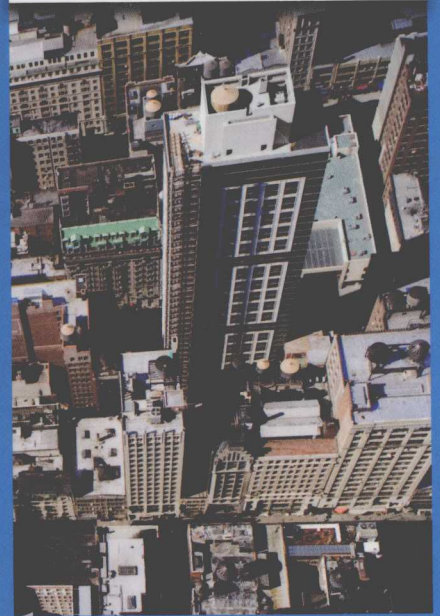


REAL ESTATE ISSUES



# Housing Markets & Planning Policy

Colin Jones & Craig Watkins

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# Housing Markets & Planning Policy

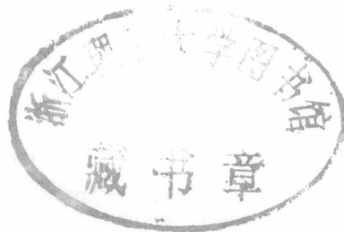
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Colin Jones  
Craig Watkins  
October 2008

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# 1

## Introduction

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At the time of writing this book, the international authorities were engaged in coordinated action to shore up the international financial system and to avoid an unprecedented global economic recession. International housing markets had already seen significant adjustments to property values and numerous developers had been plunged into serious financial difficulty. The rate at which housing markets entered recession took many by surprise and has kick-started a process of adjustment in the perceptions and expectations of consumers and investors and in the rhetoric and priorities of policy makers.

Real house prices had risen very strongly in the vast majority of OECD (Organisation for Economic Co-operation and Development) countries since the mid-1990s. The rate of inflation had been particularly high in the UK, Ireland, Spain, the Netherlands, Belgium and Australia. This housing boom was notable for the size and duration of the market upturn and for the extent to which there has been convergence in price trends across countries. Significantly, housing market trends – it is argued – have become disconnected from economic fundamentals and had moved out of step with the business cycle (Girouard *et al.*, 2006). In fact, the International Monetary Fund (IMF) suggested that house prices in the UK, Ireland and Australia were 20–30% higher than could be justified by rising incomes or population growth (IMF, 2008). The explanation for this is, of course, complex and partly reflects mortgage lending practices, and non-rational investment behaviour. The weak response of new housing supply to price signals has also been a widespread problem. This low level of responsiveness reflects the high construction costs in some countries, such as the Netherlands and Sweden. Importantly, however, it also reflects the fact that most countries have imposed tight policy constraints to limit land supply (Ball, 2006).

These governmental constraints on land supply are to some extent understandable. Spatial economic restructuring and population growth have underpinned rapid urbanisation and urban sprawl around the globe. Urban sprawl is often accompanied by a host of negative outcomes including the loss of open space and environmentally valuable land, greater car usage and traffic congestion, and the abandonment and/or disinvestment in older neighbourhoods. The response has often been to introduce and expand planning policies to control urban development and mitigate these outcomes, even if this does limit the capacity of the housing market to respond to changes in demand.

These supply constraints make less sense when viewed in a context where owner occupation is the dominant tenure, the population is growing and housing demand is rising rapidly (e.g. in USA, Australia, Spain, Iceland, Greece). In these circumstances large (and growing) segments of the population will be unable to afford access to decent quality homes. Simple (mainstream) economics principles suggest that this can be remedied by increasing the supply of units by such an extent that the price of all new and existing housing is reduced. This can be politically unacceptable. Despite the obvious benefits to households on low incomes there may not be a widespread appetite for lower house prices. In fact, most voters like rising house prices and so do many powerful business interest groups including the development industry, financial institutions, real estate agents, valuers and lawyers. As a result, affordability problems tend to be addressed in three ways: offering lower quality (and cheaper) units; lowering construction costs through grants or subsidies to producers; or lowering real occupancy costs by raising incomes (Downs, 2004). Even though planning policies often explicitly emphasise social equity in the context of housing provision, this tension between controlling sprawl by limiting development and tackling affordability problems by encouraging new building and/or propping up demand continues to pose a conundrum for policy-makers and academics worldwide. This book seeks to explore these issues. It is hoped that, while we acknowledge that the arguments developed in the book are grounded within the context of planning for housing markets in the United Kingdom, there are important lessons that reach beyond this national context. There are, however, no simple solutions.

