Michael Guest: Housing Markets and the State

Consider what might be meant by a 'broken housing market'? How might government intervene to deal with this?

Introduction

The United Nations (2014) states, every person has the right to adequate housing, defined as housing which has security of tenure, guarantees legal protection against evictions, which provides a safe, habitable structure. It also means with services; essential facilities such as sanitation, energy, water and lighting. A key issue in all nation's housing is affordability, with the United Nations (2014, p.4) expressing that housing is "not adequate if its cost threatens or compromises the occupants' enjoyment of other human rights". In a civilised society, housing should be accessible, including to the socially disadvantaged and economically marginalised.

Despite this need for adequate housing, the housing market, comprising the sale and/or purchase of properties as a place to live or rent, is in crisis in many countries, including large areas of Europe, the United Kingdom (UK), Australia, Canada and New Zealand (The Economist 2019). In UK and other countries, this includes owner occupation, private renting and impact on social renting. The crisis is nothing new, as the housing market is cyclical with a series of peaks and troughs over time. Globalisation means world imbalances in house prices can have a negative effect on the "fragility of the domestic financial system" (Anundsen et al., 2016, p.1308), evidenced by the global recession in 2008 started in the sub-prime market of the United States of America (USA). Given globalisation in housing and the financial/banking markets, the crisis spread world-wide (Shiller 2012). Respective governments have subsequently sought to bolster housing through low interest rates and increasingly relaxed credit, which has started to push prices upwards, with concerns over yet another crisis in housing (The Economist 2019).

The cyclical nature questions whether the model used in the housing market is broken on a local, national and global context. This essay explores the operation of housing markets to understand why they fail and to consider the purpose of government subsidies. The essay also assesses whether government is prepared to deal major events such as the 2008 Financial Crisis.

Broken Housing Market

There is gap between supply of and demand for housing in many locations. If the gap is ever-increasing, the inference is that the market is broken. As demand pressures increase, prices are driven upwards and affordability downwards (Department for Communities and Local Government [DCLG] 2017). The relationship between supply and demand is illustrated by examining the English housing market, where there is an overall severe housing shortage (Wilson and Barton 2018). The gap between supply and demand, rising house prices, increasing rental prices and overcrowding in social housing means that the housing system and market in the UK is broken (DCLG 2017). The National Housing Federation (NHF 2018) calculate an undersupply of approximately 340,000 each year until 2031. This is not restricted to the UK, many global countries/regions including Europe, Australia and the USA are experiencing similar events (The Economist 2019).

It is important to differentiate between the housing sector and the housing market. The former being three forms of tenure, owner-occupation, private rental sector and social housing (Davis 2013). The housing market refers to the buying and selling of properties within these tenures (Malpass 2005). Pattison (2010) adds that there are important differences between the three main tenures including taxation, subsidies and benefits, as well as economic inequalities. There are differences in stock condition, tenure security and mobility. Housing markets operate based on supply and demand, with many factors affecting both aspects (King 2016).

Demand for housing is based on several factors including population growth, health of the economy, levels of employment and income, plus consumer confidence in the housing market and the economy. It is also influenced by market prices and government social, fiscal and economic policies (Oxley 2004). Wilson and Barton (2018) add that demand for housing is influenced by location, with higher levels of demand in urban areas where there is higher access to services and employment. The housing market essentially operates at two levels, micro and macro-economic. At a micro level demand is based on willingness to pay local house prices and ability to afford such prices. Demand at this level is also influenced by expectations of home ownership and perceived value of a long-term investment in property as an investment asset. The housing market can also be understood at a macro level, where demand is based on access to credit, interest rates, employment, income and taxation; all linked to government policies. Performance at a micro- and macro- economic levels are interlinked, creating volatility within the housing market (Baddeley 2005). The importance of the market to the wider economy means that such volatility affects the employment sector in terms of access to housing and workforce mobility. Increasing prices in the owner-occupier sector puts pressure on the private rental and social housing tenures (Ferrari and Rae 2004).

As mentioned, a broken housing means that there are difficulties with demand and supply (DLCG 2017). Supply of housing is also dependent on a range of factors including productivity in the construction industry, availability and cost of land, complexity of the planning system, policy and regulations and demand for housing. Also by the state of and confidence in the economy (Wilson and Barton 2018). Scanlon et al., (2017) add that the supply of social housing is also influenced by government social policies and subsidies, grants to local councils and housing associations for supply of properties. Gallent et al., (2017) acknowledge housing supply is linked to the availability of land at reasonable prices, planning policy and development restrictions.

