

Building affordable communities makes good business sense

The real estate industry must foster affordability or see further European cities make policy interventions

In the past two years, three of Europe's most iconic cities – Barcelona, Berlin and Paris – have introduced controls to clamp down on spiralling rental prices. Measures range from rent freezes and enforced rent reductions, to reducing the amount landlords can raise rents within and between tenancies. London, another iconic city, is considering controls, while Amsterdam has introduced draft bylaws to stop investors buying new-builds to rent them out expensively.

Leaving aside the emotions, the question is, what is 'housing affordability' and how can it be measured? John Quigley and Steven Raphael noted in the *Journal of Economic Perspectives* this is difficult to define because it "jumbles together in a single term a number of disparate issues: the distribution of housing prices, the distribution of housing quality, the distribution of income, the ability of households to borrow, public policies affecting housing markets, conditions affecting the supply of new or refurbished housing, and the choices that people make."

It is not, therefore, surprising that people agree on the need for affordable housing, but rarely on what this means.

No room, no room!

The driver of escalating rents is urbanisation, a process that turbocharged during the 1950s. The pace moderated in the 1990s, but urbanisation remains a force – even in countries whose population will shrink in coming decades.

In today's globally integrated, services-based economy, businesses want to be located where capital – both human and financial – is concentrated. These places are cities as they have the infrastructure to provide the educated workforce to fulfil knowledge-based positions plus the wealth to sustain it.

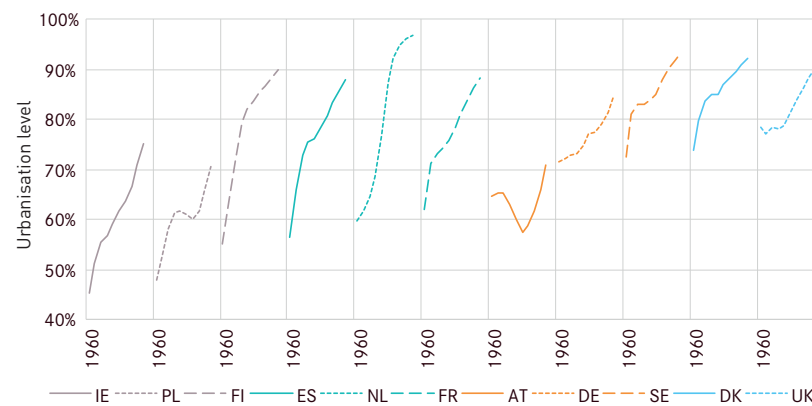
When a city offers such conditions, it attracts business. When businesses are plentiful, they offer career opportunities that attract the young and ambitious. As they flock to the city, they increase demand for housing. It is no coincidence that the most successful cities are

generally the least affordable, a process urban theorist Richard Florida refers to as 'winner-take-all urbanism.' It is also unsurprising that successful cities are where real estate developers and investors want to be.

the economy, it has not reversed the trend of rising rents and housing prices, particularly for properties in the middle or lower end of the market.

This is the cause of the anger. Like Alice at the Mad Hatter's Tea Party, it

Figure 1: Urbanisation is driving rising rent and housing prices across Europe (1960 - 2050)



Source: PATRIZIA, UN

It is the very conditions that make cities attractive that are causing conflicts. The growing demand for housing raises pressure on rent and prices. Across the European Union, housing prices rose by 19% on average between 2010 and 2019 and rents by 13%. This is pricing people on average wages out, particularly as salary increases have failed to match hikes in rental and housing.

With Europe's successful cities struggling to provide affordable housing, they are becoming places where only the wealthy can afford to live. Like Alice in Wonderland, vulnerable groups miss out on a seat at the table because there is 'No room! No room!' They are forced to the outskirts. Even workers essential to the functioning of the city (such as fire and police officers, nurses and teachers) move to the fringe, which challenges the efficiency of the city.

Given the impact of COVID-19, this situation will continue. Wages are likely to stagnate further, rural migration continue and housing costs climb. For while the pandemic has significantly impacted

is only when voters demand, in their case through the ballot box, that space is found. With irate voters rampant, affordability rockets to the top of the agendas of local politicians, who have responded with policies aimed at dampening rental and price increases.

There is no denying there is an affordability problem.

