AH(3)-03-08(p3)

A financial evaluation of the right to buy

There is a broad consensus (from various perspectives) that the 'right to buy' policy introduced in 1980 in Great Britain has been one of the most significant government policy changes over the last three decades (Stephens, Whitehead and Munro, 2005). There have also been several wide ranging studies over the years on the diverse direct and indirect impacts of the right to buy, most notably those by Alan Murie and colleagues (Forest and Murie, 1991, Jones and Murie, 1999, 2006).

There has, however, only been a limited analysis of the financial impact of the policy in terms of its impact on public sector finances, at least in terms of analyses within the public domain (Hargreaves, 2002, Wilcox, 2002). In this context the purpose of this paper is to provide an economic evaluation of the impact of the right to buy on public finances in Great Britain, with particular reference to the different ways in which the policy has evolved in England, Scotland, Wales since the devolution of housing policy to the constituent countries by the UK government in 1999. The paper also examines the operation of the similar house sales scheme introduced in Northern Ireland in 1979 (McGreal et al, 2004).

This paper begins by providing a summary of the structure of the right to buy financial provisions as at 1997 (and those of the Northern Ireland scheme), prior to the election of a 'New Labour' government, and then charts the different ways the policy has been subsequently amended in England, Scotland, Wales and Northern Ireland, and looks at the impact these changes have made on levels of sales and average levels of discounts.

This is followed by a public sector 'value for money' assessment of the impact of the right to buy, based primarily on data from England. This leads to a discussion of options for reconfiguring the policy in each of the four countries of the UK based on the policy premise that consumer choices should be maximised subject to there being a broadly neutral impact on public sector finances (and thus also potentially neutral in terms of the future supply of affordable housing).

Clearly there are other important issues to consider when evaluating the right to buy, other than the financial issues considered below, such as the mixed impacts on neighbourhoods, and concerns about the pressures on marginal home buyers. While these important issues are beyond the scope of this paper the analysis does deal with the potential impact on the availability of lettings to future households in housing need, as this is central to the financial evaluation.

The right to buy before 1997

The right to buy policy was introduced in 1980 as one of the keystone policies of the new Thatcher government. It applied uniformly across Great Britain, and applied to council and other public sector landlords, and also to housing associations that were not also registered charities.

The central financial provisions were that tenants, following a three year qualifying period were entitled to a 33% discount against the open market value. For each additional year of their tenancy they qualified for an additional 1% discount, up to a maximum level of 50%. There were some qualifications to those discounts based on the landlords ‘cost floor’, and provisions to reclaim a proportion of the discount if the sitting tenant purchaser sold the dwelling within a five year period.

Over the years those terms were varied to make the scheme more generous. In 1984 the qualifying period was reduced to two years, and the maximum discount for houses was increased from 50% to 60%. In 1986 the discounts for flats were made even more generous, so the minimum discount after the two qualifying years became 44%, rising by 2% for each subsequent year of tenancy to a maximum of 70%. The ‘cost floor’ rules were also eased, and the period during which landlords could reclaim a proportion of the discount in the event of a sale was also reduced to three years.

There was also a maximum cash limit on right to buy discounts. In England and Wales this was initially set at £25,000 in 1980, and was then raised to £35,000 in 1987, and then £50,000 in 1989, and it remained at that level until 1999. However no cash limit on maximum discounts was applied in Scotland.

The impact of the right to buy on housing associations declined after 1989, as the new assured tenancies offered to tenants after that date did not include the right to buy. This change, by the then conservative government, was primarily aimed at facilitating access by housing associations to private finance. Subsequently the proportion of social sector tenants without the right to buy has also increased as a result of local authority stock transfers. While existing tenants at the point of transfer have a ‘preserved’ right to buy, as with other housing associations, new tenancies granted after the transfer do not benefit from the right to buy.

Devolution and restraint after 1997

While the new labour government did not oppose the right to buy in principle it did set out to restrain the level of discounts. However policies to reform the right to buy have subsequently developed differently in England, Scotland and Wales following devolution of housing policy in 1999.

England

In England the maximum cash discounts were reduced in 1999, for both existing and future tenants. New limits were set on a regional basis, as shown in Table 1 below.

