



Home Economics: How Housing Shapes City Economies

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Executive Summary

Healthy economies need the right supply of housing to support the local workforce and business base. Housing can enhance a city's productivity, but if it is not of the right type, at the right price or in the right place for local people, it can impair and restrict economic potential.

Too often housing policy has been considered in isolation from other factors such as employment and business growth. There is, however, growing awareness amongst policy makers of the links between housing and economic development. Recently, this has been reflected in Housing Minister Caroline Flint's concern over the links between social housing and worklessness, and Transport Minister Rosie Winterton's call for more strategic transport planning to connect residents to jobs.

Nevertheless, the precise links between housing and the economy remain poorly understood and clear policies that link homes to jobs and economic opportunity have been less than forthcoming. The result can be ill-considered housing policy, which can undermine the way our city economies function.

Understanding this relationship is particularly important at the local level. As this report finds, it is local housing markets – not the national picture – that really matter to the economic performance of cities, and by extension, the national economy. Policy makers therefore need to set housing objectives that reflect these local requirements, and the local economic context – not just headline-driven national supply targets.

At the centre, this means that the Department for Communities and

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“Cities need to develop a better understanding of current and future housing demand in their area”

Local Government (CLG) should not be the only ‘housing department’. All departments need to improve their focus on ‘place’, and work harder to understand how their investments affect housing and city economies. City leaders must also do more to align housing investment with local economic development, transport and employment objectives.

Policy recommendations

These policy recommendations apply to CLG, the new Homes and Communities Agency (HCA) and Local Authorities.

Recommendation 1: Plan housing supply in response to clear evidence of economic demand

Cities need to develop a better understanding of current and future housing demand in their area by conducting more comprehensive housing market assessments. They need to actively engage the private sector (developers, investors, landlords and employers) and strategically align these assessments with local economic development plans. Linking housing to evidence based demand should be a key part of the proposed Local Economic Assessment duty, as well as Multi Area Agreements, where applicable (from 2010 onwards).

Recommendation 2: Pool funding across city regions – bringing housing and economic development closer together

This evidence base should be used to re-think housing markets across entire city regions. Cities need to work together and pool housing and economic development funding streams (for example, within Local Area Agreements and Multi Area Agreements). This will help to integrate housing initiatives with local labour markets, transport and regeneration needs across ‘real economies’, rather than working within existing local authority boundaries.

Recommendation 3: In cities where there is high demand for housing, cities should encourage a bigger and better private rented sector

In very high-demand areas (such as London, Cambridge, Brighton and Bristol), the HCA, cities and other partners should encourage greater investment in high quality private rented housing, which is critical to maintaining open and flexible labour markets. Central government also has a role to play in removing the financial disincentives to greater institutional investment in private-rented housing.

Recommendation 4: In cities where there is lower demand, the focus will need to be on quality of place improvements and re-balancing local housing markets

In low-demand areas (such as in parts of Sunderland and Newcastle-upon-Tyne), the focus should be on upgrading existing housing provision, investing in better public transport, other essential public services, and improvements to the wider public realm. This will help to attract high-skilled workers and investors to the region, and re-balance local housing markets.



Housing - the great British obsession

Housing matters command a great deal of attention across the UK. The concentration of wealth (and debt) in residential property, and the important role housing plays in facilitating social mobility and employment, means everyone has a considerable stake in the performance of their local housing market. New housing requires land and construction resources (as well as specialist services such as those provided by lawyers, agents and surveyors). Trading activity in the second-hand housing market also ties up household resources, creates economic activity in related markets, such as building services, and directs savings and investment into the sector. Many cities have also seen remarkable growth in residential investment through buy to let, while in others social housing and Housing Benefit remain essential safety nets for the disadvantaged.

In recent years, housing has become a priority in policy terms. A central feature of this has been the emphasis on raising the number of units being built for market sale to reduce long-term house price inflation and increase affordability. Growing attention is being paid to ways of increasing affordable housing provision, including developing shared ownership and equity products. This is being played out across towns and cities through the negotiation of planning agreements for affordable housing quotas. These have generated fierce debate over the distribution of residential development, proposed tenure splits and the ultimate economic, social and environmental sustainability of development activity.

While housing is often discussed in national terms, and the existence of important housing-macroeconomy linkages is undeniable (Goodhart and Hofmann, 2007), housing systems are 'ineluctably local' (Maclennan, 1982). The capacity of local housing systems to deliver enough housing at affordable prices, of the right type, in the right place, and at an acceptable standard, is essential to the economic health of cities and city regions.

A key conclusion of this report is that city-level policy makers need a much better understanding of how housing processes unfold, and how policy interventions are likely to impact on local economies. Housing cannot be treated as an isolated issue and policy needs to reflect better the nature of this interdependency with the wider economy. Cities need to move beyond the narrow policy agenda of delivering on national headline targets, and develop a policy approach that will harness the role of housing as a distinctive driver of urban economic performance.

This report reviews the evidence of recent housing market and economic change in the context of national housing policy concerns. The specific nature of the interdependencies between local housing systems and city economies are then explored using case study examples from UK cities, with particular attention paid to the city regions based around London and Newcastle-upon-Tyne. The report presents these interdependencies as a framework for considering future policy development.

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Recent housing market developments, responses and impacts

Due to pronounced media attention, many homeowners and commentators are now familiar with the stylised facts of the national housing market - in terms of house prices, affordability, mortgage markets, the growth of buy to let and plans to expand urban housing supply.

