

Transnational wealth elites, home ownership and lost energy savings in home heating

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Abstract

The past 40 years have seen the emergence of an elite socioeconomic class with enormous wealth and transnational financial interests. This is due to increasing income disparities within OECD countries, windfall gains among oligarchs and elites in countries with extractive governance and weak institutions, and criminal money-laundering. Due to crackdowns on transnational money havens such as Switzerland and Luxembourg, real estate in cities with positive economic performance is being used as a safe deposit box for excess wealth. This has a cascade effect on property prices across the market vertically and horizontally, preventing increasing numbers of young households from owning homes. The proportion of renters to homeowners is therefore steadily increasing among young people. Landlords are reluctant to thermally retrofit their properties, due to split incentives, and there is strong evidence that the highest rates of thermal retrofitting are among younger homeowners, who tend to buy cheaper homes in need of upgrading. It seems, then, that increasing economic inequality and permissive rules for transnational property ownership are subverting CO2 emission reductions via this roundabout route. While precise statistics are lacking, rough modelling suggests this could be very substantial. This short communication calls for new research efforts in this area.

Keywords: transnational wealth elites; home ownership; energy saving

Introduction

This short communication brings together sources of information that may at first seem unrelated, but which at least intuitively point to the increasing loss of a fairly standard, painless means of achieving deep cuts in CO2 emissions. It outlines the state of existing knowledge on these issues and their likely interconnections, and calls for more research in specific areas to check these connections, quantify the likely loss of emission reductions, and forge policy to mitigate these losses.

The argument runs as follows. Domestic heating is one of the biggest sources of CO2 emissions. These can be substantially reduced by thermal retrofitting of older homes. Private landlords are generally reluctant to undertake thermal retrofitting because, in most economies, the landlord pays for the retrofit and the tenants get the benefits through reduced heating bills. However, those who buy their first home are often keen to thermally retrofit because older homes are cheaper but often need both structural and thermal improvements. If fewer young people can buy homes due to rising prices, these properties are more likely to end up or remain in the hands of landlords and therefore less likely to be thermally retrofitted. In OECD countries the price of housing in job-rich regions has been rising rapidly relative to wages for some three decades, apart from a brief dip in some countries during the Great Recession of 2008-2010. The home ownership rate of young people (under 40 year olds) has steadily fallen during this period. There are various reasons for the relative rise in house prices (Schembri, 2015; Spencer, 2015) but one of the main ones has to do with patterns of investment. Increasingly large flows of transnational wealth are going into the purchase of prime real estate in job-rich, economically prosperous and institutionally safe cities. This has a cascade effect on house values in all price bands in these cities and overflow effects in other cities, to which local landlords retreat for more affordable properties. These international cash flows originate mostly

from a new transnational wealthy elite who use prime real estate as a safe deposit box for their wealth. This concentration of wealth has emerged through steadily increasing income disparities in OECD countries over the past thirty years, windfall gains among elites and oligarchs in countries with extractive governance and weak institutions, and criminal money laundering. The real estate purchases are enabled through offshore money havens, local tax laws favouring offshore investors and lack of adequate home ownership rules.

Section 2 of this communication outlines the three main causes of wealth accumulation among transnational wealth elites. Section 3 summarises evidence of accumulated capital being recycled into domestic property purchases. Section 4 tracks rates of home ownership of different age groups over the last thirty years in relevant countries and the UK in particular. Section 5 looks at evidence on relationships between thermal retrofitting, home ownership and age. Section 6 offers a simple model for estimating energy savings losses due to estimations of landlord reluctance to retrofit. Section 7 concludes and offers suggestions for policy and research.

2. Increasing inequality

Osberg (2013) tracks the proportion of total income of the top earning 1% in Canada, Mexico and the US over the past three decades, showing how their share of income has steadily increased in comparison to the remainder of earners. Osberg (2014) compares incomes of the top earning 1% with those of the bottom 90% in the US, Canada and Australia over the past three decades and the past 100 years. In the US the income share of the top 1% increased from 10% in 1979 to 23% in 2012, in Canada from 8% to 13% and in Australia 5% to 9%. Even though commodity booms in Canada and Australia contributed to rising incomes among the bottom 90%, the income share of the top 1% approximately doubled in both countries.

