Housing Markets and Policies in the UK, Switzerland and the US – Lessons to be learnt?

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Focus on three developed countries in Western world – **UK, Switzerland and US** – and explore their housing markets and housing policies

In three steps:

1. **Institutional setting**, current status of economy & unique geographic features
2. Main features of housing markets & main challenges
3. Key policies & assessment of effectiveness

Tentative conclusions

*Note: Sources and references given at end of presentation*
United Kingdom
Highly centralized country – political and economic power in London

Vast degree of regional disparity
  ▶ Greater London Area & South East = power house
  ▶ Most of the rest is struggling economically

Densely populated island (pop/km²: 262) but urban development extremely contained
  ▶ Only 6.8% of land area classified as “urban”
  ▶ Only 1.5% actually built on
  ▶ Difference: greenspace (parks, allotments, sport pitches), gardens, rivers, canals, lakes & reservoirs
What Greenbelt containment looks like
And from the satellite...

Reading – 60km west of London
And in London...

Source: Barney's blog
(http://barneystringer.wordpress.com/2013/11/21/londons-green-belt)
Why so contained?

- Land use planning decisions in Britain taken at local level by ‘Local Authorities’ (LAs)
- Problem
  - Since 1947 British planning system characterized by LAs facing most of cost of development (infrastructure, congestion, etc.) but very few benefits (tax revenue collected centrally and redistributed irrespective of amount of development)
  - Implication: LAs have essentially no incentives to permit development
  - Lack of incentives + NIMBYism (or BANANAs) ⇒ Perhaps most restrictive planning system in world!
Implications for British housing market(s)

- **Housing supply** curve becomes extremely inelastic, particularly in London & South East

Outline

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(Resulting) Housing market conditions

- Highest *real house price growth* over last 40 years among all major economies (& very little new construction)
- **House prices** extremely high today, especially in Greater London Area & South East
- **New houses** extremely small
  - 38% / 40% smaller than in Netherlands / Germany
- Price per square meter 2\textsuperscript{nd} highest in the world (only topped by tiny Monaco a tax heaven)
- And **price volatility** is extremely high (and growing!)
  - During last full cycle (80s/90s): UK as a whole substantially more volatile in real terms than single most volatile market in US! (*UK: +83%/-38% vs. Los Angeles: +67%/-33%*)
Real house price growth in %, average 1970 - 2006

Source: Bank for International Settlements (BIS)
Very little (and decreasing) housing construction

Source: Euroconstruct

Outline  UK – Market / Policies  Switzerland – Market / Policies  US – Market / Policies  Conclusions
Volatility has increased in recent decades...

Real Land & House Price Indices (1975 = 100)

Note: House and Land data for war years are interpolated.

Source: Cheshire (2009)
Main challenge (& No. 1 policy issue): **Housing affordability!** (& risk to stability)

Also: **British are obsessed with desire to own!**
- Strong real price growth = strong argument to own
- Homeownership rate fairly high (64%) but down from peak (69%) in 2001
- Problem: Fewer and fewer (especially young) can afford to pay the extremely high prices
Policy response (in three phases)

I. Classic: Social rental housing (since 1920s)
   ▶ “Council housing” consists of 18% of total housing stock in 2011 – down from 31% in 1981

II. Right-to-buy (since 1980, Thatcherism)
   ▶ Idea: Allow council flat tenants to buy at subsidised price
   ▶ Aim: Set ordinary people free from state control and enable them to enjoy “independence conferred by ownership”

III. Help-to-buy (since 2013, Coalition Government)
   ▶ Purported aim: Help first-time buyers to get feet on owner-occupied housing ladder
   ▶ Instruments: Equity loans by government, mortgage guarantees & shared ownership
Assessment of policies

- **Social housing** does deliver affordable housing to low income households **but**
  - Not enough: long “waiting lines”, reduces mobility & the clever more likely to succeed
  - Not particularly appealing & social housing associated with other problems (crime, neg. peer effects etc.)

