Housing Markets and Structural Policies in OECD Countries

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The OECD Housing Study

- Describes cross-country differences in housing market outcomes in OECD countries
- Provides new cross-country comparable indicators on housing policies
- Evaluates the performance of policies influencing housing markets - using empirical and descriptive analysis:
  - Do policies achieve their objectives in an efficient and equitable way?
  - Do policies have any adverse side effects outside the housing market?
- Makes policy recommendations for efficient and equitable housing policies
Policies analysed

1. Supply-side factors
   - E.g., land-use regulations

2. Housing taxation policy
   - Favourable tax treatment of housing relative to other investments
   - Transaction taxes in housing markets

3. Housing finance markets and banking supervision

4. Rental market regulations
   - E.g. rent controls, tenant protection

5. Social housing provision
Tenure structure varies across countries

Source: OECD housing questionnaire.
The responsiveness of housing supply is critical

- Differences in supply responsiveness influence how demand shocks, such as financial deregulation, affect housing prices and quantities.

- Scarce comparable cross-country empirical evidence on supply responsiveness.

- Undertaken system estimation of long-run price elasticity of new housing supply for 21 OECD countries.
Wide variation in responsiveness of housing supply

1. Estimates of the long-run price elasticity of new housing supply where new supply is measured by residential investments. All elasticities are significant at least at the 10% level. In the case of Spain, restricting the sample to the period 1995-2007, which would reflect recent developments in housing markets (such as the large stock of unsold houses resulting from the construction boom starting in 2000 and peaking in 2007-09), only slightly increases the estimate of the elasticity of housing supply from 0.45 to 0.58. Estimation period early 1980s to early 2000s. See Caldera Sánchez and Johansson (2010) for details.

Source: OECD estimates.
Determinants of supply response

Structural factors:

• Availability/scarcity of land and physical geographical limitations.

Policy factors:

• Land use/planning/building regulations.

• Regulations on supply of rental housing (e.g. rent controls, tenant/landlord regulations).

• Investment incentives through taxation to encourage conversion of under-used urban land into residential buildings.

• Provision of infrastructure, public services and public housing.
Supply responsiveness is lower in more densely populated areas...

Supply responsiveness and population density

**OECD countries**

**US cities**

Source: OECD estimations, United Nations (2007)  
Source: Green et al. (2005)
Tighter land use regulations are associated with a weaker supply response

Supply responsiveness and land-use regulation

**OECD countries**

**US cities**

![Graphs showing correlation between supply responsiveness and number of days to obtain a building permit for OECD countries and US cities.](graph.png)


*Source*: Malpezzi (1996) and Green et al. (2005).
1. Streamline construction licensing procedures.

2. Encourage a better use of land by linking the assessment of property values for tax purposes to market values.

3. Address potential “NIMBY” incentives that encourage municipalities seek to block development.

4. Provide complementary infrastructure and other public services.

5. Ensure the adequate provision of social housing.

➢ But caution is required to avoid volatility in residential investment.
Tax systems favour home ownership in many OECD countries

• Tax exemptions are common:
  
  ➢ **Imputed rental income** is generally not taxed (exceptions: CHE, ISL, LUX, NLD, SVN).
  
  ➢ **Capital gains** on the primary residence are tax exempt (albeit after some holding period in some countries).

• Many countries allow **tax deductibility of mortgage interest payments** and the value of the subsidy tends to be much higher than the taxation (if any) on the income stream from owner-occupied housing.

• Most countries use **recurrent property taxes** but:
  
  ➢ These are too small to offset the mortgage subsidy in most places.
  
  ➢ The property value for tax purposes behind the market value in many countries.
Tax relief on mortgage debt financing, 2009

Estimated wedge between the market interest rate and the after-tax debt financing cost of housing; increasing in the degree of tax relief

This indicator takes into account if interest payments on mortgage debt are deductible from taxable income and if there are any limits on the allowed period of deduction or the deductible amount, and if tax credits for loans are available. For countries that have no tax relief on debt financing costs, this indicator takes the value of zero. 

