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- Urban housing system reform and real estate market development in China
- Affordable Housing in Wales: Challenges underpinned by optimism
- The private rented sector in France
- The public markets and European residential real estate
- More expensive housing loans to be expected from Basel revision; harmonisation of international regulation leaves little room for different business models

International Union for Housing Finance

Housing Finance International

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For further details, please contact Mark Weinrich (weinrich@housingfinance.org)

International Union for Housing Finance
Rue Jacques de Lalaing 28, B 1040-Brussels - Belgium
Tel: +32 2 231 03 71
Fax: +32 2 230 82 45
www.housingfinance.org
Secretary General: Mark Weinrich

Editor's introduction

↳ **By Andrew Heywood**

The development of affordable housing by governments has been a barometer of the shifts in how government sees its responsibilities to provide for the needs of its citizens. Should government intervene to directly offer secure high-quality accommodation to those who cannot access such accommodation via the market, or should policy makers stand back in the belief that the market will ultimately serve the needs of all, if to varying degrees? Put another way, should government develop "affordable housing" as a specific category of provision standing outside the market, or should the role of the state be to create conditions in which housing is affordable?

At times of crisis, whether natural or man-made, such dilemmas are often temporarily resolved by the responsibility to urgently provide shelter to those in need. Hurricane Irma has rampaged across the Caribbean and Florida. The sight of the widespread destruction of homes and the mass dislocation of households on our television screens creates an immediate impetus towards rapid and decisive action. Yet even here difficult issues are raised. When providing help for the longer term, should one aim to reproduce the sometimes-inadequate housing of the past or to improve it? Should new housing be for rent or for sale? How should it be funded?

For much of the post-war period, the "Golden Years" as the French describe them, the issue of how to provide housing for all was resolved by a twin-track approach. Market recovery was encouraged after six years of conflict and homeownership levels rose over the following four decades. Yet this achievement was underpinned by simultaneous provision of "affordable housing" which frequently had a dual purpose. Affordable (social) housing directly provided decent homes for those who could not access the homeownership market and whose experience of private renting had in many cases been negative. At the same time, the development of large numbers of homes under the auspices of government contributed to overall new housing supply with the effect of making housing more affordable across tenures. In the UK for instance, social housing made up 53% of all new housing built during the thirty years to 1980. The high levels of affordable housing development were reproduced across much of Europe, notably in the Netherlands and France. It is ironic that the post-war boom in home ownership owed much to the provision of affordable housing in many countries.

This is not to suggest that the post-war provision of affordable housing was an unmitigated success story. The development of large unattractive mono-tenure estates often created their own set of social problems including worklessness and anti-social behaviour. Some academic studies of the life chances of those brought up in social housing went as far as to suggest that such housing was itself responsible for limiting individual opportunities and suppressing aspirations.

The last two decades of the twentieth century saw a shift in the emphasis of public policy in many countries. Governments reacted to the perceived shortcomings of existing affordable housing provision but also responded to the broader neo-liberal political climate, which supported the withdrawal of the state from responsibilities that had previously been seen as central. The emphasis of policy moved away from traditional social housing provision towards encouragement of homeownership. Social tenants were encouraged to buy their homes and in many countries the new supply of affordable housing declined.

For a while, the change in approach appeared to be working. Homeownership peaked at 80% in Ireland in 1991 and at 70% in the UK early in the next decade. As mortgage finance became more widely available it appeared that the need for affordable housing as a specific tenure would continue to reduce. Sadly, this did not last. In the wake of the Global Financial Crisis [GFC], it became increasingly clear that homeownership levels were on the decline in many markets, including the US. In addition, there remains a stubborn sector of households who cannot sustainably be accommodated by the market whether as owners or in the private rented sector. As this issue of HFI demonstrates, this has led to increased interest in affordable housing both by government but also by private investors. It is unlikely that this interest will simply reproduce the policies of the past. The trick, of course, is to learn the positive lessons while avoiding the very real mistakes.

China, in many ways epitomises the story sketched out above. From a position where the State had the central role in the direct provision of housing, China began to move decisively towards market provision of housing with an emphasis on homeownership. This policy has been highly successful in promoting a private housing market and a generation of homeowners. However, since 2007 China has recognised the need to make housing provision for those priced out of the homeownership dream. In our first major article in this issue Yusong Deng traces the changes in Chinese housing policy relating to the reform of the urban housing system over the past three decades. The article not only demonstrates the direct benefits of the reforms but links them to strong economic growth in China.

In terms of size Wales and China are at opposite poles. Nevertheless, Wales too has an interest in affordable housing provision, in part because 23% of Welsh households continue to live in poverty. In an important article, *Affordable housing in Wales: Challenges underpinned by optimism*, Matthew Kennedy provides a valuable overview of affordable housing policy in Wales in the context of the broader housing market and the economy.

The affordable housing sector has seen increased interest from private institutional investors in a number of countries including Germany, the Netherlands and the UK. In his article, *The public markets and European residential real estate*, Shaun Stevens examines the reasons for increased institutional investment in the affordable sector in Europe in the period since the GFC.

The private rented sector is often seen as a tenure standing between homeownership and social housing. In his article *The Private rented sector in France*, Claude Taffin provides an overview of the private rented sector in context and discusses its history as well as current trends. This is a very helpful article for anyone wishing to better understand housing policy and practice in France.

Our final article, by Jakob Kongsgaard Olsson, focusses on the preparations for the introduction of the Basel III capital accords. New regulation almost always involves striking a balance between protection and growth. In his article Olsson argues that the new capital floors proposed by the Basel Committee will dampen down economic growth and cause consumer detriment without providing effective additional protection from the effects of high risk lending. The article makes some telling points about the relationship between an unaccountable Basel Committee and the EU.

Contributors' biographies

Yusong Deng is the Deputy Director-General of the Institute of Market Economy at the Development Research Centre of the State Council of P. R. China [DRC]. He is the team leader on "real estate economics and policy research" at the DRC. His current research interests mainly focus on macro economy, housing markets and housing policies.

Claudia Magalhães Eloy is a consultant on housing finance and subsidy policy in Brazil, who currently works for FIPE [Fundação Instituto de Pesquisas Econômicas] and has worked for the World Bank [TA] and for the Brazilian Ministry of Cities and Companhia de Desenvolvimento Urbano e Habitacional of São Paulo [CDHU]. Claudia has also participated in the development of the National Housing Plan, in the analysis of the Housing Finance System. She holds a PHD in Urban Planning at the University of São Paulo [USP], a Master in City Planning at the University of Pennsylvania, a Master in Public Administration at Bahia's Federal University [UFBA] and a BA in Architecture and Urban Planning [UFBA], with a specialization in Real Estate Finance at the Brazilian Economists Order [OEB]. She also attended Wharton's International Housing Finance Program.

Matt Kennedy is the Policy & Public Affairs Manager, Chartered Institute of Housing Cymru. He leads and supports CIH Cymru's policy and public affairs work engaging with housing professionals working across the housing association, local government and private rented sectors in Wales. He has have worked in front line and policy roles within social housing and healthcare in Wales for the past 8 years having studied Politics & International Relations and Business & Community to degree and masters level respectively.

Jakob Kongsgaard Olsson is Head of Department at Finance Denmark, which is an association for the Danish banking sector. He is an economist by profession and has throughout his carrier been engaged with financial issues in the Danish Ministry of Economics and Business Affairs, Realkredit Danmark (second largest covered bonds issuer), the Association of Danish Mortgage Banks, University of Copenhagen and Copenhagen Business School. He has also attended Wharton's International Housing Finance Program.

Alex J. Pollock is a distinguished senior fellow at the R Street Institute in Washington DC. He was President and CEO of the Federal Home Loan Bank of Chicago 1991-2004, and President of the International Union for Housing Finance 1999-2001.

Zaigham M. Rizvi is currently serving as Secretary General of the Asia-Pacific Union of Housing Finance and is an expert consultant on housing and housing finance to international agencies including the World Bank/IFC. He is a career development finance banker with extensive experience in the field of housing and housing finance spread over more than 25 countries in Africa, the Middle-East, South-Asia, East-Asia and the Pacific. He has a passion for low-cost affordable housing for economically weaker sections of society, with a regional focus on Asia-Pacific and MENA.
EMAIL: *zaigham2r@yahoo.com*

Shaun Stevens is the strategist in the real estate securities team of BNP Paribas Asset Management, responsible for asset allocation and investment strategy. He is a chartered surveyor and has worked in a variety of roles in the real estate investment management industry in Europe since 2001.

Claude Taffin is a consultant with over 35 years of experience in the housing sector. He was first a statistician in charge of housing at the National Institute of Statistics and Economic Studies (Insee) before working for several entities involved in housing in France, including Credit Foncier, a mortgage bank, l'Union Sociale pour l'Habitat, the association of social renters, and the Notaries High Council. He also served as Senior Housing Finance Specialist for the World Bank.

Mark Weinrich holds graduate degrees in political science and economics from the University of Freiburg, Germany. He is the General Secretary of the International Union for Housing Finance and the manager for international public affairs at the Association of Private German Bausparkassen.

Housing news update from APUHF

By Zaigham M. Rizvi

3rd Annual Affordable Housing Conference

The Conference held in Malaysia on 6th to 7th September 2017 was organized by TruEventus.

The housing stock in many Asian countries is grossly deficient in quantity and quality. Shortages and poor condition are largely the result of the rapid urbanization occurring in the region. Factors like inadequate and overcrowded housing, unsafe water, poor sanitation and densely populated cities are threatening the health and well-being of millions.

In Asia, the formal housing delivery processes in most countries kept pace with demand until the 1997 financial crisis, when the economies in the regions declined, which was hard for the countries to endure. Citizens who fall into the low-income category are limited in choice causing a rise in homelessness. Despite the current initiatives to combat this problem, there remains a challenging imbalance between the demand and supply of affordable housing.

Various channels of support are needed for more effective housing policies to curb the over-heating property market. The Conference aimed to analyze the existing scenarios and scrutinize planning and policies to improve affordable housing. It featured field experts who shared ideas and solutions to address the challenges.

The conference had a very good attendance with participants coming from countries of the region including Pakistan, India, Malaysia, Singapore, Vietnam, Maldives, Philippine and some international experts as well. The papers presented covered nearly all critical areas on the supply-side as well as the demand side of housing, with the primary focus on low-income affordable housing. The topics covered: the role of the urban planners in planning and facilitating supply of affordable housing, leveraging partnership between the public and private sectors, manufacturing scale production of low-income housing, innovations in low-cost construction materials, land use and environmental considerations in horizontal and vertical housing etc. Some case studies from different countries were presented to show successful best practice that could be applied by others.

The conference sent a very strong message that each country in the region has something to offer to and something to learn from others. It also highlighted the usefulness of platforms like the International Union for Housing Finance [IUHF], African Union for Housing Finance [AUHF] and Asia-Pacific Union for Housing Finance [APUHF].

Thailand

K.I. Woo

Low-income housing programs opened to local and foreign developers

The Thai Government recently announced that both domestic and foreign investors will be invited to participate with the Government in public-private partnerships [PPP] to build low-income housing under the Pracha Rat home scheme.

Deputy Prime Minister Somkid Jatusripitak recently told the Bangkok Post that he has asked state-owned GH Bank and the National Housing Authority [NHA] to design a housing development plan for low-income and lower-middle earners nationwide. The two organizations will complete the proposed plan within six months. “The Government is very interested in helping low-income and low-middle income earners, and young state employees to acquire their own homes,” he said.

Dr. Somkid said that public-private partnerships will be used to build these homes. “The demand for housing projects remains high in Thailand because many low-income earners and lower-middle-class people don’t have access to the housing market.”

The Thai Cabinet is expected to approve PPP measures that will encourage new housing for the underserved lower-income sector.

Dr. Somkid said the Thai Government is also supporting elderly housing projects, especially because of Thailand fast-aging society. The National Economic and Social Development Board [NESDB] said that currently 11.2 million or 17% of the total population is elderly. By 2036, this number will have risen to 19.5 million or 30% of the total population. Thailand is defined as an “ageing society” because people aged 60 and older make up more than 10% of the total population.

Senior housing projects urged to partner with medical care facilities

Developers of senior-friendly residential projects are urged to partner with hospitals and medical care operators to develop housing products that match Thailand’s ageing society’s needs.

Associate Professor Trirat Jarutach, head of the Appropriate Environment for Elderly and Disabled People Research Unit, Faculty of Architecture, Chulalongkorn University, told the Bangkok Post that developers must collaborate with medical service operators. “To be successful in senior home development, developers should build trust with potential customers through partnerships with hospitals, hospitality management firms and wellness centers,” he said.

GH Bank to offer reverse mortgages

The Government Housing Bank [GH Bank] will soon be offering reverse mortgages that allow the elderly to convert their home equity to cash. Laiwan Pongsangiam, GH Bank’s senior executive vice-president, said the Bank will be amending the Government Housing Bank Act to allow it to offer reverse mortgages.

Reverse mortgages allow elderly homeowners to realize cash from the home equity without monthly loan repayments. Borrowers can use the cash to cover monthly living expenses and healthcare costs. When the borrower dies, the heirs have the option to either pay off the loan and reclaim ownership of the home or allow the lender to sell the home. “Reverse mortgages will benefit the elderly who own a house and need money for daily expenses while allowing them to remain at their homes,” Laiwan said.

GH Bank is also offering pre-financing facilities totaling Bt 3 billion ($ 909 million) to developers of senior housing projects.

"GH Bank Housing Expo@ Bangkok" grand opening

Chatchai Sirilai, GH Bank President reported that the Bank hosted a "GH Bank Housing Expo @ Bangkok" event at Queen Sirikit National Convention Center from August 24 -27, 2017. Deputy Prime Minister of Thailand Somkid Jatusripitak chaired the event's grand opening. Police General Adul Saengsingkaew, Minister of Social Development and Human Security and Surachai Danaitangtrakul, GH Bank Chairman also participated in the event. The Bank conducted this event to celebrate its 64th anniversary (September 24th, 2017). The event's housing promotions enhanced quality of life and stimulated the real estate industry. These included:

i. "Housing loans for all homes"

The Bank offered MRR-3.85% interest rates (2.90% per annum) for the 1st – 3rd year. Current MRR is 6.75% per annum. Interest rates from the fourth year until the end of the agreement will be MRR -1.00% per annum (welfare customers) and MRR -0.50% per annum for general retail customers (current MRR is 6.75% per annum). If the funds are used to purchase housing appliances and related facilities, the interest rate will be MRR. These loans are for purchasing, constructing, enlarging, renovating, paying-off existing loans, purchasing home accessories and refinancing.

The Bank also waived the following three types of fees:

- Loan submission fees (0.1% of approved loan amount)
- Collateral appraisal fees for all loan amounts (Bt 1,900 / Bt 2,800 /Bt 3,100), (($US 57) / ($US 85) / ($US 94).
- Registration and legal transaction fees (Bt 1,000) ($US 30).
- Mortgage registration fees (1% of loan proceeds)

Customers can apply for loans and loan transactions must be completed by December 29, 2017 (maximum Bt 20,000 million ($US 606 million) allocated for project).

ii. Special housing promotions

At the event GH Bank offered special housing promotions for new, second-hand and foreclosed homes and specially discounted homes from private developers (70 housing projects).

The National Housing Authority also offered new housing projects to lower-income people. The home builders and construction materials businesses showcased new construction innovations to the market.

The Bank also offered 90 good quality, prime location Non-performing assets (NPAs) in Bangkok and surrounding areas at up to 45% discounts. NPA customers can also use the Bank's special 48 month no-interest down-payment loan campaign.

The Bank auctioned specially priced second-hand houses (up to 50% discount) at the event and at all Bank branches on August 26, 2017.

Sukhumvit Asset Management Co Ltd and the Legal Execution Department also provided several types of NPAs for auction on August 25, 2017.

iii. "More money with savings deposits" campaign

The Bank offered a "More money with saving deposits" campaign with 1.80% per annum interest rates for customers who deposit amounts not exceeding Bt 1,000,000 ($US 30,000). 0.90% per annum interest rates will be paid to customers who have deposit balances of more than Bt 1,000,000 ($US 30,000). Minimum initial deposits of Bt 500 ($US 15).

iv. GH Bank unmanned branches – simulation of future customer delivery models.

These branches will provide housing loans, new account openings, deposits – account withdrawals and debt repayment without staff. They are an integral part of the Bank's "Transformation to Digital Services" plan that will use new technology to develop innovative new financial products and service channels. It will be optimized to ensure easily accessible, convenient, speedy and safe services at any time.

The Bank also conducted a "Housing for the elderly society: from policy perspective to practice" seminar that studied elderly housing ideas and innovations in various countries. Elderly housing design competition 2016 winners also received their awards at the event. The Ministry of Social Development Department of Older Persons and the Human and Security Community Organizations for Development Institute [CODI] held an exhibition that focused on elderly housing and living security.

SCG Cement – Building Materials Co., Ltd exhibited bathroom, bedrooms and living rooms models designed for the elderly and sponsored free Credit Bureau personal credit checks. Customers could access this service with their identification cards.

Pakistan

↪ Dr. M. Saleem

Pakistan Mortgage Refinance Company Limited

Pakistan Mortgage Refinance Company Limited [PMRC] has been set up by the State Bank of Pakistan [SBP] as a joint initiative of the Government of Pakistan and commercial public and private sector banks with the technical assistance of the International Finance Corporation [IFC] and the World Bank [WB] as a Mortgage Liquidity Facility [MLF]. The creation of PMRC marks an important milestone in the Government of Pakistan's objective to improve access to housing finance, particularly to the middle and low-income group of borrowers who are in dire need of access to long-term housing finance. PMRC, as a notified Development Financial Institution [DFI] regulated by the SBP, will provide medium and long-term funding to primary mortgage lenders (i.e. banks and financial institutions) by raising funds from the capital debt market at cheaper rates than the primary mortgage lenders would be able to do if acting alone. In other words, PMRC will act as an intermediary between primary mortgage lenders and capital market.

Pakistan's mortgage to GDP ratio is 0.5% as compared to South Asia's average of 3.4%. The low level of mortgage debt is due to the challenges faced by the primary mortgage lenders. Mortgage financing in Pakistan remains cautious due to several constraints. Banks are reluctant to undertake mortgage lending due to issues relating to lack of clear land titles, the slow foreclosure process, lack of long-term funding sources and the low supply of affordable housing. During the last few years, the Government has demonstrated its commitment to housing finance with initiatives which include the establishment of PMRC, recent amendments made in the Financial Institutions (Recovery of Finance Ordinance and Records) 2001 to expedite foreclosure, improvements in land titling system in Punjab and Sindh by digitalising land records and exemptions from tax on interest paid up to Rs 2.0 million for mortgage instalments by individuals. The State Bank of Pakistan [SBP] has also kept abreast of the problems faced by the primary mortgage lenders [PMLs] and introduced conducive prudential measures such as the Housing Finance Prudential Regulations (May 2014) to promote housing finance.

Currently, 24 commercial banks, one microfinance bank and the House Building Finance Company [HBFC], which is the only specialized housing finance institution in Pakistan, are providing housing finance. The market share of private sector banks increased from 31% to 32% between December 2015 and December 2016. However, the share of Islamic banks increased from 35% to 38% during the same period.

As at the end of June December 2016, the market share of Islamic banks, private sector banks and HBFC was 38%, 32% and 23% respectively. Public sector banks accounted for 7% of the total market share whilst that of the foreign banks remained at 1%. One interesting feature is that the share of Islamic banks increased from 20% at the end of June 2013 to 38% at the end of June 2016. This clearly demonstrates the growing volume of Islamic mortgages.

PMRC, the long-term liquidity facility institution in Pakistan

Mortgage market in Pakistan is again gearing up. For the last 3 years, the Compound Annual Growth Rate [CAGR] of the mortgage market was 11.65%. However, variable rate, non-standardized underwriting practices and significant maturity mismatch may expose PMLs to higher credit and liquidity risks which are reflected in higher spreads charged on mortgage loans and rising non- performing loan [NPL] ratios. This will again lead to the stagnation of the mortgage market which occurred in 2008-2009 and onwards.

