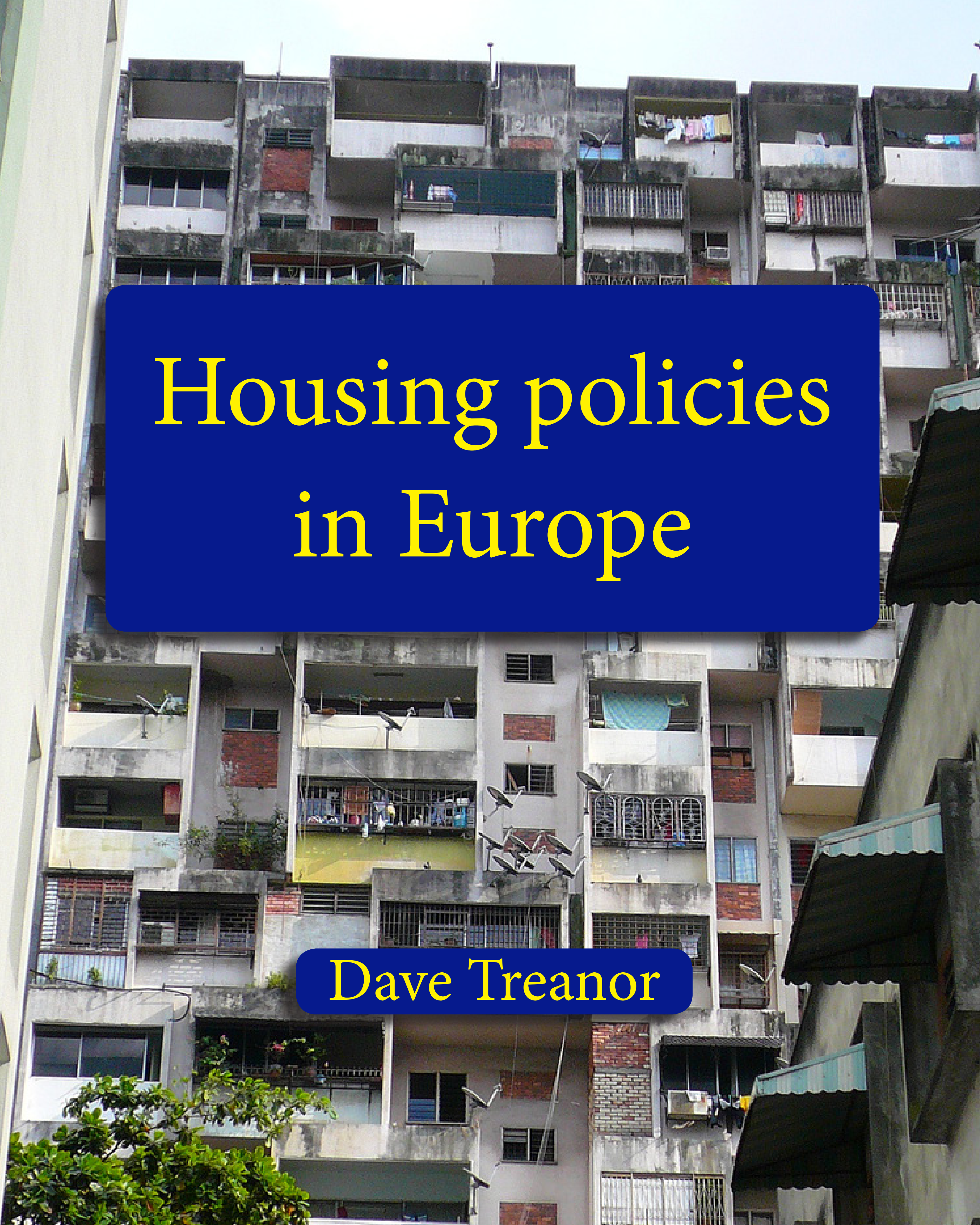

Housing policies in Europe

Dave Treanor

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About the author

Dave Treanor began his housing career with privately funded housing cooperatives in the seventies and early eighties. He was a founding member of a consultancy advising housing cooperatives and representing tenants in negotiations over the transfer of their council housing to newly formed housing associations. He worked at the National Housing Federation on the risks and opportunities arising from the 1988 Housing Act and was involved in developing a consensus on affordable rents, and defining the terms for large scale voluntary transfers of council housing. He studied the way social housing was managed and maintained around Europe as part of a review of the way repairs and maintenance was funded in England.

In the early nineties he set up a software company producing financial appraisal software widely used to manage the development of social housing. This became M3 Housing. He also led the National Housing Maintenance Forum (NHMF) that set standards for cost and quality in the delivery of repairs and maintenance by housing associations and councils, and commissioned a wide range of best practice guides on asset management and maintenance published by the National Housing Federation. He ran benchmarking clubs to help housing associations compare their costs of maintenance and development and identify opportunities to improve their services. He also served as a housing association board member.

Dave recently retired as managing director of M3 Housing and secretary of the NHMF.

His publications include:

'*Legal frameworks for communes and collectives*'; Laurieston Hall, 1974

'*Collective Housing Handbook*'; with Sarah Eno, Laurieston Hall, 1982

'*Buying your home with other people*'; Shelter, 1987

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Four articles published on **www.landlordzone.co.uk/**:

'*Economics of home-ownership*' published in 2013

'*Investment in buy-to-let*' published in 2014

'*Taking the heat out of the housing market*' published 2014

'*Pensions: a reality check*' published in 2014

Contents

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My family also contributed through a number of heated arguments around the dinner table, which only goes to show the value of children not believing everything their parents have to tell them.

I am enormously grateful to them all.

The book has been substantially re-written in response to their comments. The views expressed and any remaining errors or omissions are entirely my responsibility.

Dave Treanor

March 2015

A spread sheet showing data sources and how all the graphs were derived from the data is available from **http://www.m3h.co.uk/publications/housingpoliciesineuropedatatables.xls**

Chapter 1

Housing in Europe

What might we learn?

This book examines housing policies in a sample of countries within the European Union, based on observations from visits, a review of the literature and analysis of national statistics. It looks at the interplay of taxation on different tenures, the regulation of rents and tenancies, planning rules, housing subsidies and the funding of social housing, the extent to which responsibility for housing is devolved from central to local government, and a variety of economic and cultural factors.

It puts UK housing policy into perspective, showing where it differs from elsewhere, and how that has shaped our rental and home-ownership markets.

The mechanisms by which social housing has been delivered are shaped by local cultural and political forces in each country, making simple comparisons rather meaningless.

Social housing can fill gaps where the market fails to meet housing need at a price households can afford. So the role of social housing in each country has to be understood in relation to the total housing market, including the private rented sector and home-ownership.

In the fifties and sixties house prices in the UK were relatively stable. Most households rented. As mortgages became widely available the first of a series of housing booms occurred in the early seventies, starting a cycle that has followed a similar pattern ever since. The longer the period of sustained growth the deeper the fall when the bubble bursts, as it did most dramatically in the late eighties and again in 2008 (see Fig 1 below).

Why do house prices shoot up, and then tumble down? Is this an inevitable consequence of the way housing markets work? Or could something be done about it? If it is inevitable, how come it does not happen in

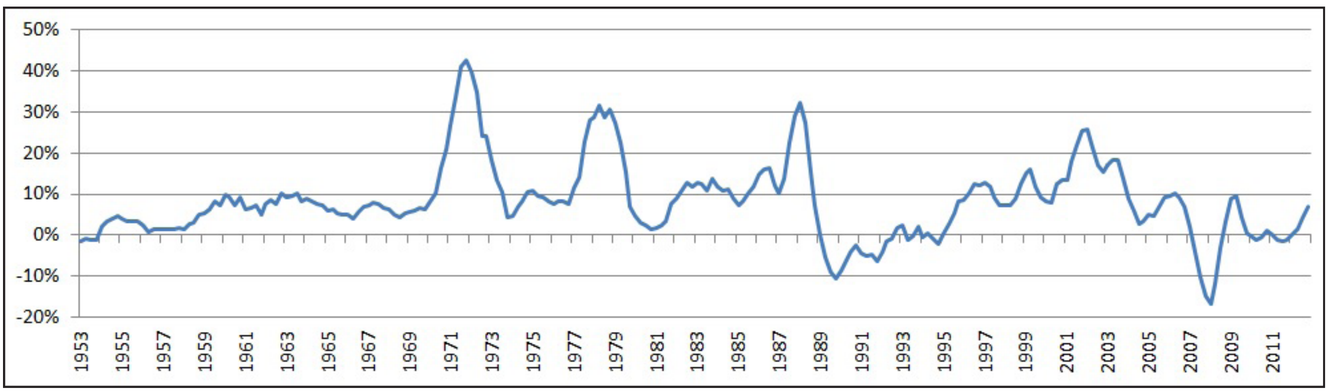

Fig 1: Annual change in house prices in the UK since 1952 [1]

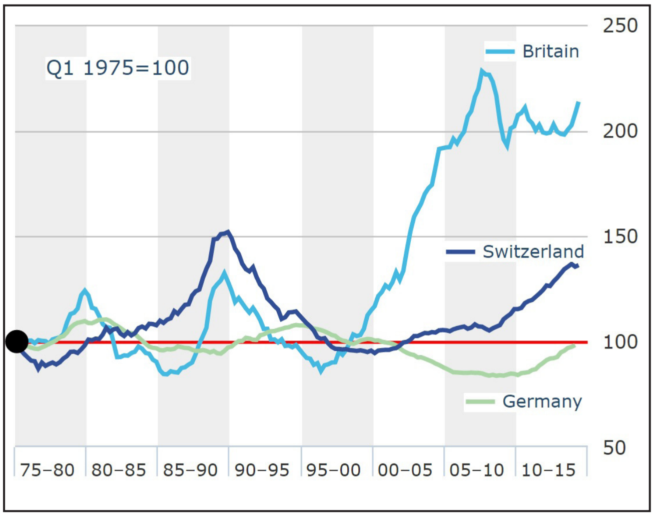

Fig 2: Index of house prices net of inflation in Britain, Germany and Switzerland [2]

Switzerland or Germany (see Fig 2)?

Young families are finding it increasingly difficult to afford a home of their own. Without financial help from their parents it can take many years to save for the deposit or to earn enough to afford the mortgage loan needed to buy a home in most of the UK.

Rising house prices mean they are stuck in private rented housing, which in Britain provides almost no security of tenure, and no control over the condition of their home. This was the price the UK banks demanded for lending to the private rental sector. Yet landlords elsewhere have no problem raising loans despite much better tenancy terms.

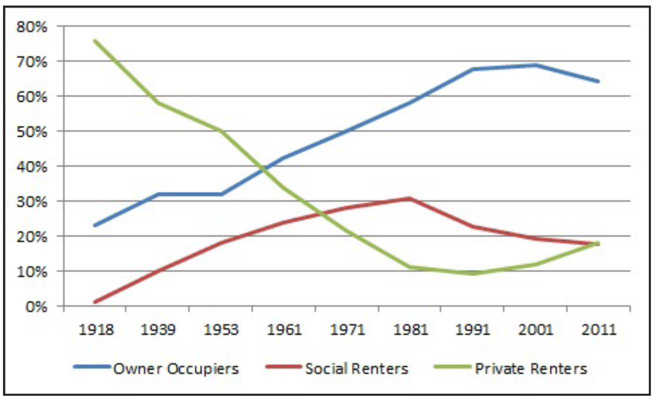

Fig 3: Tenure changes in the UK since WW1 [3]

Rising house prices produce a 'feel good factor'. Home-owners feel financially stronger, and spend more on the things that fill their homes, giving a boost to the economy. Falling prices can trap those that most recently purchased a home in negative equity. They undermine consumer confidence, leading to recession. So as well as disrupting the housing market, these wild fluctuations impact on the wider economy.

In the years following the war rent control made further investment in private renting uneconomic: the gap between the vacant value and tenanted value was too wide. The government funded the construction of council housing, which by 1980 housed more than thirty percent of the population (31.5%). Since then the number of council and housing association homes has steadily declined (Fig 3).

Public spending on housing dropped from 185,000 units a year at the end of the sixties to between 30,000 and 40,000 a year since the nineties, which was less than was needed to replace annual losses through the right-to-buy. The decline in new housing construction since the sixties more or less matches the drop in publicly funded housing (see Fig 7 on page 10). It is now well below the rate of growth in new households, which according to the government's own estimates is around 221,000 units a year. Since 2008 less than half that number have been built. The shortage of housing fuels the growth in house prices, particularly in areas of economic growth. When housing is in short supply it is low-income families that suffer the most.

Public spending on construction has been replaced by even larger amounts of spending on housing benefit, which by 2014 was claimed by 5 million households in the UK.

There is nothing unique to Britain in the need to subsidise housing for low-income households. It occurs right across Europe. Elsewhere in the world where it is lacking the poor are housed in shanty towns and slums, often illegally built on swamps and derelict land bordering the cities. The reason is simple: the amount they can afford to pay is not enough to fund the construction of decent housing.

New housing policies introduced since the sixties by successive UK government have claimed to tackle the underlying problems. Often they seem to have made matters worse. Public spending on housing has gone up while access to affordable housing is down.

Do other countries do any better? Is it possible to identify why house prices in Germany and Switzerland remain stable while housing markets in Ireland and Spain collapsed so dramatically following the banking crisis?

Do others make better provision for low-income families, and avoid the concentrations of deprivation found on some UK housing estates? Could private renting become a more respectable option to meet the long term needs of some households?

Main findings

For a strong economy the UK has a very unstable housing market with exceptionally high housing costs. This is because:

- taxation in the UK is more heavily biased in favour of home-ownership and against renting than in any other country in Europe
- home-ownership is more profitable in the UK with growth in house prices far higher than the cost of borrowing
- the supply of housing has failed to adapt to changes in demand due to inadequate planning, and because holding on to land is often more profitable than selling it for development
- lending for house purchase is relatively unrestrained allowing additional credit to pump up prices instead of increasing the supply.

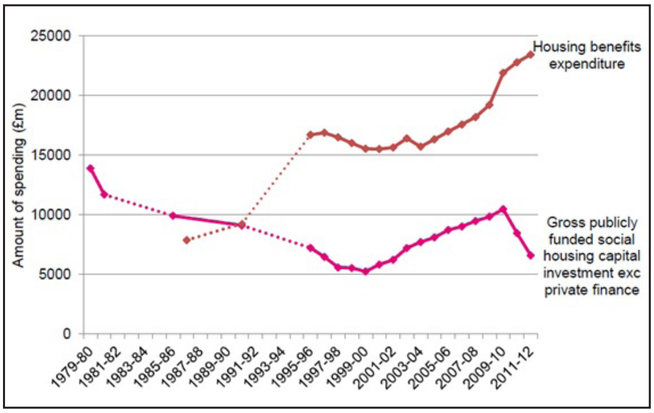

Fig 4: UK public spending on housing at 2012 prices [4]

Rising house prices have led to increasing problems of affordability so that the UK has to spend ever larger amounts on housing subsidies, which in turn add more pressures on prices (Fig 4).

It is blatantly obvious that allowing more money to flow into housing than is being spent on increasing the supply of decent homes will push up prices. This is true whether it comes through the banks lending additional money raised on wholesale markets, or from parents passing wealth down to their children, or from public subsidy.

Rising house prices should be seen as a failure of policy. Instead they have been encouraged by governments of every hue as an easy way to lift the economy out of the doldrums. The resulting burden on future generations is every bit as serious as raising public debt.

These issues are examined in Chapter 2 which compares policies in the UK with those found in other countries in Europe and further afield.

After house prices the second most serious problem is the lack of viable long term alternatives to home-ownership. Some countries, particularly in Scandinavia and the Netherlands provide this through social housing sectors that meet a wide range of housing need. Others such as Germany and France encourage high quality long-term tenancies in their private rental sectors.

The gap between the terms of private sector and social housing tenancies is unusually wide in the UK compared with almost anywhere else in Europe. Social housing rents average half those in the private sector where as well as paying more, households have very little protection.

The UK has failed to recognise the contribution private rental can make, while allowing much of the social housing stock to be lost through inadequate investment and the right to buy. This has gone too far to be reversed leaving no realistic prospect of the social housing sector growing back to previous levels through public subsidy.

Chapter 3 makes the case for a new form of medium term tenure to meet the needs of the increasing number of households renting in the private sector on a longer term basis.

The role of social housing needs a fundamental rethink. It should retain a core responsibility for housing the poor but with more emphasis on assisting them to move on. Lowering rents has to depend more on success in tackling prices in the housing market than on capital subsidies.

Social housing providers might have a bigger impact on the housing prospects of low-income households by using their financial strength and professionalism to raise the standards of rented housing, following French and German practice.

Existing social housing tenancies can be protected. New ones should be on terms similar to those available to private landlords, and include incentives to house those on council waiting lists at affordable rents in exchange for tax reliefs or other subsidies.

Discounts on right-to-buy should be replaced with a right equally available to private sector tenants, lowering some of the barriers to home-ownership for those with steady employment and sufficient income to sustain it.

The third major conclusion of this comparative study of housing policies in Europe concerns economics and government.

The gap between rich and poor and between the north and south is growing. These add considerably to housing pressures in the UK. It is pointless to deal with the symptoms without also tackling these underlying causes.

While the rest of Europe has progressively decentralised since the last war, the opposite has happened in the UK.

Local authorities have almost no financial independence, and lack the power to do much more than implement decisions made in Westminster. And yet the wide variety of pressures on housing in different parts of the country require distinctly different solutions.

Chapter 4 proposes the introduction of a regional tier of government as happened in France in the eighties, and adoption of the principles of subsidiarity under which decisions are taken at the most local level possible.

The more detailed evidence behind these findings is covered in the remaining chapters 5 to 14, which examine the way housing policy has evolved in a selection of European countries.

This book looks at UK housing policy from the perspective of Europe. It identifies a number of problems and reflects on the solutions other countries have adopted. It challenges policy makers to judge whether their own proposals will address the fundamental issues identified or merely tinker with the symptoms.

References

A spread sheet showing how all the graphs were derived from the data is available from **www.m3h.co.uk**

1. **'UK house prices since 1952'** Nationwide
2. Economist **Global House Prices**
3. 'Home ownership and renting in England and Wales' published by **ONS**
4. Graph from an article on public spending on housing published by the **Social Market Foundation** (no longer posted on their website)

Chapter 2

Housing Markets

Market pressures

The UK has one of the most unaffordable and supply-constrained housing markets. It is in a mess. Housing is an essential need, but has become a speculative commodity.

The most stable housing markets in Europe are found in Germany, Austria and Switzerland, where they have thriving rental sectors. The most erratic are in the countries emerging from communist rule in eastern Europe, together with Spain and Ireland, where prices rose dramatically and crashed most deeply following the recent banking crisis. These countries tend to have the smallest rental sectors. In the middle are the majority of the west European countries including France, Netherlands, Denmark and Sweden. The UK and Italy fall between the middle group and the most erratic (Fig 5).

Most of the stronger economies of Europe have lower rates of home-ownership than the UK (65%), including Belgium (63%) France (58%), Netherlands (58%), Sweden (58%), Denmark (52%), Austria (50%) and Germany (42%).

Successive governments have talked about calming the UK housing market and then failed to do so. Rising house prices encourage consumer spending giving a boost to the economy. Which is why governments sometimes try to stimulate the housing market in the lead up to an election. Falling house prices ring alarm bells and produce a flurry of policy initiatives, while run away prices are portrayed as the inevitable workings of a free housing market.

In general, free markets work because supply expands or contracts in response to demand. Where demand outstrips supply, prices rise, and that in turn encourages suppliers to produce more.

For some reason the UK housing market does not appear to work in that way. The 'Barker Review' in 2004 found that '*UK house building is only half as responsive as the French, a third as responsive as the US and only a quarter as responsive as German house building; and over the last 10-15 years, supply has become almost totally unresponsive, so as prices have risen, the supply of houses has not increased at all*'. [2]

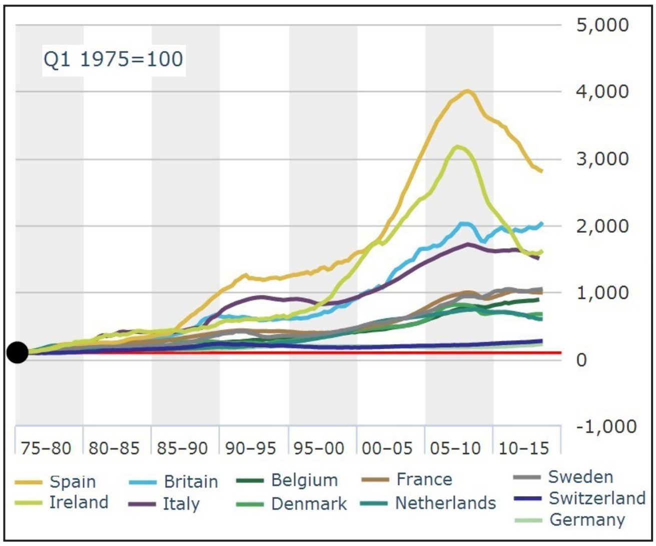

Fig 5: House price growth across Europe [1]

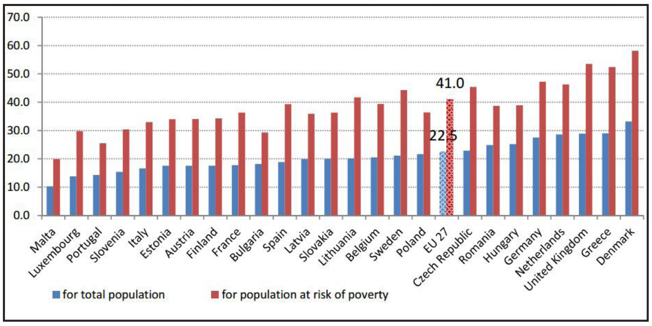

Fig 6: EU housing costs as % disposable income in 2009 [22]

High prices mean that households in the UK spend a larger proportion of their disposable income on their housing than most of the rest of Europe, with only Denmark and Greece spending more (Fig 6).

A number of factors play a part in shaping the housing market. These include:

- The supply of housing, and the extent to which this is constrained by planning regulations and construction capacity;
- The way taxation favours home-ownership, stoking demand by making it so profitable;
- The shortage of social housing and lack of credible alternative to home-ownership in the private rental sector, which adds to the pressure to buy (examined in the next chapter);
- The mortgage market and the way that new money pushes up prices rather than construction.

Land use planning

Official government statistics forecast a demand of around 221,000 new households per year between 2011 and 2021, a rise of 10% over that period. As Figure 7 shows, new supply is running at little more than half that level. The biggest failures are in the areas of greatest demand.

The private sector has not stepped in to fill the gap in supply left by the huge drop in council and social housing construction since the eighties. These trends are examined in more detail in 'Economics of home-ownership'. [3]

The most productive period for private housing construction in the UK was in the thirties, following the Depression, when interest rates were low and there were no planning restrictions. Most of it was developed by local builders on land parcelled up into building lots by land owners, creating the suburbs of semi-detached houses that surround many of our towns and cities most of which had generous gardens and sometimes a garage. The resulting sprawl prompted the first planning laws.

Similar developments were happening across Europe, where the most common solution to urban sprawl was to introduce zonal planning rules that determined what could be built and where. Providing a development corresponded with the plan it was automatically permitted. The plans were democratically approved, and had to balance the need for new housing and commerce with protecting the environment.

In the UK greenbelts were defined around existing towns and cities, where new development was banned. Local authorities have the power to change their boundaries, and some have developed the concept of 'green wedges' to control sprawl while allowing housing development around existing settlements. Others treat them as sacrosanct.

Every development had to obtain individual planning permission from the council, giving local people the right to consultation, and the not uncommon response of 'Not in my back yard' (dubbed Nimbyism). This has resulted in a shortage of land on which to build, especially in the zones outside the greenbelts that have the most potential for greenfield development.

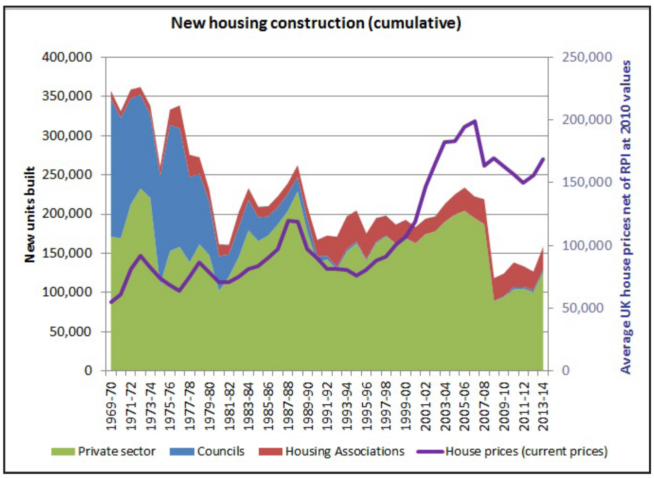

Fig 7 : Supply of new UK housing and prices net of inflation [4]

The Barker Review in 2004 identified planning regulation as a major stumbling block to the adequate supply of new housing in the UK. [2]

As with so many of these analyses they very much depend on the period chosen. Markets respond to changes in demand by raising prices or increasing the supply. Elasticity measures the extent to which supply is increased rather than just prices, with a high score showing a strong response. A more recent study in 2011 by the OECD of the elasticity of supply in response to price changes still has the UK in the bottom half of the table, but with France, Italy, Austria and the Netherlands doing even worse (Fig 8). The report concluded "*Housing supply tends to be relatively flexible in North America and some Nordic countries, while it is more rigid in continental European countries and in the United Kingdom*". [5]

The Joseph Rowntree Foundation published an 'International review of land supply and planning systems' comparing planning regulations in a number of different countries in depth. [7]

The contrast in planning policies between Belgium and Britain could not be more stark. Following the second world war Britain created greenbelts around all major towns and cities to prevent urban sprawl with barely any review or reassignment in response to changing demand for land use. [8] Belgium encouraged the construction of new housing away from urban centres and developed fast and cheap light transport networks enabling people to commute to work. [9]

The costs of travel to work in Belgium are subsidised and tax deductible. In the UK public transport subsidies are being phased out so that the full cost falls on commuters, adding to housing pressures, particularly in London.

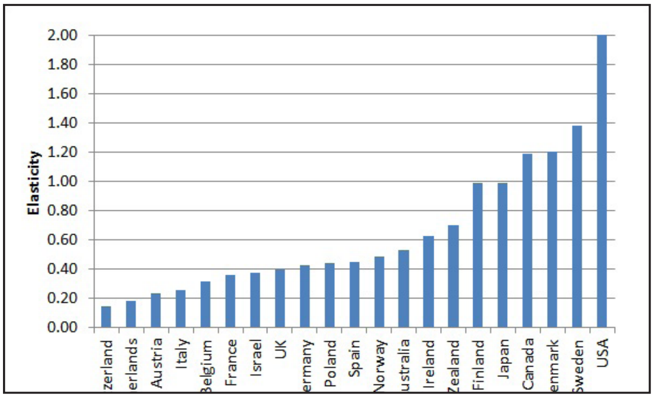

Fig 8: Elasticity of housing supply ie responsiveness of housing construction to changes in house prices [5]

Britain is unique in the discretion granted to locally elected representatives on individual planning decisions, on which local people have a right to consultation. Within Europe only Ireland has anything comparable and there it is more tightly supervised by central government, with increasing emphasis on Local Area Plans. Housing density is low in Ireland so supply is not so constrained by a shortage of development sites.

Those campaigning against developments in their neighbourhoods that might improve housing provision or employment bear none of the consequent costs where they succeed, and so have nothing to lose. Recent changes to planning rules have tried to address this, introducing some incentive by allowing local authorities to retain any increases in local council taxes that result, through the New Homes Bonus. The Dutch go further, providing compensation to those affected by planning decision, the cost of which is usually passed on to the developer.

The rest of Europe to varying degrees apply legally binding land-use plans '*with policies set at a national level handed down, often via a regional or provincial plan, to be interpreted in detail at a local authority level*'. [10] These plans are required to ensure an adequate supply of sites for housing, recreation, and industrial use and for other purposes, whilst protecting the countryside: managing growth as well as containing urban sprawl. Similar plans are required by planning law in the UK but only as guidance on local planning priorities.

The ways land-use is defined varies from one country to another. In essence they identify areas as for residential use, industrial use, for services such as retail, and as rural. They then set criteria for what can and cannot be built in each zone.

Zonal planning removes some of the speculative element from development. Anyone bidding to purchase a site knows what they can build there. That is how it works in Belgium, Denmark, Germany and Spain.

France, Netherlands, Luxemburg and Sweden all have plans that permit a degree of flexibility allowing restrictions to be waived where exceptional circumstances

Fig 9: Local opposition to development in Surrey

merit it. In Greece, Italy and Portugal decisions purport to be based on plans whilst in practice these appear to be followed with less rigour. [6, 7]

It is only in the UK that every individual decision is open to argument following local consultation, creating uncertainty even when a development complies with planning guidance.

In response to the Barker Review the Labour government introduced measures to speed up the planning process making better use of the internet and setting target time limits. They began a shift towards a more zonal approach to planning by introducing Regional Spatial Strategies responsible for assessing overall housing need and allocating it amongst the local authorities where it was to be interpreted into Local Development Frameworks, setting targets for different sorts of development. The regional plans generated a great deal of controversy and few were adopted before the change of government in 2010. [11]

In March 2013 the Coalition government's National Planning Policy Framework came into force, reflecting the conclusions of the Barker Review. This replaced any attempt at setting target numbers with a more general '*presumption in favour of sustainable development ... to ensure new development projects are not held up unless they are against a local community's collective interest*'. The planning process has to consider the impact of new developments on the local economy, and ensure that there is '*a ready supply of housing to meet demand now and in the future whilst enhancing the natural, built and historic environment*'. [12]

They shied away from making planning consent a technical issue as to whether a development complied with an agreed local plan and left local politicians to determine it. But they introduced a much stronger appeals procedure the effect of which is intended to achieve a similar objective. [13]

It is too soon to know whether these measures will be effective in freeing up more land for housing. [14] There is still a great deal of public support for local campaigns opposing development, often framed in terms of 'conservation' versus 'greed' (Fig 9). But at least there is a general consensus amongst policy makers since the Barker Review on the need for a more zonal approach and increased predictability of outcomes based on democratically approved plans.

In a rising housing market land prices rise faster than housing. The reason is quite simple: if the price of housing increases faster than the cost of constructing it, the difference flows through to the value of the land. This can sometimes act as a disincentive to releasing the land: why sell today if it will be worth more tomorrow? The reverse happens during a downturn, when land prices tend to fall by more than house prices. Urban residential land values fell to 40% of their 2007 peak following the crash in 2008 during which time house prices fell to 85% (Fig 10). [16]

So house builders need to do a certain amount of land banking in order to assemble sites, obtain planning permission, and ensure a smooth flow of work. Their profits are dependent on speculative gains from rising land values. [45] Some suffered crippling losses when the market collapsed in 2008.

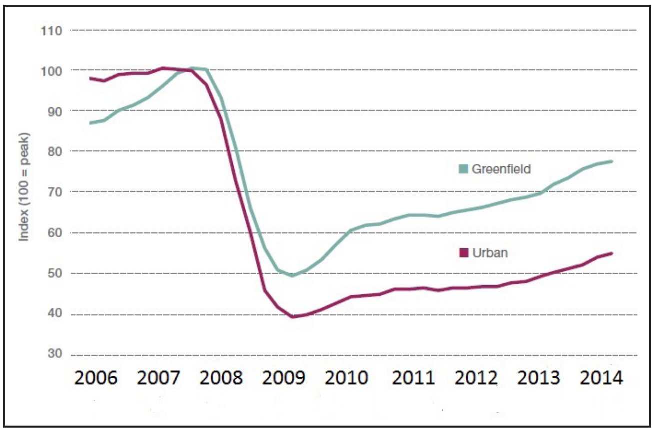

Fig 10: UK residential land prices since the crash [16]

The complexity and resulting uncertainty in planning regulation opened the door to a particular type of property speculator in the UK, who buys up potential development sites and takes them through planning, adding considerably to their value in the process.

According to a report by Savills in July 2012,[15] of the sites in London suitable for mainstream housing (ie excluding the most expensive prime market) only 27% were owned by house builders, and 17% by councils and housing associations. By far the largest portion (55%) was held by private individuals, companies or developers, profiting from the scarcity of housing sites.

The Labour Party has proposed tackling the hoarding of potential development land by giving councils the power to compulsorily purchase sites with planning permission that are not being developed or to charge fees on them. [20] As currently formulated this risks developers delaying obtaining planning permission until they are ready to sell, slowing down the supply of potential development sites.

The political debate in the UK is between regulation with targets placed on local authorities requiring them to increase the supply of development sites versus incentives and persuasion. Either way they need to be made more responsive to scarcity, as reflected in the price of building plots. [49]

Property taxes

One way of discouraging the hoarding of potential development sites is to levy taxes on them. Property and land taxes vary greatly across Europe, but in most countries they are paid on empty properties and building land, with forestry and agricultural land exempt.

There are widespread problems with valuations, and particularly in valuing land separate from any buildings on it, although this is done in Spain and Denmark and also in some states in the US and Australia. Taxing land on its potential development value (as advocated in the 19th century by Henry George [17]) is possible with a zonal planning regime, but is rarely applied to property taxation.

The Barker Review considered the potential impact of taxation on the supply of development sites, but mostly focused on planning gain and VAT. The report did not examine the potential benefits of a recurrent tax on potential building land, or how that might be defined. [2]

The Danes tax land more heavily than anything built on it so as to encourage development. The French tax undeveloped land at a higher rate than developed land with discounts for certain types of development. They also levy additional tax on empty properties. In Flanders (Belgium) they charge an 'activation fee' on undeveloped plots and a vacancy fee on empty properties in any municipality where there is a shortage of housing. In Bulgaria, undeveloped plots are assessed at 125% of the normal tax rate. Hungary taxes any 'idle' land without buildings. Spanish 'plusvalia' taxes the increase in value of urban land (excluding the buildings) when it is sold. [18,19]

Council Tax in the UK is high compared with property taxes across Europe (3.4% of GDP compared with 1.5% on average). [19] It does not apply to land awaiting development and is discounted on empty properties. The use of value bands make it regressive in that the percentage of value charged in tax falls as the value rises. In part this is a hangover from the Poll Tax which was sold to the public as a charge for local services such as rubbish collection, street cleaning, libraries, education and social services. Discounts reflected the fact that these services were not consumed by empty properties, and would be consumed less by single person households and the occupants of second homes.

Updating local property taxes has always been a fraught process. The highly unpopular Poll Tax was introduced in 1990 (1989 in Scotland) to avoid the need to revalue the imputed rents used as the basis for the Rates previously levied by councils. This was replaced by Council tax in 1993 which is stuck using 1991 values as its base. It is ripe for reform both of the basis and of the very limited bands that set the level of tax paid.

Indexing Council Tax to property values would be more counter-cyclical than basing it on imputed rental value ie the tax would rise faster if linked to prices, since rents are more stable and lag behind house prices.

Taxing home-ownership

A large part of the problem with house prices in the UK is the way demand for home-ownership is stoked by the huge gains it makes. Anyone who has paid off the cost of their home over the last thirty years is likely to have made more from the increase in its value than it cost them to purchase it, including all the interest on their mortgage. This is because on average their homes increased in value by more than they paid in interest each year. Over the last twenty years the average annual increase in UK house prices has been higher than average mortgage interest rates (Fig 15 on page 19). This is true for all regions of the UK (Fig 17).

All countries have encouraged home-ownership with favourable tax treatment over the last fifty years. The fact that taxation on rental properties falls on landlords does not alter the fact that it is paid out of rents. Even though home-owners are generally better off than tenants, it is the renters that carry the greater tax burden. This is hardly fair, and is one of the underlying reasons for overheating in the housing market.

The choice between renting and buying is heavily biased in favour of home-ownership, so people scramble to get onto the housing ladder at the earliest opportunity and at any cost, which pushes up prices.

Most home-owners are blissfully unaware of the favourable tax treatment they receive. According to the 'UK Housing Review 2010/11' this cost the Treasury £15 billion a year on average between 1995 and 2010.[21] This is almost the same as was spent on housing benefit during that same period (£15.6 billion pa). Yet that is seen as welfare, while the subsidy to home-owners is not.

The eagerness with which people in the UK are prepared to take on debt to fund home-ownership is shown by our mortgage debt to GDP ratio which is one of the highest in Europe (after the Netherlands and Denmark), and peaked at 87.7% in 2009 compared with an average across the 27 countries of the EU of 51.9%. This was despite the level of home-ownership in the UK being comparable with the EU as a whole. [22]

Until the sixties most countries taxed owner-occupiers on the 'imputed' rental value of their properties, against which they could offset interest on mortgage payments. This meant that relatively similar levels of tax would be paid on investment in a property whether it was rented out or lived in by its owner. Both were treated as investments. In abolishing this tax owner-occupied housing was treated as a 'consumer good', while rented housing remained an 'investment'.

In the UK this was known as Schedule "A" tax, and was abolished for domestic property in 1963. It still applies to some degree in Switzerland, Slovenia, Iceland, Holland, Belgium, and on second homes in Spain. France is considering re-introducing it. Denmark and Bulgaria removed the tax and left the tax relief on mortgage interest, as did the UK until 2000.

It effectively taxed the value of the housing assets net of debt. This made it fairer than property taxes such as the 'mansion tax' proposed by the Liberal Democrats and now supported by Labour in the UK, under which someone owning a very expensive property outright would pay the same as another buying it with a large mortgage.

It is a basic principle of taxation that it should relate to

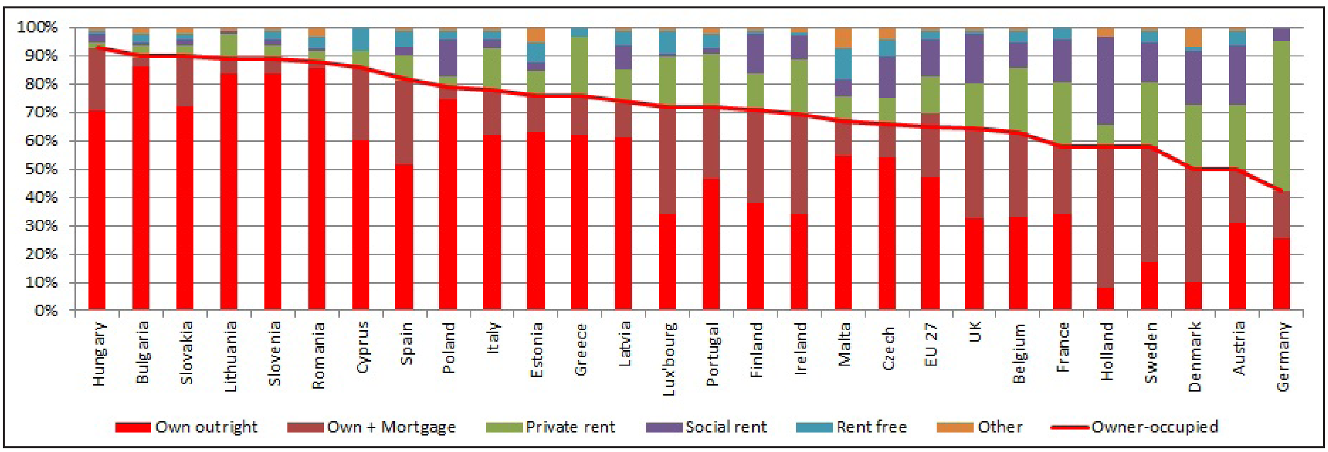

Fig 11: Tenure split across the EU (2010) [3]

people's ability to pay, based on their disposable income: the amount they can spend on consumption. Rental value tax (under Schedule "A") was introduced in an age when only the rich owned their housing, and was in line with this principle.

Compare two identical families with the same income occupying similar properties. The first one owns it with a mortgage that gets paid off over 25 years while the second rents it. To begin with the interest paid by the home-owner might be as much as or more than the tenant pays in rent, but it does not take long before inflation raises rents and the tenant pays more. The owner will then have a larger disposable income than the tenant. It is not until the mortgage interest payments are less than the rental value that the owner would begin to pay more in tax than the tenant. Even then, the additional tax they would pay would be only a small fraction of the additional rent the tenant pays, on which their landlord is taxed. Meanwhile the owner's net wealth has risen with the value of their home.

Incidentally the most learned paper on Schedule "A" tax was written by Mervyn King in 1983, long before he became governor of the Bank of England. [23]

If it is politically unacceptable to reintroduce a rental value tax perhaps we should consider making rent (net of housing benefit) tax deductible. The cost would seem prohibitive, and yet we do the equivalent for home-owners by not taxing them on the additional spending power they gain from living rent free. Mortgage payments are not the equivalent of rent: they are the cost of investing in an asset that increases in value. In any case, rental value tax would be fully discounted for mortgage interest.

Ireland allowed tenants to claim 20% of their rent against taxable income until 2013 when they had to phase it out under measures to reduce government deficits. Spain recently introduced tax relief on 10% of rent for low-income households. These two countries have amongst the highest levels of home-ownership in western Europe and the most unstable housing markets (Fig 11 above and Fig 5 on page 9). Both introduced tax relief on rents as part of deliberate policies to build stronger private rental sectors. Part of the cost was offset by a reduction in the need for housing benefit.

Reintroducing a rental value tax does not have to increase the overall tax burden. It could be matched by a reduction in other taxes (eg council tax, stamp duty or even income tax), and how that was done would determine the winners and losers. It has little impact on most first time buyers whose mortgage interest would cancel out any tax liability. As their mortgage was repaid tax would rise, but by less than the cost to tenants for renting an equivalent property. It would have the most impact on retired households where many home-owners have fully paid their mortgages while elderly tenants still pay rent. Those that are asset rich but income poor could be allowed to defer payment until their property was sold, or from their estates after death. [24, 25]

Taxes on buying and selling

When capital gains tax (CGT) was introduced in the UK in the mid-sixties home-owners were exempted.

Bulgaria and Hungary tax home-owners on capital gains in the same way as landlords. In Hungary CGT gets reduced by 10% per year after five years, down to zero by year fifteen. So in practice it is rarely paid. In Bulgaria it is levied on gains net of inflation. The Spanish tax capital gains on urban land (excluding buildings) net of inflation. They also charge CGT with rollover relief where another property is bought, with exemption for the over 65s, whose gains may eventually contribute to inheritance tax liabilities.

In the rest of Europe home-owners are exempt from capital gains tax on their main residence. In most the tax is only paid by landlords on gains where a property is sold within a few years of purchase, making it a tax on speculation and not on long term investment (eg Belgium, France, and Germany).

The UK is almost alone in taxing capital gains on long term investment in rented housing, without even rollover relief where the landlord uses the proceeds to invest in another property.

Stamp Duty Land Tax is progressive in that the tax rate is higher on more expensive properties. It is also countercyclical because as house prices rise an increasing number of transactions fall into the higher tax bands.

Stamp duty in the UK is lower than equivalent taxes in Europe, which are highest in Belgium and France. Some also charge VAT on new build, and 'transfer tax' on

OECD REPORT ON HOUSING MARKETS (2010)

'The housing market expansion that had started in the mid-1990s and has developed into a boom in many countries has ended abruptly with the collapse of the US subprime mortgage market in 2007.

During the first phase of the upturn – approximately until 2003-04 – improvements in financing conditions, as well as other fundamental factors, seem to have been the main driving force behind house price appreciation in most OECD countries. In subsequent years, many housing markets seem to have overshot, as expectations of future capital gains on houses became entrenched. These events call for a reappraisal of housing-related policies. Countries with a tax system encouraging home ownership should progressively move to more neutral settings. Monetary policy probably has a limited ability to deal with asset price booms. However, it should be paying more attention than in the recent past to the build-up of financial and economic imbalances. Fiscal policy could also play a greater role in moderating aggregate demand during booms. Regulation and supervision of the financial system has been clearly deficient in many countries.

Designing the appropriate regulatory framework in a globalised world, where financial innovation is prevalent, is challenging and will require effective international cooperation. However, it is a prerequisite for well functioning financial markets, housing finance and housing markets'. [30]

purchase of existing properties. Few countries distinguish between owner-occupiers and private landlords in taxes levied on acquisition of a property. It is quite common for social housing to be exempted from some or all acquisition taxes.

Acquisition taxes are criticised for inhibiting labour mobility. They may also reduce the impact of speculation on house prices, as appears to be the case in Belgium.

Taxing rental income

In most countries the returns from private renting are too small to attract commercial investors. If they were we would be familiar with their brand names, as we are in every other sphere of commerce.

A high proportion of individuals become landlords almost by accident, letting out their home when they move for work, or inheriting a property from their parents. Those that do purchase do so for the long term capital growth rather than an income. Even in Germany 60% of rented housing is owned by individuals who usually only have one or two investment properties.

Tax on rental income can have a big impact. The costs allowable against rental income vary. In the Netherlands professional landlords are taxed on the imputed rent with a standard deduction for costs. Otherwise all countries permit deductions for mortgage interest, management and maintenance. In some countries small landlords can make a fixed deduction from rent for operational costs (eg 30% in France).

In many countries the cost of improvements is not tax deductible except against capital gains. There are exceptions where it is offset against rents (eg Germany, and France). In others improvements to achieve a good standard of energy efficiency are fully deductible from rental income (eg Denmark).

Another big difference between countries is in their treatment of depreciation. The UK permits none. Germany depreciates the full procurement cost of rental investments at 2% pa over fifty years. France has a variety of schemes that permit depreciation, usually linked to more affordable rents.

In Belgium and Spain rental income is taxed at a reduced rate. It is common to allow losses on rental investments to be offset against other income (eg Spain and Germany). In the UK for individual landlords it is treated the same as other investment income where losses cannot be carried over to future years or offset against earned income. In France any losses can be offset or carried over to future years, as they can by corporate landlords (including housing cooperatives) in the UK.

On most of these measures the UK taxes rented housing more heavily than home-ownership, making its taxation the most biased against private rental of any country in Europe. [24]

The OECD's 2011 report on the way housing markets work suggests that *'previous studies have shown that tax-favouring of housing tends to encourage excessive leverage and be capitalised into house prices'.* [5]

The rental sector is strongest in those countries that have a history of more even-handed taxation between renting and home-ownership, such as Germany (55% rented), Switzerland (60%), Austria (50%) and to a lesser extent France (42%). These are also the countries with the most stable housing markets, although not necessarily the lowest average monthly private sector rents (Germany €385, France €760, Switzerland €1,085 compared with €794 in the UK). [26]

In the UK the private rental sector has recovered from a very low level since the nineties and appears to be thriving. But it is over-dependent on capital gains rather then net rent income. Consequently it rarely attracts property companies with a long term interest in professionally managed rented housing. [29]

Rents have risen significantly less than house prices (Fig 28 on page 34). But in the long run they are inevitably related to the price a landlord pays to procure their property.

In delaying the point at which younger households move into home-ownership rising house prices expand the demand for private rented housing.

This has led to a widespread belief that the buying power of landlords is pushing up house prices. This is examined at the end of the next chapter: it appears to have less of an impact than most people think. [27]

In the longer term the favourable taxation of home-ownership has a much bigger impact on house prices than any competition from landlords. An OECD study of housing markets concluded that '*As tax advantages increase demand for housing, they tend to increase the level of house prices, offsetting part of the tax advantage. The extent of the offset depends on the price elasticity of housing supply. In countries where supply is rigid, a great part of the tax subsidy is likely to be capitalised into house prices*'. [30]

The UK scores badly on both counts. The tax system is strongly biased in favour of home-ownership: Germany and Sweden are much more even-handed. The supply of new housing also responds only very weakly to an increase in house prices.

Mortgage finance

In the seventies 90% of mortgages in the UK were borrowed from building societies, funded from retail savings. These were non-profit mutual societies regulated by the Registrar of Friendly Societies, who was responsible for ensuring they retained sufficient liquidity to meet any likely demands for withdrawals by savers.

They were restricted to mortgage funding and not permitted to act like banks, making personal or commercial loans or providing cheque accounts. Loans could not exceed 75% of the property's value, and loan service costs were limited as a proportion of a household's income. Mortgages were typified as a '*twenty-five year repayment or endowment loan to young or middle aged couples in secure employment wishing to acquire a not-too-dilapidated detached or semi-detached house in a not-too-run-down neighbourhood*'. [31]

Where the valuation survey found damp or other defects part of the mortgage loan was retained until these had been rectified.

During the seventies and eighties restrictions on mortgages were gradually lifted. They became available to a wider range of households, and on more marginal housing.

Loan-to-value ratios were relaxed. Borrowing above 75% was backed by mortgage indemnity insurance paid with a single up-front premium that got rolled up into the loan, so it was hardly noticeable. Greater weight was given to a spouse's income so mortgages were judged affordable for larger numbers of households.

