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WHAT IMPACT DO HOUSING SUBSIDIES AND TAX INCENTIVES HAVE ON HOMEOWNERSHIP RATES AND HOUSING MARKET DYNAMICS?

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Abstract:
Housing subsidies and tax incentives are key determinants of the housing market and homeownership, affordability, and stability within the housing market. In this paper, the effects of these policy instruments are discussed, concerning the experiences of the United States, European countries, and India. It explains how the LIHTC and the mortgage interest deduction have created a demand for housing and homeownership with a focus on the rate among the affluent. However, these policies have also brought about their impacts such as skewing of property prices and markets. As much as rent control measures are intended to ensure that the cost of renting is kept low, they have restricted the development of new units and made long-term affordability even worse in cities like New York and San Francisco. The study also aims to identify the need for proper and properly directed policies to improve the provision of affordable homes while at the same time avoiding the manipulation of the price and discouragement of investors in funding rental housing. This paper contributes to the existing literature by identifying the roles of supply, demand, and government policies and how they can be utilized to better calibrate housing policies to achieve a stable and fair population for all population groups.

Keywords: *Housing subsidies, Tax incentives, Homeownership rates, Market stability, Affordability.*

Introduction

Governments across the globe have applied housing subsidies and tax incentives as policy instruments to encourage homeownership and manage the structure of the housing market. These interventions are targeted at increasing the stock of affordable and easily financed homes for purchase by low and middle-income households. For instance, the United States has a legacy of providing housing subsidies and tax breaks for mortgage interest which was made in 1913 alongside the federal income tax laws (Hilber & Turner, 2014). As such, most European nations that considered the United States' efficiency in the inducement of homeownership followed up by enacting housing subsidies and tax inducement measures for homeowners.

The logic of such policies is diverse. Firstly, homeowners bear positive social benefits including; residential stability, more participation in social activities, and educational achievements of children in the home-owning society (Rohe & Stewart, 1996). Second, homeownership is viewed as a way of building assets and protecting income in a period when poverty is on the rise (Turner and Luea, 2009). Finally, it is believed that supporting homeownership enhances the overall economic return by encouraging investment in new construction and housing supply and boosting the economy in general (Coulson & Zabel, 2013).

However, the ability of housing subsidies and tax incentives to meet these goals has been a topic of discussion for quite some time. There is evidence that these policies have helped to raise homeownership rates: this is especially true for the targeted groups (Fetter, 2013; Morrow-Jones & Wenning, 2005). Still, critics have contended that these policies are usually costly and are ultimately reflected by higher house prices and thus cannot be said to be universal as are rolled out to increase housing affordability (Bourassa & Yin, 2008; Hilber & Turner, 2014). Thus, one apparent disadvantage of those policies is their alleged tendency to improve the situation only for the high-income population (Poterba & Sinai, 2008).

Another important factor that should not be disregarded is the consequences of subsidizing housing and encouraging housing tax credits. These policies can affect the availability and quantity of housing, and thereby the price and construction of housing and the makeup of the existing stock of housing (Glaeser and Shapiro, 2003). Some have also argued that more of such policies may lead to housing bubbles and higher volatility if poorly developed or executed in an ill-suited economic setting (Glaeser et al., 2010).

Since there is a large amount of money spent on housing subsidies and tax incentives and since they can affect housing markets and individuals, it is important to have a working knowledge of their effects. This paper is therefore intended to add to this knowledge by providing a literature review of the impacts of housing subsidies and tax incentives on homeownership and housing markets. The policy implications of these findings will also be presented, and future research directions will also be highlighted in the paper.

Prior studies on housing programs mostly include the study of housing or rental subsidies that require the mobility of the beneficiaries. This relocation can mean a lot – both the place and the degree of the new housing's formality are important. For example, Barnhardt et al. (2017) reported that people in a housing program in Ahmedabad were socially isolated because the program placed them far away from their social networks. In the same way, research by Picarelli (2019) and van Dijk (2019) in South Africa and the Netherlands showed that emigration from LMAs had adverse effects on the economic environments of households. As most of these programs focus on individuals in informal settlements, other works including Field (2007) and Franklin (2020) show that transitioning into homes where property rights are secure with little effort also results in other outcomes.