In light of the above, SBP initiated the setting up of a mortgage refinance company, known as Pakistan Mortgage Refinance Company [PMRC] and its role is to develop housing finance in Pakistan to aid financial institutions to extend housing loans in greater amounts, by addressing their liquidity issues through refinancing facilities. PMRC has the objective to promote, develop and improve the housing finance market thereby increasing accessibility and availability of affordable housing finance with greater participation by PMLs and financial institutions.

The impact of PMRC is critical to keep the pace of the growth of mortgages and to make mortgage finance accessible to middle and low-income groups. By acting as a central refinancing platform, PMRC can act as a force to make the requisite changes in the market.

In Pakistan, mortgage finance for the middle and low-income groups is not available due to the high cost of servicing. Fixed rate mortgages which can be refinanced by PMRC are especially important for the middle and low-income groups who are vulnerable to the volatile interest rate movements in Pakistan. All mortgage loans in Pakistan are based on floating rates. Historically, interest rates and inflation in Pakistan are relatively volatile. With interest rates expected to rise, the borrowers' ability to meet their monthly repayment obligations will be tested and this will result in defaults. Middle and low-income groups are more exposed to any adverse interest rate volatility as their disposable incomes may not increase proportionately to interest rate increases. Any significant increase in interest rates will dampen the confidence in the market and may lead to a significant decline in the creation of mortgages. The availability of medium- or long-term fixed rates from PMRC can instill a degree of certainty that can help the mortgage markets develop with confidence.

In addition to the above, in Pakistan, the mortgage lending practices are not standardized and the underwriting and servicing skills of the PMLs can be improved further to promote a sound and viable mortgage market. In this respect, PMRC is already working with IFC/WB to introduce the Minimum Quality Standards [MQS] for the PMLs. MQS will act as industry standards for granting mortgage loans to borrowers that will qualify for refinancing with PMRC. This will promote efficiency and mitigate risks in mortgage lending and lead to more affordable house ownership. PMRC's goal is to address the issues of standardization and effective risk management. In essence, PMRC is adopting a comprehensive approach to improve the accessibility and affordability of housing finance particularly to middle and low-income groups.

PMRC as a liquidity facility will spur the development of the local bond market since its main source of funding will be from the bond market. PMRC will issue plain vanilla unsecured fixed-mark up debt instruments with lower spreads on the strength of PMRC's desirable AAA credit rating. The issuance of PMRC's bonds enables the primary mortgage lenders to obtain lower cost of funding in order to grant mortgage loans for housing particularly for middle and low-income groups. At the same time investors have the advantage of investing in safe bonds with a relatively high return.

Major Shareholders: Government of Pakistan-Ministry of Finance, National Bank of Pakistan, Askari Commercial Bank Ltd., Habib Bank Ltd., United Bank Ltd., Allied Bank Ltd.

India

↳ Zaigham Rizvi

Housing for All by 2022" Mission: National Mission for Urban Housing

India adopted a mission in 2015 for 2022 when India will be complete its 75 years of independence. The target for the mission is that no one in the country would remain without a house, everyone whether living in shanty-slums or with a meager income source, will have a place to live of his/her own. With this object in sight Pradhan Mantri Awas Yojana – the mission for Housing for All [Urban] was launched.

This mission has four components: slum rehabilitation, promotion of affordable housing through credit linked subsidy, affordable housing in partnership with the public & private sectors, and subsidy for beneficiary-led individual house construction or enhancement.

For slum rehabilitation, average grants of Indian Rs. 1 lakh per house are to be given to all eligible slum dwellers. The Government has also to establish the eligibility of slum ownership. For promoting affordability of housing, the interest rate subvention at 6.5% is being offered to both EWS/LIG categories of people. To strictly ensure the public-private partnership, the Central Government is to assist with Indian Rs. 1.5 Lakh per EWS house in projects where 35% of the houses are mandatorily for EWS. Subsidy for individual house construction or enhancement is Indian Rs. 1.5 lakh per house for EWS category in slums, if States/ cities undertake the projects.

Houses constructed under the mission are targeted to the female head of the households, or in the joint name of the male head of the household and his wife. The main purpose of the mission, obviously, is to strengthen and empower the women, particularly those who are widows and otherwise disadvantaged in the society. The beneficiaries of this scheme include the husband, wife and unmarried children, EWS Households having annual income up to Indian Rs.3,00,000/- and LIG Households having annual income between Indian Rs.3,00,000/- and up to Rs.6,00,000/-. Among the eligible beneficiaries, preference is given to manual scavengers, persons belonging to scheduled castes/ scheduled tribes/ other backward classes, minorities, persons with disabilities and transgender people.

The scheme covers all "Statutory Towns" as per the 2011 Census and towns notified subsequently. Hence, it covers the entire urban area consisting of 4041 statutory towns with an initial focus on 500 Class-I cities of the country.

Under the main mission of housing for all by 2022, a technology sub-mission has also been set up to facilitate adoption of modern, innovative and green technologies and building materials for faster and higher quality construction of houses. The technology sub-mission was also to facilitate preparation and adoption of layout designs and building plans suitable for various geo-climatic zones and for disaster resistant and environment friendly technologies.

The scheme, however, has drawn criticism from some quarters, who think that all the provisions of this scheme have loopholes that cast doubt over the scheme's bold title: 'Housing for All'. It might be nearly impossible to establish the eligibility of owners in slums for a plethora of reasons, without which nobody would be entitled to have a house of his/her own, and the scheme can cater for only those with income below a certain level. In addition, it overlooks vast numbers of people in the bigger cities like in Mumbai, for example, where over 60% of residents are living in informal housing, and it may not be possible to provide housing to all of them as it claims in its statements. (Bilal Khan and Ane Gupta on 18/04/2017).

Malaysia

↪ Datuk Chung Chee Leong

Dialogue on sustainable development of affordable housing

The dialogue on the sustainable development of affordable housing was held on 4th July 2017, organised by Cagamas Holdings Berhad at Sasana Kijang, Kuala Lumpur. The demand for housing in Malaysia remains strong with a relatively young population, rising affluence and larger middle-income group, underpinned by strong demand for housing by first time buyers. This situation had spurred the idea of hosting a dialogue on affordable housing to address various pressing issues.

Aimed at creating a platform for an exchange of views, the dialogue offered an opportunity for industry experts to deliberate on issues relating to affordable housing both locally and internationally. The panellists presented various insights and valuable knowledge on subjects which included the global perspective on affordable housing provision, the Malaysian Government's perspective and initiatives and case studies as well as the challenges faced by first time home buyers. In addition to that, the dialogue seeks to give participants a flavour of how other countries are tackling the issues of affordable housing.

Among the key takeaways discussed included the following:

- Sound, innovative and coordinated public policy is central to addressing the affordable housing challenge. This should reside with a central authority that leads, oversees and coordinates affordable housing initiatives for the nation.
- A good practical policy on affordable housing should encompass the following: targeted public resources, participation by the private sector plus a transparent and proficient regulatory environment.
- Designs for neighbourhoods and townships are also important; for example, it should not be only the higher income groups living in the city centre. Initiatives such as Federal Territory Affordable Home (RUMAWIP) should be intensified to create more diverse groups in townships and cities.
- Rent-to-Own schemes should be considered within housing policies, given that under current conditions, incomes for B40 and M40 will not be able to catch up with rising house prices and as such, these income groups will never be able to own their own homes.
- Establish a taskforce on the Sustainable Development of Affordable Housing with members drawn from The Ministry of Urban Wellbeing, Housing and Local Government, city councils, state investment agencies and housing market players. The taskforce should work hand in hand in forming innovative solutions to address the current issues. For example, the task force could look into issues such as the overhang housing units, compliance of housing developers, effectiveness of a One-Stop-Centre, eliminating obstacles to house ownership and so forth.
- A central repository as a systematic way of monitoring and managing the demand and supply of affordable housing including granting access to those seeking to purchase or rent homes.
- Efforts should also be made to increase the opportunity for potential solutions and effective project management through the study of various cases and successful developments from multiple regions as well as to develop a thriving rental market to reduce the supply-demand gap for affordable housing by strengthening the legal and institutional frameworks underlying the rental market.

Datuk Chung Chee Leong, Chief Executive Officer Cagamas Berhad with the panellist during the dialogue session

The challenges of the European banking sector – the case for a small banking box

↳ By Mark Weinrich

Almost a decade after the onset of the Global Financial Crisis [GFC] many European banks are still struggling to cover the cost of equity and to deliver an economic profit. Some of the causes of this underperformance are largely out of banks' hands, as is most strikingly the case in relation to the zero-interest rate policy of the ECB. Yet some causes are related to inherent weaknesses within the banking industry itself. The debate on potential remedies is dominated by the assumption that Europe is overbanked with reference to the cost structure and that the European banking sector had ballooned since the 1990s. Clearly, Europe remains highly dependent on banks by international standards, while capital market orientation is relatively weak by comparison. This raises the question of how to measure the size of the banking sector in an adequate and comparable way. Total assets represent the indicator which regulators and academics use most frequently. But this indicator suffers from some flaws: valuation problems for some instruments (in particular but not only derivatives), the different treatment of off-balance sheet exposures, and the lack of adequate consideration of capital market activities (as even for those liabilities where the creditors are non-banks, banks are typically involved in crucial ways). If, in particular, the different strength of equity capital markets is taken into consideration, the financial system in Europe compared to the US does not at all look outsized anymore. Instead of looking at total assets we could look also at the average number of customers per bank and will find that in the US there are 27.000 customers on average per bank, while the respective numbers for Europe and Germany are 62.000 and 47.000 customers. However, this indicator is also not really useful. Revenues and equity capital might be better indicators than the aforementioned. While revenues are cash flow-based and thus generally more reliable, as well as independent of business models and financial structures, the equity capital corresponds to the book value of a bank, which is relatively stable and mostly immune to measurement problems or differences in business models.

That something has to change in the European banking landscape seems to be evident. But traditional market consolidation may not be the answer since it normally causes a reduction in the number of small banks. Traditional consolidation goes against the policy aspiration of wanting banks to be smaller, not bigger. There is also little point in joining two small weak banks together to make one big weak bank unless it can then execute the structural and operational changes to make itself stronger. Some smaller institutions might not be able to hold their ground, while downsizing might be healthy for some larger institutions, and some services might be provided also more efficiently and better by fintech competitors.

The fragmentation of the German banking market makes it easier to establish the fact that consolidation and the creation of larger entities is not necessarily a success factor. There are also several small institutions with a cost income ratio of around 40% and return on equity (before tax) of more than 10%.[1]

Unlike other large jurisdictions, such as the USA, the EU applies the same regulatory rules to all its banks in seeking to achieve a level playing field. However, this "one size fits all" approach of common binding rules for all banks can cause distortions given that the costs of regulation tend to bear more heavily on smaller banks, in particular, on those with simple and low-risk business models. This fact has raised the case for a more proportionate regulatory regime, discussed under the label "small banking box". The discussion is not about lowering quantitative requirements – for capital or liquidity, for instance; but rather the discussion is on tracking down operational requirements that can be dispensed with. In this sense, the small banking box would be a separate framework for smaller banks, which would not affect capital or liquidity requirements but would still cut reporting and disclosure rules. In effect, the list of requirements would be much shorter and considerably easier to understand, and complying with the rules would become a much less time-consuming exercise for small institutions. This does not require establishing an entirely new set of rules; a separate, short passage in existing European law would be sufficient which determines the areas in which the rules would be eased and which establishes a definition of those institutions to which a simplified set of rules could apply.

As the previous discussion on how to measure the size of the banking industry has shown, it will be not enough to look at total assets only (whereby an absolute and relative threshold would be needed) to define whether a bank would be subject to simplified rules. A list of secondary requirements should be adopted as well to exclude credit institutions with riskier business models.

Early results are unlikely in relation to the small banking box. Many matters are still disputed and need further elaboration, like the concrete design of the small banking box or the specific requirements and thresholds for banks to qualify for the simpler set of rules.

[1] For example, Sparkasse Spree-Neiße (balance sheet total EUR 3,2 billion) with a cost income ratio of 40,3%, Sparkasse Holstein (balance sheet total EUR 5,7 billion) with ROE of 16% and Sparkasse Markgräflerland (balance sheet total EUR 2,4 billion) with ROE of 13,4%.

Latin America and Caribbean Round Up: Special housing finance funds

By Claudia Magalhães Eloy

Special housing finance funds in Latin America

Some major special housing finance funds were created in the Region around the late 60s and early 70s, to provide funding for housing finance through mandatory long-term savings schemes, which are still among the main financing sources in their respective countries.

In Brazil, FGTS[1], the workers indemnity fund, was created in 1966 to solve the lack of funding for the recently established national housing system[2]. It receives monthly mandatory contributions from employers, equivalent to 8% of formal private sector workers' salaries. At the end of 2016 it totaled US$160.4 billion[3] in assets with over 40 million active accounts, contributions of US$40.7 billion[4] and a net result of U$4.6 billion.

Mexico's Infonavit[5] was founded in 1972 to enforce a constitutional mandate for suitable housing. It receives monthly mandatory contributions equivalent to 5% of formal private sector workers' salaries and now administers over 58 million accounts. In 2016 contributions amounted to US$10 billion[6] and the net result was of U$1.27 billion.

Both FGTS and Infonavit have a dual mandate as a workers' fund and mortgage lending entity; they enjoy fiscal authority for collecting employer contributions and have council boards composed of representatives from the federal government and the labor (union) and employer sectors. Account holders are allowed to make withdrawals to use as a down payment to purchase a house, together with a loan from either the fund or from a private lender. Moreover, they both offer credit at below market rates.

Yet, while Infonavit integrates the pension system, providing savings to supplement retirement income, FGTS is an indemnity fund[7], created as a substitute for the workers' decennial stability law that was in force up to the 60's in Brazil. The commitment of FGTS is to provide workers with a personal fund that amounts to an equivalent of 1 salary per year[8] which can only be withdrawn under certain conditions, including down payment for housing acquisition[9].

Another difference is that FGTS' financing agents are two major public banks – CAIXA and Banco do Brasil but Infonavit acts as a direct lender. Infonavit is under the same reporting and control rules as commercial banks, while FGTS is not subject to oversight by the financial regulator. Furthermore, within Infonavit, only account holders are eligible for housing loans but FGTS' loans are offered to anyone who qualifies, regardless as to whether they are account holders or not, including informal workers and unregistered commercial operators, causing the subsidization of mortgagees by account holders[10]. Since the mid-2000s, as FGTS has (re)focused on lower income groups, cross-subsidies have allowed low income families to access housing finance. Cross-subsidies are also present at Infonavit. According to Chiquier and Lea (2009)[11], "Infonavit loans are linked to an index of wage inflation, to which a spread is added that varies by income category, cross-subsidizing borrowers in lower-income segments".

In 2016, FGTS and Infonavit housing loan portfolios were US$ 78.2 billion[12] and US$ 70 billion respectively and they provided around 432,000 and 373,000[13] housing loans each. Despite the growth of private market lending, Infonavit is responsible for around 70% of all mortgage lending in the country.

In both cases, macroeconomic stability has enabled the growth seen over the last two decades and subsidies (both direct and indirect) have increased down-market access. They comprise of low cost funding sources and offer affordable financing options in their markets[14]: in the case of Infonavit, payroll deductions reduce lending risk, contributing to lower interest rates that are around 12% per year; loan rates funded by FGTS range from 4% to 8% (+TR per year[15]).

This year FGTS is expected to total US$ 20 billion[16] of new housing loans, but it has been under a lot of political pressure, due to political instability and economic recession, which has resulted in the following changes:

- The creation, in 2007, of an investment fund, FIFGTS, to finance infrastructure investment projects[17], not necessarily profitable ones, totaling over US$ 10 billion;

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[1] Fundo de Garantia por Tempo de Serviço.

[2] This System, created in 1964, was originally intended to be funded from the sale of bonds by the National Housing Bank.

[3] BRL 505.3 billion, of which, BRL 339.5 billion (US$107.8 billion) were active account deposits.

[4] Withdrawals totaled US$34.1 billion, resulting in a net inflow of US$6.6 billion.

[5] Instituto del Fondo Nacional de la Vivienda para los Trabajadores. In Mexico there is also another provident fund, FOVISSTE, exclusively for public-sector employees, but much smaller than Infonavit.

[6] 181.4 million pesos.

[7] Its savings, relative to time worked, aim to provide support for workers in case of dismissal and for their dependents in the case of death.

[8] That is why monthly contributions were set to 8% of salary paid.

[9] 3 consecutive years out of FGTS, unjustified dismissal, redundancy, retirement, death, etc.

[10] The majority of resources contributed belong to a minority of account holders.

[11] CHIQUIER, Loïc; LEA, Michael. Housing Finance Policy in Emerging Markets. The World Bank, 2009.

[12] Near 49% of total assets.

[13] In 2015 Infonavit totaled 690,000 mortgages. On average, it is responsible for 74% of the formal credit market.

[14] 58% of mortgages were contracted with families with incomes of up to 4 minimum wages.

[15] The TR is a reference rate which is not a price index: it averaged 1.08% in the last decade.

[16] Of the yearly loan investment budget approved by the FGTS council board, at least 60% must be used for affordable housing loans. The remainder may be invested in sewage and infrastructure loans.

[17] Energy, ports, roads, etc.

- The rise of income and house price limits, reducing FGTS' focus on lower incomes (2017);
- The distribution of 50% of its profits among account holders[18], increasing yields[19] but subject to the same withdrawal restrictions[20] (2017);
- The temporary relaxation of withdrawal restrictions on inactive accounts releasing nearly US$ 14 billion[21] thus reducing the cash flow of the Fund (2017);

More recently, as unemployment has risen, there has been a reduction in contributions and an increase in withdrawals, resulting in negative net inflows since last March. The recent trend of reduced basic interest rates[22] has reduced financial gains from investments in treasury bonds (30% of assets). All those trends and changes together may impose financial constraints and threaten the ability of FGTS to sustain affordable loan levels. Its main challenges are, therefore, avoiding stress on cash flow and keeping up with housing finance needs.

Political influence and weak financial management that had been present for many years in Infonavit, seem to have been overcome by many reforms undertaken during the late 2000s[23]. Nonetheless, according to Sebastian Fernandez[24], three main challenges remain:

- Achieve higher quality affordable housing;
- Emphasize Infonavit's pension charter without neglecting its mortgage mandate;
- Provide housing financing solutions for the informal sector.

The National Housing Trust (NHT)[25] of Jamaica, created in 1976 also collects contributions from employers (on behalf of employees who are liable to contribute, equivalent to 3% of their total gross pay), employees (2% of the gross salary) and self-employed (from 2% to 3% of income, depending on the category) also on a monthly basis[26]. Contributions qualify employers for tax exemption. Non-compliant employers are prevented from obtaining a Clearance Letter from the NHT, which is a prerequisite for a company to be issued a Tax Compliance Certificate. Housing loans are, as is the case for Mexico, exclusively for NHT contributors[27] and can be used for acquisition of serviced lots or properties in new developments, construction, repair and improvements. Mortgage payments require a 1month prepayment and payroll deduction. NHT may also provide equity loans with deferred payments for up to 40% of the unit cost for eligible scheme applicants. Low income contributors who have contributed for at least 7 years may qualify for a subsidized loan to buy or build a unit. Interest rates on loans range from 0% to 6% depending on the contributor's income[28]. NHT is the single largest financier in Jamaica, with total assets of US$ 1.6 billion in 2014, having provided 7.8 thousand loans, representing 45% of all mortgages in the previous 12 months.

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18 In 2016, profits totaled US$4.6 billion of which US$2.6 billion is currently being distributed. FGTS' profits are tax exempt.

19 FGTS' deposits yields are fixed at 3%+TR. The average difference between yields paid by FGTS and the reference rate was of 7 percentage points in the last decade.