How to destroy a city

Despite rent control seeming the logical solution, it is bad economics if the intention is to ensure enough housing to meet the needs of the population. While economists rarely agree on anything, there

is consensus on this point. There are decades of academic work supporting the argument that Swedish economist Assar Lindbeck summed up as "next to bombing, rent control seems in many cases to be the most efficient technique so far known for destroying cities."

Yet, it is simplistic to argue that rent control doesn't work. It does, but on different markets and different groups in different ways. Existing renters benefit, which reduces the exodus of low- and middle-income workers to urban fringes. However, this causes a misallocation in the long term. Tenants are loath to move, leading to situations where empty-nest households occupy spacious, cheap apartments, while families cram into small units because they are unable to find anything larger.

Rent control also encourages owners to sell to realise market value, shrinking the number of rental properties available. Landlords can also skimp on renovations to make a profit, leading to a decline in the quality of the housing stock. An example of the negative effects was the deplorable state of housing in East German, revealed when the Berlin Wall fell in 1989. The consequences of 40 years of state-controlled rent were evident for all to see.

The well documented case of rent control in New York also shows there is little incentive to build anything other than residences geared to the wealthy who can afford rents above controlled limits or buy apartments outright. There is nothing to suggest that the policies being introduced in Europe will be less dramatic. While current renters will benefit cities will magnify the affordability problem. In ten to 15 years, rental supply will have shrunk and potential new residents locked out of the market.

Defining affordability

If rent control cannot ensure that low- and middle-income families are not squeezed out, what will? First, one must keep in mind that the issue of housing affordability is not new. Cities were created to live in, so solving housing issues

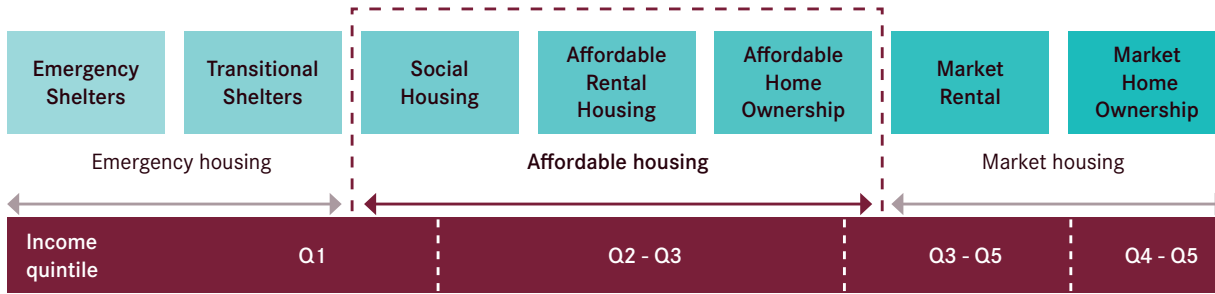
is intrinsic to the nature of the city. Second, it would be useful to have a common reference as a basis for debate. However, there is no simple definition of 'housing affordability.' Different social security systems and regulations means

if housing expenditures exceed 30% of income. Most partners in the European Housing Alliance use a similar benchmark. In comparison, Eurostat, the source of statistical information for the Euro-

the crux of affordability – the issue is really one of insufficient supply. European cities are not building enough housing, which constrains growth and makes them more expensive than they would otherwise be. 'Increase

to doing business. The industry needs to recognise that affordable housing supports social cohesion and diversity, which in turn allows more vibrant communities to exist and forms the basis of the investment opportunities that exist for us in such communities. A rethink of housing policy is clearly overdue and with it, a more nuanced discussion about how the private and public sectors can work together to ensure those who have long been part of the fabric of a city's life are not priced out.

Figure 2: The Housing continuum and income quintiles



Source: PATRIZIA, Urban Agenda for the EU

definitions depend on a country's political system, the function of a city in the national/European system and on the historical housing perspective. At the same time, affordability is frequently connected to other policy areas, such as employment, environment and health.

A starting point, however, is the 'housing continuum.' Policymakers use this concept to consider the responses available to help households access affordable and appropriate housing. This moves away from a one-size-fits-all strategy towards a range of housing options available to different households.

The housing continuum shows there is no simple answer as affordable housing consists of three solutions (affordable home ownership, affordable rental housing and social housing) that each target different groups. As affordability is often linked to income and housing cost overburden, it also makes sense to distinguish between income quintiles to see who suffers most from a lack of affordability and to which extent.