Following concerns about ‘abuses’ of the right to buy in the rising housing market (Jones, 2003) local maximum discounts of £16,000 were introduced selectively in ‘high housing pressure’ areas in 2003. These lower limits now apply in every local authority area in London, except Barking & Dagenham and Havering, and ten other local authority areas in the south of England (Chiltern, Epsom & Ewell, Hart, Oxford, Reading, Reigate & Banstead, Tonbridge & Malling, Vale of White Horse, Watford and West Berkshire).

Table 1

Maximum regional right to buy discounts introduced in 1999

Regions	Maximum Discount
London, South East	£38,000
East	£34,000
South West	£30,000
North West, West Midlands	£26,000
East Midlands, Yorkshire & Humber	£24,000
North East	£22,000

Wales

While housing policy in Wales is now devolved to the National Assembly, it still has to operate within the constraints of primary legislation determined by the Westminster Parliament, that applies to both England and Wales. Since devolution it has followed a similar approach to that in England in limiting discounts. In 1999 a new cash limit of £24,000 was imposed for the whole of Wales, and subsequently in 2003 this was reduced to £16,000.

Scotland

In Scotland the Scottish Parliament passed new legislation to amend the operation of the right to buy, and this came into force in 2002. However the new ‘modernised’ right to buy only applies to new council tenancies commencing after that date. Existing tenants continue to have the same rights as applied before 1997, and these are still not subject to any cash limit on the level of the maximum cash discount.

Under the modernised right to buy tenants qualify to the right to buy with a 20% discount after five years, and then qualify for an extra 1% discount for every subsequent year of their tenancy, rising to a maximum of 35% after 20 years. There is also a cash maximum discount of £15,000. The modernised right to buy is due to be extended to housing association tenants, but only from 2012.

There are also provisions for local authorities to apply for ‘pressured area’ status, under which the operation of the modernised right to buy can be suspended. That option does not apply, however, in respect of the old right to buy for pre 2002 tenancies. Pressured area status has now been granted to Dumfries and Galloway, East Renfrewshire, Fife, Highland, Moray and South Ayrshire, but in each case only for designated areas within the local authority.

Northern Ireland

The Housing Sales Scheme was introduced in Northern Ireland in 1979, ahead of the right to buy for Great Britain, but with essentially the same structure in terms of the discounts and qualifying periods of tenancy etc. In 2002 it set a £34,000 cash limit on maximum discounts.

Housing Act 2004

A new Housing Act introduced in 2004 has further modified the right to buy in England and Wales, but without changing the basic structure of the discounts. For new tenants (post January 2005) the qualifying period has been lengthened to five years, with discounts then starting at 35% for houses and 50% for flats. The annual rates of accumulating additional discounts, and the maximum percentage and cash discounts are unchanged.

The new Act also lengthens to five years the period during which some part of the discounts have to be repaid in the event of a resale, and bases this on the value at resale, rather than the cash amount of the discount at purchase. It also provides a general right of pre-emption for landlords to repurchase the dwelling (at full open market value) if it resold within ten years of purchase, and makes a number of other detailed amendments.

Contrasting restraints

The essential difference in the recent financial measures introduced across the UK are that in England, Wales and Northern Ireland the basic structure of the discounts has remained unchanged since the mid 1980s, while in recent years lower regional and local maximum cash limits on discounts have been introduced.

In contrast Scotland has introduced both a new, less generous, structure for discounts together with a lower maximum cash limit on discounts than anywhere else in the UK, but has only applied the revised scheme to new tenants. Pre 2002 tenants still enjoy the more generous discounts of the pre 1997 right to buy, without the application of any regional or local limits to the maximum cash discount.

