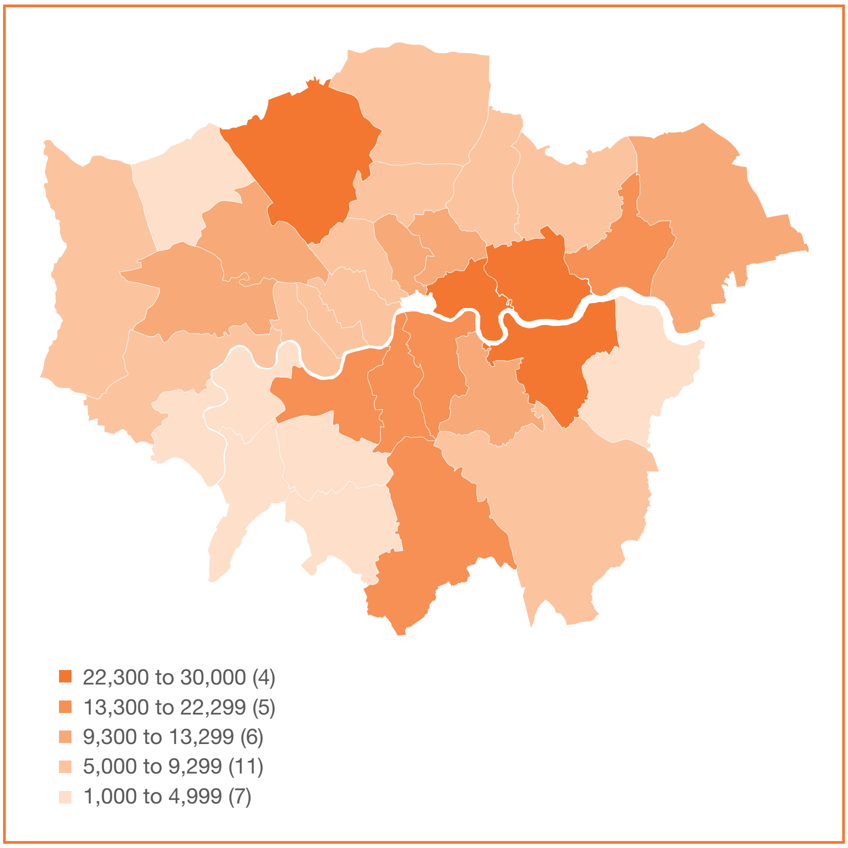


Source: GLA 2009b

The same GLA housing land review estimated that London had capacity for 360,062 new homes between 2011 and 2021. So, where is all this land? Figure 5.3 (over) indicates the available capacity in each of London's boroughs. It shows that four boroughs (Barnet, Newham, Tower Hamlets and Greenwich) have capacity for 22,300–30,000 new homes, while Croydon, Lambeth, Southwark, Wandsworth and Barking and Dagenham have capacity for between 13,300 and 22,299 homes each (all ibid).

The same GLA 2009 study also stresses the potential of London's 99,918 small sites (less than 0.25 hectares) which are sufficient to provide for 33,000 new homes over the coming decade. London's potential capacity appears to be more than sufficient to address the city's future housing needs – just three boroughs could provide more than 20 per cent of London's future housing capacity: 'The borough that makes the greatest contribution to overall capacity is Tower Hamlets at 29,973. This is followed by Greenwich with a capacity of 26,221 and Newham with a capacity of 25,748. Together, these three boroughs alone make up 23 per cent of the future housing capacity in London. This is a significant contribution to the growth of London and underscores the importance of East London as an area of future growth' (all ibid).

Figure 5.3
Total capacity by London borough



Source: GLA 2009b

Thirty of London's boroughs reported having sufficient 'five-year land supply' in 2009 (CLG 2009). The review concludes that spare land capacity has been increasing since 1999 and that this is sufficient to achieve an annual target of 33,000 new homes per year (GLA 2009b). While the above data is from 2009, given that fewer homes have been built in recent years, it appears safe to assume that much of this capacity remains untapped.

Moreover, on 1 April 2012, the mayor and the GLA enjoyed a substantial transfer of land from the London Development Agency and the Homes and Communities Agency (HCA). The scale of these additional assets is indicated by a recent GLA report: 'From 1 April 2012, the GLA will have responsibility and budgets for activities previously carried out by HCA London. Negotiations are ongoing with government over London's budget allocation and the arrangements for the transfer of HCA London assets to the GLA, but with the government already having allocated £1.7 billion of funding for housing in London for the 2011–15 four-year spending period, the GLA's budget for HCA activities will dwarf that of its other functions.' (GLA 2011d) This additional batch of land means that the mayor now has far greater flexibility and potentially a unique opportunity to achieve a major step-change in housing development in London.

As a first step, the mayor could use previous land reviews to update the picture of how much land is still held by public authorities in London (including boroughs and the GLA) to ascertain quantity, quality, location and suitability. The mayor should then work with Whitehall departments, NHS Trusts, the Metropolitan Police and other public authorities in London to identify available and suitable land and help broker deals with housing associations and developers to see it developed.

It is crucial that London's public land is used to deliver affordable housing. A GLA committee has recently proposed that the mayor should look at offering land assets he has control over – including the Greater London Authority's landholdings – at a discount, or using incentives to make building larger homes more financially viable for developers (London Assembly 2011b).

The mayor could release a substantial proportion of this land, in stages over the next decade, encouraging London boroughs to do the same. This land release must be managed in a controlled manner, so as not to flood the market, and in order to maximise the best deal for the citizens of London. The mayor should clearly set out the priorities for the type of housing London needs.

As previously noted, London benefits from the fact that the mayor retains responsibility for development and delivery of the London Plan – the overarching plan which sets out how land will be used in London over the coming decade. London is the last remaining 'region' in England to retain its own 'regional spatial strategy'. In developing the London Plan, the mayor should seize the opportunity to ensure greater supply across all tenures – socially rented, PRS, affordable and other for-sale properties. It is clear that the first priority should be the provision of social housing and genuinely affordable properties for sale and rent. However, in order to ensure mixed communities and provide wider benefits for local communities, housing associations (and developers) need to be free to include a proportion of market properties in order to ensure the economic viability of the schemes and guarantee that further resources are generated which can be invested back into future housing provision.

It is important to underline that we are not suggesting that the mayor simply give away such land, but rather strive to secure the best possible deal for London. The mayor should explore the viability of a range of approaches, including the potential for taking out equity stakes in new development. This will undoubtedly raise concerns from some housing associations and developers that such a solution may prove problematic for their longer-term financial liabilities. There are a number of options open to the mayor and it will be important that they consider the merits and detriments of all schemes and balance the viability of approaches with the need to secure the best deal for London. It should, however, be appreciated that the terms which will be available to developers via any such initiative are likely to be far more advantageous than those available on the open market. It may also be possible to build in contractual conditions regarding land use and resulting tenure type.

While it is clear that we must increase the supply of housing in London, we must also deal with the immediate problems of extremely high rents within the PRS and the burgeoning housing benefit bill.

5.2 Housing welfare reform

Given the immediacy of their impact, our starting point must be the welfare reforms already underway. We begin by examining potential short-term measures to minimise the social impact of these reforms, before suggesting an alternative, longer-term solution.

