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Making the French Housing Market Work Better

Hervé Boulhol

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ABSTRACT/RÉSUMÉ

Making the French housing market work better

Housing plays a key role in the economy, because of its weight in household expenditures and assets, its importance for social well-being, and its impact on educational outcomes and employment as well as on the business cycle. Over the past half century, the bulk of the population has benefited significantly from improved housing conditions. Yet perhaps 5% of families are still poorly-housed, and inequalities in access to housing have widened since the mid-1990s, as soaring real estate prices have produced strong distributional effects. Although the severity of the economic crisis seemed to portend a sharp downward correction, the market has in fact turned around and recovered vigorously in France as in many OECD countries, supported by exceptional financing conditions and policies to stimulate demand. While the risk that prices will fall is non negligible, particularly if credit conditions tighten, the situation in France seems to reflect a shortage of housing supply, concentrated in certain "strained" geographic areas. The key role that housing plays in ensuring the social inclusion of individuals and the many imperfections inherent in the housing market justify government intervention. A crucial question is whether the policies being implemented are helping to correct these imperfections efficiently or whether, on the contrary, they are amplifying them, with possible negative spillovers on employment, economic growth or equity. The general principles underlying government housing policies should embrace three aspects: income-tested assistance to individuals, the most effective instrument because it allows for better targeting; direct support for housing supply in areas of excess demand, especially through the social sector, which should focus on disadvantaged households; and the removal of obstacles that work against market mechanisms, so as to make supply more responsive and the market more fluid and transparent, and to limit the many distortions induced by regulation, taxation and subsidies. This Working Paper relates to the 2011 *OECD Economic Survey of France* (www.oecd.org/eco/surveys/france).

JEL classification codes: R21 ; R30 ; R31 ; R38
Keywords: housing policy; residential mobility; housing taxation; housing credit; supply responsiveness

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Améliorer le fonctionnement du marché du logement français

Le logement joue un rôle de premier plan dans l'économie de par son importance pour la dépense et le patrimoine des ménages, le bien-être, et aussi en raison de ses retombées sur les performances scolaires et l'emploi, et sur le cycle d'activité. Depuis un demi-siècle, l'amélioration impressionnante des conditions de logement bénéficie au plus grand nombre. Cependant, le mal-logement persiste, touchant environ 5 % des ménages, et les inégalités dans l'accès au logement se sont creusées depuis le milieu des années 1990, la hausse des prix immobiliers engendrant de forts effets distributifs. Alors que la brutalité de la crise économique laissait présager d'une violente correction à la baisse, le marché, soutenu par des conditions de financement exceptionnelles et certaines politiques stimulant la demande, s'est retourné et a rebondi vigoureusement en France comme dans de nombreux pays de l'OCDE. Si le risque de chute des prix est non négligeable, notamment en cas de renchérissement des conditions de crédit, la situation en France semble caractérisée par un manque d'offre de logements concentré dans certaines zones géographiques dites tendues.

Le rôle essentiel que le logement joue dans l'inclusion sociale des individus et les nombreuses imperfections inhérentes au marché du logement justifient l'intervention publique dans ce domaine. Une question cruciale est de savoir si les politiques mises en œuvre corrigent ces imperfections efficacement ou au contraire les amplifient, avec des retombées potentiellement négatives sur l'emploi, la croissance économique ou l'équité. Le principe général des politiques publiques en matière de logement devrait se décliner en trois volets : aides personnelles sous conditions de ressources, instrument le plus efficace car permettant un meilleur ciblage ; soutien direct à l'offre en zones tendues, notamment via le secteur social qui devrait se concentrer sur les ménages défavorisés ; réduction de certaines entraves aux mécanismes de marché, en rendant l'offre plus réactive, le marché plus fluide et transparent, et en limitant les nombreuses distorsions induites par la réglementation, la fiscalité et les subventions. Ce Document de travail se rapporte à l'*Étude économique de l'OCDE de la France 2011* (www.oecd.org/eco/etudes/france).

Classification JEL : R21 ; R30 ; R31 ; R38
Mots clefs : politiques du logement; mobilité résidentielle; fiscalité du logement; crédit à l'habitat; réactivité de l'offre

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MAKING THE FRENCH HOUSING MARKET WORK BETTER

Hervé Boulhol[1]

Housing plays a key role in the economy. It represents households' largest item of expenditure and their most important asset, while the performance of the housing market has a great influence both on the macroeconomic cycle and structural employment. Housing is a prime necessity, and its consumption cannot be readily modified because of the high costs related to residential mobility. It is also a central consideration in the problems related to equality of opportunity, in part because of the impact of housing quality on health and schooling outcomes. Moreover, changes in property prices, fundamental or policy-induced, can have significant distributional effects between generations and between owners and renters.

The reasons for government intervention in the housing market relate to the role played by housing in social inclusion and the many imperfections in the market, including neighbourhood externalities, information asymmetry and significant frictions. Moreover, housing is often regarded as a "merit good", *i.e.* as a good, like health or culture, that individuals, if left to their own devices, would not consume in sufficient quantities, to their own disadvantage; this situation is then deemed to justify paternalistic intervention by the state in order to guarantee a minimum level, regardless of households' financial capacity. Some housing policies also include redistribution objectives in favour of poor households, although in theory the income tax and means-tested social assistance can play this role. In practice, targeted construction subsidies can be justified, as the private sector apparently finds it unprofitable to build low-income housing. In fact, housing policies in France, as in many other OECD countries, blend elements of rent control, construction subsidies, direct transfers to individuals, regulations (*e.g.* urban planning and mortgage financing) and taxation. A crucial question, then, is whether these policies are efficiently achieving their objectives. When it comes to housing, the road to hell is paved with good intentions (Laferrère, 2006), and some public programmes may actually be exacerbating imperfections in the market and thus impede its functioning and negatively affect economic performance.

The macroeconomic importance of housing

A few key figures show the importance of housing for the French economy. Over the last 10 years, average current household spending on housing, net of housing benefit, represented 21% of households' disposable income, while residential investment accounted for 27% of total domestic investment. At end-2009, households owned housing capital worth approximately EUR 3 300 billion, excluding developed land, and developed land, housing and other buildings represented approximately 60% of total household financial and non-financial assets, which are worth EUR 10 600 billion or about five years' GDP (Couleaud and Delamarre, 2010).

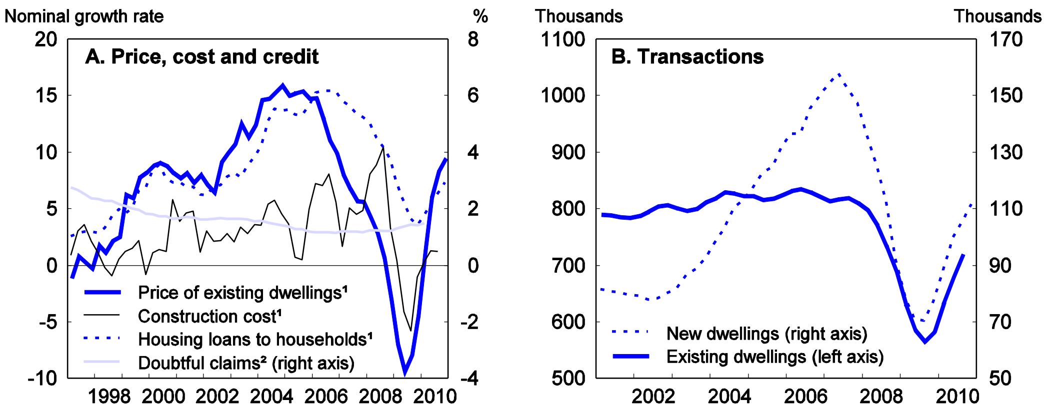
As in many OECD countries, French property prices rose sharply during the 10 years before the global financial crisis, more than doubling in nominal terms. This surge contributed to the macroeconomic cycle, with the capacity utilisation rate in the construction sector peaking at 95%. Although prices initially

1. This paper was originally produced for the 2011 OECD Economic Survey of France, published in April 2011 under the authority of the Economics and Development Review Committee (EDRC). Hervé Boulhol is Senior Economist in the Economics Department of the OED. The author is grateful to several colleagues for valuable comments, notably Christophe André, Aida Caldera Sanchez, Andrew Dean, Romain Duval, Bob Ford, Peter Jarrett, Asa Johansson and Bénédicte Rolland, as well as academic researchers and experts from the French administration for helpful suggestions. The author is also grateful to Mee-Lan Frank, Maartje Michelson and Patrizio Sicari for excellent technical assistance.

rose quickly to make up ground lost during the property slump of the 1990s, in the view of some analysts, the acceleration observed since 2002 had many bubble-like features. Besides real factors underpinning housing demand, this acceleration was also probably influenced by herd behaviour and irrational investor expectations. The downturn on global property markets at the heart of the recent recession raised fears of a sudden drop in property prices in France.

At the height of the crisis, prices fell by nearly 10%, and transactions on the existing housing stock slid by about 25% in the space of a year. However, the market has picked up again since then, and prices are back to their previous record level (Figure 1), a pattern common to many OECD countries (Chapter 1). Lending practices in France, discussed in detail below, prevented the excesses that destabilised some countries' financial system, and delinquencies have been contained. From that standpoint, in contrast with other countries, the way in which the French housing market is financed is likely to limit both the transmission of monetary policy to the economic cycle and the wealth effects resulting from fluctuating property prices. Moreover, in contrast to countries where the bubble burst and prices are not recovering (such as Spain, the United States, Ireland and Italy), few observers would suggest that there is an aggregate excess supply of housing in France. Most studies actually conclude that the rise in households' disposable income, interest rate trends, demographic and social changes such as ageing, generations living apart and divorce, etc., which have led to a larger number of households, and longer mortgages provide a relatively complete explanation for property price trends in France (Miles and Pillonca, 2008; André, 2010; de Bandt *et al.*, 2010).

Figure 1. **Year-on-year housing market trends**

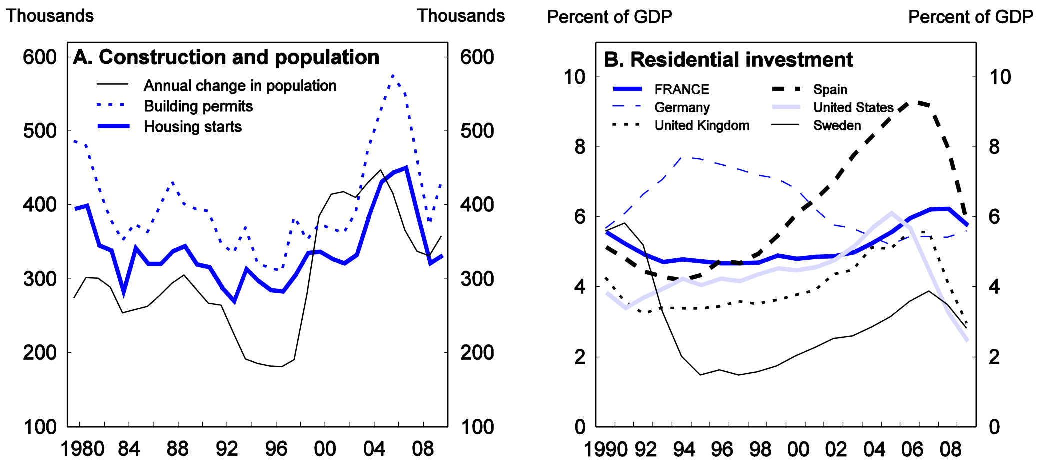


1. Nominal growth rate.
2. Rate of doubtful claims on all credit extended to households.

Source: Banque de France; CGEDD and notarial databases; INSEE; MEEDDM.

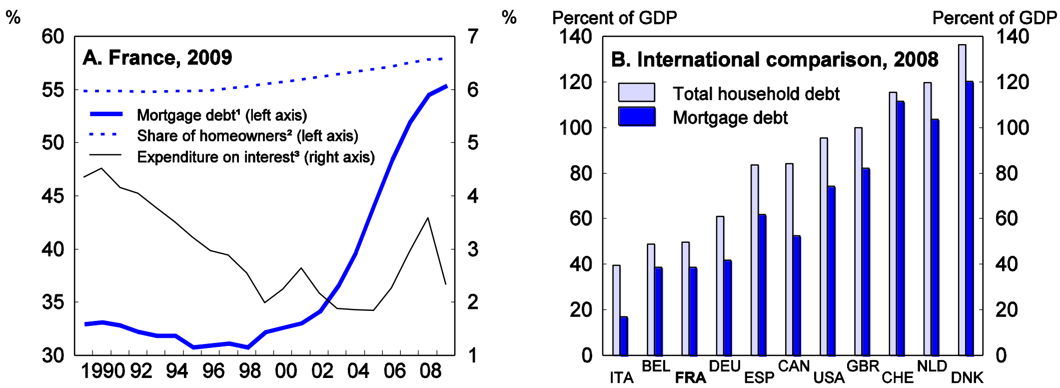
Although these empirical studies play down the likelihood of a major disconnect between prices and their fundamentals, they do not imply that housing supply is satisfactory, since, for example, supply being slow to react to the positive demand shocks may be part of these fundamentals. Housing construction and residential investment seem to have responded with a lag of at least five years to the increase in demographic growth since the late 1990s (Figure 2). Moreover, France is one of the countries where residential investment reacted least to rising prices during the last cycle, although the lack of responsiveness seems to have been even more pronounced in the United Kingdom and the Netherlands (André, 2010, chart 8). While it is difficult to extrapolate past trends, which were fuelled by rising household debt levels (albeit from a low level in relation to most OECD countries), interest costs are still moderate (Figure 3). Thus, it is still too early to rule out the risk of a major price correction since favourable borrowing terms tend to blur the analysis, as the market probably remains vulnerable to a sharp rise in the cost of borrowing. In the shorter term, however, there is a rising risk of a prolonged period of loose credit conditions resulting in an unjustified increase in prices, which generally serves as a warning against untargeted measures supporting demand.

Figure 2. **Housing construction and residential investment**



Source: INSEE; OECD, Economic Outlook 88 database.

Figure 3. **Household mortgage debt**



1. As a percentage of household disposable income.
2. As a percentage of primary residences.
3. Interest paid on total household debt, as a percentage of household disposable income.

