Social housing in the USA and France: Lessons from convergences and divergences

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ABSTRACT

The development of subsidized rental housing estates really begun in the USA after the Great Depression and in France after World War II, but has changed dramatically since that time, relying more heavily on tools that can be used by the private sector. This comparison will show that the relevant solution to housing problems in a given context should be based on the correct diagnosis of this problem and also be dependent upon the specific situation in that country, state or locality. This is the best way to create efficient, sustainable, affordable financing mechanisms for local, municipal and state governments.

This paper will discuss the different methods by which the United States and France have addressed the challenges. For the U.S., we will highlight two programs: the low income housing tax credit program, which uses the tax code as an incentive, and the capital fund financing program, that allows public housing authorities to securitize an ongoing stream of funds and use this to modernize properties.

France introduced tax subsidies to the private sector at the same period, but in addition, not as a substitute, to public housing. After heavy taxes had deterred private investors, generous tax incentives brought them back towards rental housing. Few of these programs were affordable to moderate income households. This resulted, in the recent years, in an aftermath of production of public housing units, requiring an increasing commitment from the municipalities.

Key Words: affordable rental housing, social housing, tax credit, tax subsidies

This paper is intended to analyze the differences and similarities between social housing policy in the United States and in France, so as to give a perspective to countries around the world on options for housing lower income families.

In France, housing is considered a right and, therefore, an obligation of the government to provide for its citizenry. While the provision of housing in the United States does not hold the same legal or ethical status as it does in Europe, the country still has provided a number of policies to provide housing for those in need. The tools for subsidized housing in both countries are quite varied. Whereas they are piling up in France, they have substantially changed over time in the USA.

In France, the main subsidy mechanism is now housing allowances. This tool was seen as equitable, efficient, and, at least in theory, gave tenants more control over their living situations. France nonetheless still uses supply-side subsidies to stimulate affordable rental housing, providing traditional social housing providers with a mix of upfront and tax subsidies and attracting private investors with tax subsidies.

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At the same time, in France, after heavy taxes had deterred private investors from rental housing, generous tax incentives successfully, but temporarily, brought them back towards new rental housing, seldom affordable to moderate income households. This resulted, in the recent years, in an aftermath of production of heavily subsidized public housing units, in small or mixed programs, whereas large suburban estates were being demolished.

In developing affordable rental housing, the United States has a number of embedded beliefs, ones that are sometimes in contradiction to one another. On the one hand, the U.S. has a history of believing that using market forces, and not the rule of government, is the best strategy for developing a strong economy and for giving people the opportunity to build their lives, their wealth, their jobs and their families. On the other hand, there is a strong history of intervention in the market, whether through legal and regulatory intervention, through federal, state and local appropriations, through direct management and ownership, or through the use of tax incentives to achieve policy goals.

The different tools each address different needs. The challenge is for the government to use the proper budgetary tools and tax incentives to address these needs in different housing markets, and to provide the incentives for private parties to own and manage quality, affordable rental housing.

Financing Tools for Affordable Rental Housing in the United States

Overview

The United States uses a number of tools to achieve its varied, and sometimes conflicting, housing goals. First, there is the actual provision of social housing in public housing developments run by public housing authorities, similar to what are called “estates” in Europe. Second, there is mortgage insurance and direct lending through the federal government’s Federal Housing Administration (FHA). Third, there are rental subsidies where the eligible tenant pays a portion of his or her rent, generally 30 percent, and the government pays the difference between that rent and the “fair market rent (FMR)” as determined by the government. This tool has changed over time. At first it was tied to the specific project and was known as “project based rental assistance.” In the 1980’s, the emphasis changed to tenant based rental assistance, where the tenant received a voucher and was not tied to a particular unit.

There has been no new investment in public housing since the mid 60s. It did provide low cost apartments but, in some communities they were in poor physical condition, isolated residents from the broader community, and had serious crime problems. In some cities, such as San Francisco and Chicago, the housing was torn down.