## **One housing market or many housing markets?**

In the light of the trends discussed above, the performance of *the* housing market has become a national obsession in the UK. In the upturn, new

stories about house price trends appeared in the popular press and media with relentless regularity. Even now, the appetite for housing market news remains undiminished, even though tales of significant price rises and acute affordability problems have recently been replaced by stories of double-digit price decreases and record levels of repossessions and mortgage arrears. These stories have been and continue to be fuelled by a never-ending supply of market reports produced by mortgage lenders, including HBOS and Nationwide, who have an interest in supporting the profile of their brand; by professional organisations, such as the RICS, who seek to be seen as mature commentators on the property market; and by an ever-increasing number of firms who provide HM Land Registry house price data online and have businesses to promote. Although they are used in the press in a relatively indiscriminate manner, and there is almost never any veracity warning attached, the price indices published by these organisations vary greatly in terms of the methods used in their construction, their technical reliability and their accuracy. Very often each tells a marginally different story but this only serves to fuel the interest.

Significantly, these market indicators tend to be at their least meaningful when highly aggregated (at the national or regional level) and their least reliable when disaggregated to the local level. At the highest levels, the indices suffer from aggregation bias associated with pooling prices from different markets. At the local level, where sample sizes are smaller, price changes are often a result of differences in what has been sold between reporting periods rather than any substantive change in underlying market conditions. This information offers little basis for an authoritative discussion about house prices in the UK, the South East or even the Sheffield or Edinburgh housing markets. This practice also exemplifies a more general problem in housing market analysis.

A key theme in this book is that the tendency to talk about *the* housing market is actually rather unhelpful. This masks the fact that, even in a buoyant market, there are some neighbourhoods where prices have remained flat or have fallen and that, despite the overwhelmingly gloomy media coverage in recent months, *some* homeowners in *some* neighbourhoods in *some* parts of the country have continued to experience price rises. The reality is that there are many markets for housing and that the geography of the housing market (or should that be markets) is extremely complex. These broad housing market indicators might be helpful in very general terms but one of the central arguments in this book is that it is important that the complex spatiality of the housing system (and the markets and submarkets that are its component parts) is properly understood. Planning

policy decisions, in particular, need to be informed by highly detailed and relatively sophisticated analyses of the system.

## **Housing markets and planning policy**

This brings us to a second important theme: the role of planning in the housing market. The UK housing system has, in recent years been characterised by strong household growth and acute housing affordability problems. As a result, the government plans to deliver three million new homes in England by 2010. The planning system has increasingly become central to securing the delivery of this large increase in supply, but these new housing targets are highly contentious.

The planning system has long operated in an extremely politicised context in which the powerful interests of the private development industry are opposed by a strongly protectionist environmental lobby. Both sets of combatants have become increasingly sophisticated in their engagement with the media. Both sides score occasional wins as the take on the 'conflict' surrounding housing targets switches from the folly of decisions to support the building of 'soul-less boxes' or 'concreting' over the countryside to the failure to ensure an adequate supply of homes for first-time buyers and low-income and disadvantaged groups. The planning system, it seems, never wins, largely because, as currently framed, it has been set unattainable objectives.

The goals of the planning system have actually been recast in recent years. The concern is now with spatial planning which the government believes 'goes beyond traditional land use planning to bring together and integrate policies for the development and use of land with other policies and programmes which influence the nature of places and how they can function' (ODPM, 2005a). Spatial planning it is argued involves 'critical thinking about space and place as the basis for action and intervention' (RTPI, 2007). The planning system is now responsible for place making and has been charged with supporting 'sustainable development' and helping to create 'sustainable communities'. But framing planning objectives in these holistic terms creates significant challenges. It is well established, for example, that concepts like sustainable development are too vague to be operationalised (Campbell, 1996). This vagueness and holism introduces intractable tensions between competing policy objectives, especially when these can be seen to independently argue for the primacy of economic development or environmental protection or social equity at different times and when there is a failure to acknowledge the difficulties associated with managing tradeoffs.