Aside from the importance of supply and demand as significant contributors to a broken housing market, there are wider factors which exacerbate these difficulties in the market. It is difficult to consider the operation of the housing market in isolation of other sectors and the economy. A broken housing market can adversely affect the national economy. Due to globalisation of the financial markets, the housing market is also an important factor in the global economy (Shiller 2012). It is important because it is linked to consumer spending. For instance, when the price of housing goes up, those in owner-occupation become relatively financially better-off, which can lead to borrowing against the value of a property, increased willingness to spend on goods and services, drawing on the perceived value of the property (Bank of England 2019). This creates positivity and confidence in the economy, fuelling growth in other markets (Stroebel and Vavra 2019).

Housing investment is a small and unpredictable part of total output of the economy. However, the demand and purchase for a new property contributes to total output in Gross Domestic Product (GDP) through investment in land, building materials and job creation. This has a knock-on effect on the local economy (Bank of England 2019). The opposite is true when there is a downward trend in house prices as this can erode confidence in the value of properties, increase concern about borrowing and lead to a decrease in consumer spending (Department for Communities and Local Government [DCLG] 2017).

The accumulative effect has an impact on the national and global economy. The Economic and Social Research Council (ESRC nd.) add that changes in housing wealth has a persistent impact on both stock market returns and aggregate consumption, which then impact on the national and global economy. The Bank of England (2019) add that if, in a rising market, there is a high level of borrowing of mortgages, this can create negative equity for householders and put the bank system at risk when there is a downturn in the market. Essentially, housing has become a commodity; with performance in the market affected by and contributing to economic stability and instability (Dewilde and De Decker 2016). This works against what would be perfect market conditions. That is, supply meeting demand. Volatility of demand in turn works against such a condition. This may not mean in itself that the market is 'broken' however, more that such markets are imperfect.

Government Interventions to date

The importance of housing to the national (and increasingly global) economy, means that government has tried measures and interventions to resolve the broken housing market (DCLG 2017), including government subsidies, changing social housing policies and credit access.

According to Wilson and Barton (2018), the current crisis in the housing market is linked to government policies over the past century therefore it is important to understand the impacts of such policies and the government interference in a free market as this is a major contributory factor to performance in the housing market. Pattison (2010) similarly pointing out that at the 20th century start, the main form of tenure in the UK was private rental. By 1945, after two World Wars there was a shortage of housing. The government started a national housing programme, replacing poor housing with social housing. The result was, by the 1970s, the housing market was dominated by owner-occupation and social housing, with a depleted private rental sector, as shown in Figure 1.