Project based rental assistance provided a guaranteed income stream to the owner, but, since the government set the markets based on its determination of fair market value, the rents were either too low to provide an incentive for keeping it in good repair, or too high and created a drain on the federal government. In the cases of those that had FHA insured loans, the government lost its leverage against owners of properties in poor condition because its only tool was rent abatements, potentially forcing the projects into foreclosure and thereby creating an insurance claim.

Tenant based rental assistance, while providing some degree of flexibility to the tenants, had waiting lists of years in many major cities. Moreover, a great many landlords would not participate in the program, causing a lack of good housing choices.
In all of these cases, the cost to the federal government was quite high, and, in many years, was the majority of the federal housing budget. In times of economic difficulty, the government could and did cut back on these programs.

However, the provision of affordable housing remained a necessity; and, given the budgetary impact, steered the government to try alternatives that were based more on tax incentives in order to as governments on both sides of the Atlantic Ocean tried to prompt private investors towards some new form of social housing.

In the United States, the major tool for the development of affordable housing, the Low Income Housing Tax Credit program (LIHTC) was created as part of a change in the federal tax code in 1986. This program primarily assisted families on the more moderate end of the low to moderate income spectrum, while funding for public housing continued. This program will be the main subject of discussion in this paper of rental social housing in the United States.

The Low Income Housing Tax Credit Program (LIHTC) was created in 1986, after numerous attempts at stimulating affordable rental housing, as part of broader tax reform legislation. Rather than being a program where the federal government funds, builds and manages affordable housing, the tax credit program was designed as a way for the federal government to stimulate the private and non-profit sectors using the tax code. This is a blend of enabling the tools and financial abilities of the private sector, with a targeted system to meet the policy of increasing affordable housing.

While this program has helped to create more affordable rental housing than any other program since it was created, and while it has created a financial system that has been sustained for more than two decades, it cannot work in every situation and cannot address all affordable housing needs. A country evaluating this program must have a tax system that is vibrant enough to create a tax credit program and companies with a tax burden deep enough that can use this type of tax offset.

Low Income Housing Tax Credits “are allocated to for-profit and not-for-profit developers of affordable rental housing. By reducing a developer's federal tax liability, or selling of tax credits to investors, tax credits can contribute significantly to the financial viability of developing affordable rental units.”

The tax credits allow developers who use them as a way to bring equity into a project. It was developed as a way to create a source of private equity for affordable housing. “The tax credits are more attractive than tax deductions as they provide a dollar-for-dollar reduction in a taxpayer's federal income tax, whereas a tax deduction only provides a reduction in taxable income.”

The way the program works is that a developer submits an application to an “allocating agency.” If the development is awarded an allocation of credits, the development is awarded nine percent of the qualified costs for each of the next ten years. In general, the costs associated with this basis are most of the costs incurred for the project, except for land and the costs of raising capital.

Since the capital to develop the project is needed at the beginning or in the early stages of development, the developers sell these credits to investors, such as Fannie Mae, banks and insurance companies. Alternatively, they can be sold to “syndicators,” who raise pools of capital from private investors, which are then invested in tax credit projects.

3 http://ihcda.in.gov/developers.aspx
4 http://en.wikipedia.org/wiki/Low-Income_Housing_Tax_Credit
The amount that the developers receive depends on the market value at the time. In the early years of the program, investors were only paying 45 percent of the ten year value of the credit. The balance between this equity and the costs of the project had to come from other sources. Since even with this layer of equity, the project would not provide positive cash flow due to the reduced rents, developers were forced to seek other sources to fill the financial gap, such as federal funds, foundation grants, and soft second mortgages.

As the program matured, and as investors came to believe that this was a very safe investment, investors were willing to accept lower rates of return and the value of the credits increased. By the peak of the market in 2006, the percentage of the ten year credit the developers were receiving, had more than doubled, to over 90 percent. This meant that the vast majority of the “qualified basis” came from tax credit equity. The developer only had to cover the remaining costs, the land, and the financing fees. This reduced the need to seek additional grants and low interest loans.

