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## The Role of Government in the Housing Market

**Abstract.** Nowadays one of the most intensely debated subjects in economics is government intervention in real estate market. Proponents of the free market system assert that government intervention should be strongly limited still others assert there are well-grounded reasons for government intervention. In this article the most common methods and forms of government intervention in real estate market such as legislation, subsidies, taxation, zoning, rent control, minimum and maximum price policies, licensing of market participants, transaction costs and procedures, banking system, restrictions on the involvement of financial institutions in real estate market have been observed.

In practice, each government uses these intervention methods with the choice of method depending on factors such as the political slant of the government, the levels of economic and institutional development, et cetera. Some countries even issue residence permit and citizenship foreigners who invest in the housing market. We find government intervention necessary, given the unique characteristics of real estate and the role that it plays in economic and social progress.

**Key words:** housing markets, government intervention, subsidy, taxation, renting, transaction costs and procedures

## Introduction

Once something that is vital to everyone becomes expensive, people will complain. There are not many things, however, that are vital to everyone, yet people will complain both when they are becoming too expensive and too cheap.

Real Estate is probably one of those, with well-founded causes. On the one hand, homes are significant for everyone, so when they become unaffordable, people are starting complain. On the other hand, when home prices get cheap, those people who bought houses at the top of the market will be suffered.

Banking crises in Sweden, Spain, Finland and Japan in the early 1990s have been triggered by the problems risen in the housing markets of these countries. Moreover, in 2007, due to the problems risen in the USA mortgage market the four-year global financial and economic crisis rose with the consistent recession of real estate and financial assets. All these crises have been caused by the lack or inappropriate government intervention and regulation in the housing market.

Government policy and intervention is one of the key factors that drive the housing market. In general terms, there are four types of government intervention ‘Market Shaping’,

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'Market Regulation', 'Market Stimulation' and 'Capacity building' (Tiesdell and Allmendinger, 2005). Different types are used by different countries frequently unique-to-that-country to intervene and the housing market.

The main aim of this research is to determine the role of government and the measures that they take, which affect the housing market. For that purpose, the following objectives have been set and resolved:

- ✓ Examine and state the role and importance of real estate in the economy, society and environment,
- ✓ Examine and analyze the existing methods and instruments through which governments regulate the housing market,
- ✓ Determine the role of government in the housing market.

We find it needful to state the importance of real estate to the economy as well as society in this article, considering the unique economic and physical characteristics of real estate, which set its market apart from other markets and make government intervention and regulation a necessity.

In this article have been used scientific works, scientific approaches and analysis of Polish and foreign researchers and authors, information materials and data published by various international organizations, as well as by central banks and national statistical offices.

## **The role of real estate in the economy, society and environment**

By studying real estate market of numerous developed countries, following tendencies can be drawn:

1. The work that has been done by previous generations piles up sequentially in the real estate objects (buildings, houses, built-up areas) providing a decent level of life nowadays as well as in the future. Eventually real estate is one of the few goods, which can meet also non-physical needs. For example The Great Pyramid of Giza (Egypt), The Coliseum (Italy), Leaning Tower of Pisa (Italy), The Taj Mahal (India) and so on. These man-made structures, besides meeting practical demands, apparently are exhibiting the level of development of a particular country. It is estimated that real estate with its different types constitutes approximately half the world's accumulated wealth,
2. Real estate market is a unique mechanism for stimulating economic growth of a country as initial investments of the main portion of means is made in real estate market which in turn generates qualitative changes of supply and demand and provides positive macroeconomic dynamics of development,
3. Being as the base of human and society's vital activity, real estate is a special object of market turnover, ownership and management,
4. Real estate has also a huge social role: normal activity of real estate market always gives a positive social outcome, especially the housing sector, which is primary in terms of consumption.

The real estate sector's share in the GDP in the United States is around 11-12%, in Japan 8-10% and in Poland, it is estimated 6-8%. In terms of employment, the real estate sector engages about 8.1% of the labor force in the USA, in Great Britain 6-8% and in Poland 5-6% (Kucharska-Stasiak, 2006). Moreover, housing is not only creating jobs in the housing industry but also to the industries related to housing, such as industries producing building materials and housing equipment.

