

Progressive Economics Group (PEG)

Policy Brief

The Common Ground Trust: a route out of the housing crisis

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Policy Issue

Rising house prices and rent prices systematically undermine the progressive vision of a society with equal opportunities for all. They also make our economy highly vulnerable to debt crises and other macroeconomic shocks. An end to house price inflation can be more quickly achieved than many people assume, through better macroprudential supervision of bank lending, tax reform, restrictions on the ownership of UK property by non-UK residents, and – crucially – a strengthening of tenants' rights. The challenge for policy makers is to implement these reforms *without* triggering an unmanaged and destabilising fall in house prices, which itself carries social, macroeconomic and political risks.

How can we address the urgent concerns of renters, prevent the further debt-fuelled inflation of house prices, encourage a shift from unproductive to productive investment and reduce the scale of rent-extraction by banks and landlords, *without* triggering a destabilising fall in nominal house prices, or a shortage of homes for rent?

Analysis

The hardship and injustice inflicted by our housing crisis has a number of dimensions:

- Those unable to access homeownership face far higher housing costs – both as a proportion of their income, and in absolute terms.¹
- The unearned windfalls arising from house price appreciation have tended to reward those who are already well off, and overshadow the fruits of hard work.^{2,3} For 10 out of the last 20 years, the owner of an average house in London has reaped more in annual price growth than the average full time UK worker can earn in a year.⁴
- The higher house prices and rents have crept, the more our communities have become segregated on socioeconomic lines, with poorer households priced out of areas with good schools, clear air, jobs, parks, transport links and so on.⁵
- Even where households appear to be living in 'affordable' accommodation, making ends meet often requires other compromises – such as putting up with damp, mould, cold; spending longer on the daily commute; living in overcrowded conditions⁶ – that take their toll on health, child development and life chances.

Subsidies for low income private renters (housing benefit) and for first time buyers (Help To Buy) *are not long term solutions to these problems*. They may benefit the primary recipients, but on aggregate they increase effective demand in the market and thereby push house prices and rent prices even higher.^{7,8} To address the injustices of the housing crisis we need to tackle the root causes of inflating rents and house prices, which over the past two decades have been driven more by *expansions in effective demand* than by shortages in overall supply.

Demand in the housing market has been inflated by two key developments. First, seismic changes in the UK mortgage market – including the lifting of various restrictions on banks and building societies, the growth of securitisation, and the lowering of the Bank of England base rate – have dramatically increased the supply of cheap, easy credit, and thereby boosted purchasing power available to all buyers.⁹ Second, the increasing treatment of homes as financial assets, by global and domestic elites, as well as ordinary households seeking security in retirement, has put enormous upward pressure on prices¹⁰. Most significantly, “Buy To Let” investors have benefited from a highly advantageous fiscal and regulatory environment in their bidding war with first time buyers.¹¹

Unless these demand-side drivers are brought under control, increases in the supply of homes for sale will do little to improve affordability. According to the government’s own model of house prices, building 300,000 houses every year for the next 20 years, would only reduce house prices by 6% by 2038.¹² That is not to say that house building is unnecessary. Any expansion in the social housing stock in would be a lifeline to the 1.2 million people on the social housing waiting list, and would slowly reduce pressure and improve tenant bargaining power in the private rented sector. Falling private sector rents would, eventually, feed through into lower house prices. *But we should not expect such results to be either significant or swift* - partly because there are major skills shortages in the building sector¹³, partly because there is a huge backlog of housing need¹⁴, and partly because, as discussed above, there are a range of other more powerful forces, besides supply shortages, putting upward pressure on house prices.