National Housing Market Developments

- **House prices:** according to the Council of Mortgage Lenders (CML) and CLG, the average UK house price grew steadily from £61,366 in 1992 to £204,813 by the end of 2006, a nominal 3.33 fold increase in 14 years.
- **Land prices:** for England and Wales (excluding London), an index of bulk residential land prices grew from 52.0 in 1992 to 279.9 by the end of 2006. This is an increase of nearly 5.4 fold.
- **Income and inflation:** house and land price increases far exceed those for income and for general prices. Household disposable income grew by 92 percent between 1992 and 2006 and general inflation by around 40 percent over the same period.
- **Household growth:** current estimates suggest that England's population will rise from 49.8 million to 54.8 million between 2006 and 2026, with the greatest increases in the South East. Over the same period the number of households is expected to increase from 21.5 million to nearly 26 million.
- **Mortgage defaults:** CML member lenders report rising mortgage default figures for the last 3 complete years, reaching 22,500 in 2006 and 27,100 in 2007.
- **Buy to let:** the growth of this sector has been unparalleled and distinguishes the current housing cycle from the last one. Recent figures from CML suggest that there are now more than 1.038 million buy to let loans outstanding and that the number of new loans grew every year between 1999 and 2007, with 350,900 loans in 2007 alone.

The main issue driving national housing policy over the next decade will undoubtedly be the identification of ways to generate significant increases in supply. This is likely to be supplemented by a range of initiatives to support new investment in affordable housing in order to mitigate the economic consequences of growing affordability pressure. The Government has proposed a target of 240,000 additional homes per year by 2016 (CLG, 2007b). During 2006-07, however, only 168,000 units were completed, falling behind projected household growth. With the market entering a cyclical downturn, completion rates are expected to drop further this year. Housing starts are already down by 10 percent in the year to March 2008.

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English Housing Green Paper Proposals

The Green Paper ‘Homes for the future: more affordable, more sustainable’ (CLG, 2007b) advocates a major expansion of housing supply, including affordable and social housing, in England. It is being taken forward by the Housing and Regeneration Bill (CLG, 2008b) which will include:

- A target of 3 million new homes by 2020, supported by new policy instruments and incentives to bring forward land in new ways and encourage investment
- The establishment of the new Homes and Communities Agency
- Increased levels of social and intermediate market housing
- Enhanced affordable housing delivery
- More environmentally sustainable homes
- ‘Unlocking’ of the planning system to bring land and new homes forward more quickly.

These policy objectives, if delivered, will shape city economies in several important respects:

- Apart from injecting large absolute numbers of new homes into city regions, the supply will alter the relative value and composition of existing housing stock. This may make marginal areas of existing neighbourhoods and communities more or less attractive, while creating opportunities for redevelopment and regeneration.
- The quality of complementary infrastructure development, community investment, and place making that occur alongside new housing investment will be important. Unless there is adequate investment in infrastructure, housing growth will not be sustainable, with negative long term consequences for city competitiveness.
- Increased house building and construction investment can be an important employment generating activity in itself.

Housing, however, is not a straightforward commodity to analyse.

Unanticipated factors can play a role in determining supply and demand conditions, while unintended consequences can also follow from any given policy initiative.

Housing Economics: an overview

Housing is a complex commodity (Quigley, 1979; Maclennan, 1982; O’Sullivan and Gibb, 2003; GLA Economics, 2003). In particular, it has the following distinctive economic characteristics:

- **Housing is a durable good:** raising issues around long term maintenance and depreciation, and creating opportunities for splitting ownership from consumption.
- **All houses are unique:** in terms of size, type, location, and access to services. The heterogeneity and experiential nature of housing creates difficulties for economic valuation and price index construction.
- **Housing is a joint good:** when a property is purchased or rented, a



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neighbourhood and a Local Authority are acquired at the same time. As housing is fixed in space, positive and negative spillovers, such as noise pollution and transport congestion, impact on property values.

- **Housing creates a joint market:** with housing finance. Housing is expensive relative to income and typically requires long term borrowing to facilitate purchase. The availability, terms and conditions of credit are therefore essential to determining whether the housing system is functioning well.

The fact that housing is bought both as a consumption good and as an investment creates further complications for the smooth operation of local housing systems. Changes over time in the liquidity, risk and returns to housing relative to other types of assets can lead to rapid fluctuations in the volume of funds flowing into and out of a local housing system. Tightly controlled land supply, the planning permission system of land release, and a volatile asset market for housing create a further interdependency between the private housing market and the asset market for urban land (Evans, 2003).

The extensive framework of local and national government intervention in the housing sector adds a further layer of complexity (CLG, 2007c).

- **Regulation takes place:** despite liberalisation, with respect to the private rented sector, mortgage lending, social housing and through the application of normal trading rules.
- **Considerable public subsidisation:** reduces the cost of housing through grants and subsidies, debt relief and tax privileges (such as the treatment of home ownership capital gains). The social security system annually provides more than £12 billion for housing specific low-income transfer payments.
- **Stamp duty:** causes market distortions through its ‘slab’ structure, which results in house price distortions around set thresholds.
- **Council housing:** is still provided by local government, directly and through arms-length management organisations. The housing sector is unusual in that the market sector competes with and is influenced by non-market housing.

Notwithstanding these complexities, housing markets change slowly through time. Net additions only add a percentage or two at best to the housing stock in any year. This means that any new supply will take a long time to reduce high house price to income ratios. Recent analysis by the NHPAU (2007) shows that if the Government’s house building targets are met, affordability is still set to significantly worsen. As a result, attention is starting to turn to the role the private rented sector can play in bringing greater market stability, relieving affordability pressure and supporting labour market flexibility (Glossop, 2008).



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Residential investment and urban housing markets

The rapid growth in buy to let investment activity has been one of the most discussed features of urban housing markets in recent years and has captured a large proportion of the urban new build sector.

