



Pointmaker

DON'T HIKE STAMP DUTY

By Jethro Elsdon

EXECUTIVE SUMMARY

- The stamp duty holiday has revived housing transactions, which rose from 132,090 in Q2 of 2020 up to 316,300 in Q4, the highest level since the financial crisis.
- It has also helped to stabilise the housebuilding sector, with more new-builds completed in Q3 than the same period in 2019.
- Because of this it has cost the Government only a small amount in terms of lost revenue, perhaps only £300 million - £1bn.
- With the holiday due to end, the Government risks a slump in the housing market and housebuilding sector, as happened after the financial crisis and at the tail-end of the Lawson Boom.
- This will act as a major drag on growth, make it harder for people to move in response to the changes the pandemic has brought, and deepen the housing crisis.
- To avoid this, the Government should make it permanent on primary homes.
- In an ideal world, it should go further by lowering rates or even abolishing Stamp Duty Land Tax altogether, as one of the least popular and most economically harmful taxes.
- As previous CPS work has shown, this would be far cheaper than the headline figures: raising the threshold on primary homes to £500,000 and lowering other rates to 2005 levels would cost £3.1bn in lost stamp duty revenue, but the cost falls to just £500 million once the wider economic benefits are accounted for.
- Such reforms would also boost new build construction by an estimated 20,000 homes per year, while abolition would deliver an additional 23,500 new builds annually.



INTRODUCTION

In the wake of the coronavirus pandemic, the Government introduced a stamp duty holiday in July last year. In contrast to previous recessions, this helped housing transactions to not only recover but rebound to levels last seen in 2007, prior to the global financial crisis. It has also played an instrumental role in ensuring the construction industry remained buoyant and maintaining the number of new builds coming on to the market.

However, the holiday is due to expire at the end of March. This could have serious repercussions for the economy, the housing market and the construction sector, just at the moment when we will be trying to recover from the economic damage of the pandemic. There is also good evidence that housing preferences have changed significantly – it is likely that there are a large number of people who would still like to move in response to the trends that the pandemic has created or accelerated, who will find it harder or impossible to do so.

In order to prevent a sledgehammer hitting the housing market and wider economy just when it is most vulnerable, and in order to let the housing market respond properly to the changes in housing preferences which the pandemic has caused, the Government must look to make the stamp duty holiday permanent on primary homes. However, given that stamp duty is one of the most unpopular and economically damaging taxes that the Government levies,

there is a strong case for it to go further and more broadly reform the tax, either by fixing rates at a lower level and increasing the threshold, or by outright abolition. As previous Centre for Policy Studies (CPS) work has shown, and this report demonstrates again, the economic benefit of such reforms would mean that the cost of such reforms would be much smaller than a superficial static analysis would suggest.

THE STATE OF STAMP DUTY

Before we address the impact of the stamp duty holiday, and the case for making it permanent on primary homes, it is useful to remind ourselves of how bad a tax stamp duty really is. (Those who have read recent CPS reports such as ‘Stamping Down’, ‘Help to Build’ – which successfully made the case for housing market stimulus in response to the pandemic – or ‘A Framework for the Future: Reforming the UK Tax System’ will be familiar with the arguments, and should feel free to skip ahead.)

Under the stamp duty holiday, the threshold for a primary residence is £500,000. Under that level no tax is due.

The current rates of SDLT are historically very high. Before July 1997, there was only a single rate of 1%, and as recently as the mid-1990s the median buyer of a house in England paid no stamp duty at all.¹ Since then, however, the

1 Scanlon, Kath et al, ‘A taxing question: Is Stamp Duty Land Tax suffocating the English housing market?’, (LSE, 2017). <https://www.lse.ac.uk/business-and-consultancy/consulting/assets/documents/is-stamp-duty-land-tax-suffocating-the-english-housing-market.pdf#page=9>

2 In fact once the overseas buyer surcharge comes into force in April 2021 the highest rate will become 17%. HMRC, ‘New rates of Stamp Duty Land Tax for non-UK residents from 1 April 2021’, (Gov.UK, 2020). <https://www.gov.uk/government/publications/new-rates-of-stamp-duty-land-tax-for-non-uk-residents-from-1-april-2021/new-rates-of-stamp-duty-land-tax-for-non-uk-residents-from-1-april-2021>

3 It should be noted that this was before the current stamp duty holiday. Morton, Alex, ‘Stamping Down’, (CPS, 2019). <https://www.cps.org.uk/files/reports/original/191026121449-CPSSDLT.pdf>



number of rates has shot up, as have the rates themselves. The top rate now stands at 12% (or 15% for the Higher Rate Additional Dwelling charge²), which means that in high value areas like London and the South East the marginal rate on an average property was 5% prior to the stamp duty holiday coming into force.³

The current rates of stamp duty for a primary residence can be seen below in Table 1. Table 2 shows the rates that applied before the stamp

duty holiday came into force, which are set to apply again if the holiday expires as planned at the end of March.

Under the stamp duty holiday, the threshold for a primary residence is £500,000. Under that level no tax is due. The portion of value above the threshold up to £925,000 is taxed at 5%, and the portion up to £1.5 million is taxed at 10%, and any portion above £1.5 million is taxed at 12%.

TABLE 1

SDLT rates under the stamp duty holiday	
Property or lease premium or transfer value	SDLT rate
Up to £500,000	Zero
The next £425,000 (from £500,001 to £925,000)	5%
The next £575,000 (from £925,001 to £1.5 million)	10%
The remaining amount (above £1.5 million)	12%

TABLE 2

Normal SDLT rates	
Property or lease premium or transfer value	SDLT rate
Up to £125,000	Zero
The next £125,000 (from £125,001 to £250,000)	2%
The next £675,000 (from £250,001 to £925,000)	5%
The next £575,000 (from £925,001 to £1.5 million)	10%
The remaining amount (above £1.5 million)	12%



There is also an additional charge for anyone buying a second (or third, or fourth...) home of 3%,⁴ and from April 2021 a 2% levy on foreign buyers.⁵

There is also an exemption for first-time buyers, introduced by Philip Hammond as Chancellor, up to the value of £300,000, with stamp duty then charged at 5% on the value between £300,000 and £500,000. This was, and remains, a highly popular measure.⁶ However, any purchases above £500,000 do not receive any relief.⁷ Again, this provision particularly affects buyers in London and the South East, with the average price of a first home in the capital now having reached £464,000.⁸

The central story here is that stamp duty has come to take on an ever more important factor in buyers' decisions over the last decade, and become ever more of an obstacle to buying a home or moving between them.

It is not just about the sharp increase in rates. Because the threshold at which stamp duty applies has risen far more slowly than house prices, significant fiscal drag has occurred. The proportion of property transactions liable for stamp duty rose from 42% in 1992 to 73% by 2002. Increases in the threshold, and the impact of the financial crisis, pushed the proportion of

transactions to a low of 45% in 2009 (helped by a temporary increase in the threshold to £175,000). However, it rapidly increased, hitting a peak of 80% in 2016/17 and remaining relatively high at 66% in 2019/20.⁹

The stamp duty holiday helped to reverse this picture, temporarily at least, with just 35% of property transactions liable for stamp duty in Q3 2020, down from 64% in Q2.

