The demand for housing as an investment

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

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Executive Summary

Institute for Innovation and Public Purpose

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About this report

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

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

About the author

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

Executive summary

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

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

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

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

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

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

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

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

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

The recent rise in interest rates has discouraged some types of investor, in particularly mortgaged buy-to-let landlords. However, there is little evidence of an overall decline in investment demand for UK properties, with evidence instead

of cash buyers and asset managers buying up housing, including, potentially, foreign buyers. Wealthier investors may view property in cities such as London and Manchester as good long-term investments and be less sensitive to small price changes caused by either rising interest rates or tax reforms (for example, the higher rate of Stamp Duty Land Tax (SDLT) on additional homes introduced in 2016).

Policy solutions

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

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

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

Compulsory and permanent mortgage insurance and longer term fixed-rate mortgages for first-time buyers should be introduced to bring down the cost of higher loan to value (LTV) ratios for first-time buyer mortgages. Alongside this, HMT and the Bank of England/FCA should consider lowering LTV ratios for BtL mortgages to reduce the volatility of the mortgage and housing market, and repress speculative demand during upturns or when interest rates are low.

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

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

The full report is available at:
https://www.ucl.ac.uk/bartlett/public-purpose/policyreport-2024-13