Table 1. Housing cost overburden rate by tenure status, 2014 (% of population)

	Total population	Owner occupied, with mortgage or loan	Owner occupied, no outstanding mortgage or housing loan	Tenant — rent at market price	Tenant — rent at reduced price or free
EU-28	11.4	7.4	6.8	27.1	12.7
Euro area (EA-18)	11.4	7.5	5.6	26.2	11.7
Belgium	10.4	3.1	1.8	38.1	13.3
Bulgaria	12.9	9.3	11.3	40.8	17.9
Czech Republic	10.5	8.3	6.2	29.9	7.0
Denmark (*)	15.6	5.2	7.1	32.9	.
Germany	15.9	11.3	9.6	23.1	16.6
Estonia (*)	7.2	9.2	4.8	25.6	10.4
Ireland (*)	4.9	1.4	1.7	17.8	6.8
Greece	40.7	29.2	37.6	55.8	47.5
Spain	10.9	9.0	2.8	47.5	10.8
France	5.1	1.1	0.7	15.8	9.3
Croatia	7.5	21.0	6.2	41.3	7.7
Italy	8.4	5.6	2.9	31.9	10.2
Cyprus	4.0	6.0	0.7	19.3	1.3
Latvia	9.6	15.2	8.2	15.1	9.7
Lithuania	7.1	6.8	6.4	37.3	9.2
Luxembourg	6.8	0.7	0.9	26.3	8.2
Hungary	11.4	26.0	5.8	40.1	15.9
Malta	1.6	2.8	0.6	26.6	0.7
Netherlands	15.4	11.8	3.9	24.8	14.0
Austria	6.6	1.8	2.6	15.6	6.8
Poland	9.6	18.0	8.0	25.5	10.9
Portugal	9.2	7.4	3.8	33.8	6.7
Romania	14.9	31.2	14.4	31.6	37.3
Slovenia	6.4	9.7	3.6	27.4	8.2
Slovakia	9.0	26.2	6.1	14.9	6.5
Finland	5.1	2.3	2.6	16.8	9.6
Sweden (*)	7.8	2.9	5.6	17.8	60.7
United Kingdom	12.1	6.3	4.3	33.2	15.7
Iceland (*)	8.8	6.8	7.0	17.9	14.4
Norway	8.2	5.1	4.0	34.2	16.8
Switzerland (*)	10.6	5.6	5.1	15.2	9.2
FYR of Macedonia (*)	17.6	10.3	17.1	62.4	20.2
Caribia (*)	28.0	23.4	25.2	60.4	23.1

(\*) Tenants- rent at reduced price or free: unreliable.

(\*) 2013.

Source: Eurostat (online data codes: ilc\_ljvho07c and ilc\_ljvho07a).

It is estimated that in Greece 40.7% of the total population spent more than 40% of their equivalised disposable income on housing. In the same year, the proportion of the population whose housing costs exceeded 40% of their equivalised disposable income amounted to 15.9% in Germany, 15.6% in Denmark and 15.4% in the Netherlands. In Poland, the above-mentioned proportion amounted to 9.6% (Table 1).

## Most common methods and instruments through which governments regulate the housing market

Nowadays there are numerous methods and instruments by which governments intervene and take regulatory actions in order to affect real estate market. In this respect, the most common methods and instruments are:

### Legislation

In accordance with its historical impacts and economic trends, each national Civil Code prescribes the concept of property diversely. Regarding European countries, land property comprises, except of the surface of the earth, buildings and constructions that are steadily attached to it, and extends to the space above and below it. Such regulations can be found in the Civil Code of Germany, Belgium, France, Switzerland, and The Netherlands.

Provisions of similar concept are prescribed in the Civil Codes of Greece, Spain and Portugal (Dimitrios Kitsakis and Efi Dimopoulou, 2013).

In the Czech Republic, the maxim “*superficies solo cedit*” (“*whatever is attached to land is part of it*”) did not apply, as buildings were not considered as components of the land. However, the New Civil Code (effective since 1 January 2014) returned to the principle of “*superficies solo cedit*”, under which, structures firmly connected to a plot are considered as part of that plot. The Polish Civil Code is consistent with the other Central European Civil Codes although it prescribes some special rights in rem (Kucharska-Stasiak 2006).