Source: Calculations based on the OECD Housing market questionnaire; see Johansson (2011) for details.
Consequences of favourable tax treatment

1. **Adversely affect growth**: through excessive investment in housing, which crowds out more productive investments.
   - Especially when returns on owner-occupied property (imputed rent and capital gains) are barely taxed but mortgage interest is tax deductible.

2. **Adversely affect macroeconomic stability**: by encouraging excessive borrowing and speculative behaviour by lowering the cost of mortgage finance and raising house price volatility.

3. **Tax reliefs for mortgage debt tend to be regressive.**
How housing should be taxed?

Tax housing and alternative investments in the same way:

- **First best**: Tax imputed rents and allow mortgage interest to be tax deductible.

- **Second best**: If taxing imputed rents is not politically feasible:
  - remove mortgage interest deductibility; or
  - scale-up recurrent property taxes.
Liberalisation and innovation in housing finance carry risks

1. Lower down-payment requirements and innovative financing associated with an increase in home ownership among previously constrained households.

2. Financial liberalisation estimated to have increased real house prices as much as 30% in the average OECD country over recent decades ...

3. ... and led to greater house price volatility, which can pose risks to macroeconomic stability.

Innovation in mortgage markets should be coupled with appropriate regulatory oversight and prudent banking regulation.

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Housing markets, mobility…

% Percentage of households that changed residence within the last 2 years


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Residential mobility and work reallocation

Percentage of households moving within a two-year period

1. Work reallocation rates are country averages of reallocation rates (hiring and firing rates) expressed in percentage of total dependent employment. See OECD Employment Outlook (2010).

How policies influence residential mobility

1. Homeowners are less mobile than renters and social housing tenants are less mobile than private market tenants.
   - Housing taxation should aim to be tenure neutral.
   - Well designed portable housing allowances may be preferred to direct provision of social housing.

2. High transaction costs in buying and selling houses may reduce residential mobility.

Transaction costs refer to average costs. The estimates do not take into account the various tax breaks that exist in countries for certain dwellings implying that the estimated cost may overestimate the actual cost in some countries (for example in Italy) where such tax breaks are frequent. In addition, VAT when applied to certain costs is not included due to data limitations.

Source: OECD housing questionnaire.
3. Tight rent controls/tenant protection can lead to high transaction costs and lower mobility.

4. A more responsive supply increases residential mobility.

5. Greater access to credit facilitates residential mobility, BUT

6. Excessive leverage ratios can undermine mobility.

Scale 0-6: Increasing in degree of rent control

Source: OECD housing questionnaire

1. This indicator is a composite indicator of the extent of controls of rents, how increases in rents are determined, and the permitted cost pass-through onto rents in each country.
The regional dimension is key

1. Housing markets tend to be regional/local.

2. Municipalities often have significant powers over zoning, land-use regulation, infrastructure development and spatial planning.

3. Fragmented metropolitan governance can create distortions in housing markets that affect labour markets, social integration/segregation, growth and environmental outcomes.

4. Where housing market conditions impede mobility, market fluctuations impede labour-market adjustment.

Housing policies are a crucial part of any growth-oriented regional or metropolitan development strategy.
Main policy implications

1. Improve supply responsiveness of housing by improving land-use, planning regulations and tax incentives.

2. Remove favourable tax treatment of housing.

3. Combine innovations in mortgage markets with appropriate regulatory oversight and prudential regulations.

4. Consider rent allowances to enhance housing opportunities.

5. Redesign rent controls that bring rents far out of line with market values.

6. Strike a balance between regulations that safeguard landlords’ and tenants’ rights.
Thank you!

OECD, Housing and the Economy portal:
http://www.oecd.org/document/50/0,3746,en_2649_37671049_47333810_1_1_1_1,00.html

Selected references:

