



OBSERVATIONS AND SUGGESTIONS

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LOW-INCOME HOUSING POLICIES: LESSONS FROM INTERNATIONAL EXPERIENCE

Abstract

- Based on international experience, housing policies should adopt an integrated approach connecting the provision of low-income housing to social programs, and addressing the new housing needs arising from demographic and social changes. In this process, it is important to clearly define targets and eligibility criteria to enhance policy effectiveness.
- In light of the existing low-income housing shortage, it seems appropriate to rely more on supply-side incentives in the short-to-medium term, while targeting an increased reliance on demand subsidies in the longer run.
- From the institutional point of view, low-income housing policies are in general decentralized, and the most successful programs worldwide have relied on good central-local coordination supported by appropriate legislation and incentives at both levels.
- Institutional arrangements are usually underpinned by measures to ease the access of low-income groups to housing finance, including public mortgages or guarantees, more flexible borrowing terms and preferential rates.
- The establishment of a National Housing Agency is an option for consideration. The agency could play a meaningful role in the preparation and execution of a National Housing Plan, in the establishment of a low-income housing finance scheme, and developing initiatives to foster the construction of low-income housing by the private sector.

I. Introduction

1. Following several programs of successful reforms, housing policy fundamentals in PRC have evolved from welfare to a more market oriented approach. Generally, housing indicators, including average per capita living space, have improved. However, housing remains a challenge for low-income families. Housing affordability has been further restrained by rapidly rising housing prices and the tight monetary policy implemented until recently.

2. As a part of the fiscal stimulus package from 9 November 2008, the government has announced new funding for low-income housing construction in the next three years. In addition, a set of accompanying measures including preferential interest rates, reductions in housing transaction taxes and lower down payment requirements have been approved. The envisaged housing investment plan provides the opportunity to revise and strengthen the low-income housing policy. By reviewing the specific challenges in the PRC housing market and best international practices, this policy note aims at drawing relevant policy recommendations.

II. Challenges in the PRC Housing Market

3. The Housing Provident Fund (*Zhufang Gongjijing*) and the Affordable Housing Program (*Jingji Shiyong Fang*) have contributed to smooth the transition from state to individual housing ownership. However, the scope of the initiatives is not sufficient to address the housing needs of the low-income groups.

4. The urban household profile has been changed by a growing influx of migrant workers adding pressure on low-income housing demand. Lacking proper registration (*hukou*), rural migrants cannot access housing subsidies, and slums or room rental at farmers' enclaves at the fringe of urban areas are the only options within their reach. However, those enclaves are an unsatisfactory solution, help to perpetuate the poverty of many workers, and prevent the poor from investing in their own housing.

5. The number of housing units demolished in PRC is larger than in other countries, but demolished units are often replaced by higher income housing, depriving the affected persons of housing opportunities.

6. Low-income housing distribution in PRC is often distorted by difficulties establishing effective targeting and eligibility criteria because information about individual income is imperfect. The target group of low-income housing subsidies is very wide, making the program financially unsustainable. For instance, under the Affordable Housing Program, the eligibility criteria for housing subsidies in Beijing are open to any household whose annual income falls below RMB60,000, a ceiling that is above the average household income, making most families eligible. As a result, the system is prone to inefficiencies with low-income housing acquired by higher-income households in detriment of needier groups.

7. Land supply and use are major constraints on the development of low-income housing. Land in PRC is owned by the state and developers purchase land-use rights from local governments on a leasehold basis. Local governments, in turn, have vested interests in keeping prices high as land-related transactions are a major source of revenue. Consequently, housing developments tend to be skewed towards high-priced units.

8. Another challenge is how to attract private developers into the less profitable business of low-income housing. Affordable houses in PRC are developed and sold by real estate development corporations after winning the bid with a profit limit to no more than 3% of the development cost. In practice, houses are becoming larger and more luxurious because developers can reap greater profits, which discourages housing supply for low-income families. In 2006 a regulation on economically affordable housing including the set up of a maximum housing unit size was enacted¹, but enforcement so far has been poor.