Since this was designed as a way to stimulate affordable rental housing, the program has a social objective. In exchange for the credit, the developers make a commitment to keep the units affordable for a minimum of 15 years. There is a technical definition of affordability, which is:

- At least 20% or more of the residential units in the development are both rent restricted and occupied by individuals whose income is 50% or less of the area median gross income.
- At least 40% or more of the residential units in the development are both rent restricted and occupied by individuals whose income is 60% or less of the area median gross income.

Under either of these standards low income tenants can be charged a maximum rent of 30% per month of the maximum eligible income.

As more developers saw the benefits of the tax credits, more competed for an award and the program became extremely competitive. In some states demand exceeded supply by more than ten to one. This enabled those who allocated the credit, to give higher consideration to those developers who were willing to make a commitment to even lower income people, who would keep the housing affordable for a longer period of time, who would provide social services to the tenants, and/or would be built in areas determined to be in need of affordable rental housing.

State Housing Finance Agencies and the Tax Credit Program

In designing the tax credit program, the U.S. Congress gave each state the authority to design the rules under which the tax credit would be awarded, once the basic affordability and management criteria were met. At the state level, this responsibility was delegated to Housing Finance Authorities (HFAs). These exist in all American states and in some municipalities. Some are limited in purpose and serve only as the bridge to the private sector, through tax incentives and bond issuance. Others are more full service entities, managing federal and state grant programs, housing trust funds, funding for housing development, down payment assistance to homebuyers, and rental assistance to low income families.

Each state receives an allocation of credits from the federal government, based on its population. From 1986 to 2000, “each state received a tax credit of $1.25 per person that it can allocate towards funding housing that meets program guidelines. This per capital allocation was raised to $1.50 in 2001, to $1.75 in 2002, and adjusted for inflation beginning in 2003.”

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5 http://en.wikipedia.org/wiki/Low-Income_Housing_Tax_Credit
6 Ibid
7 http://www.danter.com/taxcredit/about.htm
In terms of the low income housing tax credits, the HFAs are known as the “allocating agency”. In addition to awarding the credit, they are responsible for monitoring “the properties during the compliance period to ensure that rents and resident’s income do not exceed the program limits and that the properties are well maintained.” The allocating agency will sometimes also have other financial resources as well, such as federal grant funds, state grants and loans, housing trust funds and other sources of financing that can assist in making the development viable and affordable. Many states give additional consideration if the developer brings in other sources of financing, including those committed at the local level.

State agencies that award tax credits must, by federal law, create a “qualified allocation plan (QAP), which are the policies that guide the award of low income housing tax credits.” This is the key to accessing tax credits as it establishes the basic threshold a developer must meet for a competitive tax credit application and development proposal. If the developer does not meet these basic threshold criteria, the proposal will not be considered. Threshold criteria include site control, financing, and specific documentation.

A QAP outlines the state’s priorities in categories designed for specific groups (such as rural residents or the elderly) and in how the projects will be ranked overall. Many states’ QAPs cover the tax credit program only. Some states incorporate other programs related to rental housing, such as multi-family bonds, funds from housing trust funds, and federal funds awarded by states.

In a very simple example, if the total cost of the project is $1.2 million, of which $100,000 is for land and $100,000 is for syndication fees, the qualified basis is $1,000,000. All of the units are affordable and the project is not in a Qualified Census Tract (QCT) or Difficult to Development Area (DDA). No existing units are acquired and there are no federal funds in the project. The developer receives approximately nine percent per year ($90,000) for the next ten years in tax credits, for a total of approximately $900,000.

The U.S. Government’s Federal Housing Agency, the Department of Housing and Urban Development (HUD), gives guidance as to how the program works in its specifics. This can be seen in the following example:

“A local developer has proposed to use housing tax credits to construct 70 units of low-income rental units in Anytown, USA. No other Federal funds will be used. The development will not be located in a QCT or DDA. Forty percent (40%) of the units (and forty percent (40%) of the square footage) will be set-aside for income- and rent-restricted households. The total development costs for the project are estimated as follows:

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<td>Land Acquisition</td>
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<td>Dwelling Construction</td>
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<td>Site Improvements</td>
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8 http://ihcda.in.gov/developers.aspx
9 The laws and regulations governing the Low Income Housing Tax Credit Program derive from an act of Congress and are defined in the Internal Revenue Service’s (IRS) code. The IRS is the governmental body that regulates and collects taxes from individuals and business. Section 42 is the relevant series of regulations for the tax credit program. It notes that if a project is in a “difficult to develop area” or “qualified census tract,” the developer will receive an additional 30 percent bonus in tax credits.
Section 42(d)(5)(C) of the Internal Revenue Code defines a Qualified Census Tract as any census tract or equivalent geographic area in which at least half of the households have an income less than 60 percent of the Area Median Gross Income (AMGI). The Secretary of the United States Department of Housing and Urban Development (HUD) may also designate a Difficult Development Area if it is an area that has high construction, land and utility costs relative to the Area Median Gross Income.” HUD publishes tables of these areas, which can be found at http://www.huduser.org/DATASETS/qct.html
10 http://www.hud.gov/offices/cpd/affordablehousing/training/web/lihtc/calculating/value.cfm
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<th>Architectural/Engineering</th>
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In general terms, the amount of equity that can be raised from the sale of tax credits is calculated as follows:

- Eligible Basis = $4,000,000 (Total Development Costs - Land Cost)
- Qualified Basis = $1,600,000 (Eligible Basis x Applicable Fraction: $4,000,000 x 40%)
- Annual Credit = $144,000 ($1,600,000 x 9% Credit Rate)
- Total Amount of Housing Tax Credits = $1,440,000 ($144,000 x 10 years)

Potential limited partners have offered to purchase the tax credits at $.75 for every dollar of future tax benefit. Thus, in this case, the limited partners are willing to contribute equity of $1,080,000 today for future tax benefits of $1,440,000 (claimed at $144,000 per year for ten years). Thus the value of the housing tax credits, in this example, is $1,080,000.

We see from the above example that restricting 40 percent of the units to low-income households will produce approximately $1 million in equity from the sale of the housing tax credits. The difference between this amount and the total development cost must be covered by other funding sources, including loans, grants, or developer equity.

In the example, the affordable units (40%) probably account for $2 million of the $5 million total development costs. The value of the housing tax credits ($1,080,000) is slightly more than half of that amount. It is typical for "LIHTC equity" to cover roughly half of total development costs, in new construction projects utilizing the "9 percent" credit rate.

Strengths and Weakness of the Program

Since the program started in 1986, more affordable rental housing has been built using the low income tax credit program, than through any other type of incentive. Rather than keeping the control in the hands of the federal government, it allows broad social and financial policies to be set at the federal level, but enables states to tailor the program to meet the social policies that match its needs.

Moreover, this type of financing mechanism is quite different than one where the government finances, builds and manages the housing. It enables the discipline of the private financial sector and the private housing management sector to be used in affordable housing adding both strength and depth.

Non-governmental organizations that are rooted in the community can also have a significant role to play. They can either establish their own for-profit entities, or can partner with private firms, bringing together the social sensitivity of a non-profit organization with the discipline of a private sector business.

The housing that is built under the program is often indistinguishable from privately owned, market rate housing. The developments generally blend into the community in which they are located.

There are those that have criticisms of the program. First, because of the rents that must be charged, it can serve residents that are on the more moderate or low to moderate end of the income scale. Those who have very low incomes cannot afford these units without a much deeper form of subsidy.

Second, there are some who argue that, in some communities, the difference between market rents and the social rents established in this program are not wide enough to justify the loss to the federal treasury through this incentive.
Third, because of state priorities targeting lower income communities, it is not uncommon to see certain geographic areas overbuilt, with supply exceeding demand, whereas the need for housing in higher income areas goes unfulfilled, even if there are low income families in the areas that need it.

Fourth, the financial elements of the program can be subject to the vicissitudes of the financial market. While the program saw a steady increase in the value of the equity, the past two years have seen a significant decline. This is because the largest investors in the credit, such as Fannie Mae, cannot use the credit, and, therefore cut back on their credit purposes, because of their financial position. This change makes it difficult for developers who invested capital planning on equity at the higher price to adjust with such a deep drop. This is worsened by the difficulty developers are now seeing when it comes to borrowing.

