The crisis of housing affordability has been mounting for decades, driven by growing demand for properties in desirable areas where supply is limited. Numerous policies have been enacted across countries, but many are ineffective. **Christian Hilber** and **Olivier Schöni** explore what makes this problem so tricky for politicians the world over.

Policies for affordable housing: options and obstacles

The most common measure of the affordability of housing is the ratio of house prices to earnings. In 1995, the average house in London cost around three times the average wage: by the end of 2021, that ratio had risen to 10.9. In other words, the average full-time worker in the capital nowadays requires nearly 11 gross annual salaries to buy an average housing unit.

A multiple of three or below is generally deemed to be affordable. While London stands out, the price-to-earnings ratio similarly deteriorated for the UK as a whole over the same period, from 2.9 to 6.7.

But looking at the house price-to-earnings ratio on its own ignores two important facts. First, it ignores the cost of mortgage financing. Second, not everybody owns property, and rents may have increased less than house prices.

It is true that mortgage interest rates have come down a lot since 1995, and while they have increased notably in recent months, they are still low by historic standards. But even when financing costs are fully considered, housing affordability has deteriorated substantially. A first-time buyer's mortgage payment as a percentage of take-home pay in London increased from 25% in the first quarter of 1997 to nearly 55% in the fourth quarter of 2021. Across the UK, the equivalent increase was from 17.7% to 32.3%.

It is also true that private and social rents have increased much less than house prices over the last 20 years (Hilber and Mense, 2021). Still, in London, the average weekly social rent in 1997 was 26.6% of the weekly pay of those in the lowest 10% by income: by 2020, that had increased to 30%. For private renters, the average weekly private rent as a percentage of the 30th percentile weekly pay increased in London from 66.4% in 2005 to 70.6% in 2020.

> The affordability crisis is increasingly affecting middle-income households

While affordability for renters has deteriorated only slightly over the last 15 years, the fact that Londoners on moderate incomes would have to spend 70.6% of their gross income to afford an average rental unit in the capital is just staggering.

Demand for desirable areas

The above statistics for London illustrate the increasingly dire nature of the housing affordability crisis. Yet London is not alone. The crisis is a global phenomenon, especially in "superstar cities" such as Hong Kong (perhaps the worst affected city in the world), New York, Paris, San Francisco, Sydney and Vancouver.

But what is causing these crises of housing affordability? What policies are being implemented around the world to tackle them? How effective are these

Many mainstream affordable housing policies are ineffective

policies in attaining their stated goals? Are they worth their cost? And who are the main beneficiaries? These are some important questions that economists have been investigating for decades.

We have recently written about this research for the Oxford Research Encyclopaedia of Economics and Finance and a close-to-final draft is available as a CEP occasional paper. The main insights of our review of the research evidence can be summarised in three points.

First, the main underlying cause for the affordability crisis, which has been mounting for decades, is a combination of strong and growing demand for housing in desirable areas in conjunction with tight long-run supply constraints – both physical and man-made regulatory ones. The crisis tends to affect low- and moderate-income households predominantly. But increasingly, middle-income households – who do not usually qualify for government support – are similarly affected.

Second, policies that aim to tackle the housing affordability crisis are numerous and differ enormously across countries. Key policies include mortgage subsidies, government equity loans, rent control, social or public housing, housing vouchers, low-income tax credits and inclusionary zoning. The overarching aim of these policies is to reduce the periodic housing costs of qualifying households or improve access to a certain tenure mode for these households.

Third, many mainstream housing policies are ineffective, cost-inefficient and/or they benefit wealthy property owners rather than lower income renters. The ineffectiveness and undesirable distributional effects in supply-constrained cities such as London arise from the fact that policies – such as Help to Buy – that stimulate housing demand get "capitalised" into higher house prices and rents (Carozzi et al, 2020). This capitalisation effect offsets the policy-induced incentives (typically in the form of subsidies or tax deductions) and mainly benefits better-off homeowners and landlords.

Indirect effects

So why do voters continue to support housing policies that are ineffective and/or inefficient? Indeed, some of the most ineffective policies – such as the mortgage interest deduction (Hilber and Turner, 2014) or Help to Buy – are among the most politically popular.

This is partly because targeted households poorly understand adverse indirect effects, which is exploited by vote-seeking politicians. Partly, it is because often the true beneficiaries of the policies are the politically powerful existing property owners (homeowners and landlords), who are not targeted but nevertheless benefit from positive policy-induced house price and rent capitalisation effects.

The facts that existing homeowners often have a voter majority and that landlords additionally may be able to influence the political process via lobbying, lead to a conundrum: affordable housing policies may be politically popular yet ineffective and, in some instances, even counterproductive – potentially exacerbating affordability crises and worsening inequality.

So what should policymakers do in light of what we learned from our evidence review? In addition to implementing targeted policies for individuals most in need (for example, via housing vouchers or by providing subsidised housing), they should promote those policies that improve housing affordability for all income groups by focusing on the root causes of the problem.

These root causes are first, the strong and unequal growing demand for housing in desirable markets; and second, tight land use restrictions supported by a majority of existing property owners that limit the total supply of housing in these markets.

To design democratic policy reforms along those lines that are palatable to a voter majority is perhaps the biggest challenge that needs to be overcome to cure the rising affordability crises in superstar cities around the world. It won't be an easy task, and while research-informed change may be slow, it is possible.

This article summarises 'Housing Policy and Affordable Housing' by Christian Hilber and Olivier Schöni, CEP Occasional Paper No. 56 (https://cep.lse.ac.uk/_NEW/PUBLICATIONS/abstract.asp?index=9259).

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Further reading

Felipe Carozzi, Christian Hilber and Xiaolun Yu (2020) 'On The Economic Impacts of Mortgage Credit Expansion Policies: Evidence from Help to Buy', CEP Discussion Paper No. 1681 (https://cep.lse.ac.uk/_new/publications/abstract.asp?index=6952).

Christian Hilber and Andreas Mense (2021) 'Why Have House Prices Risen So Much More Than Rents In Superstar Cities?', CEP Discussion Paper No. 1743 (https://cep.lse.ac.uk/_NEW/PUBLICATIONS/abstract.asp?index=7690).

Christian Hilber and Tracy Turner (2014) 'The Mortgage Interest Deduction and its Impact on Homeownership Decisions', *Review of Economics and Statistics* 96(4): 618-37.

Tight land use restrictions limit the total supply of housing