By the end of the eighties 40% of loans were from banks. In the nineties building societies were mostly converted from mutual societies to commercial banking institutions.

Loans were typically on an annuity basis with level monthly payments and a variable interest rate. The amount of the payment went up and down with changing interest rates but was otherwise the same throughout the mortgage term. There were also interest-only mortgages

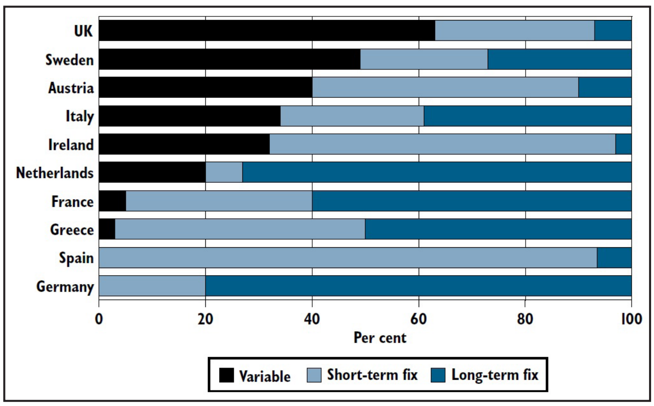

Fig 12: New mortgage terms in EU countries in 1999 [32]

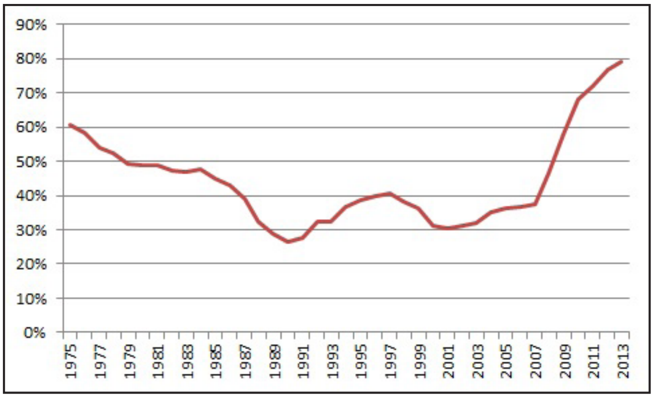

Fig 13: UK Public Sector Debt as % GDP [35]

where the capital was paid off with a lump sum when the mortgage was ended through 'endowment' policies into which the borrower made regular payments, and whose value depended on the performance of the equities into which the funds were invested.

During the nineties the range of mortgages on offer widened. Swap markets developed under which lenders sold streams of variable interest rate payments in exchange for a stream of fixed rate payments. This enabled banks to offer a variety of fixed rate loans. [32] After the fixed period (usually two to three years and rarely more than five) these loans revert to the lender's standard variable rate, which was often deliberately set at above competitive market rates. UK borrowers got used to shopping around for a new loan as these fixed periods ended and a whole new breed of mortgage brokers came into existence to advise them, charging fees to both the lender and the borrower.

By 2000 retail deposits were largely replaced by wholesale money markets as a source of funds. These were mostly funded though mortgage-backed securities, as in the US, under which the revenue streams from mortgage loans are bundled together (securitised) and sold as investments, freeing up the bank's balance sheet for more borrowing. The UK issued 40% of all mortgage securities in Europe between 2000 and 2005, followed by Italy (14%) and Spain (13%). [33]

Mortgages in the rest of Europe are largely funded by mortgage bonds issued at fixed interest rates, with yields typically about 0.25% above government bonds. Homeowners across most of the EU have a history of borrowing on fixed interest terms (Fig 12).

Fixed interest rates always come at a cost: someone has to carry the risks of fluctuations in the price of money. The protection they offer is one-sided. The real risk to a borrower is that interest rates rise in relation to their ability to pay. At times of high inflation, pay tends to rise with interest rates. So the real rate of interest net of inflation is generally more significant than the headline rate. This becomes more obvious when inflation rates fall, as they have across Europe since the financial crisis. It was only those on variable rates who benefitted as bank rates fell in the last six years, as those with tracker mortgages will appreciate.

Inflation also helps borrowers by devaluing their debt. An £80,000 mortgage taken out twenty years ago would be worth £125,000 in today's money. But even if none of it had been repaid, the debt would still only be £80,000. Deflation has the opposite effect, increasing the pain in repaying debt.

The increased supply of loan finance from wholesale markets reduced the cost of borrowing. Competition for larger shares of the mortgage market led to a steady erosion of the limitations on what people could borrow. In the UK and the Netherlands loans were available at 100% or more of the value. Some were 'self-certified' without real checks on the ability of borrowers to keep up the payments. [34]

In Spain and Ireland the ready availability of additional credit fuelled a boom in housing construction coupled with a housing bubble. In the UK despite a growing shortage of housing supply the additional money went almost entirely into raising house prices, which went up by 70% net of inflation between 2000 and 2007 while construction only rose by 20% (Fig 7 on page 10).

Increasingly sophisticated forms of mortgage-backed securities spread the risks on loans enabling them to be sold to weaker sections of the housing market. It also obscured the risks: it was the unrealistic values put on these 'sub-prime' loans particularly in the US that triggered the banking crisis, cascading through the banks in the US and then the UK and elsewhere in Europe.

The British government bailed out the banks, raising public sector debt to do so. Public sector debt rose as a result of the crisis (Fig 13). Even then public sector debt per capita was lower in the UK in 2011 than in any of

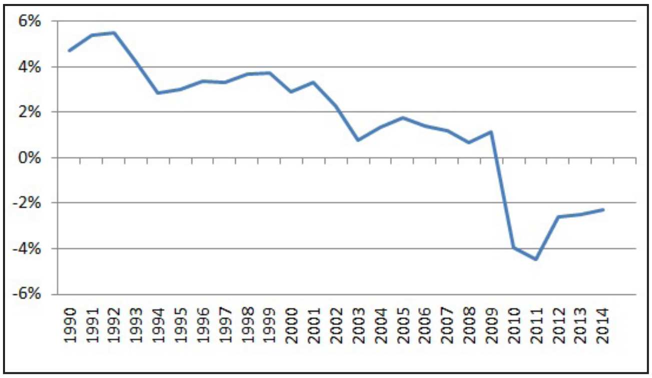

Fig 14: Bank of England base rate net of RPI

the stronger economies in Europe (Fig 38 on page 42).

The new Coalition government followed the usual practice of blaming its predecessors when they would have had no choice but to do the same if they been in power. They introduced austerity measures, and real incomes fell. Recession followed, cutting tax revenues, while the cost of servicing the additional public debt led to budget deficits.

Bank rates were cut in response to the credit crunch. With 70% of mortgages at variable interest rates this had a more immediate affect in the UK than in countries with higher levels of fixed interest mortgages. This is one of the reasons that the UK housing market recovered faster than most from the banking crisis (Fig 5 on page 9).

The Financial Conduct Authority (FCA) imposed restraint on mortgage borrowing, limiting high loan-to-value loans, requiring more stringent affordability checks, and an end to interest-only loans for owner-occupiers without a clear repayment plan. Buy-to-let mortgages and second mortgages were unaffected.

In 2012 the total value of new UK mortgage loans was £144 billion, most of which was funded by recycling repayments on existing loans with only £8 billion in new money. [34] Wholesale markets had almost stopped pumping additional money into housing.

The rug was then rather pulled from under the Bank of England in 2013 by the Coalition's 'Help to Buy' policy which had the clear and opposite intent of boosting the home-ownership market, using public funds and guarantees to back high loan-to-value mortgages in order to kick-start the economy.

Unlike the earlier 'NewBuy' scheme the additional credit was no longer tied to new supply so as to limit its impact on house prices. Coupled with 'Quantitative Easing' and the 'Funding for Lending Scheme' the supply of mortgage credit rose in 2014, fuelling another rapid rise in house prices particularly in the stronger economies of London and the south.

The supply of mortgage finance and the terms on which it is offered are key drivers of house prices. Where housing is scarce and highly profitable the amount a buyer will bid to purchase a home is largely limited by the amount they can borrow.

Higher loan-to-value limits allow people to borrow more, pushing up house prices. Lower interest rates and higher income multiples also increase the amount they can borrow with the same effect. Including a spouse's earnings in full in working out what a household can afford to borrow made it harder for single people to compete in buying a house. Additional money drawn from the bank of mum and dad is similarly pushing up prices, making it increasingly difficult for those with poorer parents to enter the housing market.

The Bank of England already has the tools needed to restrain mortgage lending in response to unsustainable increases in house prices. It requires the political backing to use them.

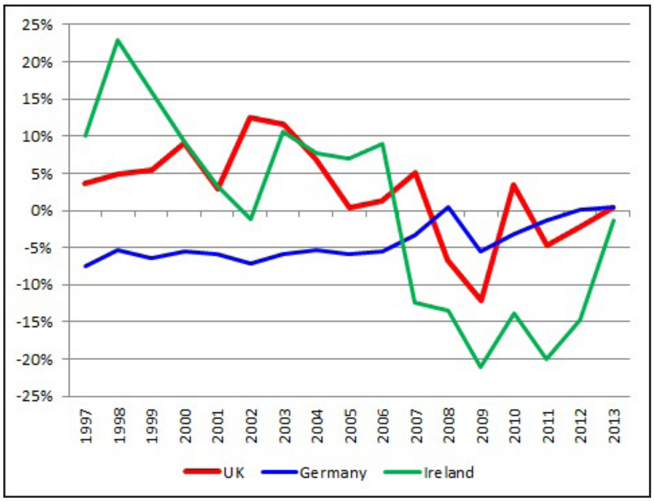

Fig 15: Growth in house prices net of mortgage interest in each year from 1997 to 2013 [39]

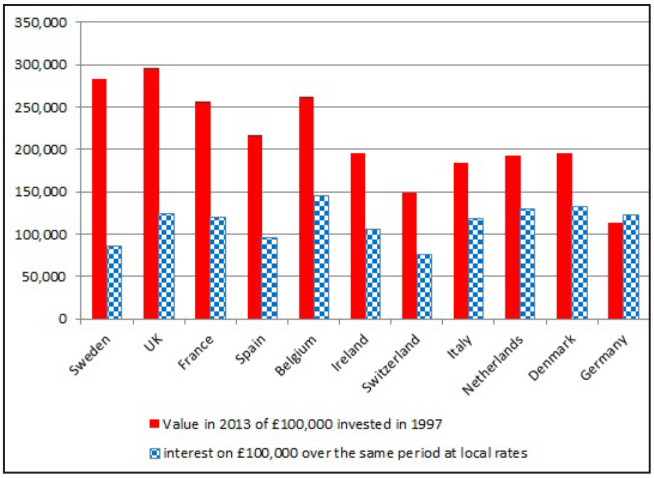

Fig 16: Value in 2013 of 100,000 invested in an average property in 1997 compared with interest on 100,000 at local rates [40]

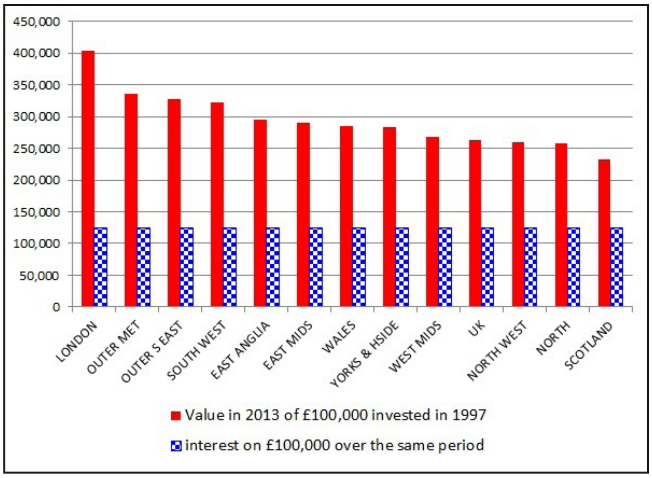

Fig 17: Regional variation in the value of 100,000 invested in 1997 compared with interest on 100,000 over the period [41]

Home ownership

Buying a home is the only investment we can make, apart from a pension, on which the profits are not taxed. And even on a pension we pay tax on the income when we draw money from it. In the short term those buying a home are vulnerable to falling house prices, rising interest rates, and anything that might undermine their own earnings. But in the longer term it is a one-way bet.

The long term trend is for house prices to rise at least as fast as earnings, which since 1975 have averaged around 2% above inflation. In recent years earnings growth has fallen behind, but in the long run it generally relates to the level of GDP. Much of the regional variation in the growth in house prices can be explained by differences in regional rates of growth and of earnings going right back to the seventies. [36]

For the last five years since 2009 we have had the unprecedented situation where bank base rates have been less than the rate of inflation (Fig 14). Tracker mortgages were widely available at rates of between 0.2% to 0.8% above Bank of England base in the ten years leading up to the banking crisis.

UK house prices have grown at a rate that is higher than average mortgage rates in all but 5 years since 1997 (Fig 15). [39]

A similar pattern can be seen in many other countries in Europe. But according to data published by the European Mortgage Federation the UK has a much higher rate of house price growth in relation to mortgage interest than any other country in the EU except Sweden.

An investment of £100,000 in housing in 1997 would have grown to £295,800 on average in the UK by 2013, giving a profit of £195,800. Interest on £100,000 borrowed at average mortgage interest rates over the same period would have cost £124,725, which is £71,075 less than the capital gain. On top of that they would have lived rent free (Fig 16).

In Germany house prices rose by less than the interest paid: low house prices are an important factor in keeping their rents down. [40]

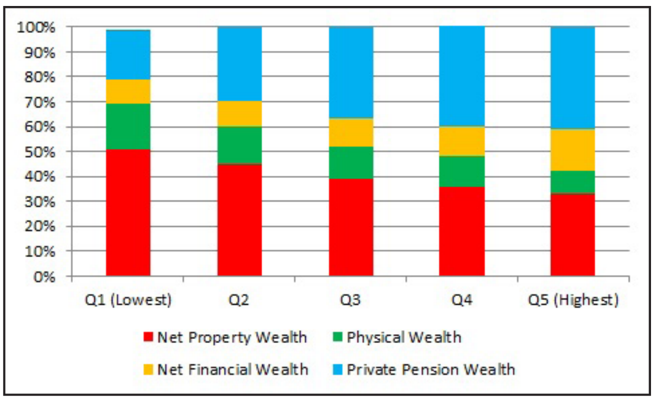

Fig 18: Components and distribution of UK wealth 2010-12 [44]

A similar analysis based on regional house prices from the Nationwide shows gains in relation to interest in London four times as large as in the north and north-west where profit were still high in relation to the rest of Europe (Fig 17).

So long as house prices rise as fast or faster than the cost of borrowing, buying a house is simply a cash flow problem: the gains can be guaranteed. The only thing restricting house prices is the borrowing capacity of those seeking to buy, and their belief that this will continue.

As a result many people in the UK see investing in their homes as providing more reliable security for them in their old age than investing in a pension. It is this that puts the heat into the housing market. The Germans have more faith in their pensions, which in turn provides the capital to invest in their industries.

There would almost certainly be a political price to pay for any party promising to tax home-owners more even-handedly. And yet exempting home-owners from CGT is hard to justify, particularly in the light of Thomas Piketty's thesis showing how growth in asset values (a large part of which is housing: Fig 18) widens the gap between rich and poor in a way that cascades down the generations. He argues for progressive taxation of net wealth and suggests this should replace existing property taxes, so as to distinguish between the person that owns a property with a large mortgage and one that owns it outright. [42] Rental value tax has some of these characteristics in that mortgage interest is offset against imputed rental income.

In a recent book Kate Barker (author of the Barker Review) suggests taxing home-owners on capital gains from their main residence as a way of reducing the pressure on house prices, with the charges rolled up over their lifetime. [43] The Conservative Party takes the opposite view and has long argued for a reduction in inheritance tax so as to take the family home out of taxation altogether.

The favourable tax treatment of home-ownership is presented as enabling more people to access the housing market. In reality the tax benefits are factored in to house prices, raising them to levels that those on lower incomes can never hope to afford.

The recent changes to stamp duty are a case in point: in the view of estate agents and valuers the reduced cost to purchasers was immediately added to the prices paid.

In countries with exceptionally high levels of home-ownership (eg in some parts of eastern Europe), those on low incomes can find it hard to maintain their homes, and keep them up to date with modern housing standards. Similar problems have occurred in the past in the UK, and were dealt with through improvement grants and neighbourhood improvement schemes.

Home-ownership appears to have peaked across western Europe, and in some cases has fallen since the banking crisis. There is no longer any justification for promoting the expansion of home-ownership through favourable tax treatment: all it does is

UK EARNINGS, INTEREST RATES & HOUSE PRICES

Up to the year 2000 the growth in house prices in the UK (RPI + 1.6%) [37] fluctuated around the rise in earnings (RPI + 1.59%)[38]. But since then they have gone up significantly faster, implying that people are spending higher multiples of their earnings on buying their homes. In the 1970s mortgages were typically limited to three times income, or in the case of a couple to three times the first income plus the second. Preceding the financial crash they were being offered at as much as five times income, and even now people are commonly offered four times their combined income.

According to the Nationwide, across the UK as a whole house prices have risen from 2.7 times average earnings in 1983 to 4.4 times in 2013. In London the increase was much greater: from 3.7 times income, to 6.7. In Scotland it was considerably less, rising from 2.5 to 3.1. The comparison in each case is based on regional average full time worker's incomes from the Office for National Statistics.

Interest rates are also lower, and are not expected to return to the levels experienced in the 1970s and 1980s. The average Bank Base Rate in the 1980s was 11.7% whereas in the ten years leading up to the crash it was 4.8%. The cost of borrowing has genuinely fallen, making higher mortgages more affordable. So £ for £ the cost of borrowing in the ten years to 2009 was 59% less than the average cost in the 1980s. But the benefit was cancelled out by a 61% increase in the ratio of house prices to earnings for the UK as a whole. The net effect is that monthly mortgage repayments take a similar proportion of household income now as they did in the eighties (25% to 30%), despite the dramatic increase in house prices since then. The exception to this is London where there has been an 82% increase in the ratio of house prices to earnings, and mortgage costs are taking a substantially increased proportion of household income.

On this basis it would be wrong to describe house prices before the banking crisis as a bubble.

to inflate house prices.

There is always a tendency for housing subsidies to push up prices. The risk might be reduced if the money spent on housing benefit and in subsidies to social housing were matched by a reduction in the hidden subsidies to home-owners. Even supply side subsidies for social housing can add to the demand for scarce building plots in high demand areas. One of the big advantages of funding social housing through planning gain agreements under S106 is that it minimises this effect by extracting funding from the increased value of the site. In recent years planning gain has been a bigger source of subsidy for social housing than Social Housing Grant.

The public have to be persuaded of the damage property speculation does, and the role home-owners play in that before they will accept the need to tax them more fairly. Falling property prices are damaging, so these changes have to be introduced slowly to act as a brake on rising prices, without bringing about a collapse.

This will require some regional variation to take account of more local economic pressures. National policy can set the framework but it needs to be adjusted in response to the local housing market.

Fortunately there is a tradition of setting property taxes locally. The reform of council tax could be the basis for changes to housing taxation, aimed at reducing speculation, replacing charges based on value bands with taxes based on rental value. Private rental has doubled since Council Tax was introduced in 1991 making it a lot easier to establish rental value for all sorts of housing.

Modern information technology reduces the administrative costs in keeping values up to date. This makes it unnecessary to base property taxes on bands or on notional rents or values in a particular year, which leads to distortions that get progressively worse over time. The rental value can be established once, and reviewed as part of the valuation whenever a property is purchased. It can then be up rated every year according to regional changes in an index, such as the Index of Private Housing Rental Prices published quarterly by the ONS. [46]

Tying property taxation to current values rather than banding based on historic values has been widely recommended, although most proposals are based on open market sales value rather than imputed rental value. [28]

One reason this has not been done in the past is that fluctuating house prices would make the returns from council taxes based on them unpredictable. Rents are much more stable than house prices, providing a more reliable basis. In the long run this change would be expected to lower house prices by about 20%, whether it applied to taxes based on property values or imputed rental values. [47]

A good case could be made for allowing home-owners to offset at least some of their mortgage interest against property tax, so that less of the burden falls on first-time buyers and it operates more like the old rental value tax regime (under Schedule “A”). This should be matched by similar measures allowing tenants to offset some of their rent (perhaps relating to average tax levels paid by private landlords), so that tenants never carry more of a burden than owners. This would reduce the need for exemptions. It would also lessen the divergence between tenants and home owners in the way their housing costs rise over time. It could be coupled with provision to defer tax for those that are rich in housing but poor in income.

This might also encourage those under-occupying their housing to trade down, making it available to house families with children. In 2014 more than half of owner-occupied housing in England was under-occupied compared with 15% of tenants in the private sector and 10% in social housing. [48]

Idle land in urban areas or anywhere zoned for development should be taxed. It has risen in value by far more than housing over the last fifty years and something must be done to make it less profitable to hang on to it.

Stamp duty should be replaced with capital gains tax, so that it falls on those that have made the gains (the ‘haves’) rather than those purchasing a home (the ‘have-nots’). The rate at which it was charged could be set to yield similar tax revenues to stamp duty, or even raise it.

A case could be made for levying it on gains net of inflation, similar to the Plusvalia tax in Spain, although applying to the property, and not just the land.

This would be expected to have less impact on mobility than stamp duty, since the level of tax would be related to how long a property had been held (and gained value). Moving home would trigger a payment but would not actually increase the capital gains tax that would eventually be paid in the way that stamp duty does.

Either or both of these measures would send the right signals, reducing expectations that owning a home would be so much cheaper in the long term than renting. Home-ownership would remain quite profitable enough and an attractive option on its own merits.

FACTORS AFFECTING HOUSE PRICES

There have been a number of econometric studies measuring the impact of different factors on house prices.

In 'A bird's eye view of OECD housing markets' Christophe André reviewed the boom in house prices that had occurred in all OECD countries in the first ten years of the new millennium, at rates averaging 120%. His conclusions can be summarised as: [30]

- Between 35% and 45% of the increase correlates with rising incomes. In Ireland this could explain a 108% increase in house prices. The impact was lowest in the Netherlands (22%) and Italy (9%).
- Falling interest rates explain rises of between 30% and 70% in various countries. Deregulation of mortgage markets, lifting loan to value ratios, extending repayment periods, and reductions in income requirements making loans available to poorer households has led to a dramatic 170% increase in household debt in OECD countries which helped to pump up house prices.
- Demographics had an impact in Spain (35%) and the USA and most of all in Ireland (70%) which experienced unprecedented inwards migration. Prices in Spain were also affected by investment from overseas.
- The expectation of capital gains, coupled with a fear of becoming priced out of the market was a major contributing factor in Sweden (55%), Spain and Denmark (45%) and the UK (39%). Germany experienced the opposite effect from low expectations of future house prices.

This study also points to the role of the private rental sector in stabilising house prices:

'*The existence of well-functioning rental markets could help reducing the volatility of house prices. When house prices rise relative to rents, an increasing share of households should opt for renting, thereby reducing pressures on prices. However, a scarcity of rental housing can prevent households from renting. It is worth noting that two of the countries that experienced large housing booms – Ireland and Spain – have very thin rental markets. In contrast, Germany and Switzerland, which have not participated in the latest house price boom, have large rental markets*'.

While many factors affect tenure choices, tax systems biased towards home-ownership, often coupled with tight regulation of rental markets have led to a decline of supply of rental accommodation, both in terms of quantity and quality, in many countries. More neutral tax systems should allow a better balance between tenures, which could produce more stable housing markets. Nevertheless, it should be noted that the path towards a more neutral tax system needs to be progressive to avoid disruptive adjustments in house prices'. [30]

Conclusions

Unless something can be done to calm the pressures on house prices no other measures to improve access to housing or tackle affordability will achieve anything more than temporary and localised relief.

Building more homes is absolutely essential, but will take a very long time to make any significant difference. The NHAPU calculated that the ratio of lower-quartile house prices to lower-quartile earnings would rise from 7.5 to 10.9 by 2026 if new housing construction gets back to about 150,000 units a year. Raising construction to the government's present target of around 221,000 a year would see it rise to a multiple 9.4 which is still a huge increase, indicating that fewer households will be able to afford home-ownership in future. [50]

It is unlikely we can build our way out of the problem. At least part of the answer has to lie in making better use of the housing we have, discouraging under-occupation particularly amongst those that have paid off most of their mortgages. [48] It also means creating jobs and opportunities in the parts of the country where housing is more plentiful and reducing the drift of people southwards in search of work. This is addressed in Chapter 4.

Something else has to be done to tackle the growth in house prices.

Reducing the bias in taxation favouring home-ownership would have a much more powerful long term impact on the housing market. It would need careful implementation to make sure it did not cause a collapse in house prices with knock-on consequences for the economy.

Controlling the supply of mortgage credit is the quickest way of reacting to changes in house prices, and the most effective short term measure. The challenge is to find ways of applying it that do not strangle housing construction, and that can restrain a rapid escalation of prices in the south without killing off a much needed recovery in the north. Two practices found in Europe might offer ways of directing credit controls more precisely:

- In some countries (eg Spain and Denmark) builders sometimes sold homes with mortgages already arranged on competitive terms, and could access some of this lending to help cover construction cash flows.

- In countries with a tradition of low loan-to-value lending on mortgages buyers often use second mortgages on less favourable terms to raise additional funds: these carry much higher risk and could be subject to tighter credit controls to restrain an over exuberant market .

Meanwhile it is essential to improve the alternatives to home-ownership which will clearly have to house many more of us in future. That is the subject of the next chapter.

OECD ANALYSIS OF HOUSE PRICES 2011

The OECD published a more detailed cross-country study in 2011. [5] This analysed the impact on house prices of a 1% deviation from the median of five factors. It drew similar conclusions:

Banking supervision had the most impact, accounting for 18% of the difference in house prices between the country with the least strict and the most strict rules. This includes limits on borrowing in relation to incomes, enforcement of limits on loan-to-value, access to global capital markets, and the extent of competition between mortgage providers.

Based on data from 2004 the UK (scoring 1.45) came third of all OECD countries in having the least strict supervision, after Luxembourg (0.0), and Ireland (0.74), followed by France (1.52), Netherlands (1.66), Spain (1.78), Finland (1.95), Germany (1.97), Denmark (2.06), Switzerland (2.11) Belgium (2.18) and the United States (2.29) which had the median value.

Maximum loan-to-value on mortgage loans accounted for 14% of the difference in house prices between those permitting the highest (Netherlands at 118% followed by the UK at 110%) and the lowest (Hungary at 70%).

Supply responsiveness had a similar 14% impact on house prices (see Fig 8 on page 11), with the UK in the bottom half of the table amongst the poorest performers. Another UK study in 2011 found that '*if the planning regulations were completely relaxed, house prices would be 21% to 38% lower (in 2008)*'. [47]

Transaction costs accounted for 12% of the variation in house prices, tending to reduce their growth. The downside of high transaction costs is that they reduce labour mobility. Transaction costs include stamp duty, transfer taxes and VAT, as well as legal and agents' fees. The UK comes third in having the lowest transaction costs on the buying and selling of property at 4.2% of property value. Belgium (14.8%), France (14.1%) and Greece (14%) are the highest with an OECD median of 8%.

Tax relief on mortgages could explain 8% of the difference in house prices between countries.

Of the five measures found to impact on house prices mortgage tax relief was the only one where the UK came out better than average, having abolished it in 2000. On all other measures the policies found in the UK promote higher house prices by more than most other countries in the OECD.

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Chapter 3

Renting

History of social housing

The UK was amongst the first countries to build social housing, starting with almshouses dating back many centuries, and then the philanthropic societies such as Peabody and The Industrial Dwellings Company in the 1860s developing housing in cities for working class households.

Following the First World War the government began funding council housing aimed initially at working families. Elsewhere in Europe social housing was more commonly run by trade unions, cooperatives and churches or charitable organisations, with public subsidies channelled through local authorities.

Council housing was seen as a long term option that working people with a wide range of incomes aspired to. A council house was modern and well maintained, and provided long term tenancies at an affordable rent in which a family could thrive and prosper. Some were rehoused following slum clearance. Others took their turn on a waiting list.

Fig 19: Peabody Trust's first estate in Commercial Rd 1863 [1]

The first signs of a change came in the sixties in reaction to the BBC drama *Cathy Come Home* on the plight of homeless families. [2] Local authorities were given a statutory duty to house them. An assessment of housing need replaced traditional allocation to local residents and their children based on how long they had spent on a waiting list.

Before long many councils found they did not have sufficient vacant properties to meet their obligations to homeless families and others in 'priority need', and began placing people in bed and breakfast and cheap hotels, the rising cost of which became an overriding concern.

The introduction of right-to-buy with huge discounts in the eighties led to the better quality council housing being sold off. Councils were prevented from building housing to replace them.

In order to stem the losses through right-to-buy many councils, starting with the non-metropolitan 'shire' counties, set up housing associations and transferred the whole of their housing stock together with their employees. Existing tenants retained their right-to-buy but new tenants did not. The 'voluntary transfer associations' borrowed private finance to pay for the transfer which had to be approved by a majority of their tenants. The price paid allowed for 'catch-up repairs' to bring the properties up to good tenantable condition, which was the main reason why tenants voted for it.

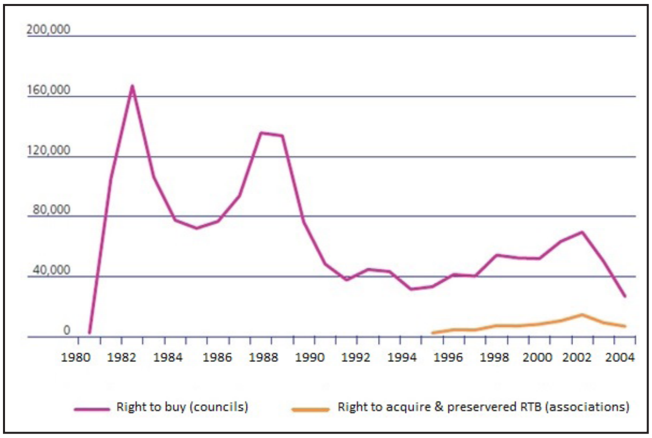

Fig 20: Right-to-buy sales [3]

With the introduction of private finance in combination with social housing grant, housing associations have continued to build, but on a much smaller scale, insufficient to match the loss of 1.5 million affordable homes through right-to-buy and increased demand through population growth (Fig 20).

Since the eighties new lettings by councils and housing associations have fallen by a third, and been focussed on those in greatest need rather than those that have waited the longest. Social housing remains a much sought after tenure, but has become more marginalised. Council estates carry more than their fair share of deprivation.

Right-to-buy flats were bought by buy-to-let landlords charging market rents. The idea that it might result in a broader social mix of owners and renters on the larger flatted estates proved illusory. Social housing is increasingly concentrated in poorer neighbourhoods. John Hills describes this in his 2007 report on the future roles of social housing in England:

These areas are far more likely to suffer from problems than others, and for tenants to report neighbourhood problems. In the areas originally built as flatted council estates: more than a fifth of social tenants report the presence of drug users or dealers as a serious problem; nearly a fifth the general level of crime, fear of being burgled, vandalism and litter; and eighteen per cent that they feel unsafe alone even at home or outside in daylight. One in seven social tenants in these areas says they are very dissatisfied with their neighbourhood. [3]

At the same time rent control was removed in the eighties. To soften the blow housing benefit was supposed to take the strain. Rent Officers were expected to prevent landlords charging more than a market rent, but with housing benefit covering 100% of the rent it did not take long for market rents to rise in London and other areas of economic growth well beyond the levels that many tenants could otherwise afford.

With the ever growing price of housing, those on the lowest incomes could not afford to pay a rent that was anywhere near the cost of providing the housing they needed. Without subsidy they would be forced into overcrowding in the most derelict properties in run-down neighbourhoods.

The proportion of households in social housing has almost halved since 1980, from 31.5% to below 17%. [4] For some of them this represents a success story in that they now own their own homes. The rest now rent from private landlords at market rents, supported where necessary by housing benefit.

In the seventies and eighties the shortage of housing was far less acute than it is in much of the country today. There were areas with large numbers of boarded up properties awaiting redevelopment, both public and privately owned, many in areas blighted by planning decisions or on developments delayed by a shortage of investment.

Councils, including many in London, were concerned to make the best use of 'hard to let' flats, often on the upper floors of four or five storey blocks without lifts.

Housing in London became increasingly scarce and unaffordable in the late eighties and nineties as its economy took off in relation to the rest of the country led by the financial sector following deregulation of financial markets.

The population of what is now Greater London peaked at 8.6 million in 1939. By 1991 it had fallen to 6.4 million. In took until 2015 to rise back up to 8.6 million.

Housing subsidies

The last Labour government's priority was to deal with a backlog of under-investment in the existing social housing stock. They brought in the 'Decent Homes Standard' which all councils and housing associations were required to meet by 2010. Many local authorities set up housing associations and transferred their stock so as to raise private finance to meet the cost of upgrading. Others formed 'Arms Length Management Organisations' (ALMOs) to devolve management of their stock without changing its ownership in order to access additional public funding. As a result most social housing (54%) is now independent of local authorities

Expenditure on capital subsidies for the development of social housing fell in the eighties, and is now dwarfed by the rising cost of housing benefit. There are concerns that recent moves to curb the costs of welfare will force low-income households back into overcrowding and out of the areas where they might find more gainful employment.

The Coalition government's solution is to put a ceiling on all welfare benefits, and eventually to replace the plethora of tax credits and welfare benefits with a single universal benefit that will ensure it always pays to take a job and seek higher earnings.

All new social housing tenancies are at 'affordable rents' pegged to 80% of market rents. The additional revenues gained by the providers of social housing from raising rents on new tenancies in their existing stock will be used to fund the development of more affordable housing.

The Coalition have also given a boost to right-to-buy so this is unlikely to halt the decline in overall social housing provision. It had fallen to less than 3,000 units a year in 2010 but was back up to 11,260 in 2013. [5] Social housing starts (rental only) averaged 27,883 a year since 2010. [6]

Social housing rents in 2013 averaged £89 per week compared with £163 for private sector tenants. [4] This

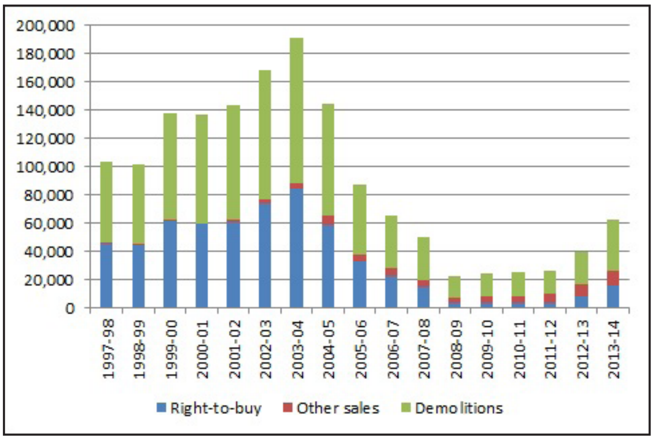

Fig 21: Right-to-buy, other sales & demolitions in England [5]

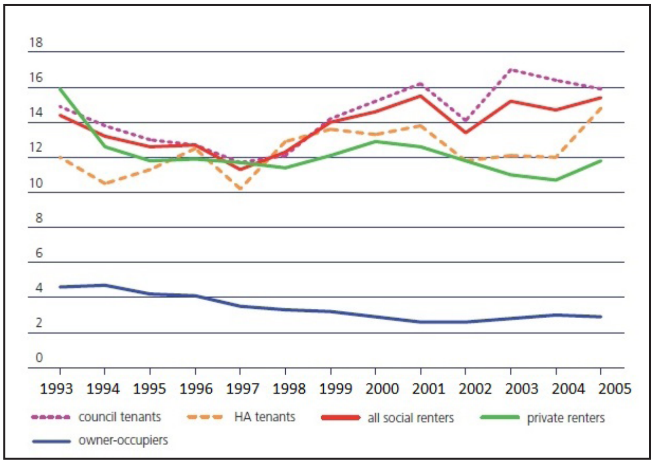

Fig 22: Percentage of UK households dissatisfied with their accommodation [3]

gap will gradually narrow as more social housing tenancies change to the new 'affordable' rents.

There have been vigorous debates on the relative merits of subsidising bricks and mortar rather than rents. Both have undesirable consequences.

There can be little doubt that it is more cost-effective to build a stock of low-rent properties. But once council housing ceased to be the tenure of choice catering for working families with a range of incomes it began to take on too many of the characteristics of the slums and ghettoes that it originally replaced. In the 1980's 47% of council and social housing tenants were employed (43% full time). By 2006 this had fallen to 32% (22% full time), reflecting increasing numbers of vulnerable tenants. [3]

In consequence council housing has become the least popular tenure, with tenants reporting far higher levels of dissatisfaction with their accommodation than those renting from private landlords. Housing associations do better, largely because their properties are less likely to be concentrated into large estates and deprived areas.

John Hills makes some very good arguments in his 2007 report in favour of personalised support rather than bricks and mortar subsidies, which can be summarised as: [3]

- The demand for social housing at subsidised rents will always outstrip supply, and have to be rationed.
- Granting a subsidised tenancy confers a huge financial benefit, which is tough on those that never make

it to the head of the queue.

- It reduces mobility by trapping social housing tenants who cannot take the benefit with them so as to move to find a job or to accommodation better suited to their changing needs, unless they can exercise some form of right-to-buy.
- It narrows choice, and perpetuates ghettoes.
- Social housing tenants are far less likely to move into work and improve their economic circumstances than comparable private sector tenants, despite the fact that higher rents double the depth of the poverty trap for private tenants as their benefits taper off with rising incomes. The causes are unclear. A higher proportion of households are recorded as 'inactive' rather than unemployed. The loss of mobility may outweigh the benefit of a shallower poverty trap in seeking gainful employment. [3]

Over the last twenty years income differentials in the UK have widened. Top salaries have risen taking most of the benefit of growth in Gross Domestic Product (GDP), at the expense of those on below average incomes (Fig 23). Those that benefited from the expansion of home ownership following the war are passing some of the resulting wealth down to their children.

This widening gap increases the demand for housing subsidies, and reduced the scope for expansion of home-ownership further down the income scale.

Both house prices (Fig 5 on page 9) and income differentials (Fig 36 on page 41) have grown more in the UK than elsewhere in Europe, increasing the demand for social housing, and for subsidies to make rental housing affordable.

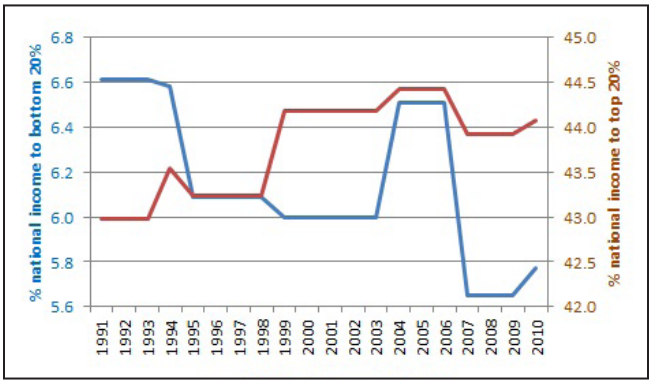

Fig 23: % of UK national income going to top & bottom 20% [10]

JUDITH'S STORY

Here is a personal story that illustrates some of the good and bad affects of the way social housing is provided in the UK.

Judith (not her real name) was a single parent in south London whose youngest was in a reception class, meaning she could leave her part-time job stacking supermarket shelves and take an office job offering training and advancement. The extra income meant she lost housing benefit, and fell into arrears. They were evicted from their privately rented flat and housed by Lambeth first in a hostel for homeless families and then in bed and breakfast.

She was already on the council waiting list, but being homeless raised her priority. After a year she was offered a flat by a London housing association, but the letter did not reach her in time: it was not posted until after the offer date which she was able to prove by the date stamp on the envelope. She had also been moved to different temporary accommodation due to a change in the housing legislation. It still took some months and several visits to the Citizens Advice Bureau to restore her place in the housing queue.

It was disruptive living in a series of temporary homes, making new arrangements for getting her kids to school on time and herself to work, but she held on because it was the only hope she had of access to affordable housing.

Some time later she was offered a flat on an estate notorious for drugs. With a black teenage son she dare not risk exposing him, but refusal would put her to the back of the queue. The Citizens Advice Bureau advised her to accept the offer and then make the argument that it was unsuitable. Fortunately she succeeded. The family was then housed on an estate south of Brixton.

Judith did well in her job, training as a bookkeeper and taking a degree in accountancy whilst still in full time employment with two children at school. The extra income meant she was able to exercise her right to buy. A few years later she bought a little house, her daughter was at university and her son heading in the same direction.

In the end the story was a happy one. But is this really the best way to provide housing for those in need? Would it not have been more cost-effective to provide the means for Judith to pay her rent in the first place instead of going through the degradation of accommodation for the homeless? Could we not do it in such a way that as her circumstances improved, she could gain a foothold on the housing ladder without reducing the stock of social housing in the process?

This may explain why, according to the OECD, the UK was second only to Ireland in the generosity of its maximum housing benefit in relation to average wages (19% using 2005 data), and had the highest proportion of households in receipt of housing benefits in 2009 (18%). [5,12] By 2014 63% of social housing tenants and 26% of those renting privately were on housing benefit. [13]

Reforming the social sector

Since the eighties there has been an ever widening gulf between the terms of social housing and private sector tenancies. A large part of the problem lies in the private sector where tenancies are in urgent need of reform to meet the needs of an increasing number of households for whom home-ownership is at best a distant dream.

The role of the social housing sector needs a fundamental rethink so that it better matches what it can achieve with the resources that are likely to be available to it.

In Berlin 90% of households rent. An average private sector flat costs around £275 to £320 a month (€350 to €400), while in Bristol they are £500 to £800 (€700 to €1,000). [11] Berlin is exceptional, due in part to its divided history. Even so, private sector rents in Germany are not much more than average social housing rents in the UK. How have they achieved that?

Could it be the way they finance their social housing? All social housing is privatised and is financed through subsidies to both the private and voluntary sector designed to bridge the gap between affordable rents and the costs of procurement. The resulting housing is let at controlled rents to low-income households that are registered through their municipalities as qualifying. After a protected period (usually of 20 years) the rents gradually rise to market levels.

The funding of social housing in Germany has laid the foundations for a very healthy private rental sector (see page 56). Similarly in France, social housing is largely provided by the private sector in exchange for subsidies and tax incentives.

Should housing associations in the UK be encouraged down a similar pathway, providing a mix of subsidised and unsubsidised housing, with the same subsidies made available to private landlords? There have been a few initiatives in this direction although housing associations have found it almost impossible to provide properties at market rents without cashing in the profits from rising house prices or finding some other source of subsidy.

So far the private sector has shown little interest in the provision of social housing in the UK, although this has been successful in France and Germany, and has recently been implemented in Spain and Ireland.

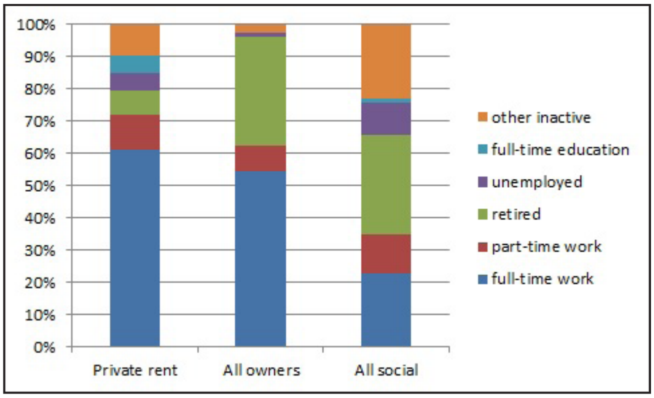

Fig 24: Occupation by tenure in England 2012/3 [8]

There are different attitudes to renting between the UK and Germany. The English and Welsh, like the Belgians and Irish, live in houses rather than flats. Scottish cities have historically followed a more European pattern typically of four storey apartment blocks, which in turn lend themselves to renting. In this way their housing is more like that of the Germans, French, and Dutch, with higher housing densities in their cities.

The gap in rents between the private sector and social housing in some parts of the UK has a hugely distorting impact on welfare provision.

Lower rents reduce the poverty trap, which ought to make it easier for social housing tenants to improve their circumstances through employment. In practice it does not seem to work like that (Fig 24): social housing tenants are twice as likely to be unemployed (10.3%) as those in the private rental sector (5.6%), with an even higher proportion otherwise inactive (23% compared with 9.8%). [8]

Instead it reduces mobility, since tenants cannot take the huge benefit of low-rent housing with them when they go. An econometric study of housing markets published by the OECD in 2011 bears this out: '*... empirical evidence finds that tenants in social housing are less mobile than private tenants - on average 6% less likely to move - possibly reflecting the reluctance to give up their below-market rents and their generally more secure tenancies.... This is particularly the case in Australia, the United Kingdom and France, which may possibly reflect that in these countries social housing is highly targeted*'. [14]

The government has established 'affordable rents' at 80% of market rents on new social housing tenancies,

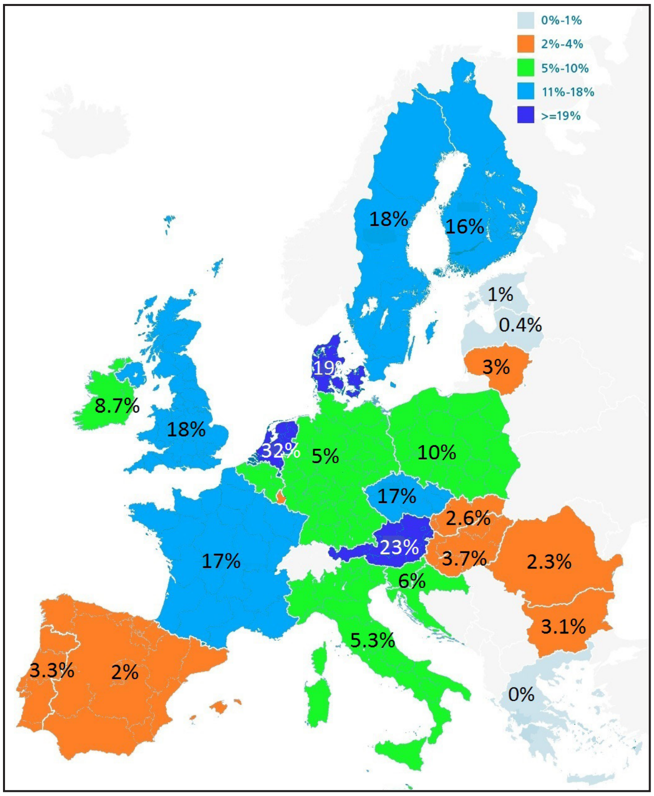

Fig 25 : Map of social housing across Europe [12]

which looks like a step in a more European direction. It will take many years for its impact to be fully felt, by which time another government might well have put the policy into reverse.

The underlying cause of high rents lies in the housing market where property prices are inflamed by the potential for speculative gains, and the shortage of new housing in response to rising demand. This is not helped by migration from the north and from depressed parts of Europe to the expanding job markets in the south of the country. It is made worse by new housing in London being bought by overseas investors taking advantage of the strong prospects for the pound and relatively low tax regime on property in the UK that applies to them, although according to Savills the numbers are often exaggerated.

Right across Europe bricks and mortar subsidies for the construction of new social housing have diminished. The only countries still building social housing on any scale are France, where it is funded by a levy on employers, and Denmark where it is done through recycling surpluses from the existing stock of social housing.

What are the prospects for increased investment in social housing making a significant impact on the widening gulf between supply and demand for housing in the UK?

Rapid economic growth across Europe in the years following the two world wars meant governments could afford to invest large amounts of capital into housing, which was needed to deal with the destruction and a backlog of shortages. Construction gave a Keynsian stimulus to economic activity, creating a virtuous circle. High growth rates meant it could be done without building up unsustainable levels of public debt.

Thomas Piketty draws on data from a wide range of countries gathered by many economists going back to the industrial revolution to show how exceptional the rates of growth during this period were (Fig 26). [42] Without similarly high levels of growth there is little prospect of a return to anything like those previous levels of public investment in social housing.

If it is true that the shortfall in new housing construction is unlikely to be filled by increased public spending on social housing, then the gap in provision for those in need of affordable housing will have to be met through expansion of the private rental sector, and making home-ownership viable for households further down the income scale. The best ways of achieving that would be to tackle escalation in the price of housing and broaden provision by narrowing the differences between social housing and the private rental sector.