In the period 1938-1978 there was no *relative* increase in the income share of the top 1% in these three countries. Although the income of the top 1% continued to rise, inclusivist policies such as Roosevelt's 'New Deal' (and Labour government policies in the UK, Australia and New Zealand) enabled the percentage rises in income of the bottom 90% to keep pace with those of the top 1% (cf. Acemoglu, 2012). However, the shift towards neoliberal economic policy in the 1970s/80s allowed market effects to dominate, leading to a continually increasing income gap. This has also occurred in the UK, Canada and New Zealand and more recently in western European countries (Acemoglu et al., 2008; Veall, 2012).

Fernandez et al. (2016) document another source of excess wealth, namely among elites and oligarchs in countries with weak financial institutions and extractive governance. This includes oil-rich Middle-Eastern oligarchs from the late 1970s on; those making windfall profits from the collapse of Soviet and Yugoslav communism in the 1990s, the new rich in China, other BRIC countries and emerging economies: and a wave of sudden wealth creation among narrow sectors in OECD countries after economic liberalisation. A third constituency among these elites is criminal elements who acquire and move large flows of money illegally (Fernandez et al., 2016). Following Fernandez et al. (2016) this paper calls these three groups 'transnational wealth elites'.

Thirty years of these phenomena have led to massive accumulations of capital among transnational wealth elites, which cannot all be spent on consumption (Osberg, 2014: 26ff). As the following section explains, much of it finds its way into real estate in safe, prosperous, job-rich regions of the world.

3. Domestic property purchases

The past thirty years have seen large scale increases in purchases of homes in job-rich, politically stable, socially desirable regions, by buyers who often live far distant from these regions. This appears to be driven principally by transnational wealth elites' need to park their excess money in safe havens. As Fernandez et al. (2016) and Fernandez and Aalbers (2016) reveal, many of the countries where this money originates have poorly developed property rights and insecure institutions for financial investment, not to mention extractive governance that can, for example,

seize assets without the restraints of the rule of law (cf. Acemoglu and Robinson, 2013). Further, traditional secretive investment options such as Switzerland and Luxembourg have come under increasing scrutiny. Real estate in job-rich, prosperous, socially desirable cities in countries with secure property rights and stable, inclusive governance has therefore become a popular option for investment. While initially most of this real estate investment was concentrated in the two ‘first-tier cities’ New York and London (Fernandez et al., 2016), real estate price bubbles in these countries led to ‘second-tier cities’ such as Sydney, Vancouver, Los Angeles and Munich being targeted, then ‘third tier cities’ Auckland, Cambridge (UK), Melbourne and many others (for a list of such cities and their recent increases in housing prices see Hay, 2016: 40).

This investment has cascade effects on property prices and ownership in these cities and on lower value property in these and other cities (Fernandez et al., 2016). As prices rise in first-tier cities, transnational investors diversify to second- and third-tier cities so that, for example, many of the new apartments in Vancouver or in Cambridge’s current housing boom are bought off-plan by foreign buyers, as has long been the case in first-tier cities (Green and Bentley, 2014). Local wealthy investors are then also forced to buy in second- and third-tier cities, raising prices further. Meanwhile the snowball effect of a steady, apparently unstoppable upward trajectory of house prices in these locations leads to ever-increasing market confidence, attracting more investors. The high prices cascade toward the lower end of the market, as more regular buyers are priced out of the higher layers and bring their capital to lower layers. A geographical ripple effect also occurs, as home buyers are forced to seek properties further away from their desired city, leading to increased confidence and real estate booms in previously side-lined towns such as Thames (an hour’s drive from Auckland), Ely (a 20-minute train journey from Cambridge) and Augsburg (an hour by train from Munich). Schembri (2015) documents increases in the real (inflation adjusted) price of houses in Australia, Canada, Norway, New Zealand and Sweden of around 400% since 1995 and comparable but lower figures for Spain, Ireland, the US, the UK and Italy, which saw sharp dips during the Great Recession of 2008-2010. However, these figures are averages for these countries as a whole. They mask the fact that prices in or near job-rich centres – where more and more people have to live in order to work – have risen to much higher levels (Hay, 2016).

Dwellings then become ‘financial shelter rather than human shelter’ (Green and Bentley, 2014), a ‘safe deposit box’ (Fernandez et al., 2016) for excess wealth. Part of what holds the edifice in place is the way local investment and tax rules favour offshore buyers with particular types of business structure. Such buyers can often escape stamp duty, capital gains tax and even tax on rent, by having their investment structures set as ‘Special Purposes Vehicles’ (SPVs) in financial havens such as the British Virgin Islands, Jersey or Panama (Fernandez et al., 2016).

