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Fiscal Instruments for the Provision of Affordable Housing

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Abstract

In the UK the majority of additional affordable housing is provided either with the help of up-front grants (Social Housing Grant) allocated to social landlords or through developer contributions to affordable housing on market sites. There is a significant gap in affordable housing policies aimed at helping those a little further up the income scale who are still unable to afford acceptable housing especially in pressure areas. Equally, developers see little reason to concentrate on the affordable end of the market.

The paper reports on a survey of policies applied in a range of countries, which might have some value within the UK context. This entailed a short questionnaire of relevant experience and of available evidence on the evaluation of available instruments. The survey showed that, while there was a wide range of mechanisms available the majority concentrated on subsidies, which, in a UK context, could add more to prices than to output. Others provided useful insights into possibilities for encouraging provision for the intermediate market. On the basis of the available evidence a possible package of measures with the potential for assisting provision of affordable is developed.

1. Introduction: The Problem

A particular concern in the UK at the present time is that there is inadequate assistance for low-income employed households who are unable to gain access to traditional social housing but who are unable to afford adequate accommodation from their own resources.

The UK support system is generous in terms of housing cost payments for households who have no working members or on the very lowest pay but provides little or no help for those on incomes above that level. This problem of affordability is illustrated in figure 1 – which shows the large gap in housing costs between those renting social housing and those who have to depend on the lower end of the market. Equally, the evidence suggests strongly that the market is not prepared to provide for this group of households. New supply is running far below that required to meet the needs even of newly emerging households and the balance between households and dwellings has tightened dramatically (Barlow et al, 2002). Moreover the planning obligation (Section 106) policy introduced in the 1990s which requires that a proportion of affordable housing be provided on market developments is adding relatively few additional affordable homes to the stock (Crook et al, 2001).

It was in this context that we were asked to examine the range of fiscal incentives available across the world to assess whether there were lessons to be learned by the UK government to help them fill the gap.

Objectives and methodology

The objectives of the research included:

(a) to identify what policy instruments might be available to increase the supply of affordable housing;
(b) to identify what policy instruments might be available to tackle the problem of affordable housing through routes other than supply;
(c) to analyse the likely impact of such instruments.

Information on fiscal instruments to promote affordable housing was collected from books and journals, a web search, questionnaires sent to housing-finance experts from Germany, Australia, France, Denmark, Sweden, the Netherlands, Finland, and the US, and discussions held with other academics in the UK. Having collected information about international fiscal instruments, we categorised the policies according to whether they affected supply or demand, and whether they were subsidies or worked through the tax system.

Framework for analysis

The objectives of policy instruments, and particularly of fiscal incentives, include (i) to change consumer income and therefore the capacity to pay for affordable housing; (ii) to change the price of affordable housing to consumers in order to increase the incentive to purchase or rent adequate accommodation; and (iii) to increase the incentive to suppliers to provide affordable housing.

Comparative static analysis has traditionally suggested that income subsidies give higher utility to consumers, mainly because of the benefits of choice. Similarly, price subsidies without constraints on choice give higher value than constrained-choice price subsidies – which may operate to increase the capacity to purchase other goods and services rather than housing itself. Therefore in well-operating, rapidly adjusting markets the emphasis tends to be on helping low-income households directly.

However, where there are additional social benefits to ensuring housing standards, or constraints on supply adjustment or distributional objectives, it will often be more appropriate to concentrate assistance on supply and prices. In particular, where the price elasticity of demand for a basic necessity is limited above a certain quality, price subsidies to help people achieve a minimum of quality will meet both distributional and efficiency aims as compared to income subsidies (Bos, 1991). These attributes are usually thought to apply to minimum standards of affordable housing.

The question as to whether price subsidies should be directed at demand or supply has been a matter of much academic and policy discussion. In principle in well-operating markets the question is irrelevant - as Figure 1 shows, both the impact on output and on the price paid by the consumer will be the same. However reality is likely to be different because of the transactions and adjustment costs involved as well as because of the relevant institutional framework. In the United States the presumption in the literature is heavily in favour of demand-side subsidies for efficiency reasons (Housing Studies special issue, 2002). Galster, for instance, who is well aware of the arguments, suggests that “Problem definition, goal weighting, and metropolitan, housing market, socio-economic and governmental characteristics collectively must be considered before an unambiguously ‘best’ housing strategy can be identified” but then concludes “The demand-side approach, however, can claim a wider range of goals over which it demonstrates comparative advantage” (Galster, 1997). The reason for this conclusion is that housing markets should be seen as a series of sub-markets. Demand-side subsidies allow people to be mobile upwards into higher-quality sub-markets and supply and price will then adjust to that shift in demand. Yates and Whitehead (1998) responded by suggesting that, at the least, there should be greater agnosticism as to their relative effectiveness. They argued that the US market was not typical of most housing markets, especially in Europe. The particular context in which markets operate, the specific design of delivery mechanisms, in particular the role of the social sector, and the potential effects on social segregation should all be taken into consideration before coming to a conclusion. Equally the political pressures towards using lower taxes rather than increased public expenditure can be important. Even so, it is recognised that there is no guarantee that supply subsidies delivered through bureaucratic procedures will necessarily be more effective because administrative failures are just as prevalent as market failures (Maclennan and More, 1997). What therefore is most important is not the debate about demand versus supply subsidies *per se*, but an examination of what prevents either from achieving their goals.

These conclusions suggest that much of the emphasis should be on the effectiveness of the administrative framework, the linkages between different instruments, the potential impacts and, especially, relevant price elasticities.

Evidence on price elasticities

The most important price elasticity in terms of the likely outcome of any fiscal instrument is the price elasticity of supply - of affordable housing, housing in general, and land in particular. If, for instance, the price elasticity of supply of housing were to be completely inelastic then the impact of either a demand subsidy or a supply subsidy would be wholly to increase price (Figure 2b). Any impact would then be limited to redistribution between affordable housing, where the subsidy was concentrated (reducing the relative price faced by consumers and suppliers in this submarket), and the unsubsidised sector where prices would increase.