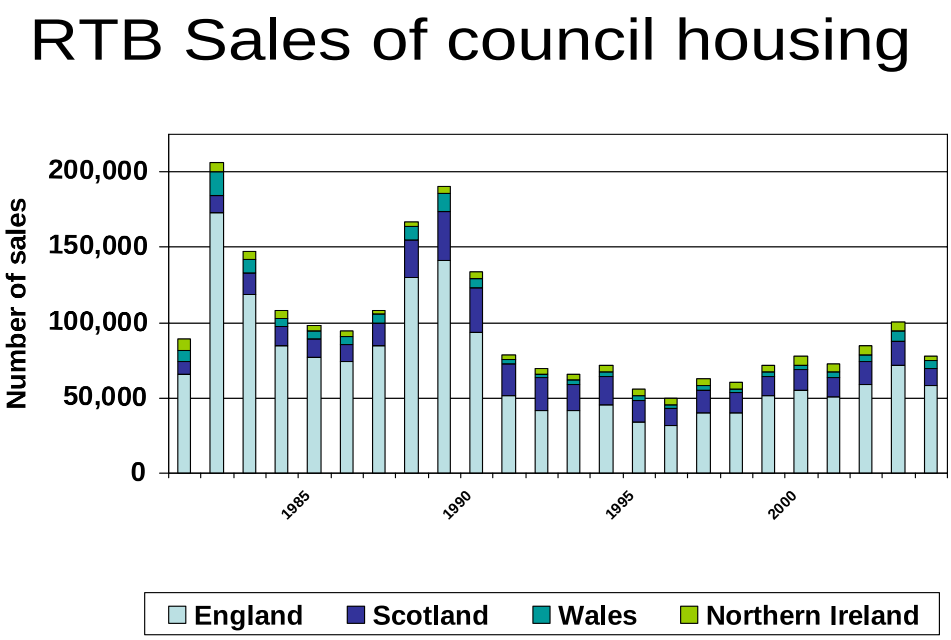
Levels of Sales and Discounts

The sheer scale of right to buy sales in the UK (including sales under the Northern Ireland scheme) over the last quarter of a century is quite breathtaking – in all over two and a quarter million council and housing association dwellings were sold between 1980 and 2004. The annual levels of council house sales are shown in Figure 1 below.

It is evident that following the initial surge of sales subsequently there have been marked variations in sales levels over the years, linked to wider housing market cycles. There is also the suggestion that the introduction of lower cash limits on discount levels in England and Wales in 2002 also contributed to a rise in RTB applications prior to their introduction (Murie et al, 2003).

While the numbers of sales are far lower at the 2003 cyclical peak, these should be seen in the context of a much smaller council house sector (both as a result of RTB sales and stock transfers). The rate of sales, as a proportion of remaining stock was just as high in 2003 as it was in the 1982 peak immediately following the introduction of the right to buy.

Figure 1



Sources : UK Housing Review 2005/06; Murie et al, 2004.

However the latest figures for England (which are now produced on a financial year basis) have shown a sharp fall in sales in 2005/06 – to 26,555 from just under 50,000 in the previous financial year. It is difficult to construe this as a cyclical change as house prices continued to rise in 2005. A more likely explanation lies in the impact of the maximum regional and local discount rules in England discussed below.

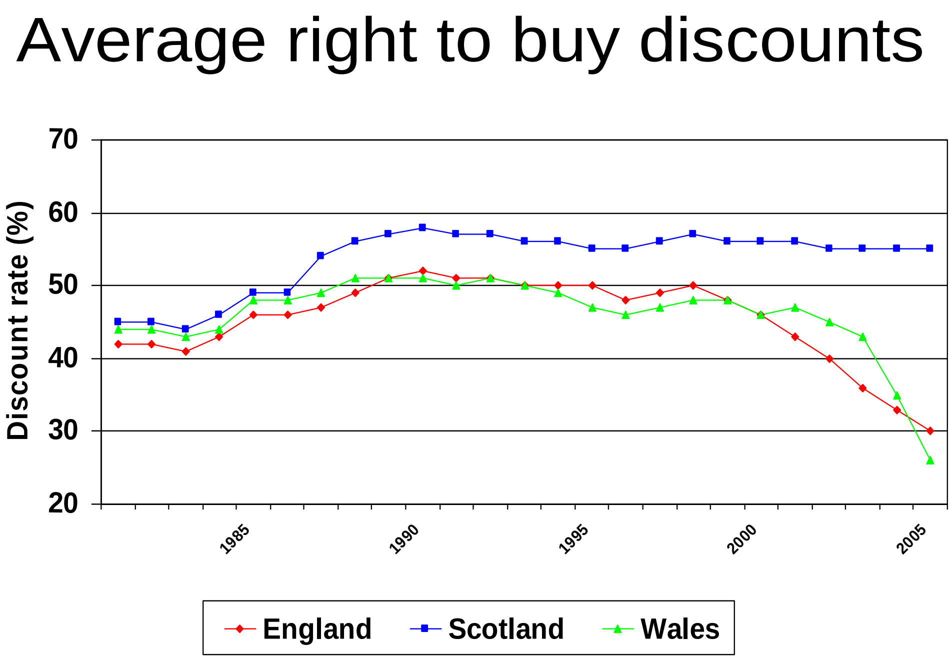
Discount levels

The critical issue for a financial evaluation of the right to buy revolves around the achieved level of discounts on sales. These reflect both the varying rules on discount rates, the average length of tenancy of purchasers, the mix of flats and houses purchased, the various rules on 'cost floors' etc, and the level of maximum cash discounts. The trends in average discount rates on RTB sales in England, Scotland and Wales are shown in Figure 2 below.