An Overview of the Buy to Let Sector

- **As a proportion of the market:** buy to let accounts for 3 percent of the national housing stock, or approximately one quarter of private rental stock.
- **Specific investor groups:** can be identified within the buy to let market including:
 1. Small-scale investors with small portfolios who expect to be letting property over the longer-term.
 2. Investors who buy property on a speculative basis and do not always rent them out (owners are primarily concerned with profiting from house price increases). This is commonly associated with the new build apartment market.
 3. A third group of larger, often corporate, landlord investors, focused more on rental income streams than speculative capital growth.
- **Aggregate vacancy rates:** are stable at around 6-7 percent, but there is considerable local variation. Recent research has suggested a vacancy rate of 30 percent in Salford Quays, 35 percent in Liverpool and 30 percent in Leeds (CLG, 2007a; Empty Homes Agency, 2007).
- **Cyclical behaviour:** there is some evidence that landlords are reducing their portfolio of holdings as interest rates rise, and increasing them as rates fall and house prices rise.
- **Buy to let and affordability:** the evidence for buy to let pricing out first time buyers is not clear. Although the increase in buy to let has had an impact on recent house price increases, other factors are more significant – in particular overall housing supply, household growth, income and interest rates.

Source: ECOTEC (2008)

Rental markets are important to city economies. The growth of these markets over the last 10 years, if sustained, will produce important long term benefits in terms of household mobility within and between urban areas. The buy to let market caters for a range of housing demands that are not well met elsewhere in the housing system. It bridges a fundamental gap for those who cannot afford to buy but are ineligible for social housing. An expanded and improved private rented sector can help mitigate the adverse effects of house price inflation, and provide households with greater levels of choice as they move through individual life cycles. For the sector to reach its full potential, however, adjustments will need to be made to the current management and investment model.

A lack of professionalism and poor management standards in parts of the market have contributed to the sector's longstanding image problem. The lower end of the rental market is often associated with transient



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communities, fragmented ownership and absentee landlords, and can be a poor substitute for social renting. Poor standards of management can compound many of the other problems affecting these areas, increasing levels of dissatisfaction and driving more mobile households out of an area (APUDG, 2008). This can have adverse effects on the local economy. Many have called for tighter regulation of the private rented sector, although others are concerned this may deter much needed investment.

It is often argued that increasing institutional investment will help to professionalise the sector. Institutional investors operate a different business model to the speculative buy to let landlord. They seek to achieve efficiencies through economies of scale, with an emphasis on stable, longer term returns, rather than short term capital growth. Institutional investors may also be better placed to help address management and quality issues, and will be less deterred by unstable market conditions.

Levels of institutional investment in the UK, however, are amongst the lowest in Europe, which has largely been put down to planning and fiscal disincentives. The UK planning system primarily focuses on the affordable and owner occupied market. The rental sector, for example, is not differentiated from owner occupation when considering social housing provision through Section 106¹. Some commentators have therefore called for the introduction of a licensing scheme which reduces the social housing requirement for properties remaining in the rental market over the long term². Others have called for a more level playing field for the taxation of institutional investment (Glossop, 2008). Institutional investors in rental property are penalised in terms of both higher levels of stamp duty than individual investors, due to their larger lot sizes, and their inability to reclaim VAT on repairs³.

Cities also need to pay greater attention to their private rental markets. They should think about how the sector can better meet their economic needs, and not simply view it as undesirable residual housing. To do this effectively, they will need to adopt a more proactive stance towards existing stock and make better use of strategic planning tools – both to influence the type of supply, and raise quality standards. The onus should be on all cities to develop a more comprehensive understanding of local housing markets (and not just focus on social housing need) if they are to deliver a housing plan that will better align supply with demand. In an economic environment where private land may be less forthcoming, cities will need to bring forward more public land to help attract institutional investors into the market.

1. Section 106, of the Town and Country Planning Act 1990, allows a local planning authority to enter into a planning obligation with private sector developers. Section 106 agreements are often used to place restrictions on the developers to require them to carry out tasks which will provide community benefits. This is currently one of the main ways local authorities achieve a quota of affordable housing on a development site.

2. Investors in new rental accommodation are required to invest higher sums of capital, as their money is tied up in the long term, relative to traditional house builders who sell immediately upon completion. The argument is that rented accommodation should therefore not attract the same Section 106 requirements – for further detail see GLA Economics (2008) Overcoming barriers to institutional investment in residential property, Working Paper 29.

3. A large investor will pay 4 percent stamp duty for a pool of residential assets compared to 1 percent for single assets under £250,000 (GLA, 2008b). Private landlords also face other tax inequalities at a more general level compared to other businesses and relative to the more favourable tax treatment of private landlords in other countries.



Are we at a housing market turning point?

Key leading indicators suggest, albeit to differing degrees across regions, that the housing market has entered a cyclical downturn. During the spring of 2008, stories of falling nominal house prices, negative equity, professional pessimism and a shrinking mortgage offer beset the market, just as more than a million borrowers approached the renewal of fixed rate mortgage contracts.

Amidst the gloom, it is important to recognise that what happens next is unlikely to be a simple repeat of what happened during the early 1990s downturn. The labour market is a key driver of the housing market and, although unemployment has started to rise, the national employment base and rates are stronger. In order for house prices to drop significantly, there would need to be a surge of property coming onto the market. Market activity is currently low and falling, with the number of transactions predicted to drop by a further 25 percent this year. Most importantly, unmet housing demand (supported by increasing household formation and high rates of in-migration), points to a continuing demand-supply imbalance. With output falling and demand rising, the downward pressure on house prices is more likely to reflect cyclical volatility than a housing market 'crash'.

The greatest uncertainty relates to the wider economy. The exact trajectory of the housing market will depend on how protracted the economic downturn is and how stable employment rates remain. An important lesson from 1989-1993 was that a housing market bust can both exacerbate and feed off wider economic decline. Recent economic growth has been strongly supported by both unsecured credit and housing wealth effects. Unfortunately, the converse is also true in recession (Maclennan and Gibb, 1993). The likelihood of future interest rate cuts will be constrained by rising inflation, fuelled by increasing global energy and food prices, and a falling pound. Compared to the 1990s, borrowers getting into difficulty have less of a safety net because of changes to income support for mortgage interest and under-provision of mortgage payment protection insurance.