This last factor should also give guidance to those who are seeking to develop the program and will note how important the tax code and financial markets of a particular country are in evaluating if and how the program can work.

**Capital Fund Financing Program: An Alternative to Address Publicly Owned Housing**

The low income housing tax credit program does not work with government owned housing. In the United States, there is a tremendous backlog of repair and modernization needs, estimated at $18 billion in 2006. Government owned housing, also known as public housing, is managed by public housing authorities all over the country. These are different than housing finance authorities and have, as their principal mission, the management of public housing. While these are funded by the federal government, and while many rules and regulations established by the federal government, there is a great deal of local control as they have independent Boards of Directors.

This housing serves, in general, a lower income population that is served by the housing developed under the low income housing tax credit program. In many cities and towns, there has been criticism of the housing because of its poor condition. While the federal government gives funding to each public housing for capital improvements, it is often not enough to address more serious rehabilitation needs.

One option for these authorities is to use a financing tool, the Capital Fund Financing Program (CFFP). Here, the authority evaluates its rehabilitation needs through a physical needs assessment. It then decides which repair or construction needs are the most critical. In order to gain access to larger pools of capital, the public housing authority has the ability, upon approval by the federal government, to pledge up to one third of its annual appropriation to either a financial institution for a loan or to investors in the case of a municipal bond. This permits the authority to receive capital for rehabilitation in the near term, rather than over a period of ten or twenty years.

While this financial mechanism aids the development needs of the authority and creates better housing conditions for low income people, there is a risk involved. Since it is pledging a share of its funding over a

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11 There are different definitions of “low income” in the U.S. government. In the housing area, the definition is usually considered to be between 50 percent and 80 percent of the area median gross income. This is then adjusted for family size. Very low income is considered to be between 35 percent and 50% of the AMGI. Extremely low income is defined as below 35 percent of the AMGI.

As an example, in 2006, San Diego California low income was defined as being at or below $49,700 for a family of three (below 80 percent of median); very low income (50 percent of median) for a family of three as being below $31,050; and extremely low income (35 percent or below) as $21,750 for the same family size. Affordability is defined as spending no more than 30 percent of a family’s income on housing. Since the tax credit program permits rents to be affordable at the 50 percent or 60 percent levels, rents for those families are not affordable to those who are extremely low income unless another type of subsidy, such as rental assistance.
long period of time, it does run the risk that if there are significant cutbacks at the federal level, it will have difficulty meeting other housing needs in the future.

Conclusion

The Low Income Housing Tax Credit Program is a financial mechanism that has permitted the growth of more affordable rental housing than any other financial incentive in the United States. It brings in the tools and the discipline of the private financial sector. Much of the housing that is built blends well into the surrounding communities and neighborhoods.

On the other hand, it does not tend to serve the very poorest populations, or, at least, does not do so without a much deeper type of subsidy. It is also targeted to housing owned by private companies, and not organizations owned by the government.

The Capital Fund Financing Program aims to a different group: public housing authorities. It does so by permitting these authorities to borrow against future capital improvement payments from the federal government. However, while it brings in capital from the private sector, it does not bring in the management tools from the private sector. Moreover, a public housing authority that pledges a portion of its assets locks them in to future payments for up to 20 years.

Financing Tools for Affordable Rental Housing in France

The orientations of housing policy in France are underscored by two general policy principles:
- The freedom of choice in terms of housing, including tenure, type of housing and location.
- The “right to housing” which has been a fundamental right since 1989 and has been made “enforceable” in 2008. It can be defined as the possibility of having access to and remaining in decent housing and suing the state if this is not the case. It is already applicable to some categories of population in great need and will apply to all, except non-regular immigrants, in 2012.
These two principles require a sufficient supply of housing, in terms of quantity and quality, but also in terms of diversity of tenure and social mix. The State, in spite of heavy pressure on budget spending is therefore due to maintain its support to social housing.