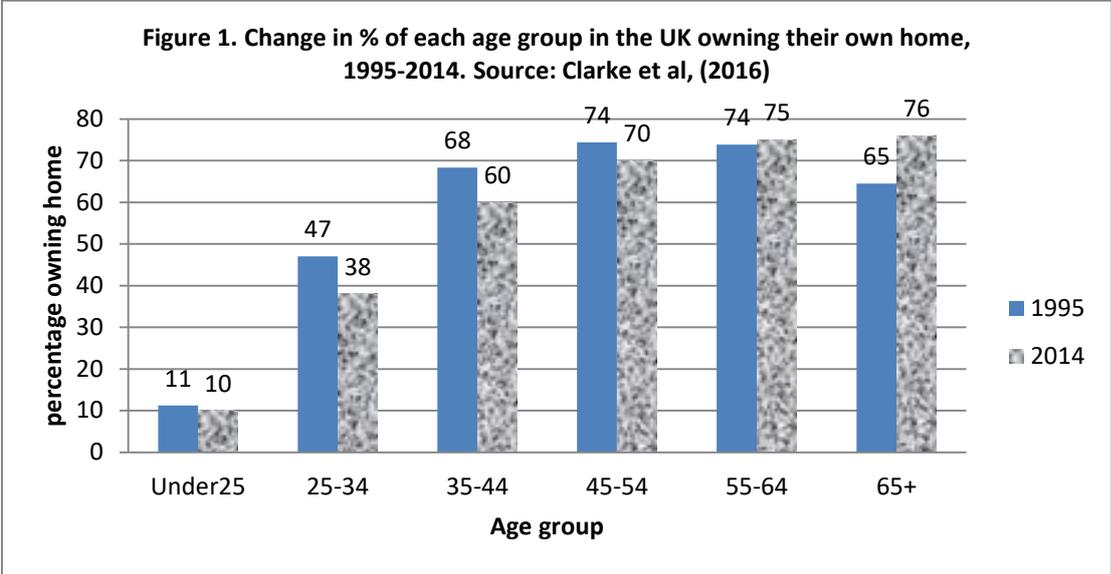
The total value of local real estate owned by offshore investors has not been estimated, but estimates of private wealth stored in offshore financial centres range from \$US7.6 to \$US8.9 trillion (Zucman, 2014: 139), which is equivalent to about half of total US GDP or about one-tenth of total global GDP (World Bank, 2015).

Aside from detrimental social effects on the life of cities, a significant socioeconomic effect of offshore real estate purchases is the changing ratio of local home owners to renters, a topic considered in the following section.

4. More renting, fewer owning

A decisive factor in the affordability of home ownership is the ratio between average house price and average household income. In the UK as a whole this increased from 3.7 to 5.9 in 1986-2016 (Hometrack, 2016). However in Cambridge the ratio in December 2015 was 12.8 (Hometrack, 2016), in Auckland 17.7, increasing from around 4.8 in 1998 (Roy, 2016; Spencer, 2015) and in Vancouver estimates put it at well over 20 (Everett-Ellen, 2016). It is generally asserted that a ratio of about 3.5 is needed, for owning one’s home to be affordable for most people.

This affects young people disproportionately because they must first save a deposit and are usually on the lowest wages. It is now becoming commonplace to complain that young people are being priced out of owning their own homes in job-rich areas in many OECD countries. Figure 1 illustrates this effect for the UK (data based on Clarke et al., 2016). From 1995 to 2014 home ownership rates fell in the UK as a whole for all age groups under 55, rising slightly for 55-64 year olds and more significantly for those over 65. The biggest falls were in the age groups 25-34 and 35-44. The fall among 25-34 year olds, from 47% to 38%, represents a 19% reduction over 1994 levels.



The proportion of working age households who own their own home, with or without a mortgage, fell from 69% in 1997 to 59% in 2014, while the proportion in private rental accommodation increased from 11% to 25% and in social renting fell from 20% to 18% (Clarke et al., 2016: 20). The picture is far more extreme for London and the south (ibid: 23ff). In London home ownership among working aged households fell from 56-44% and renting increased from 40-56%, with private renting now dominating by 3:1 over social renting.

Housing costs (rental or owned) in the UK are highest for those under 25 years old and reduce roughly proportionately with age, with those under 25 paying about twice that of 55-64 year olds and four times that of people aged 65 and over (ibid). A more detailed age-based analysis shows that younger people today are about 25% less likely to own their home as were those who were under 40 years old three decades ago (ibid: 31).