- **Right-to-buy** did temporarily raise homeownership rate **but not** housing stock

- **Help-to-buy** further increased demand (demand shift) but did not affect supply
  - HtB spurred new house price boom (prices in London up 25.8% b/w 2013q2 & 2014q2)
  - Housing not more affordable for young today – if anything less
  - Government (=tax payers) & ‘marginal’ buyers ultimately assume all the risks! (no securitization market like in US!)
Switzerland
(built on Hilber and Schöni, work in progress)
Highly decentralized – perhaps the most federalistic country in the world
  ▶ Opposite of institutional setting in UK

Local public services financed via local income taxes
  ▶ Strong incentives for local municipalities to attract new (wealthy) tax payers
    ▶ Strong incentives to permit development (contrary to UK)

Economy remarkably robust and reasonably strong & extremely low interest rates (fixed rate mortgages ~1%)

Strong immigration flows including of wealthy foreigners (mainly for tax & quality of life reasons)

Planning system fairly lax but many geographical constraints (lakes, mountains, country borders)
Particularities of Swiss housing market(s)

- Tax system comparably **neutral** towards homeownership
  - Taxation of imputed rental income for owner-occupiers (*owner-occupiers and landlords treated equally*)
  - Mortgage interest deduction for owner-occupiers and landlords (*owner-occupiers and landlords treated equally*)

- Homeownership rate extremely low by international standards
  - 37.2% in 2012 (up from 31.3% in 1990)

⇒ Switzerland is (still) a **country of renters**
Status of housing market(s)

- Massive **construction boom** since about 2009 (mainly owner-occupied)

- **Urban (and rural) sprawl** due to strong incentives to permit development in conjunction with strong demand *(especially in tourist areas where foreigners want to buy)*

- Prices have been rising steadily and at a somewhat faster pace since about 2009 *(but nowhere near UK!)*
  - Price increases strongest in desirable and geographically constrained areas

- Prices are volatile but much less so than in UK

Outline

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- Conclusions
Real price index, 1970-2014

Source: Swiss National Bank; own calculations C. Hilber
Main challenge = **urban sprawl**

But also: **Swiss are a country of renters!**

Key policies

- **Rent control** (since 1936) – rents of *existing tenants* de facto tied to mortgage interest rates

- **Restrictions on construction of 2\textsuperscript{nd} homes** (since 2012)
  - Swiss electorate approved “2\textsuperscript{nd} Home Initiative” with 50.6% in 2012
  - Purported aim: combat sprawl
  - Affects municipalities in tourist areas (with share 2\textsuperscript{nd} homes exceeding 20% of total housing stock)
Municipalities affected from 2\textsuperscript{nd} Home Initiative

Communes with a Second Home Quota of over 20%
As of August 22, 2012

Source: Federal Office for Spatial Development, Credit Suisse Economic Research, Geostat
Assessment of policies

- **Rent control**
  - Reasonably successful in stabilizing rents
  - But tying rents to mortgage interest rates problematic
    - Often significant imbalances (excess demand during booms) – vacancy rate in City of Zurich (2011): 0.05%; Switzerland (2011): 0.94% (*in US in 2011: 9.5%*)
  - Discrimination of certain ethnic-, income-, and age-groups

- **Restrictions on second homes** (*Hilber & Schoeni 2014*)
  - Shifted demand from ‘just above 20%’ to ‘just below 20%’ municipalities (but no reduction in overall sprawl!) plus
  - Big effects on price of 1st homes
    - Lowering prices in affected municipalities because can no longer sell 1st homes as 2nd homes (loss of option value)
    - Local residents worse-off!
Market response
Demand for 1st homes ↓ >20% places & up in <20% places ↑

Second Homes Rates
- 0.00 - 0.10
- 0.10 - 0.15
- 0.15 - 0.20
- 0.20 - 0.25
- 0.25 - 0.30
- 0.30 - 1.00
United States
US: Institutions, Economy & Geography

- Highly decentralized country
  - Main tax at local level = property tax
  - Vast differences across U.S. states in political ideology (TX vs. CA), in productivity (CA/NY vs. Midwest) and geography

- Some cities have very strict land use controls and tight physical constraints (SF, LA, NY) – rather like UK
- Other cities have lax controls and few geographical constraints (Columbus, OH) – more comparable to SWI

⇒ Some place have very inelastic supply of housing, while others have very elastic supply...
Implication for housing markets...