The stamp duty holiday helped to reverse this picture, temporarily at least, with just 35% of property transactions liable for stamp duty in Q3 2020, down from 64% in Q2. And in terms of primary home transactions, 87% now won't pay stamp duty, a figure which rises to 93% outside of London and the South East.¹⁰ Clearly if the SDLT threshold had been indexed linked to house price inflation it would be considerably higher than the £125,000 threshold which will return if the stamp duty holiday ends as planned at the end of March.

Because of this, stamp duty has come to take on an ever more important factor in buyers' decisions over the last decade. The increase in rates – both in absolute terms and as a proportion of earnings and more transactions

4 'Stamp Duty Land Tax', (Gov.UK, 2020). <https://www.gov.uk/stamp-duty-land-tax/residential-property-rates>

5 HMRC, 'New rates of Stamp Duty Land Tax for non-UK residents from 1 April 2021', (Gov.UK, 2020). <https://www.gov.uk/government/publications/new-rates-of-stamp-duty-land-tax-for-non-uk-residents-from-1-april-2021/new-rates-of-stamp-duty-land-tax-for-non-uk-residents-from-1-april-2021>

6 Question asking whether respondents thought 'Abolishing Stamp Duty for first-time buyers on the first £300,000 of a property' was a 'good idea', 'wrong priority', 'don't know', (Yougov/The Times, November 2017) https://d25d2506sfb94s.cloudfront.net/cumulus_uploads/document/hne3n1xg7y/TimesResults__171123_VI_BudgetQs.pdf

7 HMRC, 'Stamp Duty Land Tax: relief for first time buyers', (Gov.UK, November 2017). <https://www.gov.uk/government/publications/stamp-duty-land-tax-relief-for-first-time-buyers/stamp-duty-land-tax-relief-for-first-time-buyers>

8 Ivey, Prudence, 'First-time buyers in London: average price of first home in the capital doubled in a decade', (Evening Standard, September 2020). <https://www.standard.co.uk/homesandproperty/property-news/average-price-first-home-london-double-decade-a140106.html>

9 Seeley, Anthony & Keep, Mathew, 'Stamp duty land tax on residential property', (House of Commons Library, January 2021). <https://commonslibrary.parliament.uk/research-briefings/sn07050/>; Data on the years since 2015 are the authors own calculations using data on liable and non-liable property statistics from: HMRC, 'Quarterly Stamp Duty Statistics', (Gov.UK, 2021). <https://www.gov.uk/government/statistics/quarterly-stamp-duty-statistics>

10 HM Treasury, 'House sales rise following introduction of stamp duty holiday supporting nearly 750,000 jobs', (Gov.UK, 2020). House sales rise following introduction of stamp duty holiday supporting nearly 750,000 jobs - GOV.UK (www.gov.uk)



– and the fiscal drag described above mean that the distorting effects of stamp duty on the housing market have increased. More people have been incentivised not to move, leading to a poorer allocation of the UK’s housing stock. At the same time, tighter mortgage conditions in the wake of the financial crisis mean that buyers have to pay the tax upfront out of savings or housing equity, rather than funding it via a loan.¹¹

Ludgrove Property has estimated that the time required for the buyer to save up just to pay the stamp duty on the average home in England has risen from 0.7 years in 2001 to 3.2 years in 2018 – an increase of 357%. In London, the situation is even worse, with the time required for the average property increasing from 1.1 years to 13.7 – a staggering 1,145.5%. It estimates that 75% of the increase in the capital has been driven by rising rates and only 25% by rising house prices.¹² And most of this increase has occurred since the Conservative Party returned to power in 2010 – a bad outcome for a party which prides itself on supporting a ‘property-owning democracy’.

The one big improvement in stamp duty that has been made in recent years is the 2014 reform which switched from a slab system to a slice system. Previously, the house buyer paid the highest rate they were subject to on the entire value of the house. Now, buyers pay each rate only

on the slice of the value above the appropriate threshold.¹³ However, while giving with one hand the Government took with the other, raising the top marginal rate from 7% on properties over £2 million to 12% for properties worth over £1.5 million.

The one big improvement in stamp duty that has been made in recent years is the 2014 reform which switched from a slab system to a slice system.

The impact of a rising stamp duty burden can be seen in Figure 1, which shows annual transaction numbers for England. In the three years leading up to the crash in the property market in 2008/9, transactions in England were above 1.2 million per year and in 2006/7 were over 1.4 million. However, since then transactions have remained stubbornly well below these levels, breaking the million mark in only four of the twelve years since 2007/08 and averaging just under 912,000 per year.¹⁴ This is while the population has risen from about 60.4 million in 2005 to about 67 million today, and the stock of dwellings has risen by more than 2.5 million or 11.6%, including an increase of almost 500,000 or 3.2% in the number of owner-occupied dwellings.¹⁵

11 Scanlon, Kath et al, ‘A taxing question: Is Stamp Duty Land Tax suffocating the English housing market?’, (LSE, 2017). <https://www.lse.ac.uk/business-and-consultancy/consulting/assets/documents/is-stamp-duty-land-tax-suffocating-the-english-housing-market.pdf#page=33>

12 Slater, Fraser, ‘Stamp Duty: The £9.8bn Opportunity’, (Ludgrove Property, August 2019). <https://www.ludgroveproperty.com/post/stamp-duty-the-9-8bn-opportunity>

13 For example, under the rates set to come into force when the stamp duty holiday ends at the end of March, a buyer purchasing a primary residence worth £600,000, would pay nothing on the first £125,000 below the SDLT threshold, 2% on the next £125,000, and then 5% on the other £350,000. Giving a total tax bill of £20,000.

Under the old slab system with the lower rates the purchaser would have paid 4% on the entire £600,000 giving a total tax bill of £24,000.

