Housing Policies in the UK, Switzerland and the US: Lessons Learned

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Focus on three developed countries in Western world – UK, Switzerland and US – and explore each country’s key housing policies and their merits and demerits

Explore...

1. **Current status of housing market** – main challenges and risks

2. **Main housing policies** in UK, CH, and US – How do they work? & main objectives?

3. **Merits and demerits** of key policies

4. What are the **lessons learned**?
United Kingdom
(builds mainly on Hilber 2015 & Hilber and Vermeulen, EJ, forth.)
Current status of British housing market(s)

- UK faces extreme housing affordability crisis
  - House price per square meter 2\textsuperscript{nd} highest in world (topped only by Monaco)
  - New built homes 38\% and 40\% smaller than in similarly densely populated NL and GER
  - Price to income multiple at record high
    - 5.0 UK & 8.5 London
  - Homeownership rate in decline since 2002
    - 69.3\% (2002) to 63.5\% (2013)
Current status of British housing market(s)

- Crisis has slowly emerged over last 40 years
  - Real house prices grew faster in UK over last 40 years than in any other OECD country
    - London far outstripped rest of UK
  - Housing construction in steady decline since late 1960s (despite strong price growth)
    - Today 1/3 of construction of late 1960s

- House prices also extremely volatile
  - 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%
Current status of British housing market(s) in two graphs (1/2)
Current status of British housing market(s) in two graphs (2/2)

Outline

UK – Market / Policies
Switzerland – Market / Policies
US – Market / Policies
Conclusions
What caused the crisis?

- British planning system is **extraordinarily rigid by world standards**
  - Extreme form of urban containment through green belts (introduced in mid-1950s)
  - Strict controls on height
  - Local authorities face most of the cost of development (infrastructure, congestion) but few of the benefits (little tax revenue), so have no incentives to permit development
  - ‘Development control’: There are no zones designated for residential use – each plot of land requires separate planning application & approval
  - Each application is subject to objection by NIMBY-homeowners (or in UK better: BANANAs)
Implications for British housing market(s)

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

Outline

- UK – Market / Policies
- Switzerland – Market / Policies
- US – Market / Policies
- Conclusions
British housing policies focus on addressing housing affordability crisis & providing access to homeownership

Three key policies:

1. Social housing (or “council housing”)
2. Right-to-buy
3. Help-to-buy
UK: 1) Social Housing

- In place since 1919 to help “those in need”
  - Originally only provided by local authorities ("council housing")
  - Later also by “housing associations” = private, non-profit org. but regulated & receive public funding

- Merits
  - Provides low cost housing for households in “priority need” (homeless other ‘vulnerable’ people according to priority criteria)
  - Does not appear to be associated with negative peer effects, adversely affecting student performance (Weinhardt, 2014)
Demerits

- Associated with poor housing conditions & corruption
  - By 1970s council estates became "grim havens of decay and lawlessness" and there was a "powerful smell of corruption...as the cosy relationship of local politicians and their friends in building and architecture was laid bare" (Wheeler, 2015)
- Inefficiencies and welfare losses associated with undersupply and misallocation (due to long waiting lines)
- The ‘clever’, ‘patient’, and ‘persistent’ are successful rather than those ‘most in need’
- Taxes necessary to fund rental subsidies are associated with deadweight loss
UK: 2) Right-to-Buy

- Introduced in 1980 by Margaret Thatcher
  - Policy allowed “council estate” tenants to purchase their homes at significantly subsidized price
  - Explains rise in homeownership during 1980s/90s
  - Now: Conservatives promised to extend policy to housing association tenants in next parliament

- Merit
  - Rise in homeownership attainment (desirable to the extent that social benefits > social costs) – *literature is ambiguous*
Demerits

- Best social housing stock moved from socially rented to privately owned ⇒ potentially fosters “ghettos”
- Taxes necessary to fund subsidies are associated with deadweight losses
  - If government does not reimburse housing associations, then this will endanger their ability to finance construction of new homes
- Does not help solve housing affordability crisis
  - Aggregate demand and aggregate supply are unchanged
  - Fosters NIMBY-homeowner influence
UK: 3) Help-to-Buy

- Introduced in 2013 by Coalition Government
  - Policy aimed to stimulate housing demand
  - Policy consists of four instruments: equity loans, mortgage guarantees, shared ownership, and a ‘new buy’ scheme that permits LTV of up to 95%

- Merit
  - Probably none because demand increase in UK does not lead to more construction & price increase offsets incentives to own
UK: 3) Help-to-Buy—Cont.

- **Demerits**
  - Likely helped foster price boom: House prices in London up by 26% in year following announcement of policy
    - Does *not* help solve housing affordability crisis
    - Housing *less* affordable for young would-be-buyers
  - Taxes necessary to fund subsidies are associated with deadweight losses
  - Generates systemic risk in that government assumes most of the risks + remaining risks assumed by marginal homebuyers
  - Scheme is difficult to withdraw since possible price drop unpopular
Switzerland
(builds mainly on Werczberger 1997 & Hilber and Schoeni, work in progress)
Current status of Swiss housing market

- Switzerland is a country of renters (37.5% owned in 2013)
  - But homeownership rate on the rise with 2.9% increase since 2000

- Property market is characterized by moderate price and construction boom since around turn of millennium
  - Driven mainly by condominium-boom in booming cities & tourist areas
  - CH has 1/8 of pop. of UK but 1/3 of its construction (2013)
  - CH: real SF HP increase since 1974: 17%
  - UK / London: real HP increase since 1974: 113% / 244%

⇒ Sustained construction boom created sprawl problem
Current status of Swiss housing market (1)
Current status of Swiss housing market (2)
What caused sprawl problem?