Although the extent of the current market adjustment is unclear, what happens next to levels of new housebuilding will be important. During the first quarter of 2008, new housing starts reached their lowest level since 1996 and house prices are now falling in real terms on an annual basis, with further falls expected over 2008-09. This will have direct and indirect consequences for city economies.

Direct business activity associated with the housing market is already starting to slow. The UK's largest housebuilders, Taylor Wimpey and Barratt Developments, have both recently experienced significant jobs cuts and drops in share values. Estate agencies and other business services directly involved in the housing market are also expected to lose work. There are particular fears that work will be delayed on existing sites, leaving physical regeneration projects incomplete and unsightly gap sites that may further knock economic confidence at the city level.

Affordable housing provision is closely tied to the private market. With the majority of affordable housing completions now delivered through Section

“Unmet housing demand points to a continuing demand-supply imbalance”



106 we are likely to see a reduction in supply. There are reports that tighter public spending, in addition to the reduction in private credit availability, is beginning to squeeze the building programmes of Registered Social Landlords. The impact on Housing Associations, however, will not necessarily be severe. They tend to take a longer term view relative to private developers, who are more likely to sell immediately on completion. Housing Associations hold onto developments for the long term and may be able to take advantage of lower property prices.

There is particular uncertainty over the durability of the buy to let market, partly as a result of a growing mismatch between supply and demand. The increasing emphasis on speculative capital growth has resulted in an over supply of one and two bed flats, with some developments lying empty in city centre locations. As speculative investor demand declines in a weaker market, what is left is a gap between what investors were willing to pay for the property and what potential owner occupiers would now offer (Donnell, 2008).

In terms of the indirect effects on city economies, the downturn may influence household formation, migration and mobility decisions. If housing values fall significantly, this may reduce consumption demand for goods and services, although the Bank of England expects income levels and credit availability to be far more significant in this respect. Falling house values, however, also offer a purchase opportunity to investors and will have important redistributive effects to the benefit of potential purchasers, if their own purchasing power (and credit) remains robust. Although falling house prices may make some cities more affordable, falling incomes in a wider economic downturn will reduce the positive effects on housing demand.

The practical challenge now for cities that have ambitious building plans is to judge the level of extra housing required to meet local housing need over the longer term, and provide it in a way that does not exacerbate any of the short term effects of the current downturn. They need to separate trend from cycle, while recognising that each may to some degree moderate the other. Cities must also think through the relationships between urban economies and local housing systems, to ensure that over time delivery of the new supply occurs in such a way that reinforces city competitiveness, economic growth and quality of life.

From the perspective of the private sector, the market downturn represents both an opportunity and a challenge - an opportunity for investors to take advantage of falling property prices and increasing rents, while delivering a more diverse range of housing supply; and a challenge to ensure quality and management standards are not overlooked in a bid to maximise returns.

Moving below the national picture, we need to understand the pattern of recent housing market change at the urban and city regional level in different parts of the country. This is explored in the following section, drawing on the case study examples of London and Newcastle-upon-Tyne⁴.

4. Unless stated otherwise, data reported in this paper comes from the CLG's live tables.

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A tale of two city regions

The London Housing System

The London housing system is quite unique in UK terms⁵. The capital faces strong and enduring demand pressures but also severe income inequality and, in places, profound social deprivation. While the housing market exhibits significant sub regional variation, it also possesses certain ‘London features’. These include a large private rented sector (17 percent of dwellings, compared with 12 percent in the UK), and significant discontinuities in governance that impact on the housing system more broadly through, for instance, different approaches to land release and housing development across the London Boroughs.

Sub-Regional Variation in the London Housing Market

- **Cost of renting versus owning:** it is more expensive to buy than to rent an equally sized market home in every London borough. House prices, however, vary far more than rents. In Bromley, and Kensington and Chelsea, it is twice as expensive to buy as to rent; in Hackney and Tower Hamlets it is around 25 percent more expensive.
- **Affordability:** affordability problems are greatest in boroughs with the highest house prices. In eight boroughs in inner west and outer north London, over 60 percent of younger workers are unable to purchase a property in the borough in which they currently live.
- **Tenure:** social housing is unevenly spread across the capital, with high concentrations in inner boroughs and comparatively little in the outer suburbs. Half of London’s social housing was concentrated within a quarter of council wards in 2001.
- **Homelessness:** levels of homelessness vary widely between London boroughs, with a higher proportion in temporary accommodation in inner and north London.
- **Overcrowding:** overcrowding is also unevenly distributed, with areas of very high overcrowding across most of inner east London, Lambeth and Southwark in the south, and in Ealing and Brent in the west.
- **Supply potential:** much of the capacity for new housing supply is in the Thames Gateway boroughs, but significant potential also exists in boroughs such as Barnet, Brent and Croydon.

Source: GLA (2007; 2008a)

London’s population has been growing since the early 1980s. This has combined with shrinking household size to produce rapidly expanding housing demand⁶. Estimates suggest that without corrective action, demand for housing will increasingly outstrip supply in the years to come.

By 2006, 58 percent of London households were homeowners. Since the mid

5. The data presented for the London case study is for the Greater London Authority (GLA) area.

6. By 2004, there were 3.1 million households, projected to increase to 3.9 million by 2026. Average household size is projected to fall from 2.34 in 2006 to 2.15 by 2026.

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1990s the London economy has experienced strong economic growth, with the London housing market simultaneously experiencing a long property boom⁷. The ratio of lower quartile house prices to lower quartile incomes was 3.99 in 1997, but had risen as high as 9.14 by 2007. The Land Registry recorded the average lower quartile house price in 2007 (quarter 1) as £195,000⁸. According to CML, the average first time buyer advance in London grew from just under £66,000 in 1995 to £215,141 in 2005.

Such rapid and sustained house price increases have created acute problems of affordability in the London housing system. This has created serious supply issues in some parts of the labour market, and has led to rising business costs. According to the GLA, these housing rigidities are constraining economic growth (GLA, 2007). Beyond this, London appears to have played a key role in the transmission of house price ripple effects to surrounding housing markets.

