

THE CONVERSATION

19 March 2015, 2.23pm GMT

Help-to-Buy ISAs will end up feathering nests of the wealthy – here's how

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Feeding the beast? Diana Parkhouse, CC BY

George Osborne's bid to boost home ownership in Britain might look like an effort to give young people a leg-up onto the housing ladder, but the evidence suggests they will be sorely disappointed. The Chancellor of the Exchequer's budget unveiled a new "Help-to-Buy ISA" savings account which will subsidise deposits for first-time buyers while leaving untouched the fundamental flaws at the heart of our growing housing crisis.

The new ISA savings accounts will be available through banks and building societies from this autumn. In a nutshell, the government will add £50 to every £200 which savers manage to put away towards the deposit. First time buyers can make an initial deposit of up to £1,000 when opening the account. The total subsidy to first time buyers is capped at £3,000. It can be used by first time buyers to purchase homes priced up to £450,000 in London and £250,000 elsewhere.

The new policy is similar in spirit to the various predecessor Help-to-Buy schemes. The Help-to-Buy policy has been described by commentators as the biggest government intervention in the housing market since the Right-to-Buy scheme of the 1980s. But Help-to-Buy and, in particular, the new Help-to-Buy ISA are not a good idea. They are unlikely to help first time buyers achieve their dream of home ownership.

Why it won't work

The new ISA is intended to stimulate housing demand from first time buyers. This should translate – in theory at least – into new housing being supplied and higher home ownership.

However, evidence from the US suggests that there is only a very weak link at best between housing subsidies and improved home ownership levels. In fact, in tightly regulated housing markets in the US (where there is inflexible supply), the subsidies have a negative effect on home ownership because the price effect – through increased demand – more than offsets the income effect from the subsidy. In less regulated US markets (with flexible supply), subsidies do have a positive effect on home-ownership rates, but only for higher income groups.



Is Osborne boxing clever? Andy Rain/EPA

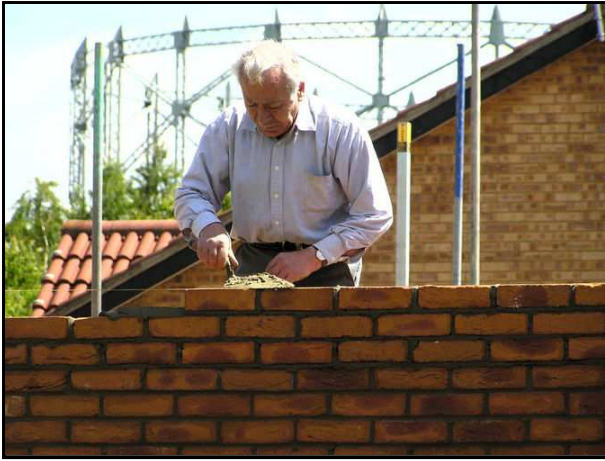
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The trouble, from the UK perspective, is that long standing evidence that I have recently considered in research with Wouter Vermeulen suggests that the UK has an extraordinarily inflexible planning system. This makes housing supply incredibly unresponsive to demand shocks and acts to push up house prices. This effect is most pronounced for London and the South East, where planning regulations are tightest. In other words, stimulation of demand by a Help-to-Buy ISA has the likely effect of driving up house prices, especially in London and the South East, while having no positive effect on construction or ownership.

A busted building boom

Consistent with this idea, according to Nationwide, house prices in London increased by 25.8% in the year following the announcement and subsequent implementation of the original Help-to-Buy scheme, from the second quarter of 2013 to the same period in 2014.

A residential building boom failed to emerge. To the contrary, housing construction is currently at record lows. According to statistics from the Department for Communities and Local Government, the UK built close to 380,000 new homes in the fiscal year of 1969/70 (when statistics began). Housing construction gradually declined towards a record low in 2012-13 of less than 135,510 new homes. In 2013-14 figures were slightly higher at 140,930 new homes, but this reflects the typical increase associated with an economic recovery rather than a building boom induced by Help-to-Buy. The UK homeownership rate has been in decline since the turn of the millennium, falling from 69% in 2001 to 64% in 2014.



Brick by brick. John Keogh, CC BY-NC

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With all likelihood the Help-to-Buy ISA scheme will have similar – if perhaps weaker – stimulating effects on housing demand and prices. The positive effect on house prices may be particularly pronounced in London and the south east and for starter homes. However, it is important to note that since starter homes, “trade-up” homes and private rental homes are all reasonably close substitutes, house prices and private rents are likely to increase across the spectrum.

No Spain, no gain

In fact research by François Ortalo-Magné and Sven Rady for both the UK and the US suggests that due to “trickle-up effects”, capital gains on starter homes incurred by credit-constrained owners can lead to a housing price overreaction, with prices of trade-up homes displaying the most volatility. As a consequence of all this, it is highly likely that first time buyers are no better off. In fact they may be worse off for two reasons. First, as tax payers they help finance the subsidies. Second, the increased prices of starter homes may mean that first time buyers can no longer reach the loan-to-income ratios recommended by the Bank of England and thus are priced out.

So who benefits from housing subsidies such as the Help-to-Buy ISA? Almost certainly it is not young first-time buyers, or even younger existing homeowners who will find trade-up homes for expanding families are further out of reach. Instead, because the subsidy likely increases house prices and private rents across the housing spectrum, the main winners may in fact be **wealthy buy-to-let owners and older homeowners**, especially those thinking about downsizing or moving to countries where housing is comparably affordable. In short, the policy may in fact subsidise wealthy owners of multiple or expensive properties and retirees who sell-up for a move to Spain.

Any political party that is serious about solving the British housing crisis should address the root-cause of the problem, which is the broken British planning system. The proposed Help-to-Buy ISA not only is likely ineffective in raising home ownership, it also likely has undesirable redistributive effects, and, perhaps worst of all, worsens the ongoing housing affordability crisis.