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Affordable Housing

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Introduction
The McKinsey Global Institute, an economic think-tank, last year published a report on global housing. The report finds that City dwellers globally pay $650bn a year more on housing costs than they can afford and wages of low income earners lag growth in housing costs leading to greater income inequality and out-migration of skilled workers. The availability of affordable housing reduces the entry costs of doing business for companies and employees and increases demand for secondary services like food and drink retailers. A city's productivity increases when lower income earners are assimilated more fully into the economy. In other words rising disposable income will add to the City's GDP. The report identifies 'idle land' as the significant problem, whether it is zoning restrictions or political difficulties in building on government controlled land. Clearly there is an affordability problem for low-income individuals and families and the inevitable peril of exorbitant rent increases. The lack of supply pushes up housing costs. Without affordable housing, because of supply shortages, a tighter labour market ensues (wage inflation) and consequently an upward spiral in housing costs and rents.

Mia Farrow, rent control and the law of unintended consequences

Policy makers and some policy advisers have put rent control forward as the solution. Rent control places a maximum price (rent ceiling) on the price (rent) of housing. The intention here is to make housing more affordable. However, the unintended consequence is to do the opposite. In the first instance supply falls as those who supply accommodation run the additional risk of not getting the required return on their investments. Demand increases because potential buyers postpone the purchasing decision and seek rented accommodation instead. The shortage is now greater under rent control than the market outcome. In classical economic theory, high prices act as a market signal that demand exceeds supply and the market reacts by increasing supply leading to lower prices. This is what Adam Smith called the 'invisible hand' of the market place that guides buyers and sellers behaviour. When this market signal is removed the available space is now rationed out by means other than market pricing – none of them pleasant.
If one thinks that opposition to rent control is the preserve of right-wing economists consider the view of Nobel Laureate Gunnar Myrdal, the architect of Sweden's Welfare State who stated that 'rent control has in certain Western countries constituted, maybe, the worst example of poor planning by governments lacking courage and vision'. The economist and socialist Assar Lindbeck memorably said that 'rent control is the best way to destroy a city apart from bombing it'.
It is not just actual rent control but the mere threat of its introduction that deters investment in housing. Policy makers may insist that any form of rent control may be a temporary measure. But perhaps we should remember that income tax was first introduced in the U.S. as a temporary measure to pay for the cost of World War 1. With rent control, developers move into other areas of investment in real estate not under control, perhaps into luxury apartments. In other words rent control creates an incentive to built for the wealthy and elite. Furthermore the elite and wealthy can take advantage of rent control because sellers

(landlords) can discriminate. Most documented examples from New York were Mia Farrow, Faye Dunaway and Ed Koch all occupying rent controlled apartments at significantly below market prices. Other forms of discrimination surface – discrimination against colour, race, single parents, and the handicapped. In addition, housing units fall into disrepair during the period of rent control because of inability to pay for repairs.
When all these 'hidden costs' are added the 'real price' of units may be higher than even the market price. This is not a transfer from landlords to those who are renting but in economic jargon it constitutes a deadweight loss.

Rent Control – the German experience
While New York's experiment with rent control is used as a textbook example of the unintended consequences of price ceilings, Germany is often seen as the poster child of such controls. About 22m households live in rented accommodation in Germany. This very high rate is partly explained by tenancy law that gives renters security of tenure but Germany also has tight rent controls. The law militates against amateur landlords who may want to buy housing units for capital gain. This has the effect of ring fencing rented accommodation and the presence of institutional investors. On the other hand, while owner occupation is discouraged in Germany here in Ireland, as it is in Britain, governments subsidise home ownership.
Ireland's Central Bank's 20% income requirement is a prudent measure to stabilize banks following the collapse of the banking sector. However, this effectively amounts to an effort to control demand and excludes many low-income earners from home ownership, which increases demand for rented accommodation putting upward pressure on rents.

Market Failure
The housing market is inflexible because the forces of supply and demand are not sensitive to price changes. Property cycles and slumps are indicative of the struggle to arrive at stable market prices. There are lengthy production time – lags where it can take years to complete a house from the initial planning stage. With all the other 'structural rigidities' such as zoning and the political difficulties in building on government controlled land, it is not surprising to find price instability within the property market.
The construction industry has a distinguishing feature that, in theory at least, can account for its cyclical nature. The investment decision to build is influenced by current market prices and therefore the supply of houses built in the future is reliant on historical prices. Currently, demand exceeds supply and prices are high and this, after the time-lag, incentivices building programmes. Consequently, this depresses prices and a fall in the number of houses built. This is followed by a contraction in supply and higher prices. Equilibrium is never achieved as prices move above and below what is stable.

Supply

With demand exceeding supply the cost of building land (with planning permission) rises dramatically and this leads to higher house prices. Kate Allen of the Financial Times reported that in Britain, land with planning permission to build houses is worth “260 times what it would be as farmland”. This could be taxed and revenues used to provide social housing. Allen reports that in South Korea, Hong Kong and Taiwan national land banks “acquire land for residential development, improve it and then sell it onto developers”. Her report also notes that in Singapore “80% of the population live in homes built by the government”. Dublin has a supply shortage and more housing units are necessary. Not doing so creates a clear division between those who own their own home and those who do not. Kate Barker, author of the UK Review of Housing Supply, describes this as the ‘haves’ and the ‘have-nots’. Those who ‘have’ enjoy capital appreciation and with supply shortages those who ’have-not’ find it difficult to buy a home.

Conclusion

Lack of affordable housing is socially undesirable, increases income inequality, leads to outward migration of skilled workers and a fall in city gross domestic product. Research points to idle land as a significant problem along with zoning restrictions and political difficulties in building on government controlled land. There are clear unintended consequences in introducing rent controls in line with the New York experiences. The European model of large-scale institutional investment combined with rent restrictions, tenancy law and ringfencing is certainly appealing. However, a move in this direction would necessitate cultural and political change to discourage subsidizing home ownership.

There is international empirical evidence supporting successful government provision of housing in the form of national acquisition of housing land banks. Current government policies on housing leads to:

- Inequality
- High housing benefits
- Restrictions on supply
- Unproductive investment (untaxed capital gains on housing)

The supply of housing must increase but given the construction market’s structural rigidities building on the scale needed is problematic. Lighter planning controls would aid substantial house completions. In addition, a land value tax would encourage more intensive use of valuable land.