Affordability problems for new households, families and key workers are critical issues and can impose high social costs. This has led to a focus on expanding affordable housing supply across the city. The GLA plans to build 30,500 properties per annum from 2008 to 2016, supported in large part by proposed developments in the Thames Gateway and the Olympics site in the Lower Lea Valley. These are ambitious and challenging targets. Even if they are met, there are concerns that, with development concentrated in the east, affordability pressures are likely to continue elsewhere in the capital.

Under the administration of the new London Mayor, closer partnership working with the borough councils is expected. The Mayor is to replace Ken Livingstone’s 50 percent affordable housing quota with a locally tailored target agreed with individual boroughs. This should help to attract more private investment, although there remains significant concern regarding how the target of 50,000 new affordable homes by 2011 will be met.

The Newcastle Housing System

The Newcastle city region is centred on Tyne and Wear, comprising five municipalities in the former Tyne and Wear County and adjacent parts of Northumberland and Durham counties. It is a medium sized city region, covering a land area of approximately 4,180km², and has a population of approximately 1.65 million people.

Over the last quarter of a century, the economic performance of the Newcastle city region has been weak compared to that of other UK city regions. While the population of the region is currently ageing at a faster rate than the UK average, the demographic profile is also influenced by an inflow of students who typically leave after graduating. More generally, there has been long term outward migration of all age groups. Within the region, there has been a pattern of migration out from the urban core to suburbs and towns within commuting distance. One consequence of these trends has been the emergence of a surplus of older housing stock.

7. Over a longer period, London house prices in 2005 were four times their 1969 level after inflation (GLA, 2007).
8. Land Registry data suggests that there were 166,578 sales in London in 2006.



“Around 20 percent of the housing stock in the North East region as a whole is at risk”

In 2002, Newcastle-Gateshead was announced as one of nine Housing Market Renewal Pathfinders. The Housing Market Renewal programme was introduced to rebuild housing markets and communities where demand for housing was relatively weak and where there had been a significant decline in population, an increase in dereliction, poor services and deteriorating social conditions.

The boundary of the ‘Bridging NewcastleGateshead’ (BNG) pathfinder covers an area from the north west of Newcastle city centre through the city’s West End and large areas of inner Gateshead to the outer east riverside area. It incorporates around 160,000 people, and 77,000 properties – of which 58,000 were assessed to be at risk of low demand (Core City Group, 2003).

HMR Pathfinder Bridging NewcastleGateshead (BNG)

- The BNG area lost around 20,000 people between 1981 and 2001
- 6.6 percent of all properties in the BNG area are empty (around 5,300 homes). Around 40 percent of homes are owner occupied and 45 percent social rented in the BNG area. This compares with 64 percent of homes owner occupied in the North East as a whole (70 percent nationally) and 28 percent of social rented homes (18 percent nationally).
- £64 million of Housing Market Renewal funding was allocated to BNG for the years 2006-8
- Average house prices more than doubled in the BNG area between 2001 and June 2007, but were still significantly below the regional average.

Source: Bridging NewcastleGateshead (2008)

The problem of low housing demand is not confined to the pathfinder area alone. The Core Cities Group (2003) reported that around 20 percent of the housing stock in the North East region as a whole is at risk.

Some of these problems have, however, been partially addressed in recent years (Newcastle City Council, 2006). While Newcastle still has a large number of areas recognised as being deprived, the city now has areas of high vitality as well. The Quayside, for example, has been a regeneration success story, where housing, employment and leisure developments have helped to uplift the city.

Affordability is now considered to be a growing problem. The available supply of cheaper property is increasingly located further afield from core housing markets. This is reflected in worsening house price to income ratios across the city. The ratio of lower quartile house prices to lower quartile incomes grew from 3.09 in 1997 to 6.82 in 2007, with the lower quartile price growing from £34,000 to £106,000 (Land Registry first quarter data). By 2007 quarter 1, the median Newcastle house price was £139,950. At the same time the availability of social housing has reduced and turnover in the private sector has increased rapidly. Household size, as elsewhere, is shrinking⁹ and this is associated with

⁹. Average household size across the North East is expected to fall from 2.26 in 2006 to 2.04 in 2024.



“The potential role for housing investment as a driver of urban growth is much more apparent in Newcastle”

an increase in housing demand. The local development framework contains plans for 18,000 new units between 2004 and 2021, two thirds of which are to be houses. The council also expects additional affordable housing will be necessary to meet growing demand in the city.

Despite this, the regional housing strategy demonstrates that obsolescence remains a key issue in the urban parts of the city region. Recent house price increases may have generated a temporary increase in demand in previously unpopular areas. Nevertheless, longer term action is still required in areas where low demand is both a symptom of economic weakness, and is directly undermining the local economy (Bramley and Pawson, 2002; North East Housing Board, 2005).

Market research into housing aspirations in the North East (Nathaniel Lichfield and Partners, 2005) reveals the need for a significant readjustment of the housing stock profile. There has been under provision of larger, detached properties, and oversupply of terraced housing and flats within specific parts of the city region – the latter being aggravated by the current profile of new housing supply. Both regional and local housing strategies also record a shortage of executive housing in desirable locations and suggest that this imbalance may be directing people out of the city and inhibiting economic growth (Newcastle City Council, 2006). The nature of future supply needs to be better matched to local housing aspiration if Newcastle is to attract the higher skilled workers needed to power business growth and expansion.

What does this mean for city economies?

Although both London and Newcastle face growing affordability issues, the underlying city regional contexts differ considerably.

In London, the housing system is restricting long term economic growth as increasing numbers of potential recruits to the labour force are priced out of the housing market. Employers are forced to increase wage and salary offers to attract or retain employees, substantially increasing the costs of doing business in the capital.

Newcastle faces different constraints. The underlying economy is not as robust, and existing housing provision is of insufficient quality to attract the level of new economic activity necessary to bridge the gap of poor comparative economic performance. The potential role for housing investment as a driver of urban growth is much more apparent in Newcastle, both as an economic activity in its own right, and in terms of improving the inherent attractiveness of the city region as a place to live and invest.

The specific nature of the interdependencies between local housing and urban economic systems in the two locations are likely to differ to such a degree that any given national housing policy initiative is likely to have significantly different impacts. It is for this reason that housing policy must be locally designed and implemented, taking full account of local economic conditions, and how one may affect the other. The following section considers the nature of these interdependencies in greater detail.



Understanding the relationship between housing and the urban economy

Housing, Planning and City Competitiveness

Various factors or drivers influence city economic performance (Simmie et al, 2006), some of which are beyond city policy control (such as the current credit crunch). One important driver is the capacity of cities to attract and retain key workers, entrepreneurs and more generally people with higher skill sets. This capacity is closely linked to a city's quality of life, place attractiveness and whether local planning systems in growing city economies allow the local housing system to match evolving housing demand and aspiration¹⁰.

Simmie and colleagues make a strong case that improvement in the physical infrastructure of cities and, indirectly, in the quality of life associated with specific areas, will be required to support city competitiveness in the future. Conversely, the lack of such an offer can help explain regional out-migration over time from, for instance, the North East, and a corresponding difficulty in attracting and retaining sufficient numbers of skilled workers, deterring business investment and growth.

Case Study Example: Sunderland

Sunderland's housing stock has suffered from a lack of investment, which has resulted in poor quality, vacant dwellings and obsolete housing in certain parts of the city. Although concerted efforts have been made to address this, the limited range of housing provision is still thought to be one of the key reasons behind the high levels of out-migration from the city into neighbouring areas, particularly of higher-income households. Over 75 percent of the housing stock in the city is in Council Tax bands A and B (under £52,000 in value), compared to only 0.5 percent in Bands G and H (£160,000 and above).

Source: Sunderland City Council (2008)

These sentiments are not controversial; many have made similar points regarding city competitiveness more generally (Begg, 2002), and of the role of housing and its impact on productivity in particular (DTZ, 2006). Competitive cities require adequate supplies of a range of good quality affordable housing that can respond flexibly to demand, and help create and sustain attractive communities within which to live and work. An unresponsive housing system, high housing costs, a lack of choice, and less attractive neighbourhoods help explain why some cities are underperforming. Moreover, housing and the residential environment play a large part in determining life chances and livelihoods (Feinstein et al, 2008), though the underlying causal processes are complex and multi-dimensional.

10. The slow and unresponsive planning system has been one of the major causes of delay in the provision of housing and the supporting infrastructure, particularly in the eyes of private sector stakeholders.

“An unresponsive housing system, high housing costs, a lack of choice, and less attractive neighbourhoods help explain why some cities are underperforming”



Understanding Housing and Urban Economic Performance

At any given point in time, all cities will possess a stock of underlying hard and soft assets - the scale, size and nature of its business base, infrastructure, land, and workforce - that will combine to determine quality of life and place attractiveness. Knowing the precise ways in which these are configured is an essential first step to understanding the nature of housing/economy interactions in specific city contexts. It is important that city leaders know where they stand in these regards if they are to use policy to influence the way in which their housing and economic systems co-evolve.

Turning directly to the nature of this co-evolution, factors from both outside and inside the city economy and urban housing market can impact on urban economic performance and shape the housing system, forming a complex two-way relationship. The following sections highlight some of the key elements.

Factors originating from outside the urban economy and housing system

The key external drivers of urban economic and housing market performance are the strength of the wider regional economy, and broader macroeconomic financial conditions. These determine relative asset returns and the state of the national credit market - both the availability of mortgage/non mortgage credit, and the interest rates at which this finance is being offered. The longer term mechanisms through which these factors will then affect the evolution of city economies and housing systems will be international and inter-regional migration on the one hand, and new housing supply volumes on the other.

National and regional policy responses, however, are often formulated to some extent independently of specific circumstances in individual cities. This can be seen in the current Government's national housing targets and initiatives such as Local Housing Companies, where affordable housing targets are set at a minimum of 50 percent regardless of local housing conditions in different cities¹¹.

Case Study Example: Bristol

Bristol's buoyant economy has fuelled household growth in excess of the British average over the past decade. The affordability gap is now worse in the South West than in the South East, and Bristol has the most households in its area affected by it. House prices are over six times average earnings and this is placing substantial pressure on the local housing system. Businesses in Bristol are now citing housing affordability as a key barrier to recruitment and retention.

Source: Bristol City Council (2005)

11. This was a key finding in an All Party Urban Development Group Inquiry (2008) into the practical constraints to delivering national housing targets. The 50 percent affordability target was deemed necessary in London if there was to be sufficient supply of housing to meet demand. In Manchester and other northern urban areas, however, a target of 20 percent was deemed more appropriate, due to the large preponderance of social housing in parts of the city. The report recommended that interventions avoid prescriptive targets and frameworks which may not deliver the types of housing different cities need.

“Businesses in Bristol are now citing housing affordability as a key barrier to recruitment and retention”



“It is essential that new housing development is supported by adequate investment in transport infrastructure”

Factors originating from within the urban economy and housing system

Within the urban economy and housing market, economic growth also induces in-migration, putting upward pressure on existing housing supply, while a growing economy also makes land more valuable.

The development of specific sectors within an urban economy can also lead to specific types of housing system development. For example, cities that build up their higher education function may see this feed into the local housing system as investment is attracted into the student accommodation and private rental market.

Case Study Example: Brighton

The implications of this can be seen in Brighton. The city is home to two universities, the University of Brighton and the University of Sussex. The large student population, and the high rental yields student accommodation brings, have seen the city emerge as one of the most popular locations for buy to let investment in the UK. Brighton’s 20,000 strong student population takes up approximately 75 percent of all rental accommodation.