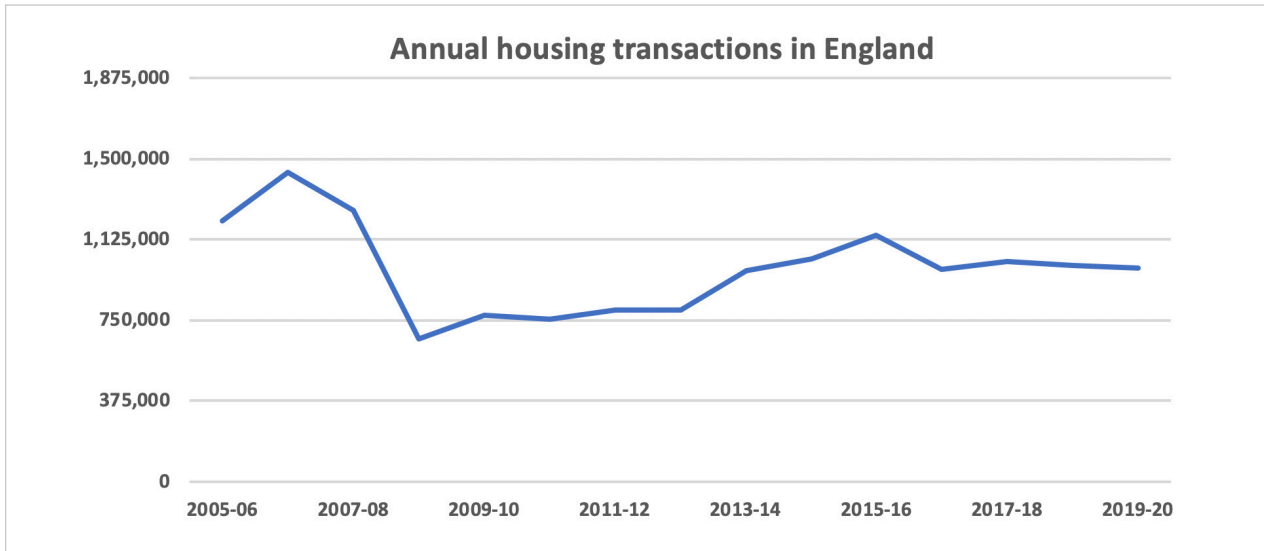
It should be noted that a lower rate system applies to first time buyers purchasing properties worth less than £500,000 and a surcharge applies buyers purchasing an additional home (the Higher Rate Additional Dwelling charge)

14 HMRC, ‘Monthly property transactions completed in the UK with value of £40,000 or above’, (Gov.UK, January 2021). <https://www.gov.uk/government/statistics/monthly-property-transactions-completed-in-the-uk-with-value-40000-or-above>

15 Park, Neil, ‘United Kingdom population mid-year estimate’, (ONS, June 2020). <https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/timeseries/ukpop/pop>; MHCLG, ‘Live tables on dwelling stock (including vacants)’, (Gov.UK, December 2020). <https://www.gov.uk/government/statistical-data-sets/live-tables-on-dwelling-stock-including-vacants>



FIGURE 1¹⁶



As the burden of stamp duty has risen and a growing proportion of transactions have become covered by it, the tax has come to raise a substantial amount of money for the Treasury. In 2019/20 residential SDLT raised about £8.4bn, while non-residential SDLT brought in just under £3.2bn, giving total revenues of £11.6bn. (This was down from the peak of £12.9bn in 2017/18 but still high historically.) This was significantly higher than the £6bn in 2010/11, which in turn was almost double the £3.2bn raised in 1999/2000 – and those figures covered the whole of the UK rather than just England.

The increasingly large sums of money raised perhaps explain why, despite the clear evidence of the damage it does, governments over the last 20 years have failed to reform the tax and ease the burden on homeowners.

HOW STAMP DUTY DAMAGES THE ECONOMY

Stamp duty is widely acknowledged as a bad tax – indeed, some have gone as far as to call it the worst tax on the UK statute books.¹⁸ The comprehensive and highly respected Mirrlees review in 2011 summarises how distorting and damaging it is: 'By discouraging mutually beneficial transactions, stamp duty ensures that properties are not held by the people who value them most. It creates a disincentive for people to move house, thereby leading to potential inflexibilities in the labour market and encouraging people to live (and businesses to operate) in properties of a size and in a location that they may well not otherwise have chosen.'¹⁹

Stamp duty is indeed far more damaging than most other taxes, with the evidence suggesting that for every pound raised as much as 70 or 80 pence of productivity and welfare losses are caused.²⁰ This is

16 HMRC, 'Monthly property transactions completed in the UK with value of £40,000 or above', (Gov.UK, January 2021). <https://www.gov.uk/government/statistics/monthly-property-transactions-completed-in-the-uk-with-value-40000-or-above>

17 HMRC, 'Quarterly Stamp Duty Statistics', (Gov.UK, 2021). <https://www.gov.uk/government/statistics/quarterly-stamp-duty-statistics>; OBR, 'Public finances databank – January 2021', (OBR, January 2021). Data (obr.uk)

18 Clougherty, Tom et al, 'A FRAMEWORK FOR THE FUTURE REFORMING THE UK TAX SYSTEM', (Centre for Policy Studies/Tax Foundation, 2020). <https://files.taxfoundation.org/20201023134831/A-Framework-for-the-Future-Reforming-the-UK-Tax-System-PDF.pdf>

19 Mirrlees, James et al, 'Tax by Design: ch.16 the taxation of land and property', (IFS, 2011). <https://www.ifs.org.uk/uploads/mirrleesreview/design/ch16.pdf#page=36>



four times the damage from income tax, and eight times the damage from VAT. It has also, as shown in previous CPS work, risen to the level where it is becoming counter-productive even for the Treasury. There is good evidence that the top rates of 12% and 10% on the highest valued properties are significantly depressing transactions in the higher value segment of the market.

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While for much of the country such transactions make up only a small share of the total, in London and the South East they are significant – and contribute significantly to tax revenues. But a decline in transactions at the top end has a knock-on effect on the entire market, right down the value chain. Research by Ludgrove Property shows that punitively high rates have caused a slump in high value transactions which has gummed up the entire property market and reduced lower value transactions.²¹ In the top five London boroughs by value, transactions are down by more than 30% since the introduction of the two new top rates of SDLT in 2014. They also find a 98% correlation between increases in the top rate of stamp duty and the decline in London property transactions since 2014.

If we want the property market to work properly, then the entire market at all levels needs to be free

to function efficiently. Reducing rates on lower valued properties while maintaining perniciously high rates on higher value properties will distort how the market functions and interfere with the chain of property transactions. In other words, the property market can't simply be split artificially into different slices: each part of the value chain is connected to the other parts and distortions at one end will feed through into distortions at the other end.

While it is the buyer who nominally pays stamp duty, in reality the cost of the tax gets shared by sellers, who pay via a lower price for their house. Evidence suggests that the incidence of stamp duty – ie who ends up actually paying it, once you account for its impact on house prices – may be split as equally as 60% paid by the buyer and 40% paid by the seller.²² And of course if you do decide to sell, you will likely buy somewhere else and have to pay stamp duty on your new house. So the tax is a burden not only on buyers but on sellers as well.