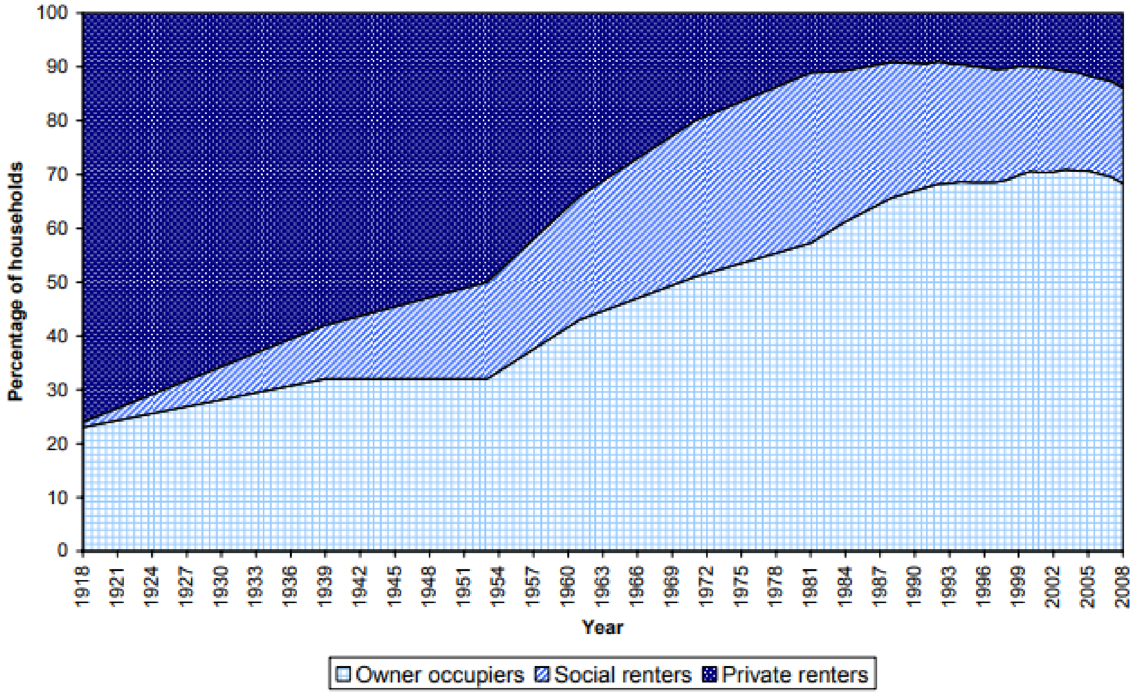

Figure 1. Tenure trend, percentage of households by tenure, England, 1918 to 2008 (Pattison 2010, p.11, Figure 3).

By the late 1970s and early 1980s the increasing social housing costs coupled with a downward trend in the global economy underpinned by an oil crisis and currency issues, meant that the government sought to reduce the cost of social housing. This resulted in housing and social policy reforms including the introduction of right to buy for social renters, deregulation of the financial markets increasing access to credit and tax incentives for owner-occupation as shown in Figure 2 (Pattison 2010; King 2010).

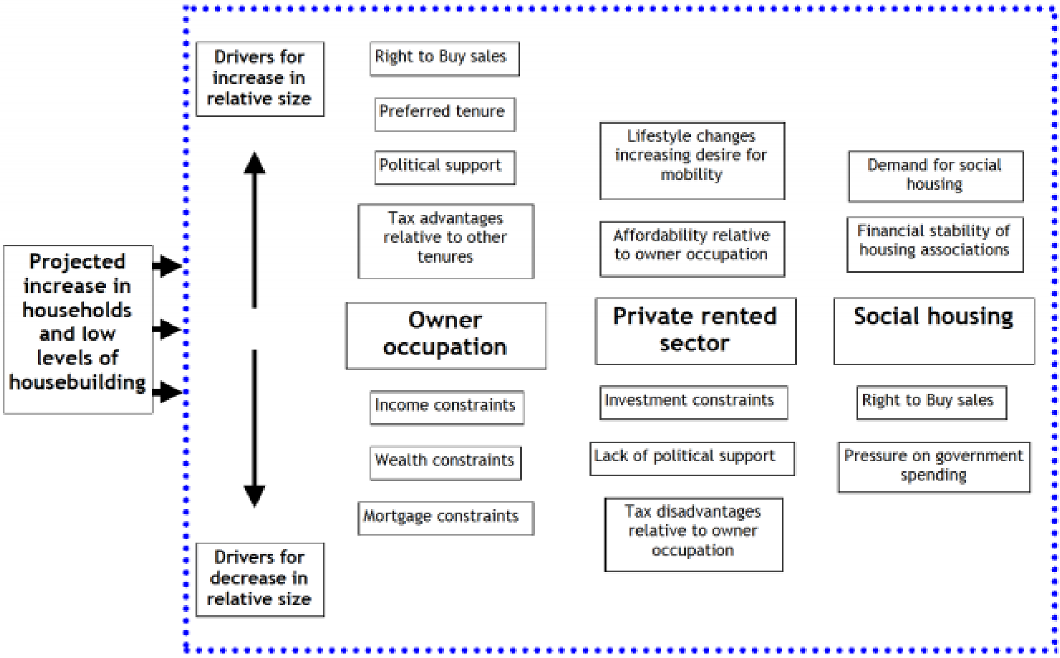

Figure 2. Key drivers of changes in tenure mix (Pattison 2010, p.5, Figure 1).

