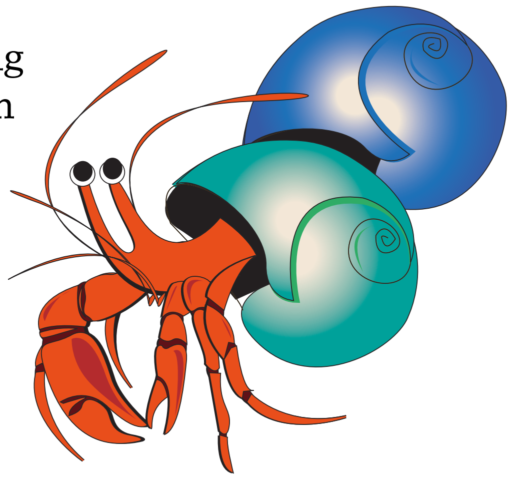
Investment in second homes has been surging around the world. **Christian Hilber** explores the underlying causes of this boom and the political backlash against wealthy investors. His analysis explains how one increasingly popular policy – banning new second home investments in desirable tourist locations – may end up hurting rather than helping local residents. It may even lead to a further rise in wealth inequality.



Second home investments

Second homes – properties that are not used as a primary residence, bought for leisure or investment purposes or a mix of the two – are in strong demand among investors, especially in superstar cities and places rich in natural amenities. Such investments are growing globally.

The data are patchy but the surge seems to have emerged during the mid-1990s. It has been dramatic in some countries, more moderate in others. The UK and China belong in the former category. The number of second homes in the UK more than doubled between 1995 and 2013 alone (English Housing Survey). In China, the number of investors surged from 6.6% of urban households in 2002 to 15% in 2007 (Huang and Yi, 2011).

The United States and Canada have seen more moderate expansion: between 1995 and 2005, the number of second homes in these countries increased by 20% and 22%, respectively (Belsky et al, 2007; Canadian Survey of Financial Security).

What explains this marked increase in second home investments? Growing income and wealth inequality with a staggering amount of wealth accumulation among a growing cohort of 'top earners' have certainly contributed.

As housing is a 'normal good', a rise in income and wealth implies greater housing consumption. And one way that this manifests itself at the top end of the income and wealth distribution is in growing consumption of second homes.

But housing is also an 'investment good': a strongly growing cohort of wealthy individuals implies disproportionately more investment in second homes. A lack of attractive alternative investment opportunities further reinforces the boom.

The surge in second home investments has not gone unnoticed. In fact, it has ultimately triggered a serious political backlash in many countries, especially in tourist areas and superstar cities. The backlash has at least in part been driven by legitimate concerns, such as ever more unaffordable housing, destruction of areas of natural beauty or creation of ghost towns during large parts of the year.

Figure 1:
Newspaper coverage of sentiments against second home investors

Sources: BBC News; *Guardian; Evening Standard*

The crucial question is how politically to address these legitimate concerns. Some countries, such as the UK, and cities, such as Vancouver, have introduced substantive transaction taxes on the purchase of second homes.

Another policy that has become increasingly popular, also in the UK, are constraints or outright bans on the construction of new second homes. The latest example is the Cornish seaside town of St. Ives. Other local communities in Cornwall and across the rest of the country have signalled interest in including similar policies in their own Neighbourhood Plans.

What are the economic impacts of such bans on local housing and labour markets? This is the question that my co-author, Olivier Schöni, and I explore in a recent CEP study that features both theoretical and empirical analysis (Hilber and Schöni, 2018).

In our theoretical analysis, we illustrate the underlying mechanisms and reveal under what conditions we should expect constraints on second home investments to have positive or negative effects on local housing and labour markets.

One key insight of our analysis is that competing effects are at play. First, a ban on the construction of new second homes may help to preserve the local character and beauty of the area and ease congested roads and overcrowding of other local infrastructure during the tourist season. This 'amenity effect' – and its anticipation – should be positively capitalised into the value of both primary and second homes.