On supply side:
- Local public services in Switzerland financed via local income taxes
  - Strong incentives for local municipalities to attract new (wealthy) tax payers
  - Strong incentives to permit development

On demand side:
- Strong immigration & robust economy throughout great recession
- Extremely low interest rates (fixed rate mortgages around 1%)
Implications for Swiss housing market(s)

Outline
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House prices

Positive demand shock

Demand today

Demand tomorrow

Long-run supply

Housing stock
Swiss housing policies focus on stabilizing rents & combat sprawl

Two key policies:
1. Rent control
2. Restrictions on construction of ‘second homes’ (“Second home initiative”)

Outline  UK – Market / Policies  Switzerland – Market / Policies  US – Market / Policies  Conclusions
CH: 1) Rent Control

- Introduced first during World War I
  - Abolished and reintroduced several times since then, ‘permanent’ since 1972

- Today’s form of rent control fairly flexible:
  - Landlords can increase rents but must justify
  - Rent levels linked to two economic indicators *average mortgage interest rate* and *CPI*
  - Only other justification for rent increase: major renovation
  - Also renters are protected against ‘abusive evictions’
Merits

- Real rents are increasing fairly moderately & steadily (by less than 33% since 1983)

Demerits

- Welfare losses associated with undersupply and misallocation (Glaeser & Luttmer, 2003)
  - Extremely low vacancy rates in CH
- Private landlords have strong incentives to select ‘good tenants’ making it more difficult for disadvantaged to rent
- Rent control may reduce HH mobility (Ault et al., 1994)
- Lowers housing quality (Gyourko and Linneman, 1990)
  - Not observed in CH since law ensures minimum quality standards + renovation provides justification for increasing rents
 CH: 2) Restricting construction of 2\textsuperscript{nd} homes

- ‘Second home initiative’ was approved by Swiss population in March 2012 with 50.6% of votes and just over half of cantons (13.5 out of 26)

- Idea: Municipalities with second home share > 20% of all houses are banned from building any new second homes

- Merit
  - Reduces sprawl in most touristic areas of country with 2\textsuperscript{nd} home share >20% (to extent no loopholes are found in law)
CH: 2) Restricting construction of 2\textsuperscript{nd} homes—\textit{Cont.}

- Demerits
  - Loopholes: Sell existing house as 2\textsuperscript{nd} home and build new first home; build hotels and rent out; merge neighboring municipalities to lower share below 20% etc.
  - Demand will shift from most touristic areas to municipalities just below 20% $\Rightarrow$ sprawl will just shift geographically
  - There may be big price and rent increases for first homes in municipalities ‘just below 20%’
United States
Current status of US housing market

- US is a country of homeowners (64.5% owned in 2014)
  - But homeownership rate in decline since 2004 (69.0%)
- Property market(s) in US hit very badly by Great Recession and only just recovering
  - House prices decreased b/w 2006 & 2012, in real terms, by 24.4%
  - Construction decreased b/w 2004 & 2009 by 71.7%
  - Very severe foreclosure crisis (in part because mortgages typically non-recourse)
Current status of US housing market in two graphs (1/2)

Index, base 1975

Year

HPI (real)  Construction  MHI (real)

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Current status of US housing market in two graphs (2/2)
But huge variation across local markets
(Real house price growth 1980-2014)
Why the huge differences across space?

- Restrictiveness of land use controls and physical supply constraints vary enormously across US
  - 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, Akron) – *comparable to CH*

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

- **Housing supply** curve becomes extremely inelastic, particularly in London & South East.
US housing policies

- US housing policies focus on providing access to homeownership (+ currently: dealing with foreclosure crisis)
- Key long-term policy: Mortgage interest deduction
MID: Subsidy to homeowners that varies by income
  - Introduced in 1986 (Tax Reform Act)
Aim of policy: Increase homeownership attainment
Cost of policy: ~$100 billion per annum in foregone tax revenue
Merits
  - In markets with flexible land use controls (Columbus, Akron) the MID does increase homeownership attainment
Demerits

- Only increases homeownership attainment of higher income HHs in markets with flexible land use controls
- In markets with tight land use controls (LA, SF, NYC) the MID reduces homeownership attainment
- Net effect over entire US: essentially zero
- May lead to overconsumption of housing of existing homeowners
- Enormous cost of policy in form of foregone tax revenue
Synthesis: A tale from three countries

- Main conclusion of analysis: Housing policies cannot and should not be judged in isolation from the institutional setting.

- For example: Whether demand focused policies (such as Help-to-Buy or the MID) work depends crucially on nature of land use planning system.
  - Demand-focused policies won’t work in markets with tight planning restrictions and/or other severe supply constraints (UK, US-superstar cities).
Policy makers should focus more on supply side and, in particular, on proper functioning of land use planning system.

The main role of land use planning system should be to correct market failure (provision of public goods; internalizing externalities).

Demand-side policies should only be implemented if supply can respond sufficiently to price signals.
Thank you!

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

http://personal.lse.ac.uk/hilber/
Presentation is based on


Note: Data sources are provided in the paper.


Further Readings

References (UK)


Further Readings—Cont.

References (Switzerland)


References (US)


References (Synthesis/Conclusion)