Position Paper

Boosting the supply of affordable rented housing: learning from other countries

Summary

1. We are developing a new and different model for the UK for the delivery of affordable housing. It is based on conditional object subsidies in the form of tax incentives[1]. Both France and the USA have long-established approaches of this type. These have successfully increased the quantity and quality of stock as well as it being accessible and affordable to households in need. There are, thus, real opportunities for lesson learning from France and the USA. In the UK, we have a housing supply crisis. We are building an insufficient number of homes despite a raft of initiatives. Moreover, the scale of public investment at £2-2.5 billion is dwarfed by the costs of housing benefits at £20-£25 billion. Our proposals would start to rebalance funding as more supply subsidies reduce the need for demand subsidies.

Introduction

2. The aims of this paper are (i) to summarise the progress on this Economic and Social Research Council (ESRC) knowledge exchange project and (ii) to provide the basis for a discussion on the principles and model(s) for boosting the supply of affordable rented housing in the UK. There are four core features of the project:

- The methodology for the project examines data collected as part of previous studies by the Centre for Comparative Housing Research (CCHR) on international policy comparisons' (Oxley *et al*, 2010).
- It builds on previous thinking by Places for People on addressing housing supply issues, for example, Real Estate Investment Trusts and writing off historic housing grant[2].
- The project, unusually, is delivered in partnership with a housing provider to 'reality check' the findings as they emerge.
- The project is specifically centred on boosting the supply of affordable rented housing through conditional object subsidies.
- It is about learning from other countries – not transferring policies.

[1] We use wherever possible the generic term, 'tax incentives'. This is because the American use of the term tax credits does not accord with the UK use of this term. Similarly, in the UK, our use of the term tax relief means something different in the USA.

[2] In the course of the research we have also examined the role of residential Real Estate Investment Trusts (REITs) in the USA and we are aware of Places for People (PfP) initiatives on this topic and the PfP response to government consultation on this issue. A summary of the potential role of residential REITs and the lessons from the USA will be included in the final report.

Housing Supply Crisis

3. There is a long-standing consensus that we are not building sufficient housing. Housing investment in the UK has been low by international standards for several decades. Measures of gross fixed capital formation in housing as a percentage of gross domestic product (GDP) capture the volume of a nation's resources devoted to house building and major improvements in the housing stock. By this measure the UK has had lower levels of housing investment than most other advanced economies. The UK figure of 3.6% in 1970 compares, for example, with 7.2% for France, 6.8% Germany, and 6.7% Netherlands; in 1980 the UK figure of 3.7% compared with 6.7% France, 6.9% Germany, 7% Netherlands and 4.4% USA. From 1996 to 2011 the UK averaged 3.3% whilst the figures were 5% for France, 6% Germany, 5.8% Netherlands and 4.5% USA (for more details see Pawson and Wilcox, 2013, table 8).

4. In England, Holmans (2013) calculates that between 2011 and 2031, we need to build 240,000-245,000 units per year, 80,000+ of which should be affordable homes. We are currently building approximately 100,000 units per year of which between 30,000 and 40,000 are affordable. In Scotland, the output of owner occupied dwellings has dramatically fallen from 22,000 in 2007/08 to 10,000 in 2011/12. In relation to affordable housing, output is running at just over two-thirds of estimated needs (Audit Scotland, 2013). In Wales, Holmans and Monk (2010) commented that 14,200 units were needed per year of which 5,100 should be 'affordable' between 2006 and 2026. In 2012/13, less than 5,500 houses were completed, of which 750 were provided by housing associations (Nicholas, 2013, p96).

5. Chronic undersupply has a human cost, for example, the average age of a first time buyer without the help of 'the bank of mum and dad' has risen to 37 years old. There are over 1.8 million households on housing registers in England – a doubling over the last decade. It also has an economic impact. Government research suggests that every 100,000 new houses built could boost GDP by one per cent. In addition, each £1 spent on housing creates £2.09 for the wider economy.

