# GLOBAL COMPARISON OF HOUSING SUBSIDIES[1]

1. Housing is important for the well being of households worldwide. Housing demand and investment in housing play significant economic roles. As a result, the housing market is subjected to more policy initiatives than any other consumer good. Government intervention is commonly justified to (i) address market failure to meet the needs of lower and middle income households, especially in times of housing shortages; (ii) ensure minimum housing standards; (iii) stimulate economic activity and job creation; and (iv) achieve positive externalities for society and local communities.[2] Accordingly, the objectives and strategic approach to housing policy globally are diverse and reflect significant differences in the importance of housing in the social-political context of each country.

2. **Diverse global approaches to housing policy.** In 1919, Britain was the first country in Western Europe to embark on a subsidized public sector housing program. Countries with social housing policies where the government plays an important role in aiding selected groups in the population who cannot secure housing for themselves include Belgium, India, Ireland, Japan, Switzerland, United Kingdom (UK), and the United States of America (USA). Some countries have moved towards a comprehensive commitment, where governments play a major role in shaping and controlling the housing market to ensure housing affordability and welfare. These countries include Denmark, France, Germany, Hong Kong, People's Republic of China (PRC), Korea, the Netherlands, Norway, Singapore, and Sweden. An overview of the approaches of India, Japan, PRC, the UK, and the USA has been outlined to contrast how housing policy has been shaped by the social-political objectives of each country, and has evolved as the country's housing and housing finance markets have developed and expanded.

3. ***India.*** Since independence in 1947, successive Indian governments have prioritized housing and supported a range of interventions. To meet the housing requirements of its vast population, early emphasis was on institution building, subsidized housing for the poor, and concessional lending to state governments to acquire and develop land for construction, and to improve housing and infrastructure for new urban centers and smaller towns. By the 7th five-year plan (1985-90), greater attention was shifted to the role of the private sector. In 1988, the National Housing Bank (NHB) was established under the aegis of the Reserve Bank of India. The NHB regulates specialized housing finance companies and acts as a second-tier lender to originating mortgage finance institutions. Subsequently, an up-front cash subsidy and concessional housing loan program was launched to provide assistance to rural families to construct housing.[3] Even with high political priority, housing finance at 7% of gross domestic product (GDP) (in 2008) remains underdeveloped.

4. ***Japan.*** The housing strategy of post-war Japan was closely linked with economic development, and focused on promoting homeownership, particularly among the growing middle class. In the 1950s, three important housing programs were initiated: (i) concessional lending provided by the Government Housing Loan Corporation (GHLC), (ii) public housing with subsidized rents for low-income households, and (iii) development of multi-family housing estates for middle-income households by the Japan Housing Corporation (a state-owned agency). Of the three programs, the concessional lending program implemented by GHLC to encourage the building of owner-occupied housing accounted for a sizeable proportion of total public funding allocated for housing, as well as a very significant fiscal commitment. By the

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1 Extracted from reports prepared for ADB by Sock-Yong Phang, Singapore Management University, 2011.
2 Greater citizen responsibility and involvement in communities, improved maintenance of housing and community properties, and improved security, scholastic achievement, and health and wellbeing.
3 T. Nenova. 2010. Appendix C in *Expanding Housing Finance to the Undeserved in South Asia: Market Review and Forward Agenda.* Washington D.C: The World Bank.

1960s, homeownership in Japan climbed to 60% where it continues to hover. Following the burst of the real estate bubble in the 1990s and the prolonged recession that followed in 2001, given the huge fiscal burden, the government decided to abolish the GHLC by 2007. The GHLC was replaced by the Japan Housing Finance Agency, which focuses on enhancing securitization and the development of a secondary market and does not offer housing loans to the general public.

5. ***People's Republic of China.*** The recent history of housing policy in PRC has seen significant changes. During the post-war period, key responsibility for housing provision was mandated to local governments. Over the last two decades, a major privatization process has been overseen by local governments. With the mass transfer of ownership, the institutional framework has been transformed with the establishment of large-scale development companies, property managers, and local housing provident funds (HPFs). In 1991, the HPF was initially introduced in Shanghai as a pilot program to lead the housing policy reform process and kick-start a housing finance system. There are now over 320 HPF management centers that manage compulsory savings that earn low interest rates and offer low interest rate mortgages. While HPFs are an important part of China's housing finance system and play an active role in promoting homeownership and broadening public knowledge of housing finance, performance has been impacted by systemic problems that include inefficient and regressive lending policies, and governance concerns.