These show average discount rates increasing in the second half of the 1980s, following the introduction of the more generous discounts in 1984 and 1986. Average discount rates have typically been higher in Scotland, and in part this reflects the higher proportion of flatted dwellings in Scotland, that have qualified for higher discounts since the mid 1980s.

The key point to note is the decline in average discount rates in England, which clearly follows on from the introduction of the lower regional maximum discount rates in 1999, as well as some initial impact from the even lower rates for selected localities introduced in 2003. Indeed by 2005 average discount rates in England had fallen further to 30%, and further falls are likely as a result of continuing house price rises, and the increasing impact of the 2003 local limits.

Figure 2



Sources : Housing Finance Review 1996/97; DCLG, Scottish Executive and National Assembly for Wales websites.

Indeed in London, where in all but two boroughs a maximum discount cap of £16,000 now applies, average discounts have now fallen to just 21%, and in some inner London boroughs discounts are now around 10%.

The trend in average discount rates in Wales is broadly similar to that in England. In 1998, prior to the introduction of the lower maximum discount of £24,000 the average rate was 48%; by 2003 under the impact of the 1999 limits the average discount rate had fallen to 43%. By 2005, following the further reduction in the maximum discount to £16,000 in 2003, the average discount rate had fallen far more sharply to just 26%.

Average discounts have also fallen in the last few years in Northern Ireland, albeit not to the same extent as in England and Wales. Between 1997 and 2003 average discounts were consistently around 47-48%; but in the year to March 2006 they fell to just 39%, as the £34,000 cash limit on discounts became more significant with rising house prices.

A Public Sector Value for Money Assessment

Central to the assessment of the financial impact of RTB sales on public sector finances is an assessment of the consequential costs of those sales, to be set against the sales receipts at discounted values. In Great Britain as a whole RTB sales over the years to 2004 have already raised receipts in excess of £40 billion.

At different times and places the rules governing the use of those receipts by landlords have varied, and currently in England and Wales local authorities are only free to re-invest 25% of RTB sales receipts; with the balance tied up in the national ‘pool’. In contrast housing associations, and local authorities in Scotland, are now free to re invest sales receipts in full.

In consequence a substantial part of RTB sales receipts effectively accrue to HM Treasury, and reduce the net level of new finance required to support government expenditure plans. Furthermore the greater part of the sales receipts available to local authority landlords has typically been applied to support investment in major repairs and improvements to the retained stock, rather than investment in new affordable housing to replace the dwellings sold through the RTB.

While the questions about which parts of the public sector benefit from sales receipts, and how those receipts have been applied, are important they go beyond the analysis attempted within this paper. The concern here is whether or not RTB receipts (and discounts) represent value for money for the public sector *as a whole* in those areas where there is a continuing need for investment in replacement affordable housing.

The future loss of relets

A critical factor to recognise is that RTB sales are made to sitting tenants, most of whom would have continued to occupy the same dwelling for many years as a tenant if they had not bought. In the private sector sales of tenanted properties are routinely made at prices discounted from vacant possession market prices, because the tenanted dwellings have less value, even when they are being let at market rents (IPD, 2005).

There is an even clearer rationale for some discounting of sale prices to sitting tenants in the social rented sector in that the rents they are paying as tenants are significantly below market values. A recent assessment suggests that average social sector rents in England are some 40% below market values (Wilcox, 2005).

However the more significant factor is that a property sold under the *RTB* would not otherwise have been likely to become available to a new tenant for many years. While there have been some insightful studies of the resales of council housing, that have indicated that such resales were generally occurring relatively slowly (as well as much else besides), those studies have not provided a clear answer to the question of how long, on average, households exercising the RTB have remained in occupation (Forrest, Murie & Gordon, 1995). This is primarily because those studies were undertaken too soon after the inception of the RTB policy for the long term evidence on this point to have emerged.