The broad scope of the objectives set for 'planning' has made it a relatively easy target for critics. Mainstream economists, in particular, have been engaged in a sustained attack on the outcomes of development control and other land-use planning policies (e.g. Evans, 1988, 2003; Dawkins and Nelson, 2002). It is hoped that, in this book, we will develop a more nuanced and broader-based discussion about the effectiveness of the planning system. One major difference in our analysis is that we see planning as the broad range of spatial policies discussed above, rather than as a narrow set of regulatory functions. Another is that we acknowledge that there are long-standing tensions between the broader visions for planning and the rather more technocratic aspects of practice. The planning practitioners operating within this complex policy environment have little unambiguous guidance on how best to resolve inherent tensions. The argument developed here is that the planning policy environment and the operation of the housing market are both complex and, by extension, it is important to recognise that the solution to contemporary challenges in planning for housing will be complex too. There are no easy fixes. Politicians need to make difficult decisions, planning professionals need to embrace new competencies, and housing economists need to offer greater conceptual clarity and better analytical tools. Significantly, however, it is our contention that the planning system will never be able to effectively plan for the housing market in its current form.

## **The analytical approach**

This book is centrally concerned with building an understanding of the workings of *housing markets*. The analytical focus will be on the *local* spatial scale and will be based on a distinctive *economic* disciplinary perspective. It is hoped that the adoption of an explicit economic perspective might be seen in a positive light. It is not our intention to add another voice to those that have used mainstream economic theory as a basis to attack the planning system. Rather it is hoped that we offer a constructive assessment of the strengths and weaknesses of planning policy and practice. The need for an effective planning system should be taken as a given.

We also hope that, in writing this book, the more esoteric concerns of applied economic analysis (undertaken by these authors and others) are presented in a relatively accessible non-technical manner. We remain aware, that as recently as the mid-1990s, there was a feeling that economists' contributions to housing policy debates were of limited interest to

other housing analysts. As Maclennan and Whitehead (1996: 341) noted in the editorial to a special issue of *Housing Studies*, 'many of those interested in housing studies find the approach taken by housing economists both difficult to follow and of insufficient interest to make it worthwhile to understand the language'.

For almost forty years, economic analysis of local housing markets has been dominated by quantitative model building. Researchers have expended considerable effort in the pursuit of mathematically elegant models of market outcomes. These models have been predicated on a well-known and widely accepted, although clearly unrealistic, set of behavioural assumptions. The primacy of this approach has had what might appear to be slightly strange consequences for the focus and goals of applied research projects. As Smith *et al.* (2006: 82) observe:

in housing economics, the essence of markets is still taken for granted: the question broadly speaking, is how can markets best be modelled, not how they are variously made.

Thus, the focus of housing economic analyses has been on accurately capturing market outcomes (prices paid and levels of new development, for example) rather than explaining the process through which these are achieved. To some extent, the way in which we arrive at these outcomes has been regarded as something of an irrelevance and, for most economists, the realism of the assumptions is unimportant as long as the world behaves 'as if' they are true and outcomes can be accurately modelled (Ball, 2002).

In this context, it is not entirely surprising that the rest of the housing research community tended to ignore the contributions of applied economists. It is equally unsurprising that practitioners engaged in local market analysis generally feel that academic research has little to offer them. But, as we argue throughout this book, it is our contention that an economic perspective has much to offer.

The challenges that academic housing economists find most difficult are similar to those that present problems in planning for housing markets in practice. First, economists have been struggling to develop a consensus about the best way to theorise the market(s) and, in particular, to deal with complex spatial structures. The analytical problems presented by the unique characteristics of housing (as an economic commodity) are well documented and economists continue to seek the best way to accommodate product heterogeneity, complex spatiality (at different scales) and temporal instability

in a coherent theoretical framework. Second, they have been looking for innovative ways with which to meet the challenges associated with finding the most appropriate methods to analyse relevant information. Third, they have been wrestling with the considerable practical constraints presented by the relatively poor quality and limited quantity of available data.

We would further argue that this analysis is particularly timely. The UK housing system is now more market-oriented than ever. Housing analysts are now concerned about the ability of the market to deliver new housing, the price and affordability of owner occupation, and the extent to which policy instruments might be used to stimulate and steer market processes. This rise in the level of interest in the role of the market would appear to have been accompanied by a perceived need for a greater understanding of market economics. This impression has been reinforced by the widespread recognition of the macroeconomic policy significance of the instability of the housing market. More specifically, Kate Barker's *Review of Housing Supply*, and subsequent consultation and evidence building exercises, has provided the impetus for numerous new regional and national econometric studies of the housing market in the UK (see Barker, 2003, 2004; Meen *et al.*, 2005b).