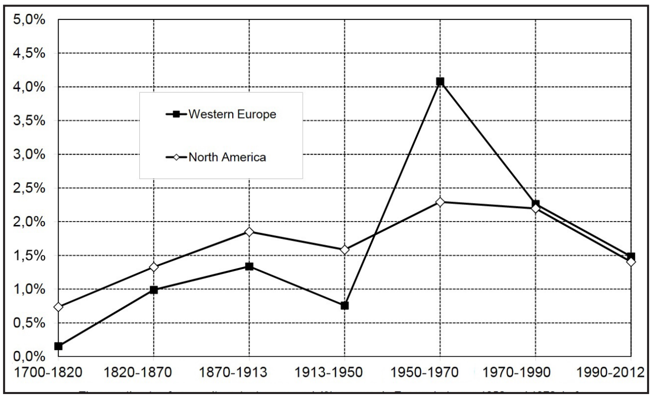

Fig 26: Per capita growth rates since the industrial revolution exceeded 4% pa in Europe between 1950 and 1970 before returning to US levels (Piketty) [15]

The gap between the social housing sector and private rental is unhealthy. Policies promoting tenure flexibility would improve labour mobility and promote mixed communities, reducing the barriers to escaping poverty.

What would it look like to import something like the German 'social market' housing model into Britain, removing all distinction between existing social housing providers and private landlords?

- Regulation by the Homes and Communities Agency in England would be replaced with something like an on-line register of landlords with information useful to a tenant in judging the quality of their landlord, including scope for tenant feedback. Some residual monitoring would be required to check that landlords met any obligations arising from subsidies they had received.
- Associations would have a major role in expanding the construction of a wide range of rented housing and find new ways to make home-ownership sustainable for those nearer the low end of household incomes. They would do this in competition with the rest of the private sector, with a variety of subsidy regimes made available to all sorts of landlord providing suitable medium or long term tenancies: in France many of these subsidies are provided through the tax regime.
- Properties developed under previous subsidy regimes would remain as social housing with all new tenancies at affordable rents, although under the German model this would be for a limited period of at least twenty years.
- Existing tenants would retain the protection provided by their tenancy agreements.
- Some housing associations might be limited in what they can do by their charitable status, and reluctant to give this up unless they could retain the most important tax exemptions. Those that did would remain constituted as nonprofit voluntary bodies, preventing asset values built up through public investment being siphoned off. But what about council housing? In Germany the municipalities were forced to transfer it to housing companies.
- Rents charged to tenants under existing tenancy agreements should be allowed to rise in line with the increase in local market rents, instead of being limited to CPI + 1%. In areas of economic decline the rent rises could be less than under the current rules. In high demand areas this would prevent the gap between existing social housing rents and market rents getting any wider.
- Perhaps the biggest challenge would be in coming up with an appropriate way of allocating social housing. Councils have obligations to house homeless families and other priority cases which would be hard to meet without retaining nomination rights. Under the German system households register through their local authority to determine who qualifies for housing subsidised to meet the needs of low-income or intermediate level households. The choice of who to house is then left entirely to the landlords who between them manage the full range of housing provision. Supported housing (for those with special needs) is handled separately through their welfare system.
- Lenders currently rely on the powers of the regulator to step in to prevent the failure of a housing association that is in financial difficulties. Other countries have found a variety of ways to achieve the same objective, most commonly involving some pooling of responsibility through loan guarantee funds.

Given the wide range of housing problems found in different parts of the country it would be helpful to loosen regulation from the centre and allow scope for organisations to find innovative solutions uniquely suited to local circumstances, as argued by the Housing Futures Network in 'Freedom to succeed'. [16] It would free the voluntary sector from the imposition of whatever the regulator sees as 'best practice' and the stifling of local initiatives where these are not directly related to national policy.

For example one London association wanted to pursue an 'independence agenda' aimed at finding routes out of social housing to suit those households able to take advantage of them. Most of the potential routes were blocked by centrally determined policy decisions.

The extent of right-to-buy is unique to the UK and Ireland, although limited rights also exists in Belgium and Denmark. It applies to council tenants. Those in housing association homes built since 1997 have a ‘right-to-acquire’ which is similar but with much smaller discounts (up to £16,000 instead of £102,700 in London and £77,000 elsewhere on RTB in 2014).

The right is sometimes abused, with tenants who could not otherwise afford it being helped to buy by others who then share in the profit when the property is subsequently sold.

It makes little sense to continue granting this right to new social housing tenants without providing rights to an equivalent benefit for those renting in the private sector. The right-to-buy always was politically motivated, and understandably popular with council tenants. It should be replaced with other options that make it easier for social housing tenants to move on, and that are also available to tenants in the private sector. There are a wide variety of answers to be found in Europe.

Most countries make provision for ‘intermediate’ households, with steady incomes that are insufficient to afford home-ownership on the open market. In Spain the government pays part of the initial purchase cost and then restricts the owners from selling on the open market for a protected period, during which they can only sell within an ‘intermediate’ housing market made up of households that meet the same low-income criteria.

The French have tried a number of initiatives to help ‘intermediate’ households into home-ownership, including subsidising the interest on loans, and leasing the house or flat whilst retaining public ownership of the site which the leaseholders then have to buy within 25 years at full market value. Like the Spanish system these schemes avoid the need to collect rent, keeping administrative costs to a minimum.

It is not uncommon in Europe for housing benefits to be paid to low-income home-owners as well as those renting (eg Belgium, France, Germany, and Hungary), but not in the UK.

‘Income Support for Mortgage Interest’ (ISMI) is available in the UK for up to two years to those that qualify (eg on job seeker’s allowance or income support). Mortgage Payment Protection Insurance was caught up in the misselling scandal surrounding PPI (Payment Protection Insurance on unsecured borrowing) and has almost disappeared. This led to suspension of the nine month delay before a borrower was eligible for ISMI.

Denmark, Holland and to a lesser extent France provide social housing for a much broader range of households than the UK. Having sold off so much of the social housing stock under the right-to-buy the level of new investment that would be required for the UK to follow similar policies is almost unimaginable.

Countries where it is allocated only to those in the greatest need inevitably find their social housing estates carry more than their share of social problems. This is made worse where whole neighbourhoods are dominated by large estates, as happens in some French suburbs and also in parts of Germany.

The French now require every local authority to make provision for its fair share of low-income housing, as part of a deliberate policy to avoid undue concentrations of deprivation in particular neighbourhoods. In Belgium any new development with 50 or more flats or 10 houses has to include 20% of social housing. The Danes pay particular attention to the need for a more balanced social mix in making allocations to estates that are in danger of becoming marginalised. In the UK planning gain agreements (S.106) are used to varying degrees in different parts of the country to ensure new developments incorporate a proportion of social housing.

It may be cheaper to provide more social housing in poorer parts of a town or city, but dealing with the consequent social problems can be much costlier.

Lessons could also be learned from other countries on ways of involving tenants more closely in the management of their estates. Danish levels of tenant cooperation

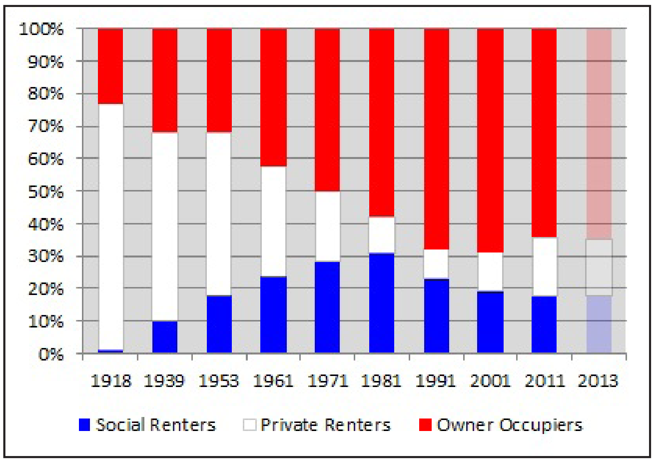

Fig 27: Changing tenures in the UK

were tried on council housing estates in Glasgow in the eighties with some notable success. The council followed a policy of requiring some commitment in return from the tenants before making a large investment in upgrading an estate, so that they tackled social and community issues at the same time as improvements to the buildings. [17] There have been similar initiatives in the north east and north west of England.

Cooperative ownership has been successful elsewhere in the UK although they have found it hard to share the financial risks involved in borrowing to finance investment so as to grow from strength to strength. In countries where cooperatives are more successful they have found ways to pool the equity so that new cooperatives can draw on the strength of existing ones (eg Sweden and Canada). [18]

The most promising recent initiatives of this type have been Community Land Trusts where public land is provided free but its value is retained by the community and cannot be cashed in by the cooperative or its members. Experience from Bristol is that it takes a great deal of patience and skill in dealing with bureaucracy to get a Community Land Trust off the ground. [19]

Private rental sector

Rent controls and security of tenure were introduced in the UK during and after the two world wars to prevent landlords exploiting the shortage of housing. These remained in place long after the crisis had passed and

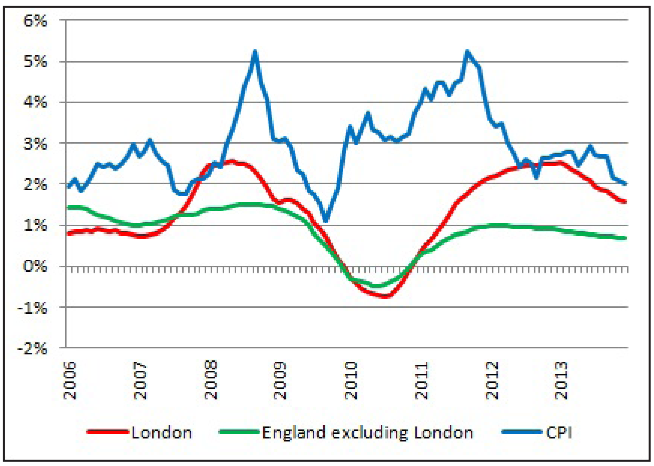

Fig 28: Rent inflation in recent years (ONS) [23]

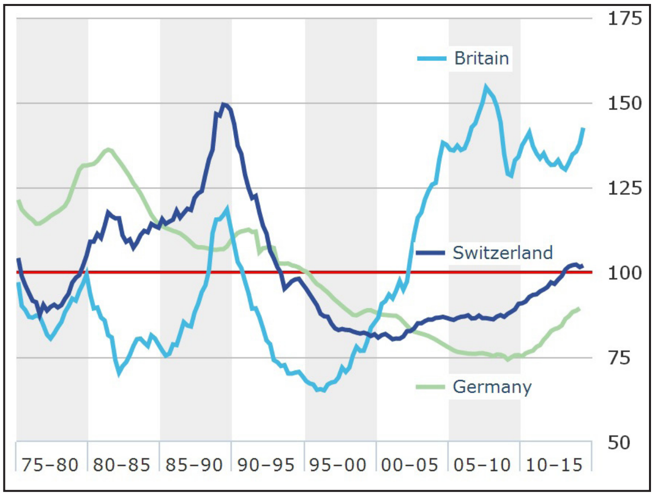

Fig 29: House prices as a multiple of rents with 100 as the long term average (Economist) [25]

they could have tapered off, making it uneconomic to invest in rented housing. The condition of the rental stock deteriorated, in contrast with newly built council housing. It is easy to blame slum landlords for the resulting misery, but private landlords could not afford to spend money on their properties, which might halve in value as soon as a tenant moved in.

Whole areas were designated for slum clearance with minimal compensation to the owners. In Moss Side and Hulme in Manchester the council paid £50 a house. Rents on similar houses were around £5 a week at that time. Many sold at a higher price to rogue landlords who let them to immigrant families in over-crowded multiple occupation, blighting large areas ahead of redevelopment. It was not until the seventies that area rehabilitation began to be seen as a viable alternative.

By the sixties the cheaper end of the rental market was no longer viable for respectable property companies, and became the province of slum landlords. Large houses in what in the early years of the century had been well-off neighbourhoods such as Notting Hill in London were crudely divided into flats and bedsits to maximise rental income.

The press demonised 'greedy landlords', and there were plenty of colourful examples they could draw upon, such as Peter Rachman. New tenants did not have the same statutory protection as existing ones, who were deliberately driven out and replaced with immigrants who had

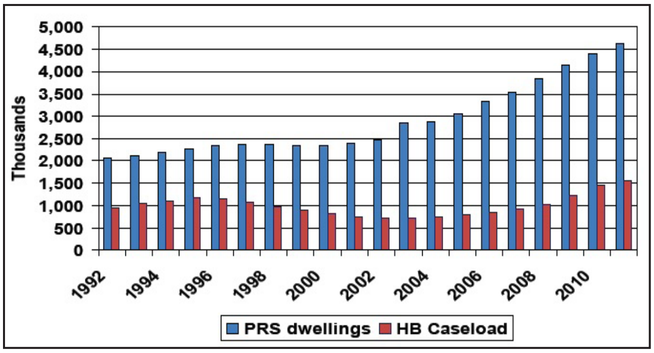

Fig 30: Growth in private rental and housing benefit [22]

no choice but to accept the higher rents, in a process that became known as Rachmanism. [20]

A parliamentary committee set up to investigate the housing shortage in the early seventies concluded that most tenants were happy with their landlords, but abuse by a minority was on the increase.

The Labour government introduced 'Fair Rents' in the mid seventies and made all tenancies secure. The intention was to prevent landlords exploiting the shortage of housing by regulating rents at the notional market rent that would apply without scarcity. There never was a rational method of valuation for determining that, as shown by the huge variation in Fair Rents between neighbouring boroughs, sometimes in the same streets.

As a result the private rental sector was squeezed out, and fell from 55% at the end of the war to 9% by the time of the 1988 Housing Act, which removed rent control on all new tenancies and allowed private landlords to let on shorthold tenancies. [21]

Since buy-to-let mortgage funding became available in the late 1990s the private rental sector has been the one part of the housing market that appears to be functioning well: supply has risen substantially in response to demand. Contrary to popular belief, rents have risen by less than inflation in recent years, whilst house prices have shot up (Fig 28). This has been true since the mid-nineties (Fig 29).

In consequence the private rental sector has expanded to 18% of the stock and is now larger than the social housing sector (Fig 3 on page 6). This shift would not have happened without cross-party commitment to a healthy private rental sector, removing the threat of a future government imposing rent controls or more stringent tenancy terms. [22] It also relies on housing benefit although most of the more recent growth has been at the upper end of the rental market where claims are less common (Fig 30).

Investment in private renting is now almost all by amateur landlords, most of whom only let out one property. In countries with thriving private rental companies the finance most commonly comes from pension funds and insurance companies, as it once did in Britain. Institutional investors in the UK have shown very little interest. They view private rental as '*cash-intensive, cyclical and relatively high risk…with costly regulation, low rental yields, reputational risk, high management costs, and lack of scale*'. [24] They would be attracted by higher yields from rent and not so much by capital growth which can only be accessed through sale of assets. Net rental yields after tax are poor compared with commercial property or other equity investments.

Buy-to-let landlords are attracted by the hope of capital gains in the longer term, and keep down management and maintenance costs by doing much of the work themselves in their own time. Consequently their operating costs at 30% to 35% of rental income compare favourably with those of social landlords, despite their charitable status and potential economies of scale. This is examined in more detail in 'Investing in buy-to-let'. [26]

Reform of private renting

The UK has one of the worst private rental sectors in the whole of western Europe in terms of quality. Private tenancies are invariably temporary without the security needed to make a satisfactory family home.

Most are on six or twelve month tenancies which then revert to monthly periodic tenancies. Who would want to redecorate or fit carpets or look after a garden when they could be evicted at one month's notice? On average tenants stay for a little under four years (3.8). One third of private renters have been in their home for less than a year compared with 4% of home-owners and 10% of those in social housing. Home-owners stay more than seventeen years on average. [8]

When shorthold tenancies were introduced in the eighties the banks told the government they could not lend unless tenancies were limited to under a year. Some still stipulate this in conditions attached to their mortgage loans.

The JRF's Housing Market Taskforce produced a report on 'Tackling housing market volatility in the UK' in 2011. This reflected a well established view of the limited role of private renting:

'*Private renting provides a flexible alternative to ownership for many younger and more mobile households, but it is unlikely to provide a suitable alternative for households requiring longer-term secure and affordable housing – particularly families with children. This highlights the importance of maintaining an affordable social rented sector as a part of the UK's mainstream housing system*'. [9]

They also suggest that '*insecurity is an intrinsic part of the small-landlord model*'. Experience from Europe contradicts these conclusions.

Germany, Denmark and The Netherlands all provide full security with no time limit. In Belgium it is nine years. In France it is three but with automatic renewal that makes it effectively unlimited. This has not stopped banks from lending to their private landlords. In most cases the bank's security does not take priority over the tenant, so banks cannot even gain vacant possession following a default.

In most of Europe there are no restrictions on the rent charged on a new tenancy, except where properties have been developed with subsidies in exchange for reduced rents. Rent increases are limited to the rise in an index related to inflation (eg Belgium, France, and The Netherlands). In Germany they are limited to the average rise in local rents. In others tenants can appeal if their rent is above a market rent. This prevents a landlord getting rid of a tenant by unreasonably raising the rent, and should not be confused with rent controls aimed at holding down market rents, which all these countries recognise should be allowed to find their own level.

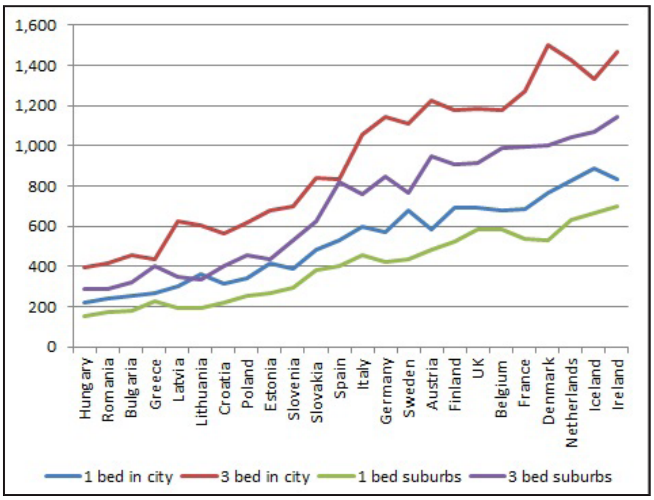

Fig 31: Average rents (Euros) across the EU [27]

Market rents across the whole of the UK are about average for the richer countries of Europe (Fig 31). Rents in London are significantly higher than most other capital cities.

There are a few rogue landlords, mostly at the bottom end of the market, and some tenants can be troublesome. But most private landlords in Britain provide a good service, and tenants for the most part act responsibly. According to the 2008 Rugg Report on the private rented sector '*three-quarters of tenants are either fairly or very satisfied with their landlords*'. They also found that '*tenant satisfaction levels are not necessarily higher amongst tenants of larger landlords. Managing agents are unregulated, and there is widespread dissatisfaction with their standards*'. [28]

In the UK a landlord can evict after the fixed period of a shorthold tenancy without giving a reason. Shelter report that more than 200,000 people had faced 'revenge eviction' in the year to March 2014 because they asked their landlord to fix a problem in their home. It is hard to see any prospects for developing a healthy private rental sector as a longer term option without re-balancing the respective rights of landlords and tenants.

The number of families with children renting in the private sector is steadily increasing. A new form of tenancy is needed in the UK to support the development of longer term rentals in the private sector.

The Irish introduced a four-year tenancy cycle in 2004 that might fit more readily into UK practice than examples from France or Germany. It can be terminated at one month's notice during the first six months, but thereafter lasts four years, and can be repeatedly renewed at four yearly intervals. [29]

Tenants need protection from unreasonable rent increases which should be limited by reference to an index specified in the agreement, defaulting to the CPI. The 'Private housing rental prices index' published by the ONS provides data on regional changes in market rents, which might be ideal. [23] There should be no restrictions on the level of rent charged on a new tenancy or on renewal of an existing one, so that rents are allowed to reach their own market level.

These medium term tenancies could take on some of the other good practices found in Europe, such as allowing tenants to take responsibility for repairs and maintenance, whilst leaving the landlord responsible for major repairs, energy efficiency, and gas safety. This could be optional as it is in Denmark and Germany. It is the norm in France, Spain and Belgium. It helps a family turn a house into their home.

There is still a need for short-term tenancies for students and highly mobile young professionals, and those that only recently moved away from the parental home. Or a householder might want to let out their property for a limited period while they are working away from home. Until the eighties a distinction was made between furnished tenancies (short term) and more secure unfurnished tenancies. France still makes this distinction. Germany too has limited-lease tenancies that serve a similar function, alongside more secure tenancies. So does Belgium.

The Labour party has proposed extending shorthold tenancies to a standard three years, with exceptions where this would break the terms of an existing mortgage agreement. The Nationwide has already begun funding loans to landlords offering three year shorthold tenancies.

Given a choice landlords prefer to rollover shorter term tenancies rather than offer longer ones. So is it necessary or desirable to compel them to do so? To be successful an opt-in approach would need to balance benefits to tenants with advantages to the landlord. The tenant would gain greater security and more control over the condition of their home. But the landlord faces additional risks from a tenant that allows their home to deteriorate beyond normal wear and tear, or is disruptive to neighbours.

One way of giving these new tenancies a clear identity and a different legal status would be to register them. To qualify the tenancy would have to meet the new conditions, which could also include meeting the 'Decent Homes Standard'. We might call them 'registered tenancies'. Similar registers are being developed in Spain and Ireland.

Landlords are more heavily taxed in the UK than elsewhere in Europe. To balance the additional risks in offering longer term tenancies these could be taxed more favourably, raising the returns from rent and reducing their dependence on capital gains to make an investment pay. Measures to consider include:

- rollover relief on Capital Gains Tax where a landlord sells one property to buy another,
- allowing improvement works to be offset against income tax, to encourage investment in upgrading their properties,
- allowing losses from renting by individual landlords to be offset against other income for tax purposes. This already applies to corporate landlords. It helps reduce the cash flow problems in the early years of a rental investment.

If additional incentives were needed, it would be better to provide them through depreciation allowances than by reducing the tax on capital gains which might encourage investment for speculative gain.

Depreciation allowances could be offered in exchange for providing medium term tenancies let to those on the council housing waiting list at rent levels eligible for housing benefit. Similar approaches have been successful in France. Local authorities should be given scope to adapt schemes to suit local circumstances and housing priorities.

Policies should aim to raise standards on both sides of the relationship between landlords and tenants without undermining the returns from private renting, which are already low in relation to comparable investments. The modern way of doing this is through open access to feedback recording tenant and landlord references, similar to those found on Trip Advisor, Ebay, or a growing number of trades registers. Given the potential threat of damage vindictive entries might cause, they might require some moderation, and perhaps to be time-limited as they are in Spain.

Landlords that stuck with short-term lets might find themselves housing the least attractive tenants. Fizzy Living is already marketing higher quality rentals. [31] Get Living London [32] offer three year tenancies in Stratford. Both illustrate the scope for introducing better quality tenancies, beginning at the upper end of the market, and progressing more widely from there.

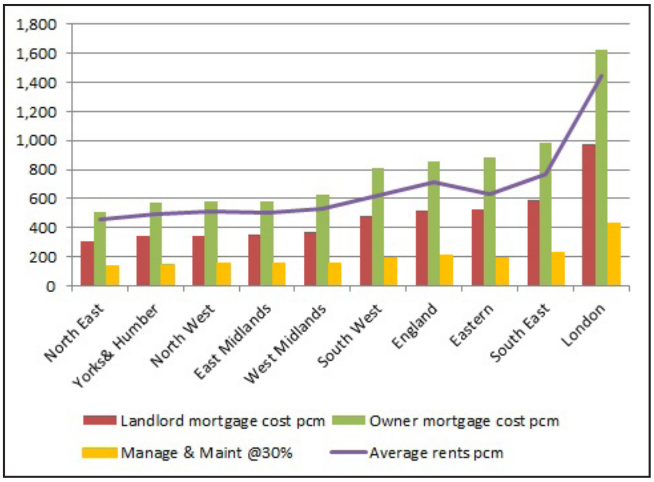

Fig 32: Landlord and owner mortgage costs cf rents based on 2012 average regional house prices & rents on a 2 bed flat, with mortgages at 3.7%, interest-only for landlords and 25 year repayment for owners [22]

Further incentives should be considered before making longer term tenancies compulsory, although that would always remain as a last resort.

None of these policies would directly reduce the levels of rent, which requires measures to hold down house prices by improving the supply and making housing less of a speculative commodity. Taxation should be more tenure neutral, removing some of the advantages home-owners have over renters. Better quality private rental has an important role to play in reducing the rush to climb onto the housing ladder that contributes to pushing up prices.

Impact on house prices

What impact has the rapid growth in the private rented sector over the last twenty years had on house prices?

Landlords usually borrow on interest-only terms. On a £180,000 mortgage loan at 4% interest an owner-occupier with a 25 years repayment mortgage would pay £861 a month. A landlord would pay £600 a month interest-only. But with operational costs (management, maintenance etc) typically around 30% plus losses on voids they would need to charge a rent of £862 a month to cover it (Fig 32).

A first time buyer would generally expect to pay more in mortgage payments than it would cost to rent the same property. So the only way a landlord could outbid a first-time buyer for the same property is by making a loss in the early years in the hope of profits as the rent rises in future. Few make money on the rent: most of their profit comes from the capital gain, on which they are taxed at 28% while an owner making the same gain is not.

Owners look for an attractive home whereas landlords are more concerned with rental returns. The best rental yields tend to be on the least desirable properties (ie with relatively low values) in the most popular areas with good access to job markets. Landlords sometimes buy new properties 'off-plan' sharing development risk in exchange for lower prices. They are more likely to buy at auction to get a competitive price, and less likely to get enthusiastic over any particular property. The vast majority of buy-to-lets are one and two bed flats rather than family sized houses.

Mortgage loans are available to first-time buyers at up to 90% loan to value (LTV), rising to 95% under Help to Buy. It can take a long time to save enough for a deposit and increasingly first-time buyers are relying on help from their parents. Lowering the maximum LTV seems to choke off demand more than raising interest rates or tightening affordability criteria.

Buy-to-let mortgages generally require a larger deposit of at least 25% of the value. As with owner-occupiers, better terms are available for those with larger deposits. Investment requires more substantial savings: most landlords are over 60 years old.

When a landlord buys a property it will still house a family, so it is not the same as removing the property from housing stock. This reduces its impact on prices.

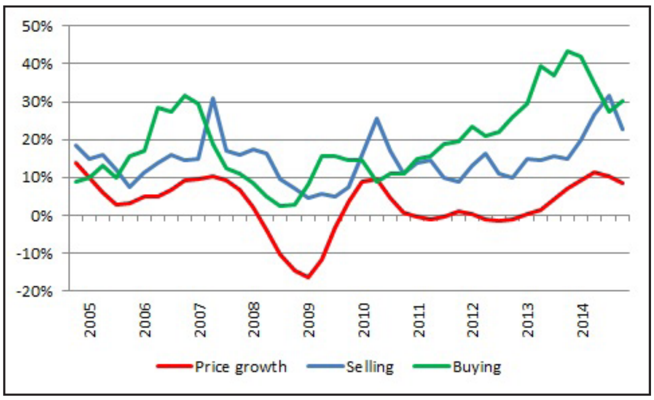

Fig 33: Agents saying landlords are buying or selling [34]

Landlords buy and sell properties, just as owner-occupiers do, although less frequently: on average they keep their properties for about 20 years.

The Association of Residential Letting Agents publishes quarterly statistics on the private rental market. [34] They ask their members (local estate agents) whether more landlords are buying than selling, or vice-versa, or whether they are much the same.

Figure 33 indicates that selling by landlords peaks just before prices begin to slacken off which could act as a brake on rising prices, and be a contributing factor to the general change in market sentiment. They seem to anticipate growth by buying early in a rising cycle, and stop purchasing when prices rise steeply. They are looking for a bargain, not a home to live in, and are less likely to keep buying once the market looks like overheating.

The private rental sector grew by 1,310,000 properties between 2007 and 2012, while the number owner-occupied fell by 420,000. Only one-third of the additional rented properties were bought with a buy-to-let mortgage. [30] Two thirds must have either inherited a property, let out their previous home after a move, or be raising the finance in another way.

In 2013 12% of mortgage lending was on buy-to-let, down from 15% in 2007 at the peak of the market. By the last quarter of 2014 it had risen to 19.6%. [35] These mortgages are subject to less stringent regulation by the FCA than those to home-owners. [37]

The National Housing and Planning Advice Unit (NHPAU) was asked by the Department for Communities and Local Government to assess the impact of buy-to-let lending on house prices, and reported in 2008. [38] They concluded that: '*The results suggest that the gross amount of BTL lending may have increased the average UK house price by up to 7 per cent by 2007 Q2. This estimate represents the upper bound*'. Most of the change came in the last five years covered by their analysis (Fig 35). [38]

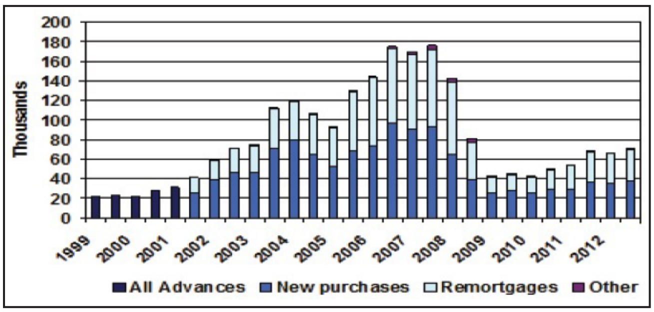

Fig 34: Number of buy-to-let mortgages [22]

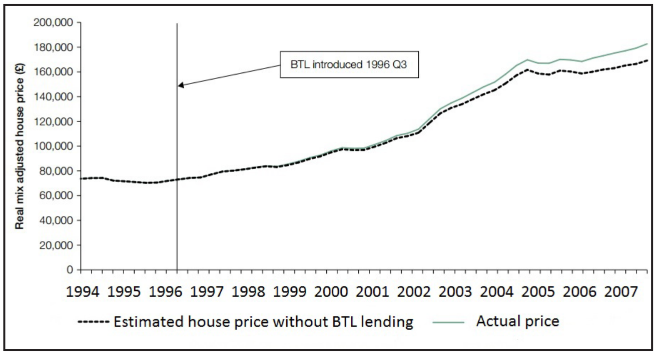

Fig 35: Impact of buy-to-let on UK house prices [38]

The NHPAU study took no account of the additional rented units that were acquired without a BTL mortgage, which might have added to the pressure on prices. And things may have altered a little since 2008, with tighter restrictions on borrowing by home-owners in

NHPAU REPORT ON BUY-TO-LET LENDING (2011) [38]

They used regression testing to examine the impact of various factors on changes in house prices in the UK between 1994 and 2007. This was different from the OECD study described at the end of the last chapter because it was carried out entirely on the UK housing market, studying changes over time. But the findings are remarkably similar. They concluded that:

- a 1% rise in the mortgage interest rate causes a 2% fall in house prices
- a 1% rise in disposable household income causes a 0.58% rise in house prices
- a 1% rise in the real user cost of capital depresses house prices by 0.44%. This is a rather complex calculation based on comparing the cost of housing with the anticipated capital gain.
- a 1% increase in gross mortgage lending inflates house prices by 0.36%
- a 1% increase in the number of households as percentage of dwellings decreases house prices by 0.28%
- a 1% rise in mortgage repossessions depresses house prices by 0.13%.

They then used their model to project changes in house prices with and without buy-to-let lending and found it had a 7% impact over the full period 1994-2007.

response to the banking crisis but not on buy-to-let mortgages.

Most campaigners seem to think buy-to-let lending is having a much bigger impact. Without a methodical analysis there is nothing more than anecdotal evidence to support that view, which is countered by clear evidence that countries with stronger rental sectors have more stable house prices, and spend a lower proportion of their household income on housing (Fig 6 on page 10).

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Chapter 4

United Kingdom

KEY STATISTICS	EU	UK
Population (2009)	499.7 million	61.6 million
Population per sq km	116	252
Dwellings (2011)	236 million	26.8 million
Units per 1,000 pop	473	443
Supply elasiticity (best high)	55%	40%
Fixed interest mortgages %	mainly fixed	28%
Per capita € GDP (2011)	29,135	30,724
Gini coeff incomes (2010)	30.8	38.0
% owner occupied (2011)	66.6%	64.7%
% social rented (2011)	6.7%	17.7%
% private rented (2011)	19.1%	16.6%
Real prices 1975-2007	109%	115%
Real prices 2007-2013	-7%	-7%

Key Statistics [1]

Economy and culture

The Gini coefficient is the most commonly used measure of income distribution. It ranges from 0 representing perfect equality in which everyone earns the same, to 100 representing absolute inequality where one person gets all the national income. It measures the gap between the rich and the poor in a country: the higher the number the wider the gap.

The UK has the highest Gini income coefficient in the European Union (Fig 36). Sweden has one of the lowest, as does Ireland. Denmark is also relatively low. Germany comes roughly in the middle. The countries of eastern Europe started with relatively low income differentials but these have risen dramatically since transition from communism (Fig 37). It began falling from a peak in the UK of 35.9 in 2007 and fell further from 33.7 to 32.3 between 2011 and 2012 as a result of low growth and austerity measures. [2]

Housing policy is often left to deal with problems that have their roots elsewhere. Inequality is a major cause of housing pressures, as a result of the growing gap in wealth between the north and south of the country and across pay scales.

Income distribution impacts on the demand for affordable housing. Where the gap between rich and poor is widest those on lowest incomes are least likely to be able to meet the cost of providing their housing without subsidy, irrespective of whether this cost is met via a landlord through rent or by the home's owner through mortgage payments and a deposit.

The United States has the highest income differentials.

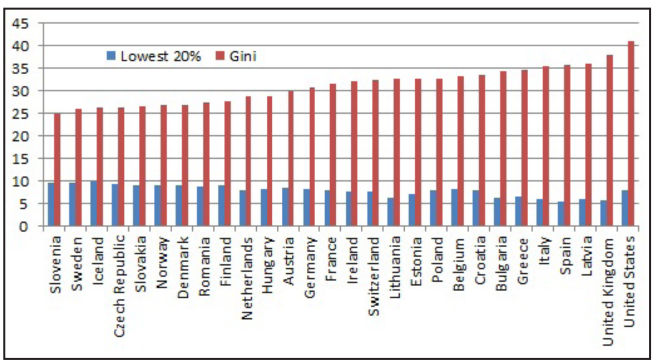

Fig 36: Gini Index ranking of counties, and share of national income going to those with the lowest 20% of income [3]

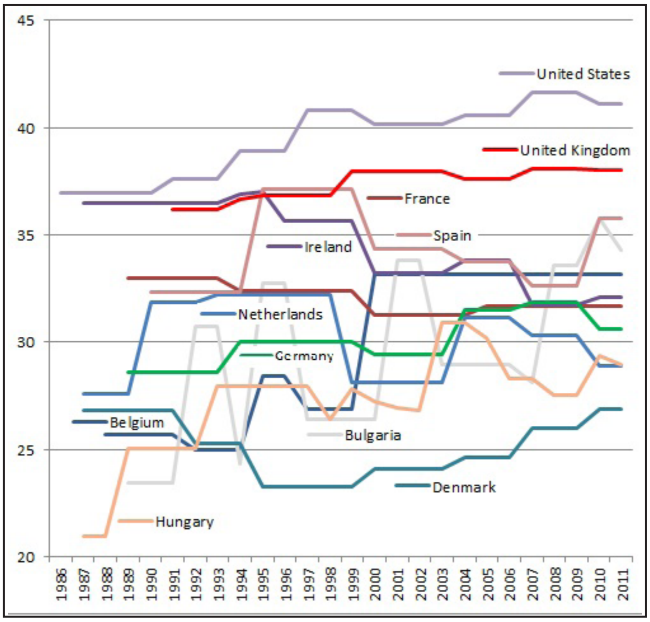

Fig 37: Gini :Income disparity since the eighties [3]

They also have the least restrictive planning rules so that their housing markets are much more responsive to increased demand for housing. The combination of tight planning restraints and high income differentials increases the need for subsidies to enable low-income households to compete for housing in the UK.

Some argue that the expansion of home-ownership extends wealth across a broader range of the households, and that private rental narrows it as landlords grow rich on their properties. International comparisons do not bear this out. There is no correlation between lower levels of private rental and reduced inequality: if anything it is the reverse. Germany, Austria and Switzerland have the largest private rental sectors and below average Gini coefficients.

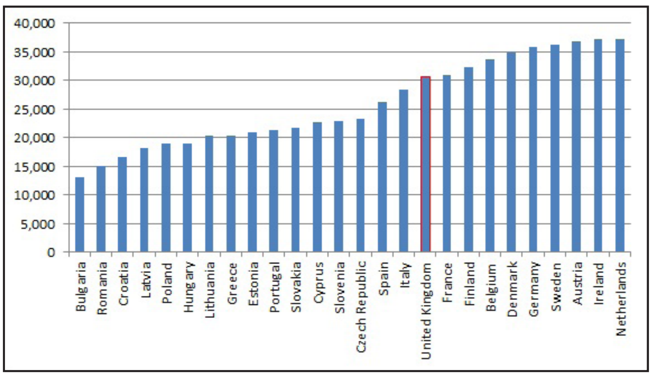

Fig 38: GDP per capita (€) in 2011 [3]

Income differentials in the poorest countries tend to narrow as their economies grow. Within the wealthier nations the differences have more to do with cultural attitudes. Scandinavians care more about equality than the United States which has one of the world's most enterprising economies. The Swedes and Danes always score highly on measures of well being. The countries of western Europe have the strongest welfare, health and education systems, but the US has some of the top hospitals and universities.

Inequality provides incentives to work harder and more efficiently, as the rewards are generally greater. This is thought by some to increase a nation's wealth and overall standard of living. It permits greater savings, because there are more wealthy income earners who save more than lower-income earners, providing capital for businesses to invest in technology and capital expansion.

On the other hand, low and middle-income households are more likely to spend whatever they earn, boosting consumption and the GDP and creating more wealth as a result. In an added twist, over the last forty years the wealthiest have become increasingly successful in sheltering their money from taxation. Almost 10% of UK wealth is held in overseas tax havens, despite depending for its creation on everything that taxation provides: education, health, justice, infrastructure, and housing subsidies that make low-wages sustainable. [4]

The UK has a more enterprising economy than its partners in Europe, and is in many ways more like the United States. That does not make it more successful. Gross Domestic Product (GDP) per person is lower in the UK than the other strong economies of Europe, including the Netherlands, Austria, Sweden, Denmark, Belgium, Finland, Germany and France (Figs 38). Public spending as % GDP is also lower in the UK than in any of these countries, except Germany (Fig 39). [5]

Concepts of solidarity and shared social responsibility are more widespread in Europe, sometimes thought to derive from the Napoleonic Code. [6] These generally give way to a more competitive, entrepreneurial, and individualistic culture in the UK and USA. This was epitomised by the fictional Gordon Gekko's "*greed is*

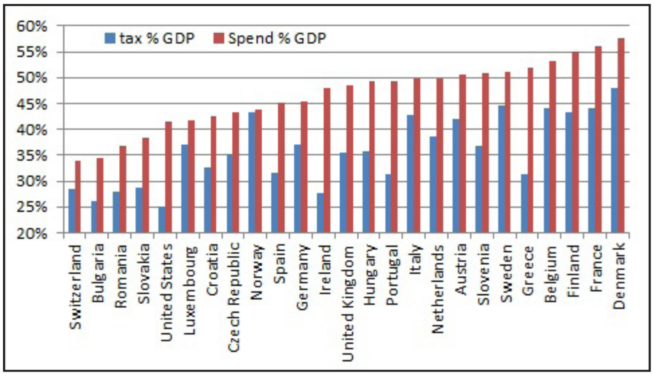

Fig 39: 2014 government spending and tax as % GDP [5]

good" in the film Wall Street, and by the only too real Margaret Thatcher saying that "*there is no such thing as society*".

In Britain we are more openly conscious of status, with a deeply embedded class system, where private health or education immediately imply privilege rather than an alternative to state control as it might in Scandinavia. This is clearly reflected in our housing, where the middle classes collect in certain neighbourhoods, and as new areas become fashionable house prices can double in a decade.

Segregation of housing in this way is common to all countries, but appears to be more pronounced in the UK than the other successful economies of Europe. It is generally associated with societies where the gap between rich and poor is widest. In the most extreme cases the middle classes live in gated communities to protect them from the poor.

This is tempered in the UK by a sense of fair play, and a general willingness to abide by the rules. The 1689 Bill of Rights was the basis for the European Convention on Human Rights. The UK justice system and institutions such as the BBC are trusted world wide. The Latin countries of southern Europe have a more flexible attitude to rules, while northern Europeans are more conventional. Even so the UK comes fourteenth in Transparency International's corruption index, behind Denmark, Sweden, the Netherlands and Germany. [7]

Politics in the UK is adversarial: we are uncomfortable with coalitions which require party leaders to compromise with others in forming a government, trading promises from their manifestos. In recent years the dominance of the two big parties has been reduced, and we have seen a rise in smaller parties. The UK may have to learn to live with multiparty government.

Housing policy in particular has very long time horizons. Changes take many years to implement. Countries where multiparty coalitions are the norm are much better at building consensus around long term policies, particularly where they divide on political rather than sectarian differences.

Devolution and Subsidiarity

The most critical housing policy decisions are taken by the Chancellor of the Exchequer, who determines the level and shape of taxes and subsidies. Effective devolution of policy has to include a significant measure of control over finance.

Some remaining housing policy is devolved to the individual countries that make up the UK. Patterns of tenure vary greatly between them.

Scottish cities have more apartments than the rest of the UK, with solidly built tenements often with a mix of tenures. Wales has the highest levels of home-ownership, followed by Northern Ireland while Scotland has the lowest, and also has the most social housing, followed by Northern Ireland.

Some issues have to be tackled through policy applied nationally. There are no regional solutions to the way housing has become a speculative commodity. This requires legislative changes to the ways it is taxed and subsidised, and to the planning systems, which can then be interpreted locally to suit particular circumstances.

Anyone seeking to make the most of a development opportunity looks at its unique characteristics. It helps if the range of options open to them is more locally controlled and open to arguments based on local issues.

A wide range of social and economic problems impact on housing, and combine in a variety of ways, including aging populations, ethnic diversity, the decline in manufacturing, or inadequate or expensive transport networks linking people to potential job markets. Poverty traps are more significant in high cost areas, while transport or child care might be more significant obstacles to entering the job market in poorer ones.

Very different mechanisms are required for promoting housing development in areas of strong economic growth and those where it is weaker, the success of which depends on local factors.

Mortgage guarantees under 'Help to Buy' may have helped the housing market to recover in the midlands and the north, but it fed an unaffordable boom in house prices in London which rose almost 20% in 2014. The bedroom tax might have some relevance in areas with an acute shortage of family housing, but just becomes another tax on the poor in areas suffering from economic decline. Both demonstrate the need for more local control of housing policies.

The UK has the most centralised system of government found anywhere in the European Union. Just 4.8% of taxes in the UK are controlled by locally elected authorities compared with 35% in Sweden. The UK ranks 20th out of 27 in Europe in the percentage of taxes spent by local authorities in 2012 (Fig 40). [9] They have lost almost all their financial independence since the eighties.

The UK has no written constitution conferring powers to local authorities, which has allowed the national government to take almost total control. Locally elected politicians are held responsible for the implementation of nationally determined policies that often contain just sufficient scope for discretion to enable the local authority to carry the blame for any consequential problems. At the same time many Westminster politicians protest loudly at powers conceded up to the European level. This fuels the general distrust of Westminster politicians, expressed as nationalism in Scotland and Wales, and by the rise of UKIP in England.

	2000	2004	2008	2012	EU Ranking 2012
Sweden	28.8	32.8	34.7	34.9	1
Denmark	33.5	34.4	24.7	26.9	2
France	9.7	10.5	11.5	12.6	9
Norway	15.1	13.7	11.9	12.5	10
Austria	11.7	10.9	11.4	12.1	10
Spain	9.1	8.7	9.2	9.9	14
Germany	6.9	7	8.1	7.9	16
Portugal	6.4	6.7	7.1	6.7	17
Hungary	9.8	12	6.4	6.3	18
Belgium	4.2	5	4.7	4.9	19
UK	**4**	**4.7**	**4.5**	**4.8**	**20**
Netherlands	3.4	4	3.3	3.8	22
Ireland	2	2.3	2.8	3.3	24
Bulgaria	10.2	1.6	2.9	3	25

Fig 40: Percentage of total tax controlled by local government [9]

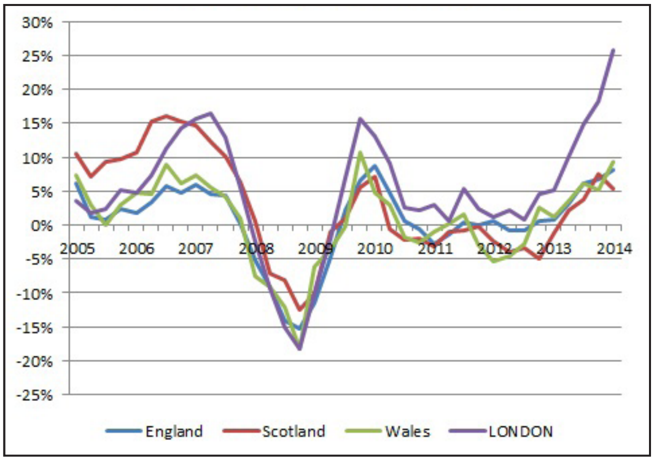

Fig 41: Average annual change in house prices [11]

Only London has a regional assembly and a mayor with significant powers. The government recently announced the introduction of a mayor for Greater Manchester with new powers over transport, infrastructure and training, and later for health and social services, and indicated that something similar could follow for Leeds and Sheffield. Elsewhere there have been another fifteen directly elected mayors. To make a difference these would require a substantial transfer of power and control over taxes from Westminster. The only real devolution of power so far has been to Scotland, and to a lesser extent to Wales and Northern Ireland. This could possibly change in response to the close result of the Scottish Referendum in 2014. [10]

A widening gap has opened up between the economy of London and the south-east and the rest of the UK. House prices have risen faster in London than the rest of the UK, and recovered more quickly following the 2008 crash (Fig 41). House prices in relation to incomes have risen substantially since the new millennium with the highest ratios in London and the south (Fig 42).

Most of the rest of Europe has chosen to devolve responsibility for housing and planning to regional and local government, together with a much larger measure of control over local taxes, their budgets and priorities for investment. To varying degrees they have accepted

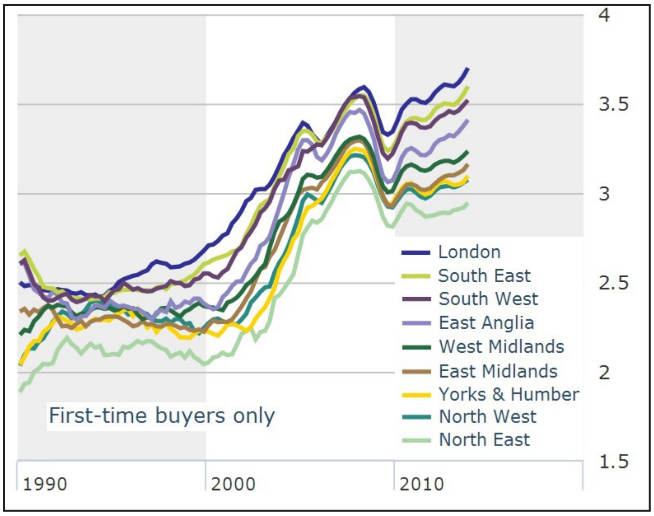

Fig 42: House prices as a multiple of earnings [12]

the principle of 'subsidiarity' adopted by the European Commission in 1997 under which matters are dealt with at the most local level possible. This is seen to make better use of local knowledge, making services more efficient. It also leads to greater participation and increased popular consent. [8]

The devolution debate as it affects England is only just beginning. One starting point might be to reinstitute the Regional Development Agencies abolished by the Coalition government in 2010. They could be given more political clout by making them accountable to committees made up of all the MPs in each region as an alternative to (and possibly a step before) a directly elected regional government.

This should be accompanied by the phased devolution of powers from Westminster along similar lines to those proposed for Scotland, Wales and Northern Ireland. Previous attempts at regional government lacked sufficient ambition to capture public support. The French successfully implemented a regional tier of government in the eighties and lessons could be learned from them. Many others have strengthened regional government. [13]

Greater powers should also be devolved to local authorities, raising the scope for councillors to have an impact in shaping the delivery of services at a local level, and more control over local taxation, for which they would be directly answerable to the local electorate.

Most of the functions of government would remain at the national (UK) level, as they do throughout Europe. By increasing regional and more local control of domestic policy the sense of alienation felt by those that did not vote for the party controlling the national government would be reduced.