6. ***Singapore.*** The government has targeted affordable homeownership for up to 90% of the population as an important social-political objective. Four-fifths of the housing stock in Singapore has been developed by the Housing and Development Board (HDB), a statutory board that receives government grants and concessional lending. Of HDB's total stock, 95% has been sold off at subsidized prices on 99-year leasehold basis. The remaining 5% remains rental units. The HDB also provides long-term housing loans at interest rates below market rates and a 90% loan-to-value ratio. The Central Provident Fund (CPF) plays a central role in successfully mobilizing savings for homeownership for both public and private sector built housing. The fund is a state-managed, tax-exempted compulsory social security fund for all citizens to which employees and employers contribute. Purchasers of housing are allowed to use CPF savings for mortgage payments. The interest rate charged for HDB mortgage loans are 0.1% above the rate paid on CPF savings. Housing grants for the purchase of HDB flats were introduced in 1994 for eligible households to purchase HDB flats in the secondary (resale) market. With the housing shortage largely solved by the 1990s, the private sector share of housing supply continues to grow.

7. ***South Korea.*** The Korea National Housing Corporation (KNHC) was established in 1962 to supply low-income housing. During a period of under investment in housing that lasted until the late 1980s, the government intervened frequently in the housing market to impose price controls and anti-speculation measures (in the form of punitive taxes on capital gains from real estate transactions). In 1988, the government announced a massive increase in housing supply with plans to build 2 million new dwellings between 1989 and 1992. As the housing shortage eased, in 1995 the government lifted housing price controls and regulations for new housing. In 2002, the Korean government announced a plan for constructing 1 million national rental housing units (2003 to 2012) to address the shortage of affordable rental housing for low-income families.

8. Korea set up the National Housing Fund (NHF) in 1981 to finance housing construction for rental and purchase and to provide housing loans to low-income households. Funding for the NHF is sourced from the government budget, national housing bonds and NHF bonds, a housing lottery, and contractual savings, foreign loans, amortized funds and other related funds.

NHF mortgage loans are offered at 3% to 5% interest rates for a 20-year term. With the ceiling on the loan amount per household, the typical loan-to-value ratio is below 30%. The Korea Housing Finance Corporation (KHFC) was formed in 2004 to promote homeownership for low- and middle-income families. KHFC offers long-term mortgage financing to low- and middle-income families by purchasing long-term fixed rate mortgages from commercial banks (based on underwriting guidelines that include a maximum loan-to-value ratio of 70% and term of up to 20 years), and packages mortgage-backed securities. KHFC is jointly owned by the central bank, i.e., the Bank of Korea, (82%) and Korean government (18%), and is secured by government guarantees to cover annual losses.

9. ***United Kingdom.*** The UK first introduced the concept of the public housing for the "working classes" in 1919, after World War I, to stimulate mass housing construction in order to replace housing stock and support expanded provision of public housing. In 1970, with waning political support for state-supported "council housing", ownership of public housing was transferred on mass to tenants or housing associations. By 1980, all public or not-for-profit housing was targeted for lower-income households. Policies that have been implemented to promote homeownership range from privatization of public housing through deregulation, and mortgage interest tax relief (1969-2000) and a number of special schemes aimed at first-time buyers and other specific target groups.[4]

10. ***United States.*** Unlike many countries in Western Europe that have focused government support on developing social rental housing, the US has offered a plethora of tax breaks and subsidies to promote homeownership. These encompass federal tax deductions offered for mortgage interest, exclusion of housing from capital gains tax, and a diverse range of state and local property tax deductions. About 75% of all Americans that have taken on mortgage loans have saved on income taxes by applying mortgage interest as a deduction for income tax purposes. Homeownership is also promoted by: regulated use of lending and credit appraisal standards, accelerated development of secondary mortgage markets (through specialized establishment of state agencies such as Fannie Mae and Freddie Mac); and targeted mortgage insurance programs for low-income households and minority groups. A number of these measures are being critically reassessed given exacerbated swings in house prices, and amplified mortgage credit growth, during the run-up to the global financial crisis of 2007-2009.[5]

11. **Housing policies to promote homeownership.** Homeownership rates vary widely across countries, as well as regionally, within a country. Canada, the UK, and the US have homeownership rates between 65% to 70%, while Germany and Switzerland have rates below 45%. Greece, Hungary, Italy, and Spain have rates of 80% or higher, as do India, Mexico, and Singapore. In PRC, UK, and Eastern Europe, privatization of the housing sector has achieved significant increases in homeownership rates over relatively short periods of time.

