

# Financing Social Housing in Finland

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Finnish society strives to create equal opportunities for all individuals and households. This is well visible in many key areas such as education and health care. In housing the overriding objective is "to promote the right of everyone to a dwelling and to support the efforts of persons to provide their own housing" (Finnish Constitutional Act). This has been broadly interpreted as the state striving to provide equal opportunities for good housing to all. Social housing has played a key role in the process.

## THE INSTITUTIONS

Finnish housing policy is at the responsibility of the Ministry of the Environment. The ministry is responsible for housing policy strategies, housing legislature, housing subsidy systems and budget planning. The ministry has a staff of 30 people for housing.

The operative arm of the Ministry is the Housing Fund of Finland. The Housing Fund of Finland grants state housing loans (arava loans), approves interest subsidized commercial loans, carries out the quality and cost control attached to subsidy systems and allocates various grants. In addition the Housing Fund of Finland designates and monitors the approved non-profit organizations. The Housing Fund of Finland has a staff of 70 people.

Various housing loans, interest subsidies and grants are financed from an off-budget fund called the State Housing Fund. The off-budget fund receives cash from interest payments and amortization of existing state housing loans and additionally from external funding (securitisation or borrowing).

## Social rental housing in Finland

- Tenant selection is based on housing need and priority is given to a homeless applicant or applicant in urgent housing need. In addition the tenant's income must be within the income limits, set by the government, when receiving the dwelling.
- Rent is cost rent, which includes a yield on capital invested by the owner. The maximum yield is defined by the legislature and is currently 8 per cent.
- Owners of social housing are municipalities either directly or indirectly, non-profit organizations for housing and student and elderly foundations.
- Social housing is financed either with state loan (arava) or interest subsidized commercial loans. The Housing Fund of Finland chooses the projects and carries out cost and quality control.
- Social rental dwellings are to be used as such the minimum of 45 years.
- Good results in avoiding segregation are achieved by high quality of social housing, planning with mixed neighborhoods and use of relatively lax income criteria at entry without an income check later on.

The municipalities play a central role in the housing sector. They decide on the land use (including the type of house and form of tenure), provide the infrastructure and are the largest owners of social housing (some 60 % of total). They also prioritize the housing projects, which apply for state subsidies.

The non-profit provisions and preconditions apply to non-profit organizations (owners of somewhat below 20 % of social housing) and other non-profit entities under private law designated by the Housing Fund of Finland as providers of social housing. The purpose of the non-profit legislation is to channel the state subsidies to social-economically disadvantaged residents. Another aim is to ensure that benefit granted in the form of state loans or subsidy remains in the hands of these organizations.

The provisions include the following conditions: maximum return on invested funds (currently 8 %), limits on risk-taking, ban on affiliation with construction firms and ban on shares being traded publicly.

The most important commercial lenders in social housing are specialized departments or branches of universal banks and a special financial institution owned by municipalities.

## RIGHT-OF-OCCUPANCY HOUSING

Finland has a special housing tenure form, right-of-occupancy housing, which has some elements of social housing. Right-of-occupancy housing was introduced in the beginning of 1990s and so far some 30 000 right-of-occupancy dwellings have been

built. Right-of-occupancy housing is a housing tenure form falling in between owner occupancy and renting.

Residents buy into the scheme by paying a specified percentage (15 %) of the value of their home (this payment is redeemable at any time adjusted by the construction cost index). Residents also pay a monthly charge, which is based on the actual costs (similar to cost rent). The right-of-occupancy dwellings cannot be transformed to owner occupancy. There are no income criteria, but the household should not have the means to buy a dwelling that would satisfy their needs. The applicants to right-of-occupancy receive a queue number, on the basis of which they are chosen to right-of-occupancy dwellings.

The right-of-occupancy housing has been so far produced only with state subsidies with a similar procedure as the social rental projects (see below). From this spring onwards it is possible to produce right-of-occupancy dwellings without state subsidies.

A new form of subsidy is also a joint municipality and state guarantee on free market right-of-occupancy and free market rental production. The annual amount of these guarantees will be limited and it will depend on the willingness of the municipality to agree to guarantee a project.