Something has to be done to stop the ever widening gulf between the economy of the south and the rest of the country, which is an important cause of many of our housing problems.

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3. Graphs of Gini and GDP by the author using data from the **World Bank Database**
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Chapter 6

Denmark

KEY STATISTICS	EU	Denmark
Population (2009)	499.7 million	5.5 million
Population per sq km	116	128
Dwellings (2011)	236 million	2.7 million
Units per 1,000 pop	473	500
Supply elasiticity (best high)	55%	121%
Fixed interest mortgages %	mainly fixed	75%
Per capita € GDP (2011)	29,135	34,852
Gini coeff incomes (2010)	30.8	26.9
% owner occupied (2011)	66.6%	51.6%
% social rented (2011)	6.7%	18.9%
% private rented (incl co-ops)	19.1%	27.8%
Real prices 1975-2007	109%	118%
Real prices 2007-2013	-7%	-27%

This comes at a cost, with higher levels of public expenditure than any other country in the OECD (58.42% of GDP in 2009 compared with an average of 46.24%). [2]

They spend a higher proportion of their disposable income housing themselves (33%) than any other country in Europe (22.5% on average). [3]

Income differentials in Scandinavia are amongst the lowest in Europe (see Fig 36 on page 41). GDP per head in Denmark in 2011 was amongst the highest at €34,852 (Fig 38 on page 42).

Behaviour is more restrained than we are used to in the UK, with social pressures to conform to a Danish way of doing things. The UK makes more of a virtue of

Danish culture

The Danes are prepared to invest in society, and less protective of their individual interests than those living in the UK. 42% agreed with the statement that social housing should be targeted at those in need regardless of their payment into the system, compared with 31% in Britain. [1]

Social housing is organised on democratic principles, with tenants largely in control of how their estate is managed, giving them a sense that they jointly own it, and are responsible for it. In the private sector those renting apartments in a block have collective rights and more security. It is much harder to find run down neighbourhoods in Danish cities than in the UK.

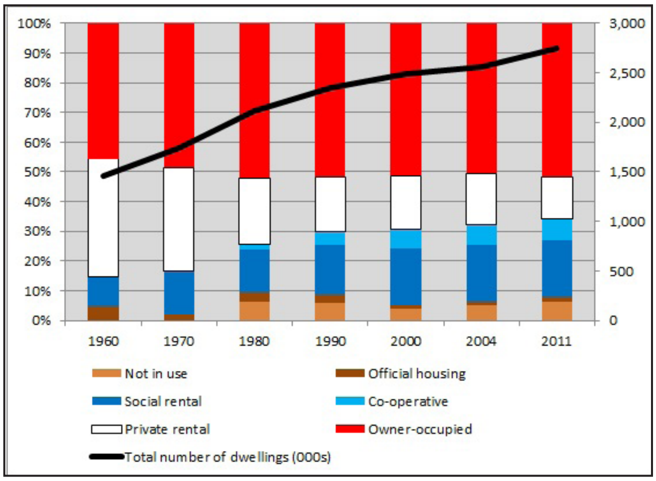

Fig 44: Danish housing by tenure [4]

cultural diversity. Crossing the street in Copenhagen without waiting for the signal might be challenged by a total stranger.

Even in Christiania, the largest squat in Europe, there are community meetings where decisions are collectively made.

Private rental sector

Private rental has more than halved since the sixties from around 40% to 21% of the housing stock while social housing has almost doubled from 10% to 19%. It is more common in the larger cities, representing 29% of the housing in Copenhagen, and tends to be in older properties (57% built before 1940). [12]

Cooperatives currently hold another 7.3% of the housing stock (Fig 44), most of which is in Copenhagen. [4] These are usually counted as part of the private rental sector in Denmark. Quite a few cooperatives ran into financial difficulties following the banking crisis in 2008 and their properties reverted back to private rented housing.

The Social Democratic Party in Denmark has long had a rather negative view of private landlords. As in the UK, landlords do not get a 'good press'. [14]

Danish law distinguishes between houses and flats in multi-unit buildings (condominiums) where rent controls historically applied, and landlords are prevented from selling units individually. 70% of rented housing falls into this category. Most of the rest is in houses (23%) with the remainder in colleges and other institutions.

Pension funds and insurance companies have been encouraged to invest in the private rental sector where their profits are taxed at half the normal rate (15% instead of 30%).

Individual landlords own 8% of the private rental stock, which is lower than elsewhere in Europe. Professional landlords own a little over half, and the rest is held by institutional landlords many of which have been in business for several decades.

There is a long history of rent regulation in Denmark dating back to 1916, during the First World War. Housing in Denmark was relatively unaffected by the Second World war. High levels of construction between the 1930s and 1960s meant there was little shortage, and rent controls lapsed. Rents on properties built before 1991 remain regulated. There are several different regulatory regimes applying to different properties, mostly according to when they were built. The most stringent controls apply to properties built before 1974.

As a result about half the private rental sector has regulated rents. This rises to 88% for condominiums. The rent regime relaxes where units are fully renovated, with rents at just below open market levels. From 2014 this will only apply where the whole building meets modern energy efficiency standards. [4]

Unregulated rents can be increased on three months written notice. The tenant can appeal to a Rent Tribunal where the increase is unreasonable (ie above market rents for similar properties). [4]

Tenants have security of tenure, which can only be ended when a building is to be demolished or substantially renovated, or where the landlord decides to occupy it as their own family home. A landlord can only restrict the length of a tenancy where they have a good reason for doing so, such as where they are letting out their home whilst working for a period abroad. Tenants can normally end a tenancy at three months notice. [4]

Tenants can also sub-let (for up to two years), and a tenancy automatically passes to a spouse or to a partner cohabiting for at least two years.

A tenancy cannot be ended because a property is sold. Under a law introduced in the 1970s the building must first be offered at market price to a co-operative if half the tenants want it. Individual units within a block of flats cannot be sold on the home-ownership market. [4] In practice this generally prevents an apartment in the private rental sector from being sold for home-ownership.

A landlord can issue proceedings for repossession where a tenant in arrears fails to repay within 14 days of a written notice to do so. Evictions are carried out by a Bailiff's court and are not usually delayed by more than 14 days.[4] This helps to keep management costs relatively low.

The government issues a standard form of contract for private tenancies which in practice is widely used, although it is not mandatory (Typeformular A). [4]

Housing benefits are paid to about 35% of tenants. A distinction is made between those on a state pension who receive housing benefit (boligydelse) and others who can qualify for housing security (boligsikring). Tenants can also obtain loans to pay the deposit required when they move into a new property, although this is more common for social housing tenants. Rent deposits for private tenants cannot exceed three months rent. [4]

Renovation grants are sometimes available to landlords in urban renewal areas, covering up to a quarter of the costs of bringing the properties up to modern energy standards and providing essential facilities (toilets, bathrooms etc). These can cover up to a third of the expenses for listed buildings. Since 1990 65,000 dwellings have been renovated using these grants out of a total rental stock of almost half a million units. [4]

Rental income and capital gains are both treated the same as income from self-employment. The tax rate depends on the tax status of the landlord, and whether they are a corporate body or an individual. All operating cost can be offset, including 33% of any mortgage interest. Improvements are offset against capital gains and not against rental income. There is little evidence of tax evasion. [4]

There are also property taxes based on the value of a property that are paid equally by landlords and owner-occupiers, including 'green taxes'. [4]

The landlord is responsible for keeping the premises in good condition including redecoration and repairs. There is an option to make internal maintenance and repairs the responsibility of the tenant under a tenancy agreement. In which case they must redecorate and do any repairs outstanding when they hand back the property.

Danish housing associations

Social housing in Denmark is owned by 700 housing associations, and supervised by the municipalities. They have 540,000 dwellings, representing 20% of the housing stock. The municipalities themselves own a small amount of emergency housing (about 2%).

As in the UK, social housing began in the middle of the 19th century with philanthropic societies in response to the industrial revolution. Trade unions and the labour movement led expansion after the First World War.

Denmark was spared the bombing and destruction many other countries suffered in the Second World War, and the consequent rush to build that followed it.

In the forties and fifties most social housing was in small estates in the middle of towns and cities. In the sixties and seventies larger peripheral estates were developed mostly as system built flats, both low and high-rise, making up 72% of the social housing stock. This is where most social problems are now found, together with the worst structural defects.

Since then developments have been smaller and more centrally located, with around half being built for the elderly or to meet special needs.

Social housing is generally of better quality than private rented housing and tends to be in larger estates, many of which have 500 or more units. It is a very popular tenure, with no social stigma attached to it. It is seen as a perfectly good alternative to owner-occupation, although restrictions on the build cost mean rooms sizes tend to be smaller. There are signs of this changing as social housing in some areas becomes more focussed on lower income groups and those with special needs.

The way their associations are run is unique to

TYPES OF DANISH HOUSING ASSOCIATION

There are three distinct types of social housing organisation in which these bodies are structured differently.

40% of the social housing stock is in the hands of self-governing or independent housing associations where the majority of the supervisory board is made up of elected tenant representatives, and the municipality is the supreme body.

The non-profit housing associations are similar and make up 37% of the social housing stock. In these the supervisory board is elected by both tenants and those on the waiting list. In the smaller ones the supreme body is an elected assembly of tenants, while for the larger ones it is the municipality.

Joint stock or guarantee companies have 24% of the social housing stock and were mostly financed by trade-unions or other labour organisations, who can receive up to 5% profit on their investments. These are independent of the municipalities. Their supreme body is a general assembly, and their supervisory boards are made up of tenants. No new ones have been approved for many years, and under recent legislation they are increasingly coming under municipal influence.

Denmark, and has more affinity with the co-operatives found in Sweden and Canada than anything in the UK. The Danish social housing sector has a long-standing tradition of tenant democracy. Tenants are elected to estate boards to represent their interests in the management of their estates.

There are about 7,500 estates, each of which is economically independent. The association cannot pool its revenues to cross-subsidise between them.

Housing associations vary considerably in size. The largest manage 30,000 units while the smallest has only 10. They mostly serve a particular area, managing several estates.

They have a 'supervisory board' of management, comparable to the board of a UK housing association. This is answerable to a 'supreme body' that has a quasi-regulatory function. The supervisory body manages each estate as a separate entity through its 'estate board' elected by tenants.

Associations are locally based and relatively independent of each other. In the UK associations have sought economies of scale through mergers and acquisitions. The way they are funded in Denmark makes this irrelevant; although since 2007 there have been increasing calls for efficiency within the sector, leading to early signs of mergers.

The government attempted to introduce a right-to-buy in 2004 with discounts of around 30% but this met with strong opposition from tenants on estate boards, resulting in less than 1,000 units being bought. [7]

Social housing rents

Rents bear no relationship to market rents. Instead associations are required by law to set a cost rent so that each estate balances its books. The loan servicing element of the rent is fixed at a percentage of the historic procurement cost, irrespective of how much has been paid off. This percentage has varied over time, falling from 3.4% in the 1980's to 2.8% since 2009. Additional payments for management and maintenance bring the rent up to around 3% of the procurement cost. For the first 20 years of a new estate the rents rise with inflation, and thereafter at 75% of inflation. [5]

This means that rents on the post-war estates tend to be

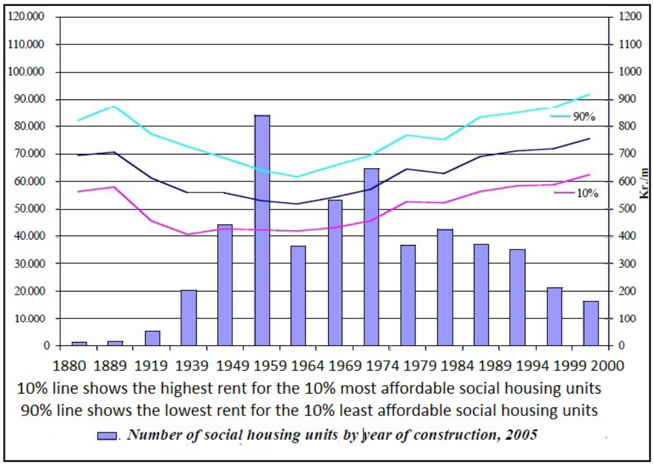

Fig 45: Number social housing units and rents (2005 prices) by year of construction [7]

much lower than on those that have to carry the cost of more recent capital investment, even though the older estates often have better quality housing. Rents are sometimes higher on older pre-war housing because of the cost of relatively recent renovations (see Fig 45).

On average social housing rents are only slightly lower than for private rented housing, which is where the lowest 10% of rents can be found.

Some tenants receive a means-tested housing benefit [6] but this never covers more than 85% of the rent, and often much less, so that some households can be too poor to afford to live on the newer estates. Even so, there has been a gradual shift of subsidies from bricks and mortar to rents. Housing benefit now covers around 50% of the rent in social housing schemes, averaging 43% for families and 64% in housing for the elderly. They are a little higher on more recently developed schemes, averaging 55% of the rent.[7]

This has led to suggestions that rents should move away from the cost-rent principle, more towards a market based system, particularly in Copenhagen and Aarhus where demand is highest.

Tenants pay 2% of the historic cost of their property as a lease premium when they take up the tenancy, which is repaid to them when they leave. Consequently the estates do not suffer from bad debts through rent arrears. This is in keeping with a view that the tenants jointly own their estate. Loans are available through the housing benefit system to help those that could not otherwise afford the deposit.

Funding of social housing

Since the eighties Danish associations have been largely funded by mortgage loans on terms set by the government. These are currently 30 year variable-rate loans, but have previously been index-linked or on fixed rates. These are raised through mortgage associations that issue bonds at fixed interest on the Copenhagen stock exchange which are invariably purchased by pension funds and life assurance companies who in turn gain special tax relief as long term investors. Mortgage loans on social housing are guaranteed through the municipalities, which enables them to obtain the best borrowing terms.

Subsidies from the municipalities to fund new projects have halved since 2011 and currently cover 7% of the costs. Tenant deposits add another 2%. The remaining 91% is borrowed from mortgage associations or banks. [2, 5]

Any shortfall between the mortgage repayments paid by residents through their rent and the cost of servicing the loan during the first 40 years is subsidised by the state. Any surplus is transferred to a 'new construction fund' (Nybyggerifonden), particularly after the 30 year loans have been fully repaid, but also at times of low interest rates. Surpluses after the 40th year are shared equally between the Danish National Building Fund (Landsbyggefonden), the housing organisation's own Disposition Fund and the Nybyggerifonden. [5]

In this way the older and financially stronger estates contribute about £90 million a year at 2011 prices into these various funds to support the rest of the social housing sector. Their purpose has been widened in recent years with increased emphasis on renovations, investment in preventative measures to deal with social problems, and subsidies to the poorer estates, as well as for construction of new social housing. As a result Denmark is one of the few countries where the social housing stock is increasing, with an unusually low dependence on taxpayers for bricks and mortar subsidies.

Social housing is exempt from income tax, and real-estate tax which gives them an advantage over other tenures. They pay the same land tax as owner-occupiers and private landlords.

Social housing repairs

The budget for each estate has to be approved by its supreme body, but is largely determined in consultation with the tenants who can set priorities for improvements, maintenance expenditure, and all other aspects of estate management. [8]

The use of concrete panels and other forms of non-traditional construction in the post-war era led to defects on certain estates that were too costly to be rectified within their budgets. These qualify for major repair grants covering two-thirds of the cost, with the remainder financed through additional borrowing.

Otherwise there is no pooling of repair costs between estates. Each is required to agree a ten year rolling programme of maintenance and repair approved by its tenants, covering the renewal of worn out building components, and any improvements required. In practice the older estates with the biggest repair costs generally carry a lower debt burden, enabling them to finance the additional repair work. [8]

The way repairs are procured is influenced by the estate based budgets they operate. Many of the estates are quite large with more than 500 units and use direct labour.

Allocation of social housing

82% of social housing is for families, 12% for the elderly and 6% for young people.

The aim in Danish social housing has always been to achieve mixed communities, rather than to focus on meeting priority needs. The municipalities get 25% of the allocations (plus more for those displaced by urban renewal), and sometimes use them to move higher-income households onto estates where this will improve the social mix.

Compared with the UK there is much greater scope for social housing tenants to move within the social housing sector as their households change or in pursuing their careers either through swaps they arrange themselves or via flexible allocations systems. They can sublet but only on a temporary basis where they get a job elsewhere. Children can inherit a tenancy where they were part of the household when their parents died.

Fig 46: A social housing estate in Denmark [7]

Anyone can apply for social housing, with no income restrictions. Family dwellings are traditionally let according to time spent on a waiting list, but certain groups now take priority. The elderly and handicapped have priority where the accommodation is suitable for them. Existing tenants have priority over incomers, enabling them to move to better and sometimes also cheaper accommodation on more attractive estates. Families with children get priority in the allocation of family sized dwellings.

Municipalities are allowed to nominate up to 25% of units for families and young people to house those with urgent social problems, which most commonly means the homeless. [5] In these cases the council is liable for any repairs requried when the tenant leaves the premises.

Denmark suffers much less than the UK from a shortage of housing, and from regional differences in growth. Housing is less of a speculative asset, and prices have grown less than in the UK, although more than in Germany. The two largest cities, Copenhagen and Aarhus have the highest proportions of social housing (one third of the stock in Copenhagen) and some of the greatest demand, particularly from key works such as teachers, nurses and firemen. In consequence waiting times in high demand areas can be as much as 10 or even 20 years. In less popular areas within commuting distance waiting times can be very much lower.

In recent years immigration has had an impact. Ethnic minorities increased from 12% of social housing tenants in 1994 to over 20% by 2004.

Housing has not been a political issue in Denmark, until relatively recently. The balance was shifted by legislation introduced in 2010 which required associations to enter into an ongoing dialogue with their local municipality and agree a set of management targets. These agreements can also include flexible letting rules allowing the municipalities to set allocation criteria for more of the stock, and even allow for some of the housing to be publicly advertised instead of being allocated from a waiting list, all aimed at improving the social mix.

In part this was a response to the deterioration of some estates characterised by unemployment and large families and a preponderance of ethnic minorities. It was done under the slogan *"Bringing the ghetto back to the community – breaking away from parallel societies in Denmark"*. Problems of social exclusion are much less acute in Denmark than on many UK housing estates, but they are having an increasing impact, so that social housing in some areas is in danger of becoming a tenure for more marginalised groups.

Some municipalities are reluctant to promote social housing because of its impact on the local tax base and the social problems associated with problem tenants. [7]

The principle that each estate is responsible for its own budget with a high level of tenant involvement is very dear to the Danes and has been retained. The contribution to the various funds to support the wider social housing sector has been steadily increasing, averaging around £30 pa per dwelling in 2011. This is seen as mutual support, and not as a clawback of funding by the state.

Home ownership

In the 2011 census home ownership was the most popular tenure at around 50% of the Danish housing stock, [12] but has risen much less since the sixties (from 46%) than in the UK.

A typical home is purchased with a 5% deposit, an 80% loan from a mortgage bank (the maximum permitted) and a further 15% borrowed separately from a bank.

At the end of 2012 outstanding mortgage loans were typically split between fixed rate mortgages (27%), adjustable rate mortgages with an interest rate cap (8%), and interest reset mortgages with interest refix intervals of between 1 and 10 years (56%). Mortgage interest averaged around

3.67% in 2012, which is fairly typical for western Europe and similar to the UK. [9]

The tax regime favours home-ownership in relation to private renting. No tax is paid on capital gains, and 33% of mortgage interest can be offset against income tax. Tax on the imputed rental income was replaced with a real estate tax, although the amount is small and has been frozen. The tax on land values is the same for rental and home-ownership, based on current value, and ranges between 1.6% and 3.4% of the assessed value of the land (not buildings), set by the local authority. [4]

Over the longer term house prices in Denmark have been more stable than in the UK, comparable with Belgium, France, The Netherlands and Sweden. The most stable are in Germany, Austria and Switzerland (Fig 5 on page 9).

Housing construction responds faster than the rest of Europe to increased demand for housing. Supply elasticity compares the rate of increase in construction with the rise in house prices in the preceding year: 100% indicates they rise at the same rate. A 2011 report by the OECD shows Sweden (at 138%) and Denmark (at 121%) having the highest supply elasticity in Europe (ave 55%), with Finland (99%) not far behind (Fig 8 on page 11). [15]

The Danish housing market has taken longer to recover from the 2008 banking crisis than other developed countries in western Europe (Fig 47). Their economy is stuck in the doldrums hovering around zero growth. Wages have fallen, dragging down consumption, while unemployment has risen (up from 5% to 7.5%).

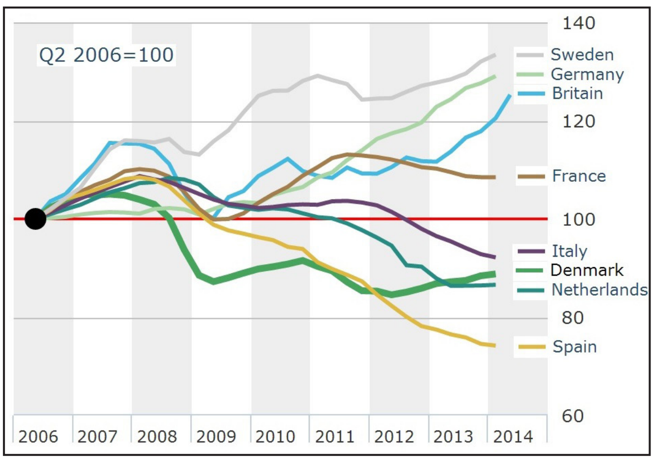

Fig 47: House prices since the crash [13]

There is no gross shortage of housing in Denmark. Incomes in the capital region are higher but the disparity with other parts of the country is low by international standards. There are no regions with significantly high levels of unemployment. Public transport is well developed and inexpensive, so that anyone should be able access the jobs market. [16, 17]

Planning regulation is zonal and designed to ensure an adequate supply of building sites to meet demand whilst protecting the environment and public amenities. There is a great deal of public consultation every four years in drawing up the plans at national, regional and especially at the local level, '*so as to combine responsibility for decision-making with accountability for financial, social, and environmental consequences*'. [10]

It then gives property owners the right to develop and use their property in accordance with the plan without requiring permission for each development unless they are seeking an exemption. There is no appeals process to a higher level in the government, and no scope for local opposition. Planning does not restrict housing supply in Denmark in the way it does in the UK.

The birth rate is low at 1.67 per woman, but this is balanced by net immigration, mostly from neighbouring counties of Europe, but also from Turkey, Iraq, Somalia, Bosnia and Asia. The population is growing slowly at around 0.28% a year, compared with 0.6% in the UK. So demographic pressures on housing are less acute than in the UK.[11]

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Chapter 7

Germany East & West

KEY STATISTICS	EU	Germany
Population (2009)	499.7 million	82 million
Population per sq km	116	230
Dwellings (2011)	236 million	39.3 million
Units per 1,000 pop	473	490
Supply elasiticity (best high)	55%	43%
Fixed interest mortgages %	mainly fixed	mainly fixed
Per capita € GDP (2011)	29,135	35,862
Gini coeff incomes (2010)	30.8	30.6
% owner occupied (2011)	66.6%	42.3%
% social rented (2011)	6.7%	4.4%
% private rented (2011)	19.1%	53.3%
Real prices 1975-2007	109%	-10%
Real prices 2007-2013	-7%	14%

A property renting democracy

Germans are less obsessed with owning their homes than the British. Tenants do not feel insecure in the rented sector or socially disadvantaged. Home-ownership still has many benefits over renting, but less so than in the UK. The taxation system is less biased in its favour.

Renting is cheaper than buying, at least in the short and medium term. The banks tend to require relatively large deposits of 20% to 30% before providing a mortgage loan. There are fewer speculative gains to be made because house prices have grown much less in Germany than the UK (see Fig 5 on page 9).

The Germans spend an average of 28% of disposable household income on their housing which is above the average for the EU of 22.5% but a little below the UK at 29% .

Planning regulation generally favours the building of housing in areas of high demand, with a right to build where this complies with a local plan. As a result the German housing market responds to rising prices by building more, although this has deteriorated in the recent past (Fig 8 on page 11). Housing construction was low in the first decade of the new millennium but has since picked up a little.

Three-quarters of households within the bottom quartile of incomes live in rented accommodation. But so do 45% of those in the highest quartile. The quality of housing in the rented sector can be just as good as owner-occupied property. [2]

There is no clear distinction between social housing and the rest of the private rental sector in Germany. Since the

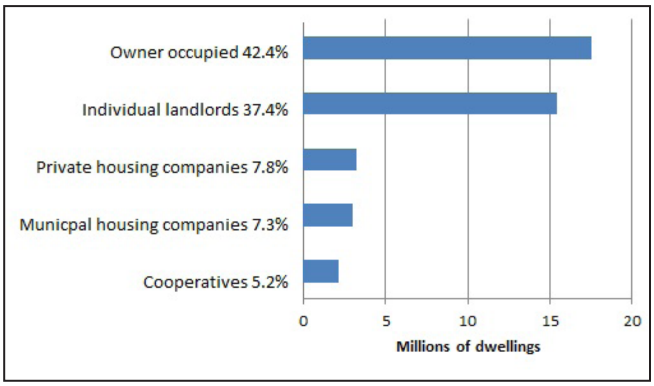

Fig 48: Ownership of German housing (2010) [1]

war the public sector has provided subsidies (grants and tax relief) to private firms to develop new social housing, or rehabilitate existing housing. In exchange these contract to house low-income households at reduced rents for a certain period. After its expiry, the owners of the dwellings are free to rent or sell at market prices. In practice, however, many of the developers are municipally-owned companies that continue to operate the units as quasi-social housing.

About 80% of the rental sector as a whole is in flats in apartment blocks (often referred to as 'multi-family dwellings'). 54% of all German housing is in flats, which is more than anywhere else in Europe and almost three times as many as in the UK.

Since unification Germany has been a federation of sixteen states (Länder). The Federal government (Bund) controls taxation nationally, but devolved responsibility for housing policy and subsidies to the federal states in 2007. Local municipalities (Gemeinde) have much greater tax raising powers than in the UK. They implement housing policy and share the costs of housing benefit and subsidies with the federal states. This is in keeping with a 'principle of subsidiarity'.

Since unification Germany has become the biggest country in Europe with 82 million people, and has Europe's strongest economy. GDP per head is well above average at €35,862 (Fig 38 on page 42). Income differentials are below the European average, as measured by the Gini coefficient (Fig 36 on page 41).

Origins of social housing

Social housing came later to Germany than the UK or France. The earliest examples in the 1890s were initiated by workers cooperatives, and trade unions, and a few philanthropists. These were a marked improvement on the older tenement barracks, but were generally only affordable by the lower middle classes, rather than the poor.

Between the First World War and the early thirties the state became increasingly active, developing three million new homes, often in partnership between the municipalities and cooperatives and labour unions. Many of these were of high quality, engaging modernist architects, and using new materials and approaches to construction. They were innovative in their approach to building communities, with provision for child care on the estates, and systems of self-governance, attracting international attention. [7]

The housing was aimed at skilled workers and the lower middle class, and came under attack from both the communists and the fascists as too expensive for the poor.

German Democratic Republic

Housing shortages following the war were less severe than in West Germany, and the housing sector was not an immediate priority in the GDR. The stock of existing buildings became state owned and the central government took exclusive control of all construction and the allocation of housing. After a few years rebuilding was running at between one third and half the rate in West Germany, with two-thirds owned by the municipalities and a quarter by workers' housing cooperatives. About 5% was owner-occupied by privileged groups. This 'mass housing' was intended for everyone without distinction by income or status, so that housing no longer represented a means of social differentiation. [4, 1]

Housing built in the sixties was of comparable standards to West Germany, but in the seventies this was overtaken by mass produced concrete panel construction (plattenbau), much of it in peripheral estates, including dormitory quarters. Many of these estates have more than 10,000 dwellings and most had more than 5,000. [4]

Since unification some of these estates have been

Fig 49: Plattenbau in Marzahn, East Berlin [13]

abandoned by the better off, with only the older and poorer residents remaining.

About 606,000 dwellings were returned to their original owners following unification. All other state properties were transferred to the municipalities, who placed them into municipal housing companies without any of the restrictions that applied to subsidised social housing. In most east European countries almost all state properties were sold to tenants at large discounts following transition, typically at around 15% of value, although given the backlog of repair liabilities they bore they might have been worth even less. [9] East Germany benefitted from financial support from West Germany and could afford to retain more of its municipal housing and take responsibility for dealing with its problems.

Some has subsequently been sold into home-ownership, which rose from 26.1% of the stock in 1993 to 34.4% in 2010, but was still below levels in what was West Germany at 48.8%. [1]

West German housing subsidies

Following the war there was a huge shortage of housing, due to allied bombing, and mass migration from the east to escape the spread of Soviet communism. Allies in the three western occupation zones (US, British and French) counted 13.7 million households and 8.2 million existing housing units, resulting in a shortfall of 5.5 million homes. This led to massive investment in housing subsidies across every sector of the housing market. [10]

In total about 9 million housing units were built from 1949-1965. About the half of them (51%) were initially constructed as social dwellings. [1]

Fig 50 : Tenure mix in Europe (at various dates 2001-2006) [4]

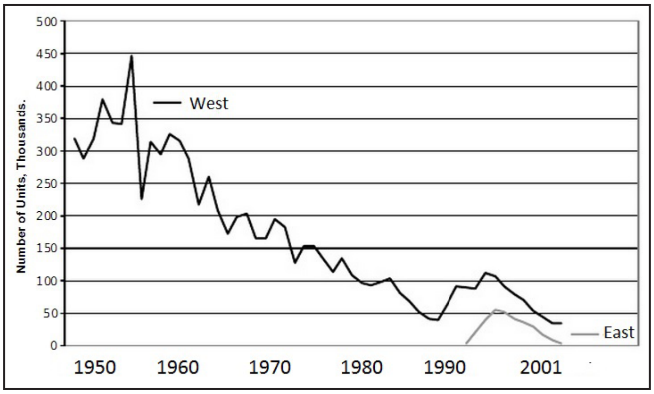

Fig 51: Social housing units created in Germany [10]

West Germany was very proud of its 'social market economy', which evolved in contrast to the socialism of its eastern neighbours. Under this approach, social welfare is designed to bring about economic progress using market forces, supported by government intervention. Hence the temporary nature of housing subsidies which were designed to overcome gaps in the provision of housing but taper away over time.

Following unification the West German approach was extended with some modification across the whole of Germany.

The 1950 social housing law split responsibility for dealing with the shortage of housing across all tiers of government: federal, state, and municipal. It required housing to be constructed *'which was designed and suitable for broad strata of the people regarding size, equipment and rents'*.

Unlike most of the rest of Europe, this was largely carried out by the private sector, with subsidies that covered the shortfall between rents and the costs in constructing, managing and maintaining the housing. Profits were fixed and limited, but once the subsidy period was over (usually 20 to 30 years), the owners were free to sell or let the properties at market rents. This contrasts with rent controls introduced in the UK and elsewhere in Europe to solve similar problems.

This housing could only be let to low-income households registered as such by the municipality with whom they had to agree the cost rents.

The development was largely carried out by housing co-operatives and private companies part or fully owned by municipalities. 3.3 million homes were built with these subsidies in their first ten years. At the same time single family homes were built in smaller peripheral developments, mostly for home-ownership. Altogether another 2.7 million homes were built in this period without housing subsidy, eliminating a large part of the shortfall.

The seventies saw some of the poorest quality of building, much of it in large estates of 500 or more dwellings using panel construction, a pattern also seen elsewhere in Europe. This contributed to a change in popular sentiment away from municipal control, which was seen as misguided and prone to financial scandal. [4]

In the eighties the subsidy system was opened up to individuals and private investors, drawing the wealthier middle classes into the financing of social housing. The focus was on providing decent homes for key workers and the lower-middle classes. Rent levels were often beyond the means of the poor. Much of it was developed with leading architects and urban designers who led the way in raising ecological standards. The flats were spacious and attractive, and never stigmatised as working-class housing. [4]

By comparison in the UK at this time competitive pressure was being used to lower the cost of social housing. While quality standards were falling in the UK they were rising in Germany. Some economists see the role of the private sector in the provision of social housing and the absence of rent controls and cost limits on construction as major factors in the success of the rental sector in Germany. [12]

Housing for the homeless and those with special needs was financed through welfare or health programmes, and never part of the housing finance system. [4]

Until 1990 the cooperatives and municipal housing companies had nonprofit status, and were sometimes referred to as 'social landlords'. That distinction no longer exists and they are now all regarded as private sector landlords. The government adopted a principal of 'local primacy' under which no housing could be the property of the state or directly owned by municipalities. By law it must all be private. [2]

By the start of the eighties the biggest non-profit housing corporation in Europe, Neue Heimat, housed 2% of the West German population. It had built more than 500,000 houses units since the war, and was expanding into other parts of Europe and even into South America. For many years it was seen as a star performer. But it over-reached itself, engaging in too many risky activities, and became embroiled in scandal.

The president of Neue Heimat and several of its managers set up an estate agency that bought land from local peasant farmers very cheaply and sold it to Neue Heimat at many times the price. Other companies owned by managers and board members sold them district heating, kitchens, TV aerials and other equipment at above market price. They profited at the expense of both poor farmers and future tenants, and diverted public funds for their own personal gain. In the mid-eighties it had to be rescued from bankruptcy by the unions, and was broken up. [6]

As a result of the scandal tighter controls were introduced preventing non-profit organisations engaging in commercial activities through subsidiaries and associated companies. The political fall out contributed to the decision that municipalities and other public bodies should be prevented from owning housing.

Housing subsidies were originally used to finance new construction, but in recent years they have also been used to purchase nomination rights on existing properties. Subsidised housing is subject to rent control with special rules on how it is allocated until the subsidy period expires. After that tenants retain their security, but their rents can rise gradually to market levels, and allocation restrictions no longer apply. [2]

Tenancies in social housing tend to last longer than in private rental, typically between 9 to 13 years. [1]

Access to subsidised housing is based on household needs and subject to income ceilings (€12,000 for single person, €18,000 for a couple plus €4,000 for each additional person in 2013). Eligible applicants are issued with permits (Wohnberechtigungsschein) and the landlords then make their own judgement in prioritising allocations to those that qualify, without the use of waiting lists or points systems to determine who qualifies first. [1]

There are two levels of permit. The income ceilings for 'elevated social housing' are 60% higher and they then qualify in most states to purchase subsidised housing at prices that take account of the subsidy. 70% of new social housing is provided to those that could only afford home-ownership on this basis. [4]

Because of the way social housing is funded for a limited period of time, the number of social housing units naturally declines each year.

Since 1988 supply side subsidies have substantially diminished. The lack of a clear distinction between social housing and the rest make it hard to compare statistics from different sources. The number of units subject to social housing subsidies fell from 3.9 million in 1987 to 1.8 million in 2001 [4] (Fig 51). In 2007 about 20% of the German housing stock was still subject to subsidies, but that has now fallen closer to 4%. [10]

Social housing also benefits from a tax regime that is generous on all rented housing (see below).

Private renting

Much of the privately rented housing in Germany was originally constructed with subsidies and let on social housing terms.

Of the rented housing in 2010 64.8% was owned by individuals, 13.5% by private companies, 12.7% by municipal companies, and 9% by cooperatives. [1]

Rent regulation introduced between the wars was largely abolished in the 1950 Housing Act in order to promote private investment in rented housing.

Renting in Germany produces higher yields net of tax than in the UK, but relatively small capital gains. Even so, only about 40% of private rental makes an annual profit, and on average it takes about 8 to 10 years before the rental income covers expenses including interest. [1]

By comparison in the UK rental yields net of tax are too low to attract commercial investment, other than from individual buy-to-let landlords, whose main interest is in the longer term capital gains from rising house prices.

Unlike other equity investments, losses from residential lettings can be offset against tax on other income. Investment can be depreciated at 2% pa. Corporate bodies are taxed on capital gains, but not cooperatives. For individuals there is no tax on capital gains except on investments of less than ten years, intended to reduce speculation. Renovation and modernisation costs can be offset against income for tax purposes, together with interest payments and other operational costs.

Property tax is payable to the municipality on all residential property and is based on 0.35% of the value subject to a locally determined multiplier.

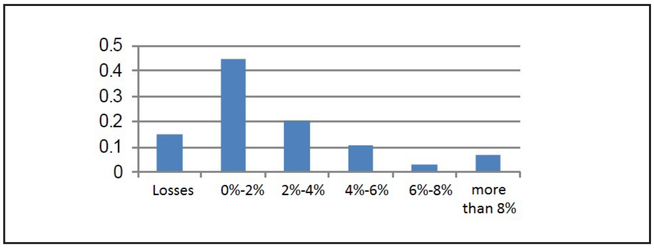

Fig 52: Net Rental returns on residential property (2014) [1]

Tenants have full security of tenure. Leases are of unlimited duration. Rent increases are restricted to local rent inflation. Additional increases of up to 11% are permitted to pay for the cost of modernisation or energy efficiency improvements. Until recently new lettings were at market rents. From 2015 rents on relets in areas of high demand (as determined by each region) will be capped at 10% above the local average for similar properties, except following major renovation. Critics say this will benefit middle class tenants without helping the poor. [14]

Rent deposits are limited to three months' rent and must be held in a separate interest bearing account the income on which gets added to the tenant's deposit. [1]

The landlord is responsible for repairs and maintenance although the tenant can take responsibility for cosmetic repairs (ie redecorating) and minor damage beyond normal wear and tear. Tenants have no rights to make improvements and would not be compensated for doing so. These need the consent of their landlord. [1]

If the landlord sells a property the tenant has preemption rights to purchase for the same price. A purchaser or someone inheriting a property takes on all the landlord's obligations to any existing tenants.

In practice private tenancies last an average of 5-6 years. Tenants can leave at three months notice, but landlords can only gain access in exceptional circumstances, and landlords cannot evict so as to let at a higher rent. Tenants can be evicted for a breach of the tenancy that is not rectified within two weeks of a notice, such as for rent arrears. In practice eviction is a slow process taking an average of 15 months or more. [1,11]

Housing benefit was introduced in April 1965. This coincided with a drop in funding for social housing, and was part of a general shift from bricks and mortar subsidies to targeting support to enable everyone to house themselves in the market. It was not until 2001 that building new social housing ceased being a significant component of housing policy, transferring responsibility to the private rental sector.

Until recently any low-income household in Germany had a right to housing benefit through the welfare system, including owners as well as renters. The rules were tightened in 2005 stopping subsidy on dwellings above a certain size or rent level or for those on other forms of long-term income support which wer then deemed to include provision for housing costs. [4]

By 2009 this was claimed by 13% of households. The maximum amount of benefit was only 2% of average wages, the lowest in Europe. [5]

Housing benefit cost €1.5 billion in 2010, compared with €1.05 billion spent on subsidised housing. By contrast the UK spends ten times as much, helping to pump up house prices at the lower end of the market.

Recent trends

By the eighties there was very little funding for new social housing. The companies and cooperatives managing it were encouraged to engage more with the market. Some municipalities saw an opportunity to generate revenues from the housing assets they had built up since the war.

150 tenement blocks in West Berlin were empty or squatted while awaiting refurbishment. Some were offered to students and younger home-seekers to renovate with a combination of loans and subsidy, for letting at higher rents than the general social housing. Similar approaches were tried in East Berlin following unification, with students and young people providing 'sweat equity' through their own labour on the renovations. In other towns and cities squatters became renovators in housing cooperatives, sometimes combining work places with housing, in combination with other ecological objectives. [7]

Following unification about 2.45 million people (17% of the population) migrated from East to West Germany, and about 1.45 million went the other way. This led to shortages in some areas. There is no longer any overall shortage of housing in Germany, except in the cities in the west where the demand for social housing always outstrips supply.

Market rents in the last twenty years rose by more than house prices until 2010, since when house prices have gone up faster. The average obscures a recent trend in the areas of high demand where rents since 2010 have risen by as much as 30% or more. [14] A similar pattern can be seen in Switzerland, whilst in the UK house prices have risen by more than rents (Fig 29 on page 34).

In the 2011 census there were 1.85 million vacant dwellings, 4.5% of the stock. [1]

By 2008 some 569,000 households were in receipt of housing benefit, including some owners-occupiers. The cost is evenly split between federal and state governments. The tightening of the rules and reduction in the rent that is covered has led to increased segregation and the concentration of deprived households in low-quality neighbourhoods. This makes them even more vulnerable and harder for the housing companies to manage.

On some of the larger and less popular estates in Bremen, Hamburg, Dortmund and Berlin better off families have moved out, and increasing numbers of immigrants have moved in.

The security German tenants feel has as much to do with social attitudes as statutory rights. Landlords are expected to show social responsibility. Since 1999 this has been undermined by municipal housing companies selling more than 600,000 units to foreign investors from

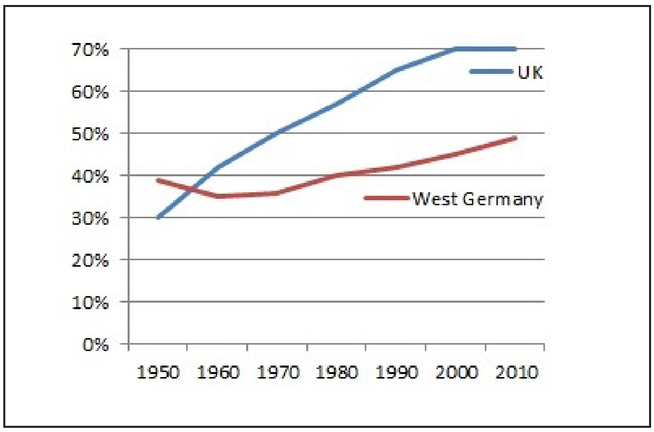

Fig 53: Home-ownership in West Germany and UK [15]

the UK, USA, Japan, Canada and Australia. These are only interested in maximising their returns. Upgrading and selling the better properties enabled them to recoup most of their original investment after only three years. Much of the money gained by the municipalities from the sales has been lost through increased housing benefit on rising rents. [4]

As state support for developing new social housing in Germany has ebbed away, a wide variety of private initiatives have evolved, building on the innovation of the eighties cooperators. These are particularly prevalent in Munich and Hamburg, as well as Berlin, but can also be found elsewhere. Institutions like the GLS Bank, Germany's first 'ethical and ecological' bank have sprung up, and the Rental Homes Syndicate which uses collateral from older cooperative ventures to help support new ones. These are supported by networks of sympathetic architects and housing professionals, who help make the initiatives work within what is left of the subsidies, tax reliefs, and housing benefits still available from a progressively smaller German welfare system. [7]

Home ownership

Home ownership subsidies (Eigenheimzulage) introduced in 1949 initially took the form of tax deductions. Procurement costs were tax deductible for the first seven years after purchase. The level of these deductions increased dramatically in the seventies. In 1982 an extra allowance was introduced to support people with children who were building new houses (Baukindergeld). [10]

By 1996 subsidies for home-ownership added up to the biggest single subsidy ever in German history at €12.8 billion a year (Fig 54). Despite these subsidies the level of home-ownership did not increase significantly. (Fig 53). The German preference for renting goes deeper than economics. These subsidies were replaced from 1996 by an allowance and no longer applied to high income households. The tax deductions could last up to seven years, and it took until January 2006 for them to be completely abolished. The change was spurred by a need to reduce the federal budget deficit. [10]

House prices are amongst the most stable in Europe, along with Austria and Switzerland (Fig 5 on page 9).

Those wanting to buy build up a deposit (typically 20% of the purchase cost) by saving in a building society

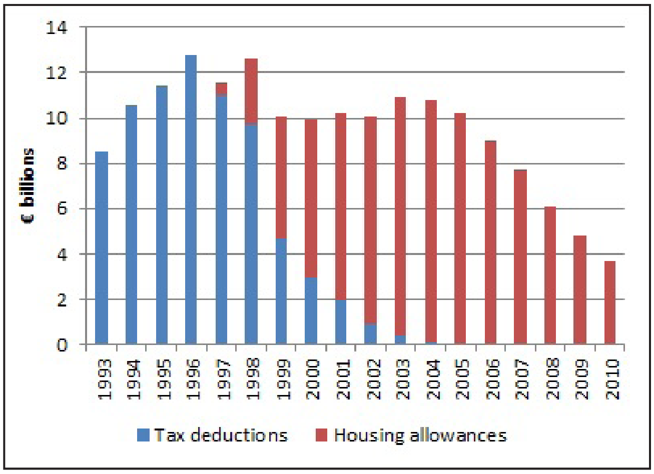

Fig 54: German home ownership subsidies €billions [10]

(Bausparken) which then provides a low-cost mortgage loan covering half the cost of purchase of a home. They borrow the rest using fixed interest bank loans. Mortgage funds are readily available, and repayments have exceeded new borrowing for several years. [8]

Banks raise the money to fund these additional mortgages by issuing fixed interest mortgage bonds usually at yields only slightly above government bonds (as they also do in Denmark and Sweden). Their banks made little use of mortgage-backed securities, selling bundled mortgages to investors to raise finance on wholesale markets. It was this form of finance that led to the banking crisis which hit UK and US banks. German banks avoided being caught up in it. [16]

The German housing market remained largely unaffected by the banking crisis in 2008, and was a stabilizing influence on the economy as a whole, in contrast to most other countries in Europe. There was no housing bubble to burst in a country where housing is less of a speculative asset. Consequently house prices have outperformed most of the rest of Europe since the crash (Fig 47 on page 52).

Lower interest rates have reduced the cost of home-ownership in relation to rents, prompting a rise in the number of first-time buyers. The volume of sales rose by 8% in 2012. The result was a modest boost to house prices. [8]

In the 2011 census 42.4% of dwellings were owner-occupied, rising to 55.3% for those aged over 60. Very few young families own their own home: 91% of those below the age of 30 rented.

There is no tax to be paid on imputed rent where a property is owner-occupied, and no tax relief on mortgage interest. Tax is paid on capital gains if an owner-occupier sells within ten years, the same as for a landlord.

A Property Tax is paid annually to the municipality by all owners of residential property. This is the same for rental properties, where it is usually charged to the tenants.

There is a property acquisition tax comparable with UK stamp duty, the level of which is set by each state and ranges from 3.5% to 5% of the value (not the price paid). Each state also sets the level of Real Property Transfer Tax, which is typically 3.5%. These taxes are equally payable by owner-occupiers and landlords. [1]

Taxation is less biased in favour of home-ownership in Germany than anywhere else in Europe.

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Chapter 8

The Netherlands

KEY STATISTICS	EU	Netherlands
Population (2009)	499.7 million	16.5 million
Population per sq km	116	464
Dwellings (2011)	236 million	7.1 million
Units per 1,000 pop	473	431
Supply elasiticity (best high)	55%	19%
Fixed interest mortgages %	mainly fixed	74%
Per capita € GDP (2011)	29,135	37,304
Gini coeff incomes (2010)	30.8	28.9
% owner occupied (2011)	66.6%	58.0%
% social rented (2011)	6.7%	31.0%
% private rented (2011)	19.1%	8.0%
Real prices 1975-2007	109%	70%
Real prices 2007-2013	-7%	-24%

Dutch housing market

The Netherlands has the largest social housing sector in Europe, accounting for almost a third of their dwelling stock. In cities like Amsterdam, The Hague, Rotterdam and Utrecht it provides 50% or more of the housing.

The private rental sector has a relatively small market share (8%). Institutional investors (pension funds and insurance companies), own about half of it. Small companies and/or private persons own the rest.

The dramatic decline since the war is due to private landlords being subject to the same rent control as social housing without access to subsidies since the eighties. Nor do they have the tax advantages and loan guarantees provided in various forms to housing associations and home-owners.

As large-scale subsidies on social housing declined and allocations became more restricted, many households turned to home-ownership. This was stimulated by the increased prosperity of the middle classes, and helped by favourable tax treatment, and mortgage guarantees.

The Netherlands is a small country with a high population density at 464 people per sq km. They have a population of 16.5 million people living in 7 million dwellings. Like the UK their housing supply appears to be constrained by a shortage of development sites. As a result every increase in demand pushes up house prices: supply elasticity is the lowest in Europe (Fig 8 on page 11).

They may be small but they are very well-off with a GDP of €37,304 per head, the highest in Europe. Income differentials are well below average, comparable with Scandinavian countries (Fig 36 on page 41).

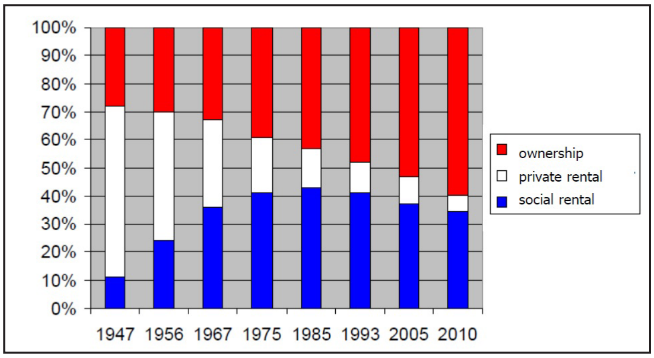

Fig 55: Changing tenure mix in the Netherlands [1]

Home ownership

Home ownership has risen since the war to 58%, but has not reached the levels found in the UK (65%). Relatively few (4%) own their properties outright, and twice as many elderly home-owners (66%) still have mortgages compared with the UK (33%).