20 Average turnaround time on account balances is 2 years.

21 60% of the total benefitted 10% of workers who were able to withdraw.

22 From over 14% per year in 2015/16 to the current rate of 9.15% with estimates of 7.5% by the end of this year.

23 According to Chiquier and Lea (2009, p.286): modernizing information and accounting systems, improving the procedures in mortgage origination and servicing, appointing external debt collectors, better tracking the evolution of employees who left their jobs (operational risk as one of the main reason of defaults), and creating new committees for risk management, auditing, and strategic policy; improving its cash flows, paying return on savings comparable to private pension funds; adopting international accounting standards and becoming subject to oversight by the financial regulator.

24 Director of Infonavit during his presentation at the IUHF Congress in Washington DC, June, 2017.

25 http://www.nht.gov.jm/

26 It also accepts voluntary contributors.

27 Those between 18 and 65 years of age who have made at least 52 weekly contributions, of which 13 must have been made in the last 26 weeks, just before the date of application. Contributors earning less than US$ 58.6 per week are only required to pay up contributions for 1 year.

28 Average of 4.9% in 2014.

Has Canada's housing bubble finally reached bursting point?

By Alex J. Pollock

Both Canadian and foreign observers have watched with wonder as Canadian house prices have continued up and up, waiting for the inevitable correction and fall. Average Canadian house prices are more than 3 times as high as they were in 2000. They already looked very high in 2012, five years ago, but have risen rapidly, by another 43%, since then. They have inflated measured household net worth, inflated household debt and debt-to-income ratios with rapidly expanding mortgages, caused the number of realtors in Toronto to expand by 77% in the last decade, and they display "an element of speculation," in the careful words of the Governor of the Bank of Canada, Stephen Poloz.

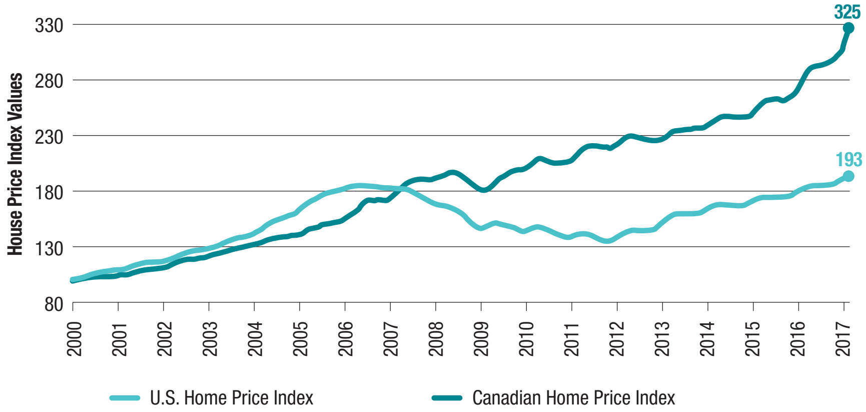
The national Housing Market Assessment of the Canada Mortgage and Housing Corporation "continues to detect strong overall evidence of problematic conditions… due to overvaluation and acceleration in house prices." This is pretty clear language for a government agency which is itself heavily at risk in the mortgage sector.

"The longer it goes, the bigger it gets, the more you start to be concerned," said Governor Poloz in June of this year.

It has gone on very long and gotten very big. Although Canada has a sophisticated and advanced financial system, although the central bank and financial regulators have, a number of times, tightened lending rules to try to moderate the house price inflation, and although the cities of Vancouver and Toronto have put on fees to slow down foreign house buying, the boom has continued. On the other hand, this is not surprising, since the Bank of Canada, like its U.S. counterpart, has run negative real interest rates for most of the last eight years. These reliably induce asset price inflations and promote bubbles.

As shown in Graph 1, the Canadian house price inflation dwarfs the infamous U.S. housing bubble, which imploded starting in 2007, as well as the U.S. price run-up of the last five years.

Graph 1 Two housing Bubbles – House Prices in Canada and U.S. 2000-2017 (2000 = 100)

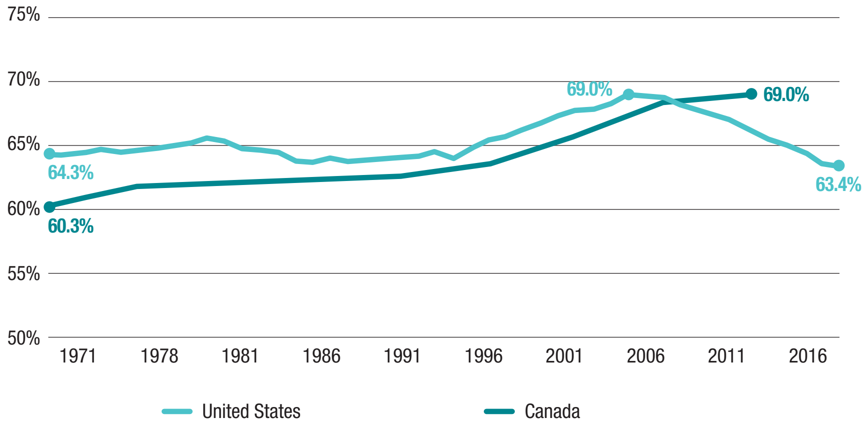


Source: S&P Case-Shiller U.S. National Home Price Index; Teranet-National Bank (11-city) Canadian Home Price Index

To add some perspective to the comparison, total residential mortgages in Canada are C$ 1.5 trillion, or $ 1.2 trillion in U.S. dollars. This is equal to about 11% of the U.S. outstanding mortgages of $ 10.3 trillion. In contrast, Canadian 2016 GDP of C$ 2.0 trillion, or $ 1.6 trillion, is 8.7% of the U.S. GDP of $ 18.6 trillion. Thus, mortgage debt in Canada is much higher relative to GDP than in the U.S.: 73% compared to 55%.

Notably, 73% is about the same ratio as the U.S. had at the peak in house prices in mid-2006.

Graph 2 Homeownership Rates: U.S. and Canada 1971-2016



Source: United States Census Bureau and Statistics Canada

Home ownership ratios in the two countries have been similar over time, but Canada's last census (2011) shows 69% home ownership, compared the recent 63.4% in the U.S. As shown in Graph 2, this reflects the pumping up of the U.S. home ownership rate during the housing bubble, then a more than 5 percentage point fall in the wake of its collapse. Whether Canada will experience a similar fall in its home ownership rate with a deflation of its housing bubble is yet to be seen.

Canada's house prices certainly look toppy to many people: "There's no question house prices can't continue at this level" is the conclusion of senior Canadian bank economist Jean-Francois Perrault. "Signs are looking increasingly negative for [the] Canadian housing bubble… The party is increasingly over," says a "Seeking Alpha" investment commentary. But calling the timing of the top of a bubble is always tricky. It may make us think of how then-Federal Reserve Chairman, Alan Greenspan, suggested in 1996 that U.S. stock prices were excessive and were displaying "irrational exuberance." After his speech, stock prices continued to go up for three more years. In the event, they crashed in 2000, so Greenspan turned out to be right in the long term – but he missed the timing by an embarrassingly long way, and failed to reissue his warning in 1999 when the irrational exuberance was at its maximum.

Has the Canadian housing bubble reached bursting point at last? Has it possibly seen a "canary in the coal mine"? One house price index for metropolitan Toronto, Canada's largest city and financial capital, fell 4.6% from June to July. Although prices are still up strongly from a year earlier, the number of house sales was down 40% from the previous year. At the same time, there was "a surge in new listings as homeowners saw a downturn looming and rushed to list their houses before prices fell… adding a flood of new inventory to the market," reported the Toronto Globe and Mail.

Was that a summer blip or a changed trend? The Toronto realtors' association suggested that it "had more to do with psychology." Yes, booms and busts in house prices always have a lot to do with psychology and sharp swings between greed and fear in beliefs about the future. There are, the realtors' association said, "would-be home buyers on the sidelines waiting to see how market conditions evolve" – waiting for lower prices, that is. The problem is that if enough people wait for lower prices, the prices will get lower.

"Everyone agrees it's a bubble; now the question is, how it ends," says another Canadian economist, David Madani, who predicts it will be a hard landing with house prices falling 20% to 40%. But whether Canada's long-running house price boom will end with a bang or a whimper, a hard or soft landing, a difficult time or a disaster, is just what no one knows. If house prices fall significantly, a lot of unrealized, paper "wealth" will disappear (it was not really there in the first place), mortgage defaults will increase, credit will become tighter, politicians will overreact, and real estate brokers will grow fewer instead of multiplying. But Canada will not necessarily follow the housing bubble deflation patterns of the U.S., or of any other country – the U.K., Ireland or Spain, for example.

Comparing Canada and the U.S., two key institutional differences are apparent. One is that Canadian residential mortgages have full recourse to the borrower, in case the price of the house is insufficient to cover the mortgage debt. This case becomes more likely after a bubble, especially for those who bought near the top. In contrast, in the U.S., either by law or practice, most mortgages are non-recourse, and can effectively be settled by "jingle mail" – moving out and sending the keys to the lender.

A second key difference is that the overwhelming majority, 87% of residential mortgages in Canada, are held on the balance sheets of depository institutions. C$1.1 trillion of the mortgages are on the books of the chartered banks, and C$ 191 billion of the credit unions, for a combined C$ 1.3 trillion out of total mortgages of C$ 1.5 trillion. In contrast, U.S. depositories hold $ 2.4 trillion in whole mortgage loans and $ 1.8 trillion in residential mortgage-backed securities, which combined make $ 4.2 trillion; so only 41% of the total mortgages are on the books of the banks. This gives Canadian mortgage finance an entirely different institutional structure. In the U.S. case, most mortgages were and are held by investors in mortgage securities, who have no direct relationship with the borrowing customer and no role in making the loan in the first place. While at one time promoted as a more advanced system, this made managing the deflation of the U.S. housing bubble much more difficult.

On the other hand, there is an important similarity between the Canadian and U.S. cases: major government guarantees of mortgages, thus government promotion of mortgage debt and exposure to mortgage credit risk. In the U.S., this happens through the guarantees of mortgage credit risk by Fannie Mae, Freddie Mac, and Ginnie Mae, which now add up to $ 6.1 trillion or 59% of the total residential mortgages. The Canada Mortgage and Housing Corporation (CMHC), itself explicitly guaranteed by the government, insures C$ 502 billion of mortgage loans, or 35% of the total market. In addition, it guarantees C$ 457 billion of mortgage-backed securities – but the securities largely contain government-insured loans, so this is a double guaranty of the same underlying credit risk.

How would CMHC fare if the Canadian bubble turns into a serious house price deflation? We may find out.

Urban housing system reform and real estate market development in China

By Yusong Deng

1. Background of China's urban housing system reform

In the era of planned economy, China's urban residential housing was distributed under a low-rent welfare-oriented system. During a period of low resident income, such a system provided safeguards for residents' basic housing needs. However, this system had significant disadvantages. First of all, it allowed urban residents to develop a dependence on welfare-oriented public housing distribution and therefore restrained residents' housing consumption. Secondly, under this system, government and state-owned enterprises were bearing the full burden of the vast increase in housing investment and maintenance expenditures. Thirdly, this system rejected the role of market mechanisms and inhibited the development of the housing market. Due to these disadvantages associated with the low-rent welfare-oriented housing system, by the end of 1977, the average per capita living space in 190 cities was only 3.6 square meters, and there was a severe housing shortage. As part of the economic institution reform initiated in 1978, China has gradually sought to resolve these problems by reforming the urban housing system since 1980. By 1998, China's urban housing system reform had entered a crucial stage.

2. Exploring the stage of urban housing system reform

In 1980, Deng Xiaoping proposed overall guidance for housing reform that allowed selling of public housing, rent adjustment, and advocated individuals purchasing and constructing homes. In 1982, four cities including Zhengzhou, Changzhou, Siping and Shashi were chosen to participate in a pilot project, where new homes were sold with allowances. Individuals only needed to pay one third of the whole housing price and the other two thirds of the price was covered by government and enterprises. This marks the beginning of China's urban housing system reform. However, results from these pilot practices were unsatisfactory. Due to low housing rent, the price to rent ratio was too high to provide incentives for individuals to purchase houses. Therefore, this practice was stopped in 1985. In 1986, China made three cities including Yantai, Tangshan and Bengbu participate in a plan that was to "increase rent with subsidies, combine house renting and selling, stimulate house selling with house renting, and carry out supporting reforms." Based on the experiences acquired from the pilots above, in February 1988, a policy to increase rent with subsidies was explicitly put forward in "The Notice of the State Council on the Nationwide Urban Housing System Reform – Implementation Plan in Phases and Batches." The plan started by reforming the low-rent public housing system. It would gradually turn physical housing allocation into monetary housing distribution. In June 1991, the State Council published "the Notice on Continuously, Actively and Steadily Carrying Out Urban Housing System Reform", which proposed measures to increase public house rent and to promote the sales of public houses. In 1994, "the Decision of the State Council on Deepening Urban Housing System Reform" explicitly mentioned that "housing construction investment should be switched from a system where the government and enterprises bear the full burden towards allowing reasonable residents' contribution; the responsibility for house construction, distribution, maintenance, and management should shift from state-owned enterprises to more society-oriented and professional entities; house distribution should switch from welfare-oriented physical allocation to monetary and income based housing distribution according to the 'to each according to his contribution' principle; an economically affordable housing supply system that focuses on middle and low-income households and provides social protection should be established; a commercial housing supply system focusing on high-income households should be established; a Housing Provident Fund system should be established; housing finance and insurance should be developed; a housing credit system that is both policy-based and commercial should be established; a normalized real estate trading market should be set up and a society-oriented house maintenance and management market should be developed; a virtuous cycle of the input to and output from the housing fund should be gradually developed; thereby the development of real estate industry and related industry could be promoted." Following the Decision, commercial housing developed rapidly; the urban housing ownership rate increased; housing conditions of urban residents also quickly improved.

3. Deepening and advancing stage of urban housing system reform

Based upon the experience of previous urban housing system reforms, in July 1998, "the Notice of the State Council on Further Deepening Urban Housing System Reform and Accelerating Housing Construction" announced the decision that "physical housing allocation would cease and monetary housing distribution would be gradually implemented; an economically-affordable-housing-dominated and multi-layer urban housing supply system should be set up and improved; current public housing reform should be continuously promoted; a house trading market should be fostered and normalized; housing finance should be developed, allowing a greater scope of individual housing loan issuance; all commercial banks should be allowed to grant loans in all urban areas; the limit on an individual's housing loan scale should be abolished." The release of this Notice represented a breakthrough in China's urban housing system reform. The institutional framework of housing marketization was officially established. Since then, the housing market has stepped into a period of rapid development.

After 2003, to further promote sustainable and healthy development of the real estate market, to encourage residents to expand housing consumption, and to resolve problems caused by the rapid increase in house prices and real estate investment in some areas, "the Notice of the State Council on Promoting Sustainable and Healthy Development of Real Estate Market" was released in August 2003. It stated that "we should be resolute in the fundamental direction of marketization of the housing system, keep improving the real estate market, and enhance the fundamental role of the market in allocating resources." This Notice put forward that "we should improve supply policy; most urban households should purchase or rent normal commercial housing; economically affordable housing would be primarily provided to low-income households; affordable rental housing should be provided to households with the lowest income." It also stressed that "we should invigorate a secondary housing market; carefully remove policy obstacles that affect the market exchange of purchased public homes; encourage residents to trade homes." Moreover, the Notice made arrangements for the development of the housing credits system and the improvement of the individual housing loan guarantee mechanism. Finally, the Notice also mentioned that "we should improve planning management and regulate land supply; for areas with excessive land supply and idle land, supply of new land should be restricted; at places where normal commercial houses and economically affordable houses are in short supply or experiencing a rapid rise in house prices, we should make appropriate adjustment according to regulations and increase land supply." In 2004, the Ministry of Land and Resources released regulations on commercial land. It required that after 31 August 2004, transfer of the rights to use of commercial land should be conducted in the form of listing and auction. The old price negotiation transfer system must be abandoned. Since then, major adjustments to the land supply system have begun.

4. Accelerating stage of the housing security system

Since the deepening reform of the urban housing system in 1998, the real estate market has been developing rapidly. However, after 2003, because of the significant increase in house prices, difficulties faced by low-income households became conspicuous. To counter this problem, in 2007, "Several Suggestions of the State Council on Resolving Housing Difficulties Faced by Low-income Urban Households" proposed that we should focus on a low-rent housing system, address housing difficulties of low-income urban households in multiple ways, improve the economically affordable housing system and House Provident Fund system, and favour low-income households. After the global financial crisis in 2008, the government significantly increased input on affordable housing system construction. Measures included provision of funds, land, and infrastructure for the construction of public rental housing and concentrated rebuilt urban shanty areas which low income households inhabited. As housing-related regulations have been continuously improving since 1998, China has formed an urban housing supply institution in which basic guarantees are provided by the government and multi-level needs are satisfied by the market.

5. The achievements of China's urban housing system reform

The reform of China's urban housing system greatly enhanced the development of the real estate market, especially after the second half of 1998, when China ceased physical housing allocation and gradually switched into monetary housing distribution. It laid the foundation for urban housing marketization and the expansion of housing consumption. The establishment of the housing finance system allowed residents to purchase houses with only a down payment. This has significantly sped up house purchasing progress for urban residents. China's urban housing system reform not only significantly improved residents' living conditions, but also promoted sustainable and rapid development of the economy.

First of all, urban residents' living conditions have been significantly improved and the homeownership rate greatly increased. Since the start of the urban housing system reform, especially after 1998, when housing construction investment started to grow rapidly and continuously, housing supply has significantly increased. From 1998 to 2016, the annual nationwide urban commercial residential housing sales increased from 108 million square meters to 1.375 billion square meters, an average growth rate of 15.2% per year. The accumulative sales area reached 12.275 billion square meters. The rapid and sustained growth in the new construction area, sales area and completed area has led to significant improvement in the living conditions of urban residents. In 1998, China had a permanent urban population of 416.08 million. Per resident floor space of residential buildings in urban area at that time was 18.66 square meters. In 2016, China's permanent urban population increased to 793.98 million. Per resident floor space of residential buildings in urban areas grew to 36.6 square meters. The number of owner-occupied dwellings hiked. China's ownership rate of urban residential houses with property right is estimated to exceed 80%.

Secondly, real estate investment became a major driving force for the rapid and sustained economic growth in China. Since the implementation of urban housing system reform in 1998, housing investment has experienced rapid growth. From 1998 to 2016, China's urban real estate development investment increased from 361.4 billion RMB to 10.2581 trillion RMB, growing at an average rate of 20.4% per year. Among all the real estate investment, residential housing investment increased from 208.2 billion RMB to 6870.4 billion RMB, growing at an average rate of 21.4%. During this period, residential housing investment accounted for 68% of real estate investment on average. This ratio was relatively stable; remaining between 60 and 70%. Between 1998 and 2016, about 20% of urban fixed asset investment was real estate development investment, which served as an important driving force for sustained and rapid economic growth. The rapid development of the housing market also promoted the growth of other industries, including metallurgy, household appliances, finance, property management, and housing intermediary services.

Thirdly, although commercial housing sales prices increased steadily, nationwide house prices grew at a lower rate than resident income. However, the housing price growth rate in certain big cities was significantly higher than income growth rates. Between 1998 and 2016, the average sale price of nationwide urban commercial residential housing grew from 1,854 RMB/m^2 to 7,203 RMB/m^2, at average annual rate of 7.83%. This rapid increase in house prices coincided with a period of rapid economic and income growth in China. Although the growth rate of nationwide urban commercial residential house prices is significantly higher, it is still less than the growth rate of urban residents' per capita disposable income, which is 10.66on average over this period. Across the entire country, the growth rate of house prices was lower than that of urban residents' per capita disposable income. However, some large cities experienced the opposite. For instance, since 2007, house prices in large cities, such as Beijing and Shenzhen, have been growing at a higher rate than incomes. This was caused by a series of factors including a continuous decline in the supply of newly-built housing and fast-growing local populations. As a result, local residents' housing purchasing power dramatically declined.

