Help to Who? Using the state to Help to Buy

Wednesday June 5th, 2013
- John Stewart, Director of Economic Affairs, Home Builders Federation
- Toby Lloyd, Head of Policy, Shelter
- Dr Christian Hilber, Reader, Department of Geography and Environment, LSE

- Chair: James Lloyd, Director, Strategic Society Centre
- When is it the role of government to underwrite private mortgage lending?
- Why are UK banks not offering higher loan-to-value mortgages? Is this a function of temporary institutional constraints or an assessment of UK house-price risk? How will lenders assess this risk when Help to Buy ends?
- What outcomes are Help to Buy trying to achieve? Do these outcomes cohere with wider housing policy objectives?
- What are the distributional consequences of Help to Buy? Who will benefit from the scheme? What does Help to Buy mean for the aspiration agenda?
- What does international and historical experience tell us about the role of the state in financing private house purchases?
Help to Who?
Using the State to Help to Buy

John Stewart
Director of Economic Affairs, HBF
5 June 2013
Presentation Outline

• Economic context
• Mortgage policy proposals
• High LTV mortgage availability
• Mortgage schemes: key details
• Impact: volumes or prices
• International comparisons
ECONOMIC CONTEXT
Comparing Recessions (GDP peak=100)

Source: Office for National Statistics; HBF
Chart 3.1 GDP and sectoral output (from Bank of England Inflation Report, May 2013)

(a) Chained-volume measures. GDP is at market prices. Indices of sectoral output are at basic prices. The figures in parentheses show 2009 weights in gross value added.
Housing contribution to GDP

Housing within GDP

- Household expenditure: 13.5%
- Capital formation: 3.3%
  Of which
  Newly built homes: ~1.4%

Net new build jobs: 2.4 direct and supply chain
Housing contribution to GDP

“Things are looking up [in the US]. Led by rising house prices, the US recovery is likely to accelerate this year.”

(Lawrence Summers, FT, 3 June 2013)
MORTGAGE POLICY PROPOSALS
Should Government underwrite mortgages?

- Temporary interventions
- Aspiration: help to buy own home
- Support home building: GDP, jobs
- “dramatic intervention to get our housing market moving” (George Osborne Budget speech)
Should Government underwrite mortgages?

“…Government’s view that the current scarcity of high loan-to-value lending is primarily a cyclical issue rather than a symptom of a longer-term structural change in the mortgage market.”

(Treasury. Help to Buy: Mortgage Guarantee. Scheme Outline)
Mortgage policies

- **Funding for Lending** scheme: to lower rates, increase net lending
- **Help to Buy: Equity Loan**: deposit gap and affordability
- **Help to Buy: Mortgage Guarantee**: deposit gap
<table>
<thead>
<tr>
<th>Year</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>June</td>
<td>April</td>
<td>January</td>
<td>January</td>
<td>May</td>
</tr>
<tr>
<td>FLS</td>
<td>starts</td>
<td>HtB: Equity Loan starts</td>
<td>HtB: Mtg Guarantee starts</td>
<td>FLS ends</td>
<td>General Election</td>
</tr>
</tbody>
</table>

Bank rate starts rising?
Perfect storm in 2016?

- Mortgage rates rising (FLS and bank rate) => affordability deteriorates
- As support for new build ends
- And mortgage support for high LTV mortgages ends
HIGH LTV MORTGAGE AVAILABILITY
First-time Buyer Median Deposit & LTV (UK)

FSA: 95%+ LTVs = 0.2% all mortgages 2011/12

Source: CML
HBF Survey: 'Major' Demand Constraints (GB)

% regarding as 'Major Constraint'

- Mortgage rates
- Mortgage terms
- Mortgage availability
- House prices

Years:
- 1992 Q1
- 1993 Q1
- 1994 Q1
- 1995 Q1
- 1996 Q1
- 1997 Q1
- 1998 Q1
- 1999 Q1
- 2000 Q1
- 2001 Q1
- 2002 Q1
- 2003 Q1
- 2004 Q1
- 2005 Q1
- 2006 Q1
- 2007 Q1
- 2008 Q1
- 2009 Q1
- 2010 Q1
- 2011 Q1
- 2012 Q1
- 2012 Q3
Why few high LTV mortgages?

- Funding crisis from 2007 H2 + need for low risk to secure funding => restrict lending to less risky, low LTV
- Basle capital requirements => LTV mortgage rate premium higher than in past*
- Lender fear of falling house prices?

* 95% mortgages currently in range 5-6%
HtB: Equity Loan

- New build, England only (at present)
- All builders can apply
- At least 5% deposit
- Government equity loan: 10-20%
- Price cap £600,000
- Projected take up: 74,000 sales, £3.5bn (around £17.5bn new home sales)
- April 2013 - March 2016
HtB: Mortgage Guarantee

- New & second hand, UK
- At least 5% deposit
- Price cap £600,000
- Govt guarantees portion* of repossession losses (7 yrs)
- Normal 95% LTV affordability & credit criteria
- Projected take up: 190,000 sales pa, £130bn mortgages
- January 2014 - December 2016

* 95% of losses down to 80% of purchase price
HtB: Mortgage Guarantee

Key issues to be resolved

- Value of commercial fee to Treasury – match commercial MIG rates?
- Capital relief?
- Mortgage rates (especially vs NewBuy)?
- Withdrawal: taper vs cliff edge?

Future Government needs Financial Policy Committee (FPC) agreement to renew
IMPACT
VOLUMES OR PRICES?
Impact: volumes or prices?

- **HtB: Equity Loan**
  New build supply response – though may not be 25,000 pa

- **HtB: Mortgage Guarantee**
  Some new build supply; second-hand supply (buyers who are sellers*); plus 190,000 pa is gross – net additional transactions lower

*CML: 326,000 home mover mortgages 2012 plus add cash buyers with home to sell (e.g. trade downs)*
Impact: volumes or prices?

Other constraints on price increases

- Will all lenders take part?
- Will Mortgage Guarantee apply to new & second-hand?
- Lenders’ tight 95% affordability & credit scoring
- MMR => some buyers constrained
- Will valuers constrain increases?
- Affordability deteriorates as prices rise
Impact: volumes or prices?

• And if prices surge, surely a response from Treasury, Monetary Policy Committee (MPC), Financial Policy Committee (FPC) – post General Election?

• Poisoned chalice for new Government?
INTERNATIONAL LESSONS
Help to Who?
Using the State to Help to Buy

John Stewart
Director of Economic Affairs, HBF
5 June 2013
Help to Buy: An academic’s view based on economic theory and empirical evidence

Christian Hilber
London School of Economics

June 2013
Overview

1. What will Help-to-Buy achieve?
   - What does economic theory predict?
   - Supporting empirical evidence

2. Who benefits?
   - Winners and losers – not who you might think...

3. What should the government (not) do?
House prices in UK are extraordinarily high
- UK has second highest buying price per square metre in the world (only topped by tiny Monaco!) (Globalpropertyguide.com; last accessed March 2013)

And we live in extremely cramped housing!
- A new-build house in UK is 38 percent smaller than in densely populated Germany and 40 percent smaller than in the even more densely populated Netherlands (Statistics Sweden, 2005)

⇒ Might ‘Help to Buy’ solve this problem?
Main effect of Help to Buy

- Equity loans and the mortgage guarantee both boost demand for housing, especially of first-time-buyers.
- Higher willingness-to-pay, all else equal.

Also: starter homes and new builds are reasonably closes substitutes for other types of housing (incl. rental).
- Positive effect on aggregate demand for housing.
Policy strongly affects ability of potential first-time buyer to afford down-payment on starter home

- Additional boost to housing demand
- Because of capital gains & ‘moving up the housing ladder’ feeds through to trade-up homes

Has substantial impact on overall housing market (Ortalo-Magné & Rady 2006)
The demand side...

House prices

Demand w/o HtB

Demand w HtB

Housing stock

Intro /Problem  Theory  Evidence  Who benefits?  What (not) to do?  References
What about supply?

- **UK planning system extraordinarily inflexible**
  - Since 1947: virtually no fiscal incentives at local level to permit development
  - Government reforms since 2010 not (yet) ‘biting’

- **Underlying causes?**
  - UK = highly centralized country, virtually no fiscal power at local level
  - Political power tilted towards homeowners (NIMBYs or better: BANANAs)

⇒ Perhaps world’s most restrictive planning system...
The supply side...

