



Spatial Economics Research Centre

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Help to Buy

Posted by Dr Christian Hilber, SERC and LSE

I recently participated in a public debate organized by the [Strategic Society Centre](#). The topic of the debate was the government's [Help to Buy scheme](#). The central question: Who will benefit from the scheme? My short answer: It is almost certainly not the young first-time buyers who are the supposed main beneficiaries of the scheme.

How can this be? Aren't the equity loan scheme and the mortgage guarantee scheme directly targeted towards first-time buyers? Yes, true. And does the equity loan scheme not only apply to new build homes? Again, yes, true. It is true that Help to Buy will likely increase mortgage availability, especially for those attempting to buy with small deposits.

However, the effect of this is an increase in demand for housing – in economics language: it shifts the individual and aggregate demand curves outwards to the right. It does not shift the supply curve. But as long as supply is 'responsive' (i.e., the supply curve is not very steep), this should still have the desired effect of more new housing and perhaps only slightly higher prices.

So what can we say about the supply side? In the very *short-run*, housing supply does of course not respond at all to demand shocks because of planning and construction lags, so prices can be expected to rise in the short-run. The trouble is that in the UK, even in the very *long-run*, supply is incredibly unresponsive to demand shocks (i.e., the long-run supply curve is very steep). Why? The main culprit is the UK planning system, which is, in an international context, extraordinarily inflexible. Since 1947 there are virtually no fiscal incentives at the local level to permit development. Local planning authorities face most of the costs of development but have very few benefits from it. Moreover, local homeowners – in the UK perhaps best described as BANANAs (Build Absolutely Nothing Anywhere Near Anything) – oppose (virtually) any development in their backyards.

As a consequence of all this, Help to Buy will likely have the effect of pushing up house prices (and rents) further with very little positive effect on new construction. Housing will likely become less – not more – affordable for young would-be-owners! The beneficiaries of the scheme are the existing (typically wealthier) homeowners who benefit from the capital gain. However, not all homeowners benefit equally. Young expanding families may not benefit at all since their new larger house will also become more expensive. The true beneficiaries are those elderly homeowners who are thinking about downsizing (not many) and those wealthier retired homeowners who decide to pocket the capital gains from Help to Buy and move to Spain or Southern France, where housing is much more affordable and spacious. First-time buyers will arguably be no better off because the easier access to credit is offset by higher prices. And mobile young households who do not want to or still cannot own will be worse off. They will face higher rents and, as tax payers, bear the burden of the schemes.

The empirical evidence strongly supports these arguments. In recent work ([here](#) and [here](#)) Wouter Vermeulen and I provide strong evidence that local planning constraints – in conjunction with strong local demand – are indeed the main culprit of the extraordinarily high house prices and the cramped spaces in the Greater London Area and the South East of England. (The UK has the second highest [house prices per square metre in the world](#) – only topped by tiny Monaco – and new build houses in the UK [are 38% smaller](#) than in densely populated Germany and 40% smaller than in the even more densely populated Netherlands.)

In [another paper](#), forthcoming at the *Review of Economics and Statistics*, Tracy Turner and I find for the US, that in tightly regulated cities mortgage rate subsidies have the effect of substantially raising house prices *and* reducing homeownership attainment – the opposite of policy makers' intentions. The aggregate effect on homeownership attainment for the US as a whole is 'zero'. Notably, this is achieved at an annual cost exceeding \$100 billion.

Proponents of Help to Buy have argued that the equity loan scheme only applies to new build homes, so this should only increase the demand for new build homes and thus lead to more construction. But this is a bogus argument: existing homes and new build homes (and in fact rental homes) are reasonably close substitutes, so Help to Buy will affect aggregate demand for housing and not just new build. There have been, at long last, clear signs of a recovery in the construction sector – in fact, for a while now; talk to architects! But this has nothing to do with Help to Buy. It is merely a (welcome) coincidence (for proponents of the scheme).

I argued above that the main beneficiaries are mainly wealthy and older homeowners. But especially the wealthy arguably also pay much of the taxes. So one might think that Help to Buy does 'no good' but it also does 'no harm' – it is a 'zero sum game'. Unfortunately, this couldn't be further from the truth for at least two important reasons. Firstly, the taxes needed to finance the schemes have a 'dead weight loss' – they are a pure welfare loss to the society. Secondly, there are 'systemic risks'. In contrast to, for example, the American and Canadian systems, there is no cushion in the form of private mortgage insurance companies that bear the risks associated with a house price bust.

In the US for example, even before the crisis, [Fannie Mae](#) and [Freddie Mac](#) only guaranteed and securitised mortgages up to a 80% loan-to-value (LTV) ratio; the portion of the loan that exceeded 80% of the house value had to be 'enhanced' by private mortgage insurance companies. These insurance companies either assumed those risks or – more likely – reinsured them, the reason why AIG got into such trouble. Should the British housing market take a significant hit (perhaps not very likely, but who would have predicted the 'Great Recession?'), then the situation for UK taxpayers would be much worse than that of US taxpayers.

This is because the government doesn't just provide an implicit warranty as a last resort (as was the case in the US) but directly takes the first hit. Private mortgage insurance companies won't provide any cushion, unlike with Fannie and Freddie (who only got into trouble because house prices in many

metro areas decreased by more than 20%). The UK government – or rather, the British tax payer – will face huge costs, even if loans go only slightly 'under water'. The fact that mortgages in the UK are 'recourse' helps in the sense that there would be fewer defaults (compared to the US mess) but would also arguably mean prolonging the crisis.

A last point: what is the exit strategy? If the scheme was indeed withdrawn abruptly after three years, then might this not cause a house price bust and yet quite possibly another recession. If this is 'too big a political risk', is it really plausible to think that the scheme will end in three years? My concern really is that we end up in a vicious circle with a policy that arguably does not only do more harm than good and is very costly but is also very hard to get rid of. If we are lucky, the two schemes will, for whatever reason, never really take off and the schemes will be silently discarded after a few years. My sincere hope is that the government does more to tackle the real problem on the supply side: the fact that there are too few incentives at the local level to permit residential (or commercial) development. I floated the idea of a genuine local property tax that would replace the current council tax and stamp duty (another harmful tax – see [here](#) and [here](#)) ...it would be a (good) start...

A version of this post first appeared on the [LSE Politics and Policy blog](#).

Posted by [Prof Henry G. Overman](#) on [Wednesday, June 26, 2013](#)

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WhatHouse.co.uk said...

There does seem some evidence that the Help to Buy scheme along with the government's Funding for Lenders scheme is enabling more mortgage take ups, however, not sure how many are first time buyers. Just generally mortgages cheaper for everyone. First time buyers still struggle to save the deposit.

[What House](#)

12 July 2013 at 08:47

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