Source: Banque de France, Household Debt Observatory; MEEDDM, Housing accounts, 2008 (Panel A); OECD, Financial statistics and Economic Outlook 88 databases; national central banks (Panel B).

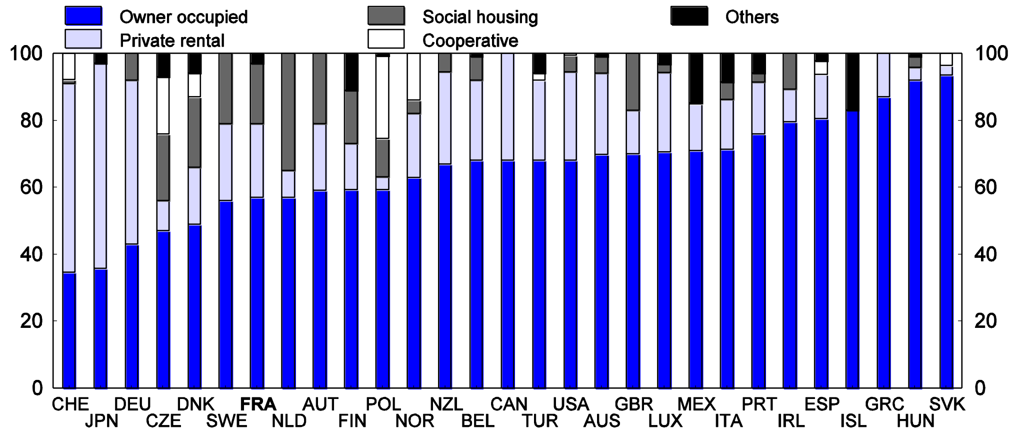
Is there a housing crisis?

An intermediate situation in terms of tenure structure

There were 27.9 million principal dwellings in France in 2009, 58% of them owner-occupied, 24% in private rental, 16% in public rental and 2% in other forms (hotels, accommodation, etc.), plus 3.2 million second homes and between 2 and 3 million vacant housing units depending on the source. In this respect France is in an intermediate situation among OECD countries (Figure 4), with a relatively low proportion of owner-occupation and a substantial share of social housing in the rental sector, albeit lower than in a number of other EU countries (Czech Republic, Netherlands, Austria, the Nordic countries, the United Kingdom, Ireland and Poland). Moreover, the private rental stock, almost entirely owned by individuals, is highly fragmented (Driant, 2008). Part of social housing, especially units built in the 1960s and 1970s, now has a negative image in terms of the urban forms that housing has assumed over the period.

Figure 4. **Tenure structure across countries**

Per cent of dwelling stock, 2009



Source: Andrews, D., A. Caldera-Sánchez and Å. Johansson (201), "Housing Markets and Structural Policies in OECD Countries", *OECD Economics Department Working Papers, No. 836*.

A trend to improved housing conditions and rising prices

After more than half a century of steady improvement for the vast majority of households, general housing conditions have never been better. In 1954, over four dwellings in ten did not have running water, only a quarter had an indoor lavatory and 10% a shower or bath. In 1984, 16% of dwellings still lacked one of those three items, compared with less than 2.5% in 2004 (Jacquot, 2005). The number of rooms per person has risen from 1.0 in 1954 to 1.4 in 1984 and 1.8 in 2006, and the average surface area per person has increased similarly. At the same time, over-crowding (under-utilisation), as defined by INSEE, has decreased (increased) dramatically, at least until the early 1990s. The higher quality of housing is an important factor in the increasing share of gross disposable income that households devote to current housing expenditure, net of housing benefit (the so-called "effort ratio" – *taux d'effort*).[2] As well, prices are being driven upward by the costs associated with changing lifestyles (population ageing, generations living apart and marital separations, etc.), which are partly a reflection of choices and rigidities (leading, for example, to the well documented under-utilisation of dwellings occupied by the elderly). The rate of ownership for principal residences has also risen by 7 percentage points in the past 20 years.

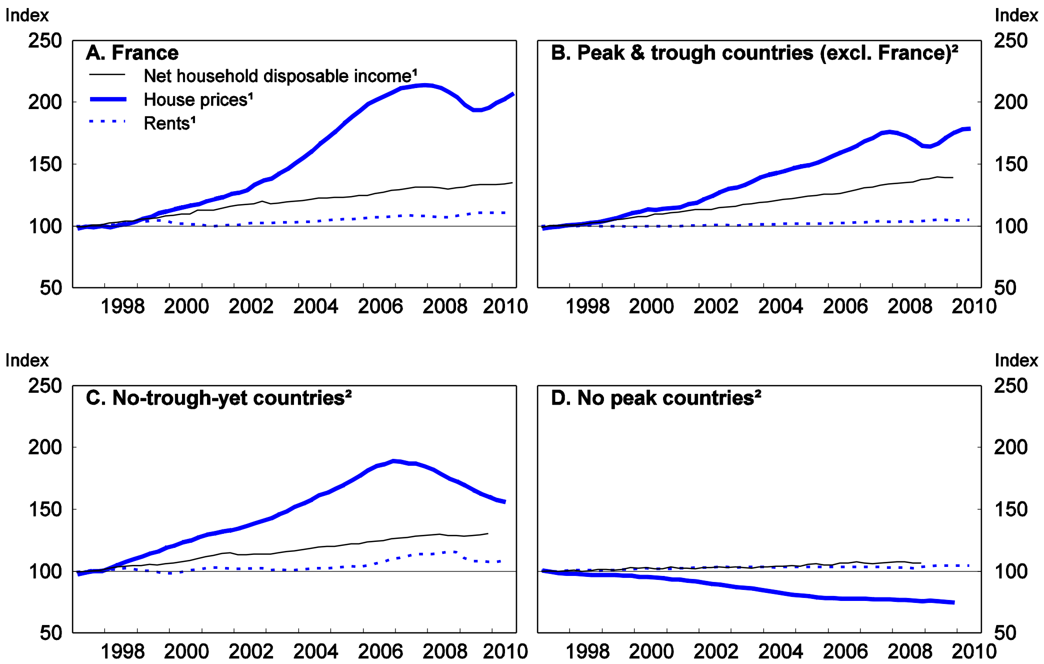
However, dearer access to housing contributes to the widespread impression of a housing crisis in France. The analysis of price and rent trends by region suggests that there is not a general housing crisis in France, but rather difficult situations concentrated in a few large urban centres marked by a strong imbalance between supply and demand. Property prices have risen significantly faster than both rents and average disposable income (Figure 5), with rents themselves increasing in real terms. That impression seems to be borne out by a sharp increase in the average effort ratio, from about 10% in the 1960s to 17% in 1984 and almost 23% in 2006 (Jacquot, 2005; Briant and Rougerie, 2008), a trend also found in most

2. Expenditure on housing increased in value by 5.2% a year on average between 1984 and 2004, with the improved quality of dwellings contributing 1.3% a year (Plateau, 2006).

other OECD countries (Figure 6). Both tenants and first-time buyers are affected by this increased burden, despite longer mortgage maturities.[3]

Figure 5. **Property prices, rents and household disposable income in real terms**

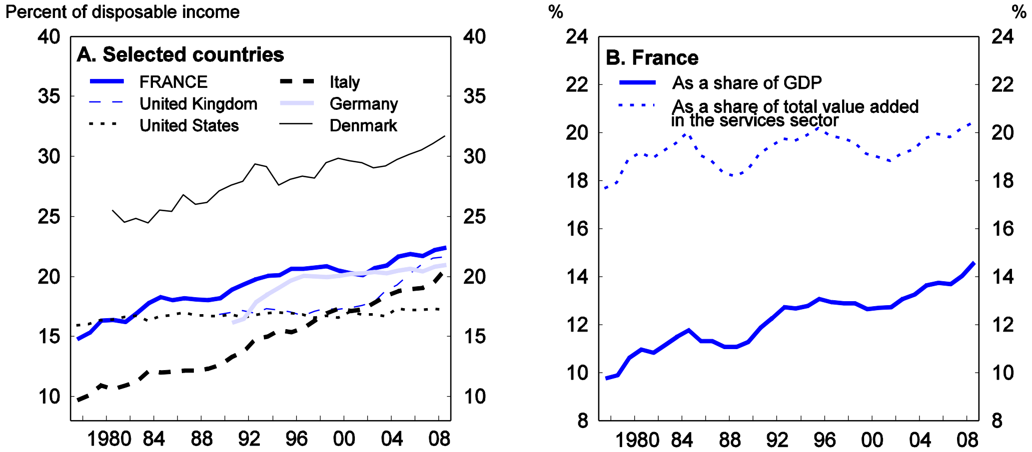
1997 = 100



1. Adjusted by the personal consumption expenditure deflator.
2. Simple average of the categories displayed in Table 1.2.

Source: OECD, Main Economic Indicators and Economic Outlook 88 databases.

Figure 6**. Household housing expenditure, 1978-2009**



Source: OECD, National accounts, STAN and Economic Outlook 88 databases.

The rise in the ratio of property prices to rents is not sufficient to prove that house prices are overvalued. In theory (see *e.g*. Poterba, 1992), the price-to-rent ratio is equal to the inverse of the user cost

3. See Jacques Friggit's long-series website http://www.cgedd.developpement-durable.gouv.fr/rubrique.php3?id_rubrique=138.

of housing, which depends on interest rates, taxation, and depreciation and property maintenance costs. A decrease in the user cost can therefore provide an explanation for a rational increase in the price-to-rent ratio. In 2010 the ratio was 41% higher than the average since 1985, but the deviation from the average is "only" 10-20% when it is adjusted to take account of the estimated user cost trend (Box 1). One limitation of this indicator, whether adjusted or not, is that it gives an idea of the price-to-rent ratio only in relation to a reference date or period and not in the absolute. If the equilibrium interest rate is close to the growth rate of potential output, the gross rental return on a property investment, measured by the annual rent relative to the purchase price, is theoretically close to the sum of taxes, depreciation and maintenance costs and the risk premium (expressed as z, see Box 1). According to Table 1, the gross rental return in a sample of 37 French cities lay between 3.6% and 7.5% (as of April 2010); the variation is less among big cities, where the yield ranged between 5% and 6%, which is consistent with reasonable orders of magnitude for z. Of course, any increase in real interest rates that does not reflect the outlook for output growth (as a long-term proxy for increases in property prices) would expose the property market to a risk of a more or less severe correction.

Table 1. **Gross rate of return**

	Sale price	Rent (per year)	Gross rate of return[1]
	EUR/m²	EUR/m²	%
Paris	6 061	304	5.0
Marseille	2 739	154	5.6
Lyon	2 924	153	5.2
Toulouse	2 527	149	5.9
Nice	3 670	171	4.7
Strasbourg	2 534	144	5.7
Montpellier	2 308	137	5.9
Bordeaux	2 830	148	5.2
Average[2]			**5.7**

1. Ratio of rent price to sale price.
2. Average for the 37 cities for which data are available.

Source: FNAIM, April 2010.

A comparison with other OECD countries does not seem to support the idea that there is an aggregate shortage of housing in France or that rents are excessive (Figure 8), even though this conclusion does not exclude the possibility that housing supply and demand are poorly matched at the local level. Moreover, it is not certain that the increase in housing expenditure relative to disposable income or GDP is an appropriate yardstick. This increase implies that other components of demand, like spending on food and clothing, are reduced in relative terms. In a context where developed countries continue their secular trend towards de-industrialisation, fuelled to a considerable extent by productivity gains that are structurally more dynamic in manufacturing than in services, and thus automatically drive up the real price of services, it is probably sounder to measure housing expenditure against value added in the services sector. On that basis, Panel B of Figure 6 sheds a very different light, showing the ratio to have been almost stable since the mid-1980s.

The problem of poor housing remains, and inequalities with respect to housing costs are increasing

Although patchy, all the available data indicate that a significant share of the population –about 5.5%, or 3.4 million people – is still housed in unsatisfactory conditions (Fondation Abbé Pierre, 2010), using a relatively broad definition of poor housing. The marked improvement for the majority makes poor housing all the less acceptable, the situation of the homeless (who number approximately 130 000 according to Briant and Donzeau, 2011) being the most glaring manifestation of social exclusion. Although poor housing covers a variety of situations, from substandard residences to emergency accommodation and homelessness, the spread of new forms like year-round camping is recent.

In many respects, the issues raised by the geographical concentration of housing for poor households go well beyond housing policies alone. A previous Economic Survey of France (OECD, 2007) devoted a chapter to social exclusion and made the following recommendations regarding the means of resisting the geographic concentration of poverty and spatial hysteresis, which are relevant to the issue of housing:

- Continue policies designed to develop social housing in areas with adequate employment opportunities. Increase targeting of this housing on the poor, but maintain the goal of social diversity. Assess housing policy, giving consideration to its many different impacts, not only on financial resources. Continue efforts to support evicted families without counterproductive constraints on landlords.

- Simplify existing zoning systems, focus them more tightly, regularly assess their effectiveness, and drop them when they are ineffective. Direct aid to the individuals concerned.

- Ensure that mechanisms for allocating resources between different geographic areas give sub-national authorities the means to fight poverty according to their needs and that they do so efficiently.

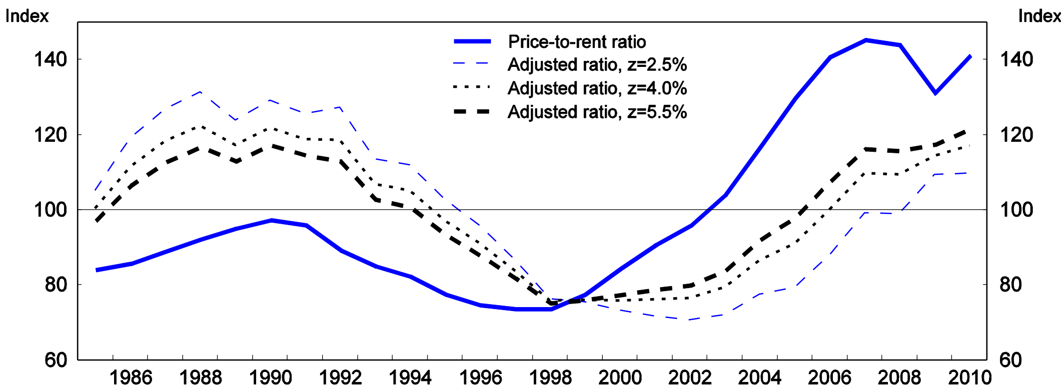
Housing is thus at the heart of the social debate, especially given the difficulties of access to housing encountered by certain categories of the population (Jacquot, 2005). According to Driant (2008), a twin disparity has emerged following the rise in the cost of housing. The vast majority of households have benefited from the improvement of the housing stock, with homeowners also benefiting from increased wealth. But for those categories living in discomfort and unsanitary conditions, the situation seems to be getting worse. In addition, even among those who enjoy better housing conditions, the gap seems to have widened between those who can choose all the features of their dwelling, especially their location, and those whose financial resources restrict them to a partial choice, causing urban sprawl and concentrations of poverty. The sharp decline in mobility in the social sector, reflected in a fall in the annual tenant turnover rate from 12.6% in 1999 to 9.5% in 2008, highlights both the limited prospects of access to social housing for the most disadvantaged households and the rigidities weighing upon the residential mobility of the occupants of social housing.