Yet arguably the biggest negative impact of the tax is how it causes the stock of housing to be poorly allocated, which leads to people living in the wrong sort of housing for their circumstances. This not only harms them, but contributes to the economy's longstanding productivity problems, since it creates a mismatch between the employment and housing markets. Research published in 2018 (based on data before the 2014 slab to slice reforms) found that a 2% jump in the tax rate reduced household mobility by almost 40%.²³

20 Clougherty, Tom et al, 'A FRAMEWORK FOR THE FUTURE REFORMING THE UK TAX SYSTEM', (Centre for Policy Studies/Tax Foundation, 2020). <https://files.taxfoundation.org/20201023134831/A-Framework-for-the-Future-Reforming-the-UK-Tax-System-PDF.pdf#page=60>

21 Slater, Fraser, 'Stamp Duty: The £9.8bn Opportunity', (Ludgrove Property, August 2019). Stamp Duty: The £9.8bn Opportunity (ludgroveproperty.com)

22 Clougherty, Tom et al, 'A FRAMEWORK FOR THE FUTURE REFORMING THE UK TAX SYSTEM', (Centre for Policy Studies/Tax Foundation, 2020). <https://files.taxfoundation.org/20201023134831/A-Framework-for-the-Future-Reforming-the-UK-Tax-System-PDF.pdf#page=61>

23 Hilber, Chistian & Lyytikäinen, Teemu, 'Stamp duty impact on the housing market', (ESRC, February 2018). <https://esrc.ukri.org/files/news-events-and-publications/evidence-briefings/stamp-duty-impact-on-the-housing-market/>



Stamp duty also makes the housing crisis worse, since elderly people are reluctant to downsize, working families cannot move in to larger homes with their children, and it becomes far harder for people to get onto, or move up and down, the housing ladder. Survey evidence confirms that stamp duty is one of the major factors preventing elderly people from downsizing²⁴ – and that even small increases in tax can deter a significant proportion of moves.²⁵

In a housing market where supply was more elastic, inefficient allocation of housing wouldn't matter as much as demand for specific sorts of houses – such as families wanting to upsize into larger houses – could be met by increasing supply. But given the UK's longstanding failure to build enough homes, demand can only be met by people transferring homes. Stamp duty instead pushes down on transaction numbers and sucks liquidity out of the housing market.²⁶ And by discouraging downsizing, it also reduces demand for housing specifically designed for the needs of the elderly. This helps to explain why on an international comparative basis the UK has so few retirement communities, and so little specialist retirement housing.²⁷

But there is another important point. As outlined further below, there is a strong relationship between the number of transactions and

the number of new builds each year. Higher transactions mean housebuilders can be confident of selling any new builds they bring to market, so if transactions rise they will increase the number of new builds. By depressing transaction numbers, stamp duty cuts the number of new builds both completed and started each year.

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Previous CPS analysis, drawing on the academic literature, suggests that a reduction of stamp duty of 1% of the value of the house would generate a 20% increase in transaction numbers. The same analysis estimated that if stamp duty were abolished on primary residences, then this would increase transactions by almost 200,000 and new builds by about 23,500. And even a broad reduction in stamp duty rates rather than full abolition could lead to 20,000 new builds.²⁸

These are large numbers: a 23,500 increase in the number of new builds completed would represent a 13% increase on the 175,250

24 Scanlon, Kath et al, 'A taxing question: Is Stamp Duty Land Tax suffocating the English housing market?', (LSE, 2017). <https://www.lse.ac.uk/business-and-consultancy/consulting/assets/documents/is-stamp-duty-land-tax-suffocating-the-english-housing-market.pdf>

25 Hilber, Chistian & Lyytikäinen, Teemu, 'Stamp duty, mobility and the UK housing crisis', (Centre for Economic Performance LSE, 2017). <https://cep.lse.ac.uk/pubs/download/cp516.pdf>

26 Southwood, Ben, 'Beyond the call of duty', (ASI, October 2017). <https://static1.squarespace.com/static/56edde762cd9413e151ac92/t/59f35a84f9619a618714a5df/1509120655818/Beyond+the+Call+of+Duty+.pdf#page=14>

27 Scanlon, Kath et al, 'A taxing question: Is Stamp Duty Land Tax suffocating the English housing market?', (LSE, 2017). <https://www.lse.ac.uk/business-and-consultancy/consulting/assets/documents/is-stamp-duty-land-tax-suffocating-the-english-housing-market.pdf>

28 Please note here that what is meant is that the size of the SDLT tax bill falls by 1% of the value of the house, not the marginal or average rate of SDLT falls by 1%. In other words, a £6,000 reduction in the SDLT bill on a £600,000 house. Morton, Alex, 'Stamping Down', (CPS, 2019). <https://www.cps.org.uk/files/reports/original/191026121449-CPSSDLT.pdf#page=27>



completed in 2019/20.²⁹ So not only does stamp duty distort the housing market and lead people to stay in housing unsuitable for their circumstances and preferences, it also depresses the construction of new builds. Which makes housing supply even less elastic to price increases and helps to perpetuate the housing crisis, with all the ramifications for the economy and general welfare that entails.

THE IMPACT OF THE STAMP DUTY HOLIDAY

When the pandemic hit at the end of the first quarter of last year and restrictions were applied, housing transactions fell sharply – down to just 132,090 in Q2, a fall of more than 100,000 on the same period the year before.³⁰

As the CPS paper ‘Help to Build’ warned last year, this fits the pattern of previous recessions: a sharp fall in house prices and transactions led to a collapse in housebuilding, from which it took the industry many years to recover (far longer, for reasons to do with the structure of the sector, than the wider economy). The result was a boom-and-bust cycle that deepened the housing crisis and made it almost impossible to reach the necessary housing targets.

In response to warnings from the CPS and others, the Government introduced a temporary stamp duty holiday on residential transactions in July 2020. This raised the threshold from £125,000 up to £500,000 for the period up to April 1st 2021, when the temporary holiday is meant to

end and the system reverts back to normal. This meant that a buyer would pay no stamp duty on the first £500,000 of the house they were purchasing, and the Government claimed this would cut the average stamp duty tax bill by £4,500.³¹ The holiday covered both primary homes and additional home purchasers. The buyers of the latter thus only have to pay the 3% surcharge on properties under the threshold.

As we hoped, the stamp duty holiday had an immediate and significant effect on the housing market and the construction industry. After its introduction at the beginning of July transactions rebounded strongly in Q3, rising to 225,870 from 132,090 in Q2. This rebound has continued in provisional results for Q4 with transactions hitting 316,300, the highest since Q4 2007, before the post-crisis slump.³²

As transaction numbers have risen, so prices have followed. Prices rose by 8.5% in year, with most of the increase occurring in the latter part of the year after the stamp duty holiday was introduced.³³

This has led some people to criticise the stamp duty holiday, arguing that it has merely translated into increased prices. But this misses the point. First, an increase in transactions is a good thing in and of itself, as we will show below.

Second, because the incidence of the tax is split between buyers and sellers – with the latter

29 MHCLG, ‘Live table on housing supply: indicators of new supply’, (Gov.UK, January 2021). <https://www.gov.uk/government/statistical-data-sets/live-tables-on-house-building>

30 HMRC, ‘Monthly property transactions completed in the UK with value of £40,000 or above’, (Gov.UK, January 2021). Monthly property transactions completed in the UK with value of £40,000 or above - GOV.UK (www.gov.uk)

31 HM Treasury, ‘A plan for jobs speech’, (gov.UK, 2020). <https://www.gov.uk/government/speeches/a-plan-for-jobs-speech>

32 HMRC, ‘Monthly property transactions completed in the UK with value of £40,000 or above’, (Gov.UK, January 2021). Monthly property transactions completed in the UK with value of £40,000 or above - GOV.UK (www.gov.uk)

33 Jones, Natalie, ‘UK House Price Index: December 2020’, (ONS, February 2021). <https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/housepriceindex/december2020>



paying the cost in the form of a lower house price – the benefits of the stamp duty holiday will have also been shared, with sellers gaining from higher house prices.