12. Government policies favoring homeownership as a tenure choice are widespread and take various forms. Supply-side subsidies for state agencies and developers/builders of new housing include land grants and access to utility services. Special tax treatment for housing includes tax concessions offered to developers, residential contractors and construction material producers, and homebuyers. On the demand side, tax concessions may be offered to homebuyers. Possible tax concessions include tax deductibility of mortgage interest and/or principal payments, property tax subsidies, and special tax treatment of capital gains from

[4] R. Groves, A. Murie and C. Watson, eds. 2007. *Housing and the New Welfare State: Perspectives from East Asia and Europe*. Aldershot, UK: Ashgate Publishing.

[5] International Monetary Fund. 2011. Chapter 3 Housing Finance and Financial Stability - Back to Basics? In *Global Financial Stability Report: Durable Financial Stability: Getting There from Here*. Washington. D.C.

housing. Governments globally have also offered mortgage interest rate subsidies and upfront grants (for principal down payments) for housing purchases. Mortgage interest rate subsidies take many forms—direct interest rate subsidies, state support for housing-related savings schemes, state-sponsored insurance or guarantees for credit risk associated with housing loans (or for securitization or liquidity facilities), and augmentation of finance to the housing sector through housing finance institutions.[6]

13. **Direct interest subsidies.** Under a direct interest subsidy scheme, the government intervenes to reduce the interest paid to private lenders. The government may do this by paying the lender a fixed amount or some proportion of the interest due based on a specific rate less than the market rate (alternatively, the balance of the interest payment may be paid based on agreed upon benchmarks). For mortgage interest rate subsidies, the reduction in rate can be for a specified period or for the life of the loan, and it may be phased out over time or phased out as the income level of the borrower increases. Preferential mortgage interest rates may be targeted to certain types of households (first-time buyers or low income) or certain types of housing (new housing). To improve fiscal sustainability, interest subsidies are often financed by household savings with interest paid at lower than market rates, offered on concessional tax terms. Direct interest subsidies are easy to implement and attractive politically, particularly if the current budget is not charged the full amount of committed future outlays. However, unless well designed, interest subsidies crowd out and distort the market, and can be regressive (as it encourages greater borrowing than required) and costly (without ceiling or in times of increasing market rates.

14. **Contractual Savings for Housing (CSH).** Under the CSH, potential borrowers accumulate savings over a number of years to build up equity, while demonstrating their capacity and reliability for repaying debt. Following the saving period, a loan is advanced that is typically equal or some low multiple of the amount already saved. The equity accumulated is disbursed jointly with the loan. Interest rates for savings are fixed below the market rate, and the incentive to follow through the scheme is the promise of a similarly below market, fixed rate loan. In many countries, other subsidy approaches are linked to the CSH to address liquidity and interest rates risks as well. CSH schemes are popular and easy to implement but are reliant on a constant flow. It is difficult to cut back commitments of future subsidies without enough new savers joining the system.

15. **Housing Provident Funds (HPF).** HPFs accrue mandatory savings from either public or private sector employees, typically as a percentage of salary. Employers may also be required to make proportional contributions. Accrued long-term savings are often remunerated at below market yield. Contributing members to the HPF may then withdraw the savings as a down payment for a housing investment, and receive a long-term housing mortgage loan usually at a preferential rate (either from the HPF or through another lending institution). While effective, HPFs may result in over-allocation of resources to housing, crowding out of consumption and investments in other sectors, and crowding out of commercial bank lending. Where low-income households get small loans thus effectively subsidizing high-income households, or cannot afford housing, horizontal inequity becomes an issue.

16. **Mortgage interest tax deductions.** In many countries, taxable income may be reduced by mortgage interest which then reduces the amount of income tax owed/paid. In its simplest form, the effective interest rate of the loan is reduced by the tax rate (e.g., 30%). Variations include (i) deductions that include principal repayment; (ii) eligibility for new, expansion, and

[6] M.C. Hoek-Smit and D.B. Diamond. 2003. *The Design and Implementation of Subsidies for Housing Finance*. Prepared for the World Bank Seminar on Housing Finance. 10–13 March.

second or additional dwellings; and (iii) limits on the amount of interest deduction or total amount of loan subject to deduction. While often adopted, mortgage interest tax deductibility is inefficient particularly if not targeted (as it subsidizes all owner-occupiers) and is considered highly regressive.