Public support

State involvement in housing finance and subsidy really started after World War II: France had to face a housing crisis which was not only due to war damages but also to earlier policies (rent control since 1916 had deterred investors from new investment and induced lack of upkeep in existing properties) and increase of housing needs because of the post-war baby-boom and rural exodus.

As time passed and the level of construction rose, the needs decreased while, with the opening of the French economy, the State was withdrawing from direct intervention, turning to market finance and concentrating its efforts onto the poorest households.

Since 1977, emphasis was thus put on housing allowances and supply-side subsidies were constantly reduced. Perhaps this reduction was too drastic and housing needs for the low and middle-income groups grew up again after the 90s crisis. As part of a “Social Cohesion Plan” the production of social rented units is being increased to an annual level of 140,000, which has not been reached for long.

The housing allowance

Low-income households are eligible to housing allowance, should they be tenants or home-ownership paying back a housing loan.
In 2006, the value of the total public support to the housing sector (subsidies and tax benefits) amounted to 30 Bn € or 1.75% of GDP. The largest part is borne by the State budget but the Social security budget pays a large part of housing allowances. The cost of housing allowance was nearly half of the total expenses (14.5 billion €). It is not only financed by the State budget but also by the Social security budget, the employers’ fund and the local authorities. The number of beneficiaries at the end of 2006 was 5.9 million, mostly tenants.

The housing allowance now appears to be a part of the “social security net” and a heavy counter-cyclical financial burden to the housing budget, leaving little margin to other housing policy goals.

The social rented sector

The stock of social rented housing is 4 million units, i.e. 17% of the total housing stock (chart 1).

*Chart 1: Permanent residences by tenure (2006)*

Source: National Housing Survey (INSEE).
Social landlords are HLM (Habitations à Loyers Modérés - Low-rent Organizations) and, for a small proportion (5%) SEM (Sociétés d’économie mixte - Semi-public companies). There are two distinct families of HLM: “Offices publics” and OPAC (Office public de construction et d’aménagement) are closely linked to local authorities, “communes” or “départements” while “Entreprise Sociales pour l’Habitat” are limited companies with some limitations on their benefits and the obligation of reinvesting it in social housing.

All these organizations are eligible to the same loans and subsidies and have the same constraints: a maximum rent and a maximum income for tenants (for an unlimited period), depending on the way the program has been financed, and allocation procedures: all financers (State, Local Authorities and employers) can propose a certain proportion of candidates as tenants in the program they contributed to finance.

A small share of the social rented stock is owned and managed by private landlords. They may not benefit from the same subsidies and off-market loans but their constraints are also reduced and they are only committed for a limited period of time.

Once in the premises, tenants have an indefinite right to stay (provided they pay their rent and behave in a decent way). When their income becomes higher than the maximum level allowed, they have to pay an additional rent which is higher when the income is higher.

After the Second World War, as financial needs were huge and the private sector was unable to provide long-term credit, long term (60 years) and low interest rate loans (2%) were directly provided by the Treasury to social landlords. Since 1966 loans to social rented housing are now provided by CDC (Caisse des Dépôts et Consignations - Deposits and Consignment Fund), a State-owned multifunctional financial institution (actually under the control of Parliament). These loans are:
- Long term (up to 40 years for construction and 50 years for land acquisition),
- Funded by (short-term) deposits on ‘Livret A’,
- At a rate (now 4.60%) that only depends on the interest paid to ‘Livret A’ savers (4% + 0.6% margin), regardless of the characteristics neither of the investor nor of its investment; 3/4 of French people (there is no minimum age) own a ‘Livret A’. Its rate used to be set by the Government. It is not linked to market conditions through the following formula: 50% Consumer Price Index (Annual change) + 25% 3-month Euribor + 25% EONIA (Overnight rate), with a minimum of CPI + 0.25 which ensures a positive real yield. It is revised every six months. Deposits on ‘Livret A’ are tax free (instead of 28% flat rate) and guaranteed by the State.