5.2.1 Short-term: Raise the LHA cap in London by £10 per week

The government's reforms to housing benefit are clearly based on the assumption that lowering the LHA cap will apply downward pressure on PRS rents (DWP 2010). It is assumed that when faced with a limit on their claims, tens of thousands of tenants will renegotiate their rents with their landlords or move. As chapter 4 suggests, this may work in other parts of the UK where supply is closer to demand and those tenants who face a shortfall in their rents can look elsewhere. This is not the case in London.

If the government's intention was to address political and public concerns regarding housing benefit funding larger properties with rents in excess of £250 per week (but rising to £500 plus), then they have arguably used a sledgehammer to crack a nut. The abolition of the five-bedroom rate will affect just 7,338 households.

In spite of the fact that these reforms are essentially designed to address profound distortions within the housing market in London, in a number of ways it would appear clear that the reforms do not work for the capital. As chapter 4 showed, the cumulative impact of the caps, benefit rate ceilings and other measures such as the removal of the single-room rate for under-35s means that there will be a significant number of losers in London as a result of the reforms. Any reform to housing benefit will inevitably result in some people being worse off. The DWP's own impact assessment identifies four main options for those households affected if they do not want to move home: work more; renegotiate rents; draw on savings (if available); or resort to discretionary housing payments (DWP 2010).

There is of course a further option: individuals could simply attempt to absorb their losses by reducing their wider outgoings – for example, by eating less, going without 'luxuries' and spending less on their children. However, such an option seems realistically open only to those whose rent shortfall is less than £10 per week.

As we saw in chapter 4, the reforms will have a disproportionate impact on London and appear unlikely to deliver the proposed results. So what can be done to ensure that a genuinely reformed housing benefit system delivers savings and policies that work for London? The central problem is the lack of alternative properties in London: those households who need to move will have nowhere to go. This ultimately means that the projected savings will not materialise. The prime minister's recent assertion that the reforms were delivering the desired downward pressure on rents was quickly rebutted (Brown 2012b).

One potential, temporary solution would be to engineer an uplift in the housing benefit cap in London. This would effectively create a London cap, which more closely reflects the very real differences which exist between London and the rest of the country. This would merely replicate enhanced rates and ceilings which exist in other areas, such as student loans and the practice of employers adding 'London weighting' for salaries in the capital. Table 5.1 (over) sets out the projected impact of the government's proposals, as articulated in the DWP's own impact assessment.

Table 5.1
Combined impact (losses per week) of welfare reforms in London (% of claimants)

Not losing	Losses of £0–5	Losses of £5–10	Losses of £10–15	Losses of £15–20	Losses of £20–30	Losses of £30–40	Losses of £40+
35	7	20	17	2	10	4	5

Source: DWP 2010

As Table 5.1 shows, 65 per cent of claimants in London will be affected, with 21 per cent being £15 or more per week worse off. It is important to record that the scale of losses involved for those in the final category (those with the highest shortfalls) means that, no matter what we do with the cap, the mitigating effect for this group will be marginal. There is little that can be done to address shortfalls in excess of £400 or more a month. But an adjustment equivalent to £10 per week would mean that the majority of claimants (62 per cent) do not lose out as a result of the reforms, with all others seeing their losses reduced accordingly. This could potentially help minimise the social impacts of the changes, while still allowing us to deal with any excesses at the upper end of the scale (see table 5.2).

Table 5.2
Impact (losses per week) of welfare reforms, after suggested uplift of housing benefit cap in London by £10 per week (% of claimants)

Not losing	Losses of £0–5	Losses of £5–10	Losses of £10–20	Losses of £20–30	Losses of £30+
62	17	2	10	4	5

Source: IPPR

By creating a London cap, £10 higher per week than elsewhere, we would be acknowledging the very different housing landscape in London. This would retain a focus on removing the most extreme cases and reduce the overall housing benefit bill. It is important to acknowledge that such an approach will deliver less savings than those projected by the DWP's analysis of the current proposals. However, there is no guarantee that the current proposal will deliver all of the projected savings in London – this is because the absence of alternative properties may prevent those experiencing a rent shortfall from moving. The bottom line is that a saving is not a saving if it cannot be delivered.

Raising the housing benefit cap in London by £10 per week would provide a temporary fix, but we must also look for a longer-term solution.

5.2.2 Long-term: devolve housing benefit to the mayor

While it is important to make adjustments to the current welfare reforms, there is a strong case for effecting a more fundamental change. A longer-term solution would be to transfer responsibility for housing benefit in London to the mayor. Under such a system, the mayor would be able to: determine how housing benefit is allocated across London; set the relevant caps in line with prevailing market and economic conditions; weigh up these decisions better with existing responsibilities in terms of homelessness; and more effectively consider the wider social impacts of any proposed changes. This would enable the mayor to adjust the current caps and remove the worst resultant iniquities – which all the major candidates in the recent mayoral election spoke out against – by better matching rates, thresholds and caps to London's circumstances.

Giving the mayor responsibility for housing benefit would effectively mean that the mayor would have responsibility for all major facets of housing in London – policy (the London Plan), land (as a result of existing and London Development Agency and HCA legacy land banks) and capital (from land sales and the greater ability to leverage funding from housing benefit).

Control over LHA rates and thresholds would give the mayor a 'bargaining chip' with the PRS. Demand subsidy policy would have democratic legitimacy with the mayor acting as a regional voice. Over the medium term, there might be savings to the exchequer if funding was used more efficiently in response to regional priorities. And such a move would allow the mayor to borrow against London's huge housing benefit allocation to raise funds to pay for new homes, the revenue stream being used to underpin borrowing for investment.

Counter-arguments certainly exist. For example, that housing benefit already supports investment through the housing revenue accounts of local authorities and the investment planning of RSLs. The issue with local authority housing investment is not housing benefit but government controls on borrowing and the accounting treatment of borrowing by public bodies, which would not be resolved by devolution of housing benefit or LHA.

Moreover, the PRS is not a single entity with which a mayor can conduct negotiations. It is dominated by small landlords serving a range of sub-markets who have little need for collective organisation and, therefore, lack comprehensive representation. Even if collective action by landlords was more prominent, as the London PRS serves a clientele evenly spread across the income distribution, LHA would be a bargaining chip with only a sub-sector. And, as there are continuous large-scale flows on and off LHA, the sub-sector specialising in LHA renting will account for only a minority of LHA tenants.

If these counter-arguments are persuasive, then the advantages of devolution primarily boil down to better matching of entitlements to London circumstances and greater legitimacy.

Taking these in turn, there can be little question that an LHA system designed by London's regional tier would be very different, both from the one introduced in 2008 and the one we have now. It is hard to believe that London would have adopted a mechanical approach to setting rates at 50 per cent of median rents in all rental market areas, which makes little sense in a London context. By failing to recognise the varying distributions of rents in different parts of London, particularly the high median rents in central London, the last government contributed to the delegitimisation of LHA as a whole. High-profile (though statistically rare and highly exaggerated) cases of excessive payments became the most visible aspect of the system for the public at large. LHA tenants themselves seem on the whole to have chosen lower rents within the constraints set by the supply of rented accommodation in London (Gaffney 2012).