Finally, it is not just the holiday that has pushed up prices. As the ONS shows, one of the things driving the price increases is a surge in demand for larger properties outside the city, as workers either flee the pandemic or discover that home working enables them to relocate further from the commuter belt (we discuss this phenomenon in more detail below). Prices for detached properties have risen twice as fast as those for flats and maisonettes.³⁴

Given the complexity of the housing market, it is hard to disentangle exactly how much of the price increase might be down to factors such as this and how much is down to the stamp duty holiday. But going forward, any increase in prices due to the stamp duty holiday is likely to stabilise. The lower burden of the tax should by now be fully incorporated in higher prices, and because of the temporary nature of the holiday shifting purchasers forward, demand is likely to fall back even if the holiday were to be made permanent on primary homes.

Equally importantly, the stamp duty holiday has been crucial to keeping the housing market moving – and the spillover impacts of the extra transactions and the boost to housing construction have helped to support the wider economy and prevent an even deeper recession. On top of this, stamp duty revenues actually rose by 27% in Q3 compared to Q2, from £1.1bn to £1.35bn, and will undoubtedly

rise again in Q4 given the continuing rise in transactions.³⁵ So although it is raising less compared to the same period in 2019, the tax cut has almost certainly increased government revenues compared to where they would be if there had been no holiday. (Though again, it is impossible to say how much of this activity has been brought forward from future purchases.)

Stamp duty revenues actually rose by 27% in Q3 compared to Q2, from £1.1bn to £1.35bn, and will undoubtedly rise again in Q4 given the continuing rise in transactions.

It is impossible to know how the housing market would have developed over the second half of last year if no stamp duty holiday had been in place, but if revenue had fallen by the same percentage as in Q2 compared to the same period a year earlier, the Government would have been raising less money from stamp duty than with the holiday in place. However, even if we assume that without a stamp duty holiday, transactions would still have recovered in Q3 and Q4 and revenue had only reduced to between 75-90% of 2019 levels (rather than the 57% in Q2) then the Government would have raised just under £300 million - £1bn more in Q3 and Q4 combined than we estimate it will do so with the stamp duty holiday in place. And that is before accounting for the economic benefits and the additional non-stamp duty tax revenue that the extra transactions have created.³⁶

³⁴ *ibid.*

³⁵ Da Silva, Marca, 'Rishi Sunak's stamp duty holiday 'has been critical in keeping the economy moving', (property industry eye, November 2020). <https://propertyindustryeye.com/rishi-sunaks-stamp-duty-holiday-has-been-critical-in-keeping-the-economy-moving/>

³⁶ We estimate stamp duty revenue for Q4 by taking the average amount of stamp duty raised per transaction in Q3, £5,915, and multiplying this by provisional transaction numbers for Q4, 316,300, giving total revenue of £1.87bn.



Furthermore, the stimulus the stamp duty holiday has provided for the construction industry will have prevented some unemployment which will have undoubtedly saved the Government money via lower benefit payments. This bears out the CPS's argument that cutting stamp duty costs far less than initial static estimates might suggest.³⁷

Indeed, these spillover benefits appear to have been particularly significant. The boost to confidence and sharp increase in transactions have caused mortgage applications and approvals to rise to their highest level since 2007. Approvals for home purchases surged in the second half of 2020, reaching 97,500 in October, a level last reached in September 2007.³⁸ Approvals grew further in November and in December stood at 103,400 for the month, 41% higher than the 73,400 approvals in February, prior to the pandemic and the introduction of the stamp duty holiday, and 1,000% higher than the trough of just 9,400 approvals in May.³⁹

Approvals for the whole of 2020 were 818,500, which despite the extremely weak first half of the year was 3.7% higher than the same figure the year before and the highest level since 2007.

THE CASE FOR MAKING THE HOLIDAY PERMANENT

In his 1988 Budget, Nigel Lawson announced that he was ending the ability for couples to pool mortgage interest relief. But rather than bringing

the measure in immediately, he delayed its introduction until August. The result was a frenzy of activity as couples sought to get in before the deadline – and then a slump lasting years.

Capital Economics argue that key to housebuilding activity is the 'absorption rate', that is how quickly housebuilders can sell new homes at prevailing market prices.

The current April deadline may be stirring up some of the same froth – but when the stamp duty holiday ends, demand is expected to drop out of the market.⁴⁰ Another Lawson-style slump would act as a major drag on growth, and would certainly hit the construction industry hard – just when we need to be recovering from the pandemic. As outlined above, there is a strong correlation between the level of transactions and the level of new builds that the construction industry brings to market each year, which Figure 2 shows in more detail. If transaction numbers are high, then housebuilders can be confident that they can sell any homes that they build, and consequently will increase output, both in terms of new builds that they complete but also new builds which they start.

Capital Economics argue that key to housebuilding activity is the 'absorption rate', that is how quickly housebuilders can sell new

These estimates of the cost should be treated with caution. We do not know what would have happened to the property market in the counterfactual where the holiday was not in place. It is possible that transaction numbers and revenue would have recovered to normal meaning the cost of the holiday is larger than suggested here, however given the size of the recession and the great uncertainty about both the course of the pandemic and the financial repercussions it would have this seems unlikely. Alternatively, it is entirely possible that the range of 75-90% is too optimistic and the property market would have struggled throughout 2020, meaning the holiday has cost even less than £300 million in lost stamp duty revenue.

37 Centre for Policy Studies, 'Tax cuts don't have to be taxing', (CPS, February 2020). <https://www.cps.org.uk/files/reports/original/200226140335-TaxCutsDontHaveToBeTaxingOnline.pdf>

38 Romei, Valentina, 'Stamp duty holiday 'stampede' drives soaring UK mortgage market', (FT, November 2020). <https://www.ft.com/content/2449d81c-4114-4f5e-991a-d4a13f1ef6ee>

39 Bank of England, 'Money and credit: December 2020', (BoE, February 2021). <https://www.bankofengland.co.uk/statistics/money-and-credit/2020/december-2020>

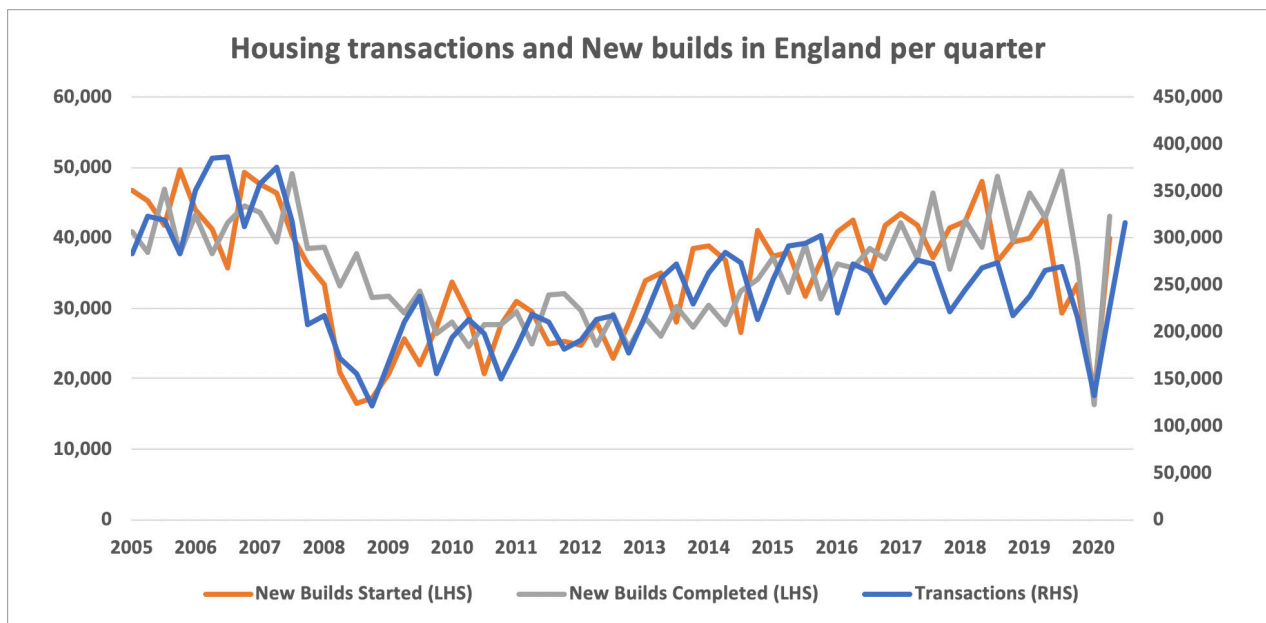
40 Romei, Valentina, 'Stamp duty holiday 'stampede' drives soaring UK mortgage market', (FT, November 2020). <https://www.ft.com/content/2449d81c-4114-4f5e-991a-d4a13f1ef6ee>



homes at prevailing market prices. If transaction numbers fall then new builds will also fall.⁴¹ They estimate that historically the rate has been 10%, that is housebuilders bring to market new dwellings at about the rate of 10% of transaction numbers each year.⁴² CPS research suggests a slightly lower ratio of 8.5 transactions to 1 new build house.⁴³

The data from the pandemic bears out this theory, with the surge in transactions being accompanied by significant increases in both new builds completed and new builds started. Between Q2 and Q3, the number of new builds started rose by 134% from 17,580 up to 39,880. The number of new builds completed rose by an even more impressive 164%, from 16,310 up to 43,070.

FIGURE 2⁴⁴



The stamp duty holiday has, in other words, acted as a very effective form of stimulus for the housing market and construction industry. Once it had been introduced and transaction numbers began to increase rapidly, housebuilders had the confidence to increase the number of new builds they were working on and bringing to market.

This meant they had sufficient work that they didn't need to scale back production or shrink their workforces. This of course will have had a knock-on effect right down the construction supply chain and in the local economy, helping to shore up demand and increase economy activity and stop unemployment from rising

41 Wishart, Andrew, 'New starts likely to remain weak as transactions slump', (Capital Economics, January 2021). https://www.capitaleconomics.com/clients/publications/uk-housing/uk-housing-market-update/new-starts-likely-to-remain-weak-as-transactions-slump/?utm_source=Sailthru&utm_medium=email&utm_campaign=UK%20Housing%20Market%20Update%20180121&utm_term=ce_updates

42 Lu, Hansen, 'Can planning changes boost housebuilding?', (Capital Economics, August 2020). <https://www.capitaleconomics.com/clients/publications/uk-housing/uk-housing-market-update/can-planning-changes-boost-housebuilding/>

43 Morton, Alex, 'Stamping Down', (CPS, 2019). <https://www.cps.org.uk/files/reports/original/191026121449-CPSSDLT.pdf>

44 HMRC, 'Monthly property transactions completed in the UK with value of £40,000 or above', (Gov.UK, January 2021). Monthly property transactions completed in the UK with value of £40,000 or above - GOV.UK (www.gov.uk) ; Live tables on housing supply: indicators of new supply - GOV.UK (www.gov.uk)

It should be noted that the figures for new builds completed and started only go up to Q3 2020, but there are provisional Q4 2020 figures for housing transactions which are here included in the graph.



further. Indeed, the evidence that cuts in stamp duty act as a highly effective form of stimulus is well established, with analysis suggesting that for each £1 of revenue lost, £1 of economic activity is created.

The Government will undoubtedly be looking at ways to spark growth and support industries which are in trouble.

As we gradually loosen restrictions in the spring and summer, the economy is likely to remain weak. Inevitably there will need to be an adjustment process as government support such as furlough is withdrawn and the economy adjusts to a post-pandemic world. The Government will undoubtedly be looking at ways to spark growth and support industries which are in trouble.

Allowing perhaps the worst and most damaging tax on the UK statute books to go back to normal, with perniciously high rates, will be a very good way of undermining growth – not to mention the possibility of a severe housebuilding slump if the housing market falls over the April cliff-edge.

The risks from not extending the holiday by making it permanent on primary homes are, therefore, significant. Unemployment will almost certainly rise over the coming year as the economy adjusts. If the recovery is poor then it could rise significantly. Higher unemployment or even just a higher risk of being made redundant may weigh down the housing market, as financial insecurity makes it less likely a person will move.

By making the stamp duty holiday permanent on primary homes the government would help to ensure that with rising unemployment and the economy still adjusting to the consequences of

the pandemic, the housing market won't be dealt a blow which it will take years to recover from – just as happened after the global financial crisis, and previous recessions.

Not extending the stamp duty holiday will also significantly hurt the construction industry. Although it has been a big beneficiary of the stamp duty holiday, the temporary nature of the policy has brought forward many house moves with buyers seeking to take advantage of lower tax rates. This means that without an extension of the holiday (or permanent reform, as discussed below) the housing market could go from feast in 2020 to famine in 2021, and perhaps in 2022 as well. This means the market for new builds will also be weak and housebuilders will not have confidence that they can sell properties that they bring to market. Thus, supply will fall.

Evidence for this is already apparent in the data for new builds started and completed. Although both rebounded strongly from the first lockdown, the recovery has been more pronounced for new builds completed than new builds started – as builders rush to finish the new builds they have already started before the stamp duty holiday ends and transactions numbers fall.

While the number of new build completions was 0.5% higher than in Q3 2019, new build starts were 7% below the pre-virus level in Q3 2020. Understandably housebuilders expect transactions and thus demand for new builds to fall once the stamp duty holiday ends, and so are planning to complete fewer new builds, instead concentrating on completing the new builds they have already started.