17. **Government guarantees/insurance*.*** The government may take over from private lenders all or a portion of the primary market or credit risk associated with all or a targeted portion of housing loans. The government can guarantee a borrower's obligation to private lenders or insure the risk (whereby the government insures the loan against default). Government guarantees/insurance is a relatively efficient way to encourage lending at lower rates or to lower-income households. The key challenge is proper pricing of risks and avoiding moral hazard.

18. Governments may also provide implicit or explicit guarantees against loss of deposits in order to support development of wholesale funding mechanisms for housing finance. This may take the form of guarantees for timely cash flows for mortgage-back securities or against default by lenders who borrow from a liquidity window. Assurances to varying degrees explicitly or implicitly protect investors from catastrophic failures of the housing finance system. Credit enhancement through government guarantees is often used to catalyze a market.

19. **State-owned housing finance institutions*.*** Governments often set up housing finance institutions (HFIs) or state housing banks as an intervention to quickly yield results when confronted with a market failure. There are many variants of state-owned HFIs—driven by financial policies and shaped by the local environment and its evolution. Some operate in the retail housing finance market, others in the wholesale market with or without regulatory powers. Some are specialized housing banks, yet others are part of a commercial bank. Some combine retail housing loan services with real estate developer functions. Government-owned HFIs to develop MBS markets were recently established in Japan and South Korea, and there has been a number of mortgage securitization institutions created in emerging markets.

20. **Mortgage subsidies.** An illustrative list of countries that have adopted various forms of mortgage subsidies is provided in Table 1. Countries that have utilized direct interest subsidies to promote homeownership include France, Hungary, the US and Japan. A brief description of the mortgage interest rate subsidy adopted by France, the US and Japan, follows.

21. **France (1977 to present).**[7] A significant 24% of all French homeowners have been supported by a direct subsidy covering part of the mortgage payment, and/or by loans at below market rates. Between 1977 and 1984, nearly 60% of new mortgagers benefited and the rate of homeownership increased markedly. Before the mid-1990s, assistance was targeted to low-income homeowners.[8] During high inflation and negative real interest rates, the government's programs were extremely popular. With a fall in inflation in 1984 but no change in the interest rate for government provided loans, real interest rates increased sharply and the private lending system was able to compete with loans at lower rates than the subsidized rates. In 1995, PAP was replaced by an interest-free loan (PTZ) of around €15,000, granted to first-time buyers (with means tested eligibility) to complement other credits. The loan cannot exceed 20% of the

[7] (i) J. Lawson and V. Milligan. 2007. *International Trends in Housing and Policy Responses.* AHURI Final Report No. 110. Melbourne: Australia Housing and Urban Research Institute. Sydney Research Centre. p. 68. (ii) A. Laferrère, and D. Le Blanc. 2006. Housing policy: Low-income households in France. In R. Arnott and D. McMillen, eds. *A Companion to Urban Economics*. Boston: Blackwell Publishing. pp. 159-178.

[8] PAP is a government loan with both income and house price limits that are offered at a lower interest rate, together with a housing grant to cover part of the monthly payment. PC is a preferred-rate mortgage loan, with dwelling but not income tests, made by banks or financial institutions under contract to the government.

purchase value and 50% of the total credit and can be paid back only after all other loans are totally repaid.

22. **Japan (1950 to 2007).** In Japan, direct interest subsidies were channeled through the state-owned GHLC created in 1950 to finance postwar reconstruction. GHLC was mainly publicly funding through special government programs and grants. During the real estate bubble period, the GHLC's lending conditions were repeatedly improved. GHLC loans were offered to house purchasers at a fixed rate below market with a 10-year maturity or at a preset fixed interest rate with a 25-year maturity. In 2002, the rates were 2.755% and 4%, respectively.[9] Private lenders unable to match concessional terms were crowded out. With the high fiscal cost of the program and the post-bubble recession of the 1990s, the program was phased out in 2007.[10]