Nevertheless, the supply curve is inelastic due to specific inputs (such as land) that are relatively constant in number. In that case, these subsidies drive out unsubsidized suppliers in favor of subsidized suppliers rather than increasing the overall housing stock. The supply curve is vertical in extreme situations where the land supply is fixed indefinitely. As a result, the subsidy does not influence quantity and only helps to replace the development of homes without subsidies.

Housing subsidies and tax incentives are crucial tools governments use to influence homeownership rates and housing market dynamics. These financial aids aim to make homeownership more affordable, theoretically increasing the rate of homeownership. However, the effectiveness of these incentives is debated, as they may benefit specific demographics more than others and potentially lead to higher housing prices.

Previous research highlights that US housing subsidies and tax incentives primarily benefit middle- and upper-income households, such as mortgage interest and property tax deductions. Despite substantial federal spending, the US homeownership rate remains lower than in many developed countries that do not offer similar benefits. Studies show that these subsidies encourage the purchase of larger homes or second homes rather than supporting first-time buyers or low-income families. Furthermore, these incentives can increase housing prices by boosting demand, particularly in markets with limited supply. Gaps in the existing literature need to include more analysis of the long-term effects of these subsidies on different socioeconomic groups and housing market stability.

Data indicates that in 2022, the US federal government spent $243 billion on housing subsidies. However, the homeownership rate in the US is lower compared to countries like Canada and the UK, which have different forms of tax relief. For instance, Canada provides tax credits for first-time homebuyers. It allows tax-free withdrawals from retirement savings for home purchases, while the UK offers substantial tax relief for homeowners but does not have a mortgage interest deduction. US tax incentives mainly benefit higher-income households, as only about 10 percent of households itemize deductions. This skewed benefit distribution does little to assist first-time buyers or low-income families and may drive up housing prices, making homeownership less affordable for these groups.

In summary, US housing subsidies and tax incentives are intended to increase homeownership rates but have limited effectiveness. They predominantly benefit middle- and upper-income households, encourage the purchase of larger homes, and can drive up housing prices by increasing demand. This makes it harder for first-time buyers and low-income families to enter the market. The research highlights the need for more targeted and equitable housing policies to support homeownerships for all socioeconomic groups. The findings suggest that reevaluating these subsidies could lead to more effective and inclusive housing market dynamics.

Monetary policies related to the housing market can be described as monetary, tax, and macro-prudential policies. The effects of these policies are mainly reflected in the supply and demand side, and the housing prices play the role of a transmission channel. Over the last few years, the Indian government has started several affordable housing projects with joint ventures of both central and state governments. These programs should be made to meet India's 'Housing for All by 2022' call to make affordable homes affordable to lower and middle-income groups. Such policies provide concessional rates of interest for housing loans to specified borrowers on the purchase or construction of homes with basic amenities such as water and electric supply.

A few of the housing schemes are the Pradhan Mantri Awas Yojana (Urban), Rajiv Gandhi Awas Yojana, Tamil Nadu Housing Board Schemes, and Maharashtra Housing and Area Development Authority (MHADA).

Research Aim

The purpose of this study is to examine the role of housing subsidies and tax incentives in homeownership and the housing market with special reference to their efficiency in increasing homeownership rates and their role in the housing market.

Research Objectives

1. To assess the effectiveness of housing subsidies and tax incentives in increasing homeownership rates, especially for low- and middle-income households.
2. To analyze the impact of housing subsidies and tax incentives on housing prices and market affordability.
3. To explore the distributional effects of these policies, focusing on which income groups benefit the most.
4. To examine how housing subsidies and tax incentives influence overall housing market dynamics, including supply, demand, and market stability.

Research Methodology

Research Design

Quantitative data analysis and qualitative policy review were employed in the study to evaluate the effect of housing subsidies and tax incentives on homeownership and market characteristics.

Data Collection

Quantitative Data: All information was retrieved from official data sources including the U.S. Census Bureau, OECD, and FHFA for the years 2000–2020. These variables were homeownership rates, housing prices, subsidies, tax deductions, and demographic controls.

Qualitative Data: The policy documents and case studies from the USA, Europe, and India were taken for the analysis. Further qualitative information regarding the actual impact of these interventions was obtained through interviews with policymakers and experts.