Second, a ban on the construction of new second homes renders the supply of new second homes perfectly unresponsive to price increases. In a dynamic setting, this 'supply effect' should raise the price of second homes, all else equal.

Third, a ban on the construction of new second homes adversely affects local construction and other local economic activity – importantly tourism. This 'local economy effect' lowers prospective earnings or, to the extent that local wages are sticky downwards, increases unemployment. In turn, it adversely affects local demand for primary homes and, all else equal, ultimately is negatively capitalised into the price of primary homes.

In a setting where primary and second homes are perfect substitutes (that is, the two types of properties are very similar in style, quality and location, and thus equally suitable for primary residents and second home investors), the price of primary and second homes must move in the same direction, but it is theoretically ambiguous whether the positive or the negative effects on the price dominate. It depends on their relative importance.

If primary and second homes are poor substitutes (think of two types of buildings traded in the same town but in separate sub-markets: wooden chalets near ski lifts suitable for second home investors and concrete buildings close to the local school and the supermarket suitable for primary residents), then we demonstrate that under realistic conditions, the price effects can be expected to go in opposite directions: positive for second homes and negative for primary homes. Labour market effects are unambiguously negative, either in the form of lower wages, higher unemployment or a mix of the two.

The negative effect on local economies of banning second home construction outweighs the positive effect of preserving local amenities

In our empirical analysis, we exploit a unique quasi-natural experiment, the Swiss Second Home Initiative (SHI), to test these theoretical predictions and identify causal effects of a ban on the construction of new second homes.

Popular initiatives – such as the SHI – are common in Switzerland as instruments of direct democracy that allow citizens to modify the country's constitution. Initiatives must be approved by both the majority of voters and the majority of regional jurisdictions, known as cantons.

The SHI requested that construction of new second homes be banned in

Switzerland's ban on the construction of new second homes lowered the price of primary homes but raised the price of second homes

Figure 2:
Yes and No campaigns in the Swiss Second Home Initiative:

Sources: www.zweitwohnungsinitiative.ch and INFOsperber. Yes campaign: We must stop setting our landscape in concrete; versus No campaign: Approving initiative would destroy your dream of a second home.

Figure 3:
Second home share and opposition to the Swiss Second Home Initiative

Sources: Hilber and Schöni (2018).

municipalities where such homes represent more than 20% of the total housing stock. The SHI was approved by the narrowest of margins – 50.6% of votes and 13.5 of 26 cantons – in March 2012. It came into force in January 2013.

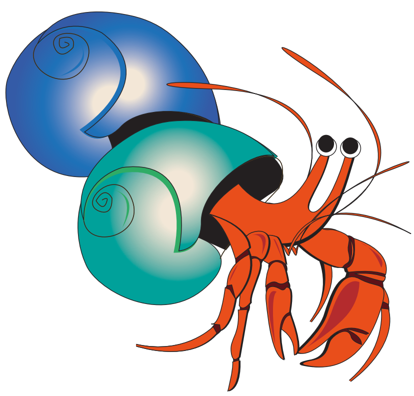
Voters in tourist municipalities with very high shares of second homes were heavily opposed (see Figure 3), presumably due to fears about adverse effects on the local economy. This contrasts with voters in the larger Swiss cities who favoured the initiative.

So what were the effects of banning the construction of new second homes in desirable Swiss tourist locations? Consistent with our theoretical framework and a setting where primary and second homes are rather poor substitutes (so are traded in different sub-markets), we find that the effects on the prices of primary and second homes go in opposite directions.

The ban on the construction of new second homes lowered the price of primary homes, adversely affecting local homeowners, but increased the price of second homes, further raising the wealth of existing – typically already wealthy – second homeowners. We also find that the policy increased unemployment rates, thus harming the local labour force.