In other parts of the country, a mechanical approach was far less likely to lead to the problems experienced in London. A system better suited to London would not have required the crude response to these perceived problems on the part of the government, involving arbitrary caps on payments which now threaten access to family-sized accommodation.

From a London perspective, it would have made sense to set entitlements, taking into consideration: the very uneven distribution of the private rented stock across the capital (where central boroughs account for 25 per cent of the entire PRS); the levels of rent typically paid by lower-income Londoners; and with a simpler set of rental market areas (perhaps with only three zones).

The case for devolution in the design of the LHA system for London makes sense. The mayor would have a more legitimate, stronger voice in a national debate which often fails to take London's perspective into account. It would also make the mayor responsible for the outcomes of the system in London, a responsibility which central government has all too often ducked. The design of a demand-side housing subsidy is one area where London's distinctive features require a departure from national approaches. However, the potential to adjust the balance between investment and demand-side subsidy, even with devolution to regional level, may be limited.

The design of the LHA has never been fit for purpose in London: the introduction of universal credit gives the opportunity for a new approach. Central government should take this opportunity to stop trying to fit London into a national straitjacket and give London's regional authority a decisive long-term role in setting the key parameters of the benefit. This should be subject to negotiation with the DWP and the Treasury within the best estimate of projected spend, in consultation with London's private and social landlords and tenants.

IPPR will return to the subject of the localisation of housing benefit in more detail in a forthcoming report.

5.3 Reasonable regulation of the private rented sector

In general, rents track house prices over the longer term but do not show the same level of volatility as owner occupation. Rents have been rising in recent years in London, after a period of stability. The upward trend pre-dates the recession, so this is not simply the effect of post-recession credit constraints (GLA 2011b). There is no indication that rents were generally rising faster in London than at national level pre-2008. However, affordability is a function of both incomes and rents, and in London affordability problems tend to play out in terms of overcrowding. There has been a major increase in overcrowding in the London PRS, detectable in the late 1990s but accelerating rapidly around the turn of the century, with 11 per cent of PRS households now overcrowded, very close to levels in London's notoriously hard-pressed social sector (ibid).

We tend to associate London's PRS with high-mobility, younger households, but households with dependent children accounted for some 25 per cent of PRS tenancies in 2006. They may well have increased their share since then: rents for larger properties have risen more than other types of dwelling, indicating increased demand (ibid). The economic profile of private renters points to affordability problems for families with children: nearly one-third of children in the PRS were in workless households in 2006. Some 45 per cent were in 'mixed' households, the category which includes single-earner couples. The indications are that dual-earner couple families with children – who face very low poverty risks in London and nationally – account for a very small share of children in the PRS, not much more than in the social sector. So there is reason to believe that families are contributing to the growth in overcrowding in the PRS.

The explosion of housing benefit expenditure since 2008, largely driven by spending in the PRS, has led to an interest in how rent inflation might be constrained. It is important to note that rent increases in the PRS played a minor role in the expenditure increase, accounting for about 10 per cent of growth in total housing benefit spending between 2008 and 2010 and 14 per cent of the increase in LHA spend (Vine 2010, Gaffney 2012). But even this would be to overstate the effect of rent inflation on spending, as increases in average LHA payments also reflected shifts in the composition of the caseload between areas: with the exception of the south east, higher rent areas increased their share of the national LHA caseload, and this shift was sufficient to raise the national average maximum LHA award by some 2.2 per cent between 2008 and 2010 (Gaffney 2010). London was by far the most important region in driving the shift, rising from 15 per cent to 18 per cent of the national LHA caseload. Spending would have been lower had rents not risen, but would not have been much lower because the main driver of the increase was the size of the caseload and its location.

The long-term problem is that growing reliance on the PRS has increased the volatility of public expenditure in response to economic downturns. London contributes disproportionately to this volatility because of its relatively high reliance on the PRS to accommodate low-income households and because rents are so high compared to other areas – not because rent inflation is higher in London. As rents will be considerably higher in London in just about any future we can imagine, ultimately driven by higher wages, this problem is not going to go away unless reliance on the PRS for lower-income households is reduced in London.

Rent constraint may therefore offer little in terms of reducing LHA expenditure in London, as rent inflation has had little effect on spending. If, as some models predict, rent regulation reduces the supply of rented accommodation, there might be changes in the stock which would exert downward pressure on *average* rents across dwelling size, if larger properties are withdrawn from the market more than other types of property. Another prediction is that landlords will tend to discriminate against tenants who are likely to stay longer (as they can increase rents more easily between tenancies). In both these ways, rent regulation could reduce average rents by shifting the composition of the renting population away from the families that account for about a quarter of tenures. In this way, rent regulation could lead to similar results to benefit caps, squeezing lower-income families out of London.

Any attempt at constraining rents in London needs to recognise these limitations.

5.3.1 Maximum base rents in the LHA sub-market

Rent control has historically been hugely controversial, particularly in the UK. The last UK incarnation of rent controls was abolished by the Housing Act 1988, in a step which was heralded as the liberation of the housing market. As Ken Livingstone recently discovered, any suggestion that they might be reintroduced is greeted by fierce criticism (Masters 2012, Bowman 2012). Critics argue that rent controls will inevitably lead to an 'exodus' of PRS landlords and contraction of the sector.

It is important to note that rent controls are widely used across Europe and elsewhere, including in Germany, the Netherlands, France, Spain, and in a number of US cities, including New York. In each of these cases, 'second generation' rent controls are used: these include a built-in mechanism which accommodates rising rents in line with external pressures such as inflation. In New York, the system is built around an inclusive 'maximum base rent', which can be raised biannually in line with agreed limits.

Many states and cities adopt a split system approach to rent control – this allows them to segment the local housing market in order to limit rent controls to those parts which need attention – invariably those are at the lower end. This also means that properties in other parts of the market are unaffected. Importantly, New York has added new caveats to its rent control system by limiting access to those whose income is below $175,000 a year. This ensures that the system is not subsidising those who can already afford to live in the city. The reality is that the world has largely moved beyond wholly unsophisticated ‘first generation’ rent controls which are so often criticised. Modern rent controls, where used, are invariably targeted and responsive to changing conditions.

One option would be for the mayor to introduce a specially tailored London ‘cap’ by adopting a series of maximum base rents for different sizes of household or property, which would limit the upper levels of rents for all those claiming LHA. This would effectively create de facto rent controls in the LHA sub-market of the PRS. The maximum base rent could include the basic rent, plus maintenance costs, relevant taxes and water charges. This integrated figure would help ensure that landlords would not be able to add service charges and the like in order to bolster incomes.

Unlike the government’s LHA reforms, a system controlled by the mayor could annually adjust the levels in order to reflect the wider market conditions and, most importantly, the relative availability of alternative properties. Such an approach may prove more successful than the current welfare reforms in applying a downward pressure on PRS rents in London.

