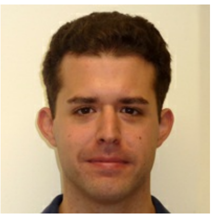
Why is it so difficult to tackle the lack of affordable housing?



Boris Johnson has pledged that more people will be helped onto the property ladder and that the supply of housing will be improved. **Christian Hilber** *and* **Olivier Schöni** *consider the history of housing policy and the challenges that politicians face in tackling the affordability crisis.*

In 2017, London Councils commissioned a poll of Londoners inquiring about the most important issues facing the city. Lack of affordable housing came top. 30% of Londoners said it is *the* most important issue, ahead of crime (14%) and transport (12%). Only 5% were most concerned about Brexit. Over half of Londoners (52%) thought housing is the most or one of the most important issues facing the capital. Moreover, 80% of the public agreed at that time that the UK has a housing crisis. Since the poll, housing affordability has further deteriorated.

Measures of housing affordability confirm that these concerns are justified. The most common, if imperfect, measure to gauge housing (un)affordability is the house price-to-earnings ratio. It increased from 3.1 in the first quarter of 1995 to 10.9 in the fourth quarter of 2021. That is, the average full-time worker in London nowadays requires nearly 11 gross annual salaries to buy an average housing unit. A multiple of three or less is generally deemed to be affordable. While London stands out, the price-to-earnings ratio similarly deteriorated for the UK as a whole over the same period, from 2.9 to 6.7.

Looking at the price-to-earnings ratio alone ignores two important facts. First, it ignores the cost of mortgage financing. Second, not everybody owns, and rents may have increased less than house prices.

It is true that mortgage interest rates have come down a lot since 1995, and while they have increased slightly in recent months, they are still low by historic standards. But, even when financing costs are fully considered, housing affordability has deteriorated substantially. A first-time buyer's mortgage payment as a percentage of take-home pay in London has increased from 25% in the first quarter of 1997 to 54.9% in the fourth quarter of 2021. In the UK the equivalent increase is from 17.7% to 32.3%.

It is also true that private and social rents have increased much less than house prices over the last 20 years. Still, the average weekly social rent as a percentage of the 10th percentile weekly pay (the lowest income decile) has increased in London from 26.6% in 1997 to 30% in 2020. The average weekly private rent as a percentage of the 30th percentile weekly pay increased in London from 66.4% in 2005 to 70.6% in 2020. While affordability for renters has deteriorated only slightly over the last 15 years, the fact that moderate income Londoners would have to spend 70.6% of their gross income to afford an average rental unit in the capital is just staggering.

The above stats for London illustrate the increasingly dire nature of the housing affordability crisis. Yet, London is not alone. Housing affordability crises are a global phenomenon, especially in so called 'superstar cities'; cities such as Hong Kong (perhaps the worst affected city in the world), New York City, San Francisco, Vancouver, Paris or Sydney.

But what is causing these housing affordability crises? What policies are implemented around the world to tackle these crises? How effective are these policies in attaining their stated goals? Are they worth their cost? And who are the main beneficiaries of these policies? These are some important questions that economists have been investigating for decades.

We have recently written about this research for the *Oxford Research Encyclopedia of Economics and Finance*. The entry is still undergoing the final stages of the peer-review process; however, the close-to-final draft is available as a CEP occasional paper. The main insights of our literature review can be summarised in three points:

1. The main underlying cause for the 'affordability crisis', which has been mounting for decades, is a combination of strong and growing demand for housing in desirable areas in conjunction with tight long-run supply constraints – both physical and man-made regulatory ones. The affordability crisis tends to predominately

affect low- and moderate-income households. Increasingly, however, middle-income households – who do not usually qualify for government support – are similarly affected.

2. Policies that aim to tackle the housing affordability issue are numerous and differ enormously across countries. Key policies include mortgage subsidies, government equity loans, rent control, social or public housing, housing vouchers, low-income tax credits, and inclusionary zoning, amongst others. The overarching aim of these policies is to (i) reduce the periodic housing costs of or (ii) improve access to a certain tenure mode for qualifying households.
3. Many mainstream housing policies are ineffective, cost-inefficient, and/or have undesirable distributional effects from an equity point of view. The ineffectiveness and undesirable distributional effects in supply constrained cities such as London arise from the fact that policies – such as Help to Buy – that stimulate housing demand get 'capitalised' into higher house prices and rents (an indirect market-adjustment effect). This capitalisation effect offsets the policy-induced incentives (typically in the form of subsidies or tax deductions) and mainly benefits existing better-off homeowners and landlords.

The reader might now wonder: why do voters continue to support housing policies that are ineffective and/or inefficient? Indeed, some of the most ineffective policies – such as the Mortgage Interest Deduction or Help to Buy – are politically amongst the most popular ones. This is partly because targeted households poorly understand adverse indirect effects, which is exploited by vote-seeking politicians. Partly, it is because often the true beneficiaries of the policies are the politically powerful existing property owners (homeowners and landlords), who are not targeted but nevertheless benefit from positive policy-induced house price and rent capitalisation effects.

The facts that (i) existing homeowners often have a voter-majority and (ii) landlords additionally may be able to influence the political process via lobbying, lead to a conundrum: housing policies may be politically popular yet ineffective and, in some instances, even counterproductive from an affordability point of view. That is, policies may exacerbate affordability crises and worsen inequality.

So, what should benevolent policymakers do, in light of what we learnt from our review? In addition to implementing targeted policies for individuals most in need (e.g., via housing vouchers or by providing subsidised housing), they should promote those policies that improve housing affordability for all income groups by focusing on the root causes of the problem. These root causes are (i) the strongly and unequally growing demand for housing in desirable markets and (ii) tight land use restrictions supported by a majority of existing property owners that limit total supply of housing in these markets. To design democratic policy reforms along those lines that are palatable to a voter-majority is perhaps the biggest challenge that needs to be overcome in order to cure the rising affordability crises in superstar cities around the world. It won't be an easy task, but as one of LSE's REF 2021 Impact Case Studies shows, research-induced change may be slow, but it is possible.

Note: the above draws on the CEP occasional paper Housing policy and affordable housing.

About the Authors

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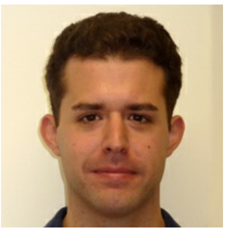

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