Breaking the housing-finance cycle

Vienna
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UCL Institute for Innovation and Public Purpose (IIPP)
• Ryan–Collins, Lloyd and Macfarlane (2017) *Rethinking the Economics of Housing and Land*, Zed Books
• Ryan-Collins (2018) *Why can’t you afford a home*, Polity
• Ryan-Collins (2019) “Breaking the housing finance cycle”, *Environment & Planning A: Economy and Space*
House price-to-income ratios in advanced economies, 1980-2018

Source: OECD Analytical house price database. Data is averaged across 15 advanced economies, market prices.
House price-to-income ratios in advanced economies, 1980-2018

Source: OECD Analytical house price database. Data is averaged across 15 advanced economies, market prices.
The decline of the ‘home-owning democracy’?

# Land and credit – a dangerous mix

<table>
<thead>
<tr>
<th></th>
<th>Land</th>
<th>Credit/money</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Supply</strong></td>
<td>High inelastic – desirable location inherently limited</td>
<td>Highly elastic: determined by banks’ confidence &amp; regulation</td>
</tr>
<tr>
<td><strong>Mobility</strong></td>
<td>Fixed/immobile</td>
<td>Highly mobile, increasingly global</td>
</tr>
<tr>
<td><strong>Value through time</strong></td>
<td>Appreciates in value with economic growth, enabling rent extraction</td>
<td>Depreciates unless invested or lent</td>
</tr>
<tr>
<td><strong>Economic role</strong></td>
<td>Conflicting economic uses: consumption good (housing) OR financial asset</td>
<td>Supports capital investment &amp; productivity OR inflates existing assets</td>
</tr>
</tbody>
</table>
Land and credit – misunderstood in neoclassical economics

Land

- Private property rights a prequisite for market exchange but presented as ‘natural’ - *origin of distribution* never questioned
- Not a unique factor of production – in long run marginal returns no different from labour or capital (J. Bates Clark)
- Theory of marginal productivity leaves no room for land rents:
  - Income = reward for one’s *contribution to production*
  - Wealth = ‘savings’ due to one’s productive investment effort.

Credit and banking

- Role of banks is to intermediate *existing* savings, not create purchasing power (Schumpeter)
- Barter myth – money just another commodity with special properties that oils the wheels of market exchange
- Money is ‘neutral’ in the long run
- Central bank can exogeneously control the money supply
The housing-finance feedback cycle

Financial innovation - securitisation of mortgage debt

Increased supply of mortgage credit

Government equity loans & guarantees of house purchases

Banks increase profits and capital base

Expectation of future house price increases

Increased mortgage debt relative to incomes

Stagnating wages, pensions & social security increases demand for home as financial asset

Increased demand for mortgage debt

Increased land and house prices relative to incomes

Speculative domestic and overseas & buy-to-let purchases

House prices and mortgage credit over 130 years in (14) advanced economies

Source: Jorda-Schularick- Taylor microhistory database www.macrohistory.net
The Austrian picture

Source: Bezemer 2016
<table>
<thead>
<tr>
<th>Housing Policy</th>
<th>Post-war, Keynesian era (1940-1970)</th>
<th>Neo-liberal / financialization era (1980-)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Subsidizes the <em>supply-side</em>: public housing, compulsory purchase powers, new towns etc.</td>
<td>Subsidize the <em>demand side</em>, in particular for first-time buyers, mortgage support, housing benefit</td>
</tr>
<tr>
<td>Bank funding</td>
<td>Limited to domestic deposit base</td>
<td>Collapse capital controls, Eurodollar market &amp; RMBS enables vast new wholesale funding streams</td>
</tr>
<tr>
<td>Tax</td>
<td>Taxes on land rents (capital gains &amp; imputed rent, inheritance)</td>
<td>Tax shifts away from property and on to income/consumption (mortgage interest relief)</td>
</tr>
<tr>
<td>Land rents</td>
<td>Democratised and spread widely via increasing middle class home ownership &amp; transport revolution</td>
<td>Increasingly concentrated in older cohorts, banking sector &amp; investment class as home ownership declines &amp; transport infrastructure hits limits</td>
</tr>
<tr>
<td>Source of growth</td>
<td>Private &amp; public investment, rising wages &amp; productivity</td>
<td>Rising housing-wealth (land rents-) and housing debt-fueled private consumption</td>
</tr>
</tbody>
</table>
The post-crisis cycle