9. Finally, low-income groups face difficulties in accessing financial resources. Banks and financial institutions are reluctant to accept high-risk borrowers, and lending is concentrated towards the high-end of the market (credit rationing).

III. International Experience in Affordable Housing and Policy Considerations

A. Main Trends and General Housing Policy Framework

10. Countries tend to opt for one of two major strategies for the provision of affordable housing, i.e. universal or targeted approaches. Countries including Singapore, the Netherlands, Sweden and Denmark have applied a universal approach, which aims to provide the whole population with decent and affordable housing. The targeted approach, which is more common, is based on the assumption that while the market plays a primary role in housing provision, special programs should be implemented to address the needs of the low-income or vulnerable groups excluded from the market distribution system. Examples of targeted approaches include Canada, Malaysia, US and most of the European Union.

11. When designing housing policies, governments have a choice between supply-side subsidies —public housing construction and subsidies to producers— and demand-side subsidies —funds directed to the household through periodical cash allowances to support housing costs, or through capital grants for households to buy or rehabilitate units. Compared with supply-side subsidies, demand subsidies are better targeted and more flexible as they are linked to household income. This allows for rapid adjustments to changes in income or family size, a feature of particular value in times of crisis. On the downside, in addition to requiring accurate and updated information on income and household composition, demand subsidies

¹ The May 29, 2006 decree requires that at least 70% of units in housing projects have a maximum floor area of 90 sqm, and that 70% of the annual supply of land for housing development be used for small-and medium-sized units.

could unleash inflationary pressures if housing shortages exist. Supply-side subsidies are often weakly targeted in terms of eligibility and priority, but have proven successful in increasing the supply of affordable housing as well as stimulating the output of the construction sector. Although there is a clear shift towards demand-side subsidies, countries frequently use both modalities, and supply-side subsidies still play a relevant role in low-income housing initiatives.

12. Regarding the preference to subsidize either house ownership or house rental, there seems to be no clear pattern, with decisions being country specific depending on cultural elements and traditions. For example, low-income housing assistance is provided only through subsidized rental in the Netherlands, while in Spain subsidized ownership is almost the rule. Among emerging economies, the Chilean model, which stands as a landmark in Latin America, opted for demand-side capital grants to foster house ownership and the development of the private housing construction sector. Many countries combine rental and ownership schemes depending on the target group's profile and income level, with rental being more suitable for the lowest income groups.

13. Experience in many countries shows that the provision of low-income housing has led to excessive spatial concentrations, social segregation and exclusion from basic services and facilities. Therefore, at present, housing policies increasingly opt for an integrated approach connecting low-income housing to social programs in education, employment, health care, infrastructure and transportation. Most policies also include improved environmental sustainability and energy efficiency criteria for the development of low-income housing.

14. In addition, housing policies are addressing the new challenges emerging from demographic, social and cultural changes. Phenomena like population aging have implications for housing policies as the number of senior citizens living alone, their specific needs, and their share in low-income housing, are growing. New social and cultural trends have also altered the profile for low-income housing tenants; the average household size has contracted along with declining fertility rates, and the number of single households like migrant workers, single parents, the elderly, and unmarried individuals, is increasing.

15. Instead of being designed and pursued independently, low-income programs have become an integral part of the national housing master plans in many countries.

B. The Role of Governments and Housing Policy Instruments

16. Low-income housing policy is in general decentralized, and regional and local governments play a major role. The most successful programs worldwide have relied on good central-local coordination supported by appropriate legislation and incentives at both levels. While central governments establish the targets, goals and characteristics of the financial scheme, local authorities are directly responsible for the implementation of the program and delivery of the unit but with flexibility to address the unique needs of their jurisdictions.

17. To attract private developers into low-income housing construction, governments use a wide range of incentives at the central and local level, including tax deductions, density bonuses², direct subsidies, land grants, land classification shifts from commercial to residential use, and bureaucratic and administrative streamlining to reduce processing costs and time. For instance, density bonuses are very popular in the US to favor higher density housing, while in England there has been an increasing planning interest in mixed-use development, with the construction of affordable flats over retail space becoming more common and an incentive for developers. Malaysia and Canada are good examples on the positive impact of the streamlining of administrative requirements through fee waivers and fast-tracking procedures.