Box 1. **The price-to-rent ratio adjusted for the user cost of housing**

The user cost of housing, R, is determined by the nominal interest rate (i), property taxes (t), the risk premium for property investment (ρ), depreciation and maintenance costs (δ) and expectations of nominal property price growth (π), such that $R = i + t + \rho + \delta - \pi$. Over the last 40 years, French property prices have risen on average more or less at the same pace as nominal GDP.* Extrapolating, the user cost can be expressed as $R = x + z - g$, where x is the expected real interest rate, $z = t + \rho + \delta$ and g is the real GDP growth rate. Orders of magnitude for z can be obtained as follows. The depreciation and maintenance rate is of the order of 2-3% per year. The risk premium is a thornier matter. Although a 2% rate is generally used to offset natural risk aversion, the acquisition of a principal dwelling may be an opportunity to protect against the risk of future rent increases, which are included in the household's inter-temporal liabilities. From this standpoint, home ownership reduces that risk. Consequently, a risk premium ranging between 0 and 2% seems reasonable. Because of adaptive expectations in particular, the safe-investment role sometimes attributed to property investment has been intensified in some OECD countries, including France, by the poor performance of equity markets over the past decade. The order of magnitude for property taxes is obtained by dividing tax revenues (land tax, residence tax, transfer duties, wealth tax) by the value of the property asset, *i.e.* approx. 0.6%, giving a range of 2.5-5.5% for z. The Figure below shows the price-to-rent ratio adjusted for various levels of user cost.

Figure 7. **Price-to-rent ratio adjusted for the user cost of housing**

Annual data, average 1985-2010 = 100



1. The interest rate and the growth rate of potential GDP are calculated as three-year moving averages. The interest rate is the yield on 10-year government bonds plus 50 basis points.

Source: OECD, Economic Outlook 88 database.

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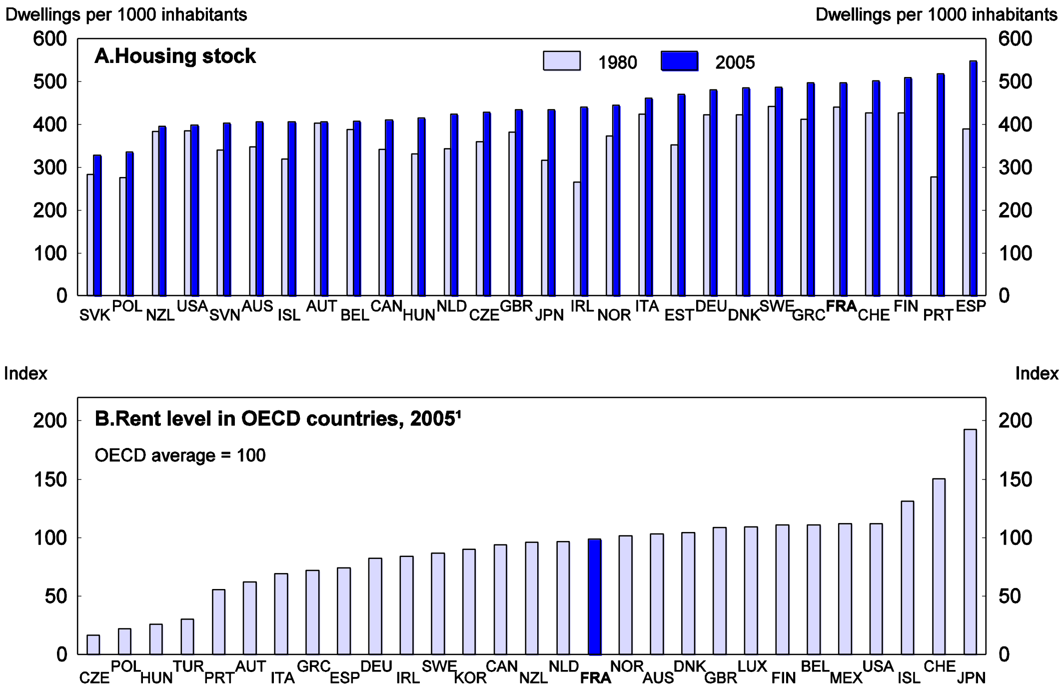
* The link between the rise in residential property prices and nominal GDP growth is also apparent in a cross-section analysis of OECD countries, omitting Korea. For countries whose series are available between 1970 and 2009, the average annual rise in property prices and nominal GDP growth displays a linear correlation coefficient of 94% (which falls to 43% when Korea is included), with an almost unitary relationship.

Figure 8. **Descriptive statistics of housing**

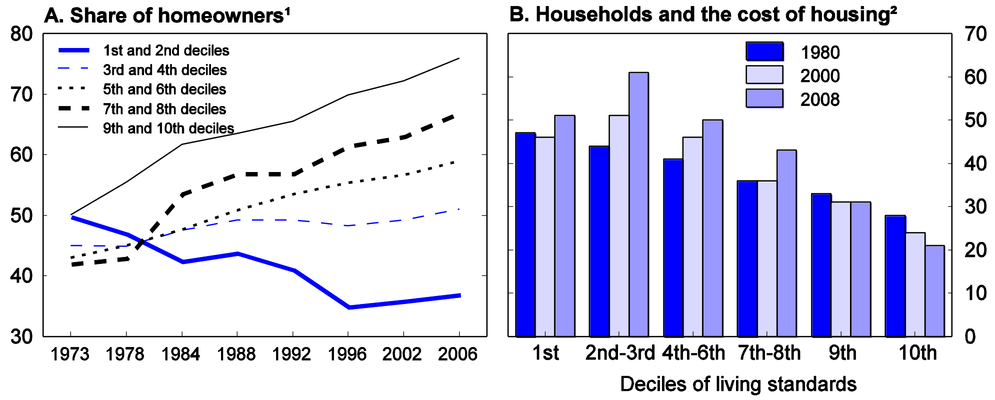


1. Rent levels are compared in purchasing power parities. They show the value of the same volume of housing services expressed in the same currency of purchase. The rent levels take into account the differences in quality in terms of the size of units, the number of rooms and the availability of central heating.

Source: Andrews, D., A. Caldera-Sánchez and Å. Johansson (2011), "Housing Markets and Structural Policies in OECD Countries", *OECD Economics Department Working Papers, No. 836*.

Differences in tenure status according to income have likewise increased significantly (Figure 9). According to Fack (2008) and Briant (2010), more and more low-income households live in rented accommodation and find it increasingly difficult to get onto the housing ladder, even though the proportion of homeowners in the first two income deciles has stabilised since the mid-1990s (Figure 9). In fact, for 30 years now housing costs have represented an increasing burden for households with a modest standard of living, and over the last decade even the upper middle classes have begun to feel the pinch. Moreover, the pressure on the housing market is concentrated geographically: the housing ministry has identified 13 *départements* where the market is tight, which are located in the Paris region, the Côte d'Azur and along the Swiss border. In these areas, the anxiety inherent in apartment search is compounded by extreme selectivity on the part of landlords.

Figure 9. **Growing inequality**



1. Share of homeowners by income decile per unit of consumption, percent of all households.
2. Share of individuals reporting that their housing costs are a burden, a heavy burden or a burden with which they cannot cope.

Source: Fack (2005, 2008), Panel A; CREDOC, enquêtes Conditions de vie et aspirations des Français, Panel B.

Housing policies in France[4]

Housing markets depend to a considerable extent on the historical and institutional context of each country. Nevertheless, most housing policies in OECD countries have the same goal: ensuring decent housing for all according to their means. Other aims are associated with that core objective, such as promoting social mixing or making it easier for first-time buyers to get a foot on the property ladder. To achieve them, government policy includes a wide range of housing benefits, building subsidies, tax breaks, soft loans and regulations. In 2008, total direct public aid amounted to EUR 37 billion, or 1.9% of GDP (Table 2 and Figure 10). In any case, a prolonged rise in spending on housing as a proportion of GDP might generate something of a dilemma with respect to public policy, since even devoting a constant share of GDP to public assistance would imply a dwindling level of support in relation to such spending and thus lower effectiveness.

The range of policy aims raises the question of their coherence and how they fit together. Promoting social mixing, for example, may conflict with the objective of ensuring housing for all according to their means, since poor households may be refused access to social housing for lack of space whereas households that could find housing in the private sector are admitted. Likewise, encouraging social housing (*e.g.* through the 2000 Urban Solidarity and Renewal Act) is compatible with encouraging first-time home ownership only at the cost of limiting the size of the private rental sector, even though it is the most fluid market segment.

4. For a more detailed treatment see Rolland (2011).

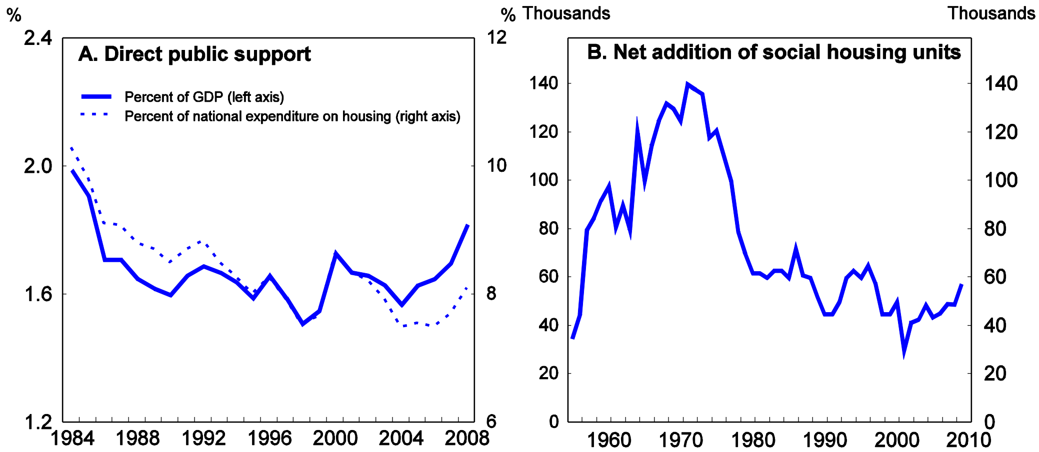
Table 2. **Government support to housing, 2008**

	€ billion		€ billion
Total	**37.1**	Exemption from residence tax	1.2
Individual housing allowances	***15.7***	Specific tax breaks for owner-occupiers	2.4
of which: First-time buyers	1.0	*Tax reduction for interest on loans*[1]	*0.2*
Tenants	14.2	*Tax credits for owner-occupiers' capital expenditure*	*2.2*
Subsidies and soft loans	***5.2***	Specific tax breaks for private landlords	2.1
Social housing construction	2.0	*Measures to encourage buy-to-let*	*0.7*
Rehabilitation	0.8	*Tax credit for improvements or capital expenditure for rental housing*	*1.3*
Zero-interest loans to first-time buyers	1.5	Specific tax breaks for social housing	2.2
Housing Action Loans	0.8	*Reduced VAT for investment in social rental housing*	*1.8*
Others, of which home savings loans	0.1	*Exemption from corporate tax*	*0.4*
Tax breaks	***16.2***	Exemption from undeveloped land tax	0.5
5.5% VAT rate for renovation	5.4	Reduction in transfer duties (compensation by central government since the 1998 reform)	1.6
Exemption from developed property tax	0.9		

1. The cost of this measure could rise to EUR 1.9 billion in 2011; even if it is likely to be suppressed in 2011, this measure will still affect public finances up to 2015.

Source: MEEDDM, Housing accounts 2008.

Figure 10. **Government support for housing**



Source: MEEDDM, Housing Accounts 2008 (Panel A); MEEDDAT/SESP (Panel B).

Ensuring decent housing for all according to their means

The right to housing is the main thrust of Act 90-449 of 31 May 1990, which states that "guaranteeing the right to housing is a duty of solidarity for the nation as a whole". Act 2007-290 of 5 March 2007 on the right to housing (a right that can be asserted before the courts) reinforces the requirement on the government to provide decent housing for all according to their needs and means, moving from a best-efforts obligation to an obligation of results, guaranteed by legal remedies before the administrative courts if a household is not rehoused despite a favourable decision by a mediation commission. Over

170 000 applications to obtain housing have been filed since 2008 (the applications of some 50 000 households have been given priority status, and over 30 000 of them have been rehoused), and the monitoring committee regularly alerts the authorities to the growing number of households that have been given priority status but have not been rehoused within the statutory time limit.[5]

In the 1950s France launched a huge effort to make up for the housing shortage left by World War 2 and the accumulated lag in construction between the two wars, which could be attributed primarily to the rent freeze, now seen as a classic example of a well intentioned idea with disastrous consequences (Laferrère, 2004). In the mid-1970s, the government's decision to stop intervening directly and to allow the market to work more freely was a major turning point in housing policy. Residential construction subsidies gave way to individual housing allowances (worth EUR 15.7 billion in 2008), which better target low-income households and were paid to 20% of all households in 2008. At first glance, it can be argued that the housing benefit has reduced the average share of disposable income devoted to rent for the poorest social housing tenants from 33% to 10% (Driant and Rieg, 2004). However, the effectiveness of these allowances has been limited by the slow response on the supply side: a substantial proportion of the benefit has merely fuelled rent increases, an effect that has persisted over the medium term (Fack, 2005).