6. There are a considerable number of independent reports covering supply. They are evidence-based and make a compelling case for increasing the supply of good quality housing especially affordable homes for households in need. The majority of studies conclude that fundamental policy changes are required and it would be inappropriate to return to the pre-downturn reliance on government grants and planning agreements. Funding and investment is, however, underplayed compared, for example, with infrastructure shortfalls, the inadequacies of the planning system and lack of land.

7. From a supply side subsidy perspective, there are relatively few detailed studies and only one recent report that adopts a comparative perspective. The latter, furthermore, provides little insight into the challenges and opportunities of lesson learning from other countries. There was, however, interest in the tax incentive scheme in the USA in the early part of the last decade (see Stothart, 2003 and Smith,

2003). A proposition was developed by Maritime Housing Association with the advice of American advisors for a housing and regeneration tax credit (HART). This, however, failed to gain political support.

8. In England, there are at least 15 national initiatives to stimulate supply (Wilson, 2013b). These are often small scale and short term as well as overlapping. They have been initiated through the government's spending reviews and budget cycles. This has resulted in a lack of continuity and simplicity for housing providers and, more importantly, a continued failure to address under-supply.

9. The housing supply side crisis reflects the long-term trend of a shift from bricks and mortar subsidies to individual income linked assistance through housing benefits. It is argued that the latter (i.e. demand side subsidies) promote individual choice and are more efficient than supply side subsidies. However, the inelasticity of housing markets leads to an ineffective supply side response and a consequential rise in house prices and rents. The UK government's measures to reduce the cost of housing benefits are a further consequence of the long-term move to demand led subsidies (Wilson, 2013a).

10. In 2010/11, help with housing costs amounted to £20 billion in Great Britain with over £12 billion for tenants in the social rented sector (Pawson and Wilcox, 2013). This compares with capital subsidies of just over £2.5 billion. We estimate that supply side support for the rental sector in 2010/11 was 75% of that in 1990/91. In comparison, demand side support through housing benefits was over four times that in 1990/91. This makes a compelling case for rebalancing bricks and mortar subsidies and individual income linked assistance. For rental housing, less supply side support requires considerably more demand side support, and with a lot more housing benefit expenditure.

11. In summary, the housing supply crisis highlights the importance of:

- Increasing supply – production / quantity;
- Meeting housing needs – targeting allocation on specific groups;
- Ensuring a high standard for homes – quality; and
- Guaranteeing affordability.

Policy Approaches

12. Given the supply crisis, the impact of the downturn and the imbalance in housing subsidies, it is essential to distinguish between a typology of four policy approaches that are used in market-based economies worldwide:

- Support those in need through **unconditional income related assistance** (help goes to households: pure subject subsidies).
- Support those in need through **conditional income related assistance** (help goes to households with housing conditions attached: conditional subject subsidies).

- Support supply through **unconditional subsidies** (help goes to suppliers: pure object subsidies).
- Support supply through **conditional subsidies** (help goes to suppliers with conditions about helping households: conditional object incentives).

13. Details of these approaches are provided in the table below:

Table 1 Rental subsidies and incentives: definitions

	Who gets the help?	**Conditions**	**Type of help**
1. Pure Subject Subsidies	Households	Personal circumstances but not specifically housing costs	Income supplements; personal tax reductions
2. Conditional Subject Subsidies	Households	Household, income, size and housing costs	Housing allowance, housing voucher
3. Pure Object Subsidies	Suppliers – including house builders and landlords of many types *	Additional housing supplied	Grants, tax reductions, cheap loans, equity finance
4. Conditional Object Incentives	Suppliers – including house builders and landlords of many types*	Additional housing supplied; Rents limited; allocation constrained (usually to households below an income threshold, but employment, household type and other indicators of need may also apply)	Grants, tax reductions, cheap loans, equity finance, tradable tax credits, cheap land

* The assistance to suppliers may come straight from the government or be channelled through an intermediary such as a financial institution or a special housing fund (with the financial institutional or fund having an obligation or incentive to supply preferential finance), or through another developer (when for example a commercial developer is required to support affordable housing through planning). In each case the assistance has its origin in a policy decision.

14. **Our project primarily centres on category four – conditional object subsidies**. This type of approach has not been developed in any major way in the UK in relation to tax incentives.