### PART-OWNERSHIP

In 2002 a new tenure form, part ownership was introduced to state subsidized social housing. The idea is that a household pays a share (20 %) of the accepted building cost and price of the plot to the developer and acquires thereby the right to buy the whole dwelling later. An interest subsidized commercial loan covers the remaining part of the cost (80 %). In the meantime the household lives as tenants in the dwelling paying rent for the developer, who owns the dwelling. Later, earliest after 5 years at the latest after 12 years, the household can choose, whether to acquire the ownership of the dwelling for a prefixed price (80 % of the accepted building costs and price of the

plot) or not. The rent is based on cost recovery principle. Households are selected on the basis of social appropriateness and financial need. The income limits used are somewhat higher than in the case of social rental dwellings. The social part ownership housing will be produced with a similar procedure as the social rental projects (see below).

### FINANCE OF SOCIAL HOUSING

Social housing is financed either with state housing loans or interest subsidized commercial loans. The available amounts of each are set annually in the state budget. The allocation of type housing (social rental, right-of-occupancy, student, elderly) and region (growth centres vs. rest of the country) are defined by the Ministry of the Environment. The Housing Fund of Finland organizes the application processes, makes decisions on the projects to be financed based on need of housing and carries out the cost and quality control on the projects.

All the key elements of social rental housing are independent of the method of finance (state loan or commercial loan). The only exception to that being the slightly higher income limits applied to projects financed with interest subsidized commercial loans.

The state housing loan covers a maximum of 90 - 95 % of building costs and price of the plot. The loan term is approximately 35 years. The loan is an index loan, where the annual payment (interest + amortization) increases annually by an amount equal to the year on year change in the Consumer Price Index plus a fixed margin. The fixed margin is 0,7 %, but may be changed annually by decree.

The interest subsidized commercial loan is granted by a bank or other financial institution. The Housing Fund Finland first accepts the project. The loan will be granted a state guarantee and it will be paid interest subsidies. The interest subsidy loan covers a maximum of 90 % of building costs and price of the plot. The loan must be based on competition and the Housing Fund makes a decision on approval on interest rate and margin.

There are two alternatives for the type of repayment of the interest subsidy loan: a loan with a fixed amortization schedule and an index loan of the type of the state housing loan. The loan term with fixed amortization schedule is 35 years and the index loan is approximately 35 years. The alternatives result in exactly the same financial costs, when the interest rate on the loan is 5,5 % and the inflation 2 %

### Securitization<sup>1</sup>

The economic recession in Finland in the first half of 1990's led to rapidly increasing public debt. The use of public funds became under strict scrutiny and there was no room for the off-budget State Housing Fund to borrow as the state itself was borrowing heavily. At first, the solution was to rely more on interest subsidized commercial loans, which did not require as large an amount of funds from the Fund. This was not a viable solution, however, as at the time interest subsidized commercial loans were more expensive for the state than state housing loan system and also ineffective in relation to state housing loans. In order to grant state housing loans, a new source of funding was needed. As there were considerable assets in the form of outstanding state housing loans for social rental housing in the Fund, the solution was to use them as a source of funds through securitisation to keep up the social housing production. The first securitisation operation, Fennica I, was carried out in 1995. So far there has been altogether 6 Fennica operations with a total amount of 2,8 billion euros. The Fennicas have all been genuine securitisations without state guarantee. The most recent securitisation operation, Fennica VI, took place in November 2001. Fennica VI was in a single floating rate tranche of 500 million euros and was priced at 6-month Euribor + 24 basis points.

throughout the loan period. The interest subsidy is paid only on the part of interest above 3,5 %. In the first year the subsidy rate is 95 % and decreases gradually so that the interest subsidy ends after 19 years. In 2002, the average interest rate in the commercial loans was 3,89 % and the average margin to a reference rate (e.g., Euribor) was 25 basis points.

### RECENT DEVELOPMENTS

The importance of social rental housing has increased considerably during the last 30 years, when 5 % of the households lived in the social sector. The increase was strongest in the 1970s, when there was a strong migration to cities.