This focus on the local level also makes this book distinctive. Those familiar with the UK housing economics literature will, of course, be aware that until recently it has largely been concerned with understanding the drivers of markets at the local authority, regional and national levels (see Meen, 2001 for a review). However, the coexistence of highly pressurised areas with acute affordability problems and depressed, low-demand neighbourhoods in need of renewal emphasises the need for enhanced understanding of the structure and operation of housing markets at the local and neighbourhood levels. As Smith and Munro (2008: 159) note:

[d]escribing, analysing and understanding how markets work...has never been more urgent. But much more is known about the macro-scales than the microstructures.

This book thus seeks to help plug this gap and, in doing so, it draws on a series of local-level studies of market and submarket dynamics undertaken by the authors (Jones *et al.*, 2003, 2004, 2005a; Jones, 2002; Watkins, 2001). It is also concerned with relating the insights of these local level studies in the context of wider debates about the relationship between public policy, planning and housing market performance.



## **Aims and objectives**

The aim of this book is to argue that effective planning decisions must be underpinned by a detailed understanding of the economic structure and operation of the housing system. There are four key objectives. These are to:

- introduce the main policy challenges that contextualise planning for housing in a market system (with particular reference to the UK);
- explore the ways in which, in extensive international literature, economists theorise urban (local) housing markets and consider the extent to which a framework that emphasises segmentation can help enhance our understanding of the workings of the owner-occupied sector;
- undertake a critical evaluation of the current system of planning for housing based on an examination of the way in which planning decisions are made locally and the aggregate impacts of these decisions and the policies that frame them;
- consider how the system of planning for housing might (or ought to) operate to better steer housing markets.

## **The structure of the book**

The pursuit of these objectives has helped to structure the book. The next part of the book (Chapter 2) sets the context for what follows by introducing the main housing and planning policy challenges in the UK today. The chapter provides an overview of house price trends at the regional and national levels during the last thirty years or so. These trends are explained in large part by macroeconomic forces. The discussion, however, also introduces housing affordability problems, the emergence of housing supply constraints, the nature and extent of tenure change, and growing concerns with sustainable urban forms. These issues are all revisited in subsequent chapters.

The second part of the book (comprising Chapters 3 to 5) is concerned with the structure and operation of the housing market. It offers a highly selective discussion of the way in which economists theorise and analyse the workings of the local systems. Chapter 3 considers market definitions and discusses different mainstream economic approaches to conceptualising the spatial structure of local housing markets. This analytical framework provides a starting point from which to begin to explore the implications of planning policies for the spatial distribution of house prices and housing



densities. The final part of the chapter explores the theoretical and practical issues in defining housing market areas for use in policy making.

Chapter 4 considers the internal structure of local housing markets. It argues that markets are highly segmented and ought to be conceptualised as a set of interrelated submarkets. This chapter provides a brief account of institutional economic approaches to theorising market structures and explains how some of the key insights, particularly the notion of the housing submarket, are now combined with mainstream models. The chapter also reviews empirical evidence of submarket existence and discusses the problems associated with identification and delineation of submarket boundaries. It concludes by suggesting that the analysis of migration data offers a relatively powerful practical solution to submarket delineation.

Chapter 5 explores the dynamics of segmented housing markets. It begins by exploring the microeconomics of household location decisions and then explores the movement (migration) of households through dwellings and relates this understanding of market processes to neighbourhood change (including disinvestment, decay and revitalisation). The analysis explicitly recognises that market dynamics are bound up with tenure patterns and with government policies toward tenure (including notably the right to buy). The influence of planning systems on the dynamics of this structure is not limited to the determination of the quantity and location of new homes. The analysis shows that the planning system has the power to reconfigure the internal structure of the market and redefine the spatial distribution of house prices.

The final part of the book (Chapters 6 to 8) focuses on planning for the housing market. Chapter 6 begins by charting the relationship between the development of planning policy and urban economic development. It provides an overview of the structure of the planning system and then focuses on the operation of the current system of planning for housing and, in particular, recent steps to increase its sensitivity to market information. The chapter offers a critique of the 'housing numbers' games that have become embedded within the system and of the rather weak role performed by strategic housing market assessments. It is argued that the system suffers from the failure to adequately theorise the market and from the relatively unambitious nature of most market assessments.

Chapter 7 draws back from these operational issues and adopts a broader perspective on the relationship between planning policies and housing markets. It locates the analysis of planning impacts in the context of policies designed to provide affordable homes, to deliver a social mix via planning agreements and to achieve sustainable development. This chapter considers