

The UK Planning System—Fit For Purpose?

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In this article discussing the British planning system, Prof. Christian Hilber, Professor of Economic Geography at the London School of Economics, argues that the UK planning system has serious flaws and delivers benefits only at excessively high costs, mainly hurting the young. Prof. Hilber offers three proposals for reform and provides a glimmer of hope for those interested in more affordable housing. This article builds on, and is in small parts, identical with the author's oral and written evidence to the Treasury Committee in April 2016.

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Introduction

There is no denial: the UK faces a serious housing affordability crisis. This crisis is not a short-term phenomenon, nor the result of a financial bubble. The crisis has been brewing for several decades. Over the last 45 years, house price growth in the UK has been faster in real terms than in any other OECD country and has far outstripped earnings growth. Normally when demand is rising, construction booms as well and that eases price growth. This has not happened in the UK; construction of new housing has been decreasing more or less steadily since the late 1960s from 353,000 units in 1968 to 118,000 units in 2014, leading to a very substantial and ever-growing housing shortfall. Not only that; newly built homes are also about 40% smaller than in similarly densely populated European countries. In the Greater London Area (GLA) the problem is particularly acute. To illustrate this, the average house price in the GLA has gone up by £65,200 year-on-year since March 2015. The latest average household income estimate for the capital for 2013 is £51,800. Put differently, in 2015, the average London homeowner earned more from capital gains than a renter from working all year long. It is, therefore, no surprise that young adults without wealthy parents are increasingly priced out from getting onto the owner-occupied housing ladder. Renting in the private sector is similarly unaffordable, so the young—even the highly skilled—increasingly have no other option but to stay at their parents' home longer or leave the city. Consistent with this, the share of those employed in inner London working in professional scientific, research, engineering and technology jobs has fallen since 2011, hurting the capital's productivity.¹ The housing affordability crisis is an economic as well as a social problem.

¹ 'Living in London—the grip tightens: faulty land-use regulation is throttling the capital' *The Economist* (London, 30 April 2016) <<https://www.economist.com/news/britain/21697575-faulty-land-use-regulation-throttling-capital-grip-tightens>> accessed 10 July 2017.

Tight local planning constraints push up house prices

Longstanding UK evidence, summarised in the Barker Review (2003),² demonstrates that housing supply is extremely unresponsive to changes in demand. That is, if real earnings and population grow over time, construction hardly responds, causing house prices to rise markedly in order for the housing market to clear. Long-run supply constraints are the only plausible explanation, but what kind of constraints? Barker suggested that the rigid planning regime may be a likely candidate. Others hypothesised that geographical and physical constraints are to blame. In a recent study—published in the March 2016 issue of the *Economic Journal*³—my co-author, Wouter Vermeulen and I rigorously tested these conflicting hypotheses. Employing methods that allow us to establish causal effects rather than just correlations, we explored the impact on house prices of three different types of local supply constraints: (i) planning induced constraints, (ii) scarcity of developable land and (iii) topographical constraints. Our evidence is strongly supportive that the planning regime in England is the main cause of the excessively high house prices, particularly in the GLA and the south-east of the country. Our estimates imply that house prices in England would have increased by about 100% less in real terms between 1974 and 2008 if, hypothetically, all regulatory constraints were completely relaxed. More pragmatically, if the south-east (the most tightly regulated English region) had the regulatory restrictiveness of the north-east (less regulated but still restrictive by world standards) house prices in the south-east would have been roughly 25% lower in 2008 and perhaps 30% lower in 2015. Topographical constraints also matter in a statistical but not in a quantitative sense. Finally, the effects on house prices of constraints due to the scarcity of developable land are mainly confined to highly urbanised areas such as the GLA, but in these locations, they are economically important. In a nutshell, house prices in London would still be fairly high by world standards

² Kate Barker, ‘Barker Review of Housing Supply: Securing Our Future Housing Needs: Interim Report—Analysis’ (HMSO 2003).

³ Christian AL Hilber and Wouter Vermeulen, ‘The Impact of Supply Constraints on House Prices in England’ (2016) 126(591) EJ 358.

even if regulatory constraints were relaxed, but housing would be substantially less unaffordable than today.

Tight planning constraints do not only push up house prices. In conjunction with business cycles, they also amplify price volatility, thereby creating systemic risks. Moreover, regulatory constraints tend to be tighter and more binding in more desirable places such as the GLA, Oxford or Cambridge, implying that housing is built in the ‘wrong’ places; far too little housing is produced in the most successful, most productive cities where demand is strongest. Evidence for the United States suggests that lowering regulatory constraints in high productivity cities like New York, San Francisco and San Jose to the level of the median US city would increase production by about 9.5%.⁴ The ballpark figure may be similar for the UK.

Weighing the benefits and costs

Planning induces both benefits and costs. There are considerable potential benefits in the form of correcting market failures such as monopoly power, externalities and lack of provision of public goods. For example, planning has the potential to solve the holdout problem in land assembly for transport infrastructure. It may prevent excesses of urban sprawl and may protect important views on landmarks and historic buildings. Planning also ensures the provision of public parks as well as the preservation of natural habitats and cultural heritage. The trouble with the UK planning system is that it often prevents, contains, preserves and protects even if no market failure is apparent, and with complete disregard to any costs that may outweigh the benefits of the intervention. One example to illustrate the point about market failure is London’s

⁴ Chang-Tai Hsieh and Enrico Moretti, ‘Housing Constraints and Spatial Misallocation’ (2015) NBER Working Paper 21154 <<https://ssrn.com/abstract=2604835>> accessed 10 July 2017; Chang-Tai Hsieh and Enrico Moretti, ‘Why Do Cities Matter? Local Growth and Aggregate Growth’ (2015) Kreisman Working Paper Series in Housing Law and Policy 30 <<https://ssrn.com/abstract=2693282>> accessed 10 July 2017.

green belt. The green belt contains areas of outstanding natural beauty that ought to be protected. However, it also contains heaps of intensive agricultural land with little environmental or amenity value near existing developments with transport infrastructure. There is a strong case to permit housing on such land.

An example to illustrate the point that the planning system disregards costs is the view corridor to St. Paul's Cathedral from King Henry the VIII's Mound in Richmond Park. This corridor was established in 1710—when the St. Paul's Cathedral was by some margin the tallest building in the country and the economic costs of view corridors were negligible. The protected vista frames the cathedral through a special gap in a holly hedging from a distance of over 16 kilometres. While this view is certainly enjoyable for those living nearby or for hikers, it arguably imposes an astronomic and ever growing economic 'opportunity cost': the protected vista prevents the construction of any tall building throughout the corridor that would obstruct the view. Worse, it also prevents tall construction in the backdrop of the cathedral, limiting development around Liverpool Street Station, one of the most productive hotspots on earth. The protected vista, through limiting supply, raises housing costs of all Londoners and adversely affects the capital's productivity.

Key flaws in the current system

More broadly, three key flaws can be identified in the UK's planning and tax systems. The first is the fact that the UK operates a so-called 'development control' system, which is inherently geared towards containing development. In contrast to a rule-based zoning system—in use throughout most of the rest of the developed world—the UK system stipulates that any change of 'use' of any parcel of land requires development control permission granted at the local level. Permissions are granted by local planning authorities, which invoke a consultation process that gives significant weight to NIMBY pressures. The trouble with the development control system is, apart from giving weight to NIMBYs, that it is complex, substantially increases the cost of the development process and creates a great degree of uncertainty during the planning stage. The lengthy and uncertain process delays and significantly reduces the

viability of projects. The viability is further threatened by agreements under Section 106 of the Town and Country Planning Act 1990 that require complicated negotiations between local authorities and developers and imply a further degree of uncertainty for the latter.

The second key flaw—the lack of fiscal incentives at the local level to permit residential development—relates to the first one. Local authorities that grant development control permission retain little tax revenue. This is made worse because of the central government grant equalisation system, which in the medium-term more or less eliminates any revenue gain for local authorities that permit more development relative to those that are more restrictive. Any increase in the local tax base is effectively equalised away by the central government. In other words, local authorities derive few benefits from permitting development, yet they face the costs of additional infrastructure that development makes necessary—local roads, schools and the like. These costs are rarely met fully by the central government. Worse, local residents bear the main burden associated with increased local congestion or pressures on public services such as local schools. This increases local opposition often beyond those neighbours who are immediately adversely affected.

The third key flaw of the UK planning system is the fact that since the Town and Country Planning Act of 1947, residential development has increasingly been prevented ‘in all directions’. The larger British cities are surrounded by enormous green belts that are effectively sacrosanct from residential development, thus preventing growth in a horizontal direction. (Moreover, green belts prevent the delivery of the type of housing—single-family owner-occupied homes—that is most desired by large fractions of the population, but is arguably in shortest supply.) Height restrictions and view corridors prevent physical development in a vertical direction. In fact even digging below ground is often not a viable option to gain living space. Height restrictions constrain tall buildings in nearly all high-demand UK cities, particularly of course large parts of London. Also, protected view corridors prevent the construction of tall buildings in some of the most productive inner city areas. Lastly, preservation policies (e.g. Conservation Areas and Listed Building designations) limit redevelopment of existing structures at higher density or better adapted to current preferences. It is this combination of rigid policies ‘in all directions’ that explains why supply is so incredibly

unresponsive in many British cities. If desirable cities such as London cannot grow physically over a longer time period, and as long as demand—mainly real earnings—grows and expectations are positive, house prices must rise markedly. (Brexit may change this. However, if house prices fall as a consequence of a fall in real earnings and an increase in unemployment, housing may not become more affordable.)

Why Help to Buy does not actually help to buy

The fact that housing supply in the UK is so extremely unresponsive also has important consequences for the effectiveness of housing policies, including the Government's flagship policy Help to Buy (HtB). The various HtB schemes are intended to stimulate housing demand, and their aim is to generate new housing supply and higher homeownership attainment. However, in a setting where housing supply does not respond to demand-side stimuli, the only direct effect of the policy is to increase house prices. The effect of HtB on house prices has not yet been rigorously quantified in academic research. However, house price and construction statistics seem strongly suggestive that HtB did not have the intended effects. According to Nationwide, following the announcement of the first HtB schemes, house prices in London shot up by 25.8% between 2013q2 and 2014q2. A residential building boom failed to emerge, and homeownership attainment continued to decline. The government may have been well intended in helping young households to get on the owner-occupied housing ladder, yet it has likely achieved the opposite. How is this possible? If the HtB subsidies indeed had the main effect of raising prices and through that the required mortgage deposits, this arguably made it even more difficult for young liquidity constrained households to afford a decent home, despite HtB. This proposition is consistent with evidence from the US, which reveals that the capitalisation of mortgage-related subsidies into house prices decreased homeownership attainment in tightly regulated cities.⁵ To make

⁵ Christian AL Hilber and Tracy Turner, 'The Mortgage Interest Deduction and Its Impact on Homeownership Decisions' (2014) 96(4) Rev Econ Stat 618.

things even worse, the HtB schemes may also have created a systemic risk in that the government (and indirectly the taxpayer) assumes most of the risks associated with the guarantee schemes, with the remaining risk being assumed by the marginal homebuyers—those who stretched themselves to obtain a loan and could not have obtained one in the absence of the scheme.

Three proposals for reform

When I gave evidence to the Treasury Committee back in April of 2016, I was asked by the Chairman what I would realistically do to tackle the affordability crisis if I were in charge of government policy. My response was the sketch of a three-pronged policy.

My first recommendation was to transition from the current development control system towards a rule-based zoning system. This transition could be piloted in a ‘Special Planning Zone’ and later introduced country-wide. The aim would be to rationalise and simplify the allocation of land use and dramatically reduce planning uncertainty, thereby also removing the valuable ‘real option’ to hoard land and delay development. The basic idea would be that instead of requiring development control permission for any change of ‘use’ of any parcel of land, certain areas would be zoned for residential purposes and within those zones, there would be an automatic presumption of development as long as the owner of land can convey that building regulations are obeyed. Neighbours could object only if they can substantiate that rules are clearly violated. This could replace the current process that involves a lengthy public consultation and often complicated Section 106 negotiations. Simplifying the planning process would have the additional benefit that it would make it easier for smaller scale developers to enter the market, thus generating more competition among developers, reducing possible cohesive ‘oligopolistic’ behaviour among large-scale developers and ultimately leading to more production of housing and smaller ‘abnormal’ profits.

Of course just changing to a rule-based zoning system does not in itself alter the incentives of local authorities to allocate land for residential purposes. My second recommendation was thus that any reform of the planning system should be accompanied by additional

fiscal incentives at local level to allocate land for residential purposes (either via granting planning permission under the current system or, preferably, via designating land areas for future residential development under the proposed rule-based zoning system). As a general principle, local property taxes should be given significantly more weight in the tax system. This could be achieved in a revenue-neutral way via replacing the national Stamp Duty Land Tax (SDLT)—a terribly inefficient tax that significantly hampers housing-related and short distance moves⁶. Moreover, development-induced increases in the tax revenue base should not be equalised away through the central government grant system.

The current council tax, which bears little relation to underlying property values, ought to be transformed into a proper annual local property tax—or better, even a local land value tax—with automatic annual revaluation based on location-specific price changes.

The key advantages of a sizeable annual local property tax are threefold:

- It would generate a permanent revenue stream that would incentivise local authorities to make more land available for residential development;
- It would reduce the occurrence of underused or vacant housing and would generally ensure the optimal use of the scarce resource land; and lastly
- Such a tax would impose a far smaller economic ‘deadweight loss’ compared to the SDLT.

On a related note, local authorities should also be allowed to introduce impact fees. Such fees are imposed on proposed development projects to pay for all or a share of the costs of providing additional local public infrastructure and services.

My final recommendation was that the central government ought to require the various enacting bodies—typically local

⁶ Christian AL Hilber and Teemu Lyytikäinen, ‘Transfer Taxes and Household Mobility: Distortion on the Housing or Labor Market?’ (2017) 110(1) *J Urban Econ and Stats* 57.

authorities—to critically review major existing planning constraints such as green belts, height restriction areas, protected view corridors or conservation areas. They would need to justify for each such constraint that a market failure exists and that the benefits associated with correcting this market failure can reasonably be argued to exceed the opportunity costs. For the case of green belt land, for example, a guiding principle could be that the enacting body needs to justify preservation for the various sub-sections of the belt one-by-one on grounds of significant environmental or amenity value. If no such values can be established for particular sub-sections, especially if such land is nearby already developed high-demand areas with pre-existing transport infrastructure, a presumption for development ought to be enacted.

Vested interests and a glimmer of hope

After I outlined my proposals to the Chairman of the Treasury Committee in April 2016, his comment was: ‘I wish you well at the polls with your three-pronged policy’. Clearly, his concern was that it would be difficult to gather majority support for my proposals. He certainly has a point, although in some sense that is surprising: if policymakers were to implement a variant of the above outlined proposals, they would be bound to make the society as a whole better-off. So, why is it so difficult to gather support for such reforms?

One reason is that the benefits of certain policies or settings are concentrated among a small group of individuals with strong vested interests (e.g. homeowners benefiting from a protected vista or living adjacent to a green belt), whereas the costs are diffused throughout the whole society (all residents facing higher housing costs). While the former group has strong incentives to influence policymakers to protect the status quo, the latter group is not capable of organising their interests in a cohesive way.

A second reason is incomplete or distorted information about the benefits and costs associated with certain policies or settings. For example, consider expanding families in London that managed to get on the owner-occupied housing ladder some time ago. The staggering capital gains on their leveraged homes may well make

them feel significantly better off. Yet, they are in fact likely losers of the broken planning system for three reasons:

- Compared to a ‘counterfactual scenario’ with more relaxed planning they live in artificially cramped housing;
- They may be increasingly priced out from moving to larger more adequate housing; and
- They cannot realise their capital gains unless they move to a less desirable city with fewer planning constraints and lower house prices (or they leave the country altogether).

The only real winners of the planning system are wealthy land and property owners who possess more property than they consume, elderly homeowners who are prepared to sell their houses, pocket the proceeds and move to a country with cheaper housing, and the children of wealthy parents once they eventually inherit property. The planning system cements wealth inequality, and the beneficiaries of this rising inequality have incentives to keep the system as it is.

Yet, there are glimmers of hope. There are signs that attitudes of the British public towards building more homes are changing, and are changing rather rapidly. The British Social Attitudes survey has shown a remarkable decline in NIMBYism in recent years. Opposition in England to new homes being built in the local area has declined by more than half between 2010 and 2014, from 46% to 21%. Similarly, support for local house building has doubled from 28% to 56%. Policymakers ought to take notice. In fact, it appears some policymakers already have taken notice: the pre-Brexit Conservative government made some encouraging announcements (among less encouraging ones). The 2016 Budget explicitly mentioned ‘moving to a more zonal planning system’ as an objective and reducing planning related uncertainty appeared to be a priority. The government also announced the full retention of the business rate by local authorities from 2020 thus providing fiscal incentives at the local level to permit commercial development. Sadly, this bold move may have the unintended consequence of discouraging local authorities from making scarce land available for private and social housing, thus potentially further worsening the housing crisis. However, it raises hope that post-Brexit governments will eventually follow with an even bolder move; to provide much stronger fiscal incentives to local authorities to permit residential development.

That really could change the dynamics for the better—particularly for the young.

There were early signs that the current Prime Minister Theresa May is serious about trying to tackle the housing crisis. In her last speech prior to taking on her current job, she stated the following: ‘Unless we deal with the housing [supply] deficit, we will see house prices keep on rising. Young people will find it even harder to afford their own home. The divide between those who inherit wealth and those who don’t will become more pronounced. And more and more of the country’s money will go into expensive housing instead of more productive investments that generate more economic growth.’ This statement would appear to suggest that Theresa May understands that lack of house building lays at the very heart of both the country’s serious and worsening social divide and its economic crisis. She seems to understand that the stakes are high and bold action is required. This is encouraging from the point of view of those interested in affordable housing, especially the younger generation and the less wealthy. What is crucial, however, is that she and her ministers realise that demand-side policies such as Help to Buy won’t solve the housing crisis and the corresponding growing social and economic problems. In fact, more Help to Buy— notwithstanding its deceptive name—is likely to aggravate the country’s social divide and economic crisis. What is needed instead are bold reforms on the supply-side—outlined in this article—that tackle the causes of the problem. This would require bold leadership that puts social welfare and social justice above vested and narrow party interests.

There is no denial that—despite changing social attitudes—implementing supply-side reforms entails a political risk. Any potential reforms are further complicated by the fact that Brexit (apart from attracting much of the political attention) is likely to significantly adversely affect the real economy and thus house prices. This may (further) reduce incentives of developers to build new homes. It may also, in the short-run, weaken political pressure to impose effective supply-side reforms, implying an even bleaker housing affordability crisis when the economy eventually recovers. If, however, Theresa May (or her successor) turned out to be a bold leader willing to take a political risk and enact meaningful supply-side reforms, then there would be real hope. Real hope particularly

for the young generation and those less wealthy. Real hope to move towards a ‘One Nation’ society that is less defined by social divide. If she (or her successor) also managed to limit the adverse long-run economic consequences of Brexit, then there would be real hope for a more prosperous future for all.⁷

⁷ This work originally appeared in two parts in *PBC Today* as ‘The UK planning system—fit for purpose?’ and ‘The UK planning system—Proposals for reform’. The author retains the copyright.