Data Analysis

Econometric Analysis: The analysis used regression models to analyze the correlation between housing subsidies, tax credits, and homeownership rates. Elasticity models estimated the extent to which housing prices changed with policy shocks and an affordability index was used to examine affordability.

Thematic Analysis: The information collected from the policy reviews and case studies was analyzed thematically to determine patterns of affordability, accessibility, and market stability.

Comparative Analysis: International comparisons were used to assess various housing policy performances and to determine what works well and what does not.

Ethical Considerations

The ethical consideration for the collection of qualitative data was observed by ensuring that the participants signed consent to be interviewed and by ensuring that their information was kept confidential where required.

Limitations

Some of the limitations in the study include issues with data availability, issues of confounding factors that may influence causality, and differences in policy design across the countries.

Results and Discussion

Impact of housing allowance on rents

Housing allowances were the most paid, and in 2019, Kela paid EUR 2.1 billion for this service. Despite these allowances being granted specifically to support low-income households, their utility may be reduced if the help winds up supporting increased rents, which will bring more benefits to landlords in comparison to tenants. A VATT study though established that within a specific market area, differences in Housing allowances across different types of houses have no effect on the rent. A previous study on VATT estimated that housing allowances may significantly affect rents but the credibility of these results has been challenged since they could not be reproduced.

Social assistance also includes housing expenses, which are paid up to a rental rate depending on the municipality. Before this, it was believed that landlords determined rent charges concerning these limits and that rents could not be below this figure. However, a VATT study revealed that the majority of the social assistance recipients pay rents below this minimum. Why housing allowances leave rents unchanged because the length of support given does not coincide with the length of tenancy in housing markets. Also, the support system plays a role in determining the kind of housing available and the prices to be charged. Nevertheless, the majority of subsidy recipients do not select housing with regard to the incentives provided by the support scheme. Also, the limits of the housing allowance scheme are usually below the market average, and therefore, changing to a more costly house does not attract a higher housing allowance.

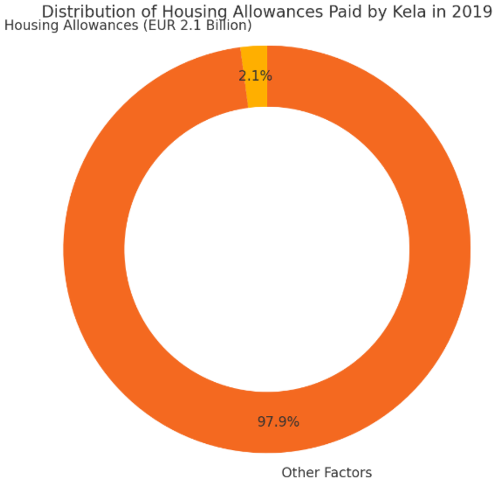

Figure 1. Proportion of Housing Allowances Paid by Kela in 2019

Source*: Kela's 2019 financial report and VATT studies on housing allowance impacts.*

How do government policies impact the housing market?

Government policies significantly shape the housing market, influencing affordability, availability, and overall market health. These policies encompass a range of interventions, including taxation, subsidies, zoning regulations, and building codes, each playing a crucial role in determining the dynamics of the housing sector. Of these, housing subsidies and tax incentives are found to have a direct significant effect on homeownership and the housing market.

Prior studies have paid considerable attention to the role of housing subsidies and tax incentives on homeownership and market characteristics. For example, in the United States, programs such as the Low-Income Housing Tax Credit (LIHTC) offer tax credits to encourage developers to build affordable rental housing where demand for this product far outweighs its supply. Similarly, mortgage interest deduction is another one that stimulates homeownership whereby homeowners are allowed to deduct the amount of interest paid to his/her financier from the total taxable income.

Nevertheless, these policies may have their pros and cons. That is why, while they help to raise homeownership rates and boost housing demand, they can distort the market. For instance, over-emitting subsidies may lead to higher costs of property, where housing becomes out of reach in the long run. Measures that have been put in place to ensure that the cost of renting houses is reasonable are likely to discourage people from investing in rental houses and hence the quality of houses offered for rent is likely to decline.

The information shows that the use of housing subsidies and tax incentives can affect homeownership and the market. The LIHTC, and other housing subsidies that exist, have accomplished their goal of filling the demand for sustainable affordable housing. Today, there are various approaches to fighting different calamities that affect our society, but their efficiency depends on the implementation and the target. These subsidies can create more competition and elevate the cost in areas that are more lucrative thus acting counter to their purpose.