These loans have no credit risk, thanks to a double guarantee system: the repayment is fully guaranteed by local authorities (95% cases) which in return benefit from up to 20% of the units reserved for designated tenants. When the municipality is not able or willing to give its guarantee, it is replaced by a mutual fund (‘Guarantee Fund for Social Rented Housing’ - CGLLS) for a 2% fee. In practice, none of these guarantees is ever called on an individual (program) basis. CGLLS and all local authorities involved may be called on a general basis to rescue a landlord in financial distress.

The present system of aids to production in the social sector also includes:
- The benefit of the Value Added Tax (VAT) reduced rate on land purchase and construction works (5.5 % instead of 19.6%),
- An upfront grant, totaling between 2.5% and 16.5% of the cost (higher for second-hand purchases and for programs targeted to very-low income households),
- A 15-year property tax exemption (any housing is 2-year exempt); it is now (2005-2009) up to 25 years.

In addition, social rented housing programs often benefit from:
- State and local land subsidies, available on high-price markets;
- Additional subsidies or off-market loans from the Employers’ Fund also called “1% levy” as it was initially funded by a contribution equal to 1% of the salaries (now 0.45%).

State support to the private rented sector

The private rented sector comprises 21% of the housing stock (chart 1). More than 90% belongs to individuals, as low return and high management costs caused disinvestment among institutional investors. Unbalanced tenant-landlord relationship and heavier taxes also incited private landlords to sell their property. As a consequence, the private rented stock was losing 1% each year in the 1980s. The new incentives permitted this stock to grow again (+ 18% between 1984 and 2002 – chart 2) and to compensate for the disinvestment which continued at the same time. As a result, the rental stock not only stopped losing units but also was transformed as many older buildings disappeared or were renovated and sold.


![Chart 2: Share of investors’ purchases in developers’ sales in France (1995 – 2007)](chart.png)

Source: Federation of Builders-Developers.

Why subsidizing investors?
The incentive schemes to investors in rented housing were launched (in 1984 and 1996) during periods when the housing market was at very low ebb. There were in fact two different goals: increasing production of new housing and increasing the supply of private rental housing (e.g., to facilitate mobility). When the first goal is emphasized, the regulations applied to the programmes were generally less demanding (for example, renting to relatives may be allowed).
Some schemes were to provide accommodation to middle-class households who could no longer afford decent housing in large cities but whose incomes were too high to apply for social housing (the French version of the “key-workers” issue). Tax subsidies under these programs were targeted to specific tenant income levels and maximum rents applied (also no relatives were accepted as tenants,) with the consequence that they became less attractive to investors.

**Why targeting individual investors?**
Individual investors not only own a large majority of the rental stock, they are also the most likely to invest as French institutional investors have been reducing the share of residential real estate in their portfolios for many years and are not likely too change their policy.

The Government knows that households tend to overestimate the tax benefit they get from such schemes so that such incentives have a big leverage on investment. They also underestimate the risk they face to suddenly lose the tax benefit (if the property is not rented in due time and during the required minimum period of time) or not to make the expected profit on resale: in some cases, a significant numbers of units built in the same neighbourhood were for sale at the same time after the minimum rental period.

**Two generations of tax incentives**
Two schemes of different natures were successively proposed: “Quilès-Méhaignerie” (QM), from 1984 to 1997 and “accelerated depreciation” introduced in 1996.

Under the QM scheme, the investor benefited from an income tax credit equal to 10% of the investment, spread over two years, with a maximum amount. In a "social" version, which was much less successful, the deduction rate eventually reached 15% and the ceiling was doubled, but the benefit spread over 4 years, with rent and tenant’s income ceilings as counterparts.

“Accelerated depreciation” proved to be a more powerful instrument. In its first version (the parameters were often modified between 1996 and 2008), private landlords could deduct from their taxable income up to 65% of the purchase price of newly-constructed (most frequent case) or heavily renovated housing: 10% during each of the first four years, then 2% per year for twenty years.

The present scheme, in use since 2006, has two versions, a “standard” one (“Robien”) and a “social” one (“Borloo”) with rent ceilings in both cases; the second one only is income-tested (table).