According to the Chinese Constitution and land laws, Property Law provides that land belong to the State and to the collectives without mentioning of rights of accession or any limitations to the vertical extents of property (The Law Library of Congress, 2015).

In some countries (for example Germany and The Netherlands), the vertical limits of land ownership extend “as far as the owner has no interest in opposing against it”, in others (such as Norway, Sweden, and Switzerland) as far as” private ownership has any economic interest to the owner of the surface property”. In France, Spain, Poland and Hungary the vertical extents of real property are subject to the laws and regulations pertaining to mines, water and air space. In the USA, the vertical limits, according to the Subsurface and Air Rights, extend up to 50 000 feet below the surface of land and not more than 1500 feet above the surface (Epley and Rabianski, 1986).

As an instrument, legislation can have not only a sizable impact on property demand and prices but also on social protection. For example, the Act to protect the rights of purchasers of apartments or family homes (Ustawa o ochronie praw nabywcy lokalu mieszkalnego lub domu jednorodzinnego) commonly referred to as the Act on Developers came into force in 2012. The Act imposes duties on developers to provide information, unifies the terms and conditions of development agreements, regulates prepayments of prospective purchasers for homes or apartments under construction and introduces specific legal mechanisms in the case of a developer’s bankruptcy through closed-end and open-end trust accounts. Due to the lack of such kind of act, many homebuyers suffered and left without both money and home in early 2000, when developers got money from home buyers during construction stages and went bankrupt because of unfavorable economic conditions.

### **Taxation**

Many governments intensely use housing subsidies in the form of taxation because it not only affects demand but also affect the way the possession whether to buy or rent.

Very stimulating were tax breaks and deductions for the construction sector introduced by Polish government in 1991-2004, which pertained to the construction of a building for rent, as well as the construction of own homes or apartments. In 1997, more than 1,190,000 people benefited from these deductions (Kucharska-Stasiak, 2006). The United States has plenty of tax deduction types, namely, Property Tax deduction from Federal Taxable Income, Mortgage Interest Itemized deduction, Tax Deductions for Rental Property Owners and so on. Forms of property tax used vary among countries and jurisdictions. Real property is often taxed based on its classification (residential, commercial, industrial and vacant). In Israel, for example, the municipality property tax rates are set double for vacant apartments versus occupied in the struggle against Jerusalem’s vacant apartments, which are owned mostly by foreigners. In Croatia, there was not any property tax until 2013. All of the property owners paid just monthly

communality fees. However, that fee was replaced with property tax. The biggest difference between them is that the communality fee was paid considering the size of the property and Property tax are charged considering the property value.

**Subsidies**

Government intervention in property sector implemented through subsidies is important in:

- I. Improving public health facilities;
- II. Improving fairness, quality and social balance;
- III. To overcome inefficiency in the housing market.

Nowadays in the USA, there are three subsidy programs Federal Housing Administration (FHA) loan, Rural Housing Services loan or the VA loan, which is a loan for veterans or their spouses (provided they don't remarry) without any downpayment.