Social housing, fragmented and with a low turnover rate, remains a major area of government intervention in the housing market, and the number of new social housing units made available seems to have rebounded since the trough of the early 2000s (see Figure 10, Panel B). Social housing operators may be from the public or the private sector; most of them operate locally and on a non-profit basis. Social housing is financed by soft loans funded by tax-free household saving schemes and is supported by a range of subsidies and tax exemptions.[6] The wide variety of subsidised loans causes a high degree of segmentation in the social housing sector, because the associated rent ceilings differ and are therefore not directed at the same category of households. The low rate at which tenants move out of social housing is due at least in part to the fact that rents are considerably lower than in the private sector and to tenants' right of security of tenure. Under certain conditions, for example, social housing units can be passed on directly to a member of the previous occupant's close family.[7] To counter the low turnover rate (9.5% in 2008, as against 18% in the private rental sector), since 2008 the rent supplement – *supplément de loyer de solidarité* or SLS – has been payable by tenants whose income exceeds the ceilings for social housing entitlement by 20% (the threshold used to be 40%), and the amount increases as household incomes rise. The Housing Act of 25 March 2009 also introduced measures to end the entitlement for tenants whose income exceeds twice the ceiling for two years. However, social housing providers have balked at implementing these measures, as to do so would deprive them of a stable source of revenue.

In order to encourage private investment in rental property, since 1984 governments have introduced a series of incentive measures, the most recent of which, the so-called Scellier scheme, is based on a tax reduction calculated proportionately to the property investment made, and which is open to landlords provided that they comply with certain conditions, such as rent caps and means-tested income limits for tenants. The measures encouraged the construction of 570 000 housing units between 1995 and 2009. The system has evolved in conjunction with the economic recovery plan, with better targeting linked to more generous tax incentives. Since its creation in 2009, the Scellier scheme, under which owners can initially

5. The time limit is generally three months. The fine set by the administrative court must correspond to the average cost of the type of accommodation deemed suitable for the applicant.

6. Social housing corporations are exempt from corporation tax, transfer duties, tax on rental income, tax on vacant dwellings and tax on buildings and benefit from the 5.5% reduced rate of VAT.

7. If a tenant leaves home or dies, a social housing lease may be transferred to the partner for the benefit of descendants, ascendants or dependants. The person concerned must be able to prove that he or she had been living with the tenant for at least a year at the date of the tenant's departure or death and must meet the social-housing qualification criteria.

claim a tax reduction equivalent to 25% of the value of their property (up to EUR 300 000), has been restricted to areas where the market is tight. The lessons of the previous system, criticised for leading to the construction of new housing in already saturated areas, have been learned. Housing improvement has been another area of ambitious government action, costing nearly EUR 7 billion in 2008, the main subsidy being the tax incentive of a 5.5% rate of VAT on renovations. Another objective of this measure was to boost activity and employment in a labour-intensive sector and to combat undocumented employment.[8] However, the use of such an instrument is questionable for it distorts the allocation of labour between sectors (Chapter 2).

Encouraging social mixing

The notion of social mixing has emerged in response to the growing concentration of poor people in disadvantaged areas, especially neighbourhoods with a great deal of social housing, where the proportion of tenants with incomes lower than the median had risen from 41% in 1973 to 68% in 2002 (Driant and Rieg, 2004). When poverty is concentrated in the same place it tends to persist, because people who live in poor areas do not have access to the social networks that could help their economic integration. In addition, the fact that some communes have resorted to free riding due to "NIMBY" (not in my backyard) attitudes shifts the effort required to supply low-cost housing elsewhere. These externalities lie behind government intervention to encourage social mixing. Introduced into law in the 1991 Urban Development Act, the social-mixing objective was confirmed in the 2000 Solidarity and Urban Regeneration Act, which institutes a 20% social housing requirement for all municipalities with more than 3 500 inhabitants. Municipalities that fail to comply are subject to a levy on their fiscal resources, but some prefer to pay the relatively mild penalties imposed by the Act rather than meet the requirement.[9]

However, achieving this objective in practice, a core policy concern, comes up against the need to house the least well-off households according to their means, which the housing ministry has to meet. For example, the introduction and subsequent toughening of the rent supplement scheme (SLS), which helps to increase mobility out of social housing, also makes it less attractive to the better-off. In addition, many players are involved in its allocation. In exchange for their financial assistance, central and local authorities and the social partners are allowed to reserve social housing and to select their priority candidates, who are not necessarily those who have the greatest need for social housing. In fact, social mixing remains limited, with a clear geographical separation between social housing for the poor and social housing for the better-off. The problems that flow from the spatial concentration of housing for the poor clearly go beyond the purview of housing policies alone. Besides, trying to combat urban segregation is challenging because it results from rational and independent social choices made by individuals (Fitoussi *et al.*, 2004).

A proactive policy to promote home ownership

The government's resolve to promote home ownership is reflected in a wide range of subsidies and tax incentives. Individual housing allowances, received by about 11% of first-time home buyers, are granted either on a means-tested basis or to accompany a regulated loan. Before its reform in 2010, the zero-interest loan (PTZ), another means-tested measure, was the most costly in budget terms, the

8. Other housing improvement subsidies are provided by public establishments like the National Agency for Urban Renewal.

9. The requirement also applies to Paris Region municipalities with more than 1 500 inhabitants situated in an urban area with more than 50 000 inhabitants. The penalties are equal to 20% of the tax potential per inhabitant multiplied by the shortfall in social housing units and are paid into a social housing fund. EUR 32 million in penalties were collected in 2009.

government assuming the interest payments.[10] As well, since 2007 taxpayers have been able to deduct part of the interest on loans taken out to acquire a principal residence from their income tax for five years. The measure is likely to cost EUR 1.9 billion in 2011 as the full effect works through. The fact that in addition capital gains on principal residences are tax-exempt and that imputed rent is not taxed also favour owner-occupation.[11] In 2010, the government decided to abolish the tax relief on mortgage interest and to extend the zero-interest loan scheme instead, removing the means test while restricting the scheme to first-time buyers. The revised scheme (PTZ+) is more heavily subsidised for low-earners, housing-shortage areas and purchases of new dwellings. The advantage accorded to new properties creates distortions between new and existing housing stock, but it may be justified in light of the sluggish response on the supply side (see below). On the other hand, an evaluation of the PTZ showed that, while it does encourage property ownership, it also has a significant windfall affect drastically limiting the multiplier effect on residential investment (Gobillon and Le Blanc, 2005). These results suggest that the mechanism should be accompanied by an income cap, with general demand support even being potentially dangerous in the current context of rising property prices. It would have been desirable to have taken advantage of the reform to abolish state-subsidised loans linked to prior saving as well, as this distorts credit to housing (see below). More generally, it would be useful for the government to systematically produce studies on the effectiveness of housing policies and to present these to parliament on a regular basis.

Residential property taxation is a significant source of government revenue

Residential property is a significant source of tax revenue: actual revenue (*i.e*. without taking account of any compensation paid by central government to local authorities) linked directly to housing amounted to EUR 66 billion in 2008, approximately 7% of total tax revenue (Table 3). Three local taxes are based on rateable values. Residence tax (EUR 15.5 billion) is payable by the occupant of residential premises and is highly individualised, since it is subject to numerous allowances and exemptions linked to the taxpayer's income and family situation, with central government in some cases compensating local authorities. Taxes on developed and undeveloped property are payable by the owner (EUR 21.5 billion). Landlords' income from property rental is also taxed, yielding EUR 3.4 billion in revenue. Real property is also included in the assets on which wealth tax is levied. Transfer duties (a total of EUR 7 billion for both residential and commercial property) are payable on sales of property assets, and include cadastral tax, registration duties, and mortgage registry fees (see below). VAT on housing raises EUR 17 billion per year.

10. The loan may amount to as much as 40% of the transaction. Other measures to help first-time buyers exist. Beyond government-guaranteed means-tested homeownership loans, the Pass-Foncier scheme allows households to buy a principal dwelling in two stages: first the dwelling, then the land. Initially for houses, it has since been extended to flats. The scheme costs nearly EUR 1 billion annually. The home savings loan is a reduced-interest loan granted to participants in a home savings scheme after an initial savings phase.

11. Real property owned for more than 15 years and sales for less than EUR 15 000 are also exempt from capital gains tax.

Table 3. **Housing-related tax revenues, 2008**

	€ billion		€ billion
Total housing-related revenue	**66.0**	**Revenue related to property transactions**	**7.2**
As percentage of total tax revenue	7.8	Cadastral tax (including mortgage registration)	0.6
Revenue from housing as a service	**41.4**	Mortgage registry fees	0.2
Residence tax	15.0	Registration duties	5.8
Developed property tax	20.0	Levy for assessment and collection costs	0.1
Undeveloped property tax	0.8	Capital gains tax on property assets	0.5
Portion of wealth tax levied on property assets[1]	2.1	**Value added tax[2]**	**17.0**
Tax on property-related income, *of which*:		On land	2.8
General social security contribution	3.3	On new residential properties	11.2
Contribution on rental income	0.1	On notary fees	0.4
Tax on vacant dwellings	0.02	On agency fees	0.5
Construction-related revenue (local development tax, etc.)	**0.5**	On improvements and major maintenance	1.9

Note: This table shows actual revenue. It does not include central government compensation to local authorities.

1. Estimate based on the property-related portion of the assets of households in the upper decile (50%).
2. VAT on energy and charges (EUR 10 billion) is not included.

Source: *Compte du Logement and Rapport de l'Observatoire des Finances Locales, 2009*.

Limiting distortions

The French housing market is affected by many policy-induced distortions, the scale of which is difficult to justify on the grounds of seeking to correct market imperfections. In particular, they concern segmentation of the rental market, private-sector rent controls, the unsuitability of rateable values and the tax treatment of different types of housing. Social housing, another source of distortions, is discussed later in the chapter.

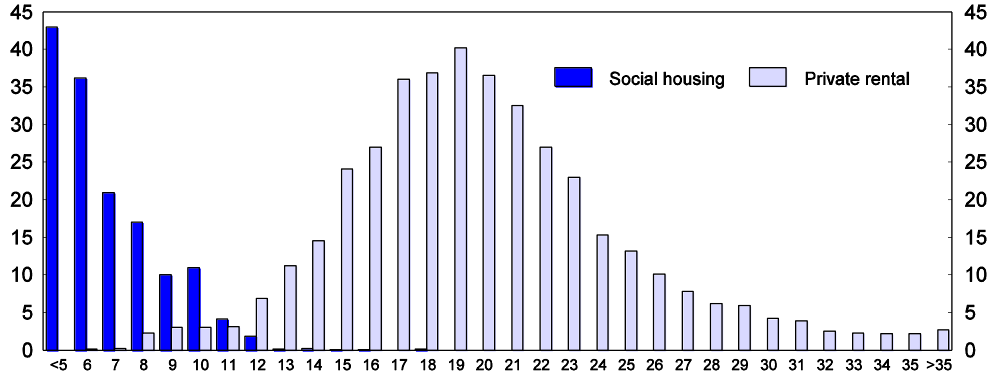
Reducing the heavy segmentation of the rental market

The French rental market is split into two. Social housing accounts for 45% of the rental stock, with significantly lower rents than in the private sector, causing a high degree of segmentation. Average social housing rents are 60% lower than in the private sector, though the discount falls to 40% when differences in location and quality are factored in (Gilli, 2006; Trevien, 2008). That means that social sector rents receive an implicit subsidy of about EUR 11 billion a year, or 0.6% of GDP.[12] Figure 3.11 illustrates the resulting segmentation in Paris, where there is a glaring shortage of mid-priced rental units. That shortage appeared after institutional investors withdrew from the property market in the mid-1990s and could be the object of a re-focusing of subsidies for private investment in rental accommodation, in the spirit of the "social version" of the Scellier law, which has the lowest rent caps in the Scellier scheme.

12. This calculation is based on an average social sector rent of EUR 320 a month, or EUR 3 840 a year, and 4.5 million social housing units: 4500000 * 3840 * (1/(1-0.4)-1) = EUR 11.5 billion.

Figure 11. **Distribution of rents in Paris, 2008**

Thousands of dwellings by monthly rent per square meter, EUR



1. Classes of rent per square meter are simplified: class 10, for example, corresponds to the price range "more than EUR 9" and "less than EUR 10" per square meter.

Source : CREDOC (2010), Les difficultés de logement des classes moyennes et les besoins de mobilité résidentielle.

What are the consequences of this segmentation? On the basis of theoretical predictions confirmed by past experience of rent control, imposing artificially low rents reduces the quantity and quality of available housing. It creates excessive demand on such advantageous terms, discourages new construction, delays necessary maintenance of the existing stock, reduces residential and labour mobility, creates a mismatch between what there is and what people want, exacerbates discrimination, encourages under-the-table transactions, favours corruption and more generally short-circuits market-driven housing mechanisms (Arnott, 1995). Although rent control in one segment of the housing stock reduces total average rents, it tends to push rents up in the uncontrolled sector and restricts overall supply. Many of these consequences are probably to be found in France, except perhaps for the one relating to the number of available housing units, given the subsidies for social housing production that go together with rent control. A back-of-the-envelope calculation indicates that rent control in the social sector pushes private-sector rents up by 5%, reduces the total average rent by 1.3% and reduces the total number of available housing units by 1.3% (see Box 2).

There are two forms of public support for social housing in France, *i.e.* production subsidies and means-tested individual allowances. The respective balance between these two types of intervention should be re-examined, for a vast amount of empirical research shows that the former is a source of both inefficiency and unfairness in comparison with the latter (Olsen, 2002 and 2009). Studies put the excess cost of the subsidised production approach at between 10% and 90%, implying that many more households could benefit from housing allowances for the same amount of money. This cost-inefficiency arises because the incentives for builders of social housing to be more efficient are insufficient, because there is a mismatch between supply and demand, because the existing stock is inadequately maintained, etc. Acting on the price of housing services seems to be an expensive way of achieving the social objectives of housing policy.