The result was that “owner occupation increased at the expense of social housing” (Pattison 2010, p.4). At the same time, reduced subsidies for social housing and the increased value of private housing stimulated the private rental sector such that, by the 2000s, the social housing market had dwindled, with a crisis in social and private housing and rising rents in the private sector. All tenures are related, whereby a change in one affects the market in the other two. According to Hunter (2016) and Gallent et al., (2017), the nature of the housing market means that prices are driven by demand, meaning that in an unrestricted market land prices are driven by demand for housing, developers seeking to recover costs from sales. This increases the price of housing and creates affordability problems at the medium and lower end of the income scales. In addition, rising prices in the owner-occupier market coupled with stagnant rates of income mean people staying longer in private rental accommodation to afford a property. Increased demand in the private rental sector pushes rent prices upwards because the constrained supply of such properties. Also, under investment in social housing has reduced the supply of these properties putting further pressure on the private rental sector and the wider housing market (Scanlon et al., 2017). The housing market is also influenced by government intervention through subsidies.

How Government can address the broken Housing Market

Aside from direct intervention in housing through planning, social and fiscal policies as set out above, the government also intervenes in the housing market using subsidies as policy. Housing Policy is the actions taken by government to influence the housing market at a national or local level. Government policy is also influenced by private and public institutions (Clapham 2018). Lawson (2018) adds that in contemporary society, there is an expectation of affordable housing and access to owner-occupation, which affects not only economic stability, but also influences social and political volatility.

Clapham (2018) states that a government can influence the housing market through planning regulations and policies. Also through direct provision of social and affordable housing and the use of subsidies. Oxley and Haffner (2010) agree, adding that subsidies and housing taxation can be effective instruments in reducing the volatility in house prices and reducing distortion between tenures, particularly between owner-occupation and private rental. Subsidies are also important in providing support for low income and vulnerable households and as a means of encouraging investment in this sector.

The government can also use subsidies to fix the market, because subsidies can stimulate the housing market. As illustrated earlier, government tends to influence the housing market and different tenures within that market in different ways (Oxley and Haffner 2010). Pattison (2010) adds that in the UK, the current housing market is, in part, the result of a series of government subsidies as shown in Figure 3.

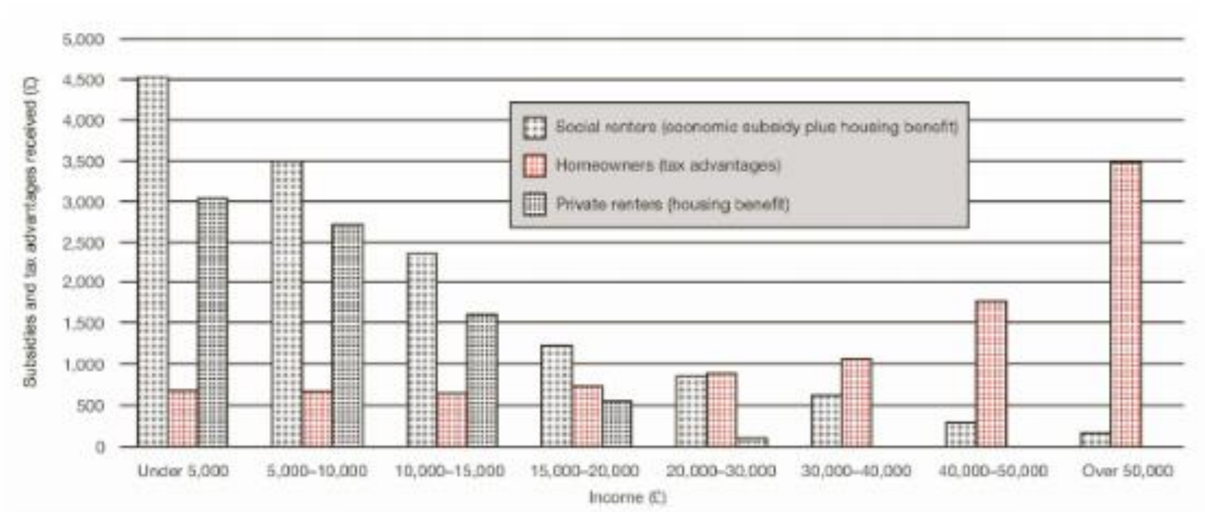

Figure 3. Housing-related subsidies and tax advantages by income band and tenure (Pattison 2010, p.8, Figure 2).