Mortgages are relatively expensive with interest rates consistently high over many years compared with the rest of western Europe. In 2012 they averaged 4.73% compared with 3.69% in the UK. They fell to 3.8% in 2013. Most (74%) interest rates are fixed for 10 years or more.

Mortgage debt is higher at 227% of disposable income compared with 119% in the UK. This is partly due to the state backed mortgage guarantees that allow households to borrow at high loan-to-value ratios.

Tax relief on interest payments encourages interest-only loans, repaid by a lump sum at the end of the term, often through a form of life-insurance akin to endowment mortgages in the UK. From 2013 mortgages have to be repaid on an annuity basis within 30 years to qualify for tax relief. [4] Tax relief on interest is the most generous of all OECD countries. [5]

Over the longer term the growth in house prices in the Netherlands falls into the same group as France, Denmark Belgium and Sweden: more stable than the UK or Italy, and much better than Spain, Ireland, and the countries of eastern Europe emerging from communism. They are less stable than Germany, Austria or Switzerland. (Fig 5 on page 9).

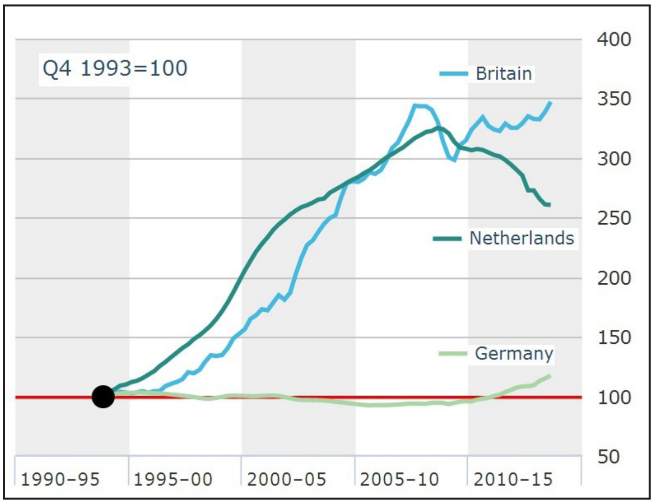

Fig 56 : Growth in house prices since the nineties [2]

House prices rose in a similar way to the UK since the nineties, but have so far failed to recover since the banking crisis in 2007 (Fig 56). GDP has fallen in three out of five years since 2009, and unemployment more than doubled to 6.7%. There has also been a drop in construction to around 20,000 units a year compared with 60,000 before the crash.

Owner-occupiers pay tax at their marginal rate on imputed rental income until their mortgage is paid off. They can claim the full cost of mortgage interest against their income tax for the first 30 years of the loan. [4]

Both owners and landlords pay VAT on new housing (at 21%) or Property Transfer Tax (overdrachtsbelasting) when purchasing an existing dwelling (down from 6% to 2% since 2011). [4]

Owner-occupiers and professional landlords (individuals below pension age who spend at least 1,225 hours a year on their rental business) do not pay tax on capital gains whereas it is taxed in the same way as other income for private individuals that are amateur landlords. [4]

They have a three tiered planning system (state, region and municipality) with a strong emphasis on local decision making based on zonal planning. Plans are revised on a ten year cycle. Housing and planning policies are closely linked which might be expected to provide an adequate supply of sites for housing development, except that high housing densities make it hard to find sites for new building. Compensation can be claimed by anyone detrimentally affected by planning changes. This is paid by the municipality and usually reimbursed by the developer. [6]

In the seventies they adopted a 'compact city policy' under which 25% to 40% of development was to be within existing built up areas. Remaining development was on greenfield land adjoining the cities preferably within cycling distance, and around other towns and villages in the suburban region. Public transport is generally good enabling people to commute to work.

Rents and security

There is very little difference in the regulation of private rental and social housing. Private landlords are subject

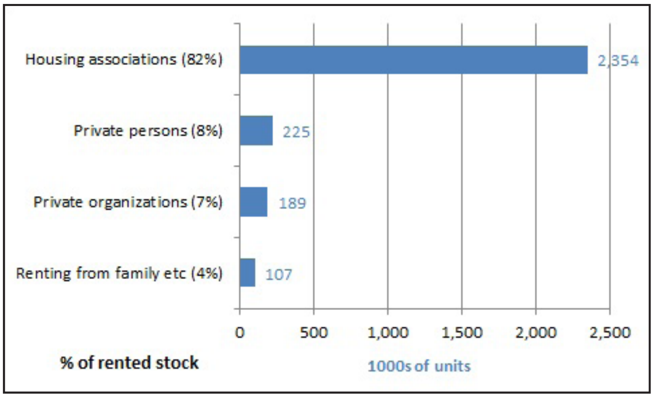

Fig 57: Mix of landlords in rented housing [4]

to the same rules, without the loan guarantees and other support provided to housing associations.

All tenants have security of tenure whether in the private or social sector. They can leave with one month's notice, but can only be evicted without cause in exceptional circumstances, even when their tenancy term has ended. Eviction must be by a bailiff following a court order. [4]

Tenancies remain in force where a property is sold. Private tenants have no preemption rights over other purchasers. [4]

Subletting requires the landlord's consent if it is no longer the tenant's main residence. A rent deposits is usually one month's rent and cannot exceed three. It must be held in a separate account. Tenants have no right to the interest. [4]

The Netherlands still has one of the strongest rent regulation regimes in Europe, covering 72% of the private rental sector [3] and 96% of the social housing sector [4]. This may have contributed to the decline in private renting from 17% in 1980 to 6% in 2013. Despite this, private sector rent levels are amongst the highest in Europe (Fig 31 on page 36).

A points system of rent regulation was introduced in 1971 and applied to all rented housing. Prior to that there was a more complex system of cost rents accompanied by subsidies that applied equally to social housing or private landlords.

Dwellings are given points on the basis of their size and quality (heating, insulation, and facilities) and access to local amenities (trains, shops, etc.). Based on the number of points, a maximum rent is determined, although landlords can charge less. The government sets the maximum percentage increase permitted each year, which has matched inflation since 2007 and applies to all regulated rents even where they are well below the maximum.

Rents up to a 'liberalisation level' (142 points) are regulated. This was €652.52 per month in July 2011 and is raised each year usually by inflation. Above that rents are unregulated.

A form of housing benefit is available for low-income households in both the private and social sector where the rent is below the 'liberalisation level'. The amount depends on their taxable income, age, household composition and the rent. In 2000 roughly a third of housing association tenants received subsidy, which averaged about 40% of the rent they were paying. Only the UK provides housing benefit to a higher proportion of households: 15% in The Netherlands and 18% in the UK.

Rents in the private rented sector average 84% of the maximum rent. Housing associations charge less, averaging 70%. [7] On a points basis 40% of social housing rents would be above the liberalisation level, which would make their tenants ineligible for housing benefit. [4] Associations choose to set rents at levels affordable by low-income households as a matter of policy. Recent changes may increase the pressure on them to raise rents.

The government might like to see those on the lowest incomes in the cheaper flats so as to reduce the cost of housing benefit, whereas the associations are more concerned to maintain a healthy social mix with a range of incomes.

As in other European countries, direct subsidies supporting investment in social housing have been replaced in recent years by rent subsidies to individuals to enable them to compete for scarce housing resources in the market place.

Amateur landlords are taxed on rental income net of operating costs and on capital gains just like any other private business, and pay tax according to which tax band they fall into, the highest being 52%. There is rollover relief on capital gains that are invested in another property, which puts them into a slightly better position than UK landlords [4]

Professional landlords are treated as investors, and benefit from a much more favourable tax regime. Since 2001 their taxable income on rental properties is calculated as 4% of the net asset value (ie value less debt) irrespective of the rental income and operating costs. On this they pay 30% tax. The actual cost of repairs and maintenance and of interest are ignored. No tax is paid on capital gains. [4]

Corporate landlords pay corporation tax on rental income net of operating costs and on capital gains. These profits were taxed at 20% up to €200,000 and 25% above that in 2011.

In the past housing associations were exempt from paying corporation tax, but partly because the range of enterprises they engage in has widened they lost this exemption in 2008 [4]

Pension funds and 'Fiscal Investment Institutions' (such as insurance companies that operate a bit like REITS[8]) are exempt from corporate income tax. This partly explains why incorporated organisations own 50% of the private rental sector. Their dwellings tend to be bigger, newer and relatively expensive compared with unincorporated landlords (ie individual persons). [4]

Housing Associations

In some countries social housing is exclusively targeted at deprived households, and most commonly found in impoverished neighbourhoods. This is not the case in the Netherlands where it houses both low and middle income households, and carries no stigma.

It is a prosperous country with little unemployment and high quality public services and infrastructure. Like the Danes, the Dutch appear more willing than the British to contribute to the public good. Politically they are used to consultation and compromise. At times there have been strongly opposed views, and some recent government proposals are highly contentious. But generally coalition governments are less adversarial, and more conducive to building consensus, which is a help in dealing with housing policy where costs and benefits accrue over many years.

The earliest social housing was developed by philanthropists who in the 1850s set up what became the first voluntary housing associations. These were followed by workers' cooperatives which began in the late 1860s and were largely self-funded from rents with help from the Labour movement. A Housing Act in 1901 established a legal framework backed by municipal loans. By the outbreak of the First World War there were more than 300 housing associations and two federations, which evolved into the church-based NCIC and more secular NWR. These amalgamated in the nineties to form Aedes.

Between the wars associations built about 100,000 homes, including some excellent housing, depending to a large extent on voluntary management. They remained weak because any profits they made had to be repaid to the state.

Following the war loans and subsidies were provided via the municipalities and large quantities of social housing was built. 46% of social housing was in flats including some high rise, and 54% in houses. Much of this was on greenfield sites on the outskirts of towns. The chronic shortage of housing meant that cost was often more important than quality.

A number of different organisations had emerged by the end of the eighties. There were 650 non-profit housing associations in which the board was elected by the membership, in a similar way to most UK associations. Another 250 were foundations in which the management boards were co-opted. There were also 300 municipal associations, owned by the municipalities who appointed their boards, but operating under the same legal and financial framework. And there were about 300 other non-profit institutions operating a bit like the unregistered housing associations in the UK, often providing housing for specific groups of people. [9]

During the sixties and seventies a framework was established under which most social housing was owned and managed by registered housing associations (known as 'housing corporations'). These were allowed to become financially strong and independent, so that risk could be transferred to them from the state. The municipalities had to give up control of their own housing in exchange for a more strategic role in setting the agenda for social housing in their domain, while the state retained the dominant role in setting housing policy, and directing funding.

Dutch housing associations then gained a great deal of expertise in urban renewal in the seventies and eighties, acquiring many pre- and post-war properties in run

Fig 58: UK maintenance managers from the NHMF visiting a thermal storage plant in Rotterdam in 2012 [10]

down areas from private landlords or owner-occupiers. Some were demolished and replaced. Other were renovated.

They pioneered the application of life-cycle costing to the planning and delivery of elemental renewal programmes. This later became the basis for catch-up repair programmes following large scale voluntary transfers in the UK and for longer term asset management plans across the social housing sector. [9]

The National Housing Maintenance Forum in the UK recently sent a study tour to the Netherlands to see what they could learn about energy conservation and reduction in carbon emissions from housing, where once again the Dutch social housing sector are at the leading edge of innovation.

Financial independence

Dutch housing associations are larger than in most of the rest of Europe, with a much stronger asset base. This both enables and obliges them to do more.

A guarantee fund for social housing (WSW) was set up in the eighties, initially covering housing loans for improvements. It now provides guarantees covering all housing association borrowing. It is self-funding, although ultimately backed by the government, and has a Triple A rating. This gives associations access to loans on highly competitive terms. They have also benefited greatly from a general lowering of interest rates over the last ten years.

Since the sixties associations have been increasingly free to manage their own affairs. This culminated in 1995 with the state writing-off all outstanding public loans in exchange for housing associations becoming entirely self-funding, operating without further subsidies ('grossing and balancing') using what was known as the 'revolving fund principle' (Fig 59).

A Central Housing Fund (CFV) supervises the financial viability of associations. It can order remedial action if they run into difficulties, and provide short-term financial support.

Since the nineties the number of associations has halved to around 400 [4]. The average size of association has risen from around 2,500 units to nearer 6,000 as a result of mergers in pursuit of economies of scale (Fig 60). In the process the number of member-based associations has declined while the non-member foundations have grown. They have become more entrepreneurial, and run by professionals, rather than representatives of the communities they serve.

The trend is for the executive to be in control, with boards being marginalised or disappearing altogether. Local ties have been broken and many operate regionally or even nationally. Similar trends are seen in the UK.

Housing associations in the Netherlands are now free to buy and sell their dwellings as they wish. They do this for a variety of reasons, including to make the best use of their assets, or improve the social mix on their estates. In the ten years following financial independence they built or bought about 300,000 homes and sold

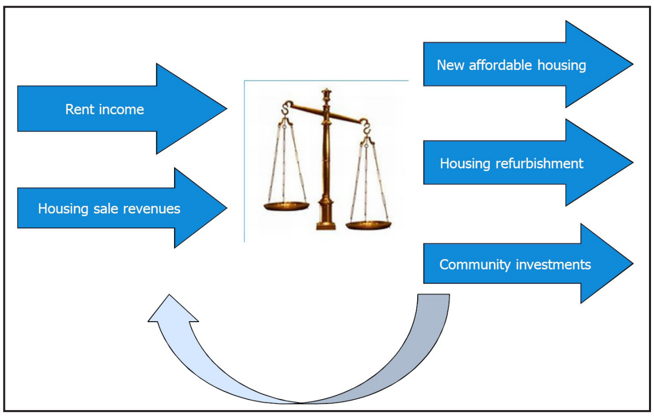

Fig 59: Revolving Fund Principle [1]

or demolished a similar number.

Tenanted properties for sale by a social landlord must be offered to the tenant who can choose either to buy or continue renting with a new owner. There is no right-to-buy, but the government is keen to expand home-ownership to those that want it and can afford it.

Associations became free to engage in a wider range of activities, and many invested in neighbourhood regeneration and a wide range of social programmes. Not all of this has been successful. There have been instances of fraud, and some public indignation at the rising salaries of senior executives.

Vestia, the largest Dutch housing association with around 89,000 units, lost almost €20 billion speculating in interest rate swaps on the financial market. It built up a €23 billion portfolio of derivatives, which one of the largest Dutch Banks (ING) concluded was *"irresponsible, both in size and composition"*. The Central Housing Fund (CFV) put them into remediation. Some of their senior managers, consultants, and the banks they worked with have faced civil prosecution. Their chief executive walked away with a €3.5 million compensation package as he was forced to resign. [11]

Over a period of years starting in 2005 the EU raised objections to the Dutch government providing state aid through WSW and CFV for services that were not strictly confined to serving the public interest. There are parallels with the EU ruling that resulted in UK housing associations being treated as public sector bodies and subject to EU procurement laws, which incidentally do not apply to Dutch associations.

The EU has taken a firm stance against universal social housing, providing for a wide range of income groups. In order to comply new restrictions were introduced on their activities in 2011. At least 90% of affordable rented properties (defined as having rents below €681 a month) must be let to low-income households with a taxable income below €34,229.

In 2013 the Dutch government was faced with budget deficits and saw an opportunity to extract money from the wealth built up by housing associations. They announced a levy which should result in a revenue for the government of €1.7 billion in 2017. In order to be able to pay this levy, housing associations may charge relatively high rent increases in the coming years, especially

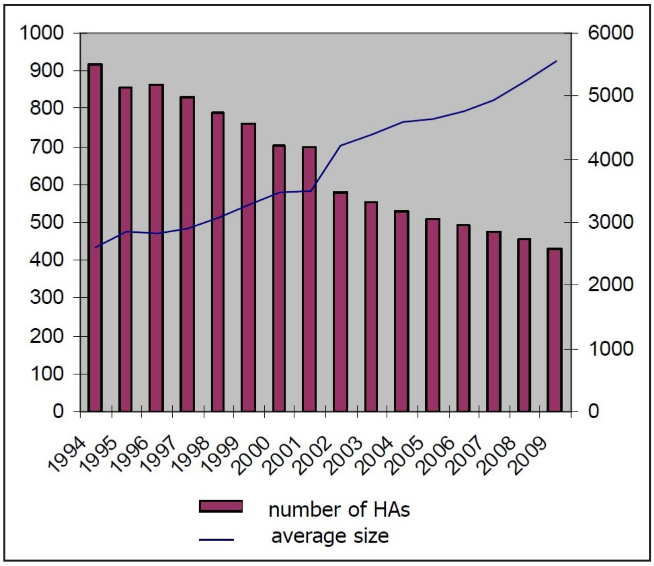

Fig 60: Merging of Dutch housing associations [1]

for higher income groups. Rents for low-income tenants will be protected, rising with inflation, but those on higher incomes will see their rents rise in real terms, encouraging them to move on where they can afford to.

Furthermore, they are supposed to work more efficiently, to lower the salaries of their employees, and to sell more dwellings. Plans to bring the housing associations under closer supervision of the national government are also being developed.

They are looking to import the shared-ownership model from the UK. Some housing associations already give their tenants a choice between renting or buying a dwelling. If they buy and wish to re-sell, they have to sell the dwelling back to the housing association .

There has even been debate around a statutory right-to-buy. Evidence from elsewhere in Europe shows a correlation between high levels of home-ownership and instability in housing markets fuelled by the potential for speculative gains. In the absence of a strong private rental sector the Dutch might be wise to think twice before going too far in that direction.

In consequence of these changes the social housing sector will become smaller and more residualised (ie more concentrated on lower income groups). They will lose part of their autonomy, and be forced to focus more on their core tasks (letting and managing rental dwellings). This is controversial.

Allocation of social housing

In 1990 the Dutch city of Delft introduced an 'advert model' for allocating social housing, that has since become known as 'choice based letting' and spread to most other municipalities, and to the UK. The French are also considering it.

Under the previous 'distribution model' housing was allocated from a waiting list, similar to council house waiting lists in the UK. Applicants received points for needs as well as waiting times, and these determined their ranking position. Needs could be severe medical or social problems related to the housing situation, a long travelling distance from home to work, lack of space in the house, or divorce.

Applicants strived to escape long waits by claiming priority credits for various reasons. A substantial portion of the registered applicants only registered in order to provide an additional option should future needs arise. As a result, many dwellings were refused when offered, lengthening the void period between lets.

Under the new system photos and details of vacant dwellings are published in a magazine or newspaper and on-line and eligible applicants can apply for specific units provided they meet the accessibility criteria, which are published alongside the advertisements, and include income level and household size.

The criteria by which applicants are ranked are published, and the whole process is intended to be transparent, so that those that missed out can see the reasons others came ahead of them, helping them decide what other properties it might be worth applying for.

The system is much simpler to administer than maintaining ever longer waiting lists. But it can add to the strain on applicants who may have to repeat countless application forms before they are successful.

It has since been refined in a variety of ways. In some areas applicants can apply via a database which then flags up all vacancies that match their preferences and where they might stand a chance.

Ideally for applicants it should work more like finding the best flight for a holiday, where they put in their preferences and personal details, and get back a list of the best options, which might include crossing municipal boundaries. This in turn requires some standardisation of the information required on applications. It need not preclude different criteria being applied by those with vacancies to offer.

Choice-based letting does not solve all of the problems, and it is interesting see how much experiment and debate there has been in seeking to improve on it in the Netherlands. [12]

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Chapter 9

Ireland

KEY STATISTICS	EU	Ireland
Population (2009)	499.7 million	4.5 million
Population per sq km	116	63
Dwellings (2011)	236 million	1.6 million
Units per 1,000 pop	473	371
Supply elasiticity (best high)	55%	63%
Fixed interest mortgages %	mainly fixed	few fixed
Per capita € GDP (2011)	29,135	37,293
Gini coeff incomes (2010)	30.8	32.1
% owner occupied (2011)	66.6%	69.7%
% social rented (2011)	6.7%	8.9%
% private rented (2011)	19.1%	19.1%
Real prices 1975-2007	109%	355%
Real prices 2007-2013	-7%	-46%

Rise and fall of social housing

The industrial revolution almost passed Ireland by. It remained a predominantly agricultural economy right into the 20th century. It did not suit the industrialists of England and the south of Scotland to compete with mill owners from Ireland. They preferred to import the raw flax and make the linen. Much of the land was owned by members of the Protestant establishment, who were resented by the predominantly Catholic tenant farmers, leading to demands for political, social and legal reform.

Land reform at the end of the 19th century in Ireland gave tenant farmers the right to buy their holdings at a multiple of the rent, and made long term loans available enabling them to do so.

Agricultural labourers felt left out by this, and their demands led to the provision of large amounts of rural social housing by local authorities. Consequently social housing in Ireland began in rural areas, and only appeared in towns much later. 10,000 labourers cottages were built in this way between 1890 and 1900, with 36% of the loan repayments met by the government. By the time the Irish Free State came into being in 1922 over 50,000 social housing dwellings had been built in rural areas and another 9,000 in towns and cities. [1] Two thirds of the population of almost 3 million people lived in rural areas.

Following independence local authorities played a dominant role in housing construction, building 40% of the housing stock by 1940. Industrialisation developed rapidly following the war, and the government increasingly

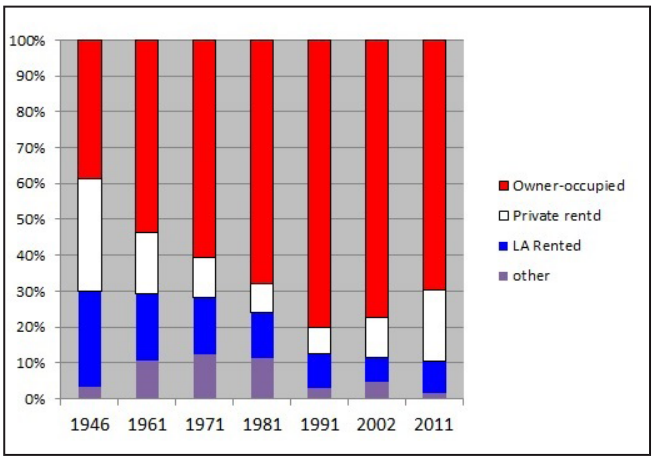

Fig 61: Changing tenure mix in Ireland [3]

turned to the private sector to expand the provision of housing in urban areas. [9]

Ireland was the first country to introduce the right-to-buy. The 1936 Labourer's Act obliged county councils to sell their labourer's cottages to the tenants, initially with fixed-term mortgage payments set at 75% of the rent, and subsequently reduced to 50%. By 1964 about 80% of the 87,000 rural social housing units had been bought by their tenants, compared with 6,400 urban units. [1]

The 1966 Housing Act extended the right-to-buy with generous discounts of up to 60% and mortgage loans from the local authorities. By the 1990s two-thirds of the 330,000 dwellings built by local authorities over the previous century had been sold to tenants, amounting to 25% of owner-occupied housing in Ireland. [2]

The housing stock in Ireland is very different from most of the rest of Europe in that 87% is in houses. Only 9% is in apartment blocks, most of which have been built since the nineties. Even now more detached houses are built than flats, even in the largest cities. There were huge developments of detached and semi-detached housing in areas surrounding Dublin in the years immediately before the crash.

A study tour for maintenance and development managers from UK housing associations in the late nineties explored planned developments surrounding Dublin Airport which were on a scale not seen in England since the era of new towns. At the same time many of the council housing estates nearer the centre of the city were in urgent need of improvements to deal with condensation and high heating costs caused by a lack of insulation. Council tenants complained of long delays in carrying out repairs. Control over the quality and cost of repairs at that time was judged to be well below UK standards.

Most social housing in Ireland is held by local authorities (87%) where tenants have the right-to-buy. The rest are provided by the voluntary sector who mostly house the elderly, disabled, and others with special needs. There are also a few housing cooperatives. Neither of these have the right-to-buy, although there are schemes to assist their tenants into home-ownership.

'Differential Rents' are set in relation to the total income of the household, with a minimum and maximum for each property. This is typically 15% of net income after deducting allowances for each member of the household.

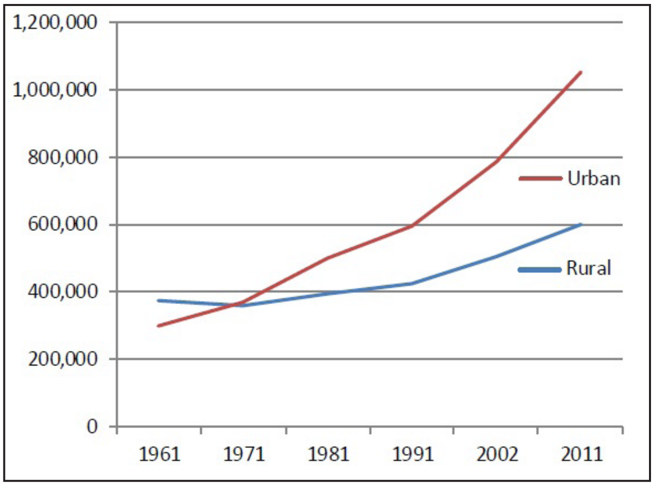

Fig 62: Rural & urban households [3]

Since they often house low-income families these sometimes fail to cover the cost of management and maintenance. [2] Market rents in Ireland are amongst the highest in Europe while social housing rents are amongst the lowest (Fig 31 on page 36).

Social housing is allocated from a waiting list where applicants are prioritised on the basis of need. Only those currently living in a local authority area qualify, including foreign nationals with a long-term right to remain. In 2011 there were 100,000 households on waiting lists for social housing.

The Irish Government's Housing Policy Statement in June 2011 signalled a shift of responsibility for developing social housing from local authorities to Approved Housing Bodies (AHBs), including both housing associations and cooperatives. [6] These would finance development with private finance backed by a variety of revenue subsidies instead of public sector borrowing. In November 2014 the government committed to supplying an additional 35,000 social housing units by 2020 under this initiative at a cost of €3.8 billion.

There are parallels with the introduction in 1988 of private finance and Social Housing Grant to fund development by housing associations in the UK.

In 2014 the voluntary sector in Ireland had a total stock of around 26,000 units, shared between 520 AHBs. The largest thirty AHBs manage between 100 and 4,000 homes. If these are to become the main suppliers of social housing they will need to develop new skills in housing investment and become financially stronger. This will be a challenge for the new Housing Agency set up to regulate them.

When private finance was introduced in Scotland they faced similar problems with relatively small housing associations, and dealt with it by transferring to them the 75,000 homes owned by the Scottish Special Housing Association. Consolidation through mergers and transfers is on the agenda in Ireland.

Other initiatives in 2014 include [7]

- reform of differential rents to encourage people to move on from social housing as their circumstances improve
- introduction of 'choice based letting' for the allocation of social housing by local authorities and AHBs
- a 'housing passport' to allow greater mobility between local authorities for social housing tenants seeking work.

Home Ownership

People living in rural communities dependent on subsistence farming are more likely to own their own housing than those moving into towns. This together with the large scale of right-to-buy helps explain why home ownership in Ireland was already amongst the highest in Europe by the end of the 1940's, and continued to rise substantially through to the 1990s (Fig 61 on page 69).

Renting was associated with poverty, echoing the historic gulf in rural Ireland between the property owning classes and the masses. Expanding home-ownership was a popular political cause. It was also seen as a way of gaining an asset and reducing dependence on welfare, particularly in old age.

Subsidies to home-ownership in Ireland at that time have been described as a 'socialised home-ownership regime', enabling the vast majority in all income groups to purchase a home. During the seventies and eighties these were reduced, allowing market forces to take over. By the nineties the level of home-ownership had begun to decline (Fig 61 on page 69). [8]

Almost half of owner-occupiers own outright without a mortgage. A similar pattern can be found in Spain, and

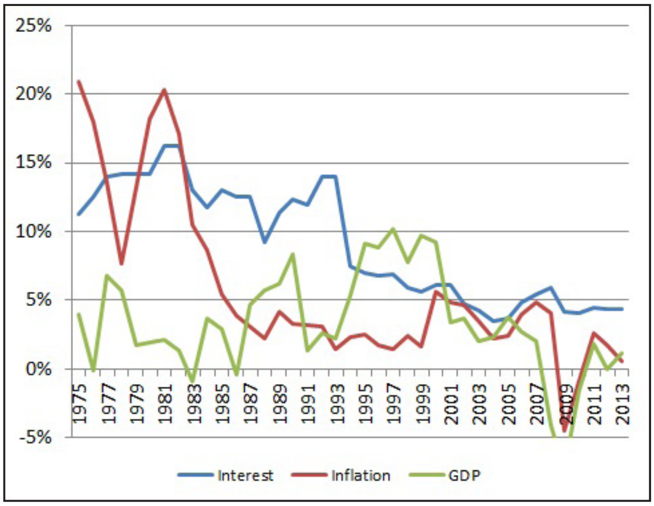

Fig 63: Interest rates inflation & GDP in Ireland [4]

in much of Eastern Europe.

Most mortgages in 2012 were at variable rates (83.9%), with half on trackers. [9] Most Europeans borrow at medium to long term fixed interest rates. The UK and Ireland are exceptional, and this makes their housing markets more sensitive to changes in interest rates.

Planning rules are similar to the UK with each development requiring individual planning permission. Housing densities are the lowest in Europe, and there is little evidence of a shortage of building land. This helps explain why construction responds well to changing demand in Ireland: supply elasticity is well above the European average, although not as high as in Scandinavia (see Fig 8 on page 11).

Ireland joined the EU in the mid seventies, and by the mid eighties their currency was part of the European Exchange Rate Mechanism. They subsequently joined the Euro. Once this had bedded in GDP began to rise and interest rates fell closer to central European levels. By the mid-nineties the Irish economy was looking strong and attracting global businesses such as Amazon, Dell and Google by acting as a low-tax haven within the EU. In 2011 GDP per person was €37,293, higher than the UK (€30,724) or Germany (€35,862). Income differentials are about average for Europe, similar to France and Germany and much lower than in the UK (Fig 36 on page 41).

Lower interest rates made mortgages more affordable.

By the early 2000s real rates of interest (net of inflation) were close to zero (Fig 64). Combined with a booming economy this made house purchase very attractive, so the housing market took off (Fig 65). The value of their homes was increasing each year by more than most people could earn in salary. New construction reached unprecedented levels, financed through Irish banks, and secured against rising property prices (Fig 66). Total residential mortgages rose from 24% of GDP in 1997 to over 70% by 2006. [5]

Similar things happened in Spain, Portugal and Greece, and for similar reasons: strongly growing economies with access to Euro level borrowing rates but with inflation and earnings growth well above the European average.

The European Central Bank was setting bank rates to suit the larger economies, particularly Germany and France, These rates were far too low to cool inflation in the smaller and less robust economies of southern Europe and Ireland.

Tax relief on mortgage interest remained available in Ireland throughout this time, and did not stop until the end of 2013. It remains for existing loans until 2017.

The bubble burst with the financial crash in 2008. GDP fell by 7.5% in 2009 and unemployment doubled to 13.2% of the workforce. Inflation went negative, at -4.5%. House prices fell 9.1% in 2008 and a further 18.5% in 2009. New mortgage lending continued through 2009 but at only 40% of volumes in 2008. New construction plummeted from over 50,000 units a year to less than 9,000 in 2011 (Fig 66). [5]

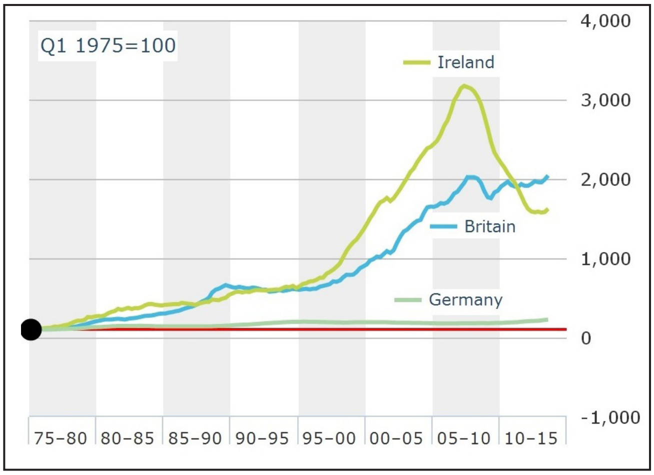

Fig 65: House prices in Ireland, UK and Germany [10]

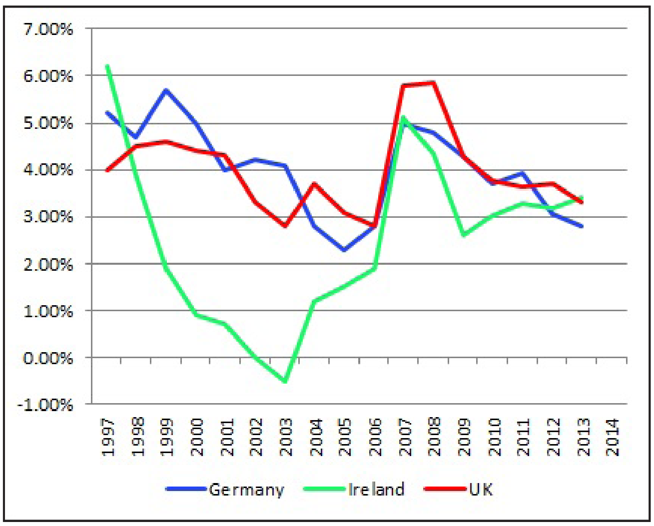

Fig 64: Mortgage interest net of inflation [5]

The government guaranteed bank deposits, and put protection in place to delay banks foreclosing on mortgages until they were at least six months in arrears. In practice it suited the banks to keep the loans in place so long as some payment was being made.

A Code of Conduct for Mortgage Arrears was introduced in January 2011 requiring each lending institution to adopt a Mortgage Arrears Resolution Process (MARP) as a framework for handling cases of mortgage arrears.

By 2011 almost 20,000 households were receiving Mortgage Interest Supplements from the government at a cost of close to £70 million a year. The number of claimants fell to 15,000 by 2012 and has continued falling since. The scheme was intended to provide short term financial support to help struggling borrowers to meet their mortgage interest payments. It is being scaled back in 2014 and will be abolished entirely by 2017.

The Irish economy picked up in 2013, but the housing market is still in the doldrums, with barely any new construction, and an overhang of properties for sale. But the fall in house prices appears to have slowed in areas of historically high demand, like Dublin. Sales volumes rose slightly in 2013.

Mortgage arrears have also begun to fall, although this is partly due to restructuring of the debt. [5] At the end of September 2013 12.9% of residential mortgage accounts were more than 90 days in arrears. The worst hit were first-time buyers, particularly around Dublin. This compares with 27.4% of buy-to-let mortgages in arrears at the end of 2012. [9]

Half-built houses abandoned on the outskirts of little towns and villages are still a common sight in Ireland. In the 2011 census there were almost 290,000 empty properties out of a stock of just under two million (14.5%). [3] Ireland has 371 dwellings per thousand people. Within the EU only Poland (348) and Slovakia (326) have less. The properties are empty because households cannot afford them, and not because there is an over supply.

Fig 67: Unfinished houses in Co Leitrim [11]

Government policy in 2011 recognised the damage that speculation in housing had done to the Irish economy, diverting investment from the creation of sustainable employment.

They announced they would no longer promote home-ownership as the ultimate tenure all should aspire to, or provide fiscal incentives encouraging people to treat housing as a commodity and a means of wealth creation.

Previous policy had been based on a paradigm of housing that put private home-ownership at the top, followed by supported home-ownership (ie tenant purchase of local authority housing, and affordable housing), with self-financed private rented accommodation further down, and State supported rental accommodation at the bottom (ie rent supplements and social housing tenancies). [6] Future housing policy would be more even handed between the tenures, with the private rented sector playing an increasingly important role.

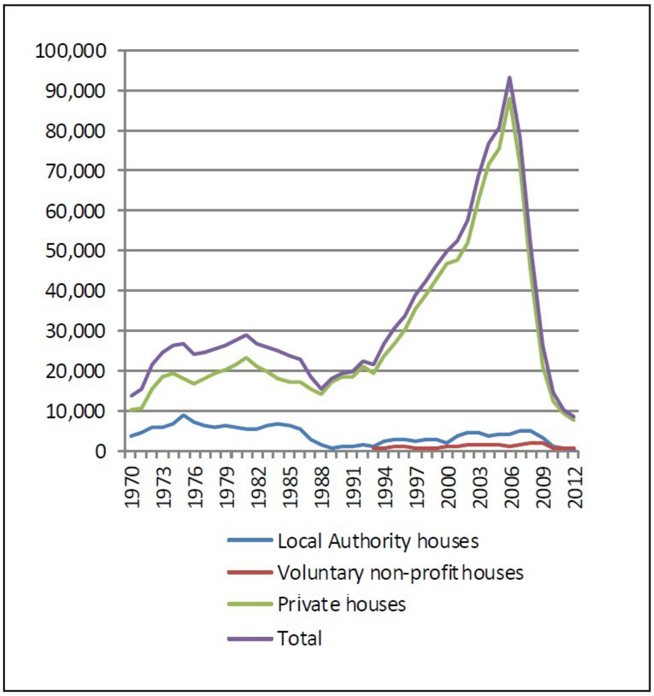

Fig 66: New housing construction [9]

Ireland has been quite innovative in dealing with the consequences of its banking crisis. The problem was caused by irresponsible lending which led to a housing bubble. Where other counties have reacted in similar situations by steps to reinvigorate the housing market, Ireland appears to be tackling the underlying problems without pumping up prices. There is no shortage of supply of housing, but there is a problem of affordability. By the end of 2014 property prices were beginning to rise again.

In January 2015 The Central Bank introduced new restrictions on residential lending. Loans to landlords are capped at 70% of value, and to owner-occupiers at 80%. Banks are prevented from issuing loans of more than 3½ times a borrowers income (combined salaries for a couple). They have left a modicum of flexibility to the banks with slightly higher loan to value limits for first time buyers who can borrow up to €198,000 at 90% of value provided no more than 15% of loans by volume breach the 80% limit. No more than 10% of loans to landlords can exceed the 10% limit. [12]

Rental sector

Private rental was described in the eighties as the 'forgotten tenure' in Ireland, chiefly providing poor quality housing for low-income households and short-term accommodation for young people leaving home. It had lost out to social housing and home-ownership both of which received generous government subsidies, whilst private renting was constrained by rent control. By the time of the 1961 census it had fallen to 17.2% of households, and by 1991 to 7%.

Rent controls were found to be unconstitutional by the Supreme Court in 1982 as an unjust attack on the property rights of landlords, and were entirely removed. [9]

Since buy-to-let mortgages became available in the nineties the private rented sector has grown. The Residential Tenancies Act of 2004 introduced major reform and set up a Private Rented Tenancy Board (PRTB) to regulate it (changed in 2012 to the Residential Tenancy Board: RTB).

Four-year tenancies were established: tenants can be evicted at one month's notice during the first six months, but thereafter they are secure for the next 3½ years unless they are in breach of the contract. After 4 years the cycle starts again.

Disputes are dealt with by legally binding arbitration but this cannot authorise eviction which has to be through court action following failure to remedy a breach notified in writing within a reasonable period of time.

Tenants can appeal to the RTB if they believe their rent exceeds a market rent. Rents can only be increased once a year. Rent deposits are limited to one month's rent. These are currently held by the landlord although in 2012 the government committed to creating a rent deposit scheme. Sub-letting requires the landlord's consent. Landlords are responsible for repairs. Tenants do not have preemption rights to purchase if their property is sold.

Minimum standards of accommodation have been steadily raised since the nineties, although inspections by local authorities were sporadic and a large proportion of landlords did not even register their properties as required by the 2004 Act. The government has provided additional funding for inspections since 2006, so that the number carried out doubled by 2009.

By the time of the 2011 census 19% of households rented from private landlords and almost 9% from social landlords.

A disproportionate number of private rental households were of non-Irish origin (39% in 2006 and 43% in 2011), and they tend to be younger and on lower incomes than home-owners. Rising unemployment following the crisis led some immigrants to look for jobs elsewhere or to return home.

Private sector market rents fell by an average of 7.6% between 2006 and 2011 from €180.28 per week to €166.61. The largest falls were in South Dublin (15.8%) and the lowest (2.5%) in Co Mayo. Since 2012 they have started to rise in Dublin, and stopped falling elsewhere. [9] Rents remain high by European standards (Fig 31 on page 36).

90% of landlords in Dublin own two or fewer properties, and they appeared to be investing in the expectation of capital growth. Rental returns were generally too low to attract investment companies and have fallen since the crash. The collapse in house prices since 2008 affected them badly.

Since the banking crisis mortgage arrears have been highest on buy-to-let with 14.5% of loans requiring restructuring compared with 10% for home-ownership. [5] Restructuring aimed to shift from short-term fixes to long-term sustainable solutions for mortgage arrears. As a result repossessions have remained low. [5]

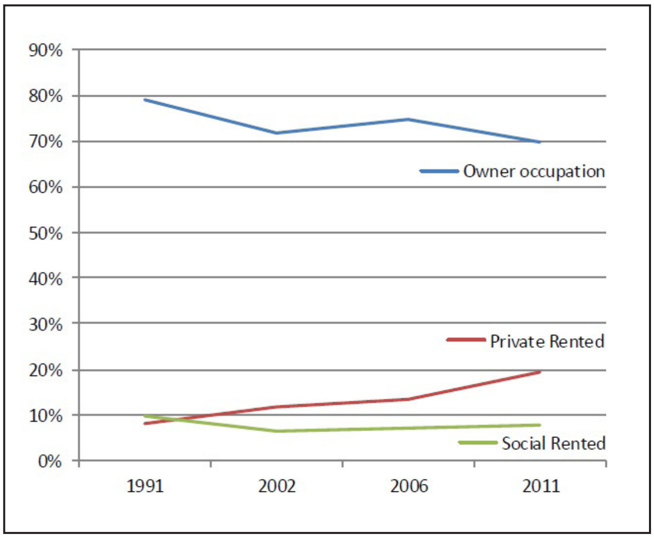

Fig 68: Recent changing patterns of tenure in Ireland [3]

Rent supplements were introduced in 1975 for private tenants on state benefits. In 2005 these contributed an average of 85.7% of a claimant's rent, and were claimed by 38% of tenants. The proportion claiming has risen substantially since 2008 as result of the recession, peaking in 2011 at almost 100,000 households and an annual cost of €503 million.

Since 2006 local authorities have been responsible for finding accommodation for claimants under the Rental Accommodation Scheme (RAS): they lease properties in bulk for re-letting to claimants, ensuring the properties meet a minimum set of standards. Tenants have less security under this scheme.

The biggest impact has been to raise the standards of housing available to them, and many of the cost savings that were expected have so far failed to materialise. Since 2009 this has largely replaced the provision of social housing, but without the right-to-buy. In the long term it is expected to be more cost-effective than rent supplements as a means of providing housing to those that cannot afford market rents or home-ownership.

In 2014 the government began replacing Rent Supplements with Housing Assistance Payments (HAP). Households in work that are unable to afford to house themselves qualify by applying to join the council housing waiting list. Under this scheme the tenant finds a suitable private rented property. It must be within rent limits which depend on household size and the locality, and are similar to those applying to Rent Supplements. The local authority pays their rent, and the tenant pays a 'differential rent' to the local authority. They remain a private tenant. The landlord must have a tax clearance certificate and the accommodation has to comply with the minimum standards set for rental housing. [15]

The government plans to meet the housing needs of 75,000 households via the private rented sector through a combination of RAS and HAP by 2020.

Landlords pay income tax (or corporation tax for an incorporated body) on all rental income net of normal operating costs. Allowable deductions include management, repairs and maintenance, insurance, ground rent, professional fees, a wear and tear allowance, and up to 75% of mortgage interest.

Capital gains are taxed at 33%. Home-owners are exempt on their main residence. Stamp duty is paid by landlords and home-owners alike at 1% for transactions of up to €1 million and 2% on transactions above that. [9]

A Local Property Tax was introduced in July 2013 at 0.18% of the value of each residential property up to €1 million and at 0.25% on any additional value above that. It is paid by landlords and owner-occupiers and also applies to vacant properties that are fit for habitation. [13]

Tenants can offset 20% of their rent against tax although since the credit crunch the government began phasing this out over seven years, disqualifying all new tenancies since 7th December 2010. [14]

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Chapter 10

France

KEY STATISTICS	EU	France
Population (2009)	499.7 million	64.4 million
Population per sq km	116	117
Dwellings (2011)	236 million	31.3 million
Units per 1,000 pop	473	509
Supply elasiticity (best high)	55%	36%
Fixed interest mortgages %	mainly fixed	86%
Per capita € GDP (2011)	29,135	30,838
Gini coeff incomes (2010)	30.8	31.7
% owner occupied (2011)	66.6%	58.0%
% social rented (2011)	6.7%	15.0%
% private rented (2011)	19.1%	22.0%
Real prices 1975-2007	109%	140%
Real prices 2007-2013	-7%	-4%

Culture and economy

France was the largest country in the European Union until the reunification of Germany in 1990. They now have a population of 64 million, living in 31 million dwellings. Population density is one of the lowest at 117 per sq km.

Their economy has suffered since the banking crisis with unpopular austerity measures to reduce their public sector deficit. Their GDP per head is very similar to the UK at €30,838. Income differentials are similar to Germany, higher than the Scandinavians but considerably lower than the UK.

The French concept of 'solidarity' which underlies their attitudes to welfare is explained by Jane Bell in a review of *Social housing in Europe* published by the LSE in 2008[3]. "*The legal basis for French welfare is solidarity: collective groups standing together and contracting to look after their own interests and those of people suffering misfortune in life. However, representatives of local interests in the allocation process tended to look after local interests in such a way that housing the disadvantaged did not affect them negatively*". There is no equivalent mechanism for empowering representatives of collective interests in the UK, where tenants' organisations and community groups have much less influence. This right to 'have your say' can have its downsides, resulting in protectionism and bureaucracy.

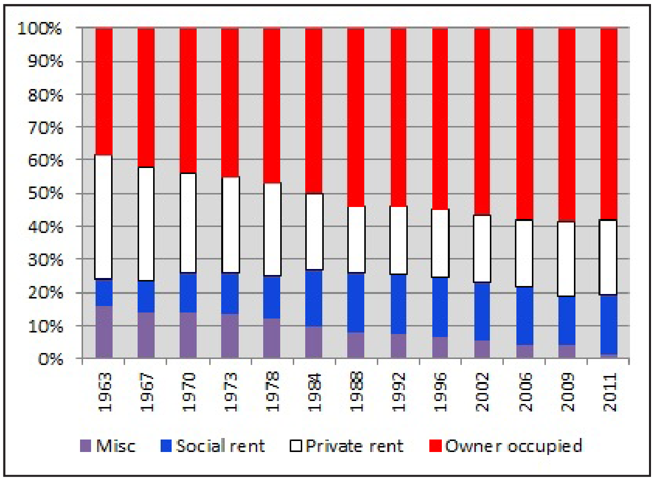

Fig 69: Tenure mix in France [2]

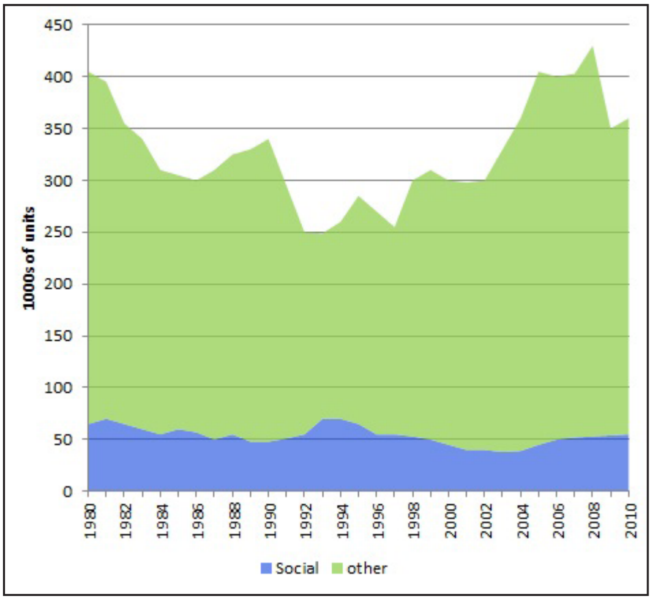

Fig 70: French social housing and other construction [5]

Social housing

The earliest social housing in France was built by factory owners and philanthropists during the mass urbanisation of the industrial revolution. Legislation in 1894, 1908 and 1912 gave it a statutory basis, and it is now provided by a variety of different organisations. [1]

The oldest are known as HLMs (Habitations à Loyer Modéré) which grew out of the earlier HBMs (sociétés d'Habitations à Bon Marché). These are the nearest equivalents to housing associations in the UK. They divide into 'Public HLMs' controlled by municipalities (Offices Publics de l'habitat) and 'Private HLMs' which are nonprofit companies (Entreprises sociales pour l'habitat) and usually have a mix of private and municipal shareholders. [1,6]

There are also SEMs (Sociétés d'Economie Mixte) that operate under the same regulations and were set up as partnerships between municipalities and private companies. Other minor players include public sector organisations letting to their employees, and housing cooperatives.