Box 2. **Consequences of the segmentation of the rental market**

This box presents a stylized model for estimating the impact of rent control in the social sector on the level of rents in the private sector and on the total housing supply. The conceptual framework is that proposed by Marks (1984). Its main hypotheses are the following. The housing market comprises two sectors, one that is subject to rent control (social housing, in the present case), while the other is the free sector. In the absence of controls, the market rent level would be R_0, and total supply would be $S = S^c + S^u$, where S^c and S^u are supply in the regulated and free sector, respectively. The elasticity of supply with respect to rent is assumed to be identical in the two sectors and is represented by ε. Rent control has the effect of lowering rents from R_0 to R_1^c in the social sector, which generates excess demand in this sector and raises rents from R_0 to R_1^u in the free sector. By expressing rent changes, $\dot{R}^k \equiv (R_1^k - R_0)/R_0$ for $k = c, u$, the total effect on supply becomes: $dS/S = S^c/S * \dot{R}^c + S^u/S * \dot{R}^u = \varepsilon\left[c\,\dot{R}^c + (1-c)\dot{R}^u\right] = \varepsilon\,\dot{R}$, where c is the proportion of social housing and $\dot{R}$ is the average change in rents due to regulation. Marks (1984) shows that $\dot{R}^u = -\dfrac{c\,\dot{R}^c}{(1-c)+\eta\,\dot{R}^c} > 0$, hence $\dot{R} = \dfrac{c\,\eta\,\dot{R}^c}{(1-c)+\eta\,\dot{R}^c} < 0$ and $dS/S = \varepsilon\,\dot{R} < 0$, where η is the elasticity of demand for housing: rent control boosts rents in the free sector and lowers average rents, at the cost of restricting supply. The increase in free-sector rents will be greater if the proportion of social housing is high, if rents in the social sector are low and if the elasticity of demand is weak. Table 3.4 below provides orders of magnitude for the impact of rent control as a function of different levels of elasticity, empirically estimated. The estimates are obtained by calibrating the model on the basis of a gap between housing rentals in the social and the free sectors (correcting for quality) of $\dot{R}^u - \dot{R}^c$ = 40 % (*cf.* text). In the first three columns, the proportion of social housing c is equal to that observed, or 16 % of all housing units (assuming that the relationship between free-sector prices and rents is consistent) while in the last column it is set at 40%, which represents the share of social housing in the rental market.

Table 4. **Effect of rent controls in the social sector on rents in the private sector and on total housing supply**

	$\dot{R}^u - \dot{R}^c = 40\%$			
	$c = 16\%$			$c = 40\%$
	$\varepsilon = 1$, $\eta = -0.75$	$\varepsilon = 0.5$, $\eta = -0.75$	$\varepsilon = 1$, $\eta = -1.5$	$\varepsilon = 1$, $\eta = -0.75$
Social sector rents	**-34.9 %**	-34.9 %	-35.8 %	-26.7 %
Free sector rents	**+5.1 %**	+5.1 %	+4.2 %	+13.3 %
Average rents	**-1.3 %**	-1.3 %	-2.2 %	-2.7 %
Total supply	**-1.3 %**	-0.7 %	-2.2 %	-2.7 %

Moreover, whereas a means-tested personal benefit system appears to be fair and gives recipients greater freedom of choice, the way social housing currently works and rental regulations in the private sector are doubly unfair. First, because they are not properly targeted they do not necessarily benefit those most in need. Indeed, it is estimated that the supply of low-rent housing is approximately 3.2 million units, broken down into 2.5 million units in the social rental sector and 700 000 in the private rental sector. This supply should be quantitatively sufficient given 2.8 million poor tenant households, *i.e.* those whose income is 60% below the median income. However, this housing is not necessarily occupied by poor households, for the 2006 National Housing Survey showed that in the social sector, only 900 000 households out of the 1.4 million poor tenants were in the 2.5 million low-rent housing units, and that in the private sector, only 200 000 households out of the 1.4 million poor tenants lived in the 700 000 low-rent housing units. Second, the segmentation of rents encourages excess demand while creating an artificial gulf between those who get social housing and others. The financial advantage to the beneficiaries is considerable: for a household that stays in its unit for 15 years, the discounted implied benefit amounts on average to about EUR 24 000, or 15 months' median net salary. However, in areas where the market is very tight, construction subsidies combined with rent caps may be preferable in order to prevent the individual subsidies from being captured by landlords through rent increases.

Revising the rent index

There are no restrictions on rents for new leases in the private rental market. In contrast, rents under current leases may not be increased by more than the rise in the benchmark rent index (IRL), published by INSEE, which corresponds to consumer price inflation excluding tobacco and rents over the latest 12 months. Having replaced the cost of construction index in January 2006, the IRL has the twin aim of moderating rent increases at the annual rent review and limiting their volatility. This method of rent regulation is often called "second-generation control" (Arnott, 1995), and its effects are very different from those caused by a stricter control of all rents as was applied in France, for example, between 1914 and 1948. This less strict regulation of rents is usually justified by the wish to protect tenants from sudden sharp variations in their housing costs. Such variations may either be "natural", *i.e.* dependent on economic conditions, or result from a market imperfection caused by the high level of mobility-related costs, which gives landlords a monopolistic market power that they could exploit if there were no controls.

However, while judicious regulation may be useful, it should not contribute to the segmentation of the rental market. With the benchmark rent index as currently defined, a structural shift in relative prices reflected in a real rise in rents is not passed on to rents under current leases. There are provisions for adjusting rents to market trends when the lease is renewed, but they are difficult to apply.[13] Altogether, according to recent OECD estimates, the degree of private-sector rent control is relatively high in France (Andrews *et al.*, 2011). Consequently, at a time of structural shift in rents relative to consumer prices for goods and services, which is the underlying trend at present, index-linking rents restricts the residential mobility of tenants with a current lease, puts the burden of the natural rise on the new leases, probably limits the supply of housing and increases the overall level of rents (see Basu and Emerson, 2000). When landlords internalise these constraints, they tend to set rents under new leases at a higher level in order to make up for the potential revenue shortfall from slower rent increases during the lease. In this case, tenants who have to move, for professional reasons for example, suffer the consequences of the distortions generated by this index. The situation may therefore lead to weaker adjustment in the labour market and a higher level of structural unemployment. The recommendation is therefore to opt for an index based on the trend of new rents, smoothing it in order to avoid sudden sharp variations.[14] The beneficial effects of such a measure would be enhanced if rent indices were available at a sufficiently localised level.

13. When a lease expires, a landlord who wishes to increase the rent by more than the rise in the index, for example in order to align it with market rents, must prove that the rent is plainly undervalued in relation to comparable housing, giving nine specific examples. If there is no agreement, the matter must be referred first to the departmental conciliation commission, then to the courts.

14. The objection could be raised that, with a structural increase in rents, this would penalise a portion of the population, including retired people whose income follows the consumer price index more closely. However, the envisaged shift affects relative prices. At a given rate of consumer price inflation, a rise in rents is reflected in a fall in the relative prices of the other components of the index. Where a household spends more than the average proportion of its income on housing, such a development would indeed cause

Updating rateable values

Updating property values for tax purposes should be a policy priority for reasons of both fairness and efficiency. Land taxes and the residence tax are currently assessed on elements of comparison derived from the reassessment of property values carried out in 1970 for developed land and in 1961 for undeveloped land. Rateable values are just updated each year by applying a uniform coefficient that fails to take account of spatial variations. Yet in some cases the values of the assets have evolved very differently within the same jurisdiction, leading to substantial gaps with the relative levels of taxation, and hence to substantial transfers of liabilities between taxpayers that are sources of injustice and distortions.[15] Tax bases more in line with the real value of property also create healthy incentives for local authorities to develop appropriate infrastructure and amenities. A general revision of rateable values was prepared in 1990 but was not applied because of strong opposition from insiders, *i.e.* those who would have faced a sharp rise in their tax bills. The simulations carried out at the time indicated that the introduction of new bases would result in most cases in a redistribution from the best-off taxpayers to the less well-off (Conseil des Prélèvements Obligatoires, 2010). From this standpoint, the current system based on out-of-date rateable values is regressive.

In France, methods for estimating rateable values are based on a cumbersome procedure and obsolete criteria, meaning that a switch to regular revaluation would require a simplification of the process. Many countries manage to overcome the obstacles to regular updating linked to property market trends: for example, Denmark, Iceland, Japan, Korea, New Zealand, the Netherlands, Norway and Sweden revise their rateable values at less than three-yearly intervals (Andrews *et al.*, 2011). In order to avoid excessive revenue volatility, a tax base more closely linked to current market values should be smoothed over a few years.

Moving towards fiscal neutrality

In France, as in most OECD countries, taxation favours the housing sector inefficiently, and principal residences in particular (non-taxation of imputed rents, no capital gain tax), *i.e.* to the detriment of other sectors and assets and hence of national income. It may, for example, contribute to excessive consumption of housing services and weaken non-residential investment, thus potentially fuelling property asset inflation until bubbles appear. Renovation and maintenance work benefits from an unjustifiable tax expenditure with a 5.5% reduced rate of VAT, one of the objectives of which is to support the building industry. In contrast, most new housing is liable to the 19.6% standard rate of VAT (though it is not subject to registration duty), but the detail of the taxation arrangement highlights the fact that the same property may be taxed several times. In some cases, if the property is resold less than five years after completion, it is again liable to VAT (with a reduced rate of registration duty), meaning that the same property may be taxed several times. Next, the five-year threshold encourages owners to wait for the deadline before selling their property and may thus curb residential mobility. A preferable solution would be to charge VAT on the property once only, on first sale, whatever the date. If the intent in the current measure is to discourage short-term speculation, it would be better to eliminate the liability for VAT progressively over time so as to avoid the five-year ratchet effect.

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its purchasing power or real income to fall. In such cases, the problem must be treated with social policy measures, rather than by avoiding it while contributing to the segmentation of the housing market.

15. Recent buildings, especially those including rent-controlled units, contain many modern conveniences covered by the arrangements. Conversely, the renovation of existing dwellings has not been fully taken into consideration, nor has the disaffection for areas where economic activity, lively in 1970, has since withered (Conseil des Prélèvements Obligatoires, 2010).

The non-taxation of imputed rents in France also induces distortions because it influences investment decisions in favour of owner-occupation, to the detriment of buy-to-let, for which rents are taxed. Only Belgium, the Netherlands, Norway and Sweden (with a ceiling) tax imputed rents, and even there the tax base tends to underestimate the value of implicit rents. Non-taxation should imply doing away with tax relief on mortgage interest for owner-occupied properties, and from this standpoint the French government's decision to scrap the tax credit on mortgage interest from 2011 is welcome. Although there are arguments based on the positive externalities induced by owner-occupation that could justify subsidising it in relation to buying to let, they are hardly compelling (Andrews *et al.*, 2011). The distortion is considerable, since imputed rents represent more than 6% of GDP in the national accounts. The implicit tax subsidy at the marginal rate of taxation is therefore substantial. The two types of residential investment should be treated more similarly by imputing to owner-occupiers the implicit rent they pay themselves, perhaps applying a discount (20%, for example) to take account of the uncertainty connected with calculating the imputed rent and possible externalities.

How should the parameters of the taxation of imputed rents be determined? They should be defined neutrally in relation to investments in financial assets (Box 3), provided that the tax is levied on the net yield of the property asset, *i.e.* the received (or implicit) rent minus financing, maintenance and depreciation costs. The problem of fiscal neutrality between asset classes is complicated in France by the heterogeneity in the taxation of savings, which raises the broader issue of its reform (and also, as in many other countries, by the dispersion in property taxation inherent in its local nature). Indeed, tax measures exist that make it possible to significantly reduce the tax liability on long-term savings. The ideal solution would be to tax income from capital and capital gains in the same way across all assets.

However, implementing a system for taxing imputed rents raises a number of thorny practical issues.[16] Where a country has a sound system for assessing rental values, the simplest solution would be to convert the taxation of rental income into an ownership tax, whether the owner is landlord only or occupant as well, and to scrap the taxation of rental income. Thus, as an example, taking as a basis a gross rental yield of 5% of the value of the asset and aggregate depreciation and maintenance costs of 3%, the tax base would be 2% of the value of the property (or 40% of the annual rental value, since 40%*5%=2%) minus interest charges, which would be taxed at the going rate (*e.g.* 28% for the withholding tax). This new layer of the property tax should be uniform nationwide.

Similar reasoning could be applied to capital gains, but taxing capital gains on the principal residence may discourage mobility, creating lock-in effects. To avoid this pitfall, capital gains on the principal residence are deferred in Portugal, Spain and Sweden, provided that they are invested in another principal residence, but only up to a certain threshold in Sweden, beyond which they are taxed immediately. However, a scheme of this sort may encourage overconsumption of housing in relation to needs that tend to diminish with age. To improve matters, taxes on capital gains would have to be payable on death, as is the case in Canada, for example.

16. France stopped taxing imputed rents in 1965 because the scheme was costly to administer and yielded relatively little, given taxpayers' tendency to underestimate their property's value (Driant and Jacquot, 2005).

Box 3. **Optimal taxation with housing**

Fiscal optimality seeks to maximise social utility for a desired level of tax revenues. The aim is therefore to strike a balance between efficiency and equity, taking account of any distortions induced by taxation. Ramsey taxes meet the efficiency criterion in a framework limited to the taxation of commodities and that ignores differences between individuals. The optimal solution in that case is to tax at a higher level commodities that have weak demand and supply elasticities, thus introducing into the optimum an element of fiscal non-neutrality between commodities. That is the standpoint from which taxes on real property and successions are generally regarded as "good", weighing little on economic growth, insofar as the tax base is relatively inelastic to tax rates.

However, when equity criteria are taken into account and the government has other instruments at its disposal, like income tax, it becomes optimal to use income tax for redistribution purposes and to tax commodities homogeneously (Atkinson and Stiglitz, 1976). In addition, the customary prescription is to not tax physical capital because it discourages investment, introduces through time growing distortion between present and future consumption and is pernicious, given the high sensitivity of the tax base to rates (Mankiw et al., 2009). Recent research taking account of the life cycle of agents and credit restrictions give less clear-cut results concerning the non-taxation of physical capital (see, for example, Conesa et al., 2009). Moreover, these discussions take no account of housing, still less its specific character as a consumer good and medium of investment.

As far as housing is concerned, the first source of distortion generated by the tax systems of most OECD countries concerns the non-taxation of imputed rents (sometimes coupled with tax relief on mortgage interest), whereas rental income is taxed. Gervais (2002) and Nakajima (2010) show that this omission has a substantial negative impact on well-being. The second source of inefficiency may arise from differences in the taxation of property, consumer goods and other assets. This is an important problem since property represents a substantial proportion of the capital stock (about 40% in the United States, for example; in France, immovable property represents 60% of household assets). Tax neutrality between consumption of housing services and consumption of other goods, and between income from property and income from other assets therefore seems desirable (Eerola and Määttänen, 2009).* Given that it is difficult in practice to levy VAT on rents (paid or imputed), the best solution is to charge the standard rate of VAT on new buildings and maintenance and renovation expenditure, as is the case for many durable goods (Metcalf, 2006).

