Austerity & Housing: A Two-Way Street

Ronan Lyons, Assistant Professor of Economics, TCD
Debating Austerity – RIA Conference, October 2015
Context: between 2008 and 2013, the Irish economy fell roughly 8 years “behind schedule”

In 2013, the economy was roughly one-third smaller than expected 5 years earlier.

Source: IMF World Economic Outlook databases
From housing to austerity...

House hunters queue outside estate in Swords five days before launch

Thursday 04 September 2014 00.02

The houses go on sale on Saturday

A number of potential house buyers are spending a second night queuing outside a new development in Swords, Co Dublin, which go on sale on Saturday.
Huge downward revision in expectations affected capacity of government to tax and spend

- As of 2007/08, “steady state” growth rate thought to be 5%+
- By 2013, this had fallen to ~3.5%...
  - ... dependent on emerging from the Great Recession
- Importance of nominal GDP for debt burden and fiscal policy
- Where does housing fit in?
  - Wealth & collateral effects
Housing and increased government spending: temporary extra revenues...

- Housing – fuelled by credit – played a significant role in bubble-era excesses

- Figures based on:
  - Employment and wage rates in construction
  - Completions of new homes and VAT rates
  - Stamp duty receipts

- Property-related revenues
  - Rose from €3bn in 2000 to €9bn in 2006

![Estimated revenues from construction, 2000-2010](chart.png)
Housing and increased government spending: 
... funding more permanent spending increases

- Between 2000 and 2008, faster growth in G than in GDP
  - Gross Gov spending grew from <€20bn in 1997 to >€60bn in 2007
  - E.g. permanent pay increases
- Where did housing fit in?
- Gov spending on housing grew roughly in line
  - About 3% of all government spending (roughly 0.8% of GDP)
End of ‘Great Moderation’ led to collapse in housing revenues – still largely not replaced

• Credit-fuelled housing cycle ended 2007 – dramatic fall since
• €6.5bn estimated fall in property-related taxation revenues 2006-2010
• A gap that persists...
  • Local property tax is roughly 1/10th of the scale of old stamp duty
  • Still no Capital Gains Tax on owner-occupied housing
Decline in government spending – particularly in capital and housing spend

- Pro-cyclical fall in gross government spending
  - And concentration in major areas: education, health, social transfers
- Decline in G of ~€10bn
  - Disproportionately capital spending that has been cut
  - Housing badly affected: from ~3% to ~1% of G
- Fall of ~€10bn in G vs. ~€6.5bn fall in property-related gov revenues
From austerity to housing...

Five sites identified to locate modular houses for homeless families

29/10/2015 - 06:09:38

Five sites have been identified for the location of up to 153 modular houses for homeless families.
The importance of counter-cyclical capacity

• Demand for housing inelastic – a basic need
  • And arguably a human right (cf. UN)
• With decline in incomes & employment 2007-2010, huge outward shift in demand for social housing
  • Larger number of households with inadequate income relative to cost of their accommodation
• Unfortunately, social housing had been largely privatised in decade to 2007
  • Burden placed on new properties (Part V) – first-time buyers, disproportionately, on below average incomes
  • Fixed rent supplement merely pits ‘working tenants’ against ‘welfare tenants’
The importance of capital spending

- Austerity has placed current needs ahead of future needs
  - Capital spending has fallen from more than 20% of G to less than 10%
  - From 8% of national income set aside to 4% (of a smaller number)
- Housing now treated as a ‘current account’ item
  - Goes against best practice in social housing policy – i.e. debt-financed building
Principles for post-austerity housing policy

• Two key strategic objectives:
  1. Assist those with inadequate incomes
  2. Preserve households’ freedom of choice

• Clear policy prescriptions follow from these
  • Income-varying housing subsidies, rather than fixed rent subsidies – at the margin, no difference between social and market housing
  • Importance of understanding and capping construction costs, relative to incomes – especially where house prices are capped relative to incomes
  • Distinguishing between planner preferences and fundamental standards (e.g. minimum sizes, orientation, lift/parking requirements) – both “size ≠ quality” and “cutting your cloth”
Rebuilding a healthy housing sector – both market and social

- Sources of demand:
  - Declining HH size & depreciation: ~25k
  - Growing number of households: ~20k
- What % of households will require a subsidy?
  - Depends on costs per sqm – here, Ireland out of line
  - Estimate that only richest 10% of households could afford new DCC 2-bed apt
  - Need reform of housing subsidies

<table>
<thead>
<tr>
<th>Figures for a 2+2 family earning €45k</th>
<th>Status Quo</th>
<th>Scenario</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hard costs / sqm</td>
<td>€1,830</td>
<td>€1,500</td>
</tr>
<tr>
<td>Min sqm (2-bed apt)</td>
<td>85</td>
<td>60</td>
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<tr>
<td>Multiplier</td>
<td>1.77</td>
<td>1.77</td>
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<tr>
<td>Total cost (ex land)</td>
<td>~€275k</td>
<td>~€160k</td>
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<tr>
<td>Cost/rent ratio</td>
<td>200</td>
<td>200</td>
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<tr>
<td>Break-even rent</td>
<td>€1,376</td>
<td>€797</td>
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<tr>
<td>Max housing spend</td>
<td>€1,000</td>
<td>€1,000</td>
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<tr>
<td>Max sqm</td>
<td>62</td>
<td>75</td>
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<tr>
<td>Monthly subsidy required</td>
<td>€376</td>
<td>-€204</td>
</tr>
</tbody>
</table>
Thank you

- Looking forward to comments and questions

- You can contact me at: ronan.lyons@tcd.ie