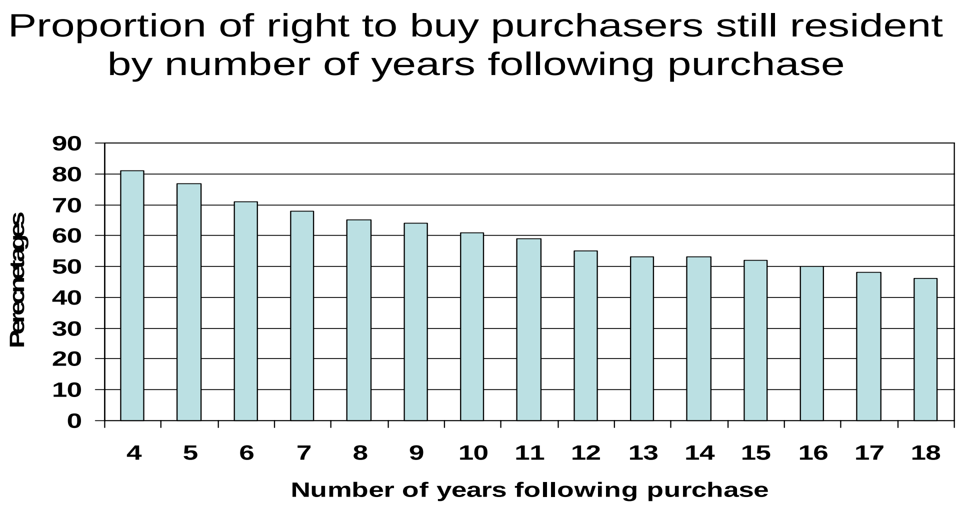
This evidence gap has now been filled by a detailed analysis of data from the Survey of English Housing (SEH). Data from the full run of SEH surveys (up to 2003/04) was used to plot the numbers of *RTB* purchasers still in residence in each year, against the year in which they exercised the *RTB*. From this data, and administrative data on the numbers of sales in each year, it was possible, with some technical adjustments, to track the 'median' case, representing the point at which only half of the *RTB* purchasers in a particular year remained in occupation.

The results for each year were then summed into 'cascading' totals, based on the number of years following the purchase date, rather than being based on a fixed starting date such as 1980. So, for example, the numbers of households found still in occupation 5 years after purchasing in 1980 (ie in 1985), were added to those found still in occupation 5 years after purchasing in 1981 (ie in 1986), and so on. Then, in order to deal with the limitations of small sample sizes the results were smoothed into rolling three year averages.

An earlier version of this analysis (based on data for the years to 2001/02) was devised and undertaken by Ed Kafka, now retired from DCLG, but was not available at the time government decisions were being made about the lower local discount rates introduced in 2003. The updated analysis, based on the same methodology and data to 2003/04, has been kindly provided by current DCLG statisticians.

The upshot of the analysis is that it suggests that the median period of occupation, for the years to 2003/04, was just over 16 years (see Figure 3). It should be recognised, however, that these are figures for the whole of England, and for the whole period of RTB purchases since 1980. There may be some 'north south' variation in the average periods of post RTB occupation, and the data also suggests that there has been some very slight increase in the rate at which more recent RTB purchasers have moved on, compared to the cohort of households that exercised the RTB during its first decade.

Figure 3



Source : Analysis of Survey of English Housing data provided by DCLG.

For the purposes of this paper the value for money assessment has therefore been made based on an assumed 15 year period of continued occupation by RTB purchasers. This is rounded down from the 16 years figure provided by the SEH overall analysis to make an allowance for the initial indications of a slight reduction in average post purchase occupation periods by more recent RTB purchasers.

Supporting evidence on relet rates

At this point it should be recognised that ideally the value for money assessment would be based on an assessment of how soon the RTB purchasers would have moved *had they not been able to exercise the right to buy*. The RTB in itself will in some cases have deterred households from moving out to buy; rather they remained in residence precisely in order to enjoy the benefits of the RTB discounts. Conversely some of the households that have exercised the RTB will have only been able to move as a result of the housing equity they obtained through the discounted RTB purchase.

However estimating such ‘counter factual’ probabilities would be a highly complex and problematic exercise that goes beyond the scope of this paper. It can, nonetheless, be observed here that evidence on turnover rates in the council sector, both before and after the advent of the right to buy, and similarly in the wider home owner sector all show average periods of occupation of 15 or more years (1).

Moreover the methodology applied here does clearly provide part of the answer to the more direct question of the level of investment in replacement affordable rented housing required in practice to offset the loss of relets that follow on as and when RTB purchasers move on.