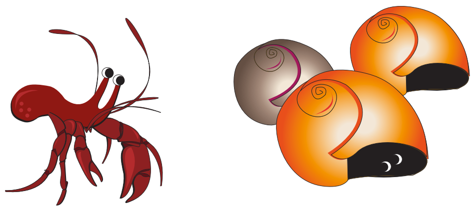
All in all, our findings suggest that the local economy effect (affecting primary house prices negatively) outweighed the amenity-preservation effect (affecting primary house prices positively), resulting in an overall fall in the price of primary homes. They also suggest that constraining the construction of new second homes reinforces rather than reduces wealth inequality, at least in a setting like the Swiss one (and many other tourist places rich in natural amenities) where primary and second homes are quite imperfect substitutes.

One fascinating puzzle is the following: whereas in Switzerland, local voters in affected tourist areas voted heavily against a ban on the construction of new second homes, in St. Ives in Cornwall, local residents overwhelmingly supported the policy. How can we make sense of this?



Constraining the construction of new second homes reinforces rather than reduces wealth inequality

An annual local tax on the value of second homes would be a much superior policy response to an outright ban



One plausible explanation is that in the particular case of St. Ives, the pivotal local voter may actually have benefited from the ban. This could be because St. Ives consists of a high share of wealthy retirees who own their homes and may care little about the local construction industry or tourism sector but far more about preserving the landscape and character of the seaside town.

In other words, local workers who depend on the tourism and construction industries may be in a political minority. Then, to the extent that primary and second homes are reasonably close substitutes and the amenity effect outweighs the local economy effect, the ban on new-build second homes may actually cause the price of both primary and second homes to increase.

So there may be an important difference here with the Swiss case: the pivotal local voter may be made better off by the ban, at least in the short run. Importantly though, this will come at the cost of younger renters – would-be buyers who are priced out of stepping onto the owner-occupied housing ladder – who work locally, typically in the adversely affected industries.

It is this group that is arguably critical for the livelihood of the seaside town in the longer run. Or put differently, the main effect of the ban on new-build second homes in St. Ives may have been to limit overall housing supply even more tightly, helping existing local homeowners to protect their accumulated capital gains (which arose from tight planning regulations in the first place), at the cost of the younger generation of local people.

Ultimately, the crucial question is whether there are better policy options for places rich in natural amenities and heavily dependent on tourism, such as the Swiss Alps or UK seaside towns or superstar cities, such as London or Vancouver. The answer is an unequivocal yes.

If the primary goals are to make housing more affordable, prevent vacant homes and ghost towns, generate more local tax revenue and reduce local wealth inequality, then an annual local tax on the value of second homes (or better even: the value of their land) would be a much superior policy response to an outright ban.

An annual local tax would also be superior to a one-time transaction tax (stamp duty) as the latter generates a mismatch in the housing market (Hilber and Lyytikäinen, 2017) and does not provide any incentives to keep houses occupied.

An annual tax wouldn't be an entirely 'free lunch' of course. This is because the local tourism and construction sectors and their workers are still bound to be hit by the comparable lack of investment as a consequence of tax-induced disincentives to build new second homes.

More generally, second home investors – especially foreign ones – are often really just a popular scapegoat. In England, for example, the housing affordability crisis is predominantly driven by an extremely inflexible and dysfunctional land use planning system and a tax system that provides virtually no incentives to local authorities to permit residential development (Cheshire, 2014; Hilber, 2015; or Hilber and Vermeulen, 2016).

Banning the construction of new second homes or imposing transaction taxes on second home purchases may be politically popular policies in the short run. But they won't do anything to cure the underlying causes of the problems.

This article builds in parts on a published interview given to Hites Amir from the International Monetary Fund: The Unassuming Economist, *Global Housing Watch Newsletter*, July 2018 (http://unassumingeconomist.com/2018/07/the-surge-in-second-home-investments-causes-consequences-and-cures/).

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Further reading

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