Anecdotal evidence and frequent media reports show a similar picture in first-, second- and third-tier cities, spreading to other regions nearby. Today’s ‘millennials’ are reported to be the first generation since the 1930s to enter adulthood with lower real wages than the preceding generation (Cribb et al., 2016).

5. Owners, renters, landlords and thermal upgrading

The phrase ‘landlord-tenant dilemma’ has long been used to denote the phenomenon that landlords are often reluctant to undertake thermal retrofitting of their properties due to split incentives: the landlord pays and the tenant benefits. Despite policy moves to overcome this, such as Germany’s new law that landlords can increase rents accordingly if they thermally retrofit (Federal building regulation: §559 Abs. 1 BGB), it is widely argued that the dilemma persists both in Germany and elsewhere (Ástmarsson et al., 2014; Bird and Hernández, 2012; Galvin, 2014; Hope and Booth, 2014).

Interestingly, it seems no studies have attempted to quantify the likelihood of a landlord compared to an owner-occupier undertaking thermal retrofitting. The nearest to such a thing known to this author is a study by the German Federal Institute for Building, Urban and Land Research (BBSR – *Bundesinstitut für Bau-, Stadt- und Raumforschung*) (Rein, 2014). This used questionnaires among a

representative selection of 10,000 German households to identify the occurrence of different types of maintenance and upgrade in homes, including thermal measures, and interviews with building firms to estimate work on rented properties. The disaggregation between types of ownership was not designed to allow straight comparison between likelihoods of homeowner- and landlord-driven thermal upgrade measures, but some of the findings are relevant here.

48% of upgrade measures were done by owner-occupiers compared to 34% in homes owned by private landlords, 11% in homes owned by commercial landlords, and the remaining 7% by tenants in their rented homes. In all cases, about 25% of the upgrade measures had a thermal component. The stated costs of the measures were in proportion to these percentages. Since about 52% of German homes are owner-occupied, this suggests owner-occupiers are more likely to undertake upgrade measures, including thermal measures, than landlords, by a ratio of about 54:46. However, the study gave no information on the actual types of thermal measures or types of homes or age groups of homeowners, and anything that could reduce energy consumption, however small, was counted as a thermal measure. The selection methods for landlords were different from those for households, with composite figures from building firms being used to estimate commercial landlords' building maintenance activity. Nevertheless, the study does suggest that both landlords and homeowners (and renters!) spend money on various upgrades to their relevant properties, a good proportion of which has some thermal content, but the question of who does how much remains open.

6. Modelling CO2 emission reductions

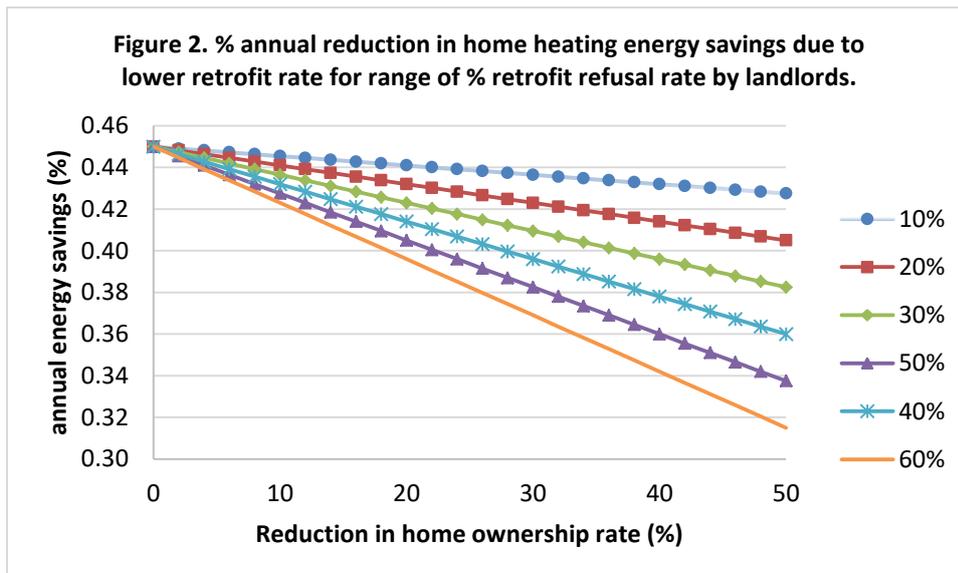
Figure 2 gives modelled effects of the percentage annual energy savings for different rates of landlord refusal to comprehensively thermally retrofit, compared to owner-occupier rates. The percentage energy saving S within a given housing subsector is:

$$S = 100 \times \left(\frac{R}{100} \times \frac{P}{100} \times \left(1 - \frac{L}{100} \times \frac{W}{100} \right) \right) \quad (1)$$

where R is the assumed percentage energy savings per comprehensive retrofit, P is the assumed annual percentage retrofit rate for owner-occupied dwellings in this housing sub-sector, L is the percentage comparative likelihood of landlords not retrofitting, and W is the percentage fall in the homeownership rate.

Assumptions are that a comprehensive retrofit would reduce energy consumption by 30% ($R = 30$), taking rebound effects into account (Galvin, 2015) and that the equivalent comprehensive retrofit rate among the target group of homeowners is 1.5% per year ($P = 1.5$). Currently the German Energy Agency estimates the equivalent comprehensive retrofit rate for all residential buildings to be about 0.8% (DENA, 2012), so it seems fair to assume that young owner-occupiers in low-cost, older houses would have a higher rate. Referring to Fig 2, if 10% fewer landlords than owner-occupiers retrofit and the home ownership rate falls by 30%, the energy saved in this housing sub-sector falls from 0.45% per year to 0.44% per year, a loss of savings of about 2%. However, if 60% fewer landlords than owner-occupiers retrofit in this scenario, energy saved falls from 0.45% to 0.37%, a loss of savings of 18%.

These are merely models based on 'what would happen if'. More focused studies would be required to obtain a credible estimate of landlord compared to homeowner thermal upgrade activity.



7. Conclusions and recommendations

There is overwhelming evidence that the concentration of excessive capital among transnational wealth elites is a major cause of the falling rate of home ownership among young people in OECD countries. These elites tend to buy high-end residential property in top-tier cities, causing cascade effects on further absentee buying, both horizontally (in surrounding regions) and vertically (down toward middle- and even lower-end property). It also has a snowball effect, drawing in local investors, due to the perceived increasing value it induces in the real estate markets and the ease with which these assets can be liquefied in such a ‘hot’ market. Houses become a safe deposit box for accumulated capital rather than shelter for local people to live in.

The resulting fall in home ownership rates among young people reduces the number of homeowners in older, cheaper houses, a good proportion of which are obvious candidates for upgrading. In the UK at least, a great deal of thermal upgrading is done as a by-product of general upgrades and renovations (Galvin and Sunikka-Blank, 2014; Wilson, 2013). Many of these houses now remain or fall into the hands of landlords. Although no studies seem yet to have quantified this, private landlords generally have a poor reputation vis-à-vis thermal retrofitting. So it seems reasonable to suggest that the pattern of real estate investment by transnational elites leads to less thermal upgrading being done.

There seems, then, to be a need for research to quantify these effects and estimate the consequent losses in CO2 emissions abatement. Is there really a landlord-tenant dilemma; would more CO2 emission reduction occur if more of these homes were owned by their occupants; and if so how much?

There also need to be more effective policies to keep homes in the hands of people who want to live in them – homes as shelters for people rather than money. Recent moves include Vancouver’s imposition of a 15% tax on foreign buyers of local real estate, New Zealand’s requirement of at least 30% deposit for offshore purchasers and Australia’s bureaucratic procedures to vet purchases from overseas investors, though the long term effects of these have yet to be seen. More significant would be bringing transnational tax and wealth havens such as the British Virgin Islands and their SPVs under proper scrutiny and control and ending local tax breaks for offshore investors. Recent exposure of wealth havens centred on Panama is a move in the right direction, but needs to be vigorously followed up with strong policy measures.

Even more ambitious – but needed – is policy to reduce the income gap between the top 1% and the bottom 90%, as policies achieved with the New Deal and similar approaches for over half a century.

There is also a need for adequate policy to prevent or limit the use of real estate as a safe deposit box for the fortunes of elites from poorly governed countries, alongside more vigorous actions against money laundering via purchases of real estate.

(3202 words)

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Highlights:

- Global super-wealthy elites are buying up prime real estate in job-rich cities
- This leads to home price bubbles, pricing owner-occupiers out of the market
- The rate of home ownership of young people is therefore falling steeply
- This results in less thermal upgrading of older, cheaper homes
- A painless source of CO2 emissions reductions is thereby being eroded