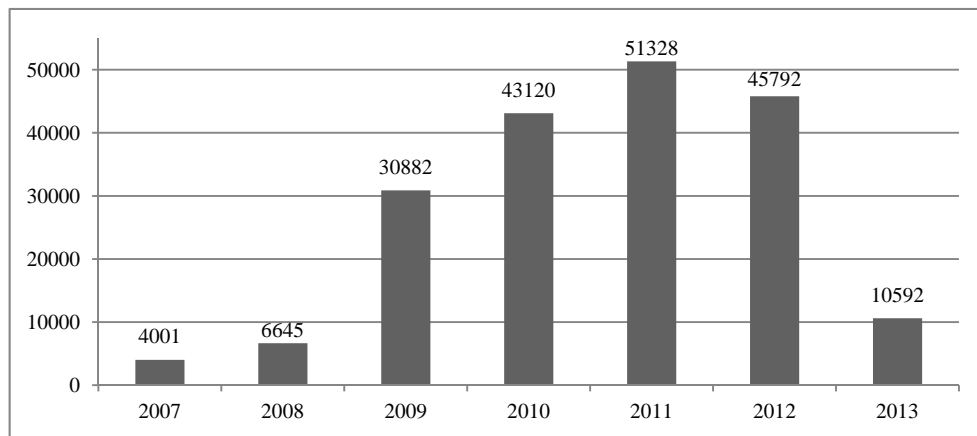


Fig. 1. Number of loans granted under Families on their Own program

Source: Bank Gospodarstwa Krajowego.

In 2006 Government subsidy program Families on their Own (Rodzina na Swoim) was introduced in Poland. Initially this program was not so effective, moreover it affected real estate market negatively (too low price limits per meter square disqualified the majority of new properties). However, later, by being subjected to continuous amendments in terms of price, cost, age and other parameters, the program boosted the real estate market (Trzebiński, 2015). In 2014, the program has been replaced by Apartments for Youth (Mieszkanie dla Młodych or MdM) program. This program aimed to help families by subsidizing home purchases particularly in the lower end market.

**Banking system**

Governments affect the housing market through quantitative and qualitative methods of control such as minimum reserve requirements and the refinancing rate. They also limit or expand the availability of mortgage loans by using two types of limit: loan-to-value (LTV) and loan-to-income (LTI). The first one based on the ratio of the loan to the price of the house and the other one based on the ratio of the loan to the income of the borrower.

Before 2008, In Poland the LTV ratio for natural persons almost in all banks was 100%. In 2008, the ratio has been reduced up to the level of 65-80% (Trzebiński, 2015). In 2014, 50.07% of new loans granted had LTVs over 80%, 36.87% between 50-80%, 9.32% between 30-50% and 3.74% below 30%.

In the same year in Italy and Sweden, the ratio on residential mortgage loans was 67%, 76% in Germany, 75% in the United Kingdom and 60% in Spain. The Dutch LTV-regime for mortgages was one of the most stringent in Europe. The maximum LTV was set –by law– at 104 percent (European Mortgage Federation, 2015). The average loan to value ratio in the United States in the fourth quarter of 2015 varied between 43.6% in Hawaii up to 71.6% in Arkansas (Statista, 2016).

### **Zoning**

Generally, local governments designate diverse zones for different uses of land, such as agricultural, commercial, industrial and residential. In that regard, in terms of land-use planning systems in the United States and Europe there are many differences. In Europe, a greater mix of uses in residential zones can be found compared with the United States. For instance, in Germany, a residential zone can include offices, cafes, stores and apartment buildings. Yet, single-family residential zones in the United States in most cases forbid those uses. Zoning in Germany also occurs for smaller land areas (almost at the block level) than in U.S. cities, where zones are much larger. Governments also use zoning in order to designate the types of buildings that can be erected in a particular area through imposing restrictions on the maximum height, density and other parameters of buildings.

### **Imposing restrictions on the involvement of financial institutions or intermediaries in real estate market**

The countries in which there was not adequate oversight of the flow of financial means to the real estate sector and where the banking system in an uncontrolled way got involved in the financing of real estate market ended up with banking crises. The vivid examples are banking crises in Sweden, Spain, Finland and Japan in 1990 (by the way Sweden crisis conditions were the same as in the USA in 2007) and 2 banking crises in Mexico (1982-1984 and 1994-1996). All these banking crises were caused by excessive involvement of this sector in real estate market. Nowadays most states impose quantitative or/and qualitative restrictions on investing abroad, in derivatives, in mutual funds, in private equity and in real estate for insurance companies and pension funds, taking into account that although they are private they have a key social role. In France, the share of real estate in the investment portfolio of an insurance company may not exceed 40%, In Germany 25%, in Poland in MBS (Mortgage-Backed Security) and real estate must not exceed 25%, wherein the share of investments in one property may not exceed 5% of an insurance fund (Kucharska-Stasiak, 2006). By contrast, UK and US rely on "prudent person rules" and do not impose any restrictions.