Learning from Other Countries

15. This project stems from a study that initially examined policy incentives for the rented sector in 27 high-income OECD member countries and then focussed with increasing detail on fewer countries (Oxley *et al*, 2010). Our current project has centred on a twin track approach in relation to other countries. These are, firstly, a nine country scoping study reviewing policies that provide affordable housing through conditional object incentives. Only two of these countries, France and the USA, have long established tax incentives that are thoroughly documented and are not complicated by other general non-specific tax measures.

France

16. Conditional incentives exist to increase the supply of intermediate housing. The principles were established in the early 1990s and are:

- A developer puts together a package within the framework of a specific government initiative.
- A property production and management package is sold to individuals.
- The project is built and a managing agent lets the units to the appropriate customers.
- The individual investor benefits from the conditional tax concessions.
- The developer benefits indirectly from the tax concessions (and other subsidies) by factoring in these in the viability modelling of the initial proposed package.

17. The impact of the overall model has been significant. Between 1995 and 2004, it accounted on average for over a third of private sector production (30,000+ units per year). In 2009/10, it amounted to over 50% of private sector production (60,000+ units).

USA

18. A system of low income housing tax credits (LIHTCs) has been in operation since 1986. It is essentially an income related construction incentive. Developers are able to obtain these subsidies *either* if at least 40% of units go to low income households whose incomes are less than 60% of the area median *or* if at least 20% of units go to low income households whose income is less than 60% of the area median. Rents also have to be held below market levels.

19. It is a federal scheme within the jurisdiction of the Internal Revenue Service. The Federal Government allocates quotas (based on population levels) to each state. The value of a tax credit is annually adjusted to take account of inflation. Each state allocates their quotas according to a qualified allocation plan (QAP). The QAPs enable each state to prioritise funding for locally important issues (for example, new build or improving existing stock, urban or rural areas, etc). The tax credits last for ten years and schemes must remain in low income occupancy for at least 15 years with 30 years becoming the norm.

20. The developer (who can be a private, public or non-profit organisation) receives the tax credit and sells them on to an investor or a syndicator. The latter is likely to pool several projects into one equity fund. There is a market for tax credits i.e. they are a tradable commodity. Investors assume the development and operating risk when they invest in LIHTC projects. They can only claim tax credits if the buildings are maintained in compliance with programme requirements, which are monitored primarily by state housing agencies. Investors are principally corporate institutions rather than individuals.

21. The outcome of the LIHTC system is impressive. In the late nineties the programme delivered around 60,000 new units rising to 80,000 at the peak, more recently delivering 35,000 in 2011. Overall it has helped to build, renovate or conserve more than 2.5 million affordable housing units. It accounts for 90% of all current affordable housing provision. Vacancy rates are lower than for market rented housing. Also, the quality of housing is high. Nevertheless, there are two interrelated issues. Firstly, extremely low income households cannot afford the rents unless they have a housing choice voucher. Secondly, developers often require an additional subsidy from the state or federal government – LIHTCs on average contribute a third of the development costs and traditional financing provides a further 40-45%. The remaining 20-25% might come from reduced public land costs (especially as land costs cannot be covered through LIHTCs).

Emerging Issues

22. The major points arising from the French and USA case studies are:

- **Conditional tax incentives operate effectively in countries with different cultures on tenure** including those with a commitment to owner occupation like the UK (for example. the USA).

- They **operate in a federal system of government (e.g. USA) and a unitary system** (for example, France).

- Schemes **can operate as the 'only game in town' for affordable housing provision as in the USA or, as part of a raft of measures** to provide new affordable homes as in France.

- Policies **can be designed to focus on individual or corporate investment.**

- **Balancing national government priorities with local requirements** is an essential component of policy design.

- Schemes can be developed so that they can **address other themes** e.g. green agenda, urban regeneration, tackling macro-economic problems, etc.

- Policies operate within a market economy and are **dependent on a mature investment market** as well as a proactive housebuilding sector.