Source: On the Move (2005)

At the same time, a city’s underlying capacity to grow will have identifiable effects on the local housing system. If a city is congested and commuting times lengthen as growth occurs, this will impact on quality of life, place attractiveness and subsequent location/employment decisions. It is essential, therefore, that new housing development is supported by adequate investment in transport infrastructure.

Case Study Example: Cambridge

Cambridge has historically had a policy of development restraint to control urban expansion and protect the character of the city. This has restricted the potential for major housing development, which has increasingly ‘leap-frogged’ across the green belt into the countryside proper - resulting in high levels of commuting, congestion and pollution. Although growth is now increasingly supported, and viewed as being of national interest, growth potential continues to be limited by a lack of infrastructure provision, environmental constraints (such as the flood plain and green belt) and general shortages of land. Although the city continues to score highly on quality of life and environment indicators - recognised as key factors in attracting highly skilled workers and businesses - both are under considerable strain.

Source: Jonas, A, While, A and Gibbs, D (2003)

Where economic growth generates rising land values and the local planning system is adept at extracting some of this for social purposes through planning agreements, city economic performance can have another direct effect on the housing system by altering the scale and geography of social housing provision. Section 106 planning agreements now contribute to 70 percent of all affordable housing completions in England. In addition, the proposed Community Infrastructure Levy is expected to lever greater levels



“Whether
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of private sector investment into infrastructure to support housing related growth.

Case Study Example: East London

The Britannia Village and Greenwich Millennium Village are both new residential developments constructed on derelict, previously industrial, sites in East London. Section 106 agreements were used to integrate different housing types and tenures with the aim of encouraging social interaction and creating more ‘balanced’ communities. Both developments successfully negotiated approximately 30 percent affordable housing provision, but the outcomes were deemed more favourable in Greenwich Village where affordable housing was pepper-potted throughout the development. Private housing in Britannia Village was developed along the dockside, with affordable housing provision largely concentrated in the lower value areas. The form and maintenance standards made the housing easily recognisable, and the physical segregation of tenures exacerbated social separation.

Source: JRF (2005)

The evidence base supporting the long run benefits of mixed communities is, nevertheless, contentious. The precise impact on levels of interaction between different social groups and on key economic indicators, such as employment rates, remains to be determined. The concentrated levels of deprivation associated with mono-tenure social housing estates has, however, provided enough evidence for many that communities need to be mixed, if they are to be sustainable (Tunstall and Fenton, 2006; JRF, 2006; SDC, 2006; TCPA, 2006).

Whether such planning mechanisms facilitate city growth, or reduce city competitiveness, remains an open question. There is growing concern that the imposition of the Community Infrastructure Levy on top of Section 106 requirements will substantially increase development costs, which could have a dampening effect on overall housing supply. Planning mechanisms will certainly have less utility in a fragile market and, while Section 106 may help to meet the ‘mixed communities’ agenda, the complexity of the system is often blamed for development delays¹².

12. In addition, Local Authorities’ ability to secure a good deal is often limited by site complexity, poor negotiating capacity and competing planning obligation requirements (JRF, 2006).