Real price growth

San Francisco, CA
(inelastic supply & volatile demand)

Columbus, OH
(elastic supply)

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Two other examples...

Los Angeles, CA
(inelastic supply & volatile demand)

Akron, OH
(elastic supply)
▲ Americans are obsessed with desire to own! (rather like the British)
  ▶ Homeownership rate fairly high (64.4%) in 2014 but down from peak (69.2%) in 2004
  ▶ Problem: Low income households & households in unstable jobs struggle to get feet on owner-occupied housing ladder or to hold on to their homes

▲ Main challenge: Access to homeownership (especially in ‘superstar cities’: such as LA, SF, NY)
Key policy:
Mortgage Interest Deduction (MID)

- Subsidy to homeowners; varies by income
- Aim of policy: Increase homeownership attainment
- Cost of policy: ~$100 billion per annum in foregone tax revenue

Does MID increase homeownership attainment?

- Would expect capitalization of MID in places with inelastic supply (SF, LA, NY) to offset benefits of subsidy
  - HV increase should reflect PV of subsidy!
- MID may even lower homeownership attainment e.g. because low-income HHs may no longer be able to make down-payment
Assessment of effectiveness of MID

- MID boosts homeownership attainment only of higher income HHs in less tightly regulated markets
- **In more restrictive places, an adverse effect exists**
- The **net effect** on homeownership attainment is **essentially zero** (at a cost of $100 billion!)
- ‘Marginal’ homebuyers who bought as consequence of MID & who subsequently defaulted lost all their wealth!

⇒ MID is highly **ineffective policy** to promote homeownership and increase social welfare (in particular in places with inelastic supply)!
Conclusions

- Housing market problems are result of unique institutional setting, economic conditions, and geographic features.

- Key policies aim to address these problems but all too often fail miserably, at a huge cost – why?

- Policies tend to have various unintended consequences (indirect general equilibrium market responses) that offset desired effects of policies.
  - Help-to-buy or Mortgage Interest Deduction boost demand and thus raise HVs – effectively making owning less affordable for young would-be buyers.
Thank you!

*Presentation with references & hyperlinks will be downloadable from:*

http://personal.lse.ac.uk/hilber/
**UK – key references**


**UK – other related readings**


Switzerland – key reference

US – key reference

US – other related readings


Conclusions / suggestions / international comparison – key references


See Google Scholar and/or my personal homepage for links to my work.
Sources
(if not mentioned in presentation)

Page 4

- Population density: 2012 estimates provided by the Population Division of the United Nations Department of Economic and Social Affairs.

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- Price per square meter: Globalpropertyguide.com ([http://www.globalpropertyguide.com/most-expensive-cities](http://www.globalpropertyguide.com/most-expensive-cities); last accessed: 28 March 2013)
- Price volatility: For UK: Nationwide; for US: Glaeser *et al.* (2008) (see under references)

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Various sources including various Wikipedia sites; Hilber (2013) (see references); conservativehome

Nationwide; see: http://www.theguardian.com/money/2014/jul/02/leap-london-house-prices-unequalled-nationwide

Mortgage interest rates: see e.g. https://www.comparis.ch/hypotheken/default.aspx


Sources (cont.)

Pages 22
- 2nd home initiative: See Hilber and Schöni (2014, work in progress) and sources mentioned therein. [not yet available]

Page 24
- Evidence: Hilber and Schöni (2014, work in progress)

Page 25
- Map: Hilber and Schöni (2014, work in progress)

Pages 28/29

Page 30

Page 31/32
- See Hilber and Turner (2014) and sources mentioned therein.