• Macroprudential policy
• But:
  – Re-embracing of securitization – EU ‘Simple Transparent Standardized’ program has lowered capital requirements for RMBS
  – QE driven down yields on government bonds
  – Real estate is the new gold (especially in cities)
  – PRS & Social housing opened up to REITS & other international investors
  – Low rates mean investors leverage v. cheaply against real estate, continuing the cycle
Policy alternatives

- Financial reform
  - Structural & institutional reform
  - Central banks/financial regulation
- Land policy reforms
  - LVT
  - Ownership
  - Tenure
Where things are different

House price to income ratio indexed against long-term OECD average (=100)

- Germany
- Korea
- Anglo-Saxon average

Long term average = 100

Source: Ryan-Collins (2018: p97)
Banking - structural reform

- Banks focused on capital investment, not real estate credit:
  - stakeholder/regional banks
  - public development banks
  - Equity based mortgage financing
## Shareholder v ‘Stakeholder’ banks

<table>
<thead>
<tr>
<th>Feature</th>
<th>Shareholder banks</th>
<th>Stakeholder banks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ownership</strong></td>
<td>Owned by institutional investors focused on quarterly returns</td>
<td>Owned by members, local or regional state, focused on public value</td>
</tr>
<tr>
<td><strong>Focus</strong></td>
<td>Short-term profits &amp; Return on Equity (10%+)</td>
<td>Financial sustainability (RoE 5%+) balanced with (local/regional) social &amp; environmental goals, including access to finance</td>
</tr>
<tr>
<td><strong>Approach to risk</strong></td>
<td>Preference for collateral/centralised credit scoring</td>
<td>Reduce information asymmetry via relationship building</td>
</tr>
<tr>
<td><strong>Lending preference</strong></td>
<td>Mortgage/intra-financial, large loans</td>
<td>Business/SME/mortgage, smaller loans</td>
</tr>
<tr>
<td><strong>Maturity of lending</strong></td>
<td>Short-term if not collateralised</td>
<td>Longer term</td>
</tr>
</tbody>
</table>
State-directed finance
Different banking systems create different housing-finance relationships

Source: Ryan-Collins 2018 (original credit data from central banks and housing data from Knoll et al (2017))
Financial policy

• Target asset prices not just consumer prices
• Quantitative ‘credit guidance’ widespread before financial deregulation in advanced economies
• Used in SE Asia and Japan throughout 1970s & 80s
• Post-crisis, CBs moving back towards sectoral credit controls?
  – ‘macroprudential policy’
  – ‘funding for lending’
Fiscal policy: land value tax

- Annual tax on the incremental increase in unimproved land value
- Salience: withdraw from pay like NI
- Make it tax neutral – reduce income & corporation tax
- Allowed delayed payment for low income pensioners or equity release
- Hypothecate LVT profits to a citizens income?
Ownership & tenure

- No economic evidence that higher levels of private landed home ownership supports economic growth (Blanchflower & Oswald 2013; Oswald 2009)
- Public ownership – removing land from market in perpetuity – solves both supply and funding problems
  - Singapore: 90% land owned by state, long leases to private sector, public mortgage system
  - South Korea: Korean Land Corporation (1975) controls 50% residential & all commercial development – purchases, develops & sells land
  - Tenure neutrality socializes rents (Germany/Switzerland/Austria!)
Research agenda

• Key role of land in the macroeconomy – do rising house/land prices ‘crowd out’ productive investment/lending by firms & banks? (see e.g. Charkraborty et al. 2014)
• Relationship between banking institutional structure and mortgage lending
• Tracking the role of capital markets in the post-crisis housing-finance cycle
• Where do land taxes work and why?
• Lessons from East Asia
Summary

• Land (and housing) have unique economic properties
• Deregulated land market will tend towards monopoly, rent extraction & inequality
• Deregulated banking sector will tend towards real estate lending, pushing up prices & increasing rents
• Policy makers must shape the land market and regulate finance to optimise social welfare
Thank you

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- www.ucl.ac.uk/bartlett/public-purpose/
The Austrian story