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* More specifically, this result is established for a Ramsey-type approach and a model class including a Cobb-Douglas utility function between housing and other consumer goods. In a more general framework, the optimal rate for the taxation of housing consumption is highly sensitive to substitution elasticities between housing, other commodities and leisure.

Making the housing market more fluid and transparent

Enhancing fluidity in the housing market ought to be an important public policy goal in order to promote a more smoothly functioning market and also to enable a better allocation of the labour force in line with economic developments. To this end, the priorities for France should be to reduce transactions costs and improve the supply response, as well as to foster the appropriate degree of residential mobility, rebalance landlord-tenant relations and improve statistical information about the state of the market.

Reducing transactions costs

Compared with other OECD countries, transactions costs in France appear to be particularly high (Andrews *et al.*, 2011), with a property purchase/sale costing on average around 12% of its value for transactions carried out using the services of a real estate agency. These costs are determined by the level of taxation (transfer tax), the regulatory environment (notary fees) and the amount of competition (agency commissions). They add to the already high costs of residential mobility (house-hunting, removals, etc.).

However, transactions costs are a source of inefficiency, since it would be less detrimental to tax income from assets (financial or real estate) than the transactions for the acquisition of those assets. As levies on income and consumption, those on transactions discourage property purchase, but they have the additional impact of causing lock-in effects and deterring transactions that might achieve a more efficient allocation of assets in response to changes in the economic environment or other developments, for example by restricting residential mobility to areas with buoyant labour demand (Johansson *et al.*, 2008). Empirical estimates suggest that a reduction in transactions costs of 1 percentage point would increase owner-to-owner residential mobility by 8% (van Ommeren and van Leuvensteijn, 2005).

It would make sense therefore to shift the tax burden from transactions onto property. To do so, it would be necessary to continue to reduce substantially the registration fees that are currently set at 5.1% (compared with 8% on average in 1999) and to increase property tax in parallel. The components of transactions costs associated with compliance with regulations and competition are dealt with below.

Improving the housing supply response

Having a housing supply that is not very elastic in the long term to housing prices is unhelpful, because shocks that stimulate demand, such as those seen in France over the past 20 years, ultimately trigger a rise in property prices, rather than an adequate response over time and space in terms of the number of houses built. A strong supply response is thus a key factor in enabling the smooth functioning of the market, which is best left unhindered by complex and unnecessary regulation. According to recent OECD estimates, housing supply elasticities vary substantially across member countries, and France is characterised as having a weak response, in absolute terms and relative to North America and the northern European countries (Andrews *et al*., 2011). In the literature, the following factors are cited as contributing to low elasticity of supply: population density, planning regulations, difficulties obtaining credit encountered by building companies, low levels of competition in the economy and the absence of a skilled labour force in the construction sector (Andrews *et al*., 2011).

Planning restrictions are useful for communities in that they take account of the negative externalities of new building. In the best-case scenario, they restrict housing supply in the interests of the collective well-being, but in so doing they increase property prices. By their very nature, they lie at the heart of the conflict of interest between "insiders", those that stand to see the price of their assets fall if planning restrictions are relaxed, and those who are excluded by such regulation. There is a risk that "insiders" may hijack regulation to serve their own ends by putting pressure on local elected representatives, thus capturing the effect of any rise in demand on prices. Recent OECD country surveys on Denmark, Finland, the Netherlands and Sweden suggest that zoning regulations may contribute to increases in property prices.

The lack of consistency between local urban planning and housing policy instruments is a frequent target of criticism. While there is no shortage of land in France, where population density is low relative to other European countries, building permits are an important aspect of planning policy. The October 2007 planning reform bill seems to have simplified building permit procedures and to have made planning laws clearer (MEEDDM, 2010). However, while housing policy has been implemented since 2004 at the inter-communality level, ensuring that it is consistent over an area that stretches beyond the commune, responsibility for granting building permits continues to fall to the commune. This situation can lead to "free-rider" behaviour, whereby municipalities bank on construction taking place in neighbouring communes, ultimately restricting aggregate supply (the "Not In My Back Yard" or NIMBY syndrome).

It is thus necessary to continue in the spirit of the abovementioned reforms and, as discussed in the framework of the Grenelle II forum (see Chapter 4), to extend inter-communal control to include building permits and the local land-use plans. It is necessary to go further and have the State through its prefects force communes to raise their planning land-use coefficients where these are too restrictive (Mistral and

Plagnol, 2008). With regard to the greater Paris area, the relevant level of government is probably that of the region, where there is a need for improved governance on housing policy. Finally, some municipalities levy a tax on owners of vacant dwellings, but it brings in only EUR 18 million per year, despite a vacancy rate that is historically low but nevertheless stands between 6.4% and 8.8% depending on the source. This vacancy rate is often considered to be mainly of frictional origin and to be very low in areas where the market is tight. However, the scope of application of the tax might be broadened, in particular the two-year period of vacancy required before the property is subject to the tax might be reduced.[17]

The Council of State (2009) has attacked the disorderly build-up of new legal, technical and environmental requirements applying to owners: for causing an increase in new housing prices, rents and fees; for hastening the obsolescence of older housing stock; for lengthening construction times; for excluding the poorest groups of the population from housing; and, ultimately, for causing a supply shortage. It has also noted that the blanket application, without an impact study, of the law on disabled access to new buildings from 2012 has translated into an inefficient requirement for additional surface area. According to the Council of State, it is the view of many observers that the preference in France for universal regulation and detailed technical standards seems to lead to the most expensive solution with the heaviest administrative burden. The report asks whether the rise in inadequate housing and homelessness coincides with the stricter requirements in terms of decent housing, building standards or levels of comfort. According to estimates by the Directorate-General for Urban Development, Habitat and Construction (see Conseil d'État, 2009), the additional costs incurred as a result of technical standards in 2006/07 for new housing stock, for example, ranged from 4.5% to 17% (from 1% to 3% for energy, from 5.5% to 6% for disabled access, from 1% to 3% for termites and from 1% to 5% for earthquake prevention). Hence, it recommended to bring this process back under control and to systematically conduct regulatory impact studies *ex ante*.[18]

Promoting residential mobility

Residential mobility is an important factor in labour mobility, which in itself can enable the economy to adjust more rapidly to shocks and, in this way, sustain total employment. France does not appear to stand out relative to other EU countries in terms of having a particularly low level of residential mobility (Caldera Sánchez and Andrews, 2011; Janiak and Wasmer, 2008). However, as in most OECD countries, the degree of mobility of the population is linked to occupancy status: owner-occupiers are far less mobile than social-housing tenants, who in turn are less mobile than private-sector tenants. The impact of occupancy status is slightly more marked in France than in the other OECD countries, with the exception of the United States (Table 5). The usual pattern, which is robust across countries, can be attributed to the high transactions costs of property acquisition and to the rent advantage granted to social-housing tenants. Of course, the causal connection could be the other way around: those who are in a more stable position, who have no real plans to move, in particular for work-related reasons, are more inclined to become property owners, all things being equal, especially since this stability affords them more time to recoup the transactions costs. The estimates also show that, in France, a low level of educational attainment appears to

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17. This tax concerns unfurnished housing units that have been vacant for at least two years (at 1 January of the tax year), located in certain urban centres with a population of over 200 000. The following are not subject to the tax: secondary residences, housing units that are vacant involuntarily, housing unit that were occupied for at least 30 consecutive days during one of the two reference years, housing units that would require major work before they could be occupied, housing units that are to be demolished or refurbished as part of city planning, renovation or demolition operations and housing units that are on the market but have not been rented or sold. The amount of the tax is progressive: 10% of the rental value for the first year, 12.5% the second year and 15% as from the third year (http://droit-finances.fr).

18. Under a framework law, it became compulsory for an impact study to be conducted in respect of draft laws submitted after 1 September 2009, but such studies continue to be optional in the case of regulations.

constitute a larger obstacle to mobility than in most other countries (Table 5). In the light of these stylised facts, it becomes more difficult to justify providing subsidies to promote home ownership instead of offering assistance to individuals to find rental housing in the private sector, particularly given the high transactions costs.

Table 5. **The effect of household characteristics on residential mobility**

Estimates from probit regressions[1]

	(1) France	(2) Belgium	(3) Germany	(4) Spain	(5) Sweden	(6) United Kingdom	(7) United States
Outright owner	**-0.198*** (0.013)**	**-0.070*** (0.014)**	**-0.144*** (0.012)**	**-0.135*** (0.014)**	**-0.114*** (0.020)**	**-0.111*** (0.014)**	**-0.197*** (0.004)**
Owner with a mortgage	**-0.155*** (0.015)**	**-0.075*** (0.016)**	**-0.080*** (0.012)**	**-0.072*** (0.013)**	**-0.105*** (0.020)**	**-0.134*** (0.023)**	**-0.216*** (0.006)**
Social/subsidised tenant	**-0.097*** (0.015)**	**-0.046*** (0.016)**	**-0.058*** (0.017)**	**-0.041*** (0.007)**	**0.000 (0.056)**	**-0.092*** (0.014)**	**-0.059*** (0.010)**
Age 35-44	**-0.135*** (0.013)**	-0.071*** (0.012)	-0.117*** (0.011)	-0.033*** (0.008)	-0.121*** (0.017)	-0.096*** (0.013)	-0.093*** (0.005)
Age 45-54	**-0.166*** (0.014)**	-0.108*** (0.012)	-0.148*** (0.011)	-0.052*** (0.007)	-0.183*** (0.015)	-0.147*** (0.011)	-0.150*** (0.005)
Age 55-68	**-0.149*** (0.012)**	-0.098*** (0.009)	-0.200*** (0.011)	-0.051*** (0.006)	-0.215*** (0.015)	-0.162*** (0.010)	-0.175*** (0.005)
Low education attainment	**-0.075*** (0.019)**	-0.039** (0.016)	-0.001 (0.020)	-0.005 (0.009)	-0.014 (0.025)	0.100*** (0.034)	-0.026*** (0.009)
Middle education attainment	**-0.038** (0.015)**	-0.037*** (0.013)	-0.017 (0.013)	-0.019** (0.009)	-0.052*** (0.017)	0.074*** (0.014)	-0.002 (0.006)
Number of observations	**5 574**	2 450	14 804	5 718	3 495	3 430	28 969

Note: Dependent variable: 1 if the head of household changed residence during the last two years; 0 otherwise.

1. Values are marginal effects. The coefficients correspond to the impact of a change in the explanatory variable on the probability of moving estimated at the average of the independent variables. The control groups are households renting in the private sector, young people and people with high education attainment. Regressions also include a large set of control variables; *** p<0.01, ** p<0.05, * p<0.1.

Source: Caldera-Sánchez, A. and D. Andrews (2011), "To Move or not to Move: What Drives Residential Mobility Rates in the OECD?", *OECD Economics Department Working Papers, No. 846*.

Recent OECD estimates show that cross-country variations in residential mobility are linked to public policy (Caldera Sánchez and Andrews, 2011). Residential mobility would be higher if real estate transactions costs were lower, if the housing supply were more elastic and if regulations governing rent control and landlord-tenant relations were more flexible. Of course, residential mobility is not an end in itself, and some regulations are even aimed at avoiding excessive mobility. Nevertheless, when such regulation becomes too onerous, it can impede labour-market performance. In this way van Ommeren and van Leuvenstejn (2005) show that high transactions costs create lock-in effects and limit labour mobility. Janiak and Wasmer (2008) find that housing-market restrictions, measured in terms of strong tenant protection, have quantitatively significant impacts on the unemployment rate in the event of negative labour-demand shocks.

Rebalancing landlord-tenant relations in order to promote investment

France is among the countries in which tenants benefit from the most protection in terms of rent control (see above), clauses on the duration and extension of rental contracts, and eviction procedures. This landlord-tenant balance arose out of reforms implemented during the 1980s. Wasmer (2008) supports the view that, although it responded to legitimate concerns, the *status quo* achieved by means of this body of laws is inefficient. Based on a comparison with Québec, Wasmer maintains that other accommodating relations between tenants and landlords are possible, which ensure a more fluid, and in certain respects, more equitable housing market. According to Wasmer, the way in which the rental market functions in Québec allows for moderate rents, high levels of mobility and the absence of distrust and problems on first contact, which means that accommodation can be rented even where the tenant is not a permanent resident or is not yet employed.

The starting point is to acknowledge that part of the population experiences difficulties securing access to housing. Insofar as the procedures for evicting a non-paying tenant are cumbersome, long and unpredictable – the courts are overwhelmed and do not have the power to enforce the eviction of a tenant – they breed negative incentives. Landlords react to the uncertainties surrounding rent recovery by conducting rigorous screening of tenants, despite the limitations provided for by law since 2009 (restricting the number of supporting documents required and reducing the amount of the security deposit to be paid from two months' to one month's rent), sometimes through objectionable discrimination, or by raising rents or limiting the supply. They tend to favour tenants with labour contracts of indefinite duration, which in turn increases the social demand for employment protection legislation (Decreuse and van Ypersele, 2010). Moreover, tenants acting in bad faith, who know how to work the complex system, may turn protection to their advantage. Instead, the principle should be that landlords who want to recover their properties for legitimate reasons, such as non-payment of rent, be able to do so very quickly: even though it is essential to avoid situations where families end up without housing as a result of eviction, it is the responsibility of the state to put in place emergency measures in order to avoid social and human tragedy.[19] As with flexicurity in the labour market, the objective of public intervention should be to secure tenants' access to housing rather than housing itself.