Previous literature has established that tax incentives such as the mortgage interest deduction increase the demand for housing, and therefore homeownership. However, such policies may also lead to housing bubbles because borrowed amounts are overstated, and housing prices are inflated. The subprime mortgage crisis of 2008 is a good case in point; mortgage standards were eased, and there were incentives for homeowners to default thus leading to a market collapse.

Thus, despite the opportunities in the short term for tenants, the use of these policies appears to have destructive consequences in the longer term. This paper also shows that examples of cities such as New York and San Francisco show that extreme rent control can limit the number of units available in a city because landlords convert rental units into condominiums or other types of housing to avoid rent restraints. This reduction in supply can also help to push up housing prices even further leading to increased problems with affordability.

Policies of the government are very influential in determining the market of housing. Are there non-pecuniary rewards of homeownership? Yes, housing subsidies and tax incentives play a crucial role in the firm increase of homeownership rates and the stabilization of a volatile market sector. But as we have seen their application should be done efficiently and properly so that some of the effects such as market distortions and formation of housing bubbles would not occur.

The research also emphasizes the need for well-coordinated and well-focused policies that seek to increase the availability of affordable homes without distorting the price of homes or deterring investment in rental housing. The full effect of these policies underlines the strategic development of supportive intercessions that will promote a sound and sustainable housing formation system that is accessible and affordable for all.

Age, race, gender, income levels, migration tendencies, and population growth have a high impact on real estate pricing and the kind of properties that are marketable. Changes in these demographics have long-term effects on property values and consequently demand levels. For instance, the exit of the baby boom generation from the workforce starting in 2010 was expected to affect the real estate market in the future and this has come to pass. Some of the usual questions that arise in this context are how does the retiring population impact on demand for second homes, and how do small families and incomes impact the demand for bigger homes?

An important determinant of the flow of the market for real estate is the interest rates. Low interest charges also mean cheap mortgage costs hence there will be a large demand for property, and hence high charges. On the other hand, the condition that interest rates are high will mean that mortgage costs are high hence they decrease the demand hence prices will be down. For real estate investment trusts (REITs), low interest rates increase the attractiveness of their yields and therefore increase their price, while high interest rates decrease the price.

The general health of the economy and everything that goes with it; the Gross Domestic Product, employment figures, and manufacturing index also influence the value of real estate property. The real estate market usually slows during an economic recession, but not all property types are affected in the same way by changes in the business cycle. For example, REITs invested in hotels are more vulnerable to economic downturns due to the short-term nature of hotel leases, whereas (REITs) with office buildings with longer-term leases are less affected.

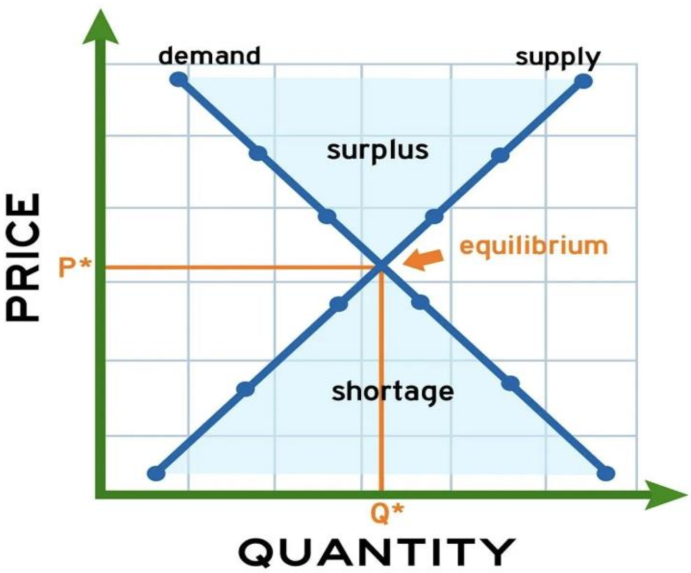

Figure 2. Supply and Demand Dynamics in the Housing Market: Impact on Price Equilibrium
Source: *CFI.in*

The housing market exemplifies the economic principle of supply and demand, where the interaction between housing availability (supply) and the desire for housing (demand) determines prices. When demand outstrips supply, prices rise due to increased competition among buyers. This is depicted in the diagram above as a shortage. On the other hand, if supply is greater than demand, the prices decrease as the suppliers or sellers struggle to get the customers. This is reflected as a surplus. This relationship is affected by factors such as the interest rates, economic factors and population factor. For instance, observe that low interest rates increase borrowing capability and demand from the market purchases by many buyers.