Other factors in the economic assesment

Many other factors could be added in to this starting point for an assessment of the economic costs (or benefits) of the right to buy. It has been argued by some critics of the right to buy that the costs of replacement housing is higher than the value of dwellings that have been sold. However this does not compare like with like as typically a new dwelling is being constructed to replace an older building, and the new dwelling will be of better quality and have lower repair costs than the dwelling sold. These factors will to a greater or lesser extent balance out, and they have therefore been disregarded in this analysis.

Moreover it is not necessary to replace ‘old’ with ‘new’; RTB receipts could also be applied to purchase existing dwellings of a similar quality, including dwellings previously sold under the RTB that come back on to the market.

One factor that does need to be taken in account, however, is the net loss of rental income on the assumption that the receipts from RTB sales are re-invested to provide replacement dwellings, and more immediate lettings against the future loss of relets from the sold stock. On this assumption the level of capital debt is unchanged before and after the RTB sales. However because of the RTB discounts the sales will only permit the purchase of a smaller number of dwellings than those sold, and there will consequently be a net loss of rental income.

For example if RTB discounts were 40% it would only be possible to build or acquire three new dwellings to replace every five sold. Similarly if RTB discounts were 33%

it would only be possible to build or acquire two new dwellings to replace every three sold. This latter scenario has been costed using data on the net rents and capital values of council dwellings in England in 2004. The net present value of net rents (calculated over 25 years using the Treasury 3.5% annual discount rate) for each property is some £16,520 which represents 21% of the average capital value of £78,300.

If one in three rent streams are lost as a result of only being able to re-invest in two new dwellings for every three sold under the RTB, then the net cost per dwelling is 7% (ie 21% divided by three). If the RTB receipts only permitted a lower replacement rate the loss of rental costs would be higher; and vice versa.

The combined assesment

If these results on the costs of lost relets, and lost net rental income, are combined this suggests that any RTB discount in excess of 32% will impose net costs on the public sector. While the loss of relets alone could permit 39% discounts without any net loss, the adjustment for lost net rental income (7% in this case assuming a two for three replacement ratio) reduces the break even point for the public sector to 32%. These figures provide a simple broad benchmark for evaluating the value for money of the RTB.

This analysis could be refined in various ways that would suggest either slightly higher or lower discounts would be potentially neutral for the public sector. While most sales tend to be of ‘better’ properties nonetheless RTB sales represents a transfer of responsibility for future major repairs and improvements from the public sector to the purchaser. Making some provision for the potential savings to the public sector in this respect would increase the break even point on discounts.

Conversely making provision for the possibility that the ‘turnover’ of future RTB purchasers will rise more significantly from past experience would reduce the break even point on discounts. But in either case the costs of lost relets and rental income provide the core equation in the financial assessment, and such refinements are not likely to fundamentally alter the outcome.

However to allow for such refinements, and to avoid placing undue weight on the central findings of the analyses above, the safer conclusions to draw are that average discounts in excess of 35% would be likely to impose net long term costs on the public sector (assuming that replacement affordable dwellings are required), while average discounts constrained to below 30% would be likely to deter sales that represent reasonable value for money for the public sector.

Value for money of the current RTB scheme

On the latest figures available the average RTB discounts in England (30%) and Wales (26%) are now below the costs associated with the loss of relets and net rental income. Moreover on current policies the average rate of RTB discounts in England and Wales are set to decline further as house prices have continued to rise against the maximum local and regional discount limits.

Thus it can be argued that the regional and local discount limits in England and Wales are now preventing sales that would represent reasonable value for money for the public sector. This is particularly the case for the local authority areas in London and the south of England where the local maximum discount limits effectively limit discounts to less than 20% of market values.

In contrast in Scotland overall average RTB average discounts remain higher than can be justified on value for money grounds. However when new post 2002 tenants begin to qualify for the modernised RTB then sales under that scheme should generally represent reasonable value for money for the public sector. In this context it is rather ironic that while the modernised RTB sales that would represent reasonable value to the public sector have now been halted in three ‘pressurised’ areas, the old RTB sales that offer poor value for money to the public sector have continued unfettered.

These assessments are all based on the presumption that there is a need for some replacement affordable housing following RTB sales. This is not, however, the case in all parts of the UK. In areas of ‘low demand’ where replacement affordable housing is not required there is therefore no reason why discount rates should not be set at higher levels without this imposing costs on the public sector. However this only applies in a limited number of areas in the UK, and is therefore more appropriately a factor to take account in evaluating options for voluntary local sales schemes, rather than the RTB as a statutory national scheme.