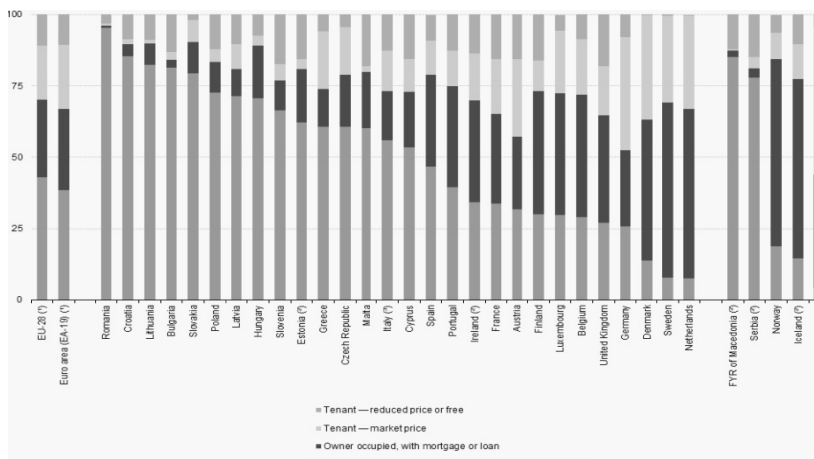
### **Licensing of market participants, transaction costs and procedures**

It takes an average of 95 days to complete all the four procedures needed to register a property in Germany. Registration of real estate purchase in Poland usually takes 33 days and there are 6 procedures to complete, in France it takes up to 58 days and there are 8 procedures. In the USA, specific procedures vary from state to state, as well as between

cities. For example completing all the four procedures in New York City takes 12 days. In this respect, in the Nordic countries (Denmark, Finland, Iceland, Norway and Sweden), notaries do not exist, moreover, Sweden and Norway is the only countries with only one real estate registration procedure. It takes an average of one day to complete the single procedure needed to register property in Norway (Global Property Guide, 2015).

**Rent control, minimum and maximum price policies**

Some governments formed a common culture of renting for accessing accommodation, through making renting much more convenient and cheaper than buying. In this aspect, the best example is Germany, where homeownership rate is quite low (It was 52.4% in 2014) (Figure 2). However, Germany shows that owner occupancy is not a decisive factor to any healthy economy. In Spain, around 80% of people live in owner-occupied housing, but unemployment was 24.5% in 2014. While in Germany, it was 5% (Eurostat, 2016). Unlike high-homeownership countries like Spain, Ireland and the USA, Germany does not let homeowners deduct mortgage-interest payments from their taxes. German rental market is heavily regulated and these regulations are quite advantageous to renters. For example, German law, which allows state governments to cap rent increases at no more than 15% over a three-year period (Bloomberg, 2013).



- (1) Estimates
- (2) 2013
- (3) Provisional data

Fig. 2. Distribution of population by tenure status, 2014 (percentage of population)

Source: Eurostat (online data code: ilc\_lvho02).

Some countries, such as Malta, Spain, Greece, Cyprus, et cetera, even boost demand in the housing market through issuing residence permit and citizenship foreigners who invest in property (apartment or house). In this regard, the cheapest and easiest option offers Latvia. The minimum real estate investment is EUR 250,000 plus a 5% State fee on the purchase price (OECD, 2015).

## Conclusion

Government plays a crucial role in stabilizing and developing the housing market. State intervention is necessary, taking into account the following factors:

- Real estate has a huge social role, especially the housing sector, which is primary in terms of consumption.
- Real estate is very capital-intensive.
- Disequilibrium is an intrinsic feature of real estate markets given the delay in supply response to demand and the relatively slow rate of change of demand.
- Continuous population growth and the limited availability of the land resources for human settlements, which require prudent and wise spatial planning and management by government.

Nevertheless, there does not exist a universal, ideal, accurate and standard method of real estate market regulation. Each state, taking intervention actions, should consider comprehensively the following:

- The unique economic and physical characteristics of real estate, that set its market apart from other markets.
- Socio-economic, Demographic and Geographical factors.
- The degree of economic interventionism (as huge doses of government intervention negatively affect the real estate market).

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