The share of social housing has been increasing also during the 1990s. This is directly attributable to the severe recession in the early part of the decade. The recession led to a collapse of a booming housing market and housing production. The state acted by increasing the state subsidized housing production, mainly social housing, as there was both housing demand and production resources available (the state intervention had also a clear objective of maintaining employment in the construction sector, where large amounts of new dwellings were left unsold, when the recession hit Finland). Later in the end of

1990s, when the economy grew strongly and free-market housing production revived, the social housing production was lowered somewhat to give way to free-market production and not to cause pressure on cost development in the sector.

However, the social housing production was kept at a reasonably high level. This was because as an outcome of rapid economic growth, there was a strong migration to largest cities, resulting in a high demand for housing. Additionally, as many of the new jobs created were in the service sector, the demand towards moderately priced dwellings was strong. The demand for social housing was also accentuated by the deregulation of private rental sector in the middle of the 1990's, which resulted in more supply but also rapidly increasing rents in the private sector.

As can be seen from the graph 2, the interest subsidized commercial loans have been used to finance some 3 000 dwellings during the last few years.

### OUTSIDER'S VIEW ON SOCIAL HOUSING AND ITS FINANCE - THE EVALUATION

The Finnish government decided in summer 2000 that " an external evaluation is to be made of Finnish housing finance and

support systems in order to identify long-range development needs in the EMU environment". The Ministry of the Environment asked four groups of experts to carry out the evaluation: the groups of professor P.J. Boelhouwer from OTB, professor Christine Whitehead from LSE and André Asselin from CMHC. In addition Mark Stephens from Glasgow University was asked to participate in evaluation of the housing finance questions.

The scope of the evaluation was by and large the entire field of housing policy. Here I will concentrate on the evaluation around social housing finance, which was perhaps also the area that drew the largest attention in Finland.

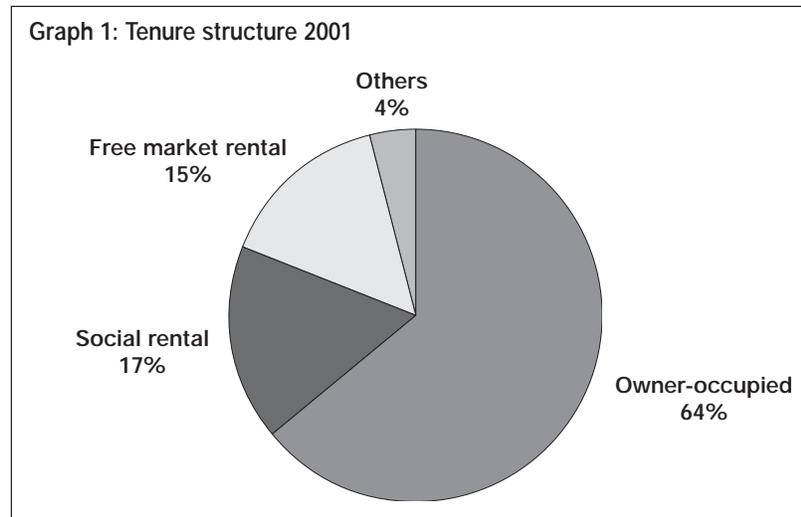
The evaluation noted the large role played by subsidized housing production in Finland. This was seen as a positive commitment of the state, unlike in many other European countries, to keep up housing output levels. The evaluators saw, however, that "current market conditions and a favorable outlook on the future of Finland may be an opportunity to revise the role played by the government".

Related to above, the evaluators also questioned the generousness of the tenant selection criteria in social housing. The fact that some 70 % of the Finns have incomes which fall within the income limits used in social rental housing raised doubts both of the targeting of social rental dwellings and the existence of a transparent target in the program. The lack of targeting was seen as a serious issue as the queues for social housing had been increasing constantly in the 1990's.