23. **United States (1968-1973).** The US government initiated program "Section 235" in 1968, to assist low-income households to become homeowners. Over four years, almost 400,000 loans or 3% of houses sold were provided through private lenders. The loan was limited to $15,000 and, while no down payment was required, repayment was set at 20% of income. Under the program, a 1-3% interest rate was offered at a time when market interest rates were 7–8% and inflation was 4–5%. The interest rate differential was billed on a monthly basis to the government by participating lenders. The government also guaranteed recovery of the loan to the lender. By the end of 1972, it was clear that cost of the interest rate differential was greatly understated and the actual fiscal cost (present value of future subsidy payments) would be quite large particularly given high rates of defaults. By early 1973, all new subsidy commitments under Section 235 were suspended.[11]

**Table 1: Forms of Mortgage Subsidies Implemented Globally for Selected Countries**

| Direct Interest Subsidies | Housing Savings Schemes | Housing Provident Funds | Mortgage Interest Tax Deductibility | Guarantees or Insurance | State-owned Housing Finance Institutions |
|---|---|---|---|---|---|
| Czech Republic | Czech Republic | Brazil | Belgium | Brazil | Algeria |
| France | France | China | Finland | Canada | Brazil |
| Hungary (2000 – 2005) | Germany | Malaysia | France (before 1998) | France | Chile |
| India | Hungary | Mexico | India | Hong Kong | India |
| Japan | New Zealand | Nigeria | Netherlands | Jordan | Iran |
| USA | Slovakia | Philippines | Switzerland | Korea | Korea |
| | UK | Singapore | UK (before 2000) | Lithuania | Japan |
| | | | USA | Malaysia | Singapore |
| | | | | Netherlands | Thailand |
| | | | | Sweden | Tunisia |
| | | | | USA | |

Sources:
1. J. Lawson and V. Milligan. 2007. *International Trends in Housing and Policy Responses.* AHURI Final Report No. 110. Melbourne: Australia Housing and Urban Research Institute. Sydney Research Centre.
2. M.C, Hoek-Smit. 2009. Chapter 16: Housing Finance Subsidies. In L. Chiquer and M. Lea, eds. *Housing Finance Policy in Emerging Markets*. Washington: The International Bank for Reconstruction and Development/The World Bank. pp. 417-461.

9 L. Chiquier and M. Lea, eds. 2009. *Housing Finance Policy in Emerging Markets*. Washington: The World Bank. p.256.
10 R. Groves, A. Murie and C. Watson, eds. 2007. *Housing and the New Welfare State: Perspectives from East Asia and Europe*. Aldershot, UK: Ashgate Publishing. p. 124.
11 D. Diamond. 1997. *The Promises and Perils of Interest Rate Subsidies: A Survey of Eight Selected Programs.* Report prepared for US Agency for International Development.

24. The choice of housing subsidy policy is highly dependent on policy goals, the country's stage of development, and specific market conditions. Supply-side policies play an important role particularly in markets with serious housing shortages or a relatively inelastic supply of housing. Demand-side subsidies are more suited to markets with an elastic supply of housing and need to be carefully crafted to avoid escalation of house prices. Mortgage subsidies, in their various forms, are often adopted in early stages of development of housing finance markets to kickstart lending and to popularize basic knowledge of housing finance. They have also been introduced in periods of high inflation to demonstrate social commitment, and encourage household savings and investment in housing. Mortgage interest rate subsidies, given potential for market distortions,[12] need to be carefully designed,[13] that is, targeted and transparently applied, fiscally sustainable, and capped with a well-structured exit strategy.

[12] Distortions, dependent on the form of mortgage interest rate subsidy, include: (i) over-borrowing and higher mortgage loans; (ii) higher costs of intermediation and servicing; (iii) crowding out of other market players; (iv) substantially higher fiscal costs (than an upfront grant towards the down payment); and (v) moral hazards related to both subsidy recipients and financial intermediaries.

[13] Experiences and lessons learned of other countries in applying various forms of mortgage interest rate subsidies demonstrate the hazards of various designs and provide practical guidance on more efficient and cost-effective approaches. (i) D. Diamond. 1997. *The Promises and Perils of Interest Rate Subsidies: A Survey of Eight Selected Programs.* Report prepared for US Agency for International Development. (ii) L. Chiquier and M. Lea, eds. 2009. *Housing Finance Policy in Emerging Markets*. Washington: The World Bank.