Fourthly, indemnificatory housing coverage[1] has been substantially improved. Since its formation in 1998, China's housing security system has been gradually improved. Especially after the global financial crisis, China has substantially increased the effort on indemnificatory housing construction. This significantly alleviated the housing difficulties of middle-and-low-income households. From 2011 to 2015, more than 40 million units of indemnificatory housing have been under construction, among which, more than 20 million have been completed. By the end of 2015, China's urban household indemnificatory housing coverage had reached around 20%.

6. A new era of real estate market development in China

With large-scale housing construction, the total housing units in China has already exceeded the total number of households. This marks a new era of housing market development – a market which used to be characterized by supply shortages has now reached a new equilibrium of balanced supply and demand. This also implies regional differences will become a new characteristic of China's housing market.

Using data from the Sixth National Population Census, new housing space under construction, completed housing space, and other relevant indicators, China's urban per household housing ownership is estimated to be 0.98 in 2010 and increased to 1.10 in 2015. Even if measures for total urban population were used instead, urban per household housing ownership is still 1.03 in 2015. However, in spite of the balanced supply and demand of urban residential housing, China's urban housing quality can still be significantly improved. As it can be seen, the percentage of housing with full sanitary facilities can be improved; the living environment of some newly-built and existing housing cannot meet residents' needs on housing quality.

Second, new housing space under construction has reached its peak and real estate investment growth has significantly slowed down. As China's economy entered a new growth stage and per-household housing ownership has exceeded 1.0 in 2013, the real estate investment growth rate and new space under construction reached their peaks consecutively since 2010. The real estate investment growth rate reached its peak (33.16%) in 2010 and decreased to 1% in 2015. Real estate development enterprises' new housing space under construction reached its peak (1.47 billion square meters) in 2011 and fell back to 1.07 billion square meters in 2015. Overall new housing space under construction reached its peak (2.012 billion square meters) in 2013 and fell back to 1.8 billion and 1.5 billion square meters in 2014 and 2015 respectively. As it can be seen from the development process of advanced economies' housing markets, after per-household housing ownership exceeded 1, a house construction peak will emerge. As the growth of population slows down and housing shortages have been mitigated, the amount of newly constructed houses will decrease. The peak of China's new housing under construction occurred in a period similar to the advanced economies.

Third, regional differences have become a conspicuous characteristic of China's housing market. Since 2013, due to factors such as the slowdown in China's economic growth, the adjustment of regional economic structures, and the change in the relationship between supply and demand in the housing market, the housing market's regional differences became increasingly conspicuous. In first-tier cities, such as Beijing and Shenzhen, house prices have kept rising, at a rate much higher than in other cities. Insufficient supply of newly-built commercial housing, successful transformation and upgrading of economic structures, continuous and rapid population influx, and rapid reaction to financial policy adjustments are the main causes of this phenomenon. Interest rates cuts in 2015 also significantly contributed to increase in house prices in Beijing and Shenzhen. On the other hand, due to excessive new construction in previous years, the decline of leading industries, and the slowing of the population influx or even a net outflow of population, some cities have an excess of housing supply and face great pressure to reduce their stock.

This new stage of China's housing market development and the new market situation both require timely adjustment in China's housing market development goals and related policies. At the end of 2016, the Chinese Government proposed that "the Government should promote steady and healthy development of the real estate market, accelerate the research and establishment of fundamental systems and long-term mechanisms that conform to our national conditions and obey market rules. The government should suppress the real estate bubble and prevent house prices drastically rising and falling." The adjustment of China's housing system and related policies will enter a new phase.

[1] Indemnificatory housing coverage represents the ratio of households that improved their housing conditions through indemnificatory housing and shanty areas rebuilding to the total number of urban households (It was calculated based on data in 2015. There are 260,527,000 households in total).

Affordable housing in Wales: Challenges underpinned by optimism

↳ By Matthew Kennedy

1. Introduction

The housing sector in Wales has seen acceleration in the creation and implementation of legislation that has changed the face of social housing delivery. Many of these changes set it apart from other UK nations. The challenges remain reasonably consistent with counterparts in other areas of the UK. Wales continues to see poverty rates remain consistent at 23% of the population. Within this there is a worrying trend around pensioner poverty where Wales bucks the trend in Britain as a whole, seeing an increase in this type of poverty. However, there is some cause for optimism with the proportion of children in low-income, materially-deprived families in Wales falling from 17% to 14% since 2013-14.[1]

The overview of gross disposable household income in 2015 makes for a varied picture. At the county level, Ceredigion saw the highest growth – 6.3% – while the lowest with 1.6% was in Merthyr Tydfil, where the GDHI is £15,821 per head.

There is much to come out in the wash following a flurry of activity to invest and support infrastructure across Wales. This has included the signing of the historic Swansea Bay City Region deal, securing 10,000 jobs in the region over a 15 year period backed by a £1.3 bn investment.[2] That's in addition to the Cardiff Capital Region City deal that brings with it £1.2 bn of investment over a 20 year period.[3] The development of a new nuclear power station on Anglesey "Wylfa Newydd" sees a boost for construction and subsequent investment in local services (such as schools) in the area in addition to skilled jobs.[4] Despite this, the challenge remains around ensuring access to meaningful employment, education and skills development for those furthest from those opportunities.

This article will consider the challenges facing housing professionals across Wales as they strive to deliver high quality housing services and homes that are affordable, sustainable and fit for the future. This, against the backdrop of devolution, the economic picture and the national policy context.

2. Devolution and Wales

Next year will be the 20-year milestone since the Government of Wales Act 1998 was passed. The Act established the Welsh Assembly as a single corporate body, where it was limited to secondary law-making powers.[5] The institution faced a number of challenges which prompted calls for structural change to separate the work of the Cabinet from the work of the National Assembly itself. This was achieved in 2007 following the Government of Wales Act 2006 coming into force. The Richard Commission, set up in 2004 to look at the future powers and size of the National Assembly, said in its report said that the Assembly's ability had been hampered by difficulties that could be overcome by enhancing its powers, in-line with those received in Scotland.[6]

The Wales Act 2006 allowed the Assembly to make primary legislation in devolved areas, called Assembly Measures. Legislative Competence Orders [LCOs] allowed the Assembly to extend the matters over which it has competence, this has been an enabling factor most recently in legislation being brought forward to Abolish the Right to Buy. Whilst other topics such as social security, consumer protection and broadcasting are exceptions and remain with the UK government in terms of competency.

Further devolution has taken forward the recommendations originally set out by the Silk Commission.[7] The Wales Act 2014 included new and significant powers for the Welsh Assembly to vary the rate of income tax by up to 10 percentage points (conditional on a referendum) in addition to new borrowing power for Welsh Ministers.[8] In more recent times the passing of the Wales Act 2017 has seen a shift change for Wales where we have now moved to a reserved powers model.

This change has been the subject of much debate, with considerable opposition both within the Assembly and beyond. Critics pointed to the long list of reservations held within the Act which stated areas where previous legislation was silent, arguably rolling back the devolution settlement in some areas.[9] In addition to the reserved powers model the 2017 Act provides Welsh Minsters with powers relating to how the Assembly conducts elections and an increase in the upper limit to the capital expenditure to which Welsh Ministers can borrow.[10]

Further changes have been set-out in late 2016 through the agreement of the Fiscal Framework between the Welsh and UK Governments. In addition to the power around income tax and

[1] https://www.bevanfoundation.org/commentary/poverty/

[2] http://gov.wales/newsroom/firstminister/2017/170320cd/?lang=en

[3] https://www.gov.uk/government/publications/city-deal-cardiff-capital-region

[4] http://www.bbc.co.uk/news/uk-wales-40013117

[5] http://www.assembly.wales/en/abthome/role-of-assembly-how-it-works/Pages/history-welsh-devolution.aspx.

[6] *Ibid*

[7] The Silk Commission was established by the UK Government in 2011. The commission looked at Wales's financial and legislative powers, producing two reports with recommendations.

[8] https://assemblyinbrief.wordpress.com/2014/12/18/the-wales-act-2014/

[9] https://www.geldards.com/wales-act-2017.aspx

[10] *Ibid*

capital expenditure borrowing this also saw the introduction of a Barnett[11] floor. This ensures that the block grant coming to Wales better reflects the needs of the people here, meaning that for every £100 spent in England, Wales will get at least £115. It also created a new Welsh cash reserve to help the Welsh Government manage budget fluctuations resulting from tax devolution.[12]

What all this has meant in practice, is that Wales walks a tightrope where domestic efforts to develop "made in Wales" solutions to deep-rooted social policy challenges are sometimes heavily influenced by national policy on non-devolved matters. Devolution continues to be firmly on the agenda and will continue to be a firm part of the narrative in assessing the Welsh Assembly's ability to effectively legislate.

3. Housebuilding in Wales

In 2015 the overall number of homes in Wales was estimated to stand at around 1.4million. This represents an increase of just slightly over 10% since 2000-01. During this period, the tenure mix has changed considerably with social housing lettings decreasing whilst the private rented sector has been growing. This increase has seen the private rented sector grow from 7% of all dwellings in 2000-01 to almost 15% in 2015. In terms of social housing the number of dwellings rented from Local Authorities has decreased by more than half since 2000-01, but for housing associations that equivalent number has more than doubled since that time, which is to be expected with stock transfer having taken place in a number of areas in Wales. However, there has been an overall drop in the percentage of social sector dwellings which now account for 16% of all dwellings compared to 19% in 2000-01.

A report on the "Future Need and Demand for Housing in Wales" estimated that over the period 2011 to 2031 an additional 240,000 homes over the period, or 12,000 a year; of which 65% would be in the market sector (7,800 a year, 156,000 over the period) and 35% in the social sector (4,200 a year, 84,000 over the period).[13]

The Welsh Government has taken considerable steps to boost the supply of social housing stock in Wales. During the period between 2011-12 to 2015-16 a total of 11,508 additional social homes were built, which at the time exceeded the target of 10,000 set by the previous government. Supply was further bolstered during this period with a total of 10,948 long-term empty homes being brought back into use – this compared with a target of 5,000 during the same period.[14]

Completions of new homes, more broadly look as follows:

	Private	Registered social landlords	Local authority	Total
2000-01	7386	900	47	8333
2001-02	7494	711	68	8273
2002-03	7522	782	6	8310
2003-04	7863	417	16	8296
2004-05	7986	475	31	8492
2005-06	7883	347	19	8249
2006-07	8988	346	0	9334
2007-08	8316	343	5	8664
2008-09	6429	692	0	7121
2009-10	5291	880	3	6174
2010-11	4513	992	0	5505
2011-12	4746	829	0	5575
2012-13	4707	744	0	5451
2013-14	5160	671	12	5843
2014-15	5333	837	0	6170
2015-16	5646	1254	0	6900
2016-17	5590	1243	0	6833

The table above shows new homes completions by year and sector.[15] Despite completions dropping significantly since the global financial crisis in 2007/08 there have been clear signs of recovery across both the private and social sectors. Local Authorities will also increasingly be enabled to build homes as the Welsh Government includes funding to support the delivery of 500 homes by them during this Assembly term.

The Welsh Government has set-out an ambitious 20,000 affordable homes target to be achieved within this Assembly. This has been supported by sustained and growing levels of Social Housing Grant which has allowed social housing providers to boost levels of supply and additional homes have also been provided through a range of alternative finance options.

The availability of this capital grant funding via the Social Housing Grant [SHG], Welsh Housing Partnership (WHP) and the Housing Finance Grant [HFG] is one of the factors which impacts on the ability of all providers, but particularly housing associations, to deliver additional affordable housing across Wales.[16]

The number of additional affordable housing units delivered with capital grant funding has continued to increase during 2015-16, rising by 15% to 1,765 units. A total of 442 units have also been delivered through the Housing Finance Grant, which is an additional source of funding available to housing associations.[17]

The housing association sector in Wales also has a strong track record of delivering additional homes without grant funding. During 2015-16 635 affordable housing units were delivered without the use of grant. Although the amount of homes provided in this way has dipped most recently with last year seeing the lowest level of provision in this form since 2010-11.

[11] The Barnett Formula was devised by Joel Barnett in 1978 to settle disputes over funding allocations. It is the name given to the calculation that dictates the level of public spending received in each devolved UK nation. Funds are allocated according to population size and which powers are already devolved. The formula was originally intended as a temporary measure but has remained in place since its inception. The formula has been subject to criticism with some politicians suggesting a needs-based system that takes account of levels of poverty and population age would be fairer.

[12] *Ibid*

[13] https://sites.cardiff.ac.uk/ppiw/files/2015/10/Future-Need-and-Demand-for-Housing-in-Wales.pdf

[14] http://www.assembly.wales/laid%20documents/pri-ld10975-em/pri-ld10975-em-e.pdf

[15] http://www.assembly.wales/laid%20documents/pri-ld10975-em/pri-ld10975-em-e.pdf

[16] http://gov.wales/docs/statistics/2016/161019-affordable-housing-provision-2015-16-en.pdf

[17] http://gov.wales/docs/statistics/2016/161019-affordable-housing-provision-2015-16-en.pdf

The balance between the number of additional affordable housing units being delivered with capital grant funding and the number delivered without capital grant funding differs considerably between the 22 local authority areas. During 2015-16, 98% of all the additional affordable housing units in Blaenau Gwent and 95% in Flintshire, Powys and Merthyr, were delivered using capital grant funding whereas in the Vale of Glamorgan 70% of the units were delivered without capital grant funding and in Gwynedd 52%.[18]

A stand-out feature of the most recent funding wave is the announcement of £20m to support the delivery of innovative housing. The funding aims to promote the building of homes that are affordable to heat and maintain and will be a key indicator in guiding the type of housing mix which could be progressed to meet the needs of Welsh communities.[19]

4. Legislation has progressed

During the last fourth Assembly (2011-2016) a considerable amount of legislation was passed. This period saw the Welsh Assembly really flex its legislative muscle. A number of key Acts were passed relating to the work of the housing sector that will continue to have a substantial impact on shaping the nature of house building and housing services in Wales.

The Housing (Wales) Act 2014 – One of the most significant pieces of legislation for the housing sector has undoubtedly been the passing and ongoing implementation of the Housing (Wales) Act 2014. The act included a new approach to addressing homelessness through greater emphasis on prevention, a compulsory licensing scheme for the private rented sector and greater support for cooperative housing provision.[20]

Renting Homes (Wales) Act 2016 – The Act aims to simplify the process of renting a home, regardless of the tenure, for both the prospective tenant and the landlord. At the heart of the act are the new 'occupation contracts'. With a limited number of exceptions, the act replaces all current tenancies and licences with just two types of occupation contract:

- **secure contract –** modelled on the current secure tenancy issued by Local Authorities
- **standard contract –** modelled on the current assured shorthold tenancy used mainly in the private rented sector.[21]

The act also seeks to address inequalities in how succeeding a tenancy can be done, introduce new fitness for human habitation standards and adjust the way joint contracts work to prevent potential homelessness if one tenant leaves and effectively ends the contract for other tenants (as is the situation under the current rules).

Well-being of Future Generations (Wales) Act 2015 – A binding piece of legislation, which works across the public sector. Although not directly related to the provision of housing, the wide-scope of the legislation, and its application to Local Authority services in particular, will see the work of the housing sector influenced by the implementation of this legislation. The Act seeks to improve the social, economic, environmental and cultural well-being of Wales.[22] The Act puts in place a number of well-being goals which include a focus on prosperity, sustainability and global accountability.

5. Legislative change on the horizon

5.1. Abolition of the Right to Buy

In an attempt to alleviate some of the pressure for social housing the Welsh Government has recently produced legislation to abolish the Right to Buy in Wales. Some Local Authorities had already successfully applied to have the Right to Buy suspended with their local areas by producing evidence of an acute housing need.

Evidence from CIH Cymru members suggested that despite the policy increasing rates of home-ownership, a number of challenges have arisen over the years, some of which will have a lasting legacy even if the bill to abolish the Right to Buy is passed.

Between 1 April 1981 and 31 March 2016 around 136,000 local authority and 3,100 housing association homes were sold under the Right to Buy and Right to Acquire schemes. (This total is equivalent to 45% of the social housing stock in 1981).[23] At its peak in 2003-04 almost 7,000 homes were lost from the stock in a single year. This peak coincided with the decision to reduce the overall discount from £24,000 to £16,000.

We feel the case for abolishing the RTB in Wales is strong considering the policy is in conflict with broader housing policy around boosting the supply of high quality affordable housing.

The Welsh Government's own research estimated that around 4,695 properties purchased under the RTB have transferred into the private rented sector. Extrapolating the sampled data from 8 authorities to an all-Wales level, the research goes on to estimate that over the period from 2010-11 to 2014-15 an annual average of £4.4 million was spent in extra housing benefit payments, a total of £21.9million over the 5-year period.[24] This research demonstrates that despite the policy intention of RTB being driven by the desire to increase the rate of home ownership, this is not always the case.

5.2. ONS Reclassification

In September 2016, the Office for National Statistics [ONS] reclassified housing associations as Public Non-Financial Corporations for the purposes of the national accounts and economic statistics. This has been the culmination of a technical accounting exercise completed by the ONS. Despite the decision being procedural in nature, it does and will prove highly problematic in ensuring housing associations can continue to operate in a way that ensures they can have maximum impact.

The change, in effect means that housing associations borrowing debt will count against the public accounts. Housing association debt will count against Welsh Government's capital budget. With new borrowing powers, the Welsh Government has outlined its capital spending plans. The borrowing available over this Assembly amounts to £445 million, with £395 million of spending currently planned for. The borrowing debt for housing associations stands at around £200 million per annum. This means that under the current decision, the borrowing capacity of housing associations will be significantly restricted and have a substantial impact on their ability to raise investment to boost the supply of affordable housing in Wales. In light of this, Carl Sargeant (The Welsh Government Cabinet Secretary for Communities and Children) has brought forward a proposal to reclassify housing associations back into the private sector by ensuring that they have a more arms-length relationship with government.

The Welsh Government changes include:

- Removing the requirement to receive consent from Welsh Ministers for the disposal of land. Rather this would be replaced by a duty to notify.

[18] http://gov.wales/docs/statistics/2016/161019-affordable-housing-provision-2015-16-en.pdf

[19] http://gov.wales/newsroom/housing-and-regeneration/2017/170209-20m-to-build-homes-fit-for-the-future/?lang=en

[20] http://gov.wales/topics/housing-and-regeneration/legislation/housing-act/?lang=en

[21] http://gov.wales/topics/housing-and-regeneration/legislation/rentingbill/?lang=en

[22] http://gov.wales/docs/dsjlg/publications/150623-guide-to-the-fg-act-en.pdf

[23] http://www.assembly.wales/laid%20documents/cr-ld11104/cr-ld11104-e.pdf

[24] http://gov.wales/docs/desh/publications/170313-analysis-of-data-on-cessation-of-right-to-buy-en.pdf

- Removing the power for Welsh Ministers to specify that sale proceeds should be show separately in accounts and to direct their use (Disposal Proceeds Fund)
- Removing any requirements for Welsh Ministers to consent to any restructure on dissolution – this will be replaced by a notification requirement

5.3. Local Government Reorganisation

The most recent white paper outlines a number of areas where the Welsh Government believes regional working should be required and where regional working should be explored. The primary list does not include housing, rather this is included in a list of areas where collaboration should be explored. Something which we strongly commented on, calling for its inclusion in the main list of priority areas.

The white paper suggests that greater regional working will create opportunities for local authorities to build sustainable services. The Welsh Government is keen to identify areas where the greatest value is likely to come from pursuing more shared services. For example, the white paper highlights the potential to increase capacity to increase the provision of Welsh language services between authorities by sharing professionals and resources.