For opponents of rent control, it might be difficult to determine how what we propose is substantively different to the government’s current LHA reforms. Both seek to place a ceiling on the amount which can be claimed under LHA. However, what we propose is a more realistic and effective regionalised variation on the principles which underpin the government’s current reforms. The real difference lies in the fact that the mayor has control of most aspects of housing in London and has the flexibility to consider wider housing conditions, including the availability of supply, when setting a London cap. The mayor can raise or reduce the cap in line with the availability of alternative properties. This would lead to a more targeted and proportionate system in which results are more likely to meet stated aims than the current reforms.

Such an approach would deal with those households who receive LHA to support them to live in London, but what about the others whose incomes are struggling to keep pace with London’s escalating private rents?

5.3.2 Rent stabilisation

In addition to the use of ‘second generation’ rent controls at the bottom end of the market, a number of cities also use rent stabilisation to constrain rent rises in situations where poor supply, high market values and inflationary pressures would otherwise leave tenants open to disproportionate rent inflation. New York has used a rent stabilisation mechanism which allows it to constrain rent rises once the overall vacancy rate (or that within particular parts of the local housing market) falls below 5 per cent. To manage its approach to rent stabilisation, New York established a rent guidelines board which brings together interested stakeholders, including local officials and representatives of both tenants and landlords on an annual basis to agree appropriate rent increases and to facilitate more effective decision-making on issues such as exemptions and matters relating to leases.

A new London rent stabilisation board could decide the level at which the rent stabilisation arrangements would operate. The scheme could be open to households which fall below the median annual income for London, currently £33,000 per annum. Alternatively, the rent stabilisation board could apply variations to the agreed rent levels in line with borough-specific rent and income levels, or more realistically, to differentiate between inner and outer London.

This use of defined thresholds would limit the extent of the scheme and ensure that it was not affecting rents for more affluent households. This would essentially ensure that the rent stabilisation system only applied to a portion of London's housing market and did not have an undesirable impact on the wider market. Finally, the scheme could also be time-limited. As soon as there is a sufficient supply of affordable homes, and rents have been adjusted accordingly, the scheme could be closed and held in reserve, as it is in New York.

5.3.3 Landlord accreditation

The mayor could adopt a London-wide approach to a landlord accreditation scheme (Cope 2011). This could involve a single, unified approach, or the mayor providing the strategic coordination of various London borough schemes which are developing and enhancing relationships with local PRS landlords.

This would comprise landlord registry and accreditation schemes, such as that in the London Borough of Newham. This offers PRS landlords accreditation and a range of incentives and services in return for landlords signing up to a series of principles which affirm that they are 'responsible landlords' who will provide good quality homes for local people.

London Borough of Newham landlord accreditation service

Why it pays to be accredited. We will provide:

- market rents paid for your properties
- priority to accredited landlords when making referrals to the PRS
- access to the bond scheme
- training and support on property management matters, for example, housing benefit rules, possession proceedings and changes in housing legislation
- housing benefit – accredited members will benefit from a 'fast track' housing benefit administration
- a comprehensive mediation service for landlords to resolve disputes with tenants through mutual arbitration
- a landlord hotline – a dedicated telephone advice line for accredited landlords
- a landlord forum – quarterly meetings with all accredited landlords.

Such schemes – and there are others across London – already enable local authorities to play a key role in driving up standards of properties within the PRS. Rather than providing a commitment to pay market rents, such schemes could include an annual facility for agreeing an appropriate level of 'affordable' rent, in exchange for a range of other measures which offer something for both landlords and tenants. As in the Newham example, this would include facilities such as preferential referrals, training and access to services, such as the bond service, which may incur a cost elsewhere.

There is significant potential to expand such schemes to further improve the offer to private sector landlords. In return, landlords could offer a refined version of 'affordable rents' which reflect the market conditions in the individual London borough, clear quality standards and a commitment to longer-term tenancy agreements of three or five years, where desirable to both parties. Such deals need to represent a genuine two-way bargain.

IPPR will return in greater detail to the idea of a new deal with landlords in forthcoming papers.

Having explored the big questions of supply, welfare and regulation, we now focus on one final issue which has an impact on property prices and rents in London: the role of overseas investors and UK tax rules in driving up London property prices.

5.4 Taxing overseas buyers

It is clear that the long-term solution to London's ever-rising property prices is to increase the supply of affordable homes that are built and available for Londoners to buy and rent. However, there is one partially hidden 'threat' at work which may undermine such a strategy – the often overlooked and increasingly significant role that overseas buyers play in the London housing market.[4]

Overseas buyers represent a large source of external demand that could further exacerbate worsening affordability in the London market, for two major reasons:

- The sheer scale of potential demand from overseas, given growing global wealth and the continued presence of large global capital imbalances (IMF 2011).
- The fact that overseas demand is potentially a powerful force shifting London's housing market away from an anchor in local wages and the traditional market boundaries of affordability. This could mean the pricing of London housing is no longer based on local income (mediated by supply and demand), but is increasingly set by other external factors.

5.4.1 The role and profile of overseas buyers

London has always had flows of external capital coming in to buy residential and commercial property. However, there is substantial evidence of its growing importance – particularly in the wake of the financial crisis, with foreign buyers making up more than half of sales activity in the years 2009 and 2010 in the 'prime central London' market (see figure 5.4 over).[5] This has been matched by a sharp jump in the total volume of money from foreign buyers entering the London market – more than doubling from £2.4 billion in 2009 to £5.2 billion in 2011 (Savills 2012).

4 It is important to be aware of several caveats regarding the data on foreign buyers in the London and UK market. No official government statistics track the nationality of buyers of residential property via the Land Registry, the Inland Revenue or in official inward investment statistics. The market is instead monitored by key market actors, using survey data from sales and buyers. There are several different sources of data from market participants (see for example DTZ 2009 and Savills 2012) only some of which has been made publicly available. In this report we tend to use data produced by Savills, who are the longest-running monitor of foreign buyers in the London market.

5 Unfortunately, the only agencies who consistently monitor overseas activity in the London residential market concentrate on higher price bands within central London. The activity of overseas buyers in lower price bands and in non-prime parts of the London market is not tracked, either officially via government or by market actors. Our knowledge of the scale of foreign capital in London property is therefore partial, and likely to underestimate both the total value and volume.
A further caveat is needed on the definitions used. Savills and others monitor overseas activity using a spatial definition called 'prime central London'. Savills define prime London as: Knightsbridge, Chelsea, Belgravia, Mayfair, Kensington, Holland Park, Notting Hill, St John's Wood, Regents Park and Marylebone. However, as with all estate agents' geographical claims, this should be treated with caution, as 'prime London' has expanded over time to include Richmond or areas around the City, and its component parts do not correspond with official government boundaries at either the local authority or middle or lower super output area level.

Figure 5.4
Overseas activity in prime London (% of market)

Source: Savills data

Overseas buyers are now an important source of demand in the London market and one significant factor marking out strong demand in the capital from the rest of the UK.

There are several reasons driving the growing importance of overseas activity in residential property.

The first is its growing *relative* importance within the new credit restrained housing market. With sharply reduced levels of mortgage capital available to domestic borrowers and lenders, foreign demand and cash has played an increasing role in how the London market operates and prices are set.

