Who is helped by Help to Buy?

*What's not to like about a policy which can expand home ownership and boost the supply of housing? **Geoff Meeks** and **J.Gay Meeks** recount some of the doubts about the efficacy of the government's Help to Buy scheme. They present new evidence on some of its regressive distributional consequences, and touch on the opportunity cost of the subsidy programme.*

At first sight the government's Help to Buy (H2B) programme is very appealing. It is targeted at a pressing economic and social problem: house prices have raced ahead of employment incomes. The average home price was 3.6 times the average income in England and Wales in 1997; it is now 7.6 times (15 times in many parts of London). H2B allows people in England to buy new homes with deposits of just 5% and a government loan on very favourable terms, to augment a commercial mortgage. The loan is interest-free for the first five years. It can be used for 20% of the property's value if outside London and 40% in London. The buyer can use the scheme for properties up to the value of £600,000. The scheme started in April 2013; so far some £7 billion of government loans have been agreed; and recently a further £10 billion have been earmarked. The scheme is restricted to purchases of new homes, but not restricted to first-time buyers.

The drawbacks

Economists often mention three potential drawbacks. First, subsidies may be showered on recipients who would have taken the targeted action anyway. Second, the subsidy may end up in the pocket of someone other than the target recipient. And, third, the subsidy may end up exacerbating the problem it's supposed to mitigate.

On the first, research suggests that about 35% of H2B recipients could have bought a home without the subsidy. On the second and third, eminent authorities including the IMF and the OBR have argued that H2B is not likely to elicit a significant increase in the supply of houses. Profit-maximising management of building plots is central to the business model of house-builders. Just as with OPEC's restriction of oil supplies, the interest of the builders is best served by drip-feeding land into the market, maintaining or increasing prices. Executives would be failing in their duty to pursue shareholders' interests if they flooded the market, depressing prices.

In practice, H2B is expected to soften buyers' resistance to builders' price rises. As it is only available for new homes, a Londoner faced with the choice between a new house costing £550k and an identical second-hand house at the same price can get an H2B subsidy of around £7k a year (the interest saved) if she opts for the new house. So the new house will be much the better buy, and it will be worth her while to pay more for the new than for the second-hand house. The builder knows this, and prices accordingly.

Sir Steve Nickell of the OBR commented to the Treasury Committee:

> The key issue is, is [H2B] going to just drive up house prices? By and large, in the short run, the answer is yes. But in the medium term, will the increased house prices stimulate more house-building? Our general answer would probably be a bit, but the historical evidence suggests probably not much.

One consequence of the H2B subsidy further stoking the inflation of house prices is that the initial aim of the scheme is subverted: renters who can't take advantage of the H2B subsidy are left further behind. Another is that part of the benefit of the subsidy is appropriated by the builders. To explore this appropriation process we have analysed the annual reports for the last seven years of the major builders involved in H2B. Table 1 shows the total H2B loans extended by the government nationally in each year since 2013; and the builders' average profit margin and return on equity for two years before and each year after H2B began.

Table 1: Help to Buy loans and builders' profitability

	H2B loans (£m)	Builders' Margin (%)	Builders' Return on Equity (%)
2011	0	9.6	4.8
2012	0	11.9	7.7
2013	565	15.9	11.8
2014	1225	18	16

	H2B loans (£m)	Builders' Margin (%)	Builders' Return on Equity (%)
2015	1469	19.9	19.7
2016	2096	21.4	20.6

Sources: See here, and the respective annual reports and accounts for Barratt, Bellway, Persimmon and Taylor Wimpey.

The profit margin shows, for each £100 received from the sale of a home, how many pounds went into the operating profits of the builder. Suppose a home costing £90k to build was previously sold for £100k: operating profit was £10k, and the operating margin was 10%. Then, if costs are unchanged but price rises to £101k, operating profit rises by the whole £1k, and the margin increases to roughly 11%.

One report suggests that H2B has allowed builders to raise selling prices by towards 10%. Table 1 shows that the margin was roughly 12% in the year before H2B. It grew to 21% in the last year for which data are available. The return on equity shows, for each £100 invested in the companies in that year by their shareholders, how many pounds of post-tax earnings were generated for those shareholders. This figure rose from around £8 before H2B to over £20 in the most recent year.