Social housing organisations are represented nationally by the USH (Union Sociale pour l'habitation). [6]

In 2005 Public HLMs provided 18% of the rented housing in France, Private HLMs had 15% and SEMs another 10%.

France now has a very similar sized social sector to the UK (18%), although it targets a wider range of income groups. There are three distinct classes of social housing, known as 'upper' (targeted at middle class households), middle or intermediate (for salaried workers) and lower (for more vulnerable groups).

The social housing sector was traditionally aimed at meeting general needs with a mix of low-income and lower middle class tenants, but over the last thirty years tenants have got poorer and poorer. It is now targeted towards people in need. This has consequences for the social mix. Run-down estates are a growing problem, and social housing is becoming increasingly stigmatised.

Tenure statistics prior to 1963 are hard to find. At the end of the war the largest sector was private rental. The following thirty years are described as a golden age for social housing (*'les trente glorieuses')*[3], which was provided for the homeless and poorly housed. Given the scale of the post-war shortages that meant almost everyone. It evolved to house working families, and many middle class households expected to rent social housing as a first step before moving on into home-ownership (Fig 69).

Following the war the government provided building subsidies and low-interest loans to builders of new homes resulting in a massive expansion of the construction industry both for social housing and home-ownership. The emphasis was on quantity, not quality, and the social housing sector enabled the building industry to try out new methods of construction, some of which resulted in poor quality high-rise developments that

Fig 71: Banlieue at Clichy-sous-Bois [4]

now have major repair problems.

Building subsidies were phased out in the mid sixties by which time the housing shortage had been largely dealt with. By the seventies financial support had shifted from production subsidies to personal subsidies. These were focused on low-income households, irrespective of tenure, and could also be claimed by owner-occupiers. Social housing has since then become increasingly focussed on low-income households. [8]

43% of the housing stock is in flats compared with 19% in the UK, but for social housing this rises to 86%. The larger French cities are full of apartment blocks. In Paris 97% of social housing is in flats.

Much social housing is in large estates. The larger peripheral estates (banlieues) are the most dilapidated, containing about a quarter of the stock. Unemployment in the banlieues is twice the national average. There is increasing segregation between the more desirable urban areas, and those with the most social housing stock (Fig 71).

Immigrants are twice as likely to live in social housing as non-immigrants, with even higher percentages amongst those from Turkey, and the old French colonies in north and sub-Saharan Africa.

France has three main levels of government: national, regional, and municipal. Housing policy and funding is determined nationally. Until the early eighties government in France was highly centralised, like in the UK. Regions were then introduced as a new tier of government and have a strategic role particularly in adapting subsidies to suit regional priorities. [7]

The municipalities are responsible for local housing. Some were reluctant, with Gaullist town halls less keen than those on the left. This led to concentrations of social housing in some areas. To counter this a law was introduced in 2000 (loi de solidarité et renouvellement urbain) requiring municipalities with more than 3,500 inhabitants to achieve a target of 20% social rental dwellings by 2020. The Hollande government proposes to raise this to 25% with a five-fold increase in the penalties for municipalities that fail to do so. [1,6]

Most housing subsidies derive from a 0.95% levy on the wages of all companies with more than 20 employees (1% logement). This reflects an historic view of the responsibility of employers to house their workers, and

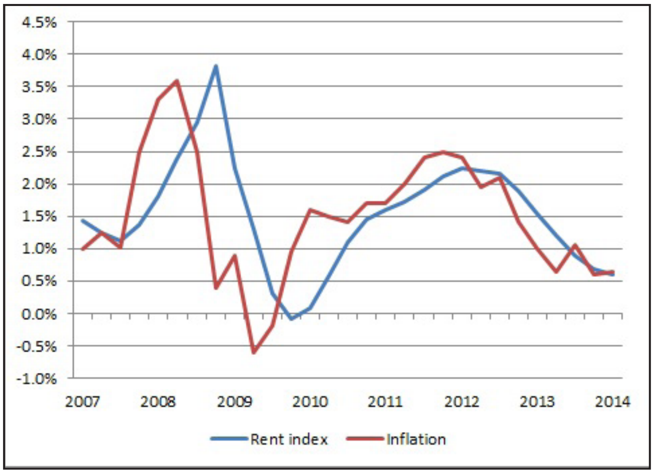

Fig 72: Rent inflation in France since 2007

in some instances it is directly used to subsidise the housing of employees involved in the scheme. Half the money raised goes to housing benefit, and the rest is used to finance social housing, urban renewal, and other financial support and services to households.

Subsidies to support investment by social housing providers have reduced over the last 30 years, while housing benefits paid directly to tenants have risen threefold. Even so, investment in social housing in France continues at a higher level than elsewhere in Europe. Over the last ten years this has resulting in development of around 60,000 to 70,000 units of social housing each year out of an annual average of 350,000 units constructed (Fig 70).

Subsidy is provided under a number of different schemes each of which involves agreements on rent levels and who the housing should be targeted at, particularly in relation to household incomes.

Loan finance over 40 to 60 years is provided on favourable terms through the Caisse des Dépôts with implicit government guarantees. State grants are still available although the amounts have fallen substantially in recent years. Social housing pays VAT at a reduced rate on construction and repairs.

In 2007 an average social rented dwelling cost €104,000, of which 80% was financed by off-market loans, 13% by grants from the state and local authorities, and 7% by equity capital from the HLM body. [3]

The maximum rent depends on the terms of the subsidy provided and the size of the dwelling and is expressed as a square metre price. This varies between regions, and rises each year against an index of construction costs. When it comes to setting rents for particular properties these are determined by a formula related to the cost of the original investment, so that older properties tend to be cheaper. [6]

Social housing rents average around 70% to 75% of market rents with larger differentials in high demand areas like Paris. In 2006 annual rents in social housing averaged €55 per m² in social housing and €90 on the open market.

The state (INSEE) issues a 'rent revision index' each year (indice de révision des loyers) which is binding on private landlords but not on social landlords for whom it provides guidance on rent increases.

Tenants pay an additional rent supplement where their incomes rise above 120% of the income limits on which the subsidy is based (supplément de loyer de solidarité: SLS), so long as their rent plus SLS does not exceed 25% of total household income. There are exemptions to encourage higher income households to remain in vulnerable areas [8]

Social housing tenants have security of tenure and can pass this to their children. They stay on average for about 10 years.

The 'Boutin' law in 2009 introduced a couple of significant changes affecting tenants of social housing: households with incomes more than twice the ceilings for new tenants have to sign a three year nonrenewable lease, after which they must move out; those in units that are too large for them are offered alternative accommodation more suited to their needs, and if they refuse three offers they lose their tenancy after six months. This does not apply to over 65s or the disabled. [6] These two measures may make more social housing available for those that need it at the expense of a broader social mix on the estates.

Allocation systems prioritise people with housing and/or social problems. There are no points systems in French social rental housing, so that different priorities can conflict with each other. This makes the allocation process rather complex and somewhat lacking in transparency.

The state allocates 30% of vacancies, and the municipality 20%, with local employers who contribute 1% of wages to the 'logement fund' also having a say. Whichever is entitled will usually propose three candidates (in order of priority) when a dwelling earmarked for them falls vacant or is completed. The dossiers of these candidates are then presented to the commission d'attribution, a committee that consists of the various relevant stakeholders (employees of the social rental landlord, the mayor of the municipality concerned,

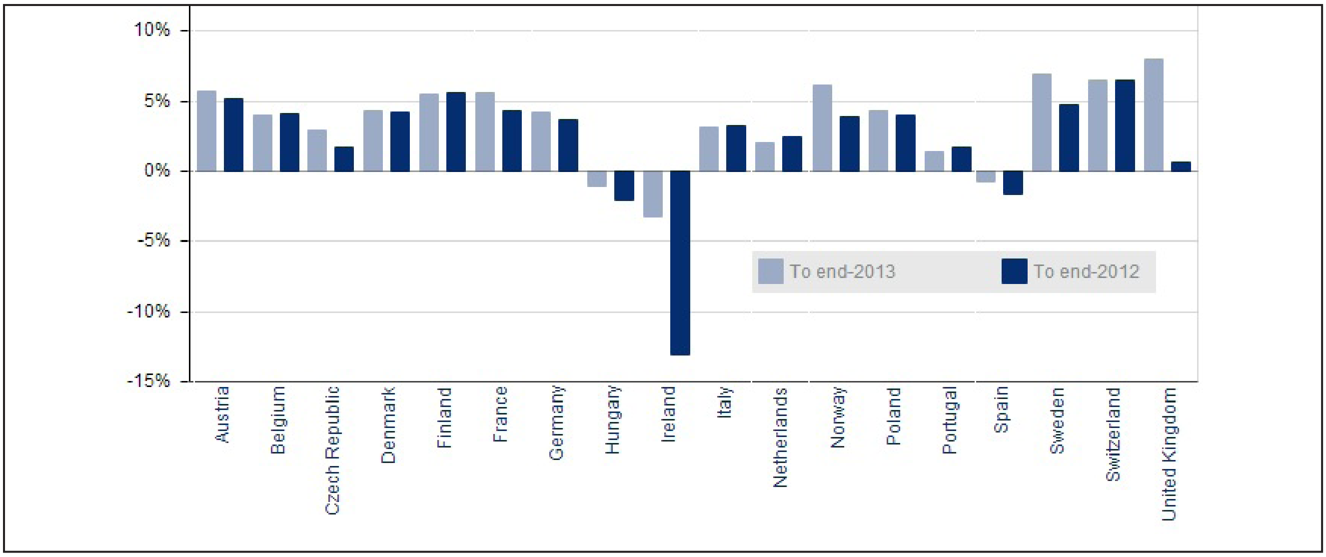

Fig 73: Average total annual returns on rent (capital and rent) across Europe over 5 years to 2012 and 2013 [9]

representatives of the département and representatives of the tenants). This committee decides to which household the free dwelling is allocated. In reality, however, the committee usually follows the advice of the different parties that put forward the candidates. [1]

Overall there is no shortage of housing in France, although changing patterns of economic growth have resulted in areas of low and high demand. Of the 32 million dwellings almost 3.2 million are second homes and another 1.9 million are vacant.

France has less than half the population density of the UK and Germany, with the Belgium and the Netherlands even higher at three and four times their density. It also has more dwellings per 1,000 inhabitants than elsewhere (513 compared with 477 in Germany, 450 in the UK and 400 in Ireland).

Private rented sector

Private renting was the dominant tenure right up to the Second World War. Rent controls introduced during the First World War remained in place throughout this time and resulted in a lack of investment in new construction and renovation. [6]

By the end of the Second World War the French housing stock was in a very bad state with severe shortages. [8] Much of the reconstruction was led by social housing organisations, regenerating areas that had previously been private rental housing.

Only 30% of private rental is in houses, although that is twice as much as is found in social housing. The rest is in apartments. Households tend to be smaller, averaging 2 persons compared with 2½ in social housing.

Institutional landlords (mostly insurance companies) have largely withdrawn because rental returns are low in relation to other investment opportunities, although they still retain some of the best quality properties. [1]

Rental returns in France are about average for Europe (Fig 73). In 2011 the gross returns from rent averaged around 3.3% and from capital growth 8.2%, making a total of 11.5%[8] before deducting operating costs. As in the UK it is fluctuations in house prices that have the most impact, and these are more stable in France than the UK, although less so than in Germany, or Switzerland where the highest returns on rent are found (Fig 73).

97% of privately rented housing is held by individuals, two thirds of whom have only one property to let. Over 60% manage this themselves without involving professional agents. Until recently few deliberately acquired property as an investment. Some inherited it, and others let out their old home having moved to find work elsewhere. Less than 40% of privately rented housing is professionally managed. Most private landlords are retired executives or professionals with substantial incomes and an average age of 57. [1]

The principles behind the French subsidy system were agreed in 1977 between the state and representatives of landlords (UNPI: *Union Nationale de la Propriété Immobilière*). This specified the financial aid that the French state would provide through both production subsidies and personal subsidies. It also formulated quality requirements for subsidised dwellings and maximum income levels for the tenants of these dwellings. [1,8] The original agreement has been subsequently modified, but remains the basis for policy, particularly relating to the involvement of private landlords in the provision of affordable housing.

A bewildering array of tax incentives (each named after the minister that introduced them) have encouraged individuals to invest in market rental over the last 20 years, and mortgage finance has become readily available. Together these halted the decline in private renting, which remains fairly steady at about 20% of the housing stock. They also amplified the role of the private rental sector in the provision of social housing, in continuation of the principal that social housing should meet a broad spectrum of housing need. [6]

Private landlords with rental income below €15,000 can choose to deduct a fixed 30% for costs, instead of actual costs, under the 'micro-foncier regime'.

Otherwise the tax incentives currently include: [1]

- Mortgage interest and other operational costs can be offset against rent for tax purposes, including maintenance, refurbishments, improvements, and property taxes.
- There is a €10,700 per unit annual limit on deductions from all sources, with any remaining costs being carried over to deduct in future years.
- Since 1999 landlords pay VAT at 5.5% instead of

Fig 74: Investment property offered to landlords by Akerys in the Paris region of 2 room 37 sq m flats for €169,000 [6]

19.6% when renovating their properties. The same applies to tenants on their own repairs, and to home-owners.

In 2010 the state spent €930 million on tax incentives to the private rental sector including those under previous schemes whose period has not yet expired. These costs are expected to continue rising as more dwellings qualify for the more expensive *Scellier* scheme introduced as a temporary measure to stimulate construction following the banking crisis. [6]

A new kind of housing developer has emerged in France in recent years with expertise in exploiting the tax and subsidy regime to provide profitable rented housing for individual landlords (eg Akerys Fig 74). In effect they sell financial packages to the landlords, and provide all the management and maintenance services, so that the individual landlord requires no local knowledge or involvement. The resulting properties tend to be small flats averaging around 60 square metres. [6]

These newer investment properties attract younger tenants, 60% of whom are under the age of 38. [6]

More traditional investment by individuals still results in the construction of about 10,000 new units a year for rent.

In the UK private renting is invariably on a very temporary basis, with leases of up to a year. French tenancies are longer and more secure, and have to comply with specific rules governing rent increases, rent deposits, and termination. The landlord is responsible for ensuring the dwelling is decent and in a fit state for letting. But under article 1754 of the Civil Code the tenant is responsible for all their own maintenance and minor repairs, which enables them to take more personal care of their homes. [8] This makes private renting in France a more viable long term alternative to home-ownership than in the UK.

Tenancies are for a minimum of three years (six for institutional landlords). The tenant can give three month's notice. In practice tenancies last an average of about five years. The landlord can only terminate following an unresolved breach. Even at the end of the lease they can only terminate in order to sell up, or for a member of their family to move in, except where the property is cleared for major refurbishment. To do so they must give six months notice. The tenant has first refusal if they wish to sell (preemption). Any new owner is bound by the terms of existing tenancies. Evictions can be painfully slow, taking an average of 18 months, and there are additional protections for tenants that cannot afford to pay their rent,

Furnished tenancies can be for one year, or nine months for a student, with the landlord giving three months notice to terminate prior to renewal.

TAX INCENTIVES

The latest time-limited tax incentives for rental housing include: [6, 8]

'*Borloo ancien*' from 2006: 30% of rent is tax deductible for six years (9 with subsidised renovation) in exchange for maximum rents of between €8.41 and €17.77 per square metre, depending on the region, and income limits for tenants. The deduction rises to 60% for '*Borloo ancien social*' with lower maximum rents.

'*Scellier*' from 2009 to 2012: the deduction of up to 25% of the investment cost against tax is spread over 9 years (ie 2.78% pa). Under '*Scellier intermêdiaire*' this can be extended for another six years at 1.33% pa in exchange for lower rents (as in *Borloo neuf*) and tenants with lower-income limits throughout the period. This costs the state about €34,000 per unit rising to €46,000 for *intermêdiaire* which compares with €52,000 for a social rental dwelling.

'*Duflot*' from 2013 to 2016 (replacing *Scellier*): 2% of the investment cost is written off against income tax each year for nine years in exchange for rents no higher than 80% of market rents, for letting to tenants within 'intermediate' income limits that are tighter than *Scellier*. It is restricted to high demand areas.

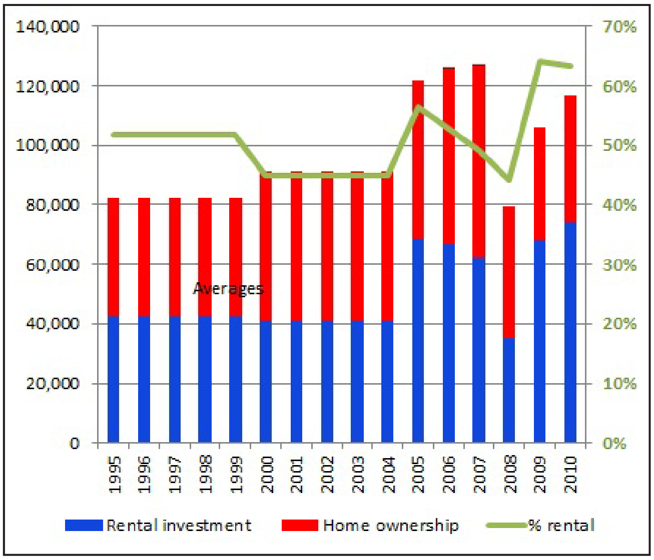

Fig 75: Housing production by French developers [6]

Prior to 1986 rents on relets were based on the previous rent. Until 2012 there was then no rent control for new lettings. Rent increases during a lease or on renewal of a lease could not exceed the increase in the 'reference rent index'. The only exception was on renewal of a lease where the landlord could show that the rent was well below comparable market rents. Reference rent increases were initially influenced by a combination of the cost of living (60%), maintenance costs (20%) and construction costs (20%), but since 2008 have followed a version of the cost of living index (Fig 72). During that time construction and maintenance costs have risen faster, at some disadvantage to landlords. [1]

In 2012 new rent controls were introduced restricting both annual increases and rents on new tenancies to the rent revision index (indice de révision des loyers), with exceptions to allow for major improvements. According to the *Economist* this depressed housing construction that was already in the doldrums.

Rent deposits are limited to one month, and not permitted where the tenant pays rent more than two months in advance. There are no restrictions on how a deposit is held.[8]

Capital gains net of inflation are taxed at 16% plus another 10% for social levies (26% in total), although this gets reduced by 10% per annum after the property has been held for 5 years. Owner-occupiers are exempt from capital gains tax. They do not pay tax on imputed rent, or get tax relief on mortgage interest.

Housing benefit in France is available to both tenants and owner-occupiers on lower incomes. The level of the benefit depends on the income and composition of the household and its housing costs, and is capped at a maximum level.

In 2009 the total amount invested in private rental was €24.2 billion. Two thirds of sales of new homes were to private landlords, amounting to €10.5 billion. €8.5 billion was in purchase of existing dwelling, and €5.2 billion in maintenance and improvement (Fig 75).

Home ownership

Home ownership has been actively promoted since the war. In the twenty years that followed builders were encouraged with state subsidies and low-interest loans, and purchasers were assisted with grants and low-interest mortgages. Between 1950 and 1963 home-ownership rose from 35% to 42%, and by 1978 it was 47%, reaching a plateau by 1990 at about 54%. It has since risen to around 60%.

By the end of the sixties the backlog in construction had been dealt with and building subsidies were phased out. During the seventies state aid was focused on low-income groups. High-interest bank accounts were provided for households saving for a home. [8]

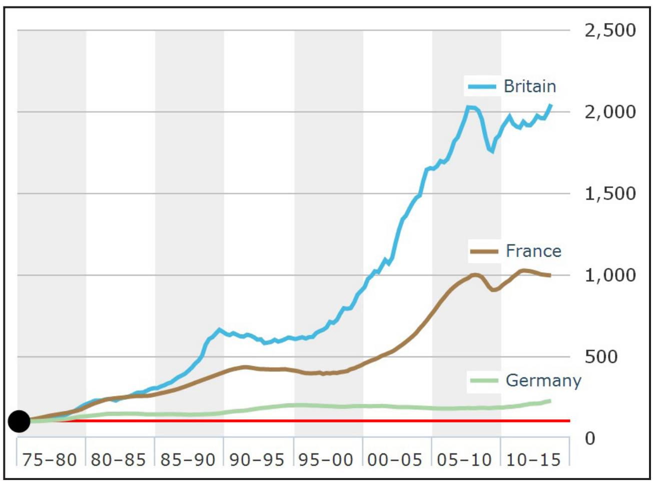

Fig 76: Growth in French house prices [10]

These days most purchases are on fixed rate mortgages of between 15 and 25 years. The government provides mortgage guarantees through FGAS (Fonds de garantie de l'accession sociale) to lower-income households. Most are at market interest rates, but since 1995 some on lower-incomes have been able to borrow at a zero interest rate for new houses or substantial renovations of an existing house, with the difference funded by FGAS.

In 2007 the Sarkozy government set a home-ownership target of 70%, and tried to get HLMS to sell more social housing to their tenants, without much success.

The 'pass-foncier' scheme in 2007 gave low-income households a free lease on the land where a new dwelling was constructed, and a lower VAT rate for the build cost. After 25 years they have to buy the land. The scheme was abolished in 2011 as part of a reduction in government expenditure. [8]

The French have a large rental sector which is evenly split between social and market rent. This may be a factor in making French house prices more stable than the UK, although less so than Germany. There is less difference in the tax treatment of home owners and private landlords. The French rental sector bears less taxation than in the UK.

There has been public debate on further reforms to the property tax system to reduce the remaining advantages of home-ownership over rental which are seen to encourage higher prices. Proposals include

- the abolition of registration fees (equivalent to UK Stamp Duty),
- applying capital gains tax at the same level to all property including home-ownership, and
- reintroducing a tax on the imputed rent of owner-occupiers (abolished in 1964, at a similar time to the UK).

The banking crisis led to a fall in house sales and house prices dropped 2.9% in 2008 and another 4.4% in 2009. This had more to do with austerity measures to deal with budget deficits than any shortage of mortgage finance. Repossessions rose only slightly.

The government adopted a Keynsian approach to increase demand in the economy by promoting investment in housing. They authorised social housing organisations to buy 30,000 additional properties to help the market to recover. The intermediate market rental sector was encouraged to build another 40,000 through the tax incentives already described above. Interest rates were reduced. By 2010 house prices had caught back up, with 9.4% growth. Since 2012 they have plateaued as a result of sluggish growth in the economy, stagnant wages and high unemployment(10.3% in 2013).

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Chapter 11

Belgium

KEY STATISTICS	EU	Belgium
Population (2009)	499.7 million	10.8 million
Population per sq km	116	352
Dwellings (2011)	236 million	5 million
Units per 1,000 pop	473	457
Supply elasiticity (best high)	55%	32%
Fixed interest mortgages %	mainly fixed	75%
Per capita € GDP (2011)	29,135	33,704
Gini coeff incomes (2010)	30.8	33.1
% owner occupied (2011)	66.6%	63.0%
% social rented (2011)	6.7%	9.0%
% private rented (2011)	19.1%	27.0%
Real prices 1975-2007	109%	140%
Real prices 2007-2013	-7%	8%

Political background

Belgium is made up of two distinct regional cultures. Flanders borders Holland in the north, and is Dutch speaking. It is smaller (45%) than the French speaking Walloon region in the south, but generally wealthier.

Flanders has two-thirds of the population (5.88 million in 2011). It is one of the most densely populated regions of Europe averaging 470 people per square kilometre. Its capital is Brussels, although the capital city has its own administrative region with a population of 766,744. In Belgium as a whole the density is 367 per km^2 compared with 257 for the UK. Only the Netherlands is higher at 497 per km^2.

There are certain similarities between Wallonia and the north of England. Both were early pioneers of the industrial revolution, generating much of the wealth on which their countries grew strong in the nineteenth century, and have had to adapt to the decline in heavy industries and mining over the last fifty years.

GDP per capita is €33,704 which is similar to Denmark, well above the UK but less than Germany or its neighbour the Netherlands. Income differentials in the eighties were similar to Scandinavia and amongst the lowest

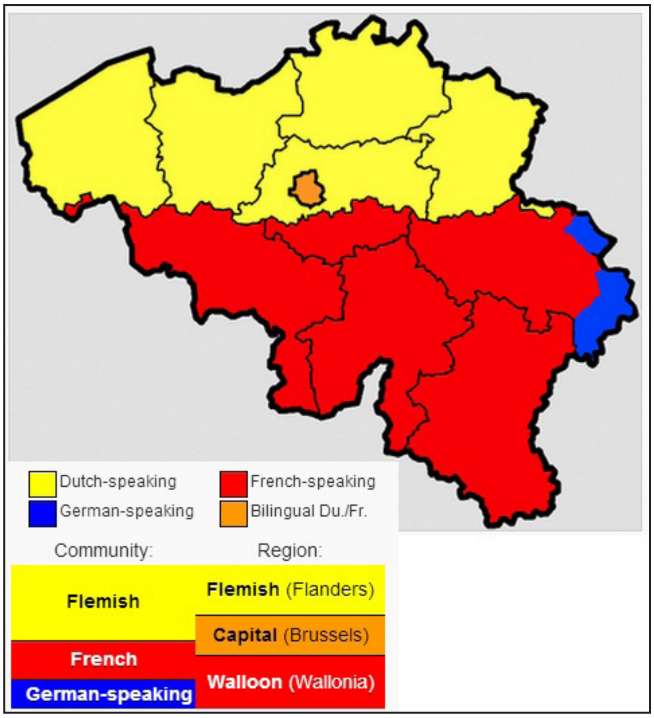

Fig 77: Map of language areas and regions of Belgium [1]

in Europe, but have since risen to be amongst the highest (Fig 37 on page 42).

The geographical regions are responsible for most domestic policy, including much of the economy, employment, housing and infrastructure. To complicate matters, it is the three language communities (French, Flemish and German) that govern education, health care, social and family policy, and these do not entirely coincide with the geographical regions.

Devolution has led to a series of major constitutional changes since 1970, turning Belgium into a federal state. Few outside the country understand the structure of their government which includes eight elected assemblies and six executives. In practice the Flemish Parliament governs Flanders and the Dutch speaking community in Brussels, while the Walloons have a French speaking Parliament that also looks after that group in Brussels. [5] It took 589 days of negotiation between 11 parties to form a Belgium government following their 2010 general election.

It is not easy to obtain housing statistics across Belgium, since these are held regionally. Despite being largely devolved to regional governments, housing policy retains a similar pattern across the country. Further devolution will give the regions control of income tax levels and the regulation of the private rental sector from 2015.

Home ownership

Belgium has a higher proportion of home-owners (67%) than most comparable countries in Western Europe (60%). Of the larger countries only Spain and Italy (with 76%) have more, as do many east European countries and Ireland. [6]

Owning your own home has long been seen as an essential part of Flemish culture, and the best basis for family well-being. Half the households were already owners in 1960. This then rose from 65% in 1981 and to 70% by 2005. [5] Home ownership was promoted by all the main political parties as a bastion against socialism. The vast majority are in houses with less than 10% in flats. In that way they are more similar to England and Wales than to Germany or France.

Subsidies to promote home-ownership were first introduced in 1889, and included tax exemptions and cheap loans to increase the supply and reduce the price of housing. Apartment blocks did not qualify, and the development of estates of cheap housing for working

TAXATION [11]

VAT is paid at the standard rate (21%) on new housing in Belgium based on the full purchase price which since 2011 includes the value of the land. The VAT rate is lower for social housing dwellings (12% if bought from a welfare organisation or 6% if bought from a social landlord). Renovation works on buildings more than five years old are also at the reduced 6% rate of VAT.

'Registration duty', equivalent to stamp duty in the UK is paid at 10% of the value in Flanders and 12.5% in other regions on all purchases of existing housing or building land. This is reduced to 1.5% when a home is purchased with a 'social loan' (see below), or to zero in Wallonia. The rate is reduced to 5% (in Flanders) or 6% (Wallonia) and zero in Brussels for modest homes (judged on the 'imputed rent') whether owner-occupied or rented.

Owner-occupiers in Flanders can offset €15,000 against their income tax in the year they purchase their main residence. The amount to be offset rises for those in the lower tax bands so that the benefit is not increased for the wealthiest households. There are a variety of other deductions available in particular circumstances varying by region.

Owner-occupiers pay tax on the 'imputed rental' income of their homes against which they can claim tax relief on mortgage interest. This is equivalent to the Schedule "A" tax that applied in the UK until the sixties. The rent is based on a 1975 valuation uprated by inflation and then discounted by 40% for notional running costs.

Tax relief is provided on both mortgage interest and repayments for purchases before January 2005. The deduction against tax for purchases since then is fixed at an amount that is inflated each year, and in 2012 was €2,129 for each adult with an additional €710 each for the first ten years, and an additional €70 if the household has three or more children.

Each region charges owners a property tax based on the 'cadastral income' of the dwelling. For rented housing this is the rental income. For owner-occupiers it is the 'imputed rent'. In Flanders the tax is 2.5% reduced to 1.6% on social housing for rent. In Wallonia and Brussels it is 1.25% or 0.8% on rented social housing. It is illegal to pass this tax on to a tenant. There are a complex range of exemptions, most notably for those who purchased their own home after 1st January 2005, so new owner-occupiers do not pay.

Owner-occupied housing is exempt from capital gains tax. Landlords are only exempt after five years, and pay as part of their income or corporation tax at 16.5% before that.

	Monthly Gross housing expenditure	Rent allowances /fiscal exemptions	Net housing expenditure	Monthly Income	Equivalent income in € after housing cost
Tenants					
low third	358	-4	354	1,125	771
mid third	418	-1	417	1,645	1,237
top third	488	0	488	1,617	2,129
top/bottom	1.4	-	1.4	2.3	2.8
Owners with a mortgage					
low third	699	-60	639	2,325	1,686
mid third	769	-92	677	3,111	2,434
top third	1,011	-98	913	4,540	3,626
top/bottom	1.4	1.6	1.4	2	2.2

Fig 78: Affordability by tenure of households that moved in Flanders 2000 to 2005 [3]

households was discouraged. Instead the emphasis was on enabling families to house themselves. Owners and families saving for a house could qualify for an extra vote. [5]

A Belgian representative at an international conference in 1902 put it like this: "*The Belgian worker prefers to construct a new house on a parcel of his own and according to his own inspiration. In order to realise that, he opts to collect enough savings in order to bargain with a credit provider, rather than to move into an existing building*". [5]

This chimed with the teachings of the Catholic Church which advocated promoting home-ownership for workers, guaranteeing the emancipation of the individual in the environment of the family. It was supported by the Christian Workers Movement, the largest trades union in Belgium, as well as Catholic political parties that were an important component of every government.

Even now, the socialist party declares amongst its principles that "*everybody has the right to a comfortable, qualitative and affordable dwelling. We want as many people to own their house as possible. This is the best guarantee for living well and it is the best way for pension saving*". [5]

Following the First World War grants were targeted at individuals rather than to social housing organisations or municipal authorities. In 1928 the shortage of housing for large families was tackled with loans at interest rates that decreased with the size of the family. [5]

Following the Second World War the De Taeye Law of 1948 provided grants for home-ownership. Between 1948 and 1961 400,000 grants of up to 15% were allocated to individuals to help finance the purchase and construction of their homes. Income limits on grants were introduced in 1960, and extended in 1967. [5]

Housing legislation was consolidated in 1970 into the National Housing Code. This aimed to tackle the housing shortage by encouraging more low-income households to become homeowners, and providing social housing for those unable to do so. It also aimed to raise the quality of housing through renewal policies.

In 1993 the De Taeye system of grants for construction was replaced by Financial Contributions to Loan Costs (TIL), which partly repaid loans to finance the purchase, construction or renovation of housing. These subsidies were halved in 1996 and abolished in 1999.

The Flemish Housing Code introduced in 1997 was based on article 23 of the Belgian constitution which gives a right to decent housing. It made local authorities responsible for setting standards for security, health and housing quality, but excluded any responsibility for social housing.

The subsidies and tax reliefs available to home-owners in Belgium are complex, with some regional variation.

In seeking to make home-ownership affordable to as many households as possible the Flemish housing subsidy system has historically been more generous to those on high incomes than to the poor. A 1995 study showed that 40% of all housing subsidies went to 20% of the wealthiest households, whilst the least wealthy

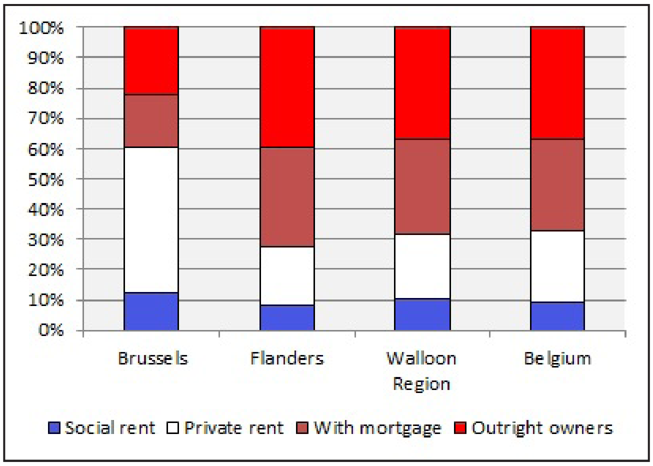

Fig 79: Regional tenure mix in 2009 [11]

20% got only 10% of the benefits. The largest benefits were from tax relief. [3] Subsequent changes have reduced some of this discrepancy.

This makes home-ownership relatively affordable. Those with a mortgage (almost half of all owners) pay an average of around 20% of their disposable income on housing. Even first time buyers average less than 23%. [4] This compares with an average of 29% in the UK and 23% across the EU (Fig 6 on page 10).

Most mortgage loans are on an annuity basis at fixed interest. There are no regulatory limits on loan to value ratios which rarely exceed 80%. Some take out additional personal loans and end up borrowing over 100%, but these are not in the form of a mortgage. Bank's do not like the cost of borrowing to exceed 33% of income.

Repossession is a long process during which banks are prevented from raising the interest rate, and this may encourage cautious lending policies. [11]

The Flemish government provides free mortgage insurance at its own expense for the first ten years of a mortgage loan. It will meet mortgage payments of up to €600 a month for a maximum of three years where the householders are unemployed. [11]

Social loans at fixed and subsidised interest rates take different forms in each region, and are available to low-income households with children purchasing modest homes. Social housing organisations also develop homes for sale to low-income families. [11]

Compared to Amsterdam, London and Paris, properties in Brussels and Antwerp look cheap. Prices in the Brussels region are considerably higher than in other areas or regions of Belgium.

In 2005 less than 12% of homeowners spent more than one third of their disposable income on housing, compared with 30% of private tenants and 9% of those in social housing.

Ever since the industrial revolution urban centres were allowed to expand into the local countryside, building houses with gardens where working people could grow their own vegetables.

Planning regulation in the UK aimed to prevent urban sprawl by defining greenbelts around existing towns and cities. In Belgium they did the opposite. Instead of a mass movement of people from the countryside to the towns, the towns were allowed to spread into the countryside, often with small and scattered clusters of housing.

They deliberately built an extensive and heavily subsidised network of railways and light transport systems to aid commuting into urban areas where most of the jobs were to be found so as to reduce the pressure on housing within the cities. The costs of commuting to work are still tax deductible in Belgium, whether by rail, bus or car. In the UK the present government is removing subsidies on commuter transport with scant regard to the impact this might have on housing pressures in the cities.

Until 1962 Belgium had no spatial planning laws, and right up to the late 1970s there were no restrictions on where new houses could be built. As a result there is no real shortage of building plots, and the cost has been kept relatively low and stable. Land still gets cheaper the further it is away from the major urban centres, encouraging sprawl. [5]

This has not prevented Belgium from having some of the most attractive cities to be found anywhere in Europe, in Brussels, Antwerp, Bruges and Ghent, and some beautiful countryside, particularly in the hilly woodland of the south. But it has led to a phenomenon also experienced in the eighties in some of the larger UK cities where the middle classes migrated to the suburbs, leaving the poor in old inner-city neighbourhoods. [5]

Planning is devolved to the regions. A Flemish Decree on Spatial Planning in 1999 required spatial plans to be developed at municipal level, that fit within provincial plans, and Flemish planning requirements. A similar process is being developed in Wallonia. Construction permits can only be refused where they conflict with the plan, and in practice even this is done with some discretion. The plans ensure sustainable development, without restraining the supply of suitable sites for development. There is a requirement that to prevent building site prices from rising, 'the market should be ample'. The preservation of open space is another key priority.

In 2010 Flanders introduced an 'activation' fee charged on undeveloped building plots, in any municipality where there was a shortage of housing in order to stimulate owners of building land to start building. They also charged a 'vacancy' fee on empty dwellings. Similar measures have been tried in other regions. [11]

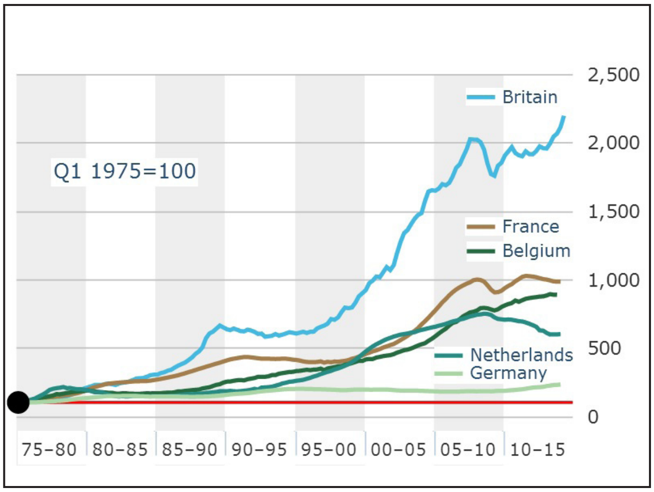

Fig 80: European house prices since 1975 [2]

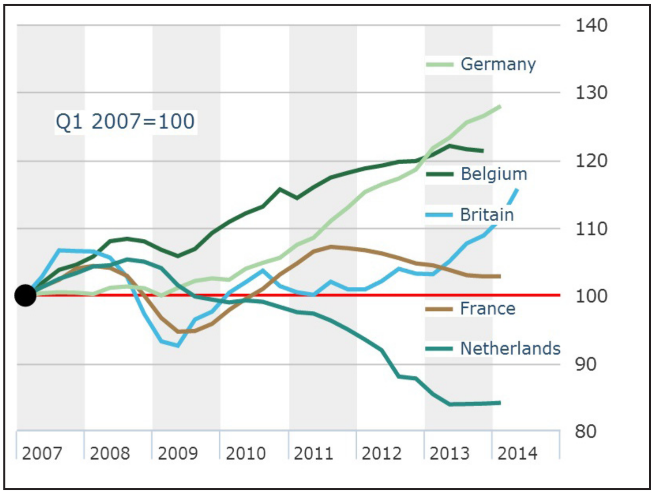

Fig 81: House prices since 2007 [2]

The spatial planning system has been largely successful in controlling urban sprawl, and helped reduce the exodus from urban areas. [5,8]

Belgium is the exception to the rule that countries with the largest rental sectors have the most stable long-term house prices. Growth rates are comparable with France, Netherlands, Sweden, and Denmark all of which have much larger rental sectors, whereas Belgium has one of the smallest (Fig 80).

One explanation might be the requirement for local plans to ensure an adequate supply of building plots, enabling supply to keep up with demand without creating any significant scarcity. Against this Belgium has one of the lowest ratings for elasticity of supply indicating a sluggish increase in construction in response to rising prices (Fig 8 on page 11).

Belgians move less often than the British which may be due in part to transaction costs in buying and selling houses being higher in Belgium than elsewhere, often amounting to 14% of the property value. Perhaps it is this that reduces the speculative element in their housing markets. [10]

The financial crisis of 2008 almost passed Belgian by. They had small falls in their GDP in 2009 and 2012. Unemployment remained steady at 7.5% although under the influence of the Euro crisis it rose to 8.4% in 2013. There was no significant fall in house prices which have continued to grow (Fig 81).

Social housing in Flanders

Following the First World War social housing was funded through the National Society for Affordable Dwellings (NMGW). From 1922 their remit was extended to providing mortgages for owner-occupied housing. The Brunfaut Law in 1949 provided additional funds to NMGW. Its name was changed in the sixties to the National Society of Housing (National Maatschappij voor de Huisvesting or NHM). [9]

Social housing construction almost ceased following an economic crisis in the early eighties, and was not revived until 1991 when a right-wing government was elected promising to build 10,000 units of social housing for rent. Once this was achieved construction fell to between 2,000 and 3,000 units a year (Fig 82).

Social landlords are much smaller than elsewhere in Europe, averaging about 1,350 units. The largest has 13,000 (in Antwerp). Between them they had 148,000 dwellings in 2013.

There are a little over 100 housing associations in Flanders. In Wallonia there are 68 Sociétés de Logement de Service Public (SLSP) managing 103,000 units. In Brussels there were 33 Openbare Vastgoedmaatschappij (OVM) managing 38,000 units in 2009. In addition municipalities and welfare organisations provide relatively small amounts of social housing, as do Social Rental Agencies working through private landlords, renting out 3,032 units in 2005 . [11]

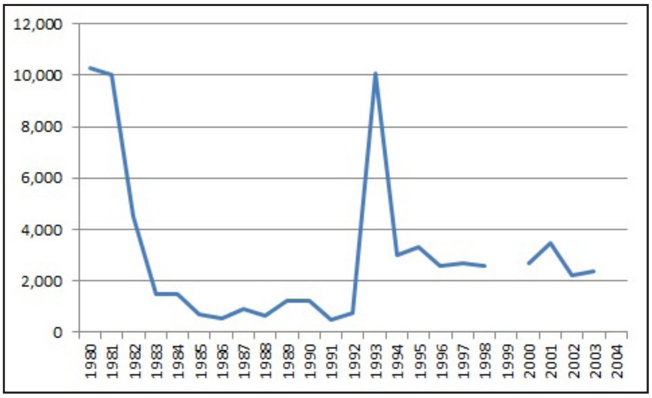

Fig 82: Social housing construction in Belgium [9]

In 2007 the Flemish government introduced a Decree on Social Renting. This restricted social housing to those that had an indefinite right to stay in the country. It put obligations on those coming from outside Flanders, requiring prospective social housing tenants to learn Dutch and attend citizenship courses. Preference could be given based on locally agreed allocations policies which might include improving the social mix or focussing on particular target groups such as the elderly or handicapped.

New tenants have a two year trial period before their lease becomes a nine year lease with a right to renewal. [9] They may not sub-let.

Social housing tenants have a right-to-buy provided that their dwelling is not an apartment, is more than 15 years old and the tenant has rented it for at least five years.

The system for financing social housing was also changed in 2008 to one based on 33 year interest-only loans the repayments on which were adjusted to match rental income less standardised allowances for expenditure. Housing Associations pay Corporation Tax at a reduced rate of 5%. VAT on construction costs is at 12% instead of the normal 21%. They also pay lower property taxes. [9]

Until 2008 rents on Flemish social housing were based on the updated cost price of each dwelling (known as the 'basic rent') and the income and composition of the household, aiming at a rent that averaged around 20% of their taxable income. The cost price included renovation and improvement as well as historic costs. [9]

The 2007 Decree on Social Renting switched to setting the 'basic rent' on each new letting at the market rent. This is adjusted so tenants pay an average of 22% of taxable income in rent, with additional discounts for the quality of the dwelling and number of dependents in the household. The difference between the market rent and the adjusted rent is known as the 'social discount'. An additional surcharge was introduced in 2009 where the dwelling was considered too large for the household. [9] So the rent varies between identical properties according to the circumstances of the household, making the subsidy a bit more like a form of housing allowance. This is similar to the 'differential rents' in Ireland.

Each year the rent is raised by the rate of inflation as measured by the consumer price index (minus the price changes of some 'unhealthy' products such as alcohol and tobacco). Leases are for nine years, and on renewal get reset at the market rent less their recalculated social discount. In Flanders until recently the rent was only recalculated during the nine years of the lease in exceptional circumstances, such as if the tenant's income had fallen by at least 20% (apart from the inflationary increase). This avoided the poverty trap found in the UK where much of the gain of any increase in a tenant's income is lost through a reduction in housing benefit. [9] Changes in household circumstances are now reviewed every year in recalculating the rent. [11]

Under this system the cost of the social discount is born by the social housing provider. This is taken into account in calculating the repayments they make on the loans that fund their capital investment. The 2007 legislation effectively removed any autonomy social housing providers had in setting their budgets, and limited their operating costs to standard management and maintenance allowances. This has many features that are comparable to the old Housing Association Grant regime on which social housing in the UK was funded until 1989.

The way social housing is subsidised differs in other regions, but follows similar principles in relating the rent to each household's circumstances. [11]

Social housing rents are typically around 59% of market rents (based on 2005 data). The quality of social housing dwellings is generally rated better than market rental properties, as judged by the tenants themselves.

The social housing sector makes up about a quarter of the rental sector in Flanders, and is run by a mix of local authorities and housing associations in which municipalities are the largest shareholders. It accounts for 9.5% of the housing stock in Brussels, 7.3% in other urban areas, and 3.9% elsewhere, and an average of a little over 5% of the stock overall. [9]

Most rental housing is in flats (55%) while 90% of owner-occupation is in houses. Space standards are generally good, and the number of rooms per occupant is high. Rental housing particularly in the private sector is generally older and in poorer condition. But Belgium does not have large estates with the concentration of deprivation found in some parts of the UK, France and Germany.

Social housing is intended for those unable to match their needs in the housing market because of low-income or special requirements. Income limits are set dependent on household size, and apply to the allocation of social housing. They do not apply to existing tenancies. In 2008 the income limit was €35,800 for a couple and €26,850 for a single, plus €1,500 per extra person.

Each housing association maintains its own waiting list of applicants, but will usually agree to pool this with others operating in the same locality. Allocation is strictly in accordance with priority, which takes into account whether the dwelling is a suitable size, and any absolute priority criteria (such as age or handicap in particular instances). The main criterion is the length of time they have been on the waiting list. There are also two optional rules for giving priority to those that have been living in the area for at least six years, and those not already living in social housing and without a long term (nine year) tenancy agreement.

Almost two thirds (64%) of social housing tenants in Flanders were not in paid employment in 2009: the elderly, single people, lone parents and the unemployed are all over-represented.

Household incomes averaged €1,318 euros a month compared with €2,236 for home-owners and €1,710 for those renting privately. Social housing tenants pay an average of about 20% of net household income on rent, compared with 27% for those renting privately (median values). [9]

In addition to social housing provided by housing association, there is a relatively small amount provided in the private rental sector via Social Rental Agencies (1% of Flemish rented housing in 2007). [11] The Agencies provide free administration and management to landlords in exchange for a lower rent, which is also guaranteed. Renovation subsidies similar to those for owner-occupiers are available on dwellings made available to the Agencies for at least nine years. This has certain similarities with the short-life housing managed by housing associations in the UK.

Fig 83: Sustainable social housing at Saint-Agatha-Berchem in Brussels region [12]

Allocation policies are similar to those for housing associations. The Agencies are funded by the Flemish government with an amount per unit that reduces as the Agency gets bigger, 75% of which is reserved for staffing costs.

The demand for social housing is increasing, while the supply is not, resulting in longer waiting lists. It is increasingly focussed on the most deprived, though on nothing like the scale found in the UK or France. This has made it unpopular with the public at large. Some municipalities have stopped development of social housing, and Flemish developers show signs of reluctance to include it on their new estates.

It is partly to address these concerns that new criteria have been applied to the allocation of social housing, requiring prospective tenants to learn Dutch, and to have lived locally for a number of years. Ironically, this often means that the homeless and others in the most desperate need fail to meet the criteria for allocation of social housing.

Under Flemish planning regulations introduced in 2011 any new development of 10 or more houses or of 50 apartments must include 20% 'certified social housing'. Similar rules are planned in Brussels.

Private Rental

Rental has declined in Belgium from around 42% in the sixties, to 33% in the eighties and less than 24% in 2005. It tends to house the most vulnerable in the population. Three-quarters is private rental and the rest social housing.