The need to reduce the time taken to resolve landlord-tenant disputes leads to two types of recommendations. First, in line with the conclusions drawn in the Pinte Report (2008), it is necessary to improve prevention measures before a case comes before a judge, who is not necessarily best placed to deal with the – inherently social – problem of re-housing tenants in accommodation that matches their capacity to pay. To achieve this, the emphasis should be placed, in particular, on pinpointing precarious situations and notifying the authorities and insurance companies about past-due payments at an early stage (Conseil d'État, 2009). Second, where prevention measures have failed to head off the non-payment of rent, it is then above all a case of ensuring that owners can quickly recover their property. In order to shorten the recovery time and speed up the legal process, Wasmer (2008) advocates the following: establishing a single legal counterpart (as opposed to a situation in which the functions of the trial judge are juxtaposed with those of the execution judge); abolishing the winter moratorium on evictions between November and mid-March (tenants often stop paying rent in October); eliminating the complex court order procedures to pay so as to shorten the period leading up to the breach of the tenancy agreement; and proceeding with eviction within two weeks of breach of the tenancy agreement. In return, since tenants would no longer be able to remain in housing for an extended period without paying, landlords should not be allowed to demand either complex guarantees or deposits. Finally, responsibility for those people who cannot pay should be a matter of national solidarity, rather than falling to private landlords. In offloading the problem onto landlords, the state is exacerbating the housing shortage. Article 57 of the Mobilisation for Housing Act of March 2009 reduces to one year the maximum additional time that a judge can stay an eviction and thus already constitutes a step in this direction.

One challenge associated with this type of reform consists of how to manage the transition towards a new equilibrium, in the sense that, in the short term, more households may be forced to leave their

19. According to the Housing Survey (*Enquête Logement*, 2002), 6.7% of tenants had made past-due payments over the two previous years. In 2009, there were around 140 000 court procedures relating to non-payment of rent, 107 000 eviction orders and around 10 600 evictions involving the law-enforcement agencies (Ministry of Justice; Ministry of the Interior).

accommodation in what is already a tight situation, with landlords not yet having changed their behaviour. It is first necessary, temporarily, to ease tensions in the housing market by developing the low-cost sector and significantly reducing the risk shouldered by landlords by automatically and quickly insuring them against losses (Wasmer, 2008). The Council of State also highlights the importance of building temporary low-cost housing units, such as the wooden houses proposed by Emmaüs France for a total unit price of around EUR 10 000; however, it stresses that acknowledging whether such housing could constitute a solution to the problem (which otherwise risks remaining insoluble) and working with local elected representatives to find locations where they could be built are primarily political issues. This type of scheme should initially be piloted in a few regions. It should also be formulated in conjunction with measures tasked with increasing mobility of tenants in the social housing stock, in particular by speeding up the exit of those whose income exceeds the ceiling set.

The *Garantie des Risques Locatifs* (Tenancy Guarantee Scheme – GRL), which was established under the impetus of the social partners, is aimed at making it easier for low-income households to access private-sector housing stock in areas of excess demand by insuring landlords against the risk of tenant default. In January 2010, the scheme was reformed and extended: all tenants whose effort ratio is lower than or equal to 50%, whatever their profile, are eligible for the GRL. The GRL is offered by insurance companies and is aimed at private-sector landlords who rent out unfurnished or furnished housing units for which the rent and additional costs and taxes are no more than EUR 2 000 per month. It insures landlords against the rental risk (default risk, degradation, litigation) up to an amount of EUR 70 000. Housing Action, managed by the social partners, and the government compensate insurers for the high delinquency rates of risky groups (*i.e.* that cannot be insured by the tenant default insurance market). The original measure seems to have had mixed success due to some forms of adverse selection. Indeed, the insurance companies use this arrangement only for the highest levels of risk, making it a very expensive subsidy. Moreover, in areas of excess demand, where the need is greatest, landlords are able to undertake strict screening in order to protect themselves against risk.

Improving statistical information

Good-quality statistical information on housing is essential for ensuring that the market is transparent, fluid and, in general, functions smoothly. Moreover, by diminishing the problem of asymmetrical information among the various players, it also leads to more efficient and equitable transactions. The *Conseil national de l'information statistique* (National Council for Statistical Information – CNIS) recently submitted a report that criticised the status of statistical information on housing and construction and put forward proposals for improvements (CNIS, 2010). The report reveals large gaps in the available data: where they exist, access to them is hindered by government departments and by national statistical authorities, even where they are destined for use by local authorities, which have a growing role in housing policy. Moreover, this situation is not consistent with the underlying logic of the Act of 17 July 1978 on free access to administrative documents and the re-use of publicly held information. The CNIS thus recommended removing the obstacles to accessing personal data where these have been previously made anonymous in line with the right to privacy, as set out in the law. In Germany, where it is compulsory to report rents, local authorities are responsible for publishing the rents charged for all housing categories according to the year of construction, fittings and state of upkeep.

An amendment to the bill on the modernisation of the regulated legal professions, approved in July 2010, is a step in this direction. It aimed to provide the information required to create a leading indicator (the first publication of which occurred in December 2010) based on notarial records of "undertakings to sell", which are preliminary contracts preceding the sale by around three months on average; this enhances the quality of current property market monitoring. This could be taken further by providing individuals with free access to the statistics gathered by notaries once they have been checked for privacy concerns. More generally, since the conditions governing access to these data are recognised by the European authorities as a mission of public service, they cannot be left up to the goodwill of professional associations. In addition, the CNIS (2010) advocates creating an official price index for new housing.

Increasing competition in the housing sector

Housing credit

Credit constraints are relatively tight

The provision of credit in France is subject to prudent banking practices, which has enabled the excesses seen in some other OECD countries to be avoided. First and foremost, regulation determines the rmaximum or usury rate on the total effective rate (TER), the annualised interest rate, that banks can charge to their customers. This is equal to the quarterly average TER applied to loans in the previous quarter, irrespective of their duration, grossed up by 33% (this was 6.09% for fixed-rate mortgages in the third quarter of 2010). While most industrialised countries impose safeguards on credit extended to private individuals, the 33% rule is stricter than elsewhere, since, for example, Italy accepts a mark-up of 50%, and the German courts deem the rate to be excessive when it exceeds twice that available on the market.[20]

Second, in granting a mortgage, banks assess the income of borrowers rather than their wealth (including the underlying property), which results in more weight being given to the repayments/income ratio. Furthermore – and this is good practice – loans are presented in an easy-to-understand and transparent way so as to better protect the borrower. For example, most mortgages are offered at a fixed rate: as the share of variable-rate mortgages was starting to expand, credit institutions were forced to limit the repercussions of the interest rate hikes that occurred between 2006 and 2008.[21] Since then, variable-rate mortgages have been subject to an upper ceiling, which significantly limits the range of the variable rate applied (and thus the potential attractiveness of such mortgages). Generally speaking, the tradition in France with regard to credit is often deemed paternalistic, in that it endeavours to protect consumers, even from themselves.

The subprime crisis admittedly justified the cautious approach of French banks, which is reflected in a low loss ratio. In addition, the average rates practiced are relatively low, which is mainly the result of lively competition in the field of real estate loans, which the major network banks use as a means of attracting customers, as well as of other factors, such as the existence of a cross-subsidy mechanism with the associated insurance (which has generous profit margins, or at least did have until the reform of July 2010; see below). However, it seems reasonable to assume that the cautious practices in granting real estate credit effectively exclude certain households with a riskier profile from access to credit. It is difficult to know to what extent they restrict access to home ownership and total household indebtedness, which are relatively low by international standards. In order to reduce this possible constraint, the definition of usury could be relaxed and rationalised, the levels differentiated depending on the maturity of loans, and the excess over the average rate raised, but this would be certainly at the expense of a deterioration in the quality of the real estate loans on the balance sheets of financial institutions.

20. Source: http://www.cbanque.com/credit/taux-usure.php.

21. Since the second quarter of 2009, the share of variable-rate loans has stabilised at 12-13% of aggregate lending. Following the hike in short-term rates that occurred in the period 2006-08, in May 2008 the banks made a series of commitments to the government aimed at preventing practices that increase borrower vulnerability, such as abandoning call rates and negative principal amortisation practices. Moreover, the risk to the borrower is contained, since interest-rate variation is typically restricted to a range of 50 to 150 basis points.

Legal, tax and regulatory obstacles to the development of the mortgage market

The mortgage market is not highly developed in France. Formally, guarantees are provided in the form of a mortgage or an institutional guarantee known as a *cautionnement*.[22] This institutional guarantee, which first appeared in the early 1980s, is a specifically French instrument based on a pooling of default risks, while the mortgage is a real surety, *i.e.* backed by an asset. Thus, since a mortgage is in principle based on the value of the asset pledged rather than on the solvency of the borrower, the development of the institutional guarantee may cause low-income households to be excluded from access to credit. This might be cause for concern especially since the share of institutional guarantees is growing rapidly and accounted for 56% of total guarantees in 2008, as opposed to 28% in 2000, while at the same time mortgages dropped from 53 to 38%. In reality, this is a moot point, given the practices in France. Even when credit institutions grant loans on the basis of a mortgage, the borrower's solvency plays a key role, so that the actual difference between a mortgage and an institutional guarantee is not as great as it seems. This is due to the fact that the company granting the guarantee, which must reimburse the creditor if the borrower defaults, takes responsibility for recovery of the debt and can therefore initiate a judicial mortgage foreclosure and undertake the seizure of any of the debtor's assets.

In general, lenders' behaviour is explained, then, by the difficulty of recovering outstanding debts in the event of default, which correspondingly reduces the effectiveness of the guarantee provided by the mortgage. The procedures are lengthy, and judicial sales are often concluded at low prices that do not necessarily enable creditors to recover the totality of the debt (Baude and Bosvieux, 2002). As Mistral and Plagnol (2008) have pointed out, a reform of the guarantee method can be achieved only by substantially reducing the costs and legal uncertainties related to granting mortgages. The social and legal environment in France hinders risk-taking on mortgage loans, since lenders are held to be responsible for the loans they grant, either because borrowers may take legal action to cancel the debt in the event of a dispute, or because of the complexity and difficulty of using the courts for seizure of property, which has some similarities with the issue of tenant expulsion discussed earlier. As a result, lenders have come to consider that they cannot be indifferent to the social treatment of defaulting borrowers, and they prefer not to lend in some cases (Taffin and Vorms, 2007). By contrast, in Denmark, a country with a well functioning mortgage market (for a description see OECD, 2006), the community does not rely on the lender to protect, for example, a surviving spouse who had not taken out life insurance: while the property is sold very rapidly in the event of default, the municipality takes responsibility for finding new housing for him/her.

With regard to borrowers, the preference for the *cautionnement* is explained by its lower cost. This is in part due to tax and regulatory differences, since only mortgages are subject to the land registration tax (see note 21) and to the costs of registering and lifting mortgages and to higher notary fees.[23] Thus, the Economic and Social Council (2005) estimated that the cost of taking out mortgages in France is

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22. In France, a distinction is made between a conventional mortgage (*hypothèque conventionnelle*) and a "first priority lien" (*privilège de prêteur de deniers* or PPD). Just like a mortgage, the PPD enables lenders to protect themselves against the risk of non-repayment of loans, and the contract must be signed before a notary. If borrowers fail to meet their payments, creditors can initiate a real estate seizure procedure leading to the sale of the property and the priority reimbursement of the holder of the lien. There are two differences, however. Unlike a mortgage, the PPD is limited to an existing property (*i.e.* it may not be used for new construction) and can be applied only to the property financed. In addition, the PPD is not subject to the land registration tax (*taxe de publicité foncière*), which is 0.615% of the guaranteed amount, so its cost is lower.

23. The mortgage is registered by the notary with the mortgage registry office, which deducts a charge to cover the registrars' salaries. As from 2012, mortgage registrars will be gradually replaced by "public finance administrators". The removal of the mortgage from the list of mortgaged properties is a legal act called *mainlevée d'hypothèque* (mortgage release), for which a fee is also charged.

three to four times higher than in the United Kingdom or Germany. Lastly, competition with regard to institutional guarantees is unsatisfactory, since the credit institution imposes on the borrower the company granting the guarantee; the price of the institutional guarantee, then, seems to be set just low enough to make it more attractive to borrowers than a mortgage.

All this probably explains why the securitisation of mortgages is comparatively rare in France, even though there is no specific legislation to prevent it. The preponderance of French all-purpose banks in the distribution of housing loans, which rely on abundant savings supported by tax schemes, is a factor behind this low popularity of mortgages with non-bank lenders specialised in lower quality loans than banks. Consequently, the development of the mortgage market would be promoted by eliminating the distortions caused by the tax-free status of certain savings accounts, such as the home savings plan (PEL), and by greater entry of foreign specialists, provided that the legal obstacles to debt recovery are lifted. In addition, the lack of real interest in mortgages limits the need for creditors to ensure high-quality statistical monitoring, contributing to unsatisfactory knowledge of transactions prices and properties purchased.

For all these reasons, it seems advisable to reduce the effective costs of taking out a mortgage, while avoiding the abuses found elsewhere. Besides, the provision regarding the *pacte commissoire* (contractual appropriation) – a clause whereby the parties agree that the creditor will take ownership of the property in the event of non-payment via a rapid procedure and, above all, without the intervention of a judge – has been legal only since the Order of 23 March 2006 on sureties, but this has limited scope, since primary residences are excluded. This exclusion is apparently being maintained out of fear of abuse by creditors, who might force debtors to sell their property at far below market prices (even though the Order specifies that the value of the property at the time of the transfer must be determined by an independent expert).[24] Consequently, to adapt the rules for recovering the mortgaged asset, it would be advisable, as recommended by Mistral and Plagnol (2008), to extend the *pacte commissoire* provision to primary residences. The tax distortion against mortgages should also be eliminated and the related notary fees reduced substantially.

Some practices restrict competition …

France also stands out because of the fact that credit institutions require borrowers to take out insurance covering the risks of death, invalidity and loss of employment, even for mortgages. Although this practice is not based on any legal requirement, the granting of credit is always subject to the granting of this insurance. The Consumer Credit Reform Act published in July 2010 to ensure transposition of the European Directive on consumer credit contains an article on the “decoupling” of borrower’s insurance and real estate credit, which is aimed at liberalising the real estate credit market. In 2007, banks held 85% of the French borrower’s insurance market, accounting for an annual turnover of EUR 6.5 billion. Henceforth, lenders cannot refuse to accept another insurance policy as a guarantee, provided that it offers a level of guarantee equivalent to the one that they are proposing. In addition, the bank cannot adjust its interest rate on the basis of the insurance option and must justify its decision if it refuses to accept insurance other than its own. This is an important reform for housing credit for a number of reasons. Firstly, because, although there was lively competition over interest rates, since the lending rate is used as a means of attracting customers, it concealed cross-subsidies with the other components of the loan, and in particular the borrower’s insurance, which was a source of substantial profits. Secondly, it will increase competition in the field of insurance and make the real cost structure of credit more transparent. Thirdly, by clearly isolating the portion of the cost of credit connected with insurance premiums, it can prompt a reassessment of the practices of credit institutions, in particular by challenging the very need for such

24. However, the ban on the “fast-track” clause (*clause de la voie parée*) by which the amount of the transfer might be negotiated privately has been maintained. Under this procedure, the property, even if it is still occupied, might be sold without the intervention of a judge.

insurance. Naturally, improving debt recovery in the event of default would directly reduce the use of this insurance by lenders, and thereby the cost of credit. Lastly, extending the “decoupling” to institutional guarantees (*cautionnements*) should be envisaged, since the market for such guarantees is not competitive.