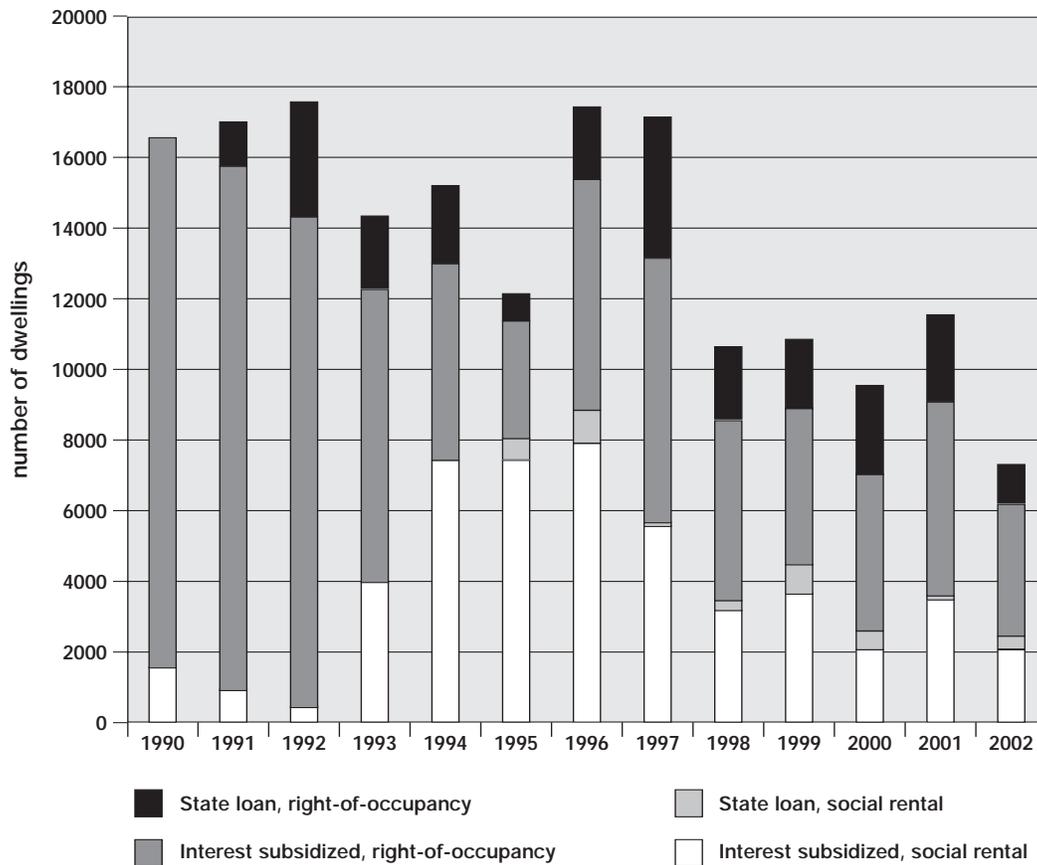
Put together, the significant role of subsidized production and generous eligibility rules, were seen to crowd out private developers, especially in the rental market, but also in other intermediate tenures (right-of-occupancy, low cost home initiatives). Therefore, giving more room to private developers was seen to increase the supply of housing in the growth areas.

The evaluators were also asked to evaluate the methods of social housing finance: the

Graph 1: Tenure structure 2001



Graph 2. Social rental housing production in Finland 1990-2002



state loan and the commercial interest subsidy loan (guaranteed by the state). The evaluators point out that the projected output levels in social housing are not achieved and especially the state loan system seems uncompetitive. The reasons for these results arise from two different sources. On the one hand, the strong housing market directs the resources of housing production to most profitable projects, i.e. to private housing. At the same time some non profit organizations have been rethinking their operations to become more commercial. On the other hand, the state loan system especially loses its competitiveness when market interest rates fall. This is because the parameters of the state loan system do not automatically follow the market interest rates, but require

a separate decision from the government.

The evaluators discuss a number of ways to improve the situation. At one extreme is the abolishment of the Housing Fund and letting a privately funded system prevail and the other extreme would be to rely solely on state housing loans, because state has access to the cheapest funding.

The recommendation of the evaluation is to maintain the current two systems for social housing finance and ensure a flat playing field with respect to the choice among them, so that whichever is more efficient in different circumstances can be made available. In addition it was suggested that the parameters and the working of the systems should be improved so that all

parties are happy with the outcome and that benefits flow through more effectively to final consumers. The evaluators also suggest that in addition to these a third system of privately funded schemes without state guarantee but with subsidies should be considered.