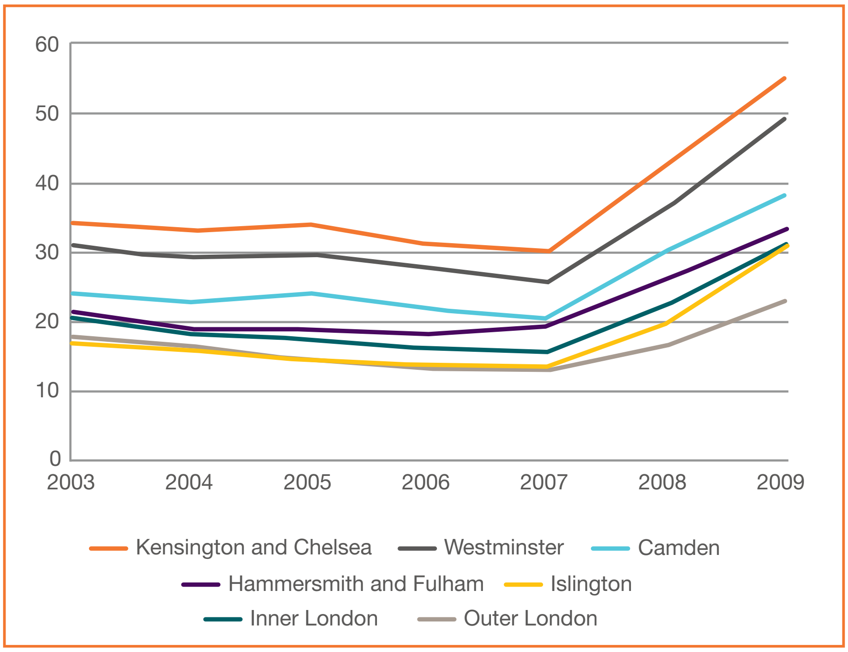
This shift can be seen in the substantial shift towards cash buyers within the London market since 2007 (see figure 5.5 over). Although notably the case in wealthier local authorities – in Kensington and Chelsea for example, over 50 per cent of buyers used cash in 2009, rising to nearly 70 per cent in some parts of central London[6] – this is a cross-London phenomenon. Cash buyers in outer London local authorities increased from 13 to 23 per cent between 2006 and 2009.

This is set within a wider context of much lower overall transaction levels. The resulting lower level of market supply has skewed sales towards those who are wealthy enough to pay for continued high London prices. The London market has become increasingly set by those who are equity rich – overseas buyers being the most notable examples.

If low transaction levels are the 'new normal' then the role of overseas demand becomes correspondingly more important to the setting of London residential market prices.

6 For example, in the middle-layer super output area in Kensington and Chelsea between the Victoria and Albert Museum and the Kings Road, 70 per cent of all purchases were in cash in 2009 (ONS data).

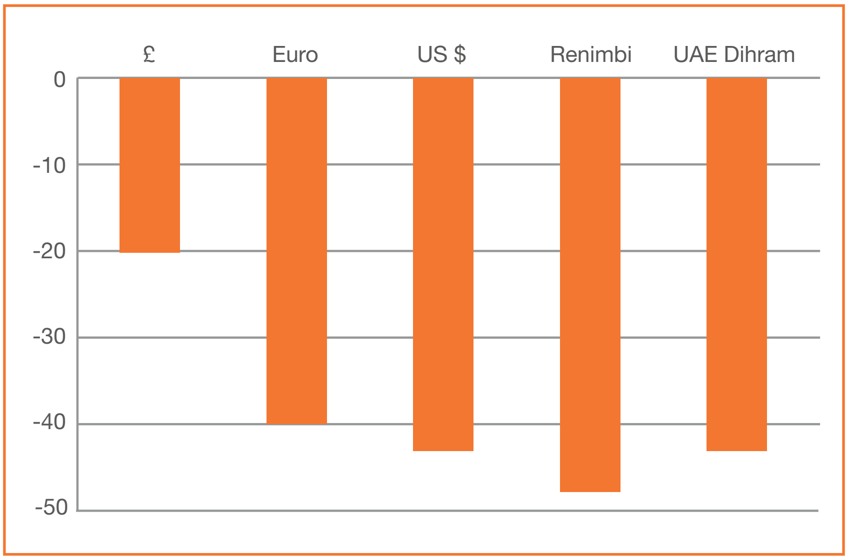
Figure 5.5
Cash buyers as percentage of housing market, 2003–2009



Source: ONS

The second major factor is that London property, when priced in non-sterling terms, has been significantly cheaper since 2007. A weaker pound has increased the incentives for overseas buyers to buy London property – exacerbating the gap between the relative purchasing power of UK and non-UK buyers and thus the growing gap between local affordability and market demand (see figure 5.6).

Figure 5.6
Exchange-rate-adjusted central London house price change, Q3 2007–Q1 2009



Source: Selected foreign exchange rates

The third major factor, which we examine below, is that investing in London property has had both substantial tax advantages and fewer regulatory obstacles than nearly all other developed country real estate markets.

5.4.2 Who is the overseas investor?

The overseas investor can be broadly broken down into three 'types':

- The European or North American buyer for residency or investment purposes.
- Wealthy buyers from non-OECD countries, seeking a form of economic security, buying in the London market from existing secondhand stock. Their investment is based upon the twin rationale of capital gains and preserving relative economic wealth.
- The yield-based investor, typically from east Asian countries, who is buying lower-value, new-build properties with the aim of renting them out in the open market for a combination of yield-based income and eventual capital gain.

The most important category of buyer until now has been from wealthy non-OECD countries, who comprised well over half of overseas buyers in higher-value London residential property in 2011 (see table 5.3). Europeans made up 28 per cent of foreign buyers, North Americans made up 9 per cent in higher value houses (Knight Frank 2011).

Table 5.3
Major non-OECD buyers of London properties worth over £2 million

Country	% of London foreign buyers*	Capital account balance as % of GDP**	Corruption index†	Gini coefficient‡
Russia	11.4	5.5	143	42.3
Kazakhstan	1.0	5.9	120	30.9
United Arab Emirates	8.5	10.3	28	N/A
South Africa	3.1	-2.8	64	67.4
Nigeria	2.3	13.5	143	42.9
Bahrain	1.7	12.6	46	N/A
Egypt	1.6	-1.9	112	32.1
Iran	1.2	7.8	120	38.3
Singapore	5.8	19.8	5	42.5
India	5.4	-2.19	95	36.8
Hong Kong	4.5	5.4	12	43.4
China	3.9	5.2	75	41.5
Malaysia	2.5	11.3	60	46.2

Sources:
* Knight Frank 2011
** IMF World Economic Outlook Datasets, 2011 data
† Transparency International Corruptions Perceptions Index 2011, listed by country, with 182 as the most corrupt and 1 as the least corrupt.
‡ World Bank database 2012, each country score given from latest available data: http://data.worldbank.org/indicator/SI.POV.GINI?page=1

There is some diversity in the countries of origin among leading non-OECD overseas buyers. The most striking commonality is that nearly all are countries with very large current account surpluses, expressed here as a percentage of GDP. In cash terms some of these surpluses are huge – Russia had a current account surplus of over US$104 billion in 2011, while China has a surplus of over US$360 billion (World Bank economic database).

The flow of foreign capital into London real estate is part of a broader picture of global capital imbalances. As the lead up to the credit crunch demonstrated, high levels of surpluses in a range of exporting countries has created a demand for low-risk, high-value assets (Rajan 2010). London overseas buyers are partly driven by the wider need to acquire foreign assets from deficit countries like the UK.

These capital flows clearly have the potential to cause financial instability and, as we have seen, this is particularly the case with housing markets (Dolphin and Griffith 2011, Eichengreen 2008). They also have the potential to become very large indeed – with possible far-reaching consequences for London's housing market.

Other notable factors for a significant number of dominant foreign buyers are the presence of either governance issues, illustrated above using corruption statistics, or relatively high levels of inequality in their country of origin. This suggests that many foreign buyers of London property may be doing so not just in strict investment terms, but as a hedge against political and economic risk and legal uncertainty in their own country.

A significant segment of overseas buyers have a broader investment rationale than that of yield and income. A wealthy Russian is as likely to be mindful of political risk, wealth preservation and portfolio diversification as they are of the long-term value of London property when weighted by price to income ratios (Citi Private Bank 2010).

London's position in a developed country outside of the eurozone, with strong property rights, a deep financial sector and an open economy, provides a high level of attraction for clients who are nervous of domestic political and economic change, as the recent influx of Libyan, Egyptian and, most recently, Greek and Italian money into the London market demonstrates.[7]

All these factors pose challenges to policymakers seeking to re-anchor London housing costs in local wages and some semblance of affordability.

5.4.3 The yield-based investor

Most recently, there has been the emergence of east Asian buyers of new-build properties. This has largely been driven by the UK development sector which, as a response to the collapse in UK domestic demand following the financial crisis, targeted east Asian buyers through marketing in Dubai, Singapore, Malaysia and Hong Kong (Molior 2012). Anecdotal evidence suggests that this class of buyer is less wealthy and more income-driven in their investment decisions.[8]

This segment of demand remains substantially smaller than other foreign buyers, comprising only £0.4 billion of the £3.7 billion of foreign buyers tracked by Savills in 2010 (2011c), but has assumed some importance as a source of development finance for London new-build property.

There is, therefore, a distinction between foreign buyers who are seeking to invest in new-build property, which is economically and socially valuable to London, and those

7 The levels of corruption within some originating countries also indicate that some of the money entering the London market is not legally acquired. There is probably some truth in the assertion that London property appears to being used for offshoring and laundering money in a way that is legally secure, easy to disguise and with few transaction costs.
The high presence of other countries among London buyers can alternatively be explained by cultural and historical links with the UK, for example, India and South Africa.

8 Author discussion with industry figures.

seeking to capitalise on the restricted nature of London property as an investment. This is something policymakers should be aware of in tailoring any intervention in the market.

Indeed, exploiting the scarcity value of land and property is an explicit investment rationale for the leading prime London property investment fund:

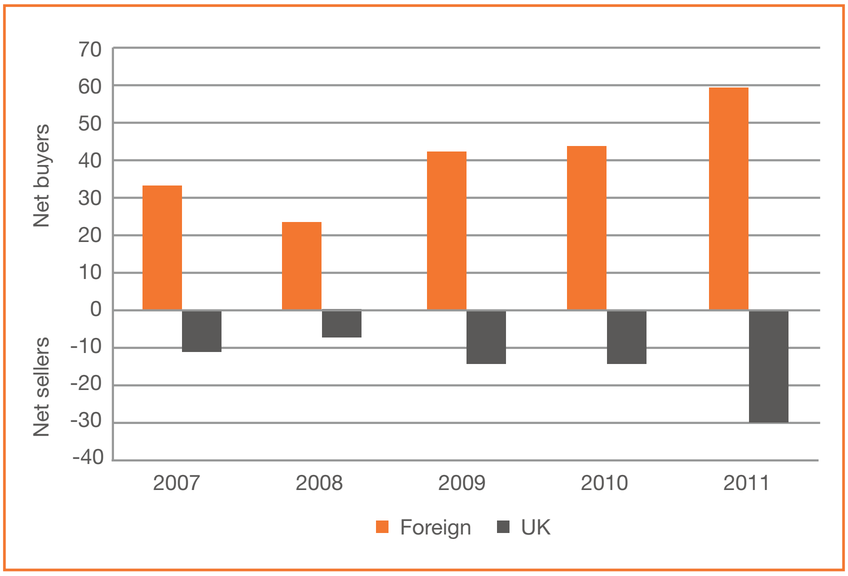
> **'There is very little scope for new build within the Prime Central London area … The planning process is very restrictive. Sophisticated and well resourced opposition can be expected to many development proposals … The supply of new property is finite. At the same time demand is global.'**
> D&G Asset Management 2011

5.4.4 Overseas demand and London prices

What might the price impact of overseas buyers be? Getting a precise answer is difficult, because of lack of government data differentiating domestic and foreign demand. It is also made difficult by the fact that, up until now, those who do track foreign buyers in the market have not given access to the data needed in order to be able to quantify the price impact of foreign capital inflows.[9] We can, however, look at several proximate indicators of foreign demand and its importance.

First, we can note that the net importance of foreign buyers in relation to domestic buyers has been growing sharply, with a significant shift in stock towards foreign ownership (see figure 5.7).

Figure 5.7
Net buyers/sellers by origin of transactor, proportional difference, prime London market, 2007–2011



Source: Savills

We can also gauge the importance of foreign buyers of prime property in relation to the London market as a whole.[10]

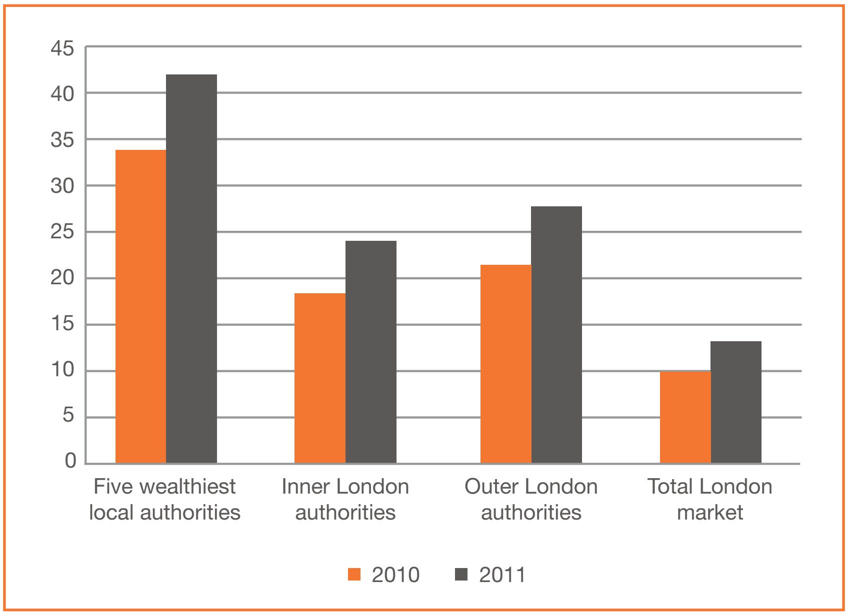
9 Any econometric modelling of the price impact of overseas demand would need relatively fine granular data over a longer timescale than is available through currently published material.