Individual landlords account for 85% of the private rented sector. Most let one or two properties they manage themselves. A high proportion of landlords are more than fifty years old, and most are more than 60.

Two 'housing property firms' provide most of the rest of the sector. There is also a firm providing flats for the elderly who buy shares in the company, which operates rather like a housing cooperative, with government subsidies.

Tenancy law is a federal government responsibility. This will be transferred to the regions in two stages in 2014 and 2015. The Belgian Rent Acts require certain terms in a tenancy contract. Tenants are responsible for normal maintenance and repairs including damage by fire. Landlords are liable for all major repairs, and work to renew worn out elements of the building and deal with defects under their responsibility to provide a decent home. [11] This is similar to France.

There are four types of tenancy, based on the rules governing security of tenure. These are life-long agreements, nine-year agreements (the default option), long term agreements of more than nine years, and short term agreements of up to three years.

A short term agreement can only be renewed once before becoming a nine year agreement, and must be renewed on the same terms. If the landlord terminates at the end of the term they can only let to a new tenant on the same terms as the old one, so there is no incentive to end the tenancy in order to raise the rent.

In practice a three-year lease can be for any agreed period up to a maximum of three years. It fixes the rent for the period of the lease and commits the tenant to pay for the entire period of the lease, with no right to terminate earlier. These were intended to be exceptional when introduced by the Belgian Parliament, but now account for 52% of private tenancies in Flanders. [11]

Tenancy agreements can only be terminated by the landlord at the end of the term with six months notice, and will otherwise continue as a new nine year agreement. Sale of the property does not affect the rights of the tenant, with the new owner simply replacing the original landlord in the tenancy contract. Termination for a breach requires court action, which tends to give tenants every opportunity to remedy it before facing eviction.

A common form of tenancy is known as the '3-6-9' lease, where the base rent can be increased at each three-year term of the contract. The tenant can terminate by giving three months' notice. However, if they leave in the first, second or third year, they pay an indemnity of three, two or one month's rent respectively. From year four, there is no penalty for leaving.

All new lettings are at market rent, with rent increases during a lease limited to the rate of inflation. As a result rents on older tenancies in high demand areas can fall behind market rents. Exceptional increases can be authorised by a court, and allow for improvements where these raise additional costs by at least 10%. Other expenses (service charges) can only be levied 'at cost'.

Rent deposits cannot exceed three month's rent, and must be held in an account in the tenant's name. The tenant benefits from the interest. An alternative is for the tenant to provide a bank guarantee. For those that qualify for social assistance this guarantee can be provided by a welfare body. There are proposals to provide these through a state Rent Guarantee Fund. Deductions on termination must be settled in court if the parties fail to agree. [11]

In practice 53% of private rental tenancies are short term, 45% are for nine years, and 2% are longer term.

Since 2007 new tenancies should be registered with the government, otherwise the tenant can leave at no notice and without any reimbursement to the landlord.

The 1991 Belgian Rent Act requires rental dwellings to meet certain minimum standards of health and safety and habitation facilities. New tenancies can include a 'renovation contract' stipulating renovations to be carried out within a specified period.

Rental properties in the Walloon region tend to be the oldest, with the highest number falling below modern standards (eg without central heating, or suffering from damp).

Where the landlord is an individual, the 'imputed rental income' is taxed, not the actual rent charged. In theory this is net income minus a 40% reduction for imputed costs. Firms pay tax on the actual net rent, although the two largest firms have agreed special tax arrangements.

There is no equivalent in Belgium to the housing benefit payable in the UK. But there is an allowance to help low-income households or those with a handicap to move from a bad quality dwelling to one that meets modern standards. This is paid monthly, with an additional initial payment equivalent to three months allowance. Only 2% of private tenants receive this subsidy, with a monthly average of €120 per beneficiary.

Private rental is more heavily taxed than home-ownership or social rental, but less so than in the UK. Rental income is taxed at a lower rate than other income. Mortgage interest and other operational costs are tax deductible. For private landlords any profits on the sale of a property within five years of purchase are treated the same as any other income for tax purposes, whereas owner-occupiers are exempt.

Landlords pay VAT at the full rate (21%) on renovations, whereas for owner-occupiers it is reduced to 6% provided the property is at least 5 years old.

Owners are generally permitted to rent out their properties but must obtain the permission of their mortgage provider for tenancies of nine years or more. The lender cannot evict to recover their loan following repossession. [11]

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Chapter 12

Spain

KEY STATISTICS	EU	Spain
Population (2009)	499.7 million	45.8 million
Population per sq km	116	91
Dwellings (2011)	236 million	25.1 million
Units per 1,000 pop	473	544
Supply elasiticity (best high)	55%	45%
Fixed interest mortgages %	mainly fixed	20%
Per capita € GDP (2011)	29,135	26,225
Gini coeff incomes (2010)	30.8	35.8
% owner occupied (2011)	66.6%	82.2%
% social rented (2011)	6.7%	2.8%
% private rented (2011)	19.1%	15.0%
Real prices 1975-2007	109%	250%
Real prices 2007-2013	-7%	-37%

Background

Housing policy is governed by the Spanish Housing Ministry with the 'autonomous regions' and their municipalities interpreting and implementing policies at a more local level.

A right to housing is guaranteed by the Spanish constitution: '*All Spaniards have the right to enjoy decent and adequate housing. The public authorities shall promote the necessary conditions and establish appropriate rules to uphold this right, regulating the use of land in accordance with the general interest to prevent speculation*'. [11] This is not a right granted to individuals, but is an obligation on the government. In practice there is no real shortage except locally in areas of high demand.

Spain and Portugal have the highest number of dwellings per 1,000 inhabitants in the EU (544 and 557), compared with 443 in the UK and an average of 473 in the EU. [12,1] Housing costs as % of disposable income are 11% which is just below the EU average (12%) and well below the UK average of 18%. [12]

According to the *EU Quality of Life survey (2006)* on average there are 1.6 rooms per person in Spanish households, compared with 2.6 in the UK and an EU average of 1.9. Even so, there is very little overcrowding even amongst the poorest households. Only 14% of households complain of a lack of space, compared with 22% in the UK and 17% in the EU.[2]

Fig 84: Autonomous regions of Spain [3]

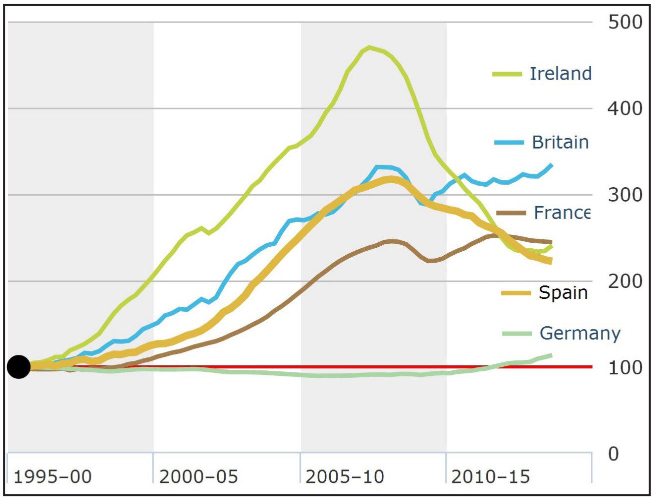

Fig 85: Index of growth in house prices 1995=100 [5]

It is a large country. The 45 million people live at a density of only 91 per sq km, the lowest in the EU until Bulgaria joined in 2007. Their economy was held back under the Franco regime and still has the lowest GDP per head in western Europe at €26,225. Income differentials are second only to the UK (Fig 36 on page 41), and rising faster than anywhere in Europe except France.

Housing crisis

Spain is part way through a radical change in housing policy following the collapse in their housing market in 2008 as a result of the banking crisis. House prices have halved since their peak at the end of 2007. There have been tens of thousands of evictions and 3.5 million empty houses. Unemployment in 2013 was 26% with youth unemployment at 60%. [8]

Austerity measures have resulted in the cancellation of many housing subsidies and tax reliefs. Almost every aspect of housing policy has changed, affecting all tenures. The emphasis has shifted from home-ownership to promoting a rental sector. Changes in national housing policy have resulted in a wide variety of responses from regional governments.

It may be a while before any clear and coherent descriptions of the current position become available. The sections below describe what was happening in the lead up to the crisis, and some of the new measures introduced to deal with it.

Home ownership

Spain has one of the highest rates of home-ownership in Europe. In the fifties half were owner-occupied and it peaked in 2007 at 87% compared with an EU average of 60%. Two-thirds owned their homes outright without a mortgage. Home-ownership has since fallen to around 82% [4]

Even amongst households in the bottom quartile for income 59% own their home, compared with 27% in the UK and 45% across the EU. The only countries with a higher proportion of low-income home-owners are those where properties were given or sold cheaply to their tenants following the overthrow of communist regimes in Eastern Europe (eg Bulgaria 82%, Hungary 87%, Lithuania and Slovenia 90%). In these countries there is little relationship between household income and home-ownership.

The Spanish tax regime was favourable to home-owners, who could offset 15% of mortgage interest against their income tax, until this was abolished under austerity measures in 2011. Mortgages were once almost all at fixed interest but are now mostly (97%) at variable interest sometimes over very long terms of up to 50 years. [9] Loan terms have been tightened since the banking crisis with lower loan-to-value and higher income requirements. On newly constructed properties the buyers usually subrogate themselves into the mortgage loan originally granted to the developer, benefiting from more competitive terms. [15]

Capital gains tax on their main residence can be offset

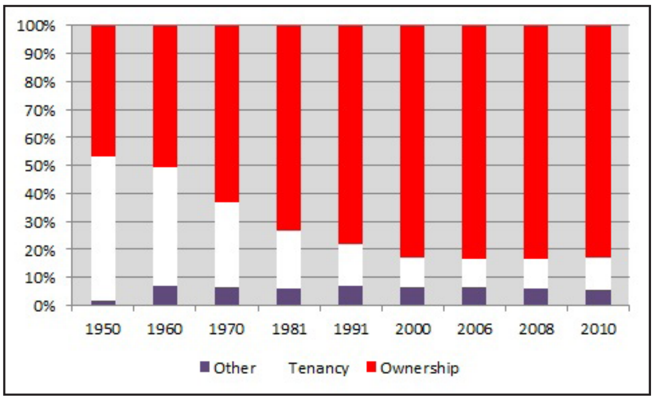

Fig 86: Spanish tenure mix since 1950 [4]

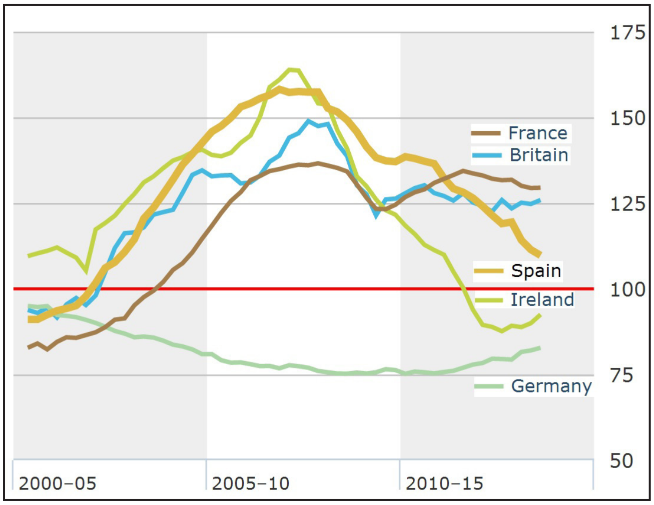

Fig 87: House prices in relation to Earnings [5]

against purchase of another home provided it is bought within four years. Those aged over 65 are exempted altogether. There is also 95% tax relief on the inherited value of a main home up to €122,606 per inheritor provided they are family members (including spouses, children, grandchildren and in-laws) and lived in the property for two years prior to the death.

It is not unusual for the selling price in the public deed of sale to be lower than the amount actually paid by a purchaser, so as to reduce the seller's tax liabilities. [15]

A local property tax is levied on the notional rental value to fund local government, similar to the 'rates' that applied in the UK before the poll tax and subsequent council tax.

There is also a tax called 'Plusvalia' on the increased value of urban land when it is sold. Transfers between spouses are exempt, but otherwise it applies to all property whether owner-occupied or rented out. The rate of tax is set by the local town hall, and depends on the size of the local population and the length of ownership. It is typically between 20% and 30% of the increased value of the land net of inflation (excluding any buildings).

House prices in Spain rose faster after 2000 than almost anywhere else in the EU, second only to Ireland. This was demand-led, fuelled by an increasing number of households. The rise in the population from 40 million in the nineties to 46 million now was largely due to immigration particularly from Latin America, North Africa and Eastern Europe. Two-thirds of immigrant households rent their housing, compared with 17% of Spaniards. The longer they stay the more likely they are to enter the housing market.

The formation of new households was boosted by a number of other factors that include: the 70s baby boom children setting up homes of their own; the rising number of divorces; and the elderly living longer and less often housed within an extended family.

The demand for second homes from Spaniards, and for relatively wealthy people from the UK and the richer countries of northern Europe added to the market pressure, particularly along the coast. Londoners have experienced something similar in recent years with an influx of foreign investors buying up prime properties.

Between 1995 and 2006 the average house price rose from 3.6 times average household income to 7.1 times.

Similar changes were happening in the UK and Ireland, and to a lesser extent in France and Denmark, in response to lower interest rates and the ready availability of mortgage loans.

According to an OECD study in 2010 demographic changes and overseas investment had a big impact on Spanish house prices while rising incomes accounted for more of the rise in property prices in Ireland, whilst also contributing in Spain. In both countries this was then amplified to an even greater extent by rising expectations of capital gain, leading to a housing bubble. [7]

In regions with the strongest markets (Madrid, Catalona and Basque country) affordability was a major issue in the lead up to the banking crisis. The demand for

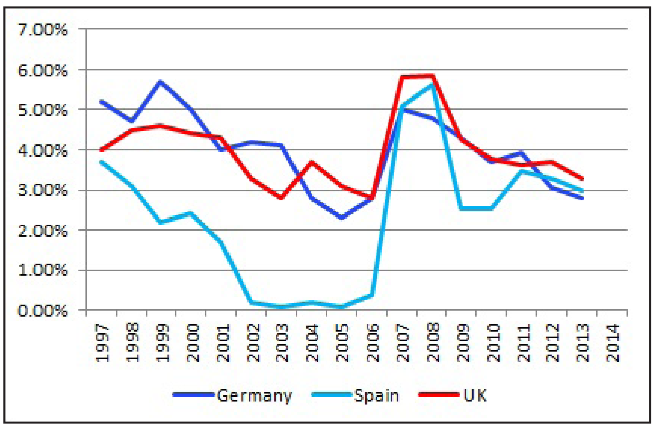

Fig 88: Mortgage interest net of inflation [8]

subsidised housing outstripped the supply, and was sometimes allocated via a lottery. Waiting times of five to ten years were common.

Spanish house prices are more volatile than the UK, and fell further in Spain following the financial crash than in other EU countries except Greece and Ireland (Fig 86).

When they joined the Euro in 1999 Spanish banks could access capital at lower interest rates. The European Central Bank had the impossible task of setting interest rates to balance the needs of the larger economies of northern Europe with the less efficient economies of the Eurozone where inflation levels remained relatively high, and wages were spiralling upwards.

The combination of rising demand, low interest rates and an abundance of capital supply made investment in housing very attractive, and even more so as prices continued to rise at well above the rates of interest being charged. Rates of return from capital growth were far higher and appeared less volatile than the stock market. So much so that many in Spain preferred to keep their investment properties vacant and see their value grow, rather than let them to tenants which might make them harder to sell.

40% of houses built between 1991 and 2001 were not used as a main residence. In 2011 this still applied to 31%. [15] Housing was increasingly becoming a speculative commodity. Long before the crash analysts from the OECD, IMF, ECG and some banks were warning of the risks of a housing bubble. Economists in 2003 ascribed 30% of the rise in house prices to speculative factors. Others, such as the BBVA Bank, forecast a gradual deceleration of house prices with a softer landing and were happy to continue lending. [10]

Access to cheap money led to a boom in housing construction. This was running at between 500,000 and 800,000 units a year for several years leading up to the crash, which was more than France, Germany and Italy combined and five times as much as the UK. This construction activity was a major factor in raising GDP to double the European average, at around 3.75%. Unemployment fell from 25% in 1994 to 8.9% in 2008. The construction industry employed one person in eight, and represented 18% of GDP. This in turn raised incomes, with an increasing number of two-income households, enabling them to borrow ever larger mortgages.

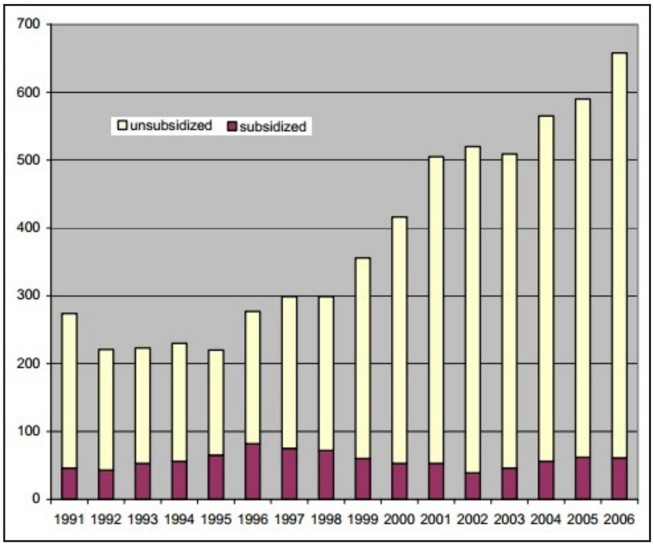

Fig 89: New housing construction in Spain [6]

The construction booms in Spain and Ireland that accompanied the huge rises in house prices meant there was little scarcity of housing, and the number of households stretching their finances to the limit to get onto the housing ladder was much larger than in the UK, France or Denmark. The impact of the banking crisis was more severe in Spain and Ireland, resulting in deeper falls in house prices and little sign of any recovery. This may well be due in part to the much larger number of households affected by negative equity. It is also because house prices had reached unsustainable levels.

The welfare system in Spain as in many Mediterranean countries is weaker than in northern Europe, and this encourages people to invest in bricks and mortar (inversión en ladrillo) as a buffer against hard times. They have a relatively large informal economy and much of the resulting black money is invested in property. [10]

The weakness of state welfare is compensated by a sharing of responsibilities within families to help each other out. Most young people leaving home to start a family of their own receive assistance in purchasing somewhere to live.

The banking crisis hit Spain particularly hard. The supply of mortgages dried up, and house prices fell, leaving large numbers in negative equity, and banks with assets valued at less than their liabilities. In 2012 only 37% of house purchases were financed with a mortgage, whereas in 2006 more than 60%were. [11]

House prices in 2011 were depressed by an overhang of around 688,000 unsold properties. [15]

Some demographers expect the population of Spain to decline, and see the growth of the last twenty years as a temporary phenomenon. [13] If they are right, the housing market may take even longer to recover.

Economists point out that prior to the banking crisis Spanish government debt was a mere 36% of GDP, much lower than in Germany where it was 65%.

It was not profligate government spending that caused the financial crisis in Spain, which was largely due to the bursting of the housing bubble, and the cost of bailing out the banks where falling property values had reduced the value of the assets backing their loans.

The boom in construction following the introduction of the Euro helped fuel wage increases which rose 40% relative to Germany in the ten years leading up to the crash. Imports became cheap, and exports too expensive, leading to imports 10% higher than exports by 2007 and 2008.

Spain had an over-valued currency that it shared with Germany who benefitted from an undervalued currency. If they were not in a currency union Spain could have devalued the peseta, which would have had the effect of bringing their wage levels back into balance. Without that option they depended on support from the more successful economies of the Eurozone which was politically hard for those countries to deliver.

The banks have been re-capitalised with massive cash injections from the EU, and Spain's dependence on further assistance has been reduced by unpopular but effective austerity measures. They are left with high unemployment at 26.7% in 2014, and wage levels that remain uneconomic in a global market. This presents a hefty challenge to the Spanish economy. Housing policy was a significant cause of the problem, and must be an essential part of any solution.

Under austerity measures introduced in July 2012 tax exemptions on buying a new home were ended. There are no more state subsidised loans or financial assistance to first-time buyers (with a few exceptions for those under 35). This is partly justified by the fall in house prices. Rents also fell by 5.5% in 2008 and 3.9% in 2009.

Various temporary measures were introduced to mitigate repossessions, including a moratorium on enforcements against people in need.

Subsidised home-ownership

Spain is notable for its historic approach to social housing, which has been to provide subsidised housing for sale at below market values to low-income households, who cannot then sell it at market prices for a protected period, typically 20 to 30 years. Similar policies can be found in Portugal and Greece, although not to the same extent.

The Spanish approach to subsidised owner-occupied housing has many unique features, that are worthy of consideration in other countries. A good analysis can be found in *Recent changes in Spanish housing policies* presented to an ENHR conference in Rotterdam in 2007, from which much of the information in this section is taken. [10]

The level of subsidy varied regionally so as to keep prices affordable (see Fig 90). In the most expensive regions it could be as much as two thirds of the value, falling to 12% in low cost areas.

Subsidised housing for owner-occupation remains as social housing for a 'protected period'. During that time it can only be sold at prices set by the government, which are broadly the same as those for newly developed subsidised housing and targeted to the same clientele from waiting lists maintained by the autonomous regions. This prevents those benefiting from the subsidy from cashing it in as a speculative gain. The maximum price is capped at twice the initial sales price, up-rated for inflation. Subsequent sales are only allowed after ten years.

In the fifties and sixties protected periods ranged between 20 and 50 years. In the seventies these were standardised at 30 years, and in 1993 reduced to 20 years. In 2008 the minimum period went back up to 30 years and regions were given discretion to vary it. Once the protected period expires the properties revert to normal home-ownership.

It is interesting to compare the Spanish scheme with low-cost home-ownership in the UK and Ireland. Under the shared-ownership scheme leaseholders buy

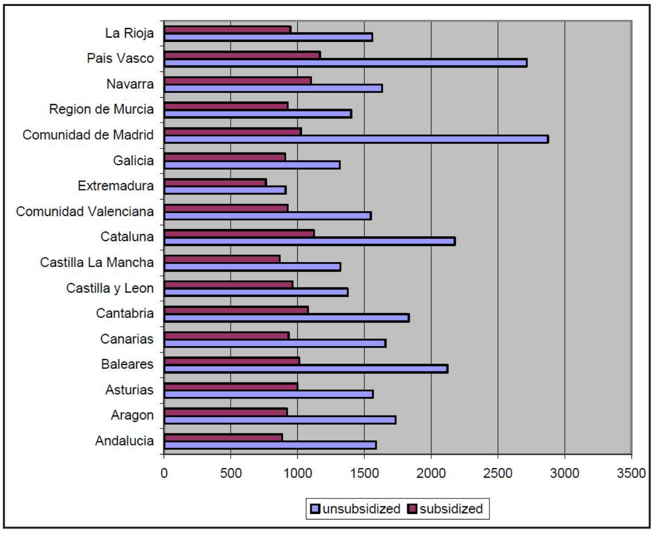

Fig 90: Regional variation in the price per m² of subsidised and open market housing (2006) [10]

a percentage of the equity and typically pay 2% of the value of the rest in rent to a social housing provider. They can purchase the remaining equity in tranches as their economic circumstances improve, in a process known as 'staircasing'.

In the traditional Spanish scheme there is a strong incentive for households to retain their properties in the longer term to benefit from the full market value at the end of the protected period. This is seen as a mixed blessing. It can inhibit mobility in response to changing household needs or job opportunities. If they need to move in the meantime they can still profit from part of the increase in value of the property.

In the UK there is no equivalent to the 'protected period', and shared-owners sometimes sell up after two or three years particularly when house prices are buoyant. They invariably buy the remaining equity at the same time as they sell the property outright, and it ceases to be part of the social housing stock. There are exceptions for rural housing and some schemes funded through planning gain in which staircasing is limited to 75%.

The Spanish scheme has a number of significant advantages. There is no rent to be collected, and no management required by a social housing provider, so once a household has bought on subsidised terms the tenure feels much more like home-ownership. They do not have to pay rent or a fee for management, making it more affordable and more efficient as a way of delivering affordable housing Together these make it easier to integrate low-cost home-ownership into other housing developments.

The initial cost in subsidy is similar to shared-ownership but instead of social housing providers recycling the subsidy from staircasing sales into new shared-ownership developments, as in the UK, the properties remain as low-cost homes for the whole of the protected period, which in some regions can be for as long as the property remains fit for human habitation.

Regional governments have developed this form of tenure in a variety of ways. Catalonia, Asturias, and Extremadura extended the protected periods to make it more like a permanent intermediate tenure, and others have developed shorter term versions, particularly in Madrid. The Catalan government has recently (2011) introduced shared-ownership based on the UK model. [15]

The Basque Country retains ownership of the land, separate from the buildings which are sold on 75 year leases from the regional government. This has parallels with the Community Land Trusts being pioneered in the UK, particularly in Wales and the south west of England, where permanent housing with a variety of tenures is built on land usually provided free or cheaply by a local authority. No one is then supposed to profit from future sale of the land although separating the value of land from the housing on it can be difficult. If this distinction was rigorously made, and where house prices rise faster than construction costs, most of the increase would fall on the land. [14]

It is unclear what impact the new policy since 2012 of promoting a rental sector will have on the long term future of low-cost home ownership in Spain.

Social housing for rent

Social housing in Spain is known as 'vivienda de proteccion oficial' (VPO) meaning it is 'publicly protected housing'. It provides barely 2% of the housing stock compared with an average of 18% across the EU (Fig 25 on page 31).[15] There are income ceilings for those in social housing, but these are high enough to cover 80% of households. Priority criteria are established by the autonomous regions according to local circumstances, and include those with disabilities, and exclude anyone that owns or has permanent use of another dwelling.

Development of social housing is subsidised by the state and to a lesser degree by regional authorities through a wide variety of organisations including public bodies, cooperatives, non-profit bodies, and commercial developers. A 'VPO de promoción pública' is owned by a government authority, whereas a 'VPO de promoción privada' is privately owned providing subsidised flats under the control of the local authority. The subsidies come in a variety of forms, including grants and cheap loans.

In 2008 16% of new construction was social housing, most of which was for subsidised sale. Planning laws introduced following the financial crash required that a minimum 30% of urban development was for social housing, and the government plan for 2009 to 2012 required 40% of this to be for rent. A total of €10.2 billion in state support for subsidised dwellings was budgeted for that period.

Since 2012 new subsidies for low-cost home-ownership have been suspended as part of the austerity programme, and have been replaced by support for the development of the private rented sector, and social rented housing.

Public authorities and non-profit organisations can apply for subsidies to develop social housing for rent, up to a maximum of €22,500 per unit and no more than 30% of the costs.

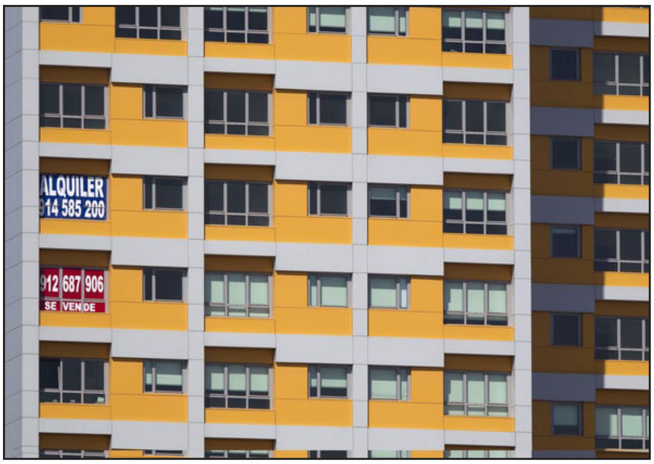

Fig 91: Spanish banks offering repossessed properties in Madrid for rent [17]

Regional governments have introduced their own measures. In Andalucia the government has sought to discourage the banks from repossessing properties with mortgage arrears and have taken powers to expropriates houses repossessed by the banks for a temporary period of three years to rehouse those made homeless by repossessions. Companies that fail to rent out vacant dwellings face fines, and individual owners of vacant properties are given incentives to rent them out.

The Basque Country are seeking new ways of continuing to subsidise low-cost home-ownership as a long term tenure, whilst promoting buy-to-let and taking over part of the debt with an equity stake in properties threatened with repossession.

Private renting

Most rented housing is owned by individuals (86%), with only 6.7% owned by institutional landlords, and the rest by public bodies or rent free.

The tax regime on private rental in Spain is more generous than the average across Europe, although there is no allowance for depreciation of the asset, as found in the countries with the largest rental sectors such as Germany, Austria, and Switzerland. [15] Rental income net of mortgage interest and operational costs is taxed at a special low rate, and any losses can be offset against other income.

There are thought to be about 1.2 million tenancies that are not declared to the tax authorities, representing 55% of the rental housing stock with a turnover of €2.9 billion. [15]

Some of the older rented properties originally let on contracts before 1964 are still subject to rent controls introduced to deal with housing shortages following the Spanish Civil War, with rents well below market levels, and protected tenancies. Rents were fixed and contracts were automatically renewed and extended even to adult children living at home. These properties tend to be in very poor condition, with the land sometimes being worth as much as the properties.

It was not just rent control that has made investment in private renting unattractive. The legal procedures for recovering rent arrears and evicting tenants failing to pay can be very slow and costly, taking several months. The 2003 Arbitration Act sought to speed up the process with unconvincing results. [10]

The combination of rent controls and a tax regime that favoured home-ownership over rental led to a fall in the rental sector from 50% of the stock in the 1950s to 10% by 2001. [10]

New tenancies were deregulated in 1985. Following protests from tenants a milder form of regulation was introduced in the Urban Letting Act of 1994. New lettings could be set at a market rent. Rent increases during a tenancy were limited to the rate of inflation, although exceptions were permitted where specified in a tenancy contract. Rental contracts had a standard length of five years, and the landlord could only terminate during that time for non-payment of the rent or another serious breach of the contract. Subletting requires the landlord's consent and cannot be at a higher rent.

Unless the landlord gave notice to terminate before the end of the lease it was automatically renewed for a further three years. Tenants could leave at 30 days notice, but can be required to make a compensation payment under the terms of the lease. [10]

Minor repairs and maintenance are the responsibility of the tenant, as in France. The standard of maintenance of rented housing in Spain is generally rated very poor.

The Spanish see paying rent as a waste of money. That is why the rental sector largely houses people who are economically insecure or transitory, such as young people who have recently left home and cannot afford access to ownership, recently divorced people and immigrants with precarious employment. [10]

The financial crisis of 2007 had an impact on returns from rental investments. Many investors withdrew from the market.

In 2005 almost 15% of all dwellings in Spain were vacant, so the government set up a public rent fund (Sociedad publica de alquiler) to encourage owners of empty properties to let them to social tenants. Agencies act as intermediaries between landlords and tenants, providing a degree of protection to the landlord and a guaranteed rent. This was set at a maximum of 7% of the value of the property, and a fee of 20% of rental income was paid to the fund to cover its expenses. Any initial renovation required was done by the agencies, and they carried out all management and maintenance. [17]

Allocation of these dwellings was to households on no more than 1.5 times the Spanish minimum salary, and the rent was limited to 30% of their income.

These had very little impact on the problem of vacant housing, accounting for about 12,000 units by the end of 2009. By 2010 the vacancy rate was still 13.2% of the stock, although some commentators believe this to be an under-estimate. [15] For a more detailed description see a 2010 paper on 'Country Policy Framework: Spain' by Joris Hoekstra. [17]

As further encouragement in the use of empty properties, anyone letting an empty home for the first time could claim a €6,000 subsidy. They were also exempt from tax on 50% of the rental income, rising to 100% where the tenants were less than 35 years old.

Young adults leave home later in Spain than elsewhere in Europe, due to a shortage of affordable housing, or any assistance with the rent, and high youth unemployment.

In 2007 the socialist government aimed to tackle this by introducing a 'basic emancipation allowance' (RBE) for young people between the ages of 22 and 30. It paid part of the rent, depending on average rents in the region and the young person's income. This was paid to the tenant or joint tenants in a shared house, and was conditional on them not being in arrears. [15]

The number of young people benefitting from the allowance rose from 63,166 in 2008 to 301,254 in 2011.

In 2011 the allowance was abolished for new applicants as part of the austerity plan to deal with government deficits. Prior to that there were signs that it might be having an inflationary impact on rents, although this is hard to prove.

In 2009 the tax regime was altered to create a Spanish version of the Real Estate Investment Trusts (REITS) that originated in the US and had been developing in neighbouring countries. These are known as SOCIMIs (Sociedades Anónimas Cotizadas de Inversión en el Mercado Inmobiliario). In essence these allow those owning shares in a company renting out at least three properties to be taxed as if they owned the properties themselves, without any corporation tax being charged on the company's profits. These are expanding, with increased flexibility since 2012, but remain marginal. [8]

In 2013 there were still 3.4 million empty properties in

Fig 92: Squatted housing in Barcelona [19]

Spain. In Andalusia half the 700,000 vacant properties were owned by corporate bodies including banks and real estate companies.

According to an article in the Guardian many unemployed people in Spain have resorted to occupying empty properties. This has *"given rise to 'corralas', where groups of people take over apartment buildings that are left unoccupied. Unlike squatters, they approach the landlord and offer them a low rent in return for the chance to stay in the accommodation. If they can prove it will be their primary residence, courts can overrule a landlord's objection and the mortgage company can't intervene"*. These can be found in Seville, Málaga, and a number of smaller towns in Andalusia. [19]

The rent levels required to recoup investments made at the height of the property boom were more than the market would bear. Few of the owners were attracted by the idea of dealing with tenants, and saw regulation as biased in their favour.

Since the end of 2011 tenants with less than €24,107 a year in taxable income are allowed to deduct 10.05% of the amounts paid for the rent of their main residence. Some of the cost of this to the Treasury can be offset against the additional taxes on net rents that were previously hidden in the black market. [15]

Historically housing benefit in Spain was almost nonexistent: less than 1% of households qualified for any assistance. [16] In 2012 a housing allowance was introduced for low-income groups covering up to 40% of their rent with a maximum of €2,400 a year. Tax deductions for rental payments have recently been increased, aiming to level the fiscal treatment with first home purchases.

A new Rental Law was introduced in 2014 with the specific aim of increasing the availability of rental housing as an alternative to home-ownership.

It included measures to encourage owners of unsold vacant properties to make them available for rent:

- Standard tenancies were reduced from five years to three and automatically renewed year on year (instead of three years at a time) unless the landlord gives at least a month's notice of termination prior to the end of the term
- No restrictions are applied to the initial rent which can then rise annually by the rate of inflation in the Consumer Prices Index unless an alternative index is specified in the tenancy contract, with additional increases of up to 20% where justified by the costs (net of any subsidies) of improvement works
- Tax breaks on rental income were extended to foreign landlords, and raised from 60% to 100% on lettings where the tenant was 30 or younger with earnings above the level that entitled them to state benefits
- Landlords could recover a property at two months notice for a member of their immediate family to use as their permanent main residence
- A rapid eviction process without costly court action was introduced for non-payment of rent, giving the tenant ten days to repay arrears or face immediate eviction
- The automatic right for a tenant to buy the property ('derecho de tanteo y retracto') was removed, except where it was written into the tenancy contract
- Anyone buying a property where a tenancy has been lodged at the Land Registry will be bound by the existing terms of the tenancy contract
- Freedom for tenants to terminate a tenancy at one-month's notice without paying any compensation after the first six months
- The creation of a Central Registry that landlords can consult to see whether potential tenants have a history of non-payment or if they are currently involved in legal proceedings for eviction. Tenants can have historic entries removed after six years.

New rules were also introduced requiring properties rented to tourists to be licenced by the local authority and to meet stringent health and safety requirements including a 24 hours a day contact to deal with emergencies. This was in response to complaints by the tourist industry that 75% of overnight stays in 2012 were in private apartments, usually booked through the internet (eg Airbnb). It is expected to reduce tax avoidance on the resulting income, and encourage owners to rent in the residential market.

As a result of these and earlier changes in 1964, 1985, 1995, and 2013 the regulation of tenancies varies widely according to when they commenced, affecting rent control, termination, and the consequences of a breach in the tenancy agreement, not helped by inconsistent court rulings and confusion arising from the resulting complexity. [15]

Government policy since 2012 has been to promote the rental sector, encouraging the owners of vacant properties to rent them out, and reducing the bias in taxation in favour of home-ownership. Evidence from elsewhere in Europe shows that a healthy rental sector can help to stabilise house prices, and increase the mobility of labour. But the urge to own is deeply imbedded in Spanish culture.

So despite all the measures introduced by the government in recent years the rental market remains in many ways dysfunctional. The average rent of a dwelling (€560 a month) is 86% of the minimum wage of a full time employee (€645), making it unaffordable by those on the lowest incomes. There are still large number of empty properties where the owners are unwilling to rent them out. Half the rental sector still operates within a black market and is undeclared to the tax authorities. Disrepair is widespread. All of which leads to a lack of respect for rented housing that it might take many years to overcome. [15]

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Chapter 13

Eastern Europe

Socialist housing model

Under the 'socialist housing model' the state controlled access to housing. Some was redistributed from those with more than they needed. During reconstruction following the war huge estates of apartment blocks were constructed on the outskirts of existing towns and cities, much of it using modern methods of concrete panel construction.

Housing was sold or rented from public bodies at below market prices and allocated on the basis of need and merit instead of price. In most countries private housing construction continued to exist alongside the provision of public housing, for home-ownership and rental in a regulated market. This was particularly common outside the main urban centres.

Opposition to communism was crushed in Berlin in 1953, Hungary in 1956, Czechoslovakia in 1968, and Poland in 1980 before the fall of the Berlin Wall on 9th November 1989 signalled its demise.

In August 1989 a non-communist government was elected in Poland. In October Hungary adopted a new democratic constitution with free elections, and a few months later the communists were voted out of power. In December Vaclav Havel was elected the democratic president of Czechoslovakia. In the same month Ceausescu was overthrown in Romania following a violent attempt at repression, and a reformist leader took over in Bulgaria, promising elections. Albania soon followed. In March 1990 Lithuania declared independence from the USSR and Ukraine claimed its own sovereignty.

In June 1991 Croatia and Slovenia declared independence from Yugoslavia, and the Balkan wars began. In August Estonia declared independence from the USSR. In April 1992 Bosnia's claim for independence started a civil war that lasted until 1996.

In 2004 the first group accepted into the EU included Hungary, Poland, the Czech Republic, Slovakia, Estonia, Latvia, Lithuania, and Slovenia. Malta and Cyprus joined at the same time. These are sometimes

called the 'Accession States' (appearing as 'AS' in statistical tables). Three years later these were followed in 2007 by Bulgaria and Romania. Croatia joined in July 2013. The others are still in the process of joining.

Before 2004 the EU consisted of 15 states (EU15), whose economies were relatively successful and inter-related. Those that joined subsequently are often referred to in EU reports as 'New Member States' (NMS), or sometimes as 'Central and Eastern Europe' countries (CEE).

Most EU countries joined the Euro currency union in 1999 except the UK, Denmark and Sweden. Greece was late to qualify and joined in 2000. Following accession to the EU Slovenia joined in 2007, Cyprus in 2008, Slovakia in 2009, Estonia in 2011, Latvia in 2014, and Lithuania in 2015. The rest of the NMS countries retain their own currencies (Bulgaria, Czech Republic, Croatia, Hungary, Poland and Romania) but are committed to joining when their currencies are sufficiently aligned.

Professionals from the Eastern Bloc countries appear to be more critical of the communist era than those working in manual trades. There was a job for everyone, and all were expected to work. Young people leaving home to start a family were generally found somewhere to live. The elderly were provided for.

It was the poor that suffered most following the collapse of communism. There was a great deal of corruption in the disposal of state assets, with some people becoming incredibly rich. It takes time to develop the cultural foundations on which effective democracy depends, and for new political alliances to evolve. Meanwhile many of the same people remained in power, wearing different hats. Some are still there today.

The EU played a vital role in guiding the new governments towards democracy, setting criteria they must meet in order to become members. The IMF and World Bank advised on economic reforms. This was a time when the free market economics of Fredrich Hayek and Ayn Rand was leading the political agenda in the USA under Ronald Reagan and in the UK under Margaret Thatcher.

The challenges faced by the countries emerging from communism were immense, and given the limited resources at their disposal there was little scope to focus on matters that were not essential to their applications for membership of the EU or to gain financial support from international financial institutions, or membership of NATO. Social housing was not on their agenda, and was seen as 'socialist'.

The new governments following the overthrow of communism handed state owned housing to the local authorities (municipalities). Much of it was in dire need of renovation and repair, but the municipalities lacked the funds, and rents were well below costs. In the most extreme cases there was no recognisable system of rent collection under a regime where everyone was a state employee, and was housed by the state.

Before long most of the properties were sold off cheaply or given to their tenants, often with a backlog of repairs they could not afford to deal with. In Romania, Estonia and Slovenia more than 90% of the State owned housing stock was transferred in this way; less so in Poland, Czech Republic and Slovakia, where the housing was generally of better quality.

Much of the industry in Eastern Europe was unable to compete in global markets, causing economic collapse. Governments no longer had the profits from state industries to subsidise housing or many of the other

	1990	2000	% privatised
Albania	35.5%	1.0%	97.2%
Armenia	52.5%	4.0%	92.4%
Bulgaria	6.6%	3.0%	54.5%
Croatia	24.0%	2.9%	87.9%
Czech Republic	39.1%	17.0%	56.5%
Estonia	61.0%	5.2%	91.5%
Hungary	23.0%	4.0%	82.6%
Kazakhstan	66.1%	6.8%	89.7%
Latvia	59.0%	16.0%	72.9%
Lithuania	60.8%	2.4%	96.1%
Poland	31.6%	16.1%	49.1%
Moldova	21.0%	5.5%	73.8%
Romania	32.7%	2.7%	91.7%
Russia	67.0%	29.0%	56.7%
Serbia Montenegro	22.2%	2.8%	87.4%
Slovakia	27.7%	6.5%	76.5%
Slovenia	31.0%	3.0%	90.3%
Ukraine	47.3%	20.0%	57.7%

Fig 93: Public housing as % of all dwellings [2]

welfare regimes on which the less well-off depended. Investment in the basic infrastructure became dependent on aid from abroad, particularly the EU, who set the priorities.

In consequence there are high levels of home-ownership in all of these countries, much of it in need of major repairs. The top seven EU countries for levels of home-ownership are all New Member States (NMS). Only two NMS appear in the bottom half of the table: Poland and Czech Republic.

The introduction of market economies led to a rapid increase in income inequality. Many low-income households live in condominiums with shared responsibility for maintenance for which they lack the financial resources.

The basic story may be similar for the countries of Eastern Europe, but behind it lie differences every bit as great as those between older members of the EU. In some such as Hungry, Poland and Czechoslovakia there were significant market-led enterprises including substantial amounts of private housing and a housing market, whilst in others, like Romania and Bulgaria, collectivisation was more rigidly imposed.

In a presentation to the CSDCS in 2012 [1] Lucia Ilieva divided the NMS into three groups:

1. The Czech Republic and Poland have relatively well developed housing policies, with both social housing companies and a significant private rental sector in Poland, and the Czechs retaining 75% of the stock in public ownership;
2. Slovenia, Slovakia, Hungary, Estonia, Lithuania, and Latvia have a less well balanced housing market and limited public housing;
3. Housing markets in Romania and Bulgaria are in serious crisis with public authorities playing almost no role and the highest levels of impoverished owner occupation.

In many of these countries house prices and rents have risen faster than earnings, causing growing affordability problems. Utility bills have risen (energy, water, sewerage) as subsidies were removed. The investment required to deal with the deterioration of the buildings is simply not available. Homelessness is becoming a problem.

The scope for raising rents to fully cover costs is limited by the poverty of the tenants. Fiscal restraints prevent governments providing adequate housing allowances to bridge the gap.

The socialist housing model described above is a gross simplification of what actually happened, which varied widely between the different countries of Eastern Europe. But its principles underlie the housing policies found in all of them.

Two of these countries are examined in more detail in the chapters that follow. They impact on EU statistics in ways that can be misleading so it is important to understand what lies behind those averages. Otherwise there are relatively few lessons to be learned from them of relevance to UK housing policy. They provide reminders of the problems that can arise where impoverished home-owners are unable to maintain their properties. They also serve as warnings of some of the dangers of over regulation and the rapid introduction of a free market.

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Chapter 14

Hungary

KEY STATISTICS	EU 27	Hungary
Population (2009)	499.7 million	10 million
Population per sq km	116	108
Dwellings (2011)	236 million	4.3 million
Units per 1,000 pop	473	429
Per capita € GDP (2011)	29,135	19,019
Gini coefficient (2010)	30.8	28.9
% owner occupied (2011)	70.0%	93.0%
% social rented (2011)	6.7%	3.0%
% private rented (2011)	19.1%	2.0%

Socialist Housing in Hungary

Unbiased information about Hungary under communism is hard to find. Much of this chapter is based on a paper written by Simon Ratcliffe in 1989 on the way socialist housing policy operated in Hungary. [3]

Between 1949 and 1954 about half the existing housing stock was nationalised under the control of municipal housing agencies. Rents were low at around 2.3% of household income, and set by a formula based on floor area, number of rooms, and the level of services.

Low rents led to disrepair. As rents failed to cover maintenance it became common to replace old units rather than improve or repair them. State subsidies which were aimed at new construction, reinforced this practice. Thus 335,000 dwellings were demolished between 1950 and 1975.

The shortage of housing led to a black market, with tenants sub-letting at much higher rentals.

State construction companies were supposed to have a monopoly on building materials but that did not stop two thirds of new housing production between 1951 and 1978 being through private sponsorship (1,187,000 units compared with 577,000 built by the state).[3] Most urban developments were state-sponsored while more than 90% of housing in rural areas was privately developed.

State built housing was either rented out, or sold at prices that did not necessarily reflect cost or market value. Heavily subsidised loans were provided from the National Saving Bank (NSB).

The early fifties was a period of rapid industrialisation, leading to migration into Budapest. A decree in 1958 drafted a fifteen year housing plan that envisaged a million new dwellings mostly built with public funds. But this depended on economic growth which in turn took priority over other investment, resulting in a reduction in housing development.

Regional urban centres were developed in the seventies to counter the pressure on Budapest, at Debrecen, Gyor, Miskolcs, Pecs, and Szeged. In the eighties the focus shifted to developing more medium and small sized centres.

As it became clear that public investment was drying up, private construction stepped in to fill the gap, mostly building single family houses. These were seen by the public authorities as bourgeois and wasteful of valuable building materials. Planning laws prevented private building in most rural areas. Nationalised land was used for public construction. When this declined in the early sixties subsidies were introduced for private builders, but only to construct apartment blocks.

In rural areas especially there was a great deal of mutual self-help in replacing rundown buildings, often using recycled materials, and financed by relatives.

'New Economic Mechanisms' were introduced in 1968, aiming to increase productivity through incentives linked to economic performance, and a shift from central planning to allow more influence for market forces. This 'market socialism' was nicknamed 'goulash communism'.

The 1971 Housing Act introduced income limits on eligibility for publicly funded housing, and focussed subsidies on those least able to meet their own needs. Rents were lifted to more economic levels. Higher rents on better quality state-owned properties, encouraged the better off to move into the growing private housing sector.

Self-build projects received state support and subsidised loans, widening this route into housing to include those with a broader range of incomes. Private housing was built in less valuable areas, but was of better quality than state provision. The state still largely controlled the availability of land for building, and ensured that most private building was located in the urban periphery. Despite this it is reckoned that by 1979 about 93,000 private houses had been built without permission in urban areas. [3]

The oil crisis in the mid seventies brought inflation, and rising foreign debt, limiting the scope for state subsidies. Between 1973 and the early nineties the national debt grew from $1 billion to $15 billion. [5]

The 1983 Housing Act promoted the private provision of housing through market mechanisms, in response to the shortage of public funds. Large scale developments by state construction companies on the edge of urban areas was halted. Private construction was dependent on the financial capacity of the families to be housed, and relied on the growing market economy to provide the additional income.

Rents went up by an average of 130%. Large deposits were charged for initial occupation of public housing. Responsibility for repairs and maintenance was passed from the state to the tenants, who were legally entitled to form residents' co-operatives to manage the work. Remaining subsidies in the rental sector were directed towards families in need instead of into construction. The only construction subsidies went to the development of owner-occupied housing.

Land became available on the open market, even in the cities, and prices rose in response to demand. A wealthy middle class had emerged in Hungary deriving their incomes from the market economy. State enterprise had been focused on heavy industry. Failures in planning had left gaps in the economy reflecting unfulfilled needs for products and services. A secondary market economy evolved to meet these needs, sometimes operating on the fringes of legality, and diverting resources intended for other purposes.