18. In spite of the decentralization trend, a return to higher central government participation can be noted in countries facing severe shortages of affordable housing. This is, for instance, the case of the UK and Spain, where housing bubbles have deprived low- and middle- income citizens of affordable housing, prompting higher government intervention through increased central budget allocations and stringent inclusionary zoning requirements by local governments.

19. Inclusionary zoning refers to municipal and county planning ordinances requiring that a given share of new construction be affordable to low-income groups. Successful programs have been underpinned by extensive legislation supporting local government's efforts to develop appropriate policies, standards and goals. A good example is California, which stands as the leading US state in low-income housing provision following the implementation of a comprehensive package of legislation.

20. Zoning failed in countries where the regulatory framework was weak, and the central or the regional government was only marginally involved, like in Canada, where in some regions municipal initiatives were not supported by provincial legislation. Effective zoning also requires comprehensive and updated information on the characteristics of the eligible tenants, as well as substantial investments in staff resources and capacity building, which could be very costly, particularly at the municipal and county levels.

21. Central governments' involvement in zoning is important given its costs. In Malaysia, the government has established public-private business partnerships under which the state provides land for low-income housing and streamlines administrative procedural aspects, while the market provides financial resources, supports the program's implementation and delivers the units. Government regulations include minimum size requirements, an inclusionary housing quota of 30% affordable units in any new development, a ceiling price on private developers, and additional incentives are extended for developers who wish to exceed the 30% quota, such as access to fast-tracking windows, lower land premiums, subsidized infrastructure and utilities, etc.

2 Density bonuses are granted for projects in which the developer agrees to include a certain number of affordable housing units. Essentially, for every one unit of affordable housing a developer agrees to build, a jurisdiction allows the construction of a greater number of market rate units than would be allowed otherwise.

These incentives are implemented at both the state and local level. A national computerized system to register eligible recipients and track their income standards in a transparent way ensures that low-housing units reach the eligible recipients.

22. In countries confronting the challenges of high population concentrations, like Hong Kong and Singapore, high-density zoning through the construction of high-rise buildings linked to an effective public transportation system have proven successful in meeting the housing needs of urban low-income groups. High-density zoning has been enhanced in Hong Kong by land-sharing schemes where a part of the development site is given for commercial space, which cross-subsidizes housing for low-income groups, increasing the appeal to private developers.

23. On financial arrangements, as local governments have a prominent role in the provision of low-income housing, property taxes are used in many countries to provide local authorities with a stable source of revenue for the delivery of essential public services, including housing. In the US, about 75% of local government revenue is from property taxes. The rate varies between cities and districts and is typically 1-2%, based on assessed property values. Countries in the European Union have a property tax in the same range, which serves as a principal source of local government revenue. Property taxes are progressive and include a threshold to protect low-income households and owners of small properties. This system is vital to guarantee the long-term sustainability of any low-income housing program.

24. In addition to the property tax, in countries experiencing severe shortages of affordable housing, central governments make specific direct budget contributions, the size of which varies depending on the scale of the shortage. Increases in the stock of affordable housing are typically complemented by measures to facilitate the access to housing finance and to reduce borrowing costs.

C. Institutional Framework and Housing Agencies

25. Along with local governments, private sector, not-for-profit organizations and specialized public/private housing agencies have acquired a prominent role in low-income housing provision. Specialized housing developers —public, private or private-public partnerships— are used in a number of countries to develop low-income housing, usually supported by priority access to land and older housing stock for rehabilitation. These agencies also undertake complementary programs for social and economic development directed to low-income tenants. Several western European countries, including Finland and the Netherlands, have specifically implanted low-income housing programs through a National Housing Agency or Fund. This model has also been adopted by some eastern European transitional economies. Housing agencies are typically in charge of housing planning and financing, and often evolve into an independent or semi-independent institution cooperating with the private sector, and are empowered to issue guarantees for collateral-backed mortgages. Some countries have been very successful developing Housing Agencies with unique characteristics. The cases of Finland, the Netherlands and Singapore stand as success stories and for that reason are briefly reviewed in this note.