Table 2 shows how the stock market responded to these data. It compares an index of the share price of housebuilders listed on the stock exchange with a corresponding index for companies at large – the FTSE 350. From 2009 to 2012, they moved in step. After H2B was introduced, the house-builders' price index showed a startling rise from 150 in 2012 to 500 in 2016, whereas for companies at large it rose from 150 to 220.

Table 2: Indices of share prices

	FTSE 350	Listed house-builders
2009	100	100
2012	150	150
2016	220	500

Source: see here.

Now we are not claiming that H2B is responsible for all the gains in profits and share prices. But the correlation is consistent with there being the house price response economists would expect. And the stock market certainly credited H2B with significant profit consequences for the builders: when rumours circulated on 4 August 2017 that H2B might be withdrawn, £1.3 billion was wiped off the stock market value of the five biggest builders within 90 minutes.

Who benefits?

Managers as well as shareholders have prospered with H2B. The benefits received by one or two senior executives of these builders have recently attracted media attention. Again we have analysed the information provided by companies' annual reports on executives' incomes and gains before and after the introduction of H2B. The accounting rules mean that their published benefits figure comprises salary, bonus, pension and those share options that actually vest in a particular year. For the chief executives of those three of our four builders whose data are consistent, the average annual value of this package was £2,040,000 in 2010-2012; in 2013-16 it was £4,290,000. They also gained from the 230% rise between 2013 and 2016 in the price of their shares in their companies under H2B (Table 2). In their last annual reports, the chief executives of our four builders held collectively around £17million of shares in their companies.

But these numbers are dwarfed in some cases by further, lagged, benefits which have arisen from share options (buying company shares at a future date at a predetermined price, yielding a profit for the executive if the share price has risen in the meantime). Often, options held by an executive can only be exercised at some future date if certain financial performance targets are met. And the profit will depend on the future price of the shares. The accountants don't like to count chickens that have yet to be hatched: estimates of future gains which might be realised from as yet unvested options are therefore excluded from the annual figures we noted above.

So in the Persimmon case, for example, the pay figure for chief executive Fairburn given in the accounts for 2016 – confining gains from share options to those realisable in the respective year – was £2100k. But at the end of 2017, many of the options owned by Mr Fairburn in 2016 could be exercised – the chickens hatched. The chickens turned out to be very plump indeed: towards £50million for Mr Fairburn, with a similar further gain likely to come later.

Aside from the builders' experience with H2B, there is another stark fairness consideration – concerning the distribution of the subsidy across different home buyers. The biggest beneficiary of H2B is a Londoner buying a £600k home, with a £240k H2B contribution. To qualify for the maximum accompanying commercial mortgage, that buyer would probably have to be in the top 10% of UK earners. As against that, for a would-be London buyer on average income, a commercial mortgage would be restricted to perhaps £100k. So this buyer's total budget to buy a home (combining £100k commercial mortgage, £67k H2B contribution, and deposit) would be around £175k.

At current interest rates, the effective H2B subsidy to this Londoner in the top 10% of the earnings distribution would be in the region of £140 per week. For an average earner in London it would be just £40 per week; outside London around £14 per week. The scheme is steeply regressive.

A further distributional impact requires even more tentative estimation, but although it is hard to pin down, it can't be ignored. The government's H2B loans obviously have to be funded. On current plans, financing the H2B loans will add some £17billion to government borrowing. That would bring an extra interest bill for the Exchequer of several hundred million pounds a year.

With the current taboo on raising tax rates, that means corresponding cuts in public expenditure if H2B is to be financed while meeting the public sector deficit target. Examples abound of such cuts in recent years, from cuts in nurses' pay to freezes in benefits. Particularly relevant to the issue at hand is the tight restriction on local authority building of affordable homes to rent, the instrument the Conservative Government of the 1950s deployed so effectively to relieve housing shortages.

One retort to this line of argument is that H2B has been structured so as to be costless to the Exchequer. These are "equity loans", which means the government's stake in a participating house changes at the same rate with the value of the house. As house prices rise, the argument goes, the government achieves capital gains, which offset the interest costs of servicing the debt which funds H2B. This is true. But similarly, if house prices fall, then the Exchequer will be faced not just with the interest bill but also with a capital loss impairing the public sector balance sheet: the total cost of H2B will be higher still.

So on top of the pressure from existing home-owners not to suffer falls in the value of their homes, and from house-builders anxious to keep the party going, H2B creates another political imperative to keep the bubble inflating – avoiding impairment of the government's H2B loans. It is no surprise that the Chancellor gave the housing market junkie another H2B fix, against the advice of most economists.

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