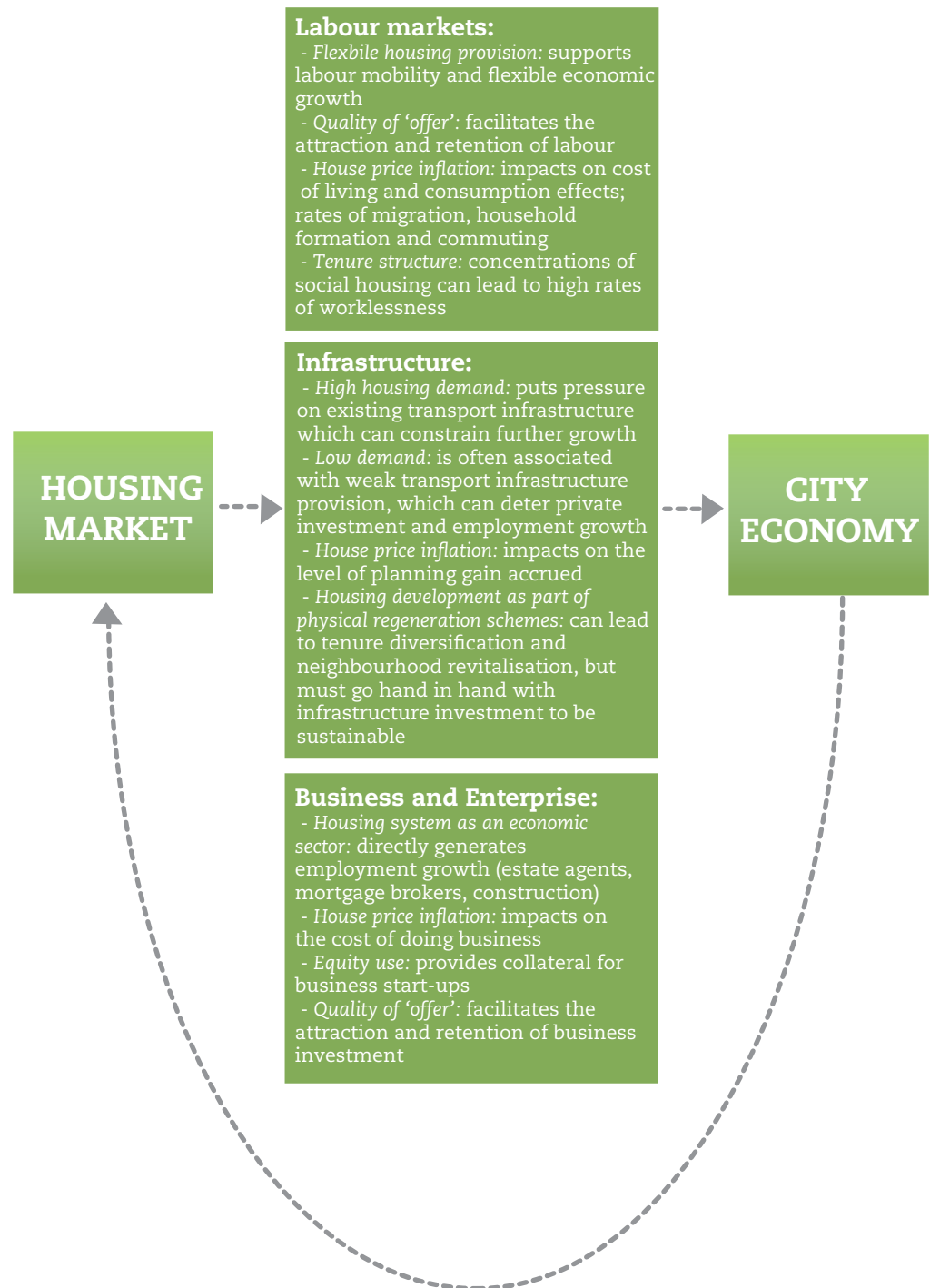


The Relationship between Local Housing Markets and City Economies

The way in which a city’s housing market can impact on the local economy can be summarised under three broad headings: labour markets, infrastructure, and business and enterprise.

Figure 1: How Housing Markets Impact on City Economies

“Housing development as part of physical regeneration schemes can lead to tenure diversification and neighbourhood revitalisation, but must go hand in hand with infrastructure investment to be sustainable”





Labour markets

A flexible housing system - by which we mean one with adequate supplies of a range of housing, including easy access rental housing - is essential to sustaining growth and labour market flexibility, mitigating the adverse effects of migration, and providing housing opportunities for households to move through their individual life cycles. According to Meen et al (2001), a high quality housing and wider neighbourhood environment can play an important role in attracting investment into regions, with jobs following pools of highly skilled workers. Where augmentation of the housing stock fails to keep up with increasing demand, however, this can result in house price inflation, reducing levels of disposable income, increasing commutes and causing suburbanisation. The local tenure structure can also have important impacts on local labour markets - Hills (2007), for example, has pointed to the wider impacts of worklessness among social tenants.

Infrastructure

Housing and population growth can put substantial strain on local infrastructure. If this is not met with adequate investment, cities can suffer high economic costs, such as London. Although house price inflation can lead to greater levels of planning gain, which may be directed towards funding infrastructure improvements, significant funding gaps are likely to remain. Low demand areas are often badly served by public transport, which can restrict resident access to nearby employment opportunities and deter private investment. Housing investment is often a necessary condition for positive neighbourhood change (as in the Newcastle-Gateshead pathfinder example), but this must go alongside investment in the supporting infrastructure for housing development to be sustainable over the longer term.

Business and Enterprise

The housing system is an important economic sector in its own right in terms of capital employed, jobs provided directly from construction, sale and turnover, and housing repairs and maintenance (Gibb and Keoghan, 1998). The housing sector in the London Thames Gateway, for example, has experienced significant jobs growth and is an important local employer. In areas of high demand, such as in London, Cambridge and Brighton, high costs of living will impact on the costs of doing business by raising wage levels – although house price inflation can also provide new business collateral. In areas of lower demand, costs will be lower, but the limited range and often poorer quality of housing provision can fail to attract the necessary skills base.

At any point in time, and in any given city, some of these relationships may be more relevant than others. Attention to the specifics in individual city contexts will be fundamental if policy makers are to reach more effective conclusions on whether, when, where and how best to intervene in local housing markets.

“The local tenure structure can also have important impacts on local labour markets, for example the wider impacts of worklessness among social tenants”



“The local policy agenda needs to move beyond simply increasing supply, and develop a better understanding of housing as a driver of economic performance”

Conclusions and policy recommendations

The overarching message of this report is that housing cannot be treated in isolation. It is inherently linked to urban economic performance through its impact on investor confidence, labour markets, business investment, consumer spending and quality of place. The local policy agenda needs to move beyond simply increasing supply, and develop a better understanding of housing as a driver of urban economic performance. This has implications for the way policy needs to be developed at the city, regional and national level, and for the investment decisions of private sector stakeholders.

These policy recommendations apply to CLG, the new Homes and Communities Agency and Local Authorities.

Recommendation 1: Plan housing supply in response to clear evidence of economic demand

Cities need to develop a better understanding of current and future housing demand in their area by conducting more comprehensive housing market assessments. They need to actively engage the private sector (developers, investors, landlords and employers) and strategically align these assessments with local economic development plans. Linking housing to evidence based demand should be a key part of the proposed Local Economic Assessment duty, as well as Multi Area Agreements, where applicable (from 2010 onwards).

Recommendation 2: Pool funding across city regions – bringing housing and economic development closer together

This evidence base should be used to re-think housing markets across entire city regions. Cities need to work together and pool housing and economic development funding streams (for example, within Local Area Agreements and Multi Area Agreements). This will help to integrate housing initiatives with local labour markets, transport and regeneration needs across ‘real economies’, rather than working within existing local authority boundaries.

Recommendation 3: In cities where there is high demand for housing, cities should encourage a bigger and better private rented sector

In very high-demand areas (such as London, Cambridge, Brighton and Bristol), the HCA, cities and other partners should encourage greater investment in high quality private rented housing, which is critical to maintaining open and flexible labour markets. Central government also has a role to play in removing the financial disincentives to greater institutional investment in private-rented housing.

Recommendation 4: In cities where there is lower demand, the focus will need to be on quality of place improvements and re-balancing local housing markets

In low-demand areas (such as in parts of Sunderland and Newcastle-upon-Tyne), the focus should be on upgrading existing housing provision, investing in better public transport, other essential public services, and improvements to the wider public realm. This will help to attract high-skilled workers and investors to the region, and re-balance local housing markets.



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