The benefits are twofold: First, this sheds light on affordability, but also emphasises that it is complex topic. Second, it defines who may need help by focusing primarily on the first, second and third population quintiles (low-income and lower middle-class households). Importantly, it reveals that affordable housing is not only an issue affecting low-income households, but also the middle-class.

Measuring affordability

Having established an approach to understand affordability, the next step is to measure it. Unfortunately, no consensus has been reached on how to do this. The standard method is to define a threshold value that housing cost should not exceed as a proportion of household income.

However, when thresholds from different countries and regions are compared, differences emerge. In the US, affordability is considered a problem

pean Union, sees households spending more than 40% on housing as overburdened. Finally, tenant organisations are targeting 25% as a threshold above which housing is unaffordable. Given the competing definitions, opinions have coalesced around 30% as the default above which housing is considered 'unaffordable.'

It's also what you build

How useful is this 30% value? Applying it to a median household income based on national data and assuming a family has one child and requires a three-room apartment,* a theoretical rent level can be calculated per city.

Figure three shows why the 30% rule is a favoured approach, but also why it is misleading. The reason is that national net income data does not account for childcare costs and ignore the fact that one income earner in many families will be focused on child rearing so will be prevented or, at best, hampered from earning a median income. In addition, differing sizes of apartments (Rotterdam 78sqm v. Munich 88sqm), location, quality and commuting costs, are not considered although they have considerable impact on affordability.

Only in Berlin, Rotterdam and Vienna do rents appear affordable as the asking level falls in or under the calculated synthetic affordability band. Contrasting this with the feelings of the people living in these cities indicates why the measurement and calculation of affordability is so challenging.

At best 30% is a rule of thumb. It requires adapting to the realities of place. This way, this number and rigorous, sound analysis helps us understand the peculiarities of a city. It is worth noting that such a definition of affordability does not mean solutions must be provided by governments. They can also be provided and managed by private stakeholders as this is purely an income focused approach. This touches upon

supply' has been the policy mantra for decades, but rising anger around rent indicates something is failing. Low interest rates, the rise of home stay sites like Airbnb and Flipkey, Nimbyism ("not in my backyard"), scarcity of affordable zoned building land, and increasing environmental regulation burdens are factors squeezing supply. Market forces are failing to solve the problem.

The former London Deputy Mayor for Housing, James Murray, often cited a statistic that 80% of housing built in the UK capital was affordable to only 8% of Londoners. This tendency of developers to focus on the luxury end of the real estate market at the expense of the lower ends exacerbates the problem.

It is unrealistic to expect politicians to ignore the demands of renters. Generally, renters are increasing in numbers. In Berlin, for example, 85% of the population rent, making them a formidable demographic. If affordability continues to be an issue, then more city-dwellers will demand governments step in between developers and landlords.

This will not be in the interest of anyone, least of all real estate companies who will face tougher conditions

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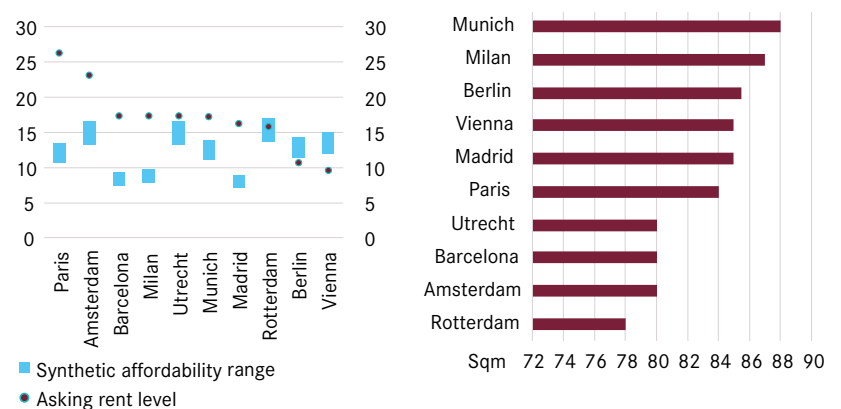
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*living room, two bedrooms and kitchen as well as bath

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Figure 3: Asking rents and affordable rents 2019: Average size of apartments under offer



Source: PATRIZIA