Making the holiday permanent on primary homes will likely cost the government lost revenue. However, as already explained, because a



reduction in stamp duty boosts transactions this will reduce the cost. Furthermore, the spillover effects such as consumer spending associated with house moves and the boost to housebuilding will feed through into other taxes such as VAT or corporation tax.

On top of that, a severe reduction in transaction numbers could plunge the housebuilding sector into crisis and risk much higher unemployment, which would lead to higher benefit costs for the government and might even conceivably lead to the Government having to spend money trying to save the sector from a collapse.

It is also important to recognise that the pandemic and the lockdowns which have resulted from it have changed consumer preferences for housing. As outlined above, demand has shifted from smaller properties such as flats located in inner city areas to larger, more rural properties with access to green spaces. Detached houses have become the most popular property type, increasing their share of transactions from just under 25% in March 2020 to just under 30% in November, while there has been a significant fall in the appetite for flats, with their share falling from 18% to just over 12%.⁴⁵

Rightmove, similarly, has found that 49% of renters and 39% of buyers have changed their housing preferences due to the lockdown. In January 2020, two- and three-bed flats were in the top five most popular property types for buyers, and for renters studio flats were number one. But by May, the top five for both buyers

and renters was entirely made up of houses. Demand shifted to larger properties with more space, with four- and six-bedroom houses making the top five for buyers.⁴⁶

Demand for gardens or access to gardens also grew precipitously, with searches for homes with gardens increasing by 84% among renters and 42% among buyers.

Demand for gardens or access to gardens also grew precipitously, with searches for homes with gardens increasing by 84% among renters and 42% among buyers. Unsurprisingly, home working was a big consideration with 36% of buyers and 26% of renters saying they were after better home working space.

It is not just the sort of properties that people want that is changing, but their location: 30% of buyers now report that they want to live in a rural area,⁴⁷ while searches have doubled for homes in small towns and villages with populations under 11,000.⁴⁸

While the end of the pandemic may slow down or perhaps even reverse these trends to some degree, it seems unlikely that we will simply go back to how things were. Home working, for instance, is likely to continue for many people. At least in the short term the trends towards larger, more rural properties is likely to continue, and factors such as closeness to transport links or length of commute are likely to continue to be less important.

45 Keane, Kathryn, 'Recent trends in the housing market: January 2021', (ONS, February 2021). <https://www.ons.gov.uk/economy/inflationandpriceindices/articles/priceseconomicanalysisquarterly/january2021>

46 Rightmove, 'Flats drop out of most sought after property types as home-hunters seek space', (Rightmove, 2020). <https://www.rightmove.co.uk/press-centre/flats-drop-out-of-most-sought-after-property-types-as-home-hunters-seek-space/#:~:text=The%20most%20sought%20after%20property,type>

47 Ibid.

48 Read, Simon & Espiner, Tom, 'Lockdown city living 'wasn't the best idea'', (BBC NEWS,). <https://www.bbc.co.uk/news/business-544549900>



Yet moving home is a stressful and costly business. It takes time to identify a property you want to move to. And it is highly unlikely that everyone whose housing preferences have changed due to the pandemic, and would thus like to move, has been able to.

With the demand side of the housing market having altered, the market needs to be able to adjust to meet that alteration. The Government should not be trying to stand in the way of this change – indeed, it should be making it as easy as possible for people to improve their welfare by moving to more suitable housing. But failing to extend the stamp duty holiday will do the opposite.

As a transaction tax, it will raise the marginal cost of buying and also selling – since someone selling their home will also have to pay SDLT if they are selling in order to buy another house – and thus depress transaction numbers. This will reduce the choice available for prospective buyers, and the pool of people who might in turn buy that buyer's own house. This in turn will make transaction chains less robust and make them more likely to collapse.

In short, making the stamp duty holiday permanent on primary homes may have a short-term cost to the Treasury. But it risks a far more damaging slump in the housing market. If the Government takes the view that it simply cannot afford the cost of the lost revenue, then significant damage will be done and the recovery will be undermined, especially in the construction industry.

We therefore urge the Government to make the holiday permanent. However, we suggest as a compromise that it could remove transactions involving additional properties – second, third and fourth homes – from the holiday. At present,

such homes are covered by the holiday and only pay the 3% surcharge on the value under the £500,000 threshold. By making them subject to the normal rates of stamp duty plus the HRAD surcharge, the Government would lower the cost of making the stamp duty holiday permanent on primary homes while tipping the scales in the favour of home ownership by owner occupiers.

THE CASE FOR FURTHER REFORM

There is, as outlined above, an extremely strong case for making the stamp duty holiday permanent on primary homes. But there is an even better one for broader, permanent reforms to this awful, damaging and hugely unpopular tax, or even abolishing it entirely.

The top marginal rates of 10% and 12% would remain on high value properties, creating distortions throughout the property market.

Although extending the stamp duty holiday by making it permanent on primary homes would be far preferable to simply letting the tax revert back to normal, it would still leave significant distortions in the housing market and create economic inefficiencies. The top marginal rates of 10% and 12% would remain on high value properties, creating distortions throughout the property market.

In order to avoid these issues, the government could opt for broader permanent reform. Since transaction taxes are inherently flawed and distorting, the optimal policy reform would probably be to abolish stamp duty both for residential and non-residential properties, including the Higher Rate Dwelling and overseas buyer surcharge. As already explained, removing the transaction tax would



allow the market to function properly resulting in a much better allocation of the housing stock. It would also deliver a significant boost to transaction numbers, which in turn would feed through into additional consumer spending and new builds, all of which will lead to other taxes such as VAT, PAYE, and Corporation tax rising and helping to make up the shortfall. This option, which was recommended by the Mirrlees review, has been costed by the CPS at a little over £5bn, once all the beneficial spillover effects are accounted for.⁴⁹

Given the politics and the parlous state of government finances as a result of the pandemic, complete abolition might be a bridge too far: a Government focused on 'levelling up' is unlikely to hand a massive tax break to millionaires in the South East. Mirrlees advocated replacing stamp duty with some form of annual property tax or a Land Value Tax (LVT), both of which could easily make up for the fiscal shortfall and would be far less damaging and distortionary.⁵⁰ However, a property tax or a form of LVT would prove politically difficult, and would likely run into the same issue that council tax suffers from today, namely the political toxicity of revaluations (hence why the last one took place almost 30 years ago in 1993).

There is, however, a public appetite for reform. Research by Public First for the TaxPayers' Alliance found that, by a margin of 66% to 17%,

voters would support the abolition of stamp duty on properties under £1m.⁵¹ More recent research by YouGov has found that stamp duty is among the taxes that voters would least likely to see rise after the pandemic, if tax rises are necessary, with only council tax proving less popular.⁵² Another YouGov survey found 53-18 support for cutting stamp duty after the pandemic is over.⁵³

Research by Public First for the TaxPayers' Alliance found that, by a margin of 66% to 17%, voters would support the abolition of stamp duty on properties under £1m.