Suggestions on where services could be shared either national or regionally include:

- Technology platforms e.g new planning portal
- Specialist services where expert knowledge can be in high demand
- Joint or shared transactional services e.g. council tax collection

Whatever the shape, it seems clear that reorganisation remains firmly on the agenda. there is much still to understand in terms of how this looks and how it will impact on public perception of the local services people receive.

6. Welfare

Despite a relatively positive and optimistic feeling within the social housing sector in Wales, there continues to be a long shadow cast by the changes to the welfare system. The challenges related to capping social rents at Local Housing Allowance [LHA] rates and introduction of the Shared Accommodation rate [SAR] for those under 35, the overall benefit cap and universal credit all combine to create a complicated situation across the UK for housing professionals. Not to mention, the substantial impact felt by individuals and families who as a result have had the affordability of their home compromised.

The Local Housing Allowance cap is set to further complicate matters across the UK, from both a general needs and supported housing prospective. For the latter, calling into question the potential viability of many services. In his analysis of the cap in Wales, the editor of the Welsh Housing Quarterly and journalist for Inside Housing Jules Birch highlighted:

> *The effect of the cap will vary according to rent levels, LHA rates and stock profiles around the country. In Broad Rental Market Areas (BRMAs) for cities such as Cardiff, Swansea and Newport, LHA rates are above current social rent levels.*[25]
>
> *However, in deprived areas, such as the Valleys, LHA rates are significantly lower than rents. That means not just the shared accommodation rate for the under-35s, but also one, two and even three-bed homes in some places.*[26]

As organisations seek to support tenants impacted by the swathe of changes there are and will continue to be considerable challenges in ensuring rents are affordable and the ability of the sector to invest in new homes is not compromised. CIH research “Mind the Gap” which considered the growing shortfall between private rents and support with housing costs, recommended that the UK government should consider realigning LHA rates for all categories of accommodation, and in particular for those on the shared accommodation rate (considering the impact this will have on those under 35).

This is driving the housing sector to think differently in Wales and really bring in to question how we consider affordability going forward whilst also meeting the housing aspirations of Welsh Communities.

7. Getting Housing Association regulation right

The Welsh Government’s Housing Regulation Team produced a report in March 2016 outlining the sector risks facing housing associations in Wales with a view to informing and supporting risk management at a board level. In that report, the team identified a number of prominent risks for the sector and the boards of respective organisations to consider. These included a need for boards to understand and mitigate the risks of welfare reform; reliance on Supporting People funding; pension costs; increased costs of business operations; managing large-scale programmes of housing development; business diversity; stock condition and debt (both existing and new).[27]

Mitigating risk, financial viability and future proofing are firmly on the agenda in terms of areas of focus for the regulator in Wales. These are underpinned by an approach that seeks to place tenants at the heart of regulation. The revised approach will see the regulator produce a judgement of each Association’s “capacity to improve”. These will be published annually as “governance statuses” that will also capture a reflection of service quality and financial viability. This, it is hoped, will provide tenants, staff and lenders with assurances that an association is performing at the desirable levels, and focussing resources in the right areas.

Gavin Smart, Deputy Chief Executive of the Chartered Institute of Housing reflected in his evidence to the Welsh Assembly on housing association regulation in Wales that regulation will not have a definitive “end point”. Strong regulation should be characterised by action that takes into account changes to the operating environment and continues to scrutinise efforts in partnership with tenants and wider communities. Whilst high profile regulatory cases have hit the headlines in recent times, there is a clear appetite to learn from more complex regulatory cases and ensure there are robust processes for involving tenants and focussing in on areas where the most risk exists to the sustainability of organisations both in the short and longer term.

8. The homelessness challenge

A key feature of the housing policy landscape for years has been the prominence of measures and legislation to tackle and address homelessness in Wales. Homelessness produces significant costs to the housing system across the UK, with a reported £3.5 bn spent on temporary accommodation in the last 5 years.[28] This has however decreased in Wales by 25% from £9 m to £7 m during the same 5-year period. This has coincided with a substantial policy change to address homelessness in Wales.

The changes under Part 2 of the Housing (Wales) Act 2014 made the following changes to the approach to tackling homelessness in Wales:

[25] http://www.insidehousing.co.uk/lha-cap-a-sinking-feeling/7019680.article

[26] http://www.insidehousing.co.uk/lha-cap-a-sinking-feeling/7019680.article

[27] http://gov.wales/docs/desh/publications/160331-sector-risks-facing-housing-associations-en.pdf (January 5, 2017).

[28] http://www.bbc.co.uk/news/uk-38016728

- a new duty on Local Authorities to help anyone threatened with homelessness within the next 56 days
- a duty to provide help to any homeless person to help them secure a home
- a power rather than a duty to apply the intentionality test
- new powers for local authorities to discharge their homelessness duties through finding accommodation in the private rented sector
- stronger duties on Housing Associations to support Local authorities in carrying out their homelessness duties

During 2016-17, a total of 9,210 households were assessed as threatened with homelessness within 56 days and for 5,718 households (62%) homelessness was successfully prevented for at least 6 months.[29]

The discussion around addressing homelessness is increasingly driven by the desire to see a *Housing First* approach. A model successfully adopted in Finland where street homelessness has been all but eradicated. The model, which provides a home as the first step in addressing homelessness has gained considerable international attention. In Finland, sustained investment in supported housing provision has ensured the availability of homes to make the model workable in practice.

Interest in Wales has led to a pilot of the model in Anglesey. However, some caution is necessary as the Supporting People budget, which itself is a vital Welsh Government funding stream to provide services that support people who are homeless, has only been protected for the first year of the Welsh Government's budget. The case will need to continue to be made to protect this budget which is both crucial to the current approach and a key component of any *Housing First* model.

9. A change in service emphasis

Adverse Childhood Experiences [ACEs] is a term that has strongly characterised the narrative from the Welsh Government on how public services should be seeking to address the root causes of issues within society.

ACEs; meaning the stressful experiences occurring during childhood that directly harm a child or affect the environment in which they live,[30] include physical abuse, parental separation, mental illness, drug use and incarceration.[31]

Public Health Wales, in their report analysing the impact of ACEs in Wales found that:

- For every 100 adults in Wales, 47 have suffered at least one ACE during their childhood and 14 have suffered 4 or more
- Compared to people with no ACEs, those with 4+ are 20 times more likely to be incarcerated at any point in their lifetime
- Preventing ACEs in future generations could reduce levels of high risk drinking by 35%, violence victimisation by 57% and use of heroin/crack cocaine by 66%[32]

The challenge for the housing sector is now in demonstrating how practice currently focusses on addressing these areas, particularly in support services. Considerable challenges remain when funding is uncertain and unpredictable despite a positive recognition that much good can be done if an ACE-informed approach to service provision could be taken.

10. Conclusion

Wales stands at an exciting point in the evolution of social housing. With increased powers the Assembly has seen its way to delivering progressive and ambitious legislation that has set a Welsh approach, distinct from its UK counterparts. Welfare reform, however, continues to create complex challenges in creating homes that are truly affordable within some of Wales's most deprived communities.

Whilst poverty continues to loom large, investment in infrastructure is encouraging as is the investment in social housing and the push to deliver more innovative solutions to address housing need. Legislative changes have been far-reaching and considerable in their scope and scale during recent years. These changes and their impact will continue to require close monitoring to ensure the intended policy and practice effects are being realised.

Although both the challenges that are distinct to Wales and those shared across the UK continue to be daunting in their size and complexity, it continues to feel like Wales is really turning a corner on housing policy – both in terms of pushing to be more ambitious and really recognising what it takes to maintain and increase people's well-being. Moreover, recognising that this doesn't end with the completion of a unit, but begins through the building of a home.

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The public markets and European residential real estate

↳ By Shaun Stevens

1. Introduction

August 2017 marked the 10th anniversary of the Global Financial Crisis [GFC]. The aftermath of the 2007/08 crisis has seen an ongoing search by investors for sustainable yield, amid positive demographic and urbanisation trends, new challenges of housing affordability and growing interest in sustainable or environmental, social and governance [ESG] investing. In combination, these factors have made residential investment a more attractive proposition for institutional equity investors.

In the intervening period, institutional equity investors have become increasingly interested in investing in residential property in general and more recently in affordable housing. The listed real estate securities sector has similarly been more active in investing in the residential sector in parts of Europe. There could well be further interest in affordable and social housing as prospects for returns in this sector look attractive against the backdrop of low interest rates.

Institutions have traditionally accessed affordable and social housing via the debt markets. There is now growing involvement by and increasing interest from equity market participants, particularly from private or non-listed equity markets and more recently from the public equity markets.

2. Background

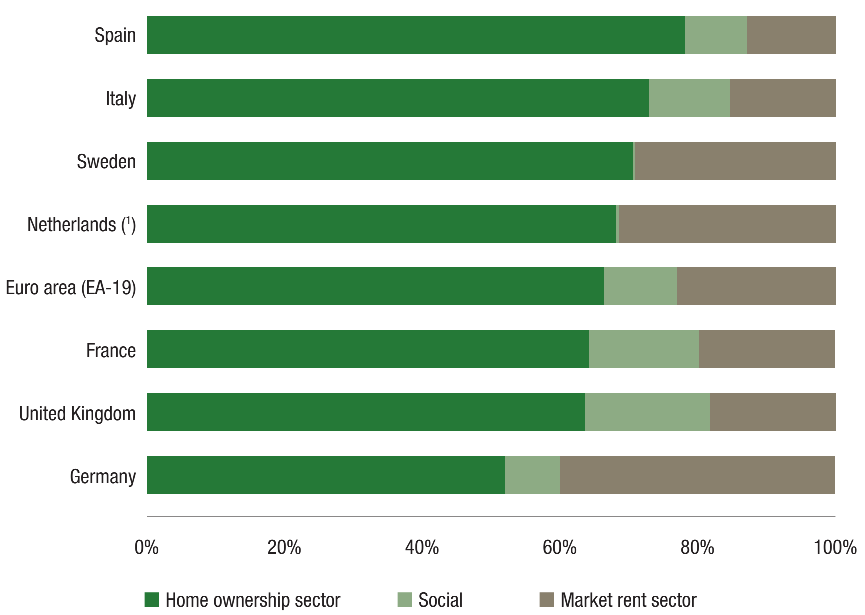
Investors typically gain exposure to real estate via a range of investment routes including equity and debt, direct and indirect, and listed and unlisted. Over the past 25 years in public equity markets, US REITs in particular, have grown their exposure to the residential market by investing in multi-family housing, student housing, manufactured homes, single family rentals and senior housing. In Europe, interest has been growing most notably since the financial crisis.

Demographic change, urbanisation and the changing macroeconomic environment have driven the growth in residential real estate investing. Moreover, trends in investing such as a greater emphasis on ESG criteria may, in future, lead to further attention being paid to ways of investing in social and affordable housing.

The rented housing sector in Europe is substantial and growing, with renters constituting more than 25% of households in the EU28 and up to 50% in countries such as Germany and as such present an enormous investment opportunity. The social housing sector is a substantial part of the overall housing framework, particularly in countries such as the Netherlands and the UK where social landlords have been sustained by their ability to tap private finance via the bond markets for more than 25 years. Thus, it is not surprising that investor interest in Europe in social and affordable housing is growing.

Until recently, equity markets have been slow to look at the affordable and social housing sector across Europe, but there is a growing recognition now that affordable housing and increasingly social housing is an opportunity for institutional investors. Given the scale of the stock in the non-profit sector and events in markets such as Germany over the last 10 years, interest is developing. In the UK, there have been initial public offerings (IPOs) of vehicles targeting investments in the social housing sector in 2016 and 2017.

Figure 1 Housing tenure by country, 2015



Source: Eurostat 2015, Social refers to the Eurostat category, reduced rent, rent free or rent controlled housing[1]

[1] Note: In a number of markets Eurostat has included housing associations under the market rented sector, so the social housing sector can appear understated in countries like the Netherlands.

3. Institutional investor demand

Institutional investors typically expect real estate investment to provide their portfolios with attractive risk-adjusted returns, low correlations to other asset classes and the potential for moderate, long-term capital appreciation. Commercial real estate has historically offered investors a consistent yield derived from its steady cash flow from tenanted property, protection via market rents rising in response to inflation and capital appreciation from rising land and property prices. It provides diversification in a typical institutional portfolio of equities and bonds.

There are various structures that equity investors can adopt in investing in real estate, but they typically take one of three forms. The most familiar and traditional form of equity investment in real estate is via direct investment in a property or series of properties, with the institution owning the assets outright. Equity investors can also invest in companies, or funds, alongside other investors, in so-called pooled investments. A real estate investment vehicle or fund or company can be accessed via a listing on a stock exchange, in the form of a publicly trade security. Alternatively, it can take the form of a non-listed real estate vehicle where the shares are only exchanged, if at all, via private arrangements.

Investors in the public markets will usually expect real estate securities returns to be composed of three elements. Firstly, investment income will come in the form of dividends or dividend yield. Listed real estate companies have a history of raising their dividends, as a result of cash flow growth coming either organically, from rising rents and occupancies, or externally from development and acquisitions. The second element is capital appreciation over the longer term from rising rents and land values, and improving portfolios as a result of development and acquisition. Thirdly, there is a share price repricing factor for the security which is largely market sentiment-driven, with stocks repricing by more if they are sought after by market participants.

Public markets offer daily liquidity, which is often attractive to investors in need of ease of access to their capital, but at the same time, the liquidity of the securities market can provide too much volatility for some investors looking for sovereign bond-like characteristics from an asset class. The long-term relationship between direct property ownership and listed real estate also allows investors to build a diverse portfolio by adding listed real estate.

4. Listed real estate: the search for sustainable yield

As described, investors have been searching more intensively for income or yield since major central banks, seeking to avoid a deflationary slump, initiated their quantitative easing [QE] programmes in the wake of the GFC. These non-conventional policy measures supressed bond yields and return expectations globally. They also dragged prime commercial property yields and dividend yields on listed real estate companies lower.

But, relative to bonds, property has offered investors attractive yields, with demand also boosted by the drop-in property financing costs. Demand should remain strong as investors continue to find it increasingly difficult to obtain sufficient returns from traditional asset classes such as equities and bonds.

5. Institutional investment in real estate

In the five years since global QE began, institutional investment in real estate has gradually risen. Institutions are now allocating 10% to real estate in their total portfolios[2].

In markets such as the UK, allocations by insurers and pension funds were steady at around 5% over the last 20 years, but have also started to rise. Likewise, in the US, allocations were typically 6%-8% during the last cycle. According to the Emerging trends in real estate 2017 report from the Urban Land Institute [ULI][3], the top institutions are now allocating around 10%.[4]

The size and importance of real estate in the wider economy is significant, with the opportunity for investing in commercial real estate in general and residential in particular.

Data from the European Public Real Estate Association [EPRA] shows that commercial investible real estate, including residential, represents about 45% of GDP in developed market economies.

Globally, the listed equity real estate sector has a market capitalisation of EUR 2.0 trillion, which is estimated to include about 12% of global investible commercial real estate. The market sector sees daily trading volumes of EUR 330 million. Actual ownership by listed and non-listed companies is still relatively small, although the scale of institutional investment in equity real estate is increasing. In Europe,

Figure 2 Real estate yields versus bond yields - listed real estate

Source: FTSE EPRA NAREIT, Bloomberg, 31 July 2017

[2] 2016 Institutional Real Estate Allocations Monitor, Cornell University and Hodes Weill & Associates' October 2016

[3] Source: ULI, Emerging trends in real estate, The global outlook for 2017, ULI, PWC March 2017)

[4] Source: ULI, Emerging trends in real estate, The global outlook for 2017, ULI, PWC March 2017)

the sector is estimated to own a total of EUR 376 billion of assets.[5]

Listed real estate companies have significant exposure to rented housing in markets across the world, but there is still clearly an opportunity to expand exposure. Currently, investment in residential rental property by listed real estate companies across the world is about 14% of the total market capitalisation (source: GPR). In Europe, listed real estate companies have a higher exposure to the residential sector. Rental property comprises currently 25% of the European real estate index, up from less than 5% in 2007.

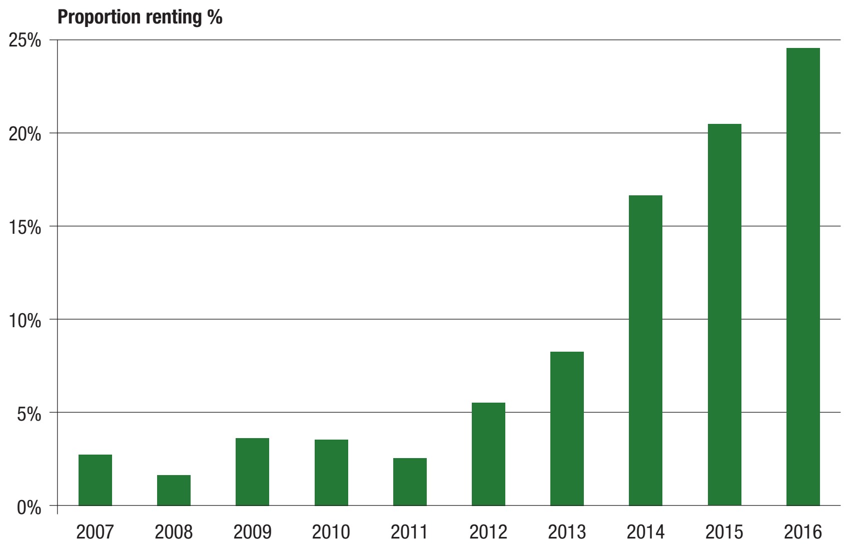
By way of comparison, based on data from the European Association for Investors in Non-Listed Real Estate Vehicles [INREV][6], the non-listed sector had EUR 20 billion, or about 10% of total assets, invested in dedicated residential funds in the European non-listed real estate fund sector at the end of March 2017. Markets in the Netherlands and Germany dominated institutional capital flows.

Figure 3 Size of the total commercial real estate market – developed markets (EUR, Billions)

	Commercial real estate	Total listed real estate	Market capitalisation
Europe	6,244	376	239
Asia	3,409	617	442
North America	7,594	1,008	712
Total global (developed markets)	**17,247**	**2,001**	**1,394**

Source: FTSE, EPRA, NAREIT, March 2017

Figure 4 Residential real estate owned by publicly listed companies in Europe as a share of total market capitalisation



Source: FTSE EPRA NAREIT, Bloomberg, 31 July 2017

6. 'Affordable' residential options for institutional investors

Management companies along with investors have recognised the investment opportunity presented by the problems of affordability affecting access to both home ownership and large parts of the market rented sector, especially for newly forming households, and particularly in expanding urban areas. Demand for residential rental property has been increasing among both individual and institutional investors since the financial crisis. Demand has been driven by the growing perception that residential property is an undervalued asset class, partly because it is seen as an investment that offers lower, if stable, longer-term returns.

Investors looking for assets that can achieve index-linked returns, while at the same time allowing them to lower overall risk in their portfolios, have increased their equity participation in the residential sector, as noted by the UK's Investment Property Forum [IPF] study into institutional investment in UK social housing.[7]

Investor demand for residential real estate in Germany has been notably strong, putting it at the forefront of equity investment in affordable and social rented housing in Europe over the past decade.

Germany has been the catalyst in Europe for the growth of interest in residential rented portfolios among investors in publicly listed securities. The expansion of the listed residential sector in Germany has made an important contribution to the growing demand for lower-risk, bond-like returns. Interest from the public markets in social and affordable in Germany arose after large portfolios of social and affordable housing were first privatised and then listed on the stock exchange.

Listed German residential companies have been operating since the late 1990s, originating from housing owned and managed by Germany's corporate sector and from non-profit sector landlords led by companies such as Deutsche Wohnen SE.

The sector expanded significantly with the privatisation of Deutsche Annington and its subsequent listing in 2013. A number of mergers and acquisitions followed in the German listed sector and the listed residential sector is now an industry with a EUR 50 billion market capitalisation. Consequently, it has become an important sector for European real estate securities investors.

7. Equity investing in UK social housing

The ULI's 2017 annual European survey on investor trends noted growing interest in affordable and social housing among investors.[8]

[5] EPRA March 2017 Total Markets Table

[6] European Association for investors in non-listed real estate vehicles index of non-listed real estate funds, 31 March 2017

[7] IPF 2015, Prospects for institutional investing in social housing

[8] Urban Land Institute, Price Waterhouse Coopers, Emerging trends in real estate Europe report

Investors rated social and affordable housing as offering among the best investment prospects in 2017. Prolonged low interest rates support perception of the sector as low risk, despite the relatively low returns and yields on offer.

Since the advent of the private finance regime in the UK (in 1988 the then Conservative Government moved to restrict borrowing by local authorities and decided only to support new investment by Housing Associations within a new funding regime) investors have used the bond market to access the social housing sector.

Institutional equity investment in the affordable housing sector has been less widespread in the UK, but it has been evident in markets such as the Netherlands and Germany. However, as the availability of public funding diminishes and demand for social housing increases, social landlords in the UK are widely seen as being more open to equity investor involvement. Most interest in the UK has come from pension funds and insurers, with joint ventures and sole equity provision alongside landlords operating in affordable housing, and market sector, affordable housing all under consideration.[9]

In the UK, the listed residential sector is relatively small at just 3.5% of the overall sector (according to GPR data). Most of it concerns student housing or private rental property free of government subsidy or rent regulation.

In 2015, the IPF report[10] concluded that there was little demand from housing associations or institutional investors for listed real estate companies or real estate investment trusts [REITs] as a source of capital for affordable housing. The research showed UK institutional investors had limited exposure to residential property and little equity ownership of social housing, although it noted a growing appetite for the sector. Although total assets exceed GBP 3 trillion and property assets amount to well over GBP 150 billion, equity investment in social housing accounts for only GBP 0.4 billion – a tiny fraction of the value of social housing in the UK.

Neither social housing providers nor institutional investors saw social housing REITs as a useful vehicle for their investment needs, with the challenges of a sustainable dividend yield and additional costs cited as reasons. Similarly, the liquidity available through both listed real estate companies and REITS was not seen as an advantage by either investors or social landlords in the UK.[11]

Nonetheless, despite the initial scepticism among UK investors, there have been three initial public offerings [IPOs] of companies with stock exchange listings in the UK since November 2016 of companies intending to own and manage social housing. The companies have raised or hope to raise an impressive GBP 630 million to buy social housing assets from housing associations and local authorities, with ambitions to raise more money.

The various companies and REITs which have been raising capital in the last 12 months intend to offer investors long-term inflation-linked yields and are targeting returns of 6% to 8%, based mainly on an income yield of 5% or more. So far, the companies have small seed portfolios of assets, but expect to acquire more assets.

The profile of the returns that the new companies offer is part of the reason behind the succession of launches. Long-dated, secure and inflation-linked income should be hugely attractive to investors at a time when bond yields languish at record lows.

Figure 5 Capital raising by social housing initial public offerings as at November 2016 (GBP million)

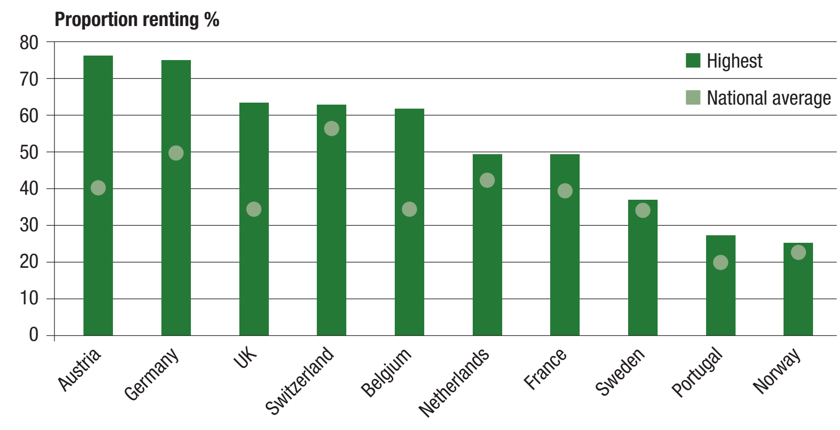
CIVITAS SOCIAL HOUSING	Novermber 2016	**350**
RESIDENTIAL SECURE INCOME	July 2017	**180**
TRIPLE POINT SOCIAL HOUSING	August 2017	**200**

Source: Bloomberg 31 August 2017

8. The future of the European rental market – will institutional interest continue to grow?

As already noted, one of the key attractions of residential investment is the long-term supply-demand dynamic. Demographics and geographical trends in urban areas, such as the tendency for households to shrink, are contributing to housing shortages in sought-after, high-barrier-to-entry markets such as London, Berlin, Stockholm and Paris. The decline in home ownership rates in markets such as the US and the UK is indicative of broader trends. Indeed, home ownership is down in England from 70.9% in 2003 to 62.9% in 2016, mirroring a European trend that has seen owner occupation fall from 73.2% in 2009 to 69.5% in 2016.[12]

Figure 6 Proportion of people renting - country average & highest percentage in a city in a country



Source: Eurostat, 2017, Department for Communities and Local Government, 2017[13]

[9] Emerging trends in real estate Europe 2017

[10] IPF Research 2015, Prospects for institutional investing in social housing

[11] IPF Research 2015, Prospects for institutional investing in social housing

[12] Eurostat, Trading Economics, 2017 & The English Housing Survey, produced by the Department for Communities and Local Government, 2017

[13] Eurostat, Trading Economics, 2017 & The English Housing Survey, produced by the Department for Communities and Local Government, 2017

Urbanisation is expected to increase over the next 10 years across Europe, with markets such as Germany and the UK expected to see a 2.5% increase in urbanisation by 2025, according to UN data. While the rate of urbanisation is less rapid than other parts of the world, it should nonetheless provide a significant impulse for demand for residential property.

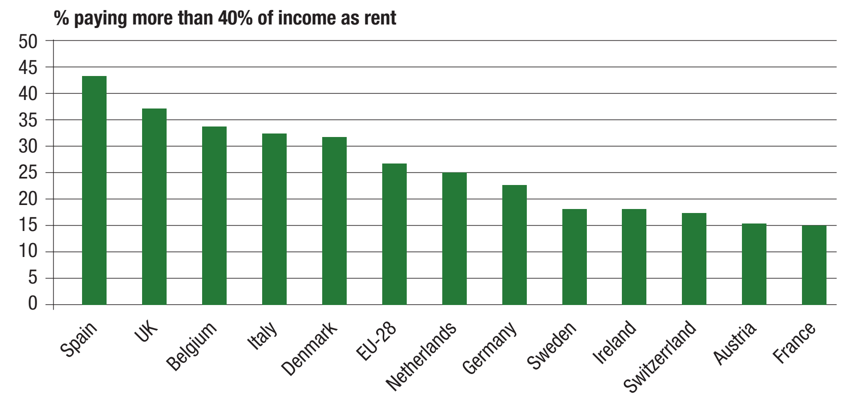
Affordability is an ongoing issue. An EU Urban Agenda report from 2016 highlighted that 11.4% of the EU-28 population lived in households that spent 40% or more of their 'equivalised disposable income' on housing (Eurostat November 2015). The average covers significant differences between countries and tenures, with 27% of tenants in the private sector spending 40% or more of their income on housing costs. The report identifies young people encountering more difficulties compared to past generations, while the drop-in investments that provide social housing between 2008 and 2012 has contributed to the affordability problems. In addition, there are numerous pressures in relation to the demographic changes and migration trends that will raise the need for new investment in housing in many countries, in particular, in large cities and metropolitan areas.

The fall in property yields alongside global bond yields since 2010 in Europe has continued in a global investment market with a solid global economic backdrop of stable, if lower, growth prospects and a monetary policy framework that is still broadly supportive of real estate after seven years of accommodative policy.

Based on the experience in the US, we expect demand for rental housing investment in Europe to increase. The US has seen REIT investment grow in different types of housing via multi-family REITs, single-family rentals, student housing and park homes or manufactured housing. Likewise, healthcare has become an increasingly important sub-sector of the US REIT investment universe, with a focus on investing in housing for older people or senior housing. Moreover, concerns about lower long-term economic growth, weaker demand for home ownership and changing demand for commercial real estate are driving the increased popularity of alternatives such as private and, more recently, social rented residential.

Another factor behind investor demand for social and affordable housing could be the growing demand from investors for investments that satisfy their environmental, social and governance [ESG] criteria. ESG requirements are beginning to influence investment strategies in both the listed and non-listed sectors. While the percentage of institutions with formal ESG policies has remained relatively steady in recent years, a global study of investors has revealed that the percentage of institutions that indicated that their investment processes are actually influenced by ESG considerations increased to 29% in 2016 from 16% in 2015. ESG has typically been associated with green buildings. However, with affordability in urban areas a growing consideration for institutions, as well as the long-term sustainability of cities, affordable housing should be a core aspect of ESG investing, according to the 2016 Institutional Real Estate Allocations Monitor from Cornell University.[14]

Figure 7 Proportion of households in the private rented sector spending 40% or more of their disposable income on housing



Source: Eurostat, European Union, 2015

9. Conclusions

There are several reasons to believe that investor interest in rental property in Europe will continue to grow and, with it, demand for affordable and social housing.

A combination of demand for rental housing, shortages of affordable housing in urban areas and a growing base of investors looking for stable, long-term returns from residential property could create the conditions for a flow of new capital into affordable residential property in a number of European markets, with the listed real estate sector also recognising fresh opportunities.

Institutional expertise in European residential property has historically been limited partly due to a perception that there was a shortage of good, investible opportunities, but it has evolved over the last 10 years in response to investor demand. There is greater appetite to own the sector. Many fund managers believe there are now more opportunities to build pan-European residential portfolios now than in previous decades. The Emerging trends Europe survey 2017[15] highlighted the growing awareness of real estate and residential among equity investors.

The growth in demand has coincided with falling interest rates since the end of the global financial crisis. Investors have been looking increasingly at asset classes which offer a higher yield, and have increased their allocations to real estate, whether in the public markets via equities, investing in unlisted funds or buying real assets directly. Capital markets are expecting inflation and therefore interest rates to remain lower for longer in North America and Europe, which should be a tailwind for residential investment. Public real estate markets should view the opportunity with interest. The development of publicly quoted German residential companies provides a reminder of investor interest in affordable private rented property, a sector which has been experiencing significant, above-inflation rental growth.

The biggest challenge has typically been how and where to invest. Equity markets have traditionally had limited exposure to residential housing in markets such as the UK, but have begun to work with social housing landlords as the opportunity becomes clearer. The public securities markets have been active in Germany, albeit in the more market-oriented segment of the affordable housing spectrum. In the past 12 months, there have been a number of UK

[14] Cornell University and Hodes, Weill & Associates' October 2016

[15] Emerging trends in real estate Europe 2017

social housing offerings that have attracted UK institutional capital.

It is likely that more structures will come to market and attract equity, but the extent will depend on the scale of social and affordable housing moving into investible vehicles, the regulatory frameworks and the degree to which alternatives in the commercial property markets in Europe begin to lose some of their investment appeal.

The success of companies in Germany is noteworthy in first building portfolios from existing stocks of property, using dedicated investors with longer-term investment horizons as a source of capital, before looking to the public markets for equity. Building large-scale portfolios in the public markets is a different challenge and investors in public securities may be less keen to invest in blind pools, not least because in most markets, particularly in European countries, large-scale portfolios of properties are difficult to find.

The Private Rented Sector in France

↳ By Claude Taffin

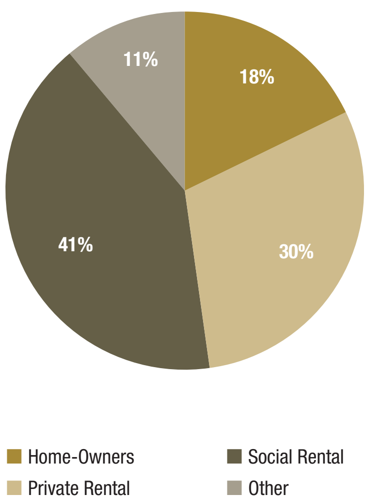
1. Introduction

The orientation of housing policy in France is underscored by two general policy principles:

- The "enforceable right to housing" ["Droit au logement opposable, or DALO], which was made a law in March 2007. The right to housing means having access to and remaining in decent housing. Enforceable means that the eligible households who do not get a unit may sue the State. In practice, it works like priority access to a social rental unit;
- The freedom of choice in terms of housing, including tenure, type of housing and location: Even before DALO, France was supporting one of the largest social rental stocks in the world, while encouraging home purchase (through milder taxation, subsidized loans and guarantee loans) like many other countries, but not at the expenses of private rental, considered as the best choice for young and mobile populations.

This all-sided support has a high cost, which is more and more questioned by successive governments: 41.7 billion €, or 1.9% of GDP (2016), the private rental sector [PRS] receiving 30% of the total (Figure 1). Direct subsidies (mostly housing allowances) make up the largest proportion (50%). Tenants in both the private and social rented sectors are eligible, so are homeowners with a debt burden[1].

Figure 1 Public aid for housing by sector



Source: Ministère de l'Environnement, de l'énergie et de la mer, en charge des relations internationales sur le climat, Compte du logement 2016 (July 2017).

2. Overview of the private rental sector

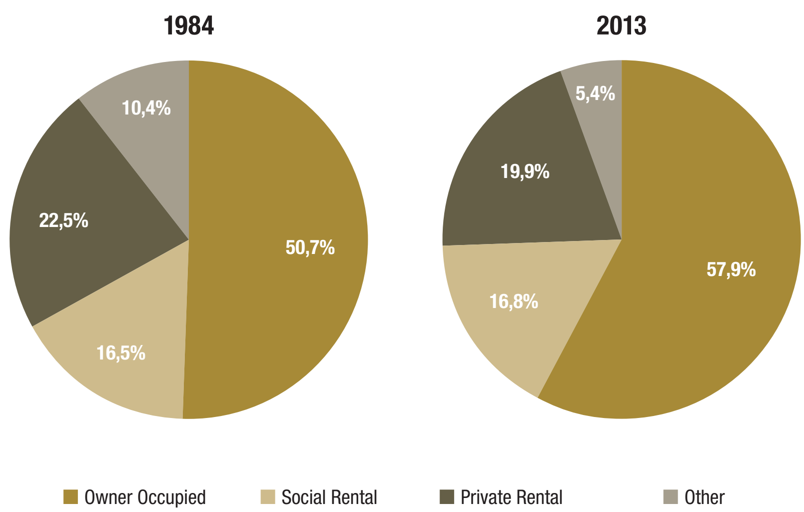
The rapid growth of the social housing stock since World War II is in contrast to the erosion of the PRS, although the two phenomena have not coincided. The social housing stock mostly developed between the middle of the 50's and the end of the 70's whereas the decline of the PRS was significant between the middle of the 60's and the middle of the 80's (Figures 2 and 3). For more than thirty years now, the PRS has resumed a moderate growth thanks to fiscal investment incentives (below).

The PRS remains therefore larger (5.6 million units) than the SRS (4.7 million units)[2].

2.1. Contour and organization

The distinction between private and social is not fully relevant. In theory, private should be opposed to public but whichever definition of social housing is used, about half is not public. No definition of social housing exists which is unanimously accepted. Several approaches are indeed possible, the most commonly used being in terms of landlord organizations for social housing; this is without a doubt the most frequent definition and social housing is often but wrongly assimilated to the housing stock of HLMs ["Habitations à loyers modérés", i.e. "Moderate rent dwellings"] organizations as SRS is not limited to HLMs: it also includes the

Figure 2 Tenure distribution in 1984 and 2013 (% of main residences)

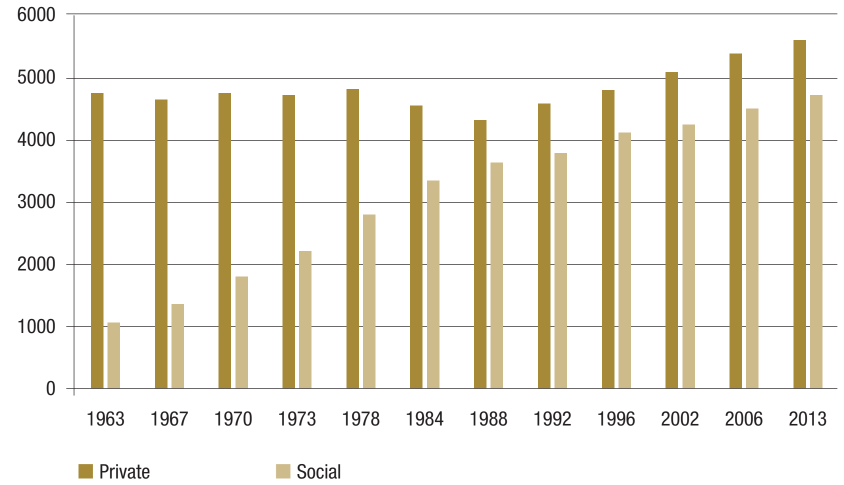


Source: INSEE, National Housing Surveys

[1] More details on housing subsidies in France can be found in "Latest trends in social housing finance policies in France" by J.P. Schaefer, IUHF Journal Autumn 2015.

[2] Vacant units (the vacancy rate in the social sector was 3.3% in January 2016) are not included, neither are private units rented furnished, sublet or occupied for free, which are classified under "other" in figure 2.

Figure 3 Changes in the rental stock 1963-2013



Source: INSEE, National Housing Surveys

Figure 4 Tenants' characteristics by sector

	PRS	SRS
AGE OF THE REFERENCE PERSON		
Under the age of 30	28.0	9.5
30 to 39 years old	20.8	17.3
40 to 49 years old	16.9	22.2
50 to 64 years old	20.4	29.2
65 and over	13.9	21.9
QUARTILE OF INCOME PER CU		
First Quartile	36.3	50.1
Second Quartile	26.1	28.7
Third Quartile	22.2	16.1
Fourth Quartile	15.5	5.0
HOUSEHOLD TYPE		
Person alone	47.3	23.7
Single-parent family	9.3	16.5
Couple without children	20.3	14.0
Couple with children	18.8	23.7
Other cases	4.3	4.7
NATIONALITY		
French by birth	87.9	79.5
French by naturalization	3.8	8.6
Foreign	8.3	11.8

Source: INSEE, 2013 National Housing Survey

contractually regulated part of SEM ["Sociétés d'économie mixte". i.e. "Semi-public companies"] properties and the contractually regulated part of PRS, usually named "logement intermédiaire" ["intermediate housing"].

More than 96% of the PRS belongs to individuals, as the low return and heavy management costs have been causing disinvestment among institutional investors for several decades. Most of these landlords are "amateurs" who own a small number of units, often one or two. The few large-scale landlords, "institutional investors", are mostly life insurance companies and real estate companies, the (unlisted) SCPI[3] and the (listed) SIIC[4]. Like their counterparts in other countries, these companies prefer investing in commercial properties. However, a few SCPIs specialize in housing as they benefit from the same tax incentives as individual investors (below).

As a consequence of this overwhelming share of individual owners, private rented units are mostly apartments sharing condominium buildings with owner-occupied units (45%) or individual houses (30%). They are less often grouped in rental buildings with a single owner (25%); such buildings were sold in the last decades, mostly in the 70's and 80's, either by apartments to the tenants or other individuals, or else as a whole to social housing companies.

2.2. Tenants' characteristics

While in Germany, most tenants are tenants by choice and in the United Kingdom by necessity, France stands somewhere in between. The social housing stock is in the majority occupied by low-income workers, and now retired persons. The private rental sector, diverse in location, size and quality, houses different groups including low-income people on a waiting list for social housing, house starters of all income groups and all those who privilege mobility and a central urban location.

As a consequence, there are significant differences in the distribution of the various tenures by age, income, household type and nationality. Comparing tenants in the PRS and in the SRS, the former appear to be much younger, with 28% under the age of 30 vs. 9.5%, less poor, with 36% below the first quartile of income per consumption unit distribution vs. 50%, with 68% of households composed of a single person or a couple without children vs. 38% (Figure 4).

Although their dwellings are a little smaller (66 sq. m. vs. 69 sq. m. on average), tenants in the PRS spend more than in the SRS: 28.4% of their income vs. 24.1%, taking into account the rent properly speaking, payments for utilities and housing tax, and deducting the housing allowance. Their rent per square meter is much higher: 105€ per year vs. 72€, and their income is also higher, which reduces their allowance (14€ vs. 20€); they pay a little less for utilities and similar housing taxes[5] (source: 2013 Housing Survey).

2.3. Location of the dwellings

PRS units are usually located in the large urban areas where home purchase is the most expensive and implies for many a suburban if not peri urban location. The density of the PRS has however another geographical bias: it is higher in the South, and more particularly in the South-East, than in the North (Figure 5). The SRS on the contrary is far more developed in a large North-East quarter which is the most industrialized part of the country whereas the homeownership rate is higher in the Western part. This is also the reason why the share of the PRS in the Paris region is smaller than in most other big cities[6].

3. Regulation

The least one can say is that the PRS is strictly regulated and heavily taxed. Moreover, rules tend to change so often, in particular tax rules, that legal instability is one of the main landlords' complaints, as the future factors affecting their investment are not predictable. Landlords claim more for their stability than for their alleviation.

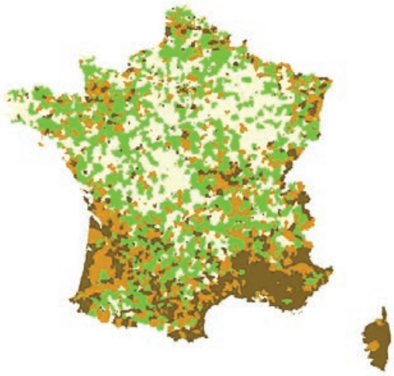
[3] Société civile de placement immobilier (Real Estate Investment Company).

[4] Société d'investissement immobilier cotée (Listed Real Estate Investment Company).

[5] "Les conditions de logement en France", édition 2017, INSEE.

[6] J. Bosvieux: "Bailleurs et locataires dans le parc privé". Habitat Actualités, November 2012, ANIL.

Figure 5 Location of tenants in PRS



Source: MEDDTL – SoeS, Filocom 2009

3.1. A short history of the PRS in the twentieth century

A hard regime of rent control was put in place during the First World War. It was extended by successive laws after the end of the war, transforming the protection of war victims into the protection of all tenants. Under a 1922 law, rents were set free in newly built units and landlords were allowed to terminate the lease for their own occupation. Rigid rent control was temporarily lifted in 1926-28, but only for the units with the highest rents in the existing stock. As a result, rents (in real terms) were then worth on average 25% of their value in 1914 and reached a maximum of 58% of this value in the early thirties. During the Second World War, rigid rent control was extended to all units built before 1939. In 1948, the average rent was worth 13% of that of 1939 and 5% of that of 1914. The "rate of effort", i.e. the rent-to-income ratio, of a worker in Paris was then estimated to be 1.6%, ten times less than in 1914.

The two World Wars (France was invaded each time and liberated after intense air bombing by the allied forces in 1944-45) and the rent control in place during and between the wars perfectly illustrate the famous sentence[7]: "In many cases rent control appears to be the most efficient technique presently known to destroy a city – except for bombing". France had both. Approximately 20% of the housing stock in 1939 had been destroyed or severely damaged; less than 120,000 units had been built per year between 1919 and 1939; the number of decrepit units rose from 150,000 to 2.8 million and the average age of the housing stock reached about 100 years.

It appeared therefore necessary to end rent control but rents were so low and the shortage so massive that a quick return to the law of the market was also impossible. Hence the 1948 law, which was probably the most important housing law of the century, and still has some impact today on a small minority of rents. Its main dispositions are:

- Security of tenure is granted to all occupants "in good faith", with some limitations in case of under-occupation,
- The owner may terminate the lease for his own occupation, or other "legitimate motive" or even without motive provided that he relocates the tenant in similar conditions,
- Generous rent increases are allowed in the existing stock: for each unit, the law first defines a "rental value" obtained by multiplying a unit value depending on location only by a "weighted area" ["surface corrigée"], which takes into account the quality of the building and of the unit (location and environment, maintenance, sunshine, equipment).

The law applies only to the existing stock in urban areas. Rents are freely determined in newly-built units.

Municipalities are free to enter or leave the framework of the law. Very few cities chose to come in but many went out in the middle of the 60's.

The 1948 law gave the Government the power to set rents by decree, instead of the Parliament. After a few years, this power was used to control rents again, so that the theoretical "rental value" was never reached. As a result, most people today believe that the 1948 law introduced rent control when the initial purpose of the law was on the contrary to allow rent increases.

Only in 1986 the law was de-grandfathered, i.e. that the occupancy right can still be transferred to parents or children but only if they have been living with the deceased tenant for at least one year, and, to exit from the 1948 law, two transitional 6 or 8-year specific leases were created. Today, only a few thousand units, about 2% of the PRS, mostly uncomfortable and located in Paris, remain under the 1948 law; their rents are close to those of the SRS.

After the 1948 law, tenant-landlord relationships were not regulated until 1982 when the "Quilliot" law significantly strengthened tenants' rights and introduced (soft) rent controls across the entire stock. After two changes due to political shifts and market evolution, the "Méhaignerie" law that relaxed rent control in 1986 and the "Mermaz – Malandain" law which reintroduced stricter controls in 1989, a stable equilibrium seemed to have been reached. The main features of the 1989 law remained applicable during the next 25 years. They are as follows:

- The rental agreement must be in written form; its duration is three years when the landlord is an individual, six years when it is a company;
- The landlord may terminate the lease when it has expired in three situations only: for own occupation, for sale (in that case, the tenant has a preemption right), and in case of a "legitimate and serious motive" after following strictly regulated procedures; moreover, if the tenant is 70 years old or more and if her / his income is below 1.5 times the minimum wage, the landlord must offer her / him another rental unit, which must be comparable in location, quality and price;
- Only when the tenant does not respect his commitments (non-payment of rents or utilities), can the landlord terminate the lease before expiration;
- On the contrary, the tenant may terminate the lease at any time with three-months' notice (one month in a few cases);
- The rent is freely set in all new leases (newly rented unit or new tenant); it is pegged to the Indice de référence des loyers [IRL, "reference rent index"] during the three or six-year lease. The reference rent index is equal to the average of the last twelve-monthly consumer price indexes (without rents and tobacco)[8]. When the lease is renewed with the same tenant, the reference rent index also applies. The rent can be adjusted in order to reach the level of similar units in the neighborhood[9] only if it is far below market level. In the Paris area, such increases are limited to half the gap[10]. Limited increases are also permitted in case of improvement works;

[7] Lindbeck, Assar. 1972. "The Political Economy of the New Left". Harper and Row, New York.

[8] The definition of the reference rent index has changed several times since 1989.

[9] Rent level estimated based on six references in cities of more than one million inhabitants, three in smaller cities; two-thirds of the reference must correspond to units occupied by the same tenant for more than three years.

[10] In any case, an increase of 10% or less must be applied gradually over three years, an increase of more than 10% over six years.

- The law precisely defines which expenses (maintenance, utilities, etc.) will be paid by the landlord and by the tenant.

3.2. The ALUR law (2014)

The explanatory memorandum of the ALUR law is as follows: "In view of the deterioration in the conditions of access to housing and the exacerbation of tensions in the real estate markets, this law seeks to implement a comprehensive, coherent and extensive strategy to regulate market dysfunctions, protect landlords and tenants, and allow for the expansion of the supply of housing in conditions respectful of territorial equilibrium".

The 177 articles of the law also deal with condominiums, real estate professions and social housing, but the reinforcement of tenant's rights, including a harder rent control and the extension to furnished rentals of the protection granted to tenants of unfurnished rentals, is a major component. A much-discussed provision was the introduction of a "Universal rent guarantee" which was finally abandoned, due to its high cost and potential abuses.

The ALUR law marks a new step in the attempt to limit rent levels in high pressure areas. The only exception in the 1989 law was the Paris region; this exception was later extended to 27 other high pressure areas. But these limitations only concerned rent increases. The new law now imposes caps on rent levels, as is the case in Germany, but this requires a precise knowledge of the rental market. Although the 1989 law already asked for the creation of local rent observatories, only the city of Paris built one and was able to apply the new regulation shortly after the decrees were issued. There are now more than twenty observatories, with variable perimeters, between the city and the "département", but only four of them have been certified: Alençon, Lille, Paris and Rennes. Among them, only Lille decided to join Paris and adopted the new rent control system in February 2017. The picture of rent regulation is therefore getting more complex (Figure 6).

Figure 6 New rent regulation (ALUR law)

LOW PRESSURE AREAS	HIGH PRESSURE AREAS	ADDITIONAL MEASURES IN HIGH PRESSURE AREAS WITH A CERTIFIED RENT OBSERVATORY
First contract Rent setting: Free	*First rental or vacant more than 18 months or improvement works for more than one year's rent in the last 6 months* Rent setting: Free *Other first contract* Same as below	*First contract* ▪ Rent set based on local reference rent (average for similar units, rent tables available in the bigger cities); ▪ Maximum rent: 20% above the reference rate (possible exemptions).
Renewed contract ▪ Limited to the increase in the "reference rent index" (average of the last twelve monthly CPIs); ▪ Possible higher increase only if rent is far below market level (based on at least 6 references for comparable dwellings in the same neighborhood); increase to be equally spread over the 3 years of the lease, or 6 years if more than 10%	*Renewed contract* ▪ Limited to the increase in the "reference rent index" (average of the last twelve monthly CPIs); ▪ Possible higher increase in 2 cases: 1/ if rent is far below market level, maximum increase = 50% of the gap, 2/ improvement works for more than 6 month's rent, maximum increase = 15% of work cost.	*Renewed contract* ▪ The tenant may ask for a decrease if the rent is above Ref Rent + 20%; ▪ The landlord may ask for an increase if the rent is below Ref Rent – 30%; he cannot go beyond Ref Rent – 30%.
During the lease (3 or 6 years) Rent pegged to the "reference rent index" (only if mentioned in the contract).		

3.3. Taxation

Any individual receiving income from an unfurnished rented housing property has to pay two specific taxes:

- Income tax: the rental income is added to the other incomes of the taxpayer. The marginal rate is 45% in 2017. Expenses are deductible, including property tax and interest payments, but depreciation is not. When the net taxable rental income is negative, the deficit is allowable against other income up to a maximum of 10,700€. Any additional deficit can be carried forward during the next ten years. If the rental income is less than 15,000€, the landlord may choose to deduct a flat 30% whatever the real expenses are.
- Social taxes: 15.5% of the net taxable rental income in 2017[11].

For those who pay the wealth tax, the rate of which varies between 0.5% and 1.5% of the market value, equivalent to 10% to 30% of the gross rent (based on a rent multiplier of 20), the tax burden may confiscate almost all their rental income.

Companies pay corporate tax at the flat rate of 15%, 28% or 331/3%, depending on their net benefit. Social housing companies are exempt for their social rental activity. All expenses are deductible including depreciation. Companies have also to pay an additional contribution on rental income from properties built 15 years ago or more; the rate is 2.5% of the gross income.

Unlike owner-occupied main residences, rented properties are subject to capital gains tax. The tax rate is 34.5% (19% income tax flat rate + 15.5% social taxes). The income tax base (the nominal capital gain reduced by the amount of improvement and renovation works) is reduced by 10% each year after 5 years, resulting in an exemption after 15 years. However, the full exemption will not occur until 30 years as the tax base of social taxes decreases very slowly (2% per year, then 4%, finally 8% in the last five years).

A tax on vacant units was introduced in 1999. The tax is due from private landlords whose unit has been vacant for more than two years. It is only applicable in the 28 high pressure areas. Units that need heavy renovation works or that are unsuccessfully offered for rent are exempt. A subsidy from ANAH[12] is available to landlords willing to renovate their unit in order to rent it.

A tax on high rents was created in 2012 as rents of "micro-dwellings" were skyrocketing in Paris. This tax applies in high pressure areas to dwellings of less than 14 sq. m. with a monthly rent of more than 41.64€ per sq. m. (in 2017). Its rate is progressive and goes up to 40% for rents higher than 79.12€ per sq. m. As a consequence, the benefit of charging a rent higher than the triggering threshold of the tax is very small and may even be negative.

[11] 5.1% are deductible from the overall income of the year when it is paid.

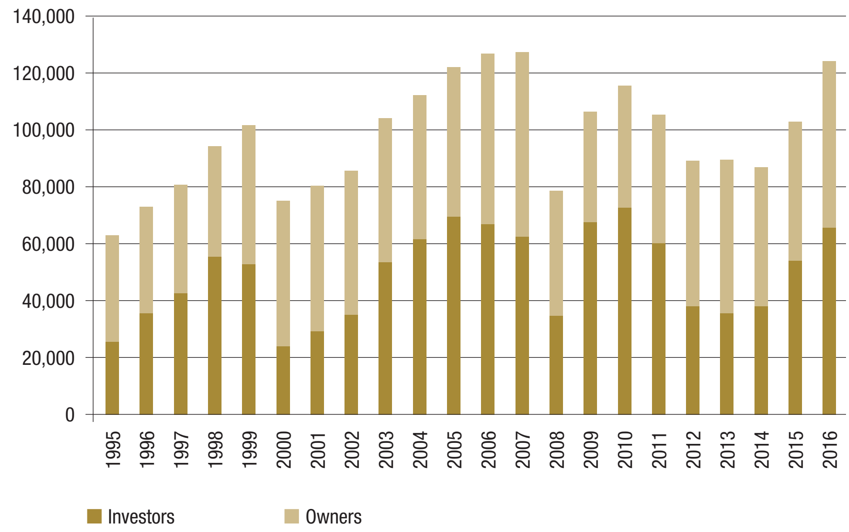
[12] "Agence nationale de l'habitat".

3.4. Tax incentives for investors

Already in the 1970s low return and high management costs caused disinvestment among institutional investors. Then, after the Quilliot law, or even a few years before, as the political shift was anticipated, unbalanced tenant-landlord relationship, rent controls and heavier taxes also incentivised private landlords to sell their properties. As a consequence, the PRS was losing 1% each year in the early 1980s.

Incentive schemes for individual investors in rental housing were launched (in 1984 and 1996) during periods when the housing market was at very low ebb. They were indeed killing two birds with one stone: supporting the construction sector and increasing the supply of private rental housing (e.g., to facilitate mobility). When the emphasis was on the first goal, the regulations applied to the programs were generally less demanding (for example, renting to relatives was allowed).

Figure 7 Proportion of investors' purchases of developers' sales (1995 – 2016)



Source: FPI France (Fédération des promoteurs immobiliers – Developers' Association)

Some schemes were targeted at middle-class households who could no longer afford decent housing in large cities but whose incomes were too high to be eligible for a unit in the SRS, the so-called "logement intermédiaire". Tax subsidies under these programs were targeted at specific tenant income levels and maximum rents were applied (also no relatives were accepted as tenants) with the consequence that they became less attractive to investors.

Several schemes have been introduced since 1984. Their major common requirement is that the property must remain rented for a minimum period of time, between six and nine years. From a technical viewpoint, two kinds of schemes can be distinguished:

- The first schemes ("Quilès-Méhaignerie" from 1984 to 1996) and the most recent ones ("Sellier", "Duflot" and "Pinel") allow the landlord to deduct directly each year from the income tax a proportion of the investment;
- "Accelerated depreciation" was used between 1996 and 2007. For example, in the very successful "Perissol scheme" (1996-1999), 8% of the amortizable value (80% of the purchasing price) could be deducted from the rental income during the first eight years and 2% during the next twenty years.

In the present "Pinel" scheme, 2% of the price is deducted from the income tax during years 1 to 9, and 1% in the three next years. Finally, the deduction reaches 12% of the price in the 6-year scheme, 18% in the 9-year scheme and 21% in the 12-year scheme. The dwelling must remain rented during the whole period. It must be newly-built and energy-efficient. There is a maximum price of 300,000€ and a maximum price per sq. m. of 5,500€. There is also a rent ceiling which roughly corresponds to 80% of the market value (12.5€ / sq. m. in large cities, a little more for small units) and an income ceiling (3,000€ / month in large cities and Paris for a single person). A much-appreciated characteristic is that renting to parents and children is allowed.

In recent years, between 50,000 and 100,000 units were sold each year to investors under these schemes and this represents up to two-thirds of developers' housing sales (Figure 7). The schemes proved to be the most efficient (in terms of number of units sold), when no rent or income limits were imposed on investors. The main issue is the location of the investments: as rates of return are higher in cities where demand is low, the parameters had to be changed several times in order to better adjust supply and demand. In spite of that, when the crisis burst out in 2008, several programs in small cities remained unsold and were finally sold to social housing organizations.

With the new incentives, the private rental stock started to grow again (+ 1 million between 1988 and 2006). In parallel, the disinvestment went on: tenants' protection and rent control were tightened by the ALUR law, tax pressure constantly increased in the last 10 years, and a new competitor appeared with the development of the very lucrative but often illegal short-term rentals. These changes translated into a global renewal and quality improvement of the SRS, which of course also means that rents went up.

Given the tax burden on rental income once the initial highly profitable period has come to its end, it would be rational to resell the property after the minimum rental period to cash the capital gain, avoid heavier taxation, and why not reinvest using a new tax credit program. Many units are probably sold, and sometimes with difficulty due to the cluster effect when many units of similar characteristics are put onto the market at the same time. According to the National Housing Survey (INSEE, 2013), 22% of PRS units had benefited from one of the schemes and 92% of them were rented, but this mixes all generations, including the recent ones still under the rental commitment.

In spite of its apparent success, many criticisms have been expressed about this system:

- The impact on prices and quality: many programs are targeted towards investors only (no home-buyers) who are dazzled by the tax benefit and do not pay enough attention to location and value for money;
- The impact on location, as already mentioned: the rent limit (a proportion of average market rent in a large zone) concentrates the supply on cities or neighborhoods where local market rents are low, i.e. where housing needs are low. For that reason, the schemes are now limited to the major urban areas (with exemptions).

4. And now?

The present scheme is due to end in December 2017. The efficiency of the 1.9% of GDP worth of public support to housing, much more than any comparable EU country except for UK, is often questioned and the government is considering a cut in the housing allowances. Housing allowances cost 18 billion € whereas the rental housing tax credit schemes cost 2.2 billion €. They will probably be reviewed downwards and their scope focused on the areas where demand is highest but they are unlikely to be brutally discontinued. Most of all, they need to be seriously evaluated as their efficiency is questioned by several research studies that tend to show that they have a substantial windfall effect.

As concerns tenants and landlords' rights and duties, the recent ALUR law increases the imbalance in favor of tenants and consequently the temptation for landlords to privilege short term rentals in large cities and tourist areas. The importance of this phenomenon also needs to be evaluated. However, instead of liberalizing long-term rental, the present trend, at least in Paris, is rather to try to regulate short term rentals. And the government is unlikely to oppose the extension of rigid rent control to other cities than Paris and Lille as long as municipalities want it.

More expensive housing loans to be expected from Basel revision

↳ By Jakob Kongsgaard Olsson

1. Introduction

Banks involved in low-risk lending for housing must put more capital aside in the future as a buffer against losses, while high-risk lenders need do nothing. This scenario is hardly desired by financial regulators anywhere in the world due to the adverse risk management incentives it creates, and it is surely not the right recipe to prevent a new financial crisis.

Nevertheless, exactly this scenario could be the reality after the Basel Committee has finalized its revision of the Basel III accords.