If, which is somewhat more realistic, it is the price elasticity of the supply of land which is completely inelastic it may be possible to obtain some additional housing through the impact on increased densities. However the greatest effect will still be on prices rather than output. The evidence on price elasticities of supply of land, and therefore the supply of new housing overall, suggests that adjustment in Britain is very slow and that price elasticities are low (Whitehead, 1999; Malpezzi and Maclennan, 2000; Bramley 1993; Monk *et al*, 1996). Empirical evidence in England suggests that they do vary between regions and that, rather surprisingly, elasticities might be higher for London than for many other regions (Cheshire and Shepherd, 2000). What is undoubtedly the case is that the land-use planning system plays a major role in determining production in its effect both on the amount of land made available and the capacity to vary density in response to price increases (Bramley *et al*, 1995). The most important pressures to adjust land supply and densities may also be as much political as direct responses to price change (Barter and Jarvis, 2000).

This evidence suggests in the UK context that policies that can achieve additional land and housing are likely to be particularly effective in the addressing the affordable housing problem. At the present time, while affordable housing is a "material consideration" in planning terms (i.e. the planning authority may take it directly into account when making the decision), its provision will not generally directly affect overall land supply. It is suggested that the supply of accommodation from within the housing stock may be rather more price elastic, and that an increase in price may elicit responses such as bringing dwellings back into use, conversions to smaller units and the transfer from commercial and other uses to housing. However the empirical evidence on this is limited and there are obvious problems in relation to standards and the location and appropriateness of vacant units (Kleinman *et al*, 1999).

The extent of substitution between affordable and market housing – i.e., the extent to which affordable housing is occupied by households who could afford to pay for market housing-- is equally unclear, although there is undoubtedly some such substitution. In the other direction, to the extent that affordable housing comes from the existing market sector, assisting one group of households put pressures on the other.

On the demand side, the evidence suggests that price elasticities are certainly less than one and may be very much less, while income elasticities are probably close to one (Whitehead, 1999). Thus, if additional income is provided, demand will rise roughly in proportion. There will be limited supply response. To restrict demand in the market sector will require therefore significant price adjustment. Additional complications arise from expectational changes in response to price increases in both supply and demand.

The evidence on price elasticities, in particular, suggests that it is important to direct fiscal instruments in such a way as to increase responsiveness as much as possible – both in the administered and market sectors. It also suggests that, however well directed, any instrument large enough to have a significant effect on affordable housing provision will add to the pressures on house prices, particularly in highly constrained areas.

Deadweight losses/additionality

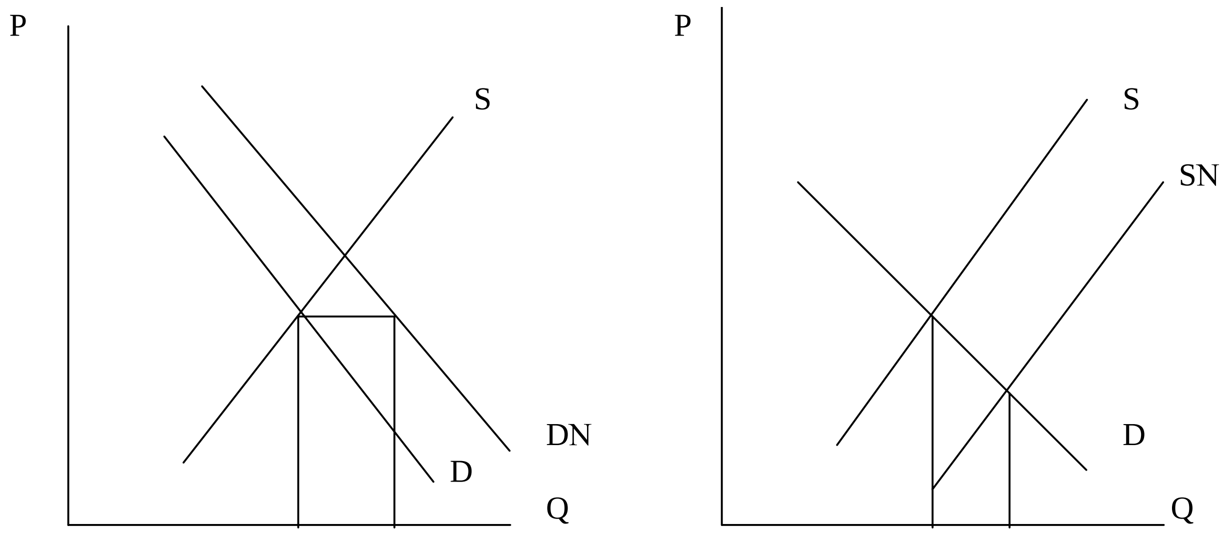
An important element in any assessment of fiscal measures must be the extent to which the cost to the government will directly impact on demand or supply. If, for instance, a tax benefit is given to suppliers to produce more affordable housing, how much of that payment might go to suppliers who would anyway have been provided the accommodation (Figure 2b)? Other things being equal, the lower the amount of benefit, the higher the proportion that will go on helping dwellings that would anyway be provided. Larger payments will bring forward additional investment, so increasing the proportion. The two most important questions are therefore (i) how well targeted can the instrument be (so as to exclude those that would anyway be prepared to supply) and (ii) what are the elasticities of the demand or the derived demand and supply in the relevant housing market? In addition, as the instrument will almost certainly be applied to a sub-market, there is a question of the extent of output loss in other markets.

The relevant UK comparator

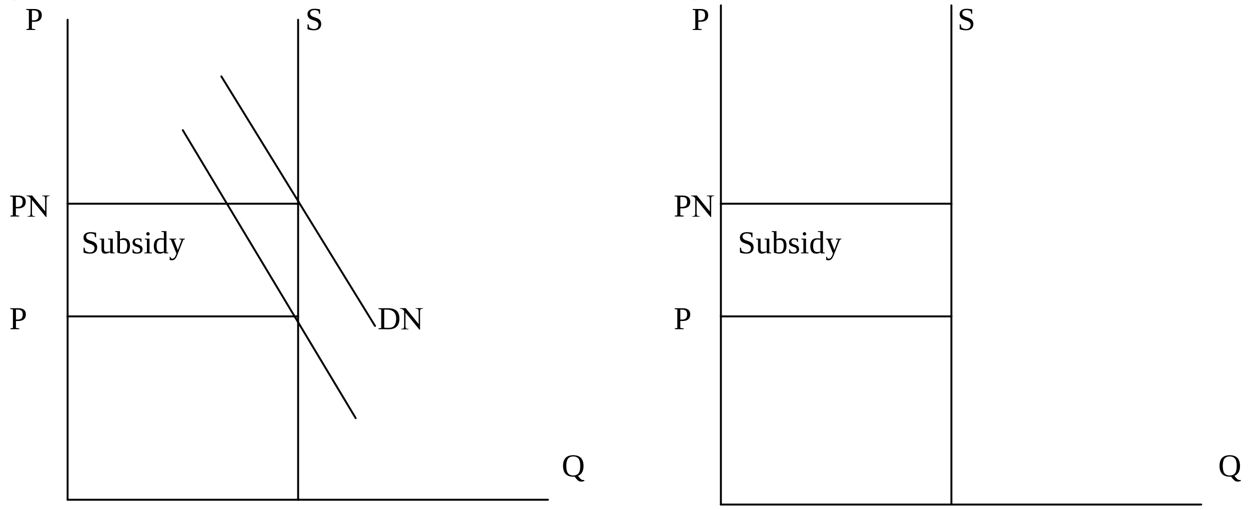
The current method of provision of additional affordable housing in the UK is through Social Housing Grant (SHG), a subsidy to providers of social housing (normally housing associations), together with contributions from S106. Social Housing Grant is an up-front subsidy (implying that all the direct impact on public expenditure is taken in the first year). The headline grant rate is 68%. The actual level depends upon the bidding process and the impact of rent restructuring. All payments must be directly used for additional provision (including large-scale rehabilitation and transfers from the market sector). The deadweight losses are therefore restricted to the impact on costs of production, including land costs and any crowding-out effect--e.g. with respect to provision of market-price accommodation by affordable-housing providers--as well as the potential loss of demand in other sectors. Except for the substitution effect these are likely to be small.

The depth of subsidy under SHG is very considerable. However, allocation systems ensure that this is targeted at low-income households (except that there is little pressure on them to move on when their circumstances improve). The vast majority of the benefits of SHG are tied to renting from housing associations. This may be a desirable option for many households, but some households may prefer a smaller amount of cash and greater freedom of choice.

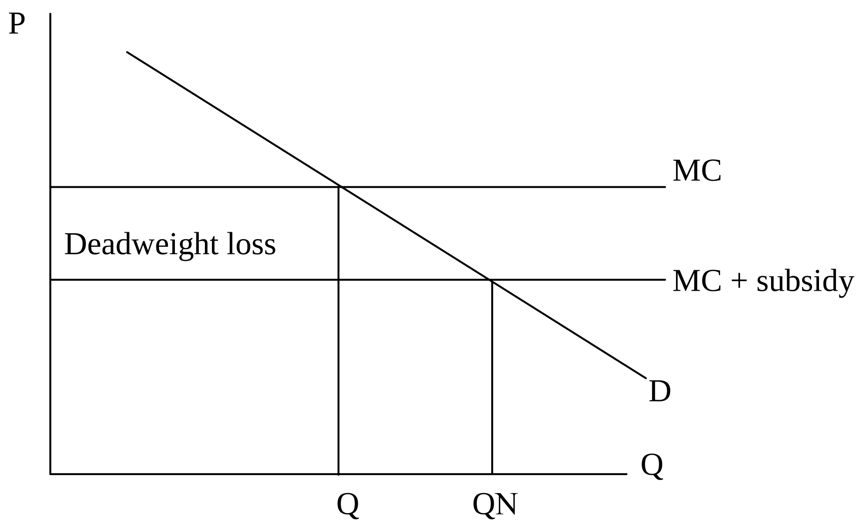
In comparing other instruments with the existing system in the UK it is therefore appropriate to take account not just of the depth of subsidy and its impact on affordability but also the extent to which the subsidy is effectively targeted, the freedom of choice provided to the consumer and the benefits of spreading the public expenditure costs over time.



(Figure 1) Formal equivalence of demand and supply subsidies



(Figure 2) Impact of supply inelasticity



(Figure 3) Deadweight loss from subsidy

P = price PN = price with subsidy Q = quantity QN = quantity with subsidy D = demand
DN = demand with subsidy S = supply SN = supply with subsidy MC = marginal cost

2. A typology of policies

Categorisation

The following matrix sets out the possible types of government intervention, in the form of subsidies or tax relief, to encourage affordable housing.

More general fiscal measures, such as the lack of tax on imputed rents and exemption from capital gains tax, are not directed at affordable housing *per se* and therefore are not included in the matrix.

	Tax	Subsidy	Regulation
Demand	***Category 1*** 1) Mortgage interest tax deductible 2) Owner-occupiers can claim depreciation 3) Preferential tax treatment of home-savings plans 4) Rent payments tax deductible 5) Tax credits for low-income tenants 6) Exemption from transfer tax for first-time buyers 7) Tax relief for employee on employer-run house savings schemes, to equate with treatment of pension contributions 8) Property tax relief for low-income households 9) Exemption from transfer tax for new homes	***Category 2*** 1) Housing allowance 2) Subsidies to savings for house purchase (interest subsidies or one-off grants on house purchase) 3) Subsidised mortgages for low-income households 4) Grants and other assistance to first-time buyers 5) Grants for low-income buyers (not tied to savings) 6) Right-to buy and other discounts for council tenants 7) Improvement grants for low-income owners	***Category 3*** 1) Government assigns housing to low-income households
Supply	***Category 4*** *Income tax* *1)* Providers of social housing exempt from income tax *2)* Tax relief on investment in construction of affordable housing for rent or sale, to be set against income from all sources *3)* Depreciation for rental units *4)* Landlords can deduct interest on loans and operating expenses *5)* Landlords can set rental losses against other income *6)* Lower tax rate for landlords' capital gains *7)* Tax relief for interest from mortgage-backed securities used to fund low-interest mortgages or low-income housing *8)* Allow capital outlays on construction/conversion of rental property to be offset against rental income *9)* Preferential treatment for housing-finance institutions *10)* Preferential tax treatment for employer-provided housing *Land/property tax* *11)* Taxation of empty land to encourage housebuilding *12)* Taxation of empty property to bring back into use *13)* Discount for new/renovated houses, or abatement for specified period *VAT* 14) Reduced rate on conversions, new build *15)* RSLs pay lower VAT	***Category 5*** 1) Grants for construction or renovation of affordable housing 2) Subsidised loans for developers of affordable housing 3) Provision of land for affordable housing at below market value or free 4) Grants to bring empty homes back into use with allocation attachments 5) Government guarantees for housing association loans 6) Government guarantees of rent or mortgage payments from low-income households	***Category 6*** 1) Require developers to include certain % of affordable housing 2) Rent control 3) Require employers to provide housing 4) Prohibit move of rental flats to owner occupation

The Policies

The main fiscal and other affordable-housing policies in the UK and 13 other countries which we identified are summarised in the following matrix together with short descriptions of the policy categories.

International affordable housing policies (followed now or recently)

Cate-gory	Policy description	UK	USA	F	SP	N	DK	B	IT	IR	G	FI	AU	SW	CA
1.1	Mortgage interest tax deductible	•	•	•		•	•	•		•					
1.2	Owner-occupiers can claim depreciation										•				
1.3	Preferential tax treatment of home-savings plans			•							•				•
1.4	Rent payments tax deductible								•	•					
1.5	Tax credits for low-income tenants		•												
1.6	Exemption from transfer tax for first-time buyers														
1.7	Tax relief for employee on employer-run house saving schemes														
1.8	Property tax relief for low-income households	•				•									
1.9	Exemption from transfer tax for new homes	•								•					
2.1	Housing allowance	•	•	•	•	•	•	•		•	•	•	•	•	•
2.2	Subsidies to savings for house purchase				•						•	•			
2.3	Subsidised mortgages for low-income households			•	•	•									•
2.4	Grants to first-time buyers	•			•						•				
2.5	Grants for low-income buyers	•	•												
2.6	Right-to-buy discounts for council tenants	•													
2.7	Improvement grants for low-income owners	•													
4.1	Providers of social housing exempt from income tax	•				•	•				•				
4.2	Tax relief on investment in construction of affordable housing		•								•				
4.3	Depreciation for rental units		•								•		•		•
4.4	Landlords can deduct interest on loans and operating expenses	•	•								•				•
4.5	Landlords can set rental losses against other income		•								•	•			•
4.6	Lower tax rate for landlords' capital gains		•												
4.7	Tax relief for interest from mortgage-backed securities for housing		•												
4.8	Landlords can set capital outlays against rental income	•							•	•					
4.9	Preferential tax treatment for housing-finance institutions										•				
4.10	Preferential tax treatment for employer-provided housing														
4.11	Taxation of empty land to encourage housebuilding														
4.12	Taxation of empty property to bring back into use														
4.13	Property-tax discount for new/renovated houses, or abatement	•		•										•	
4.14	Reduced rate of VAT on conversions, new build				•										
4.15	RSLs pay lower VAT			•											
5.1	Grants for construction or renovation of affordable housing	•		•	•						•			•	
5.2	Subsidised loans for developers of affordable housing		•	•	•						•	•		•	•
5.3	Land provided for affordable housing at below market value/free	•			•				•						
5.4	Grants to refurbish empty homes w/ allocation attachments	•													
5.5	Government guarantees housing association loans						•								
5.6	Government guarantees rent/mortgage payment of low-income households	•	•	•							•				

F = France SP = Spain N = Netherlands DK = Denmark B = Belgium IT = Italy IR = Ireland G = Germany FI = Finland AU = Australia SW = Sweden CA = Canada

Category 1: Demand-side tax measures

1.1 Mortgage interest tax deductible

This is not necessarily a policy directed at affordable housing per se; in fact, if mortgage interest is deductible at the taxpayer's marginal tax rate, the policy favours high earners.

Owner-occupiers can no longer deduct mortgage interest payments in the UK. Landlords in the private rented sector can deduct interest payments as a business expense.

Many countries allow this. In some countries, such as the Netherlands, mortgage interest is deductible, but owner-occupiers are taxed on the imputed rental value of their homes. In others, such as the USA, mortgage interest is deductible at marginal rate for all but the very largest loans, but there is no corresponding tax on imputed rental value. In Belgium the amount deductible is related to the size of the family, and is higher for new buildings; it declines over time. In France 25% of interest could be deducted up to a ceiling that depended on the number of children in the family and whether the building was new or old. The deduction is no longer allowed for purchases agreed after the 1st of January '98. Imputed rent is not taxed.

Ireland allowed deduction of 80% of mortgage interest at the marginal rate; this was due to change (in 1996) to standard rate. However, 100% of mortgage interest is tax deductible for first-time buyers up to £5000 (married) and £2500 (single) for the first five years after purchase.

Italy allows a percentage of interest on loans for repair to be deducted.

1.2 Owner-occupiers can claim depreciation

In Germany owner-occupiers could deduct 5% of construction costs annually for the first eight years. This was replaced in 1996 by a concession limited to households under a certain income threshold. Such households could deduct 5% of the building cost of a new house up to DM5000 annually, or 2.5% of the value of a second-hand house up to DM 2500 annually. Families with children got extra amounts. If this resulted in negative income tax, the credit could be held over to use in other years. In 2000 this tax relief was replaced by a cash allowance.

1.3 Preferential tax treatment of home-savings plans

In Canada during the 1970s any resident non-homeowner could contribute $1000 per year, up to a total of $10,000, in a registered home-ownership savings plan. Contributions were tax-deductible and the income was not taxed while in the plan. No tax was payable if the capital and interest were used to buy an owner-occupied house.

In 1965 France introduced Housing Savings Schemes, under which households could save up to FF 100,000 for construction or repair of a house. Interest was paid tax-free. There was no requirement for regular deposits, and after 18 months the saver had the right to a loan related to the size of his savings. In 1969 Housing Savings Plans were introduced. The new regulations required regular annual deposits, and the account had to be maintained for a minimum of four years.

In Germany, holders of Bausparkassen accounts whose income is above the threshold for government grants (see below) can receive interest on these accounts tax-free.

1.4 Tax-deductible rent payments

In Ireland the over-55s can treat rent to private landlords as a tax allowance. Italy allows low-income renters to deduct housing expenditure. In Greece tenants may deduct 30% of their rent, up to 15% of taxable net income.

1.5 Tax credits for low-income tenants

The state of California has a small fixed renters' tax credit (maximum $120/year); the legislature has proposed a special renters' tax credit of $500 for entry-level teachers and police and fire officers living in high-rent areas.

1.6 Exemption from transfer tax for first-time buyers

Greece allows this; the size of the exemption is related to family size.

1.7 Tax relief for employee on employer-run house savings schemes, similar to tax treatment of pension contributions

In Hungary employers provide preferential loans to employees; a significant share of firms' profits are spent on supporting dwelling purchases by their employees. From 1995 in Switzerland, people covered by an occupational pension scheme were allowed to use part of their accumulated equity to acquire an owner-occupied dwelling, pay down existing mortgage debt, or buy shares in a housing co-operative. If they were under 50 years old they could use all their equity; if over 50 they could use equity to the value of what they had at 50, or one-half.

1.8 Property-tax relief for low-income households

Low-income households are eligible for council-tax benefit in the UK. In the Netherlands low-income households are exempt from paying the 40% of property tax collected from the user of the dwelling (the other 60% is paid by the owner).

1.9 Exemption from transfer tax for new homes

The UK government recently announced the abolition of stamp duty for purchases of dwellings in certain low-demand areas. A price ceiling applies. Ireland exempts new homes from stamp duty.

Category 2: Demand-side subsidies

2.1 Housing allowance

Almost all countries have some housing allowance scheme.

2.2 Subsidies to savings for house purchase (interest subsidies or one-off grants on house purchase)

The UK has the Starter Home initiative; cash-limited payments to certain key workers. The German Bausparen, or contract savings and loans system, offers loans on the basis of specific house-savings contracts, under which borrowers have to make regular deposits in advance until a certain savings target is reached, when the they become eligible for a mortgage. The government pays 10% of the annual savings amount as a subsidy to low-income households. Spain gives grants to buyers with housing-savings accounts at the time of house purchase. France pays an interest premium to savings for homeownership.

Under a 1980 law, the Finnish government pays an interest subsidy of 70% of the interest rate over 4.5% for loans taken out under the ASP programmes. This is designed to help first-time buyers between 18 and 30 years old. Borrowers must have saved a down payment of 15% over at least two years. The interest on savings if 1% + 2-4% (negotiated with the bank) and is tax free. There are upper limits on the loan sum, depending on where the dwelling is in Finland. The maximum was needed in 1992 when 5% of all new housing loans were ASP. Interest has risen again since upper limits were raised.

2.3 Subsidised mortgages for low-income households

Spain subsidises mortgages for low-income purchasers of new units of "regulated housing", which must met certain criteria and be registered with the government. The amount qualifying for a subsidy depends on the buyer's income and the size of the dwelling. If the buyer sells in less than five years he must return the subsidy with interest; if not, after five years he is re-assessed for continuing subsidy. There is a similar programme for used dwellings.

In Austria the state offers loans for new construction, the amount depending on family size.   For low-income households these loans are interest-free. France's PAP programme offered subsidised loans for owner-occupation. These were only for principal homes for low-income borrowers; the dwelling had to meet certain size and cost requirements, and be new or professionally refurbished. France introduced 0% mortgages for home ownership in the subsidised sector in 1995, and in 1993 introduced a new loan programme for low-income owner-occupiers who wanted to renovate their homes themselves.

In the Netherlands the government offers three types of subsidy, depending on house values. For the cheapest houses, the government pays the principal and interest on a part (the size of which depends on the buyer's income) of the mortgage. The subsidy is treated as taxable income. For somewhat more expensive houses there is a fixed contribution from the government for five years (also taxable, income cap applies). For the third band of houses there is a price cap but no income cap; these attract a one-off contribution from the government.

In New Zealand before 1993 the government subsidised loans for low-income wage earners. The Australian government offers short-term help for low-income home buyers in difficulty with mortgage repayments.

In Canada in the mid-1970s the Assisted Home Ownership Programme was designed to enable low-income families to buy homes using less than 25% of their income to repay principal and interest. A government corporation provided interest-free loans to buyers for five years.

In Argentina households are lent 5% of the purchase price at the beginning of construction and up to 33% of the mortgage payments for a ten-year loan which they repay at 4% interest over the following ten years. This is paid for by the National Housing Fund (FONAVI) originally financed from an employment surcharge; now from a petrol tax.

2.4 Grants to first-time buyers, Homebuy, shared ownership

The Spanish region of Catalonia offers grants to buyers under 30. Australia gives AUS $7000 to first-time buyers, with an additional $7000 for those who buy new homes (reduced to $10,000 total for 2002). There are no income or dwelling-cost restrictions. Germany offers subsidies to first-time buyers, related to their income level and the number of children they have.

In New Zealand from 1986 to 1993 the Homestart programme offered grants to bridge the gap between the savings of low-income households and the required deposit.

Ireland has a programme of shared ownership, where the house is part-owned by the occupier, part by the state. The occupier pays rent on the part owned by the state, and mortgage repayments or interest on the rest. The occupier can buy part or all of the remaining equity when his income allows.

2.5 Grants for low-income buyers (not tied to house savings)

In the UK: Shared ownership and DIYSO: subsidised rental element of either newly built home or one from the existing market sector. Homebuy: Interest-free loan for a proportion of asset to make home ownership affordable. Under the US 1968 Housing Act, private buyers bought homes from developers and paid a percentage of their income; the federal government made up the difference. In Hungary, the state gives a grant to assist with down payments or construction costs for families. This can cover up to 45% of construction costs, depending on the number of children in the family.

2.6 Right-to-buy discounts for tenants of public housing

In the UK council tenants have the right to buy their dwelling at a discount from the market price. The size of the discount depends on how long they have lived there and the type of property. Tenants incentive schemes provide assistance to transfer to the private sector.

2.7 Improvement grants for low-income owners

In the UK local authorities give grants to enable low-income owners to carry out certain essential repairs.

Category 3: Demand-side regulations

3.1 Government assigns housing to low-income households

Common for social housing in many countries.

Category 4: Supply-side tax relief

Income tax

4.1 Providers of social housing exempt from income tax

In the UK housing associations, as non-profit organisations, pay no income tax.The Netherlands and Denmark exempt providers of social housing from income tax.   In Germany they were exempt until 1990.

4.2 Tax credits for construction of affordable housing

The USA allows developers of low-income housing to take a tax credit (set directly against the tax bill) of 9% of reckonable construction costs annually for ten years. A certain proportion of the units in the development must be for low-income households. The tax credits are allocated to specific low-income housing projects by state housing authorities; developers raise equity by selling the credits (selling prices are typically about 60 cents on the dollar). To qualify for the credit, the developer must undertake substantial expenditure for construction or rehabilitation. The credit is earned over 15 years, but is taken over ten. It is subject to recapture with interest if the project (or more than a one-third interest in it) is sold before the end of the 15-year compliance period, or if the project is not occupied by low-income households.

German allows tax relief for construction of dwellings to be let at below market rents; a percentage of the capital invested may be set against other income from all sources.

4.2 Depreciation for rental units

Landlords were permitted to depreciate their units over 15 years in the USA for a period during the 1980s; this has now changed to 27.5 years. In 1990 Germany increased the allowed rate of depreciation to try to boost the supply of rental housing.

Australia allows investors in newly constructed private rental housing to depreciate their investment at a rate of 2.5% per year. Canada allows 4%.

4.3 Landlords can deduct interest on loans and operating expenses

In the UK landlords receive unlimited marginal-rate tax relief on interest payments. Germany, the USA and Canada allow landlords to deduct interest on loans and operating expenses from taxable income.

4.4 Landlords can set rental losses against other income

Germany, the US and Canada allow this. In the 1960s Finland exempted investors in rental housing from income and property tax; these provisions were changed by 1972.

4.5 Lower tax rate for landlords' capital gains

The USA taxed landlords' capital gains at a special lower rate until 1986.

4.6 Tax relief for interest from mortgage-backed securities used to fund low-interest mortgages or low-income housing

Such securities are issued by US states or municipalities to fund affordable housing.

4.7 Allow capital outlays on construction/conversion of rental property to be offset against rental income

The UK permitted this only in the flats-above-shops programme, which ran from 1992 to 1995. Ireland allows it. These outlays can be deducted from rental income from the property in question or from other property owned by the landlord. Italy allows a percentage of the cost of renovation (of rental or owner-occupied property) to be set directly against the income tax bill.

4.9 Preferential tax treatment for housing finance institutions

German *Bausparen* operate under a special tax regime.

Land/property tax

4.13 Discount for new/renovated houses, or abatement for specified period

In the UK new build is zero-rated. Renovation work attracts VAT at the full rate, except for certain conversion work (changing the number of units in a building), where VAT is applied at a reduced rate. In Sweden new and renovated houses benefit from a ten-year discount on property tax. In France new homes are exempted from land taxes; construction for the private rented sector is exempt from land tax for two years. All new dwellings are exempted from property tax for two years

VAT

4.14 Reduced rate on conversions, new build

Spain gives a discount of 6% on VAT for new homes.

4.15 RSLs pay lower VAT

In France HLM organisations (like RSLs) pay a lower rate of VAT.

Category 5: Supply-side subsidies

5.1 Grants for construction or renovation of affordable housing

In the UK providers of social housing receive Approved Development Programme (ADP) funding for construction or acquisition and rehabilitation of rental units and shared ownership accommodation. Local authorities also provide Social Housing Grant.

Spain provides grants of 10 to 25% for the cost of building affordable housing. Sweden provides grants for developers (private or public) building affordable rental housing. There is a cost ceiling, and the developer must make a commitment to rent to low-income households. The grant covers approximately 15% of building costs.

Germany provides subsidies at a level designed to cover all costs exceeding the predetermined social (below-market) rent. The dwellings must meet certain standards, and tenancies are open to certain groups only. Social rents are essentially fixed; only some cost-based rent increases are allowed.

Switzerland offers a six-year subsidy to encourage renovation of existing housing (not necessarily affordable). It covers 2% of the total cost of upgrading the housing unit.

France offered a grant of 12.7% of the cost of schemes to construct new social housing, or to renovate existing stock. This was associated with a subsidised loan (PLA). Private developers were also eligible, if their developments met certain physical standards and they observed rent limits. A higher level of grant—20%--was available for developments aimed at very low-income households; permitted rents were correspondingly lower. Another scheme (ANAH) was created to improve existing rented stock owned by private landlords. It covers 25% of improvement costs up to a standard limit; buildings must be over 15 years old. There are no constraints on rents for housing improved using an ANAH grant, but the renter is eligible for a higher housing allowance if the landlord accepts rent regulation. Homeowners under a certain income ceiling are eligible for another grant (PAH). The ANAH and PAH grants cover 20 to 35% of repair costs up to a standard cost limit.

5.2 Subsidised loans for developers of affordable housing

Spain provides subsidised loans, as well as grants. The USA provides them subject to rents remaining below a specified level for 20 years. Germany provides preferential loans to public or private-sector providers of affordable housing; the dwellings must be operated as social housing for a period of 30 years (originally 60). Lettings are restricted to certain income groups, and rents are held below market level. Sweden subsidises interest for new construction or renovation; the subsidy decreases year by year, and is calculated on the basis of a standardised investment cost rather than actual cost. The subsidy is available to developers of both private and social housing, and is not targeted to low-income groups. Interest subsidies are now being phased out.

In Finland after 1949 the state granted low-interest loans for construction of rental units (covering 60% of costs) or single-family homes (40%); there was no income restriction at first. The government still grants low-cost construction loans, but now eligibility is limited by household income and family size. Equally 80% of the government subsidised production is to be concentrated in the six growing regions with 50% in Helsinki alone.

Canada’s Assisted Rental Program, which ran only from 1975 to 1978, offered concessionary loans over ten years to facilitate the construction of affordable private rented housing.

France’s grant programme for social housing (described above) includes an element of subsidised loan.

5.3 Provision of land for affordable housing at below market value or free

UK local authorities may provide their own land for social housing. Traditionally they built the housing themselves; more recently they have developed it in partnership with either housebuilders or housing associations. Where a local authority sold land for less than market value it would normally expect to receive nomination rights to social housing in return.

In Italy, local authorities are empowered to acquire, by compulsory purchase, land for housing programmes. Spain also provides land for housing.

5.4 Grants to bring empty homes back into use with allocation attachments

These exist in the UK, and are local-authority based.

5.5 Government guarantees for housing association loans

In Denmark local and central government guarantee housing-association borrowing.

5.6 Government guarantees of rent or mortgage payments from low-income households

In the UK the possibility exists but it is not used, except in the case of payment of mortgage interest for certain unemployed people on income support. Mortgage Payment Protection Insurance is not government guaranteed. The French government guarantees rent payments. The US government, through the Federal Housing Administration, Ginnie Mae and Fannie Mac, guarantees the mortgage payments of low-income borrowers. In eastern German states the federal government has introduced public guarantees for private mortgages, to overcome the requirement for high down payments.

Category 6: Supply-side regulations

6.1 Require developers to include a certain percentage of affordable housing in new developments

In the UK, Section 106 can be used to enforce such requirements. There is a minimum development size (smaller in London than elsewhere). At the moment this is applied only to residential development, not commercial except in one or two authorities.

Rural exceptions sites may be identified at the parish level to provide affordable housing for local needs. Public-sector organisations must sell land at the best consideration – this may enable them to sell at below market value in order to obtain nominations.

In Ireland, under the Planning and Development Act 2000, local authorities can acquire up to 20% of the area of development sites purchased by private developers for affordable housing, paying either existing use or agricultural value.

Sweden is changing its cadastral system to make possible mixed-used development and especially low-cost housing in areas not zoned or intended for residential use.

6.2 Rent control

The UK has rent control for social housing. Denmark has traditional rent regulation for private rental housing, with low legal maximum rents. Many countries—for example Switzerland and Germany—control rents for dwellings built with government subsidies. Landlords are permitted to set rents at a level that will cover costs only.

In Austria, rent levels of almost all rented flats in multi-storey buildings are restricted by government legislation. There are rent limits for both new and existing tenancy contracts. Rent increases for existing tenants are allowed only for inflation or to cover urgent maintenance.

6.3 Require employers to provide housing

This was common practice in transition economies.

6.4 Prohibit move of rental flats to owner occupation

In Germany, local regulations inhibit the movement of rental flats into homeownership.

Category 7: Other measures

7 Advice to low-income households on homeownership

The UK provides some. In the US, the government provides advice on passing credit tests and managing mortgage commitments. It is often organised through Community Development Corporations (CDCs) and targeted at ethnic minority groups, whose levels of owner occupation are lower.

3. A Package of Measures for the UK

After examination of the international evidence and of the specific UK environment and experience, six policies and associated measures were identified as having potential in the UK environment:

1. Tax incentives for construction of affordable housing, allowing costs to be set against other income (tax relief) or offering a pound-for-pound reduction in the amount of tax payable (tax credits). They could be applied to both rented housing and housing built for owner-occupation or shared-equity schemes.

2. An instrument to provide government assistance to purchasers of housing in high-cost areas, structured to bring in a wider range of lower-income workers than current programmes, and probably geographically targeted. This would build on existing, more narrowly based, programmes such as the Starter Home Initiative.

3. Savings schemes for first-time buyers, which might include an employer element – including, for instance, allowing tax reliefs for mortgage savings similar to those given to pensions. Schemes of this type, while they have

fallen out of general use, have been reintroduced to help particular groups in a number of countries.

4. Policies to increase employer involvement, which would reintroduce an old established practice and make it tax efficient for employers to play a direct role in assisting their workers. Related to this is the question of whether modifications of the Treasury rule on "best consideration" rule could be clarified to make clear that public-sector employers could use their land to provide affordable housing for their employees, particularly in London.)

5. Ways of encouraging mixed-use or housing-only development on sites previously designated for non-residential development. This might include extending Section 106 agreements to non-residential sites (which have both the potential for providing additional land for housing, and may generate the need for more affordable housing) as well as fiscal incentives to lubricate this process.

6. Reduction of Value Added Tax (VAT) on renovation of affordable housing (perhaps in the first instance by exempting Registered Social Landlords).

Initial Assessment

Certain questions are fundamental to an assessment of new affordable-housing policies: What is the depth of subsidy involved? Will it produce the desired results? What will be the deadweight losses? Will the policy have any effect on land supply?

Policy 1 is consistent with the Treasury's general approach to modernising the tax and benefit framework – although the potential for a secondary market in credits is more problematic. A new tax-incentive scheme has just been introduced England in the form of the Community Investment Tax Credit, which gives investors tax incentives for investing in community development institutions. The existence of this precedent would make it easier to implement Policy 1 through an affordable-housing tax incentive that concentrated on particular areas, dwelling types and occupant groups. Such a scheme would work most effectively if the credits can be traded and land supply increased.

Policy 2, which would extend Homebuy and the Starter Homes Initiative into a more coherent but carefully targeted scheme, appears appropriate, as it could help fulfil the reasonable aspirations of lower-income employed households.

Savings schemes (Policy 3) could only provide very limited help unless it was possible to extending income-tax relief to employer contributions to mortgage payments, but this goes against general tax principles.

Employers (Policy 4) clearly have a potential role as partners in Policy 1. They could also provide land, develop shared-equity schemes and facilitate the implementation of other fiscal instruments. Whether employers become involved will depend partly on whether they perceive particular relative advantages to providing housing assistance rather than increased pay.

Policy 5 would level the playing field between residential and non-residential sites in terms of the requirement to provide affordable housing. It could increase the number of sites coming forward for residential and particularly affordable-housing use; however, it would have to be combined with fiscal incentives such as Policy 1 to generate large-scale changes.

Reducing the VAT rate on renovation (Policy 6) to 5%--the minimum permissible under EU regulations--would reduce the cost of providing affordable housing through renovation. Restricting the tax reduction to RSLs would concentrate the policy on affordable housing and make it easier to monitor.

There are a number of modifications to the more general framework which could make policies more effective. They include in particular (i) clarifying the definition of best consideration so it includes allocating land for affordable housing at sub-market prices and (ii) developing standard contracts and transparent frameworks for shared-equity arrangements, so that both employers and employees can better evaluate the schemes. Increasing the scale of shared-equity schemes so as to encourage the involvement of institutional investors could generate large benefits, but these are a long way off.

Overall there is a strong case for experimenting with Policy 1 (tax incentives) and for developing a more coherent approach to demand assistance as described in Policy 2 (assistance to purchasers in high-cost areas). The other policies can act in support of these two more fundamental changes.

The only policy that would directly increase the supply of land devoted to affordable housing is Policy 5 (housing on non-residential land). Clarifying the rules on best consideration (see Policy 4 - employer involvement) could also bring a limited amount of land into residential use. Policy 1 (tax incentives) could indirectly stimulate an increase in land supply (assuming the planning system permitted adjustment), because it would give developers an incentive to look for additional land on which to build.

None of these policies would address the same needs as Social Housing Grant, which is concentrated on lower-income households with longer-term needs, and provides higher subsidies and greater targeting. Instead they could supplement that provision by bringing in different players, greater choice and a more market-oriented approach. As such they could fill an important, and increasingly recognised, gap in government incentive structures. They would however generate some deadweight losses from transactions costs and inadequate targeting. They would work best if their use could be directly combined with expansion of land supply.

4. Conclusions

In the UK owner-occupation is now effectively treated as a consumption good. It is therefore tax-free except for stamp duty and the price-related part of council tax, while the costs of owner-occupation are taxed. For private rented housing, on the other hand, the landlord is subject to income tax (with cost deductions, but no depreciation) and to capital gains tax – housing is thus treated as an investment good.

Other interventions – especially housing benefit – lower the cost of renting to low-income households, but there is nothing to provide regular assistance for low-income owners. There is a patchwork of other policies, including right-to-buy discounts, Homebuy, the Starter Homes Initiative, and improvement grants, but with the exception of right-to-buy these have a limited effect.

In general there is much less subsidy now than a few years ago. The main remaining subsidies are concentrated at the bottom end of the market, mainly through housing benefit. There are very few mechanisms outside Social Housing Grant directly to assist additional provision.

Internationally there is a wide range of both demand-side and supply-side instruments. These have been applied both quite generally to increase production and in a more concentrated fashion targeting either affordable housing or particular groups. Almost every element of our typology can be found somewhere in the countries that we examined.

Ssome countries have emphasised tax reliefs, while others concentrate on grants – the choice relates more to their general fiscal ideology than to the problems, which they address. Overall, the policies often look more as if they just grew in response to particular political pressures rather than representing a coherent approach to ensuring adequate affordable housing. A general trend in most countries has been the move towards less general assistance and increasing concentration on particular low-income groups and localities. Evaluation of these policies depends on a reasonable understanding of the overall tax systems and housing markets in the relevant countries. Transferring policies to another institutional environment is always problematic.

It is not surprising, therefore, that any package seen as potentially feasible in the UK is likely to be based more on developing existing structures and wider fiscal innovations then on lessons from international experience. Even so much can be learned about both problems and potential solutions.

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