26. Subsidized housing in Finland is mainly provided through low-cost rental by municipalities and not-for-profit organizations with financial support from the Housing Fund of Finland (ARA). ARA was established in 1990 as an off-budget state fund under the supervision of the Ministry of Environment to finance state-subsidized housing production. Support comes through public loans and guaranteed and/or state-subsidized interest rates. Even though most of the housing assistance is implemented through subsidized rental determined on cost-recovery principles, not-for-profit organizations are shifting into the construction of home-ownership single-family houses, reflecting the higher preference of the population to own a house. In addition, ARA supports the housing needs of special groups including the elderly, homeless, students and refugees, with investment grants of up to 35% of the total financial cost. ARA relies on different financial resources including securitization, loan agreements with the European Investment Bank, and state budget contributions.

27. The case of the Netherlands is unique with 500 low-income housing associations managing 35% of the total housing stock in the country. Support takes the form of subsidized rental only. The associations are regulated by the state but are financially independent from the government, with funding coming from the capital market at preferential rates without direct central government guarantees. The Central Housing Fund (CHF) and the Social Housing Guarantee Fund (SHGF) provide financial security. The CHF is financed by annual contributions from the housing associations amounting up to 1% of their rent income depending on their financial situation. The CHF provides financial assistance to housing associations that have run into problems or face liquidity constraints, thus securing the continuity of the system. The SHGF is a non-profit foundation backed by the state that allows registered housing associations to attract loans at relatively favourable terms for new housing construction, renovation and refurbishment, and acquisition of existing housing units. Most of the housing associations participate in the SHGF, and loans are granted based on rented property only. If a housing association is deemed at risk no further guarantee provisions are issued by the SGHF, and a referral is made to the Central Housing Fund for financial support, thus guaranteeing the soundness and financial security of the scheme.

28. In Singapore, the success of the Housing Development Board (HDB) addressing housing shortages, particularly during the 1960s and 1970s, is well known. The HDB is a government agency responsible for the provision of public housing in conjunction with the Provident Fund, which provides financial support. At present, over 88% of the total population lives in HDB apartments, which are not actually purchased but leased in a 99-year leasehold. The program's success is explained by the small size of the population and the accelerated and egalitarian economic development achieved, although in recent times the HDB faces the challenges of addressing the population's changing preferences and needs, and sales are stagnant. It should be noted, however, that given the country's high income per capita level, public housing provision in Singapore entails a wider dimension than any other examples in the world, and has long departed from the concept of low-income housing provision. In fact, property prices for the

smallest public housing in Singapore are often higher than private housing in many developed countries.

IV. Policy Recommendations

A. Establishing a General Housing Policy Framework

29. The immense financial implications of the universal approach given the size of the PRC's population, suggest that the targeted approach is more suitable to deliver results and rapidly alleviate low-income housing shortages. To ensure the effectiveness of the targeted policy it is fundamental to have well-defined targets and eligibility criteria. For that purpose, a comprehensive survey on income standards and housing needs among the diverse target groups should be conducted and periodically updated. In this regard, efforts to facilitate the access of migrant workers to formal registration (*hukou*) will help to identify more accurately the existing low-income housing needs.

30. Regarding the choice between supply and demand-side subsidies, it is recommended that PRC relies on both instruments to correct the existing shortage of low-income housing. However, in light of the existing housing shortage, it seems appropriate to rely more on supply-side incentives in the short-to-medium term, while targeting an increased reliance on demand subsidies in the longer run. Suggested supply-side subsidies to attract the participation of the private sector in low-income housing include, capital grants, tax incentives, priority access to land, state guarantees for loans or public mortgages for developers, favorable and streamlined regulations, planning and zoning. Demand-side subsidies should cover tax exemptions (property transfer tax, tax credit for mortgage repayment, tax relief as opposed to deduction from taxable income), cash subsidies or housing allowances, capital grants, state guarantees and/or public mortgages to overcome credit rationing. Demand subsidies could be also extended to first-time owners, the elderly and students.