… and exclude some specific groups of people from credit access

In the absence of a competitive mortgage sector, people who have limited access to borrowers’ insurance, such as the elderly and those with serious health risks or unstable income, can find themselves excluded from long-term credit, even though in most OECD countries age is not a handicap to borrowing, provided that the property constitutes a sufficient guarantee (Taffin and Vorms, 2007).[25] In many countries, such as Canada, the United States and Denmark, the mere fact of asking borrowers for information about their age or the state of their health would fall within the scope of anti-discrimination legislation. Recently, new instruments have been created, *i.e.* guaranteed mortgage loans (*prêts hypothécaires cautionnés*), which are specially designed for seniors. These are loans that have a double guarantee, in which the mortgage loan is supplemented by a supplementary guarantee replacing death and invalidity insurance. Once again, the success of these loans will depend on the real value of the guarantee, which in this case will be affected by the slow pace of certain procedures for administering estates (Taffin and Vorms, 2007). Although this instrument is original and interesting, it nevertheless illustrates the dysfunctions of conventional mortgages by seeking to bypass them without eliminating their impact on the cost of credit.[26]

Facilitating loan transfers seems to be a measure that would be relatively easy to implement in order to promote residential mobility. The costs of mobility for owner-occupiers who wish to buy a new primary residence include moving costs, transactions costs and generally the costs related to early repayment of their loan and arrangement of new credit. ANIL (2009) shows that there is no legal obstacle to transferring the outstanding loan, either to finance a new purchase or to have it taken over by a new purchaser, but this practice is virtually non-existent in France, unlike Canada. Transferring it to the newly purchased property should nevertheless be easy in France, given the more personal approach to credit; it would also avoid the need to take out life insurance that is more costly than the initial insurance, since the purchaser will have aged if not experienced any health problems. In its proposal, ANIL shows that transferring the loan, the insurance, the guarantee and even the mortgage does not pose any particular problem, at least when the value of the new property is higher than the amount of debt outstanding. This transfer naturally generates effective costs, but these are much lower than those generated by repaying the former loan and obtaining a

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25. The case of people with a “serious health risk” is addressed by the AERAS Agreement concluded in July 2006 between the central government, professional federations of banks, insurance companies, mutual companies and patients’ and consumer associations. Some 10% of applications for insurance received are identified as involving a serious health risk. In 2008, in 93% of these cases, an offer of insurance cover was made (see the “Assessment of the Application of the AERAS Agreement”, Report to the Government and Parliament, November 2009).

26. The 2006 Order also created two new types of loan – rechargeable mortgage loans (*prêt hypothécaire rechargeable*) and life annuity mortgage loans (*prêt viager hypothécaire*), which enable owners to borrow by mortgaging their property, for purposes including consumption. The mechanism of rechargeable mortgages has been strictly regulated (for example, the amount that can be borrowed is limited to the amount of the loan already repaid, even if the asset has appreciated), and as a result it has had only limited success thus far. Given that the rechargeable mortgage is generally used to promote consumption, its analysis goes well beyond the framework of this chapter, which is focused on the functioning of the housing market. However, the subprime crisis highlighted the dangers of a broadly pro-cyclical credit mechanism, since it enables borrowers to go deeper into debt in order to consume when the value of assets rises, and it facilitates the emergence of speculative real estate bubbles. Lastly, one must be wary of the recommendations frequently made to systematically include options for renegotiating loans at an apparently lower cost, since the real costs of these options are in one way or another incorporated into the initial cost of the loan.

new one. It is therefore recommended that institutions explicitly define the conditions for transfer in the initial loan contract.

Notaries

Notaries in France act as public officials and play an important role in ensuring that transactions are secure by authenticating instruments and conserving contracts – functions over which they enjoy a monopoly. Despite the European Commission's reservations, the European Parliament excluded the profession of notary from the scope of the "services" Directive. By international standards, notarial costs do not seem particularly high in France, even though there should be greater transparency regarding the discretionary portion of fees. However, although notarial activity should continue to be regulated, a relaxation of the regulations might improve the fluidity of the real estate market. The most pressing issue is no doubt the need to eliminate the *numerus clausus*, which would make it possible to reduce the excessive interval between the signature of the preliminary contract and the sale – about three months on average – even though the length of this interval is also related to the time required to grant a real estate loan, cities' right of pre-emption and the various statutory inspections. The way that the notarial function is transmitted – sometimes by co-optation between family members or close friends – is often criticised for its lack of transparency, which leads to a *de facto* exclusion of young graduates wishing to practice the profession freely. Moreover, the administered fixed prices should be eliminated. Lastly, the current legislation allows notaries to engage in real estate brokerage activities alongside their duties as public officials, which enables them to broker on average some 10% of the sales of existing housing (Friggit, 2008). However, given their monopoly on registering deeds and the possibilities of cross-subsidies between the different activities, it is legitimate to wonder whether authorisation should be given for these two roles to be combined, since this distorts competition with real estate agents.

Real estate agents

There do not seem to be any barriers to entry in the real estate agent business, and the number of agencies virtually tripled over the last ten years, with agencies recently accounting for 60% of the sales of existing housing, as opposed to 30% in 1980 (Friggit, 2008). However, agency fees are high in comparison with those charged in other OECD countries and in terms of the quality of the service provided. Competition could be improved by making the prices charged and the services provided more transparent. Exclusive contracts for the sale of property, in fact, have ambiguous economic effects. On the one hand, they limit the incentives for agencies to conclude transactions rapidly, since there is no competition from other agencies for these properties. On the other hand, they provide the upstream incentives necessary for agencies to take a pro-active approach to prospecting that will promote and accelerate bringing new properties onto the market. A solution to this dilemma might be to encourage the establishment of pooled listing system among agencies, modeled after the Multiple Listing Services (MLS) found mainly in United States and Canada but also in Europe (Spain) and based on a co-operative approach (commissions being shared between the buyer's and seller's agents). However, the practices of MLS raise intricate competition issues, and such cooperation seems to be used to prop up high fees for agents, notably by leading to exclusive listings (OECD, 2010). In any case, it would be advisable to eliminate the tacit renewal of exclusive contracts and to require the parties to sign an explicit contract every three months, which would also enable sellers to negotiate modifications more easily. Actually, France is unusual among OECD countries because almost 50% of transactions are direct sales from owner to buyer, with no real estate agent intermediary. Maintaining this active market is important. As websites develop increasing dominance over purchasers, they should be required to allow listings from individual sellers.[27]

27. *Se loger.com* is the most dominant website for purchasers, but requires a real estate license to advertise. *Explorimmo*, on the other hand, does not require a license in order to advertise. *Particulier à particulier* remains an important but declining force which obviously takes advertisement from non-license holders.

A survey by the Directorate-General for Competition Policy, Consumer Affairs and Fraud Control (DGCCRF) also revealed at the end of 2007 that many agencies were failing to comply with some regulations, in particular regarding fees charged, terms of sale and commercial advertising. Although commission rates, which are degressive for the various sales price categories, must be posted in agencies, these scales, which are rarely displayed prominently, show maximum rates and, given that reductions are frequently granted, provide only imperfect information about the fees actually charged. However, the amount of any agency fees and the arrangements regarding who will pay them (the seller or the buyer) are stipulated in the preliminary contract. In order to make the market more transparent for consumers, notarial offices might therefore, in co-operation with INSEE and as is done for house prices, design and produce a quarterly publication, for each department, of prevailing commission rates and average commissions per square meter. Consumers would then have a reference on the basis of which they could negotiate the agency fees.

Property management companies

The rules and practices governing condominium ownership, which concerns some 7.6 million homes and 60% of first-time home buyers, tend to impede competition among property management companies, whose activity has generated a growing number of complaints to the DGCCRF. Although the fees charged by these companies have been unrestricted since 1986, their lack of transparency is detrimental to competition and to owners' ability to exercise their right of control. In March 2010, the government adopted an order clarifying the invoicing of the activities of property management companies by distinguishing between ordinary management fees and special services, which have been rising at an alarming rate. Other supplementary measures are no doubt necessary not only to enhance transparency, but also to improve condominium owners' understanding of what these companies do, for they are generally poorly informed of their options for changing managers. Both cancellation and non-renewal of the company's contract must be placed on the agenda of the annual condominium owners' general assembly, at an owner's request, and this request must comply with formal requirements and be made long in advance. To cancel a contract, the majority required in the general assembly may be difficult to achieve out of fear of the company's reaction, while for non-renewal, the owner must obtain contracts from competing companies and forward them to the manager at the same time as the request to place the issue of non-renewal on the agenda.

To lower the fees charged would require better regulation of the method of remunerating management companies, in order to fight against certain practices that tend to inflate fees, such as the temptation not to bargain for the best price for the services provided by third parties, since the company is generally paid a percentage of the amount charged for the work. Lowering these fees will also require establishing tighter rules for managers in order to encourage them to comply better with the legal requirements governing the awarding of contracts (use of competitive procedures, opinion of the condominium owners' council and prior authorisation by the general assembly of contracts awarded to companies that have ties with the manager). The establishment of incentive contracts would make it possible to provide incentives to improve the cost-effectiveness of property management companies.

France in the spectrum of social housing systems[28]

Much of Western Europe is atypical of the industrialised world in treating housing as part of the welfare state. In many transition countries, governments have switched from regarding it as part of the social wage to full privatisation. In Australia, Canada, the United States and much of southern Europe, public rented housing has always been restricted to a very small part of the total stock. The French social housing sector accommodates 19% of households, comparable to the United Kingdom, Sweden and

28. Details relating to the issues discussed in this section can be found in Whitehead and Scanlon (2011).

Denmark. But its traditional goal of accommodating a wide range of households is more like the Netherlands or Austria.

In the traditional model of social housing, rents were based on historical costs, which were themselves kept low with the help of government assistance in the form of loan guarantees, reduced interest rates, capital subsidies and/or subsidised land. Across Europe, however, governments are increasingly trying to limit the extent of their financial support to the sector by encouraging housing providers to borrow on the open market against existing assets; increasing private-sector involvement, including more provision by government-regulated profit-seeking organisations; and better targeting subsidies both to suppliers and to households most in need. Yet, although France is shifting towards greater targeting, it has on the whole appeared relatively immune to these pressures. It remains strongly committed to social housing as a central element in the housing system and in the menu of welfare support (Levy-Vroelant and Tutin, 2010).

In those countries where housing has been seen as part of the welfare state, social rented housing has traditionally been provided by municipalities, local non-profit organisations or co-operatives aiming to meet local needs. Ownership in France is concentrated among a very large number of HLMs (an acronym for *Habitation à loyer modéré*), all of which are local non-profit housing providers. Some are local public bodies; others are social enterprises including subsidiaries of large profit-making or non-profit organisations or semi-public companies. This rather "localist" model has been modified in some European countries, notably the Netherlands and the United Kingdom, where housing providers are now normally larger, less locally specific non-profit associations that can achieve economies of scale in construction and management as well as being conducive to mobility across localities.

Funding social housing

In most of the rest of Europe the systems of both funding and subsidisation have changed over the last 30 years as social housing has been brought more directly into the mainstream of financial markets, with financing at market rates, saving public money and increasing the incentives for efficiency. These pressures have been far more limited in France, where special funding sources remain in place and supply is boosted through subsidised loans, a 1% employer social contribution and budgetary support, as well as grants related to unit production costs. In any case, loans have been readily available to HLMs that are seeking to expand. This system has generated large-scale investment in new construction, but mainly in areas where social-housing organisations are well established, *i.e.* without necessarily targeting areas where the market is tight, with potential supply-demand mismatches in terms of location.

The nation that France perhaps most resembles in this respect is Austria, where funding is also concentrated on new construction and takes the form of grants and interest-rate subsidies (Reinprecht, 2007). The big difference is that in Austria funding is available across the spectrum of providers and not just for social landlords, while in France this practice is not very widespread. France has also often been compared to Sweden. It has a similar share of social rented housing, which is owned by municipal housing companies and was traditionally funded by interest-rate subsidies. But Sweden's housing policy trajectory over the last 20 years has been very different from France's. Triggered by the need to reduce government spending, Sweden eliminated interest-rate subsidies (Turner and Whitehead, 2002). In recent years targeting has been further increased on both the supply and demand sides, and the sector now concentrates increasingly on vulnerable households, similar to the model observed in much of Northern Europe.

In countries that have adopted a more privatised financing model, special circuits of funding have been removed and providers pay the market price for capital. Interest-rate subsidies have been phased out, mainly because funding was not reaching the areas with the greatest need, in part because of the uncertainty over financing commitments; employer contributions have also all but disappeared. Subsidies to housing increasingly go to assist lower-income households, rather than on bricks and mortar. There has also been an emphasis on bringing in individual equity through the transfer of units into owner-occupation and in some cases to private owners and developers. Supply subsidies now tend to be in the form of up-front capital grants to build in identified areas with particular housing needs, a course of action that France has been following given that construction subsidies are granted at the local level, and are being refocused on areas where the market is tight. In those countries where stock was transferred from the public to the non-profit or private sector, the dominant motivation was to reduce public expenditure. But it was also about improving the focus and efficiency of management (Stephens *et al*., 2008; Whitehead, 2008).

The United States provides an example of a different private-sector-oriented approach to support. The Low-Income Housing Tax Credit (LIHTC) is funded by the federal government and distributed by states to housing providers, who are mainly private, profit-making companies and either use the credits to fund the construction of affordable rental housing or trade them to other providers or investors. A similar scheme has been introduced in Australia, where subsidies to provide time-limited social or affordable housing are becoming more prevalent. In