10 Again we should note that the following figures apply just to the high-value prime London market and do not track the possibly significant levels of overseas activity in lower London price bands.

In 2010 the volume of foreign capital flowing into prime London property reached £3.7 billion. This was equivalent to over one-third of the total annual value of sales in the five richest London boroughs, just under 20 per cent of the value of all 14 inner London local authorities or, alternatively, over 20 per cent of the value of all 19 outer London local authorities. In total it reached nearly 10 per cent of the entire London market.

Since then the total amount of foreign capital flowing into prime London property has risen another 71 per cent to £5.2 billion (Savills 2012). Official government data for the value of property transactions in London for 2011 is not yet available. But, if we assume that domestic demand stayed constant, £5.2 billion would be the equivalent of nearly a quarter of all money spent in all 14 inner London local authorities and be worth over 13 per cent of the value of the total annual London property market (see figure 5.8).

Figure 5.8
Prime London overseas money as percentage of total value of selected London markets, 2010–2011



Source: Savills, CLG, IPPR calculations

This is clearly a growing and important component of overall demand, with a likely upwards impact on prices. In 2011, Knight Frank calculated that 'overseas demand is now the biggest single contributor to price growth … The most important driver behind price growth has been growing demand for London property from international buyers' (Knight Frank 2011).

How this money moves into different parts of the UK property market is hard to track precisely, given the data constraints we face. Knowledge of sellers and what they buy is needed to track how increased demand impacts on specific housing market areas[11] – even though the sheer volume of additional overseas demand in the market indicates considerable upwards price pressure.

11 Although this is not the only way in which higher prices are transmitted. A Russian buyer from a UK seller in Mayfair who then uses the proceeds to buy a house in Richmond will push up prices in Richmond. But equally, a Russian buyer from a Russian seller in Mayfair may still push up Richmond house prices by displacing UK domestic demand, who previously would have bought in Mayfair, into the Richmond market.

Data from Savills suggests that the total inflows of foreign capital into prime central London areas was matched approximately by an equivalent outflow to other parts of the London property market – transmitting higher demand, and higher relative prices, throughout London (Savills 2011b). To quote Savills' findings:

> **'Equity funnelled in at the centre migrates down London's wealth corridors. So, as billionaires displace multi-millionaires from the top addresses, so they in their turn displace millionaires. Equity migrates to more peripheral areas of the capital and, eventually, out of the capital to the rest of the UK.'**
> Savills 2011a

5.4.5 Tax and regulatory policy

> **'International investors are restricted as to what they can buy, and what they can do with what they buy (that is, sublet) in other major international cities such as New York and Tokyo. These restrictions do not apply in London, making it attractive as a destination to the world's wealthy.'**
> D&G Asset Management 2011

> **'Russian buyers are very positive in terms of their views on the outlook for London ... With most buyers being both non-resident and non-domiciled, tax changes are almost irrelevant.'**
> Elena Norton, the head of estate agent Knight Frank's Russian desk (quoted in Knight Frank 2010)

One of the major factors that has assisted the flow of overseas demand into London residential property has been the UK's highly favourable regulatory and tax environment for foreign buyers. This is partly regulatory – how easy it is for overseas buyers to acquire property varies from country to country.[12] In addition, the UK has no legal restrictions on the buying and selling of residential property by nationality.

Of particular interest is Switzerland, another high-income country with a large financial sector and a long history of openness to international capital flows. Switzerland's experience of high external demand coupled with scarcity of supply has led to tight controls on the ability of overseas buyers to acquire Swiss property.[13]

Imposing regulatory restrictions on foreign ownership would be a significant leap for the UK government, both culturally and in implementation terms, particularly given our position within the EU and the legal obligations this brings. For those looking to ensure that London is better balanced with other international competitors in its treatment of overseas buyers, the area of tax policy is the most compelling.

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12 Examples where there are strict restrictions on foreign nationals buying residential property include the Czech Republic, Switzerland and Denmark.

13 The Swiss federal government sets an annual quota of permits to be given to non-resident foreigners seeking to buy property in Switzerland. These permits are in certain cantons and, even then, are often restricted to those considered to be tourist resorts. Some cantons also restrict the size of property that a foreigner can purchase and sometimes the re-sale of property may carry restrictions. Foreign companies (including Swiss ones with more than 30 per cent foreign ownership) are barred from acquiring property.

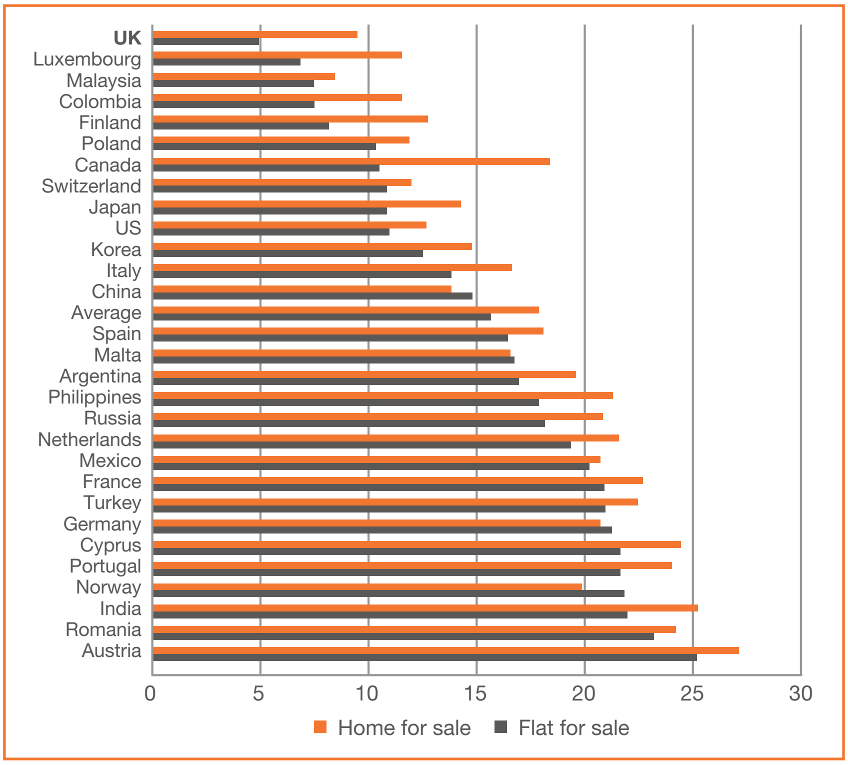
5.4.6 Property tax

The taxation of property in the UK, albeit not progressive in its structure, is above the OECD average as a percentage of GDP through a combination of council tax, stamp duty and capital gains for investment properties (OECD 2012, Haffner and Oxley 2010).

Until recently, this picture was very different when we looked at the UK's tax treatment of foreign buyers compared to our international counterparts. The UK has taxed overseas buyers less than almost any other developed or emerging country.