31. When opting for rental or ownership subsidies, it is suggested to rely on a combination of both; subsidized rental targeting the lowest-income segments, and subsidized ownership addressing the needs of the upper tier of the low-income group. The latter will translate into a significant increase in the concerned households' wealth in the long-term.

32. Considerations on units' layout and size are also important. Units should comprise basic layout requirements (built-in kitchen and toilet facilities), and limits on minimum and maximum size are to be determined. International practice suggests that 70 sqm for two-bedroom units and 90 sqm for three-bedroom units is an appropriate standard.

33. Low-income housing initiatives should be integrated into a National Housing Master Plan. Low-income housing planning should adopt an holistic approach by connecting it to social programs (skills training, education and health care, transportation infrastructure, etc.) to avoid social segregation and to secure access to basic services. It is also important to prioritize the environmental sustainability and energy efficiency of the new or rehabilitated housing sites.

Policies should also acknowledge and anticipate the new challenges emerging from demographic, social and cultural changes, like population aging, reduced household size due to declining fertility rates, increased numbers of single tenants, etc.

34. In order to strengthen housing security for the more vulnerable groups, reconstruction projects including the demolition of low-quality housing and slums should aim at replacing demolished units with affordable housing for the affected persons. Existing tenants should also be given priority in the allocation of the new units.

B. The Role of the Government and Housing Policy Instruments

35. Close coordination and a clear division of functions between the central and the local government enhance the effectiveness of low-income housing policies. It should be the role of the central government to provide, and effectively enforce, a comprehensive regulatory framework comprising an appropriate legal base, a definition of the main goals and targets, and an affordable housing finance scheme. Within this framework, and with flexibility to address the specific challenges of each jurisdiction, local governments should be directly responsible for low-income housing provision.

36. Inclusionary zoning and high-density zoning are both appropriate strategies to increase the stock of affordable housing. Zoning can be strengthened with incentives for developers, such as tax deductions, density bonuses, direct subsidies, land grants and bureaucratic and administrative streamlining to reduce processing costs and time. Incentives should be implemented at the central and local level.

37. To guarantee the sustainability of low-income housing, the introduction of a progressive property tax will provide local governments with a stable source of income to offset expected reductions in revenue from land-related transactions stemming from less lucrative housing construction. International experience suggests that it would be appropriate to establish a progressive property tax in the range of 1-2%.

38. Developing a well-targeted scheme of public guarantees or public mortgages will help to avert credit rationing and to improve low-income groups' access to financing. More flexible terms for mortgages, lower down payment requirements, and specific programs like microfinance, are also appropriate provided target and eligibility criteria are clearly defined and strictly enforced.

C. Institutional Framework

39. Because the preparation of housing programs requires inputs from different ministries and agencies at the central, regional and municipal level, the establishment of a leading National Housing Agency is an option for consideration. To function effectively, the agency has to be supported by a solid legal basis including enforcement measures, and endowed with enough resources, competencies and capacity building to meet the challenges of its mandate. The

agency should count on a national computerized system to register eligible recipients and track their income standards, to guarantee the efficient allocation of the low-income units in a transparent manner.

40. The National Housing Agency should develop a Geographic Information System (GIS) for the housing sector to collect, map and update all housing related information—socioeconomic, physical, and spatial. A GIS will be an imperative to meet the multifaceted information needs of several agencies involved in the implementation of national housing policies. It will help overlay housing related information spatially on infrastructure, socioeconomic, as well as urban zoning maps and facilitate better coordination between various agencies to plan in implement low cost housing. Among other benefits, GIS will help (i) prevent spatial concentration of low-cost housing, (ii) improve the monitoring of impact of government housing policies, (iii) provide better access to infrastructure to low income households, and (iv) enhance the planning, implementation, and monitoring capacity of the National Housing Agency.

41. The agency could be in charge of the preparation and execution of a National Housing Plan, coordinating central, local and municipal inputs and their respective financial contributions, and fostering the participation of the private sector and not-for profit organizations. In addition, the agency could also take on the role of a national mortgage agency for affordable housing, in addition to supporting other initiatives to ease the access of the lowest-income groups to housing finance.