Politically and economically, therefore, it makes sense for the Government to support the kind of stamp duty reform proposed by the CPS in its report 'Stamping Down'.⁵⁴ If abolishing stamp duty on all primary residencies is viewed as unaffordable, it proposed a compromise measure: raising the threshold for stamp duty on primary homes to £500,000 and lowering the top rates to where they were in 2005 (while retaining the current slice system).

Under this system, a buyer would pay nothing on the first £500,000, 4% on the value of the house between £500,000 and £1,000,000, and 5% above £1,000,000. This would mean someone buying a

49 Clougherty, Tom et al, 'A FRAMEWORK FOR THE FUTURE REFORMING THE UK TAX SYSTEM', (Centre for Policy Studies/ Tax Foundation, 2020). <https://files.taxfoundation.org/20201023134831/A-Framework-for-the-Future-Reforming-the-UK-Tax-System-PDF.pdf>

50 Mirrlees, James et al, 'Tax by Design: ch.16 the taxation of land and property', (IFS, 2011). <https://www.ifs.org.uk/uploads/mirrleesreview/design/ch16.pdf#page=36>

51 Public First & Taxpayers' Alliance, 'Question: We should reform stamp duty so only those moving to homes worth more than £1m have to pay', (Public First & Taxpayers' Alliance, 2019). http://www.publicfirst.co.uk/wp-content/uploads/2019/10/TPA_Research_July.pdf

52 Yougov, 'Question: If taxes HAD to rise after the next general election, which of the following would you MOST like to see increased? Please tick up to three', (Yougov, 2020). https://docs.cdn.yougov.com/x4tvsgofx8/P_Main_Political_Tracker_Survey_R3_SR_10.pdf

53 Smith, Matthew, 'Few Britons willing to pay more tax to dig public finances out of coronavirus hole', (Yougov, July 2020). <https://yougov.co.uk/topics/politics/articles-reports/2020/07/08/few-britons-willing-pay-more-tax-dig-public-financ>

54 Morton, Alex, 'Stamping Down', (CPS, 2019). <https://www.cps.org.uk/files/reports/original/191026121449-CPSSDLT.pdf>



£600,000 house would pay a total of £4,000 in stamp duty. This compares to the £5,000 they would currently pay with the stamp duty holiday in place, and the £20,000 they would be set to pay when the holiday ends.

Under both the abolition and reform scenarios, non-residential stamp duty would be left as it currently is. In terms of residential stamp duty, the reforms would only apply to primary homes, so buyers purchasing an additional dwelling would face stamp duty rates as they are set to operate from April if the holiday ends. On top of this the HRAD and overseas buyers' surcharges would be retained.

Although this would obviously cause economic distortions, there are two main advantages. First, by continuing to apply normal stamp duty rates plus the surcharges to such transactions, the Government will be able lower the cost of reforming stamp duty for home owners. And second, it will introduce a significant bias in favour of home ownership by owner occupiers, which as the CPS has outlined in multiple reports is a huge economic, social and (for the Conservative Party) political good.

According to the CPS's calculations, abolition would cost an estimated £5.1bn, while its suggested cuts would cost £3.1bn. However, these estimates only account for the increase in SDLT that extra transactions from a lower rate are likely to generate. In reality the reforms would also generate gains in revenue and reduction in expenditure from an increase in housebuilding due to higher transaction numbers (the reduction in expenditure coming from higher payments from housebuilders via Section 106 and similar routes, and less need to spend money on affordable housing grants). Once these are accounted for then the estimated cost of abolition falls to £3.3bn, while the suggested reform would cost £1.56bn.

However, we also need to take account of the increase in transaction numbers creating additional revenues via other taxes such as VAT, PAYE, corporation tax etc, due to complementary spending associated with house moves, or the beneficial spillover effects of a more efficient housing market and more buoyant construction sector.

Thus, the true costs are likely to be significantly lower than these estimates. For example, under the second option transactions are forecast to increase by 176,004. If each of those results in the average gain in non-stamp tax revenue that Ludgrove Property estimate is generated by a house move, £5,837, then it would generate over £1bn in additional duty revenue, reducing the fiscal cost of reform down to about £0.5bn. The 199,375 additional transactions forecast to occur under the abolition option would generate just under £1.2bn, reducing the cost to just over £2bn.

While outright across-the-board abolition of SDLT (rather than just abolishing it on primary residences) would achieve the maximum economic and welfare gain, both of these reform options would capture much of the economic benefit and make the property market far more liquid than it currently is, while coming at a significantly lower cost and not needing a new politically contentious property tax to make up any shortfall. Stamp duty cuts are also, as outlined above, extremely politically popular.

Furthermore, by retaining the HRAD and overseas buyers surcharge, both proposals would ensure that buy-to-let and foreign investors would pay a penalty for buying property in this country, tipping the balance in favour of domestic owner occupiers and helping to ensure that the UK housing market doesn't become dominated by investors.



CONCLUSION

Stamp duty may well be the worst tax on the UK's statute books. Although 30 years ago the tax was charged at a low level and on only a minority of transactions, it now represents a significant burden for prospective buyers and has caused increasingly large distortions in the UK housing market. It damages the economy, and leaves people stuck in the wrong homes. It is bad for the elderly, for the young, and for the middle-aged. By depressing the number of transactions, it also reduces the number of new builds brought to market each year, which makes the housing crisis harder to solve.

The introduction of the stamp duty holiday last July did not just rescue the housing market and construction sector, but proved conclusively that high stamp duty rates have become a damaging drag on the economy, the housing market and people's aspirations.

By temporarily reversing much of the damage the tax does, the Chancellor's reforms caused transaction numbers to surge to levels not seen since before the global financial crisis, which in turn prevented the number of new builds from collapsing.

But with the holiday due to finish at the end of March, and the economy in an extremely weak state due to the pandemic, the government risks creating a 1988-style slump in the housing market if stamp duty simply returns to normal,

with the same perniciously high rates and low thresholds. It will also slow down the necessary changes in housing preferences due to the pandemic, again harming the wider economy.

The one blessing of stamp duty is that it is such a bad tax, and so economically damaging, that the costs of reducing or abolishing it are far lower than the headline figures would suggest.

The one blessing of stamp duty is that it is such a bad tax, and so economically damaging, that the costs of reducing or abolishing it are far lower than the headline figures would suggest. That is why we urge the Government to either to adopt the CPS's proposed reforms to make the £500,000 threshold permanent on primary homes and lower rates above that even further.

However, if the Government cannot bring itself to sacrifice this relatively small amount of revenue, it must at the very least look to make the current stamp duty holiday permanent on primary homes. Failing to do so, just at the moment when we will be emerging from the pandemic, risks delivering a sledgehammer blow to the housing market, which will act as a drag on growth in the rest of the economy – just when we need to be pushing for the strongest recovery possible.

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