Principles of a New Approach

23. The success of a specific policy based on the principle of conditional object subsidies has been identified in France and the USA. It centres on four aspects – production, allocation, quality and affordability. These are key points that are frequently stressed in reports in England on tackling the housing supply crisis (see above) and are crucial in developing a new approach.

24. More specifically, tax incentives in France and the USA (i.e. a type of conditional object subsidies) address these four aspects:

    - **Production**: Tax incentives in both countries provide significant numbers of new homes. The incentives increase the net supply of housing especially affordable homes – there is little evidence of substitution i.e. diverting delivery from other programmes.

    - **Allocation**: The housing can be targeted on households in housing need i.e. those unable to afford market rents or enter the owner-occupied sector.

    - **Quality**: The incentives provide good quality accommodation and can include requirements to meet, for instance, high standards of sustainable building and lifetime homes requirements.

    - **Affordability**: The housing is affordable in terms of measures of rent against income for a specific period of time, say 15 years. Specific affordability targets have been designed in both countries to reflect changing political priorities on whether to focus on very low income households i.e. deep subsidies, or low income households i.e. shallow subsidies. In both countries, the focus on the former involves both conditional object incentives and conditional subject subsidies.

Potential Barriers to a New Approach

25. In developing our new approach to boost the supply of affordable housing, regard has to be given to potential barriers. There are not insurmountable but highlight that it challenges conventional systems that have been used in the UK for many decades. They are:

    - **Structural**: The housing sector has generally been geared up to a system of affordable housing provision based on government grants and the use of planning agreements. Because of the credit crunch, recession and public expenditure cuts, it is highly unlikely that we will return to the apparent halcyon days of generous levels of grant and high affordable site specific housing targets.

New innovative approaches are required that will necessitate a restructuring of the housing development system.

- **Ideological**: The promotion of owner occupation to meet the aspirations of newly forming households has been a major tenet of government policy in the UK for many decades. Boosting affordable housing supply through tax incentives does not challenge this principle. Instead, it provides an alternative model for affordable housing provision that would also meet other government priorities of reducing the scale of housing benefit payments.

- **Regulatory**: New models of affordable housing supply will require different regulatory approaches. A conditional tax incentive model (as, for example, in the USA) has a regime based primarily on monitoring outputs of completed schemes rather than one centred on assessing potential providers. In addition, proposals would need to be EU 'proofed' in relation, for example, to state aid and competition policies.

- **Fiscal**: A conditional tax incentive model is based on 'tax foregone' rather than direct public expenditure. This represents a very different system compared to existing approaches in the UK for the provision of affordable housing. Furthermore, if tax credits for affordable housing were to be tradable, as in the USA, a market in tax credits would need to be established.

- **Lesson learning**: Our approach centres on lesson learning from other countries rather than simplistic policy transfer of an idea. The latter may appear to be more straightforward but often fails to appreciate the different economic, political and social environments. We would argue that this was a major reason why the previous attempt to 'import' the low income housing tax credit system from the USA in the early part of the less decade failed.

- **Innovation inertia**: Many stakeholders, whilst supporting our narrative on the long term supply crisis, fail to bring forward innovative and realistic proposals. Some call for a return to generous grant funding, while other suggest that the solution is for the Treasury to change its approach on financial accounting from the PBSR (public sector borrowing requirement) to GGFD (general government financial deficit), as the latter does not include borrowing by public corporations. Both are non-starters as all of the main political parties have ruled out such measures.

New Model(s)

26. We believe that our new and unique approach for the UK based on the principles set out above is both innovative and politically realistic.