Taxand, a leading tax adviser to international real estate investment, publishes an index of the tax burden on foreign residential investors. It put the UK as providing the second-lowest tax burden when buying homes and the lowest tax burden when buying flats out of 29 countries (see figure 5.9).

Figure 5.9
Tax for foreign buyers on residential property sales, percentage of tax in overall transaction costs



Source: Taxand 2012[14]

The reason for this is simple – overseas buyers and non-UK residents were exempt from several UK property taxes and able to avoid others. This breaks down into three significant areas: lower rates and avoidance of stamp duty; exemption from capital gains tax and inheritance tax; and very low tax rates for the holding of property (in the UK's case, through council tax).

Stamp duty

To his credit, the chancellor George Osborne announced in the 2012 budget significant moves to end the avoidance by super-rich house-buyers of stamp duty land tax. First,

14 Taxand's methodology considers four main areas of taxation: VAT, transfer tax at acquisition of land, capital at the point of exit, and income and real estate taxes. Administrative fees, notary fees and court fees are excluded.

he raised the rate of stamp duty on homes worth £2 million or more to 7 per cent (from 5 per cent). Second, he raised to 15 per cent (from 0.5 per cent) the stamp duty levied on homes hidden in property-owning companies, whether UK resident or not. Before that, non-UK resident property owning vehicles could avoid both UK stamp duty and stamp duty land tax entirely by transfering the deeds of the property into a trust or company registered as offshore. Future buyers would purchase the company, rather than the property, and thus avoid any stamp duty. This practice was seen by industry commentators as widespread, particularly in higher-value properties where the avoidance incentives were greater (Gibson 2011).

The Treasury had estimated that some £250 million was lost to the taxpayer through the register of property at a lower rate through placing in a UK-owned company. Estimates for the cost to the taxpayer from offshore companies were considerably higher – between £500 million and £1 billion annually.

Capital gains and inheritance tax

Another major set of tax windfalls for overseas investors concerns the avoidance of payment of both capital gains tax and inheritance tax. Currently, non-UK residents are not charged tax on gains made on UK-based capital assets, including land and property. In the latest budget the chancellor also announced measures to clamp down on this practice, after consultation, making non-residents eligible for capital gains tax. Capital gains on property are paid by overseas owners in the US, Australia, Canada, Cyprus, Hungary, Iceland, Ireland and Spain and it is common for the tax to extend to property-owning vehicles as well (Towerbridge Tax Practice 2011).

Given the clear investment rationale of overseas buyers and the role that the UK economy has in creating any 'value' for the property bought and sold, there is clearly a strong case for closing this loophole, including requiring offshore trusts to pay capital gains tax. Rather than simply channel any funds raised into Treasury coffers, we further propose that any additional revenue obtained from increasing the tax liabilities of overseas property owners should be ringfenced to strengthen housing provision. This ringfencing should occur on a regional basis in order to prioritise funding for areas responsible for the greatest share of the uplift and highest levels of housing needs.

Critics will no doubt argue that increase to property-related taxes will hit those who generate wealth for the UK, discourage inward investment and ultimately deliver only a fraction of the projected uplift because it is notoriously difficult to collect such taxes from overseas investors. In response, we offer three arguments.

- First, in an age when politicians of all political hues are keen to emphasis a commitment to 'fairness', there is little fair about a system in which overseas investors receive preferential tax treatment which is not open to UK residents.
- Second, the purpose of the proposal is not to discourage inward investment into the UK; it is simply to create a level playing field for all, whether resident in the UK or overseas. Equalising the tax treatment of UK and non-UK investors would only unduly impact the current yield-based overseas investor in as much as it made them pay the same rates of tax as his UK counterpart.
- Third, the notion that it is difficult to collect property-related taxes from overseas individuals and businesses is not clearly borne out by either UK or wider international experience. At present, non-residents are liable for a range of other taxes including corporation tax, council tax and business rates and there is little to suggest that these pose a significant problem.

Increasing the 'holding tax' for London high-value properties
Tax reform around overseas buyers and UK property is thus broadly a case of levelling the playing field between UK citizens and non-UK nationals. There is, however, also a case for strengthening the tax take from the wealthiest group of non-EU buyers targeting London real estate as a way to make money, not from investing in new build, but in exploiting scarce supply.

As this report outlines, the bigger challenge, and revenue opportunity, is how an open and attractive economy such as London's handles the large overseas demand of investors seeking to park growing amounts of capital in UK property. These investors are exploiting the high degree of economic, legal and political security investing in London brings. From the UK's perspective, they appear to be hoarding an asset that is not productive, has few positive spill-over effects in the wider economy and significant disadvantages in higher house prices and rents for the UK's economic base.

At present the 'holding cost' of overseas investors owning London property is extremely low, particularly when compared to other, higher risk, investments. An investor in a stock market fund would expect to pay 1 to 2 per cent of fees annually; investors in hedge funds face management fees in the double digits; keeping gold in the bank incurs significant deposit fees – but an owner of a £10 million townhouse in Mayfair attracts an annual holding cost of just 0.0001 per cent of its value (see table 5.4) via very low council tax rates. In the budget the chancellor also announced a consultation on the introduction of an annual tax on properties worth over £2 million owned by non-residents. We believe there is a strong case for introducing just such a new annual 'holding tax' on such owners in the region of 1 to 2 per cent of the property's value. Present data suggests this would include over half of buying activity for properties in central London, while it would avoid penalising the yield-based investor in London new build, who buys at a much lower price threshold.

Table 5.4
Annual tax rate as percentage of value for different property prices from council tax, 2011–12

	Highest council tax band	£500k	£1m	£2m	£5m	£10m
Westminster	£1,369.04	0.2738	0.1369	0.0685	0.0003	0.0001
Kensington & Chelsea	£2,158.24	0.4316	0.2158	0.1079	0.0004	0.0002
Ham'smith & Fulham	£2,243.20	0.4486	0.2243	0.1122	0.0004	0.0002

Source: Selected London councils

6. CONCLUSIONS

The challenges facing housing in London are formidable. In this report we have argued that, foremost among them is the problem of the widespread unaffordability of homes to buy and rent in the capital, likely to be made worse by the government's welfare reforms. In response, we have proposed that the following options merit further consideration:

- Increasing the supply of housing in the capital by:
  - exploring novel roles for RSLs in the provision of new properties, including in the PRS
  - releasing more public land for development.
- Improving London's welfare reforms by:
  - in the short term, raising the LHA caps in London by £10 per week
  - in the longer term, devolving power and responsibility for housing benefit to the mayor.
- Achieving reasonable regulation of the private rented sector by:
  - exploring the idea of maximum base rents in the LHA-sub-market of the PRS
  - forming a London rent stabilisation board to check unreasonable rent rises
  - starting an accreditation scheme to codify a new 'something for something' deal with landlords.
- Increasing the taxation of foreign buyers of prime London property by pressing ahead with levying capital gains tax, inheritance tax and a new 'holding tax' on their London properties (on which the government is now consulting).

The mayor of London now needs to offer real leadership in tackling the capital's growing housing crisis. These are our suggestions for some changes the mayor could implement or instigate, by way of a start.

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