**Table 1: New schemes of tax incentives to investors (Since 2006)**

<table>
<thead>
<tr>
<th></th>
<th>« Robien »</th>
<th>« Borloo »</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum income</td>
<td>None</td>
<td>9th decile</td>
</tr>
<tr>
<td>Maximum rent</td>
<td>90% market</td>
<td>70% market</td>
</tr>
<tr>
<td>Minimum rental period</td>
<td>9 years</td>
<td>9, 12 or 15 years</td>
</tr>
<tr>
<td>Rate of Depreciation</td>
<td>4% during 2 years</td>
<td>4% during 2 years</td>
</tr>
<tr>
<td></td>
<td>2.5% during 0, 3, 6 years</td>
<td></td>
</tr>
</tbody>
</table>

**Efficiency**
It is estimated that between 30,000 and 50,000 units were sold each year to investors under the first schemes. The most recent ones reached between 60,000 and 70,000 (chart 2).
The various schemes proved to be quite efficient (in terms of number of units sold) when no constraints applied to investors. However, an important proportion of them were sold after the minimum rental period. Also, some of them were either secondary homes or units to be occupied by relatives; cases of cross investment (two households renting to one another instead of buying their own unit) may also have occurred. So the objective of supporting the housing industry or generally increasing the stock is better reached than the objective of increasing the supply of rental housing.

Except in times of trough or in unconstrained markets, these schemes pushed prices up as many programs are targeted towards investors only: as they overestimate their expected tax benefit, they are ready to pay a higher price than would home-buyers.

Another source of inefficiency was related to the price ceiling which maximized the benefit in the QM scheme: it concentrated the developers’ supply on standardized units such as 1-bedroom in the Paris region, 2-bedroom in other large cities and 3-bedroom elsewhere, which aggravated the difficulties in resale mentioned above.

The negative impact on location may be the most important flaw of these schemes. The rent limit (a proportion of average market rent in a large zone) concentrates the developers’ supply on cities where local markets rents are low. As a consequence, they fail to increase the supply where the demand is higher, in spite of the changes in zoning and maximum rent levels introduced over years.

**Conclusion**

Given the social cost of changing the delicate balance of tenant-landlord relations and the budget cost of reducing the tax pressure on the rented stock, it is easy to understand why successive French governments have been resorting to such schemes for almost 20 years. The remedy looks costly: tax revenues are cut by more than 500 million € every year. But there are immediate gains in terms of VAT and other taxes and the building sector is an important contributor to economic growth. The main issue may be this one: how to create incentives for developers to concentrate their supply in places where it is most needed.

* * *

The United States’ financing options for social rental housing has the advantage of being able to target different options for different needs. Public housing for its poorest citizens. Rental subsidies for lower income families. Tax credit developments for the upper end of the low to moderate income scale—although these sometimes can be combined with rental subsidies, bringing the rents to a more affordable level.

Unfortunately, at the current time, the United States is undergoing a crisis in its housing and housing finance sectors. In the current environment of the mortgage crisis, both debt and equity for social rental housing are more difficult to obtain and more expensive when they can be obtained. Additionally, financial pressure on all levels of government caused by the need to assist both homeowners and financial institutions creates further challenges for financing affordable rental housing.

The backlog of rehabilitation needs on public housing properties is nearly $20 billion. The budget for capital funding declined six years running. Waiting lists for rental subsidies are often years long in major cities. The declining value of tax credit equity and the increasing cost of debt create roadblocks for developers.

In spite of a generous, hence costly, system of housing allowances, needs for affordable housing remain important in major French cities, where large public and private estates built in the 60s and 70s also need renovation or replacement. Subsidizing registered social housing companies and private investors is therefore necessary.
Both France and the United States understand that providing social rental housing is an important goal, but they are faced with the reality of budgetary constraints. With a relatively new administration in France, and with the upcoming administration of President-Elect Obama, we will see how each country keeps on its current path or creates new opportunities for quality, affordable rental housing. In the short-term, its positive impact both on the supply and the demand side, should make social housing an important component of any rescue plan.

Reference:


Housing Europe 2007: review of social, cooperative and public housing in the 27 EU member states. European Social Housing Observatory, Cecodhas.