It is evident from the above figure that the type of subsidies differs for each tenure, with the social sector receiving subsidies such as housing benefit and social payments, whilst some in lower income households in the private rental sector receive housing benefit only, (now including the housing element of Universal Credit [UC]). Households in the ownership tenure receive subsidies in the form of tax advantages (Pattison 2010). There are a variety of taxation and subsidies used in housing in the UK including Council tax, Stamp duty, Capital gains tax, Inheritance tax and the Rent-a-room scheme (Crawshaw 2009). However Oxley and Haffner (2010) say this system continues to favour the owner-occupier (partly by design and partly as a consequence of wider policy), which stimulates demand for this form of tenure, thereby contributing to the volatility of the housing market. This is supported by a comparative study of the impact of government subsidies on the housing market, comparing housing systems in Denmark, Germany, the Netherlands and the USA with the UK. This study found that the housing market in the UK is more volatile than in Germany and the USA. A key difference is that in Germany and the USA there is some form of taxation on capital gains on the sale of housing in owner-occupation tenure. Both countries have real estate taxes, some of which are related to local market values, forming a price-dampening function, with for example, Germany using taxes and subsidies to provide incentives for rental supply, including subsidies for private landlords to make properties available for the social housing sector (Oxley and Haffner 2010).

It is evident that the housing market is complex and trends in the market are cyclical, affected by government influences, as well as private agencies (DCLG 2017). Markets tend to be ‘naturally’ cyclical despite claims sometimes that they do not have to be. At the heart of the housing system is the gap in supply and demand in parts of the UK and parts of regional markets, and whilst government subsidies may reduce that gap in a minor way, the market could be stabilised by increasing the supply of housing and making housing more affordable. Fatica and Prammer (2017) maintain that government subsidies in the form of taxation favour those in owner-occupation, a phenomenon which is prevalent in the world housing market. In Europe there are significant differences in homeownership rates and the prevalence of mortgage debt and loan-to-value ratios, yet in the majority of countries owner-occupiers are officially under-taxed. In a study of European Union nations it was found that the user cost of owner-occupied housing is 40% below the “efficient level under a neutral tax system where the net return to owner-occupiers is fully subject to taxation” (Fatica and Prammer 2017, p.3). Also that the majority of the average tax subsidy is from under-taxation of the home equity return, whereas the average contribution of the rebate for mortgage interest payments is suppressed by relatively low loan-to-value ratios, thus reducing the cost of debt, creating a bias for high household borrowing. In addition tax reforms which reduce the fiscal benefit to homeowners are complementary to policy measures which seek to increase flexibility on the supply side of the housing market. Subsidies in the form of mortgage interest tax relief had mild regressive effects on household income and progressive effects on net wealth (Fatica and Prammer 2017, pp.3-4).

Regarding supply and demand relating to parts of the UK, and of regional housing markets, this can be influenced not only by supply and demand, but also the desirability of housing built. There may be adequate supply in some locations, but much of it may be obsolete (old), or built in a manner not wanted by people (post-war modernist developments).

According to Wilson and Barton (2018), governments also support the social housing sector through subsidies, which in the UK takes the form of housing benefit (or housing element of UC). The difficulty in the UK is that there was a gradual shift away from direct investment in the supply of housing since the 1970s to reduce pubic spending and increased spending in terms of subsidies such as housing benefit/UC. A switch from supply-side to demand side subsidies, reducing the number of social housing, thus contributing to the volatility of the UK. Scanlon et al.,(2017) add social housing subsidies have been subjected to several cuts, to the point where the social housing sector is in crisis, as a result of austerity, welfare cutbacks, economic uncertainty and rising costs.

The ESRC (nd.) carried out research on the effect of government policies such as greater financial flexibility on the rates of owner-occupation (homeownership), house prices and consumption. It also investigated the impact of land availability of the housing market. It concluded that changes in financing constraints have a limited effect on house prices. Tenants or credit-constrained home owners have low levels of disposable income, so the effect of relaxing the regulations on borrowing has little effect on house prices as it is absorbed by the conversion of rental housing into private housing. The ERSC (nd.,) advocates effective government policies include a mix of financial, planning and transport initiatives. For instance, policy focus on the housing market government policy should be on increasing the supply by changing planning policy to taller buildings in urban centres, particularly in areas of high economic activity and high population densities. The DCLG (2017) suggest that measures like using planning regulation and increasing the release of land to reduce the price of construction, should increase the supply of housing. It is difficult to achieve such increases, and the volatility of the housing market in the UK and on a global level continues. A broken housing market is one where there is understanding that the gap in supply and demand creates volatility and affordability problems in the housing market, whilst being unable to create a coherent and integrated approach to resolving these issues.