Some future policy options

The value for money assessment in this paper suggests that a balance can be struck that seeks to maximise sales at discount levels that still represent reasonable value to the public sector, and that such a balance could be acheived where average RTB discounts were within the range of 30-35% of open market value.

These results therefore suggest that there is a case for substantially reducing the maximum percentage discounts that apply to the right to buy across the UK (although only to pre 2002 council tenants in Scotland). Conversely there is also a case for relaxing the lower local maximum cash limits on discounts that have been applied to most of London and to several other areas in the south of England.

There is also a case for reviewing the regional cash RTB limits currently being applied in England, and the national limits being applied in Scotland and Wales, as in some cases these may also now be deterring sales that would represent reasonable value for money to the public sector.

In Scotland it can be argued that the modernised RTB, that provides for discounts rising from 20% to 35% of open market value, is likely to provide overall reasonable value for money for the public sector, without unduly restricting economically advantageous sales. Indeed the discount structure of the modernised right to buy in Scotland is broadly consistent with the financial assessment in this paper, and thus it provides a model that is worthy of serious consideration by the governments in England, Wales and Northern Ireland.

At the same time the economic analysis provides no rationale either for the £15,000 cash limit applied to the modernised right to buy in Scotland, or the arrangements for suspending the modernised right to buy in pressurised areas. Indeed it suggests that it would be more advantageous in those areas to promote sales under the modernised RTB in order to generate receipts for investment in new affordable housing, as this would bring far more immediate relief to the housing market pressures.

At the same time in Scotland the excessive discounts under the 'old' right to buy have not been eroded by maximum cash discount limits, as has been the case in England, Wales and Northern Ireland. The economic case for introducing such a limit is very strong, and could also be used as a trigger to transfer existing tenants from the 'old' to the 'modernised' right to buy.

Currently the RTB applies only to a minority of housing association tenants, although there are plans to extend the modernised RTB to housing association tenants in Scotland in 2012. If, however, the RTB is reformed on a basis so that it provides reasonable value for money for the public sector then there is no *economic* reason why that policy should not be applied to the housing association, as well as the local authority sector.

Finally, as noted, above, in those areas where dwellings sold under the RTB to not need to be replaced, there is a case for promoting sales to sitting tenants at much higher discount rates, provided that the sales receipts at least match the capitalised net value of the foregone rental streams.

At present authorities need government consent for sales to sitting tenants at discount rates above those set out under the RTB scheme. If authorities are to consider this option as part of their strategic planning the government needs to give a clear indication that it would be willing, in principle, to give those consents, provided that it is satisfied there is not a requirement for replacement housing.

Local authorities might also be more willing to consider such voluntary sales if the rules on sales receipts were more favourable, and the requirement to place a proportion of receipts into the 'national capital receipts pool' was set at no more than necessary to compensate the housing revenue account for the loss of future net rental income. The current rules requiring a 75% contribution to the national pool (except for 'in and out' sales of vacant dwellings) does not provide authorities with the incentive to make decisions that would be economically rationale in terms of their overall impact on public finances, as well as appropriate to their local housing market.

Conclusion

The right to buy has been, and will continue to be, a highly politically sensitive policy. In the past it has imposed very substantial net costs on the public sector, which are still being felt in terms of the long term gradual but cumulative impact of sales on the numbers of relets available to assist the next generation of housing needs.

However the regional and local limits introduced in 1999 and 2003 are now in many cases discouraging sales that would represent good value for money to the public sector. There is a strong case for reforming the right to buy in England, Wales and Northern Ireland along similar lines to the ‘modernised’ right to buy introduced for new tenants in Scotland from 2002. There is an equally strong case in Scotland for either extending the modernised scheme to all tenants, or to introduce maximum cash limits to reduce the excessive discounts still being provided to pre 2002 tenants under the original RTB scheme.

Such reforms, and the examination of sales on a more favourable basis in areas where replacement affordable housing is not required, provide a very real opportunity to improve the outcomes from sales policies, and to balance and maximise the gains from policies that can promote greater consumer choice and empowerment, while at the same time imposing no net economic costs on the public sector.

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September 2006

Note

(1) A longer paper with a detailed analysis of average occupation periods in the council and home owners sectors, and their relationship to the occupation periods of RTB purchasers will be published later in the year. Details will be provided on the UK Housing Review website.

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