House prices

Long-run supply

Demand w/o HtB

Housing stock
The effect of Help to Buy...
Hilber and Vermeulen (2010, 2012)

- Demonstrate that tight local planning constraints in parts of England (in conjunction with strong demand) are to a good extent responsible for extraordinarily high house prices

- Had the SE the restrictiveness of the NE, house prices in the SE would be 25% lower
Hilber and Turner (forthcoming)

- Mortgage interest deduction in US
  - Raises house prices in regulated cities
  - Reduces homeownership attainment in these cities
  - Zero overall effect on homeownership attainment

- Why? Subsidy pushes up prices in constrained places and prevents marginal would-be-buyers from becoming homeowners

⇒ US wastes 100 Billion US-dollar each year!
Winners and Losers

- **Main beneficiaries = Existing owners of owner-occupied housing**
  - Mainly wealthy & elderly population
- **First time buyers not better-off**
- **Mobile renters worse-off**
  - Typically poor & young
- **Tax payers bear cost of schemes & risk**
  - But wealthy also pay more taxes
  - Zero sum game?
We may ALL be losers...

1. Taxes needed to finance scheme have a ‘deadweight loss’
   - Pure welfare loss for society

2. Systemic risk (...yet again)
   - Government does not only provide ‘implicit government guarantee’ but directly bears various costs and risks
   - If housing markets collapse then government takes direct hit...
   - Unlikely? Perhaps, but...
Subsidies to consumers are ineffective, costly & risky

Must tackle ‘supply side’ problems instead!

- Give strong incentives to local authorities (and NIMBYs) to facilitate construction of new housing and expansion of existing housing

- One idea (of many): Introduce proper local property tax and get rid of e.g. ‘absurd’ stamp duty (Mirrlees Review 2011; Hilber & Lyytikäinen 2013)
And what can we learn from the US housing crisis?

- **Securitization can improve social welfare in principle BUT...**
  - Design and implementation of securities market in US was flawed + markets were poorly regulated

- **Lessons from the US debacle**
  1. Ensure competition – no monopoly or duopoly
  2. ‘Too big to fail’ is bad – commit to **no** government backing, so investors face true risks
  3. Regulation ought to focus on market efficiency and systemic risks

⇒ It appears British politicians may not have learned these lessons....


Thank you!

*Presentation with references & hyperlinks is downloadable from:*

http://personal.lse.ac.uk/hilber/
Until there’s a home for everyone

Who does Help to Buy need to help?

Toby Lloyd
Head of Policy

Thursday, 6 June 13
A decade of big change in renting
Change among renter groups

Change in private renters' household composition 2007–2010/11

Is it a ‘choice’ between renting/owning?

- 2/3s of renting families want to own but don’t think they’ll ever be able to afford
- Fewer than 1 in 10 renting families value flexibility of renting
- 44% of parents feel their children would have a better childhood if they had more stability
- Fewer than half of renting families can save more than £50 a month
Why not? Is it a lack of lending?
Why not? Is it house prices?

UK house price to earnings ratio

Long run average

Source: Nationwide, ONS
Affordability for median families

90% mortgage on a median local home

59% affordable
Affordability for median families

90% mortgage on a median local home

95% mortgage on a median local home

59% affordable

49% affordable
Pen portrait: Jo and Dave in Watford

- Earn £50k (1.5x median local FTE)
- Local median house price is £208,000
- Would need to earn £5,500 more to afford a 90% mortgage
- Would need to earn an extra £8,500 to afford a 95% mortgage
Affordability for lower quartile families

90% mortgage on a median local home

18% affordable
Affordability for lower quartile families

90% mortgage on a median local home
18% affordable

95% mortgage on a median local home
12% affordable

Data: DCLG, Nationwide, HMT. Image: A Right to Build, Architecture 00:;/, 2012 http://issuu.com/architecture00/docs/arighttobuild
Strategic Society Centre
32-36 Loman Street
London
SE1 0EH
info@strategicsociety.org.uk
www.strategicsociety.org.uk
Twitter: @sscthinktank

The Strategic Society Centre is a registered charity (No. 1144565) incorporated with limited liability in England and Wales (Company No. 7273418).