King (2016) agrees that performance in the housing market is cyclical, typically occurring as boom and bust. This cycle is not particular to any specific country, found throughout the world. As previously mentioned, increasing levels of globalisation means that such cycles have become an international phenomena, evidenced by the 2008 global financial crisis. Given that these cycles are national and global, and are a frequent occurrence in the housing market, this raises the question as to whether governments can prevent such occurrences. A key issue in the usefulness of government intervention in the housing market is that it is difficult to predicting performance because of imperfect information relating to this market.

Baddeley (2005) links the problem of predicting market performance to imperfect information, suggesting that in a risk-free market, all parties would have complete information about market trends that would facilitate decision-making and prediction of market performance. However, demand for housing is actually based on imperfect information, as demand is influenced by human emotions, home ownership expectations and perceived value of a property in terms of capital appreciation and depreciation.

King (2016) suggests that this is part of the problem, governments and financial institutions not believing the lessons learned from each crisis enabling them to manage/prevent future crises. This leads to confidence, translating to increased risk taking and ultimately to another boom and bust cycle. There are factors which can be learned from each crisis that can be used to predict a new crisis and to put measures in place to minimise the impacts of such an event.

Firstly, as mentioned earlier, funding of housing is obtained through mortgages from financial institutions. The sums borrowed are significant and typically involve international banking. As such, an indicator for a possible housing bubble is shifts in patterns in the world economy. The second factor which can be used by governments is the lag between supply and demand. It was noted earlier that when there is a gap in supply and demand, this pushes house prices upwards. Demand for housing is more volatile than supply; so when demand increases there is a lag before supply can increase to match that demand, resulting in a clear indicator to government of a possible housing crisis.

Unlike other markets where an increase in price may suppress demand for that product, in the housing market an increase in price can increase demand, on the premise that prices will continue to rise; as such, it is logical to get onto the property ladder or to trade-up within the market at the start of the increase. Also, the willingness to pay a certain price for a property is based on perceived value, where the concept of value can mean different things for different people. The market may be affected by exuberance whereby if there is an expectation that the market is going to fall, then this will typically occur because people adjust their behaviour accordingly (Pavlidis et al., 2016). This can result in a loss of confidence in the banking system, banks reduce their lending to the public and to each other, creating a financial crisis which ultimately leads to failure of the housing market and recession in the wider economy. Banks are responsible for the circulation of money, resulting in governments under pressure to bail these institutions out of financial trouble (King 2016).

Conclusion

This essay considered the meaning of a broken housing market whilst considering ways in which government can intervene to deal with this problem. It finds that the housing market is a complex mix of internal and external factors affecting supply and demand, creating house price volatility. In the past, this volatility may have been confined to a local or a national market, however the sums of money involved in housing finance and credit facilities mean that the housing market is also now affected by and a key influencer of the global economy.

A broken housing market is one where demand outstrips supply, creating a housing price bubble, increases problems of affordability, an undersupply of social housing and an upward trend in the private rental sector. Ultimately these issues result in overcrowding in existing properties and homelessness.

Housing demand is linked to population growth, willingness to pay, employment and consumer confidence. Supply is influenced by construction industry productivity, land prices, planning regulations and the supply of land. There is an imbalance with respect to location, linked to income and opportunities for employment. The housing market is broken when there is an insufficient number of affordable properties for the populous, across all forms of housing tenure.

The government can address this problem through use of subsidies, including housing benefit/UC, taxation and social benefits. The difficulty is that trends in the market and these subsidies are affected by wider social and fiscal policies; as such, it is ineffective to simply address the broken market using subsidies only.

The fact remains that housing is cyclical and despite several past housing bubbles of boom and bust, there is little that governments and the market can do to prevent the next cycle, unless there is learning about indicators of movement within the market. The evidence in this essay indicates governments would not be much better prepared to deal with future housing market events than they have been in the past because of, apart from learning, and possibly lack of power in relation to the global economy, inadequate policy direction.

Word count: 4000

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