The evaluation report came out some four months before the general elections. Therefore, the incumbent government was not in a position to initiate any large changes based on the evaluation.

An exception was made regarding social housing finance. There had been a process to improve the terms of the state housing loans, but it was postponed until the evaluation report was finished. When the

evaluation's outcome was known, the process was continued and in February the government made significant changes in the state housing loan system. The changes included lowering the interest rate, slowing down the annual increase in loan payments and introducing a market interest rate as reference rate for new state housing loans.

An important consideration in the reform of the state loan system was the relation of the state loan system to interest subsidized commercial loan system. The aim and the result was that both systems remain competitive vis-à-vis each other.

### THE WAY FORWARD

The general elections resulted in a new government coalition formed by the Centre Party, the Social Democratic Party and the Swedish People's Party. The government programme now formulates the housing policy, which is to be exercised during the term of the government. In addition to the government programme, a separate housing policy program, which takes into account the results of the evaluation, will be formulated by the end of this year. The formulation of a separate program gives the opportunity to discuss the policy issues in more detail and without a tight time limit. A separate program also enables a comprehensive treatment of the housing policy. The government program, however, gives already a good picture of the housing policy during the next few years, especially with regard to social housing.

First of all, in state subsidized housing an annual production volume of about 10 000 new dwellings will be made possible. Social housing, when right-of-occupancy is included, makes some 90 % of this amount. The actual production volumes will depend on the need of social housing and willingness of owners to initiate housing projects. The production will be directed to growth centers and other areas with strong need and demand for dwellings. With the present division of production, the share of commercial housing loans in social housing is around one third of total. However, any

changes in terms of the loans (see below), new policy decisions and factors influencing the demand of the two finance methods could affect the shares of the two systems.

The terms of the state loan will be modified, so that they will be competitive with regard to market interest rates. At this point it is yet unclear what kind of modifications are needed for this outcome, but for example some of the existing state housing loans have interest rates which are well above the market interest rate level at the moment. Other improvements to state housing loan system are already clearly stated. The increase in the annual payment will be slowed down and made equal to inflation rate (currently inflation + 0,7 %). In addition, a predetermined amortization schedule is introduced, as is the case already in the system of interest subsidized commercial loans.

The government programme also includes measures that will strengthen the position of the non-profit sector. It sets out to change the tenant selection criteria in a way that would enable a wider social mix of tenants. This is to be interpreted as an increase of the income limits in some cases (eg based on the characteristics of a household or a region). The programme also formulates a goal to ensure for non-profit organizations an operation environment, which enables them to operate viably in the long run. A working group has already been nominated to begin the work towards this goal.

### FINANCE OPPORTUNITIES IN THE NEAR FUTURE

With regard to finance of housing production, it would seem that the recent history (see graph 2), would be the best forecast for the next few years. Commercial lenders would in that case finance, with the help of state guarantee, annually the production of some 3 000 new dwellings. Largest share of these dwellings would be social rental dwellings. If the social part-ownership housing becomes popular, the amount could be higher. Furthermore, the popularity of free market right-of-

occupancy production and free market rental production, both benefiting in some cases from state guarantee, could increase the production figures. Naturally, the economic environment will be decisive in the need of housing and type of housing demanded. Low interest rates have made ownership an option for many households, whereas the weak job market has slowed down migration to growth centers and thus the demand for new housing.

In recent years, as the market interest rates have continuously decreased, state housing loans for social housing have increasingly lost their competitiveness with respect to commercial loans. This has led the owners to convert the state housing loans to market loans. The amount of conversions has varied between 60 and 500 million euros annually since 1998. The significant improvements on the conditions of state housing loans this year are, however, likely to dampen the conversions considerably.

The funding of the State Housing Fund has been carried out with several alternative methods. In addition to securitisation, direct government borrowing and direct borrowing by the State Housing Fund has been used during the last couple of years. The use of different methods is likely to continue also in the future.

### REFERENCE

<sup>1</sup> See Securitizing Funds for Social Housing by Teuvo Ijäs and Hari Hiltunen, *Housing Finance International*, December 1998