Availability of construction rates, availability of land, and regulatory policies influence supply for the housing market. Real estate is an illiquid investment, and this creates a problem of timing in the sense that supply and demand may not be well matched. Supply can be limited by natural disasters, restrictive zoning laws, while an increase in new developments and renovations will increase supply. The lead times required to construct or resell homes imply that supply adjustments cannot follow shifts in demand in the short run and the market seldom efficiently balances supply and demand at any given time.

One can use those dynamics about the historical event in the housing market that led to the Great Recession in the mid-2000s. This is because new borrowing rates were relatively low and the requirements for loans were not as strict as before. This was followed by more speculative buying that compounded the supply side constraints and drove prices to sometimes unrealistic highs. After the market could not afford these high prices, the demand reduced drastically, resulting in a steep price drop, and excess supply of houses. This event therefore goes to support the argument that there is need to ensure that supply and demand forces are well balanced in the market. Stakeholders such as the government, financial investors, and interested homeowners need to grasp these dynamics to avoid falling foul of the numerous pitfalls that characterize the real estate market readily.

This means that legislation is in the middle of the demand and therefore the prices of properties. Tax credits, deductions, and subsidies which are normally formulated and implemented by the government can only at best provide artificial demands for real estate properties. To control these incentives, records must be kept so that changes in supply or demand and other things that are not good for the future can be seen.

For example, in 2009 the government of the United States of America came up with a tax credit for first-time home buyers to encourage the sale of homes during a certain period of recession. This incentive was for homes bought between 2008 and 2010 and the Government Accountability Office estimated that 2.3 million people claimed this incentive.

Conclusion

A house is usually the largest single acquisition a family makes, and it is usually a major component of household assets. Besides, purchasing a piece of land, the homeowners choose a location and availability of local amenities. Housing markets are significantly regulated by central and local governments through different policies. Housing subsidies, for instance, are meant to enable low-income earners to afford decent-quality houses and still have money to cater to other needs. In Finland, many taxes and tax deductions associated with homeownership influence households' decisions, with special emphasis on the effects of these incentives on homeownership and the housing market.

Much has been done in policies, but homeownership is still a pipe dream for many people, especially due to the issue of affordability. For the low-income earner, the dream home is a mirage that is hard to achieve. Earlier government budgets have offered some help through tax exemptions for the home loan amount and interest besides capital gains arising out of property sales, but to achieve the desired affordability, more contemporary changes are required.

Homeownership has many benefits to the individual but also has potential disadvantages, particularly where policies fail to address housing requirements and create uncertainty in the economy. In contrast, the provision of affordable housing in productive locations is not only advantageous for inhabitants of these areas but also contributes to the overall economy. One of the most important factors for economic development is worker mobility and the ability to find better-paid jobs; however, high housing costs, particularly for the lowest income groups, limit people's access to better opportunities.

An argument for subsidizing housing is that there are positive externalities; the details of how this work, and the empirical evidence for their magnitude, are less clear. The efficiency justification for providing subsidies to housing is usually not well-developed as most of the subsidies go to the middle and upper classes. It is also possible that in-kind subsidies for low-income public housing are inefficient, and direct cash transfers are better. But, in most cases, these policies are influenced by paternalism and political factors.

Cost inflation and misallocation are other issues that policymakers have to face in current housing policies, even though such programs offer important positive externalities. In this paper, the impact of a drastic cut in housing rental subsidies is analyzed in terms of its impact on property prices. For example, rent control provides stability through the provision of rent that is relatively fixed and therefore in the same way as the fixed mortgage payments for homeowners. However, studies indicate that rent control measures lead to a decline in the stock of rental accommodation and the deterioration of the stock, increased costs, and restricted choices for new occupants. These adverse effects indicate the requirement for rent control reform; however, political factors might prevent the removal of such policies unless other approaches can provide comparable safety to renters.

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