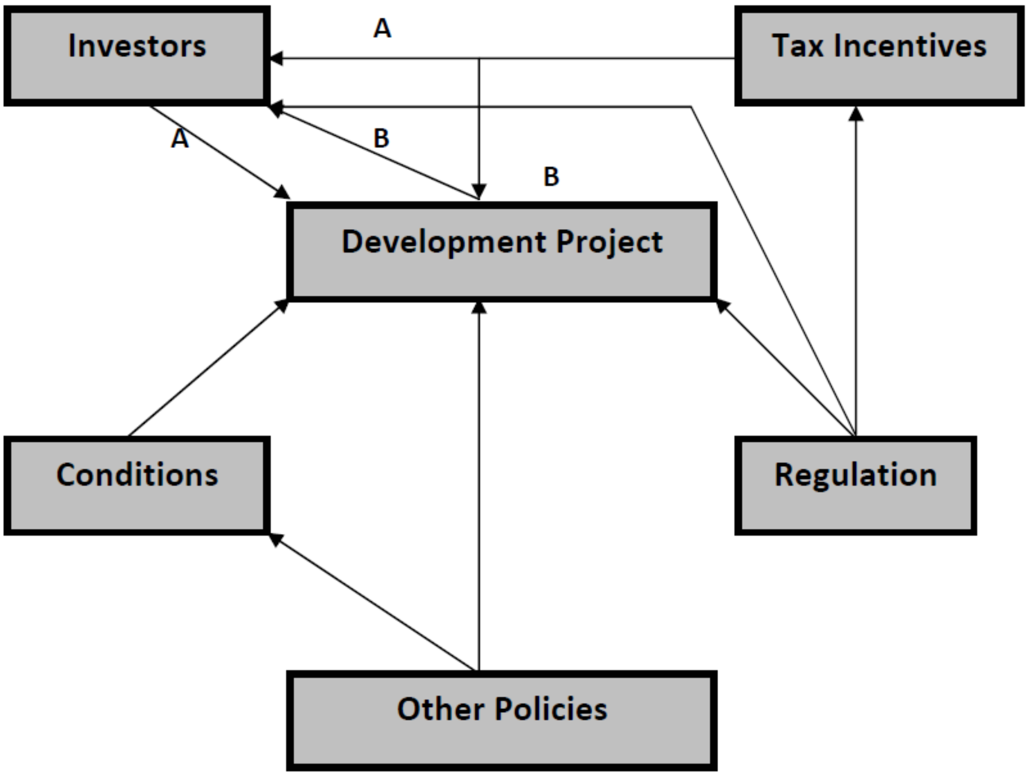
27. Set out below is the outline of a conditional object subsidy model based on tax incentives to achieve, production, accessibility, quality and affordability.

28. Our approach for consultation centres on six issues:

- Development project;
- Investors;
- Tax incentives;
- Conditions;
- Regulation; and
- Relationship with other policies.

Each of these has a subset of issues – see the full consultation paper.

29. Diagrammatically, the overall approach is:



The key points are:

- The development project would take account of tax incentives, investors, conditions, regulation and other policies.

- Tax incentives could be development (routes B) or investor led (route A). In the case of the former, the development would attract tax incentives that would be marketed to investors. In relation to the latter, investors would decide what to invest in (or even to invest in affordable housing at all).

- Regulation of tax incentives, investors and projects would be required.

- Other policies (for example, the ‘green’ agenda) could either be linked to conditions or applied directly to projects.

- Other policies are crucial in achieving the localism agenda, if there is no local influence on conditions.

- This overall approach would need to be EU ‘proofed’ to take account of areas such as state aid and competition policy.

Discussion and Questions

1. **Is the problem specified correctly?**

2. **Is this overall approach appropriate?**

3. **What are your views on the tax incentives routes?**

4. **Should other policies be part of the conditions or a direct requirement for each project?**

5. **Where should the localism agenda be built in – conditions or other policies?**

6. **We believe that EU proofing ought not to be a major issue, but is this the case?**

7. **What are the main constraints to a change of policy that will result in an increase on the supply of affordable rented housing?**

References

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Appendix: List of Supporting Papers

The following detailed papers are available on request:

1. A Typology of Policy Approaches
2. Consultation Paper
3. Policy Position
4. Supporting the Supply of Affordable Housing through Conditional Tax Incentives – Policies in Other Countries
5. The Supply of Affordable Housing in England and the UK: A Review of Recent Research Reports [including a Table Summarising Selected Reports]

Notes:

1. For permission to quote from this paper, contact the project team via rlishman@dmu.ac.uk.
2. Further information about the project is available online from http://housingsupply.our.dmu.ac.uk.

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