If this scenario becomes a reality, it would make housing in Europe more expensive and less accessible – due to the rising cost of capital. It is hardly desired in any country to make housing more expensive and less accessible as many European countries are struggling to meet the housing demand resulting from the past years' migratory influx. Therefore policy-makers in Europe should be careful when adapting the recommendations from the Basel Committee.

Moreover, capital floors are a break with the risk-based approach and destroy the motivation for better risk management. This view is supported by financial organizations in a number of countries, including several European banking associations and international financial organizations. In a consultation response from March 2015 to the Basel Committee[1], the latter wrote, *"We are concerned that capital floors are inconsistent with the aims of risk sensitivity, simplicity and comparability."* Moreover, the Basel Committee's capital floors are colliding with the Committee's own recommendations from 2004, according to which capital requirements should reflect to a greater extent the risks related to an institution's lending business.

2. Why capital floors?

So why would the Basel Committee even consider making recommendations on capital requirements that appear to make no sense? The idea is to create a new backstop of capital to be held by banks in the form of a minimum requirement of capital – known as a capital floor – regardless of how small the risk is that the bank actually loses its money. Parts of the Committee are afraid that the level of capital – working as a safety buffer against crisis – is too low in banks using internal models to calculate the riskiness of their business. Put differently, parts of the Committee believe that the calculated risks in banks' internal models do not reflect the actual risk.

If there is a problem with the inaccuracy of internal risk models – as claimed – it must be addressed by making banks' internal models better – not by introducing a new rudimentary minimum capital floor that would incentivise banks to take more risks. This could be done, for example, by adopting clearer principles for the supervision of the models in the individual countries.

It was not low risk lending that sparked the financial crisis in 2008 and 2009. Subprime lending and other types of high risk lending played a significant role in fueling the crisis. It seems like a step backwards to incentivize banks to take more risk.

If politicians want to reduce the number of traffic casualties by putting up new lighting along state highways it would make no sense to use tax payers' money to put up extra lighting, where there is already lighting today. Asking low risk banks to put more capital aside is analogous: The same money could be used much better to create more safety in other and more risky parts of the financial sector.

Another reason for not introducing a capital floor is that a capital backstop requiring banks to hold a minimum amount of capital regardless of the riskiness of the activities will soon be introduced. The backstop is called the leverage ratio and requires banks to hold capital equivalent to 3% of their unweighted activities.

3. Many European banks will be affected

The capital floor will be very costly for a lot of banks across EU and thus lead to a significant reduction in economic growth.

This cost will be added to the costs incurred by the sector from raising new regulatory capital over the past few years. These costs mean

[1] https://www.iif.com/publication/regulatory-comment-letter/joint-associations-response-proposed-revisions-bcbs-0

lower growth and employment. Higher borrowing costs for home-owners means that they have less money to spend on consumption and investment. Higher borrowing costs for businesses – including SMEs – are also toxic for growth and employment.

In many low-risk banking models, lenders are almost by definition cautious in their credit assessments and therefore the banks' losses are very low. Lending from Danish mortgage banks is no exception. In more than 200 years not a single mortgage bank has ever gone bankrupt, and during the last crises Danish mortgage banks handled the crises with few losses and no government support.

Consequently, housing loans in Denmark are typically assigned low risk weights. As an example, risk weights on low risk lending could be 15% for a bank using an internal model. On a housing loan of EURO 100,000 banks consequently calculate capital requirements as EURO 15,000.

Instead of using internal models – where the credit risk is calculated internally – banks can use a standardized approach with risk weights assigned by the Basel Committee. If the risk weights in the standard approach are hypothetically assumed to be 35%, banks would have to calculate the capital requirements as EURO 35,000 instead of EURO 15,000.

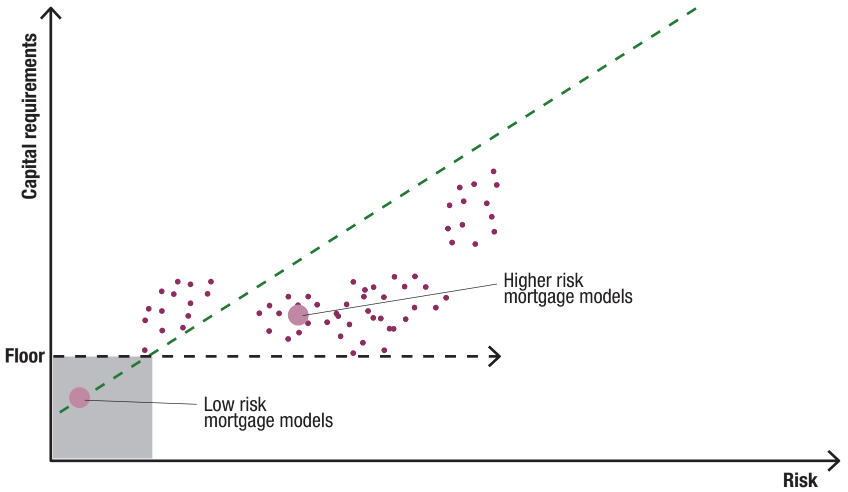
The new floors could end up in the range of 70-75% of the risk weights in the standardized approach. Banks using internal models would in the example above then have to raise risk weights from 15% to 25-26%. Consequently, banks involved in low risk lending would have to hold more capital even though the risks have not changed and remain minimal.

The cost of capital floors could be huge in many countries. In Denmark, a preliminary government report concludes that the largest Danish credit institutions would have to increase capital levels by 27-39% compared to already known future capital requirements. It corresponds to an increase in capital of EURO 9-12 billion[2].

The calculation from the government committee also shows that mortgage loans to both households and corporates will be relatively more affected than other risk areas.

Additionally, the government committee is concerned with the decrease in the capital requirement's risk sensitivity, which the new capital floor would imply. The committee believes that the capital requirement determined by the floor will be less sensitive to the actual risk in the portfolio. This can remove some of the incentive to lend to the low risk segments. The committee warns that in turn it could lead to an increase in risk and have negative consequences for financial stability.

Illustration of capital floors



Source: Finance Denmark

4. Business models could be squeezed

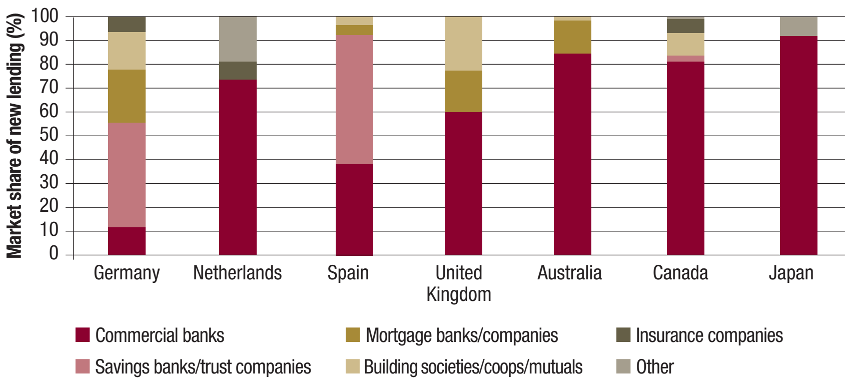
In the end, introducing new capital floors could squeeze many of the different low risk bank models that exist around the world. In Denmark, the loans-splitting model could be challenged.

In the loan-splitting housing finance model one loan is granted by a mortgage bank covering up to 80% of the property value for residential lending and 60% for commercial lending. This part of the loan is known as the inner collateral. Hence, almost by definition the loans granted by mortgage banks are low risk, and have low risk weights.

The other loan in the loan splitting model is typically granted by a universal bank. The universal banks then have the outer (top-up) collateral. Almost by definition the top-up loan will be higher risk and is therefore assigned a higher risk weight than the capital floors imply.

If the two loans in the loan-splitting model are replaced by a single loan covering all of

Many types business models around the world: Mortgage lenders by type



Source: Housing finance policy in emerging markets, IMF

[2] Link to government report: http://em.dk/~/media/files/2017/08-22-impact-calculations-from-the-basel-expert-group--ft180817.ashx?la=da

the financing needs, then it is less likely that the new capital floors would lead to a higher capital requirement – even though the credit risk on the total exposure has not changed. Thus, new capital floors would make it more attractive to channel the lending through universal banks. In other words, mortgage banks may risk being forced out of the market.

There are many different business models around the world like the Danish loan splitting model, and also different funding models. Having different business models is a huge advantage for competition in the financial sector. If introducing new regulation leads to less competition, politicians should worry.

5. More democracy in financial regulation

Rule-makers should keep differences in business models in mind and never try to harmonize at the expense of diversity, transparency and competition in the financial sector.

It is a concern that many financial rules are created by the Basel Committee, which is a members-only club. The vast majority of EU member states are not members of the Basel Committee.

The Bank for International Settlements [BIS] is located in Basel, Switzerland. The BIS is the bank of central banks. The BIS has various committees and working groups. The most significant committee is the Basel Committee on Banking Supervision, also known as the Basel Committee.

The Basel Committee sets standards for rules in the financial area throughout the world. A selected group of central bank governors and heads of national supervisory authorities – the Group of Governors and Heads of Supervision [GHOS] – is the oversight body of the Basel Committee. There is no democratic process deciding whether a country is a member of the Basel Committee. Nor is the membership decided according to a country's size. Only nine EU member states are members, leaving nineteen outside.

The Basel Committee is a members-only club of central bank governors working behind closed doors, and it is impossible to gain insight into their background analyses. Consultations only concern proposals for new recommendations.

In connection with the implementation of Basel III and the Liquidity Coverage Ratio [LCR] liquidity rules, the EU dissociated itself from the Basel Committee's proposals. The Basel Committee did not want to allow for the fact that covered bonds – which are a common funding tool in Europe – can be just as liquid as government bonds. The EU should maintain and reinforce its stance of complete independence regarding the Basel Committee's recommendations.

The impression is that Basel aims at moving lending and the funding thereof away from the balance sheets of the financial undertakings and towards, for example, securitization. This means that lending and funding will no longer take place through financial undertakings subject to supervision. The consequences of this could be a less regulated supply of credit and thus potentially a more unstable supply of credit, especially during crises.

Indeed, in a statement from December 2014[3] by the leading members of the ECON committee of the European Parliament, they disapproved of the Basel Committee's influence on EU regulation. They stated as follows:

> *"A large majority of Members of the European Parliament cannot accept that the Basel Committee puts into question the tools to finance the economy (especially SMEs and corporate).*
>
> *Even if we are aware of the necessity of international cooperation, the European law is made by the European Parliament and the Council of Ministers.*
>
> *The opinion of a body that is working without legitimacy and without any transparency cannot modify the decisions taken democratically by the European institutions."*

The task of the Basel Committee is to set out recommendations for rules for large international banks, i.e. banks operating in several countries. This generally makes good sense.

The EU has opted to extend the application of Basel recommendations to all financial undertakings – regardless of their size and regardless of whether they only operate nationally or in several different countries.

It is therefore entirely appropriate that the EU prepares rules according to European conditions, also if they deviate from the recommendations of the Basel Committee.

6. Harmonizing with room for diversity

Harmonization of financial rules and regulation has many benefits for consumers and society, so it is important that harmonization is conducted properly and democratically.

The integration and harmonization of markets in the EU provides many good examples. Harmonization towards common rules in the EU may be good for competition and give consumers and businesses better opportunities. It ultimately benefits growth and employment in the EU. Within the financial arena harmonization of rules for financial institutions, borrowers and investors has been an ongoing work process.

The benefits of harmonization have to outweigh the potential costs. Harmonizing with no room for diversity may harm competition and lead to higher prices for consumers and businesses. Research shows that harmonization resulting in fewer competition variables or uniform business models would harm competition.

It is important that common rules are framed to support and fortify efficient markets for financial services with continuous room for diversity. Such an approach ensures a wide range of products and enriches competitiveness, which ultimately leads to higher growth and more employment.

European banks have a lot to lose if common financial EU-rules do not leave room for diversity which the new capital floor could erode.

Borrowers, investors, mortgage banks and universal banks all play a part in creating an efficient common market for financial services that enhances growth and employment in the EU. Many examples prove that rules have made the single market for financial services even stronger.

Defining secure and collateralized bonds has been an ongoing process within the EU since the eighties – a definition that later embodied covered bonds and has been tightened continually. The definition has sustained a high demand for Danish covered bonds. With this definition mortgage bonds have joined a powerful category of covered bonds. Covered bonds have become a brand known for its high level of security and quality.

When harmonizing it is important to ensure a high level of market transparency, and break down the tendency to buy domestic bonds rather than foreign ones.[4]

[3] http://pr.euractiv.com/pr/senior-meps-rebuff-criticism-basel-committee-122431

[4] New Evidence on the Home Bias in European Investment, Duisenberg School of Finance, September 2014

The Danish mortgage model has enabled Danish borrowers through mortgage banks to gain access to international capital markets. Foreign investors own EUR 93 bn of Danish covered bonds. By using large and liquid covered bonds issues, the issuers gain the necessary transparency. Consequently, it makes Danish covered bonds more attractive to foreign investors.

Common rules for clearing and trading have also helped make it easier to issue, trade and settle trades across national borders. Harmonized rules make it easier for clearing houses to compete across national borders and to trade their services outside national borders.

7. Harmonization could lead to less competition

Common rules have a great potential to support growth and employment in the EU. However, it is important to make room for diverse efficient business models. Harmonization and standardization of rules may also lead to less competition and harm the market supply.

This may happen if harmonization forces suppliers away from the market or if it leads to fewer variables to compete on. Lawrence J. White, Professor at the Leonard N. Stern School of Business, has identified pros and cons regarding harmonization[5]. He warns against loss of market diversity:

> *"The forced uniformity that harmonization would bring would mean too great loss of diversity and of valuable adaptions to local (national) conditions. Also, even if uniformity at the proper regulatory standard would be better than the local (read. national) diversity, the risk that a forced harmonization would occur at an inappropriate regulatory standard is too great."*

Harmonization can lead to less diversity because suppliers that diverge could be forced out of the market. In addition, harmonization in the EU may not lead to a larger market as it is often presumed[6].

European banks may be challenged by harmonization of financial rules, as international rules are often harmonized according to a universal banking model.

Harmonization of rules should aim at creating as much information and transparency as possible rather than standardizing business models. The absence of information and transparency hampers competition because consumers and investors do not respond adequately on price and quality[7].

The Danish loans splitting model has been challenged several times due to harmonizing that did not take diversity into consideration. For instance Danish covered bonds almost failed to obtain a satisfactory treatment in the new liquid requirements (LCR-requirements). If Danish covered bonds had not been accepted into the most liquid category it would have led to higher interest rates for Danish homeowners and businesses.

8. Integrational success on capital markets

In general, financial market integration in the Euro Area is a success. More than half of debt securities held by European investors are non-domestic assets. It makes sense for professional investors to diversify portfolios and invest across countries.

Through professional investors' cross-border investments in assets (funding loans), ordinary borrowers indirectly gain access to international capital markets. It is a clear benefit for borrowers as the international investor base provides liquidity and demand, which in the end will be reflected in loan rates.

Even though financial integration is significant, there is a strong investment home bias. Taxation differences, exchange rate risk and better home-market knowledge can explain the home biases.

9. Little integration of loan markets

Integration of loan markets in Europe is a completely different story. Cross-border loans to households, as a share of total household loans, are negligible and on a very slight downward trend.

Financial market integration is significant: Holdings by euro area investors (all sectors) of debt securities

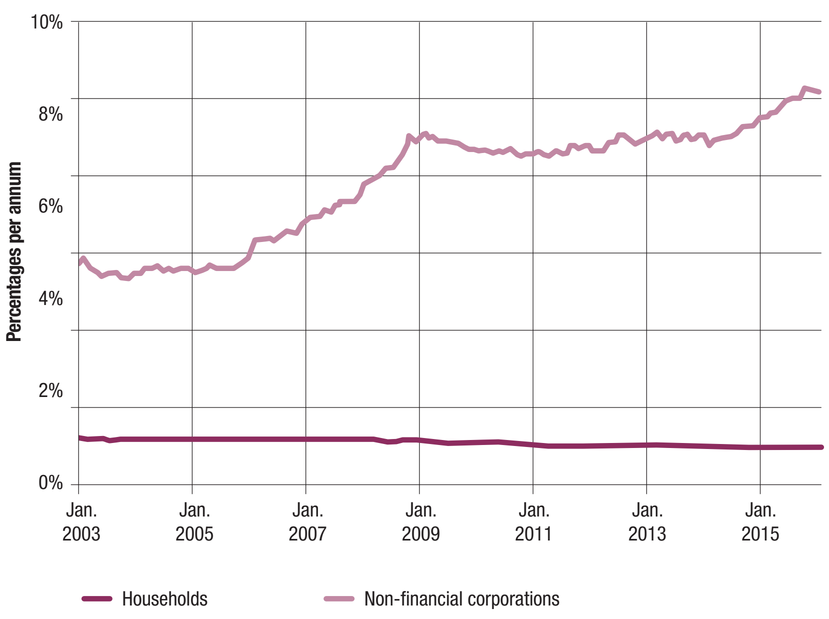
Source: ECB (BSI statistics)

[5] Lawrence J. White, "Competition versus Harmonization - An Overview of International Regulation" page 5-48 (Barfield, v. 1996); R. van den Bergh, Regulatory Competition or Harmonization of Laws – page 30.

[6] The internal market and the relevant geographical market The impact of the completion of the Single Market Programme on the definition of the geographical market, Final report, 03 February 2003, Copenhagen Economics.

[7] Peter Møllgaard, Literature study for the Danish Competition and Consumer Authority and Forbrugerrådet (consumer organization), Aktive forbrugere og økonomisk performance, Centre for Economic Business Research, June 2011.

Financial market integration is significant: Holdings by euro area investors (all sectors) of debt securities



Source: ECB (BSI statistics)

Notes: Cross-border loans include loans to other euro area countries for all maturities and currencies. Interbank loans do not include central bank loans.

There are numerous barriers to cross-border lending. There are natural barriers such as geographical distances, languages, habits. There are structural barriers, which include different tax policies, rules on consumer regulation and insolvency rules. In fact, many banks would like to operate cross-border, but consumer regulation is often a show stopper. Differences in supervisory setups are also a barrier. As a result of these barriers loan markets are fragmented across European countries with big differences in for instance mortgage rates.

In December 2015, the European Commission launched an initiative to identify potential barriers to customers using financial services across the EU (e.g. loans and mortgages), and earlier this year the European Commission published its Action Plan as a follow-up. In the Action Plan the Commission stressed the importance of increasing consumer trust abroad, to reduce legal and regulatory obstacles and support development of an innovative digital world.

Going forward the Commission will explore ways of facilitating access to loans across borders. It will examine national consumer protection and conduct rules to assess whether they create unjustified barriers to cross-border business. Last, it will seek to introduce common creditworthiness assessment standards and principles for lending to consumers.

The European Commission's action plan suffers from the assumption that market harmonization per se would create better opportunities and cheaper financial services. But it is questionable if market integration is a desirable goal in itself. The main concern for borrowers is not integration and harmonization of loan markets.

This same wrong assumption might lead countries to adapt the Basel recommendation; maybe overlooking that it would not benefit markets, consumers or even enhance financial stability.

10. Looking forward – how should policy makers respond to Basel recommendations

When the Basel Committee has finalized its recommendation, the countries or Unions such as the EU should independently assess whether the recommendations are appropriate. They should also take the different business models into consideration. It is especially important in the EU, where only certain countries are also members of the Basel Committee.

Those with responsibility for policy in the EU should realize that the Basel Committee's proposals have been made on the wrong basis. And they should also realize that the consequences of capital floors are unreasonable for low risk models such as the Danish mortgage model. There is also the negative impact on growth and employment as well as an additional cost for SMEs.

The EU must come to realize politically that the Basel Committee cannot be the one to say stop and to announce that we have reached an appropriate level of regulation. It is invariably a political decision to determine when the costs of new regulation can no longer be justified by the potential advantages.