Housing became a consumer good whose price was determined by market forces.

By the end of the communist era, public housing consisted of a mixture of:

- older 3-5 storey apartment buildings in central locations which were nationalised after the war
- high rise blocks of flats built on the outskirts of cities,
- and cheaper working class tenements often with just one room and a kitchen and communal facilities,

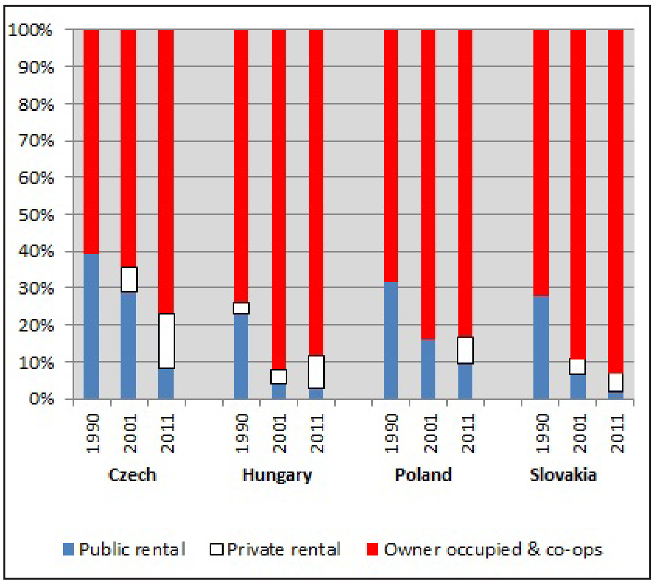

Fig 94: Tenure changes since Transition [4]

most of which were in inner cities.

Private sector housing included:

- villas in prestigious locations with gardens, relatively small in number,
- condominiums or modern multi-storey blocks of better quality apartments in prestigious areas and
- family houses similar to rural houses but located on the outer fringes of urban areas where the infrastructure was limited.

In 1980 almost 75% of dwellings were privately owned. Only 8% of these were in flats and 7% in housing co-operatives, with the remaining 85% in single family houses. [3]

At a national level 71% of housing was owner-occupied, and the rest was rented or sub-let.

State housing was funded through the state industries and local authorities, with the National Savings Bank (NSB) providing loans for state provision of owner-occupied homes. Housing associations and co-ops received some state funds and loans from the NSB. Private housing benefited from favourable pricing of building materials and land, but was otherwise entirely funded by private loans from the NSB and other private money.

In a free market system housing is allocated by price. The most successful people with higher incomes can afford to buy or rent the best properties. In a socialist system the state controls the construction and allocation of housing, which is provided at below cost and below market price.

It is hard to imagine a system in which rising managers and bureaucrats reduced their housing prospects as they rose through the system. So homes in the state sector, which included some state controlled owner-occupation as well as rented housing, were allocated on merit, rather than on housing need.

In the early years of the communist regime the aim was to keep rents low in relation to income with little variation according to cost or quality, and to distribute housing more fairly according to need. This was dependent on the success of state industries in generating the wealth to finance construction, and as the years progressed, this became increasingly difficult. By the seventies it was the secondary market-driven economy that generated much of the wealth, and built private

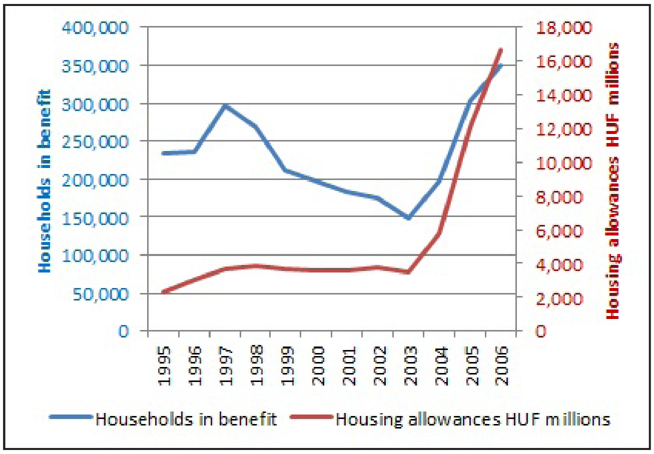

Fig 95: Hungarian housing allowances [6]

housing. It grew in scale as the middle classes expanded.

Better quality newly built flats had been accessible to the lower income groups, particularly during the 1970s, through heavy subsidies. Construction doubled between the fifties and seventies and for a while it appeared possible to produce cheap housing on a large scale, until the oil crisis hit the balance of payments and raised the cost of imports, and heavy industries became increasingly uncompetitative.

Public allocation of housing became a source of inequality as people with higher positions in the division of labour were able to influence the allocations process. The most modern housing in the most favourable locations and with the highest subsidies tended to be allocated to those people who occupied the highest paid positions.

By the end of communist rule rents had risen to reflect the cost and quality of the housing, and market mechanisms played an increasing role in the allocation of housing.

Years of transition

Eastern bloc countries traded with each other, and the Soviet Union on favourable terms within COMECON. But once exposed to global markets much of the industry in Hungary was unable to compete, and they lost 70% of their exports. GDP fell by 15% in the five years following transition and did not get back to 1989 levels until 2001.

Factories closed leaving 800,000 unemployed. The number of employed persons fell from 5.4 million in 1985 to 3.8 million in 1995.[6] Inflation rose to 20% and peaked at 35%. Many were pushed into early retirement, or forced into marginal self-employment.

Much of the market economy that grew up under communism was informal and hidden, and this remained the case following transition, with a great deal of tax evasion and black market activity. The informal economy was estimated at about 23% of GDP in 2009. [4]

For those in work, income differentials rose with the best paid 10% earning 7.6 times as much as the lowest 10% by 2004, compared with 4.8 times in 1987.[6] These were still narrow compared with western Europe (Fig 36 on page 41).

The economic downturn and black economy hit tax revenues. Action was urgently needed to reduce government spending which was running 10% higher than its income.

The subsidy on housing loans from the communist era was costing more than 2% of GDP. These were long term loans at between 1% and 3% to those that had bought flats from state construction companies, and to finance much of the self-built housing. In 1991 borrowers were given the option to pay off half the loan (usually by borrowing on the open market) in which case the other half would be written off. 78% took up the offer, leaving only the poorest households facing the alternative, which was to convert them to loans at 15% interest.

Two thirds of the revenues for publicly owned housing came from state subsidies: rents only covered one-third

	€ GDP per capita 2011	GDP % 2013	2013 Gini coefficient
Slovenia	22,888	-1.00%	24.87
Czech Republic	23,206	-0.70%	26.39
Slovakia	21,799	1.42%	26.58
Romania	15,106	3.50%	27.33
Hungary	19,019	1.53%	28.94
Lithuania	20,321	3.25%	32.63
Estonia	20,860	1.63%	32.69
Poland	18,988	1.67%	32.78
Croatia	16,652	-0.94%	33.61
Bulgaria	13,027	1.07%	34.28
Latvia	18,114	4.11%	36.03

Fig 96: Economies of Eastern Europe [12]

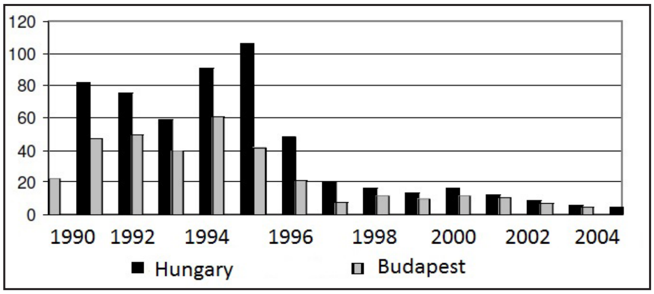

Fig 97: Privatisation of housing stock (1,000s units) [8]

despite rising significantly in the previous ten years. So to stem the losses a right-to-buy scheme was introduced in 1990 for almost all state housing, with prices discounted to 10-15% of market value, making it a bargain that few would refuse if they could afford it, although some properties were suffering from a backlog of repairs. The state rental sector fell from around 23% of dwellings in 1989 to 4% by 2000. It was the better off that gained the most, since they were occupying the best properties. [6]

Real incomes fell by between 30% and 35%, and did not begin rising above pre-transition levels until 2000.

This combined with the removal of housing subsidies inevitably raised the proportion of income spent on housing from around 11% in 1990 to 21% in 2004, which is more or less where it has remained ever since (Fig 6 on page 10).

For those on the lowest incomes affordability was considerably worse, and as income differentials rose this problem became more acute.

The Social Act of 1993 required local authorities to introduce housing allowances for those with housing costs that were more than 35% of household income. This applied to about 5% of households, and each local authority had discretion to decide what form it should take.

Ten years later surveys showed that 10% to 15% of households still had difficulty with housing costs, so in 2004 the government replaced it with its own program of housing allowances that went to households earning less than €110 per month, tripling the number that qualified. It aimed to reduce net housing costs to 20% of income and applied to home-owners as well as those renting. The cost of the allowance rose from 3.5 billion

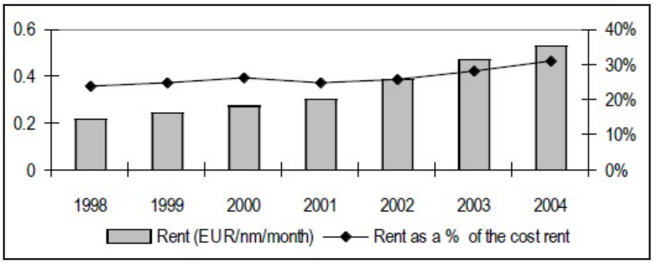

Fig 98: Social housing rents in Euros per m2 per month and as % of the cost rent [8]

Forint in 2003 to 16.7 billion (€13.6 million to €65 million) by 2006.[6]

Around 350,000 households received housing allowance in 2013, out of a total of around 4 million households. [4]

Rising energy and utility bills were posing at least as much of a problem as loan servicing and rent. In 2007 the government increased gas to the world market price, and replaced their previous flat rate subsidy with a means-tested benefit that cost it seven times as much as the housing allowance. The number with utility cost arrears increased to 15-20% of households between 2008 and 2012.[4]

Debts resulting from unpaid bills forced some people to move to a less valuable home so as to release equity to pay them off. This 'downward mobility' helped polarise areas, concentrating deprivation into poorer districts.

The ex-communist countries of eastern Europe are still catching up with the economies of the west. Hungary's GDP per capita is about average for these countries at €19,019, which is about half that of the Netherlands or Ireland (Fig 96).

Income differentials remain a little less than the average for these east European countries, and still well below the levels typically found in western Europe. But these differentials are steadily rising and are already well above Scandinavian levels (Fig 37 on page 42).

Social housing

Following privatisation of state housing on generous right-to-buy terms in the early nineties, only 4% of dwellings remained in local authority or other public ownership, as social rented housing. Most was in the larger cities (58%) and another 20% in towns with less than 50,000 inhabitants.

All those that could afford to had exercised the right-to-buy, so that only the poorest households unable to support the modest levels of borrowing required had remained in the social housing sector.

Each local authority was free to manage their social housing as they pleased, including tenancy contracts, allocations, sale of properties, housing allowances, and their approach to repairs and maintenance.

Rent control was abolished in 1991. Tenants were poor so there was little scope to raise rents which only covered between 20% to 40% of actual costs. Even with housing allowances many struggled to pay, and in 2003 about 22% of households were in arrears, compared with 5% of owner-occupiers. The losses made it hard for local authorities to invest in repairs, leading to a backlog estimated at 300 billion Forint (€1.2 billion) which was 30 times their annual housing revenues.

Attitudes to social housing varied enormously between local authorities. Some were overwhelmed by the scale of the housing problems in their area. A few exported their problems, for example by offering grants to Roma households to move into other districts. Tenants in the most serious arrears were moved into the poorest housing. Evictions were widespread. To avoid being seen to evict, some local authorities sold parts of their housing as a going concern, and turned a blind eye when the buyers evicted tenants in arrears.

Others raised rents to more economic levels, and provided more generous housing allowances to those that could not afford to pay. This only worked in the better off districts where sufficient numbers could afford the higher rents.

Between 2000 and 2004 government grants of up to 75% of construction costs were offered to local authorities to develop public rented housing. Altogether about 13,000 units were built at a cost of 60 billion Forint (€244 million).

A cost-rent programme was also funded with government grants that covered 75% of the development cost. Rents were set at a minimum of 2% of construction costs, which was around half the level of a market rent.

This ended in 2004 after a change of government. The new government made a number of attempts to subsidise social housing provision through the private

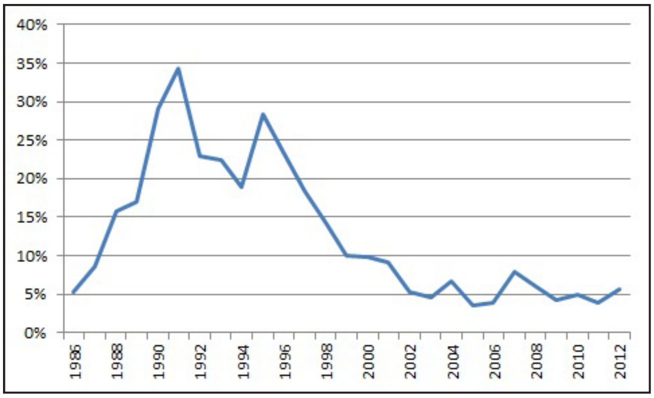

Fig 99: Inflation in Hungary [12]

rented sector, none of which were a success, at least in part because they required private landlords to file tax returns.

There are still large numbers of vacant municipal apartments requiring investment to make them habitable, and this problem is growing, not diminishing.

Meanwhile access to affordable housing of an acceptable standard where jobs and services are accessible has remained out of reach for a significant share of households. The public rental sector offers affordable housing, but the demand is several times higher than the supply. Private rental costs are too high to be considered affordable, partly because of the legal uncertainties and the subsidy/tax policy. [4]

Owner occupation is the main tenure form, but is unaffordable for a significant part of the population.

Part of the problem is that the housing subsidy system is biased in favour of home-ownership, making it cheaper to buy than to rent at least in the medium term. Under the old regime too much subsidy went to the better off, and these have also been the biggest beneficiaries of privatisation and of tax and subsidy regimes since transition.

Little has been done to promote the role of churches and NGOs or any charitable or voluntary organisations in the provision of social housing, which is almost exclusively provided by local authorities.

The population of Hungary has fallen slightly over the last 25 years, and is around 10 million. Households in the 2011 census averaged about 2.48 persons, which is close to the EU average of 2.4%. Fertility is below average and falling, leading to an ageing population.

There is no overall shortage of housing but much of it is still in need of renovation, and some of the older prefab housing needs total replacement. Between 10% and 12% of the stock is classed as 'dwellings without comfort'.

Private Rental Sector

The private rental sector remains small (about 4%) and largely remains in the informal sector, with a high proportion of private landlords not declaring the income for tax.

The fact it is taxed at 16% in the same way as any other commercial enterprise and hugely disadvantaged in relation to other tenures does not encourage landlords to declare it. Normal operating costs can be deducted with an option to deduct a flat 10% of rental income for expenses, which is nowhere near sufficient to cover management and maintenance costs.

Capital gains on sales of a property net of documented costs are also taxed at 16%. After five years the liability declines by 10% for every year, disappearing altogether after 15 years.

Property taxes are set by each local authority, within maximum levels set by the government at €6 per square metre or 3.6% of the market value of the building and 3% of the value of the land. Idle land is also taxed at €1 per sq m. [10]

There is little regulation of tenancies. The parties are free to negotiate rents, and the basis of rent increases. The same applies to rent deposits. The tenancy agreement may be for a fixed term, or an indefinite term, or until the occurrence of a certain condition defined in the agreement. The landlord must give a termination notice to the tenant prior to expiration of the contract.[10]

Owner occupation

Home-ownership was heavily subsidised during the communist era, with low-interest housing loans and an up-front subsidy based on household size. Both were abolished following transition as the government dealt with the budget deficit, and loans were largely converted to market interest rates.

Inflation in Hungary was running at 30% at the time of transition and it was not until 2000 that it fell below 10%. Records of house prices in the first ten years after transition are unreliable. According to some, they fell 40% in real terms (ie net of inflation).[11]

At this time mortgage-related loan portfolios were practically nonexistent, and only those who had their own funds could afford to construct or buy homes. Average mortgage loans were below 10% of the property value, and interest rates were high, typically around 20%. All of this was reflected in a decline in housing construction.

It took a while for a privatised banking systems to develop following transition. The FHB Bank was set up in 1997 as a joint venture by the government and four existing banks to provide mortgage loans and stimulate the housing market.

The year 2000 marked a turning point in housing policy. The government re-introduced interest subsidies, substantially reducing the cost of borrowing. These varied according to household size. They enabled families with children buying new properties to borrow at 8%. The rate was guaranteed not to exceed that for ten years, by which time the government expected falling inflation to bring market interest rates down to more affordable levels. Construction doubled in volume. [9]

These measures were coupled with a personal income tax exemption under which 40% of the loan repayment could be offset against taxable income.

During Hungary's housing boom (1998-2007), house prices soared by 264% (102% inflation-adjusted), before the market started to fall in 2008, mainly due to the financial crisis [10]

Rising house prices boosted people's confidence, leading to higher levels of consumption and growth in the economy. According to the Hungarian National Bank between 2001 and 2003 households spent around 15-30% of mortgage loans granted for the purchase of existing houses on financing consumption. [13]

Throughout this period the availability of subsidies was expanding, and in 2002 they were extended to include the purchase of existing homes. Housing subsidies were running at between 1.5% and 2% of GDP. [13] By the end of 2003 this was putting too much pressure on available government revenues and becoming unsustainable. Subsidies were tightened and interest rates rose.

House prices continued to rise until 2009. By 2004 the rises averaging about 4% pa were effectively cancelled out by inflation running at about 5%, although it took a while before this became obvious to home-owners.

Until September 2008 household consumption funded by loans had continued to increase, but at the same time industrial production, employment and exports were falling. The Hungarian economy was close to recession even before the credit crunch so the global financial crisis hit Hungary the hardest among EU economies. [15]

The increasing cost of borrowing in Hungary encouraged households to take mortgage loans from foreign banks. There was no real shortage of credit. By the end of 2004 foreign mortgages accounted for almost a quarter of the total, rising to 70% of all loans by 2010, when government restrictions put a stop to them.

Around 86% of overseas loans were denominated in Swiss Francs, with the rest in Euros. Interest rates were much lower, and few recognised the extent of the currency risk. Households subsequently saw their debt growing larger and the cost of their monthly repayments rapidly rising as the value of the Forint fell in relation to the Euro and Swiss Franc between 2008 and 2010.

The financial crisis had a big impact on borrowing in Hungary, which fell by 70% between September 2008 and January 2009 and has not recovered since. Housing construction fell from 44,000 units a year in 2008 to less than 16,000 in 2011 and is now below 8,000.[16]

The government was forced to cut its fiscal deficit in

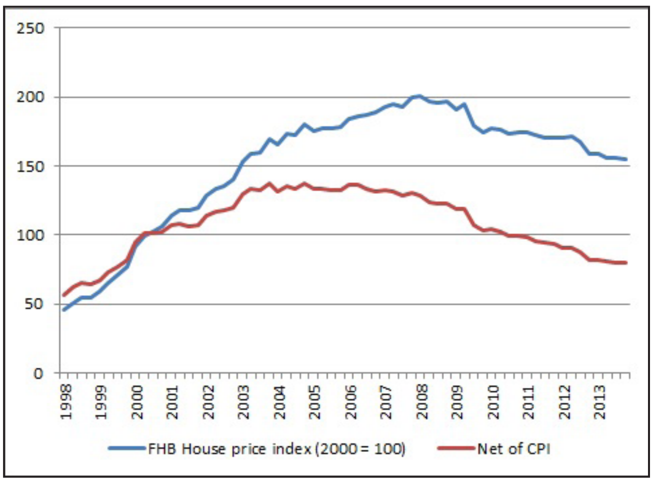

Fig 100: House prices in Hungary

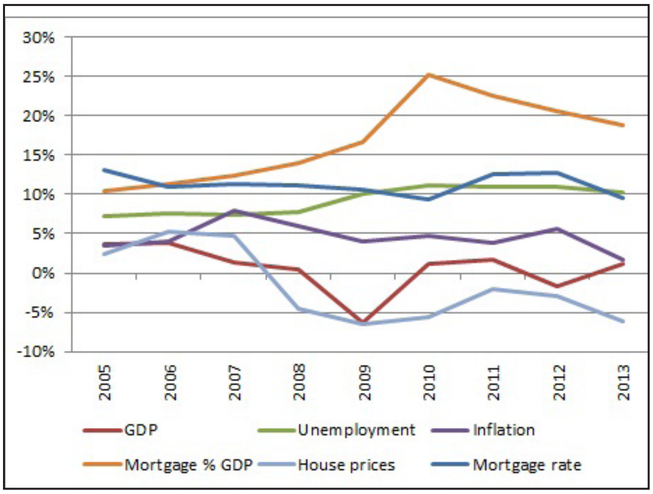

Fig 101: Economic indicators for Hungary [15]

return for an IMF loan, and drastically cut housing subsidies. Interest rate subsidies, and home-ownership down payment grants were suspended at the beginning of 2010.

It introduced a temporary moratorium on repossessions and assisted the banks in restructuring loans. Foreign mortgages were gradually replaced by loans in Forints with the banks sharing some of the currency costs. Others joined an 'exchange rate cap scheme' designed to limit their exposure. By the end of 2012 the government had reduced its budget deficit to 1.9%, and international pressures were eased. [15]

With interest rates at 12.77% a new interest rate subsidy was introduced in September 2012 together with a lump sum 'social subsidy for housing purposes' for first time buyers, to help revive the mortgage market and restart housing construction.

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Chapter 15

Bulgaria

KEY STATISTICS	EU 27	Bulgaria
Population (2009)	499.7 million	7.6 million
Population per sq km	116	69
Dwellings (2011)	236 million	3.9 million
Units per 1,000 pop	473	507
Per capita € GDP (2011)	29,135	13,027
Gini coefficient (2010)	30.8	34.3
% owner occupied (2011)	70.0%	90.0%
% social rented (2011)	6.7%	1.0%
% private rented (2011)	19.1%	5.0%

Economy

Bulgaria sits in the south-east corner of Europe between Romania to the north and Greece and Turkey to the south. From the end of the 14th century until 1878 it was ruled by the Ottoman Turks, although it remained predominantly Christian Orthodox. It found itself on the losing side in two World Wars, and then came under the control of the Soviets. [1]

It is administered through 28 regions and 278 municipalities.

It is mostly mountainous, with lowlands in the north and southeast. Before the Second World War it was predominantly an agricultural economy. Most housing was owner-occupied, with only small amounts held by state enterprises, private landlords, and cooperatives.[2]

Under communist rule all real estate and capital came under the control of the state. Bulgaria was transformed from a largely agricultural economy to an industrial one. By 1956 private economic activity was scrapped and replaced with a centrally planned economy. Some housing was redistributed amongst the socially disadvantaged, but very little new housing was built.

The productivity of Bulgarian agriculture increased rapidly after collectivisation. Much of the sector was mechanised resulting in immense growth in labour productivity. Food was heavily subsidised at a huge cost to the government.

This was also a period of intensive industrialisation. Factories were built particularly in the chemical

Fig 102: Map of Eastern Europe

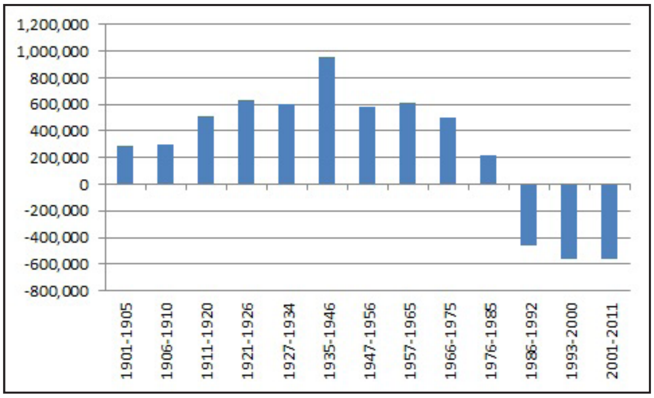

Fig 103: Increase in population between the censuses [3]

industries. The mining (bauxite, copper, lead, zinc, coal) and steel industries were developed, and dozens of dams and hydro-electric schemes were constructed. Some of this was done using labour brigades and what was described as 'voluntary labour'.

A certain amount of liberalisation was introduced in the sixties, and investment was directed towards light industry, information technology and tourism. By the seventies their standard of living was at least as good as in neighbouring countries of the eastern block: every household had a TV, 96% had a fridge, and 40% owned a car.

In the sixties and seventies the municipalities set up house building corporations to develop housing on a large scale. Most was in medium to high rise blocks of a very uniform character. Many smaller building enterprises were liquidated and replaced with state

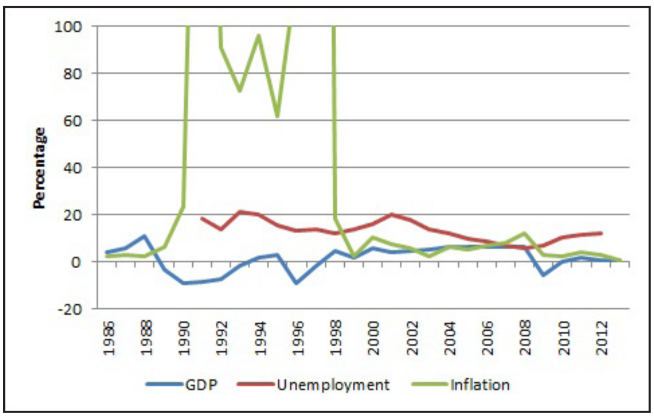

Fig 104: Economic indicators since Transition [6]

enterprises. Some private house building continued throughout this period, but the proportion of privately built housing declined from 42% in 1965 to 23% by 1985.

By the mid-eighties state housing construction had become discredited. A decree in 1986 declared that '*housing should be provided primarily by the private market ... while the state would continue to address the needs of the socially weak, and work on renovating and modernising the existing housing stock*'.[2]

In practice this relieved the state of responsibility for a growing housing crisis. The lack of building sites in urban areas and the high cost of building materials and skilled labour made private construction uneconomic, resulting in a severe shortage of housing in the places where the jobs were, and leaving many villages depopulated with empty properties.

By the end of the communist era, 85% of the housing stock in Bulgaria was private.

Following transition the incoming government adopted a policy of 'shock therapy', abolishing price and currency controls and withdrawing state subsidies in order to change as rapidly as possible from a planned to a market economy.

Industrial and agricultural output plummeted. GDP fell by 10%, and inflation reached levels of between 100% and 1,000% between 1991 and 1997.

The resulting economic collapse led to a massive fall in the population. Some 937,000 to 1,200,000 people, mostly young adults, left the country between 1990 and 2005. Between the 2001 and 2011 censuses the population fell by 564,331 to 7,365,570 people, an annual decrease of 0.7%. Less than one third of this was through emigration. Most was the result of an aging population and falling birth rates. [2]

Bulgaria's birth rate is amongst the lowest in the world with 1.43 children per woman, and well below the replacement rate of 2.1. The average life expectancy is 74.4 years, a little below the EU average of 77. [4]

A third of all households consist of only one person and three-quarters of families have no children under the age of 16. The majority (57.5%) of children born in 2010 were to unmarried mothers. [5]

In the 2011 census only 55% of the rural population was of working age, compared with 65% in urban areas.

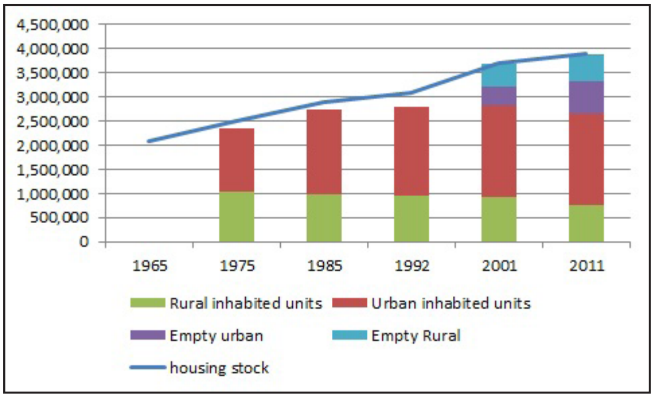

Fig 105: Bulgarian housing stock [3]

Following transition it took about 10 years for the economy to recover, and then only slowly, and with wide regional divergence. The main industrial activities include the mining of metals and minerals, production of chemicals, machinery and vehicle components, petrol refining, and steel. These employ about 35% of the workforce.

Agriculture employs another 7%, with the remainder in service industries. Tourism is expanding, as is their energy sector with nuclear, wind and solar energy production all growing.

Four of their six nuclear plants are being decommissioned with help from the Kozloduy International Decommissioning Support Fund because of safety concerns. The money comes from the EU and west European countries, and is also aimed at raising energy efficiency in Bulgaria.

Bulgaria joined the EU in 2007 but is not yet in the Eurozone. A little over a year later the banking crisis hit European economies, and the government adopted austerity measures under pressure from the IMF and the EU. GDP once again plummeted. Polls carried out in 2014 found that only 15% of Bulgarians felt they had personally benefited from membership of the EU, with almost 40% of the population saying they would not bother to vote in the 2014 EU elections.[5]

In 2012 wages averaged €393 per month, less than half those across the EU. Even now nearly 20% earn a minimum wage of €1 per hour. Household incomes are somewhat higher because of the extent of the black economy which Eurostat reckoned at about 32% of GDP in 2012.[5] Five out of the six poorest regions of the EU are in Bulgaria.

In 2011 Bulgaria's GDP per head was the lowest in the European Union at €13,027, which is less than half the levels found in most of western Europe. What is perhaps more surprising is that income differentials are amongst the highest in Europe (Fig 36 on page 41).

Bulgaria is rated one of the most corrupt European Union members, not helped by weak law enforcement. Several anti-corruption programs have been undertaken by different government agencies since they joined the EU. [8]

Housing stock

With a falling population there should be plenty of housing available in Bulgaria: 3.3 million households and almost 3.88 million dwellings. Not all of it is in the right place: there are still housing shortages in some of the major cities despite large amounts of uninhabited housing, particularly in rural areas. But it is the condition of the housing stock that causes the most concern and the investment needed to bring it up to a modern standard, and this is particularly true of rural housing.

The vast majority of the housing was built between the sixties and eighties, and is showing signs of aging. About 30% is prefabricated, and in need of modernisation. In 2001 55% of urban housing was of concrete block or reinforced concrete construction, compared with less than 5% of rural housing. 18% of rural housing in 2001 consisted of flimsy structures not really fit for human habitation.[2]

At the time of the 2001 census 65% of urban housing

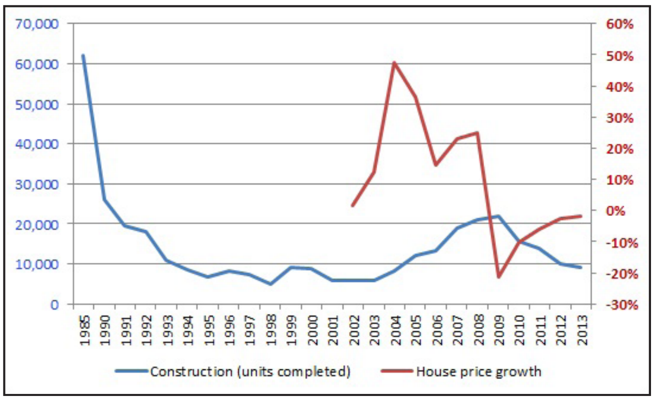

Fig 106: Construction and house price growth [12, 2]

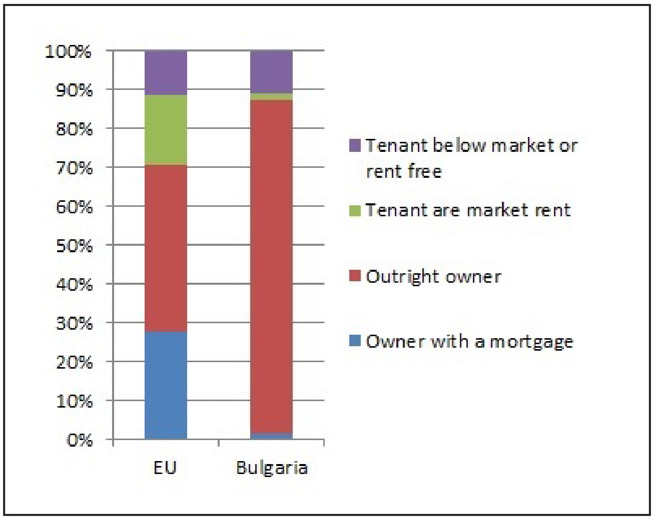

Fig 107: Tenure mix in Bulgaria compared with EU 2011 [14]

was in apartment blocks, and all but 3.5% was privately owned. 2.6% was owned by municipalities, and let as social housing. This tends to be the worst of the housing stock.

There are inconsistencies in some of the data on housing stock which may be to do with the way it was counted, and whether empty, flimsy and derelict properties were included. With a falling population it was the number of habitable units that mattered, and bringing them up to an acceptable condition.

New housing construction fell from 62,000 units a year in 1985 to around 25,000 in 1991 and below 10,000 a year after 1995. [2] It picked up again in 2004 reaching over 20,000 a year before collapsing following the banking crisis in 2009 as house prices fell (Fig 106). [12]

Planning permission is required for all development under the Spatial Development Acts.

Many homes do not have central heating and use individual room heaters. About 20% use district heating and the rest are heated by wood, coal or electricity. Poor insulation results in very high energy consumption. To central heat a home would take 40% of an average household's disposable income, and is often unaffordable.

The number of homes with no inside toilet fell from 40% in 2001 to less than 20% in 2011 but is still high by European standards.

In order to address the condition of their housing a National Housing Strategy for Bulgaria was adopted in 2004. This provided for '*Renovation of Housing Buildings in the Republic of Bulgaria*' and set a number of targets. These included the renovation of 105,000 buildings of concrete panel housing in the largest cities (Sofia, Plovdiv, Varna and Burgas) at a cost of 670 million BGL (€543 million), and another 830 million BGL (€424 million) in subsidies to owners of substandard properties, mostly of concrete panel construction.

The European Regional Development Fund allocated €1,361 million to Bulgaria of which €34 million was for housing. According to the Bulgarian National Association of Municipalities in 2010 the municipalities *"will be giving up European projects, as they will not be able to provide the required 5% down payments from the municipal budget"*. Limited additional resources have since been provided enabling them to access these funds. Owners have to provide 50% of the cost of renovation, usually with the aid of mortgage funding.

Roma

Turks were the largest ethnic minority at 8.8% in the 2011 census, down from 9.7% in 2001. During the communist era many of them were forced to integrate, taking Bulgarian names, and about 160,000 were deported during the fifties. [1]

The Roma have become the majority of the poor in Bulgaria and live in the most run down neighbourhoods. [2] The number of Roma changed little between the 2001 and 2011, making up just under 5% of the population. [3] Some dispute these figures because the Roma often fail to identify themselves as such on census returns. They reckon the Roma are closer to 9% of the population, and this is supported by EU studies.[2]

According to a 2009 EU study on Roma in Bulgaria[9] '*Only 29.8 per cent of Romany dwellings have sewerage, 4.1 per cent have running warm water, and 10.5 per cent have an indoor toilet.*

While 92 per cent of all buildings in the total housing stock that are occupied by Bulgarians are supplied with electricity, running water and sewerage, only 46 per cent of the Romany dwellings have such utilities. The situation of urban Roma is further exacerbated by the fact that as many as 70 per cent of the houses in urban Romany neighbourhoods are built illegally, either outside

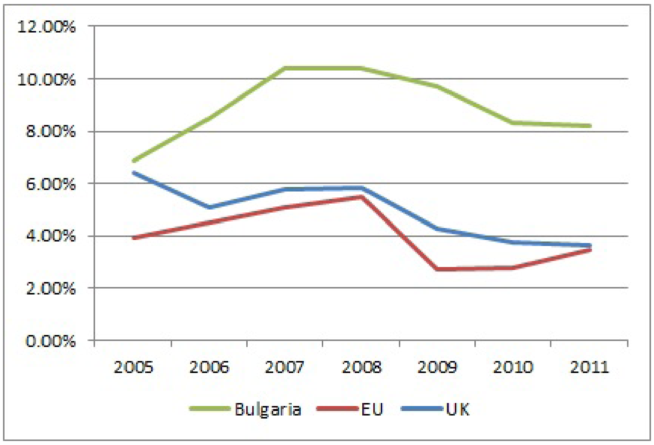

Fig 108: Mortgage interest rates [12]

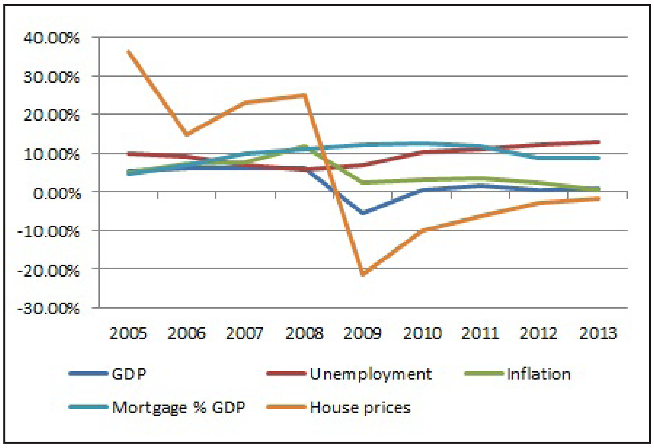

Fig 109: Economic indicators since the crash [12]

municipal boundaries or without due clearance by local authorities. In some neighbourhoods, this proportion reaches 85-90 per cent of the houses'. [9]

Romany households have an average of 6 people, compared with 2.9 for Bulgarians.

Private rental sector

Under communism rent levels were regulated. An owner could be required to house a tenant at a regulated rent if they were thought to have excess accommodation. All rent control was abolished in 1990 in line with the principles of free enterprise. Private property rights were protected.

Tenancy contracts are unregulated, except that tenants have the right not to be disturbed while occupying the property, or expelled arbitrarily without due legal process. A written notice must be served giving the tenant time to remedy any breach of the tenancy (eg to pay any arrears) before an eviction can be processed. They cannot be evicted for a minor breach so long as this is remedied. The maximum length of a tenancy contract is 10 years. There is no minimum period. Their only other protection comes from the European Convention on Human Rights to which Bulgaria is a signatory. In practice many tenancy contracts are oral with nothing in writing. [15]

The landlord is responsible for repairs except those of a minor nature or caused by the tenant. Tenants can be evicted for breaching the rules of a condominium.

Public tenancies are more heavily regulated, putting obligations on both the public landlord and the tenants. It is harder to evict, and public authorities complain of large arrears in rent and utility bills which eventually have to be written off.

The courts can be slow and expensive, which can be particularly problematic for landlords trying to recover rent arrears.

A report on *Tenancy Law and Housing Policy* published by the EU in 2014 provides a detailed explanation of the laws on renting and owning property in Bulgaria. [15]

In the 2011 census 81.7% of dwellings were owner-occupied and 13.5% tenanted, with the rest part-tenanted and part owner-occupied. Very few were let at market rents (1.7% of households). These figures exclude the 1.2 million unoccupied properties.[8]

Most tenants are students and young families that have left home in search of employment. Young couples often prefer to live with their parents to avoid the cost of paying rent.

99% of pensioners own their own housing and half have a second house, often because when the family moved from the country to town they kept their previous home, which with a falling rural population would not have been worth selling.

Housing benefits are very limited and not available to tenants in the private sector, although help with heating costs is sometimes available.

There are about half a million tenanted properties in Bulgaria, representing 18.3% of the housing stock. In urban areas 21.8% are rented, while in rural areas it is 9.3%. Almost a third of tenants live rent free. Some share houses with their owners.

The range of tenancy options is very diverse making it hard to gather statistics on tenures in Bulgaria. For example, those owning apartments in condominiums can pay relatively high rents and service charges to the freeholder, making them more like tenants than owner-occupiers.

A number of factors are holding back the development of a free market in renting. These include the large numbers of vacant properties, often in very poor condition, and sometimes squatted; widespread poverty and an absence of housing benefits or other assistance to pay a rent; and the lack of regulation and shadowy nature of the rental sector.

Landlords are taxed at 10% on rental income, although there is widespread tax avoidance, with an estimated 80% of landlords either not paying, or declaring less than the full amount. Tenants are encouraged by the tax authorities to report tax abuses by their landlords through anonymous emails and phone calls. A standard 10% of the rent is ignored as an allowance for expenses, although that is unlikely to be sufficient to allow for management and maintenance. There is no offset for mortgage interest or any other expenses. [15]

VAT is charged at 20% on rent where the landlord is registered for VAT. Few of them are.

Most landlords own one or two dwellings. Some let out their home while abroad looking for work. Very few own larger numbers of properties.[15]

Social housing

Under the communist regime there was no homelessness, and housing was generally affordable even by the poorest sections of society. New families were provided with housing, although how long this took depended on the length of the waiting list.

Publicly owned housing was mostly sold off during transition, falling from 441,493 units in 1985 to 69,878 by 2011. [8]

Social housing was built by local authorities, some for rent but most for sale to owner-occupants. Construction by the municipalities fell fairly steadily from 4,542 units in 1993 to a negligible 154 in 2001, by which time most of their existing stock had been sold off. [2]

A few municipalities are still developing social housing through joint ventures with construction companies in exchange for building sites. But the scope for this is limited: most publicly owned land and property was privatised, sometimes through corrupt arrangements in what is commonly referred to as the 'plundering of public property'. In some cases the tenants of blocks of housing found their landlord had changed from the municipality to a private individual or company with no publicly accountable process.

The municipalities once maintained lists of households needing social housing, but by 2001 they no longer had the resources for meeting these needs. Before 1993 there were 322,524 households (109,959 in Sofia) on the waiting lists. [2]

In 1994 the criteria for defining social housing needs changed and the lists were drastically reduced. By the end of 2001 the lists contained only 80,000 households (27,000 for Sofia). The ranking system for the queue was based on age, number of children, income, type of unit desired and previous waiting time. [2] In the 2011 census 2.6% of inhabited dwellings were rented from public bodies.

The National Housing Strategy includes plans to create

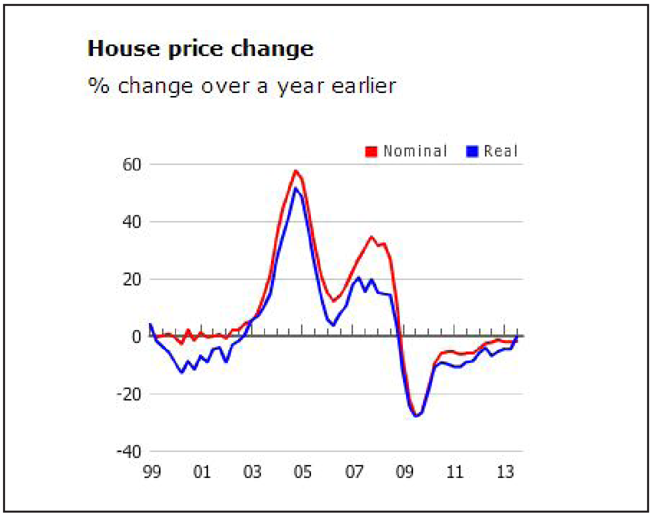

Fig 110: House prices in Bulgaria [10]

a voluntary housing sector to develop social housing, with the municipalities having a supervisory role. It also intends to stimulate housing investment through establishing housing savings banks.

Rents on social housing can be as low as €5-10 a month, and are typically 20% to 25% of market rents. [15] These households tend to be extremely poor, and many fail to pay either rent or bills for water, gas and electricity, building up debts that cannot in practice be recovered, at a cost to the municipalities.

Home Ownership

Home-ownership was relatively high in Bulgaria before the communists took over in 1944. Thereafter the price of housing was controlled by the state, and people waited in turn for the opportunity to purchase, with very limited choice over what they bought. Most purchased apartments in prefabricated blocks.

The Law of Ownership of the Citizens limited each family to owning one main residential property, and one villa or holiday home, limiting the scope for private rental except through shared occupation of the owner's residence. At the time of transition 85% of housing was privately owned.

In 1990 a new Property Law gave everyone the right to possess an unlimited amount of real estate with no restrictions, and allowed anyone to sell or buy a property at free market prices, without the involvement of the state or municipal authorities. [2]

In 2005 96.5% of homes were owner-occupied. Within the EU only Estonia and Romania had higher levels of home-ownership.

By 2000 the economy of Bulgaria was growing at a steady annual rate of 6% or more. Inflation was under control at around 5%. Unemployment was coming down from around 20% in 2001 to 5% in 2008. This attracted foreign investment, and mortgage funding became more readily available.

Prior to 2005 most loans were short term, for less than ten years. Loans over 25 years became available with loan to value ratios of between 60% and 80%. Interest rates came down from 16% in 2001 to less than 5% in 2005. [12] Real rates of interest (net of inflation) were much lower, at between 2% to 3%. This opened up the housing market for those able to afford it.

Bulgaria joined the EU in 2007 and was aligning their currency with the Euro in preparation for joining the Eurozone. Growing household consumption pushed inflation rates up closer to 8%.

In that years Bulgaria had the highest growth rate for mortgage borrowing of any country in the EU. Housing construction was rising, but only slowly, and the main concern remained the condition of properties rather than the supply. House prices were rising rapidly. Similar things were happening in other New Member States of the EU, but only the smaller countries of Estonia and Lithuania had higher price rises. [12]

Levels of mortgage borrowing in Bulgaria are much lower than the rest of the EU, rising from 4.7% of GDP in 2005 to 11.7% in 2011. The average for the EU was around 50%, and in the UK mortgages over that period ranged between 80% and 85% of GDP. Most households in Bulgaria owned their homes outright, without a mortgage. These were either inherited or acquired through the sale of an existing home or other property. Some received property under the 1992 Law of Restitution where their families had suffered expropriation under the communist regime.

The scope for further borrowing in Bulgaria was limited because incomes were low relative to utility and living costs. The number of households at risk of poverty rose by 60% between 2005 and 2011.[13]

Mortgage interest rates are much higher than elsewhere in the EU, and have not fallen back since the financial crisis.

An EU report on Tenancy Law and Housing Policy in 2014 summarised the current state of the housing market:

'*The economic crisis after 2009 ended the construction boom, and generated increase in the supply of properties for sale. The restricted access to housing loans and the weaker financial situation of households slowed down purchases. The lower demand also decreased prices in private rental. Moreover, many private owners that had built houses with investment purposes (with the intention to sell them at higher price) need to wait for the end of the crisis, so that prices rise back to pre-2008 levels. These currently unmarketable dwellings further raise available private rental housing, and additionally decrease rental* *prices*'. [15]

Restrictions on overseas buyers were lifted in 2011. Relatively low property prices have attracted foreign buyers, particularly around the ski and sea resorts. It is a popular destination for holiday homes amongst the middle classes from Russia and former Soviet Republics.

House prices have fluctuated wildly since 2000, undermining confidence in the housing market. Sellers have been reluctant to put their houses on the market, and buyers have found mortgages harder to obtain. The housing market has taken longer to recover in Bulgaria than elsewhere in Europe with real (net of inflation) house prices still below the levels of 15 years ago.

The war in Syria and unrest in neighbouring countries have resulted in net immigration to Bulgaria for the first time since transition. This will introduce new pressures on the housing market, particularly on cheaper rental accommodation in areas where work is available. Other demographic factors mean the population is still expected to shrink for the foreseeable future.

A local 'property tax' and 'communal tax' are payable to the municipality by the owners of all property, whether occupied or not. It is based on the value of the property. The rates are set by each municipality. Additional fees are charged to the occupant of each property for household waste disposal.

Residential tenants do not pay VAT on rent, while commercial tenants do.

A 10% tax is charged on the difference between the price at which a property is sold and its acquisition cost. Exemptions cover single properties sold after three years or two properties sold after five years of purchase, so most home-owners and landlords do not pay. It is a tax on short term speculative gains. [15]

Young families can offset interest payments on their mortgage against their income tax liabilities. In practice only 5,112 families qualified for this in 2009, and 3,890 in 2011, so its impact is very limited. [15]

Buildings sold as homes are exempt from VAT on the purchase. There are proposals to limit this to smaller apartments of up to 80 square metres costing up to €95,000, excluding wealthy buyers. [15]

A local tax of 2% of value is paid on purchasing a property which applies equally to home-owners and landlords. [15]

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Illustrations

A comparative study of housing policies in Europe