It is perfectly possible to bring these inflationary forces under control through the reforms summarised in figure 1. Perhaps the most popular and immediately realisable of these are those measures designed to strengthen tenants’ rights.¹⁵ These reforms make sense on their own terms - since the constant threat of rent hikes and evictions is having a detrimental effect on the health, relationships and life chances of millions of people¹⁶ - but they have the added benefit of dampening demand from Buy To Let investors, and therefore removing one of the key drivers of house price inflation.¹⁷

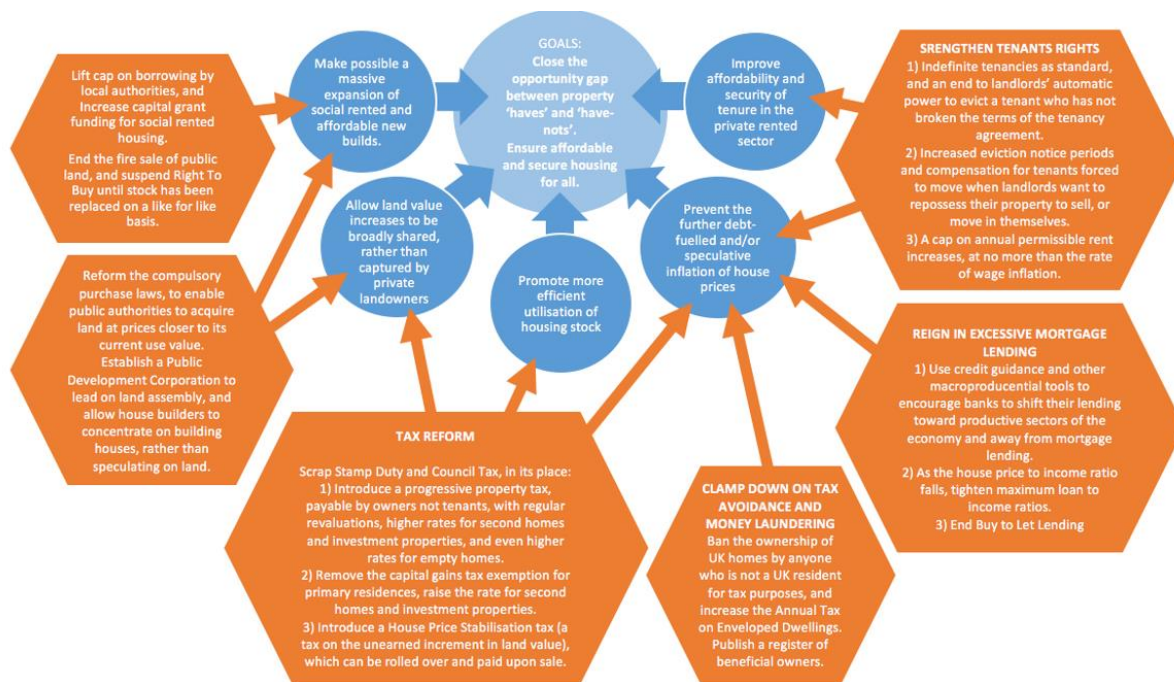


Figure 1: Policies to ensure affordable and secure housing for all

Risks associated with housing market reform

The policies designed to end house price inflation and improve renters rights will inevitably reduce the attraction of Buy To Let and Buy To Leave for some investors (thereby removing *demand* from the housing market), and potentially prompt some investors to sell (thereby increasing the *supply* of homes to the second hand market). If new buyers do not emerge to 'plug the gap' left by investors in the market, the result could be falling nominal house prices.

Once prices begin to falter banks could become more cautious about extending mortgages, and households more cautious about taking out large mortgages. Just as demand in the housing market can be inflated by an increase the availability of (or demand for) bank credit, it can be deflated by a decrease in availability of (or demand for) bank credit.

This effect is likely to be most pronounced in London where prices are now 70% higher than they were at in 2007, before the crash, and around 30% of homes are owned by landlords. As the Bank of England has repeatedly warned, the behaviour of investors tends to amplify house price movements during a downturn, just as they do during a boom, since houses which are primarily conceived of as financial assets rather than homes are readily put up for sale if they no longer present a good investment.¹⁸

A fall in prices would of course be welcomed by many people who are currently locked out of homeownership. But falling nominal house prices also carry political, social and macroeconomic risks. The UK has one of the highest levels of mortgage indebtedness in the world. Low interest rates and weak supervision of mortgage lending have enabled loan-to-income ratios to creep even higher than they were in 2007. In this context a price fall could

push a significant minority of households into negative equity, making it difficult to either move house or re-mortgage. This would be particularly problematic for those coming to the end of cheap introductory mortgage deals, thus facing the possibility of a large increase in variable rates. Mortgage defaults could, in turn, affect the solvency of major banks whose balance sheets are now dominated by mortgage loans. Meanwhile, households worried about their loss of housing equity may cut back on consumer spending, leading to a general contraction of the economy. Further, if a large number of tenants are evicted to prepare for a sale, and then homes sit empty on the market as potential buyers wait for prices to 'bottom out', this could lead to a shortage of homes for rent.

A lack of preparedness for managing these risks is a major barrier to systemic reform of our housing system. The Common Ground Trust is offered as a way out of this apparent deadlock, although delivers a number of other benefits too.

Policy Framework

Overview

The *Common Ground Trust* (CGT hereafter) is proposed as a publicly backed but independent non-profit institution which would buy land from underneath houses and lease it to members. Membership of the CGT would be most obviously attractive for people who want to access a form of homeownership (privately or mutually) - in order to gain greater security and agency over their own living space - but who cannot meet the mortgage deposit requirements.

Households or housing coops could approach the CGT when they'd found a house they wanted to buy and ask the CGT to cover the cost of the land and then seek normal mortgage finance to cover the cost of the bricks and mortar. Since bricks and mortar can account for as little as 30% of the price of a property, this would require people to save much lower deposits than is conventionally the case. The new buyers would sign a lease with the CGT which would entitle them to exclusive and indefinite use of the land in return for paying a land rent.

When moving house, members of the CGT would sell only the bricks and mortar. The title to the land itself would remain with CGT, and the lease (and obligation to pay land rent) would transfer to the new occupant¹⁹.

Once the CGT had accrued a surplus this would be pooled and used to fund a 'rainy days and retirement discount' for members. This would help to improve the attractiveness of the scheme compared to both renting and the mainstream model of mortgaged homeownership since it would improve security of tenure for members who had fallen on hard times, and/or were unable to work any longer.

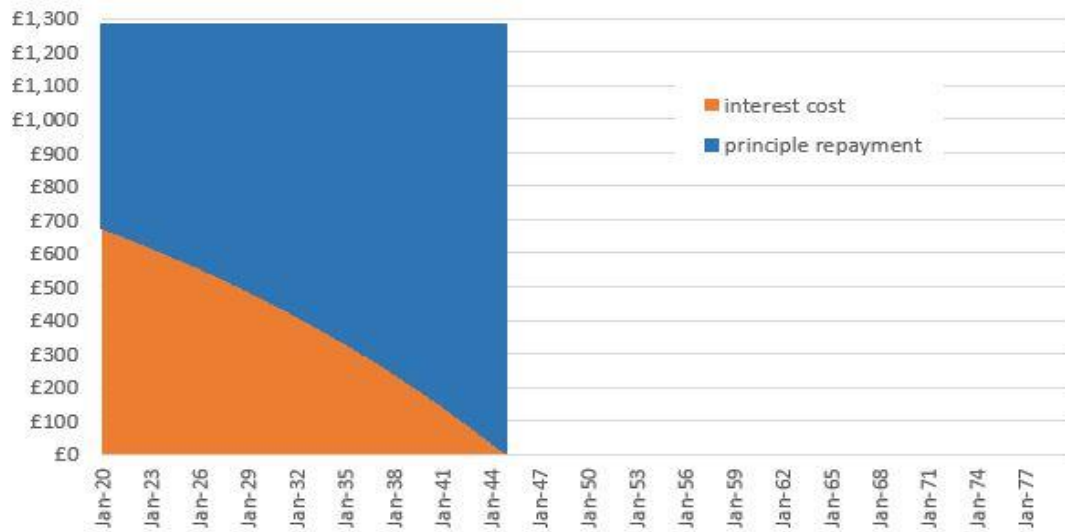
In short, the Common Ground Trust would be a vehicle for bringing land under existing homes into common ownership, with three goals in mind:

- To reduce the scale of land rents that are siphoned off and pocketed by financiers and landlords, and to use those rents instead to provide a safety net for members who have hit hard times
- To create a pool of aspiring homeowners ready and able to buy as landlords and investors exit the housing market. This would make it safe to introduce the much needed reforms to the private rented sector, the tax system, the mortgage system and so on, that have been outlined above.
- To give more people the opportunity to access a form of home ownership. Even with improved conditions in the private rented sector, many people will have an understandable desire for a home they can substantially renovate and invest in, and the peace of mind that they will never be served an eviction notice.

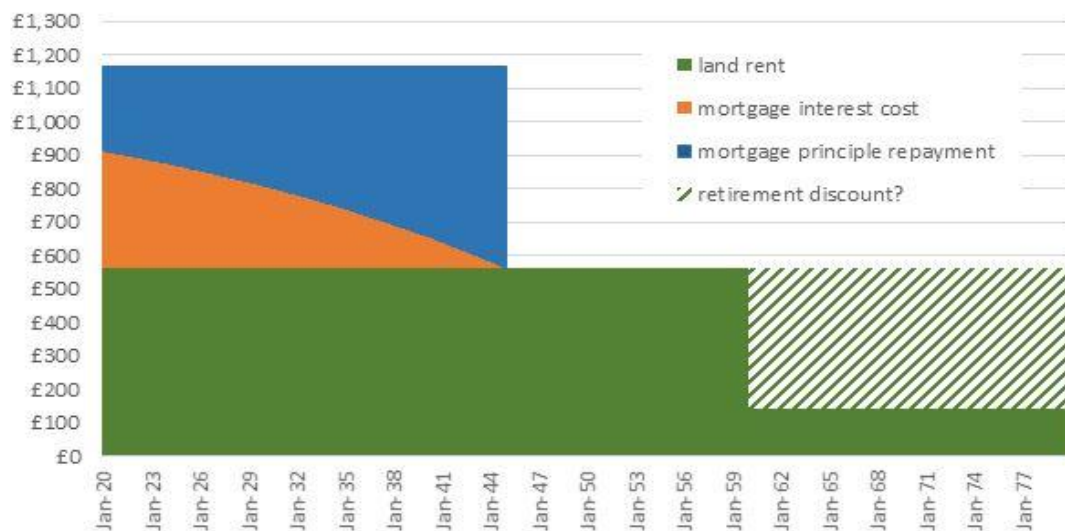
Example

The Smith family find a house they want to buy for £300,000. They have £30,000 in savings – a 10% deposit. If they had a higher household income they might be able to get a mortgage to cover the remaining £270,000. In this case, if they borrowed at 3% interest over 25 years, they'd have a monthly bill of **£1280** (figure 1). But the Smith's mortgage lender explains that – based on their income and credit record – the maximum they can borrow is £150,000. So the Smiths contact the Common Ground Trust, and discover the land accounts for half the total value of the property: £150,000. The Common Ground Trust agrees to purchase the land, and the Smiths sign a lease that entitles them to indefinite use of the land in return for paying a land rent at, say, 4.5% of the sales value of the land, or £563 per month. The Smiths then pursue normal mortgage finance to cover the cost of the bricks and mortar. With the land rent as committed monthly spending, the amount the Smiths can borrow drops to £120,000. The interest rate also rises slightly to 3.5% to take account of the fact that bricks and mortar are more likely to depreciate than land. But with this loan, and their deposit of £30,000, they have enough to purchase the bricks and mortar. Their monthly mortgage repayment costs are £601, bringing total monthly housing costs to **£1163**. Once they have paid off their mortgage, and assuming stable land values, the Smiths can expect monthly costs of £500, until they reach retirement (figure 2). For comparison, if they were to rent a house like this it would cost around **£1100** per month indefinitely²⁰.

Monthly housing costs for mortgaged homeowner



Monthly housing costs for CGT member



Setting land rents

Land rents would be reviewed annually, and adjusted if necessary to keep them in line with changing land values, with the explicit aim of making sure that the sale price for the bricks and mortar remained roughly stable (assuming properties were properly maintained). Ensuring that land rents accurately reflect changing land values is important to prevent undeserved windfall gains or unexpected losses for households when they come to move. For example, if land rents were not raised in response to, say, improvements to transport

infrastructure, then when CGT members came to move house, the new buyers would end up bidding more for the 'bricks and mortar' than they were really worth, and the sellers would walk away with a windfall gain.

Security of tenure

With the various reforms outlined to discourage real estate speculation, instances of land values inflating faster than wages would be relatively rare. Even so, to ensure security of tenure, land rent increases for households with outstanding mortgages could be capped at the rate of increase of median wages, and only fully adjusted when the property changed hands. This adjustment at point of sale is imperative to ensure the separation of ownership of land and house does not break down.

Rainy Days and Retirement Discount

In the short to medium term land rents would be used to recover the cost of purchasing the land. After these costs had been repaid, land rents in excess of operational costs could be pooled and used to fund a discount for members who had fallen on hard times, or were entering retirement. The retirement discount would only be available to members who had been paying in for a minimum period, such as 25 years. It would reduce but not eliminate the land rent, partly to encourage downsizing where this is possible.

How would the CGT be financed?

Options could include bond issue, or taxes on windfall gains for real estate investors. The form of finance obviously has a bearing on how quickly the CGT can be expected to run a surplus.

Negative equity and debt cancellation

If a government were to come to power in the aftermath of a house price shock that had *already* pushed significant numbers into negative equity (say, in the aftermath of Brexit) the CGT – with sufficient public backing – could also be a vehicle for helping households who wanted to move house or needed to remortgage, but who were prevented from doing so because they had been pushed into negative equity. Households in negative equity could sell the land from underneath their homes to the CGT at a price that was closer to the pre-crash value, enabling them to pay down their mortgage debt.

How does the CGT compare with other demand-side supports in the housing market?

There are of course other ways that the government can reduce the risk of a nominal house price fall. Keeping interest rates rock bottom, loosening Loan To Income ratios, extending the Help To Buy policy, are all levers for introducing demand into the housing market. The downside is that they all push households deeper into debt, and increase the fragility of the macroeconomy. The *Common Ground Trust* offers a more sustainable and progressive approach, and one we believe has several positive side effects.

A non-reformist reform

The Common Ground Trust creates a mechanism for the gradual, voluntary, but potentially large scale, transfer of *existing* residential land – our single most valuable asset - into collective ownership, so that the associated land rents can be socialised, rather than captured by private landowners and banks at society's expense. Second, it helps to establish in the popular imagination the idea that unearned rents arising from the control of a scarce natural resource ought to be shared. Third, if the CGT proved popular and expanded its membership, so the proportion of land remaining in private ownership would shrink. Thus it would become gradually more politically feasible to raise land taxes and advance the broader land reform agenda. As such, the CGT is an institutional change that does not require rupture or coercion, and yet makes possible profound long term political transformation.

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¹ Belfield, C., Cribb, J., Hood, A., Joyce, R., 2014. Living Standards, Poverty and Inequality in the UK: 2014. IFS, London.

² Robert Joyce and Andrew Hood, "Inheritances and Inequality across and within Generations" (IFS, 2017), <https://doi.org/10.1920/BN.IFS.2017.0192>.

³ Conor D'Arcy and Laura Gardiner, "The Generation of Wealth: Asset Accumulation across and within Cohorts," Intergenerational Commission Wealth Series (Resolution Foundation, 2017), <http://www.resolutionfoundation.org/publications/the-generation-of-wealth-asset-accumulation-across-and-within-cohorts/>.

⁴ Land Registry Data and Annual Survey of Hours and Earnings

⁵ John Muellbauer, "Housing, Debt and the Economy: A Tale of Two Countries," *National Institute Economic Review* 245 (August 2018): R20–33, <https://doi.org/10.1177/002795011824500112>; Stephen Gibbons and Stephen Machin, "Valuing School Quality, Better Transport, and Lower Crime: Evidence from House Prices," *Oxford Review of Economic Policy* 24, no. 1 (March 1, 2008): 99–119, <https://doi.org/10.1093/oxrep/grn008>.

⁶ ONS, "What Does the 2011 Census Tell Us about Concealed Families Living in Multi-Family Households in England and Wales?" (Office for National Statistics, 2014), <http://www.ons.gov.uk/ons/rel/census/2011-census-analysis/what-does-the-2011-census-tell-us-about-concealed-families-living-in-multi-family-households-in-england-and-wales-/index.html>.

⁷ "Help to buy has mostly helped housebuilders boost profits", The Guardian, October 21st 2017, <https://www.theguardian.com/money/blog/2017/oct/21/help-to-buy-property-new-build-price-rise>.

⁸ "Housebuilders charge premium for Help to Buy properties", Financial Times, August 8th 2017, <https://www.ft.com/content/d763c9fa-7c31-11e7-9108-edda0bc928>.

⁹ See Tony Dolphin and Matt Griffith, "Forever Blowing Bubbles? Housing's Role in the UK Economy" (London: IPPR, 2011); Josh Ryan-Collins, Toby Lloyd, and Laurie McFarlane, *Rethinking the Economics of Land and Housing* (London: Zed Books, 2017).

¹⁰ Our tax system has failed to discourage such behavior. See Corlett and Gardiner, “Home affairs: options for reforming property taxation”, (Resolution Foundation, March 2018)

¹¹ Peter Saunders, *Restoring a Nation of Home Owners: What Went Wrong with Home Ownership in Britain, and How to Start Putting It Right* (London: Civitas, 2016).

¹² Ian Mulheirn, “What Would 300,000 Houses per Year Do to Prices?,” *Medium* (blog), April 20, 2018, <https://medium.com/@ian.mulheirn/what-would-300-000-houses-per-year-do-to-prices-f506e82bbe8d>.

¹³ <https://www.telegraph.co.uk/business/2017/11/16/skills-shortage-tightens-around-uk-construction-sector/>

¹⁴ It is estimated, based on the Labour Force Survey, that the number of concealed households in the UK - that is, family units without their own home - rose by 50 percent in the past decade, from 1.6m in 1996, to 2.5m households in 2016. Aldridge, Stephen (2018) ‘The housing market: challenges and policy responses’, *National Institute Economic Review*, 245 (August) 2018.

¹⁵ See Generation Rent (2016). Secure tenancies, strong families, stable communities: reforming private renting.

¹⁶ Evictions are the number one cause of homelessness. Even for those unlikely to be made homeless, section 21 can mean constant anxiety and insecurity. See Shelter, “Unsettled and Insecure: The Toll Insecure Private Renting Is Taking on English Families,” February 2017, https://england.shelter.org.uk/_data/assets/pdf_file/0005/1343390/unsettled_and_insecure.pdf. Shelter, “Press Release: Eviction from a Private Tenancy Accounts for 78% of the Rise in Homelessness since 2011,” March 23, 2017, https://england.shelter.org.uk/media/press_releases/articles/eviction_from_a_private_tenancy_accounts_for_78_of_the_rise_in_homelessness_since_2011.

¹⁷ John Muellbauer, “Housing, Debt and the Economy: A Tale of Two Countries,” *National Institute Economic Review* 245, no. 1 (August 2018): R20–33, <https://doi.org/10.1177/002795011824500112>.

¹⁸ See Financial Stability Report June 2017, Bank of England, pp. 6-7, <https://www.bankofengland.co.uk/financialstability-report/2017/june-2017>.

¹⁹ Where sellers struggle to find a buyer to purchase only the bricks and mortar, the CGT could potentially act as a ‘buyer of last resort’, to ensure that members don’t become trapped.

²⁰ The precise ratio between sales values and rental values varies by region. This figure is based on the average gross rental yield for England and Wales in June 2018. Your Move, “England and Wales Rental Tracker,” July 2018, https://isl-assets.s3.amazonaws.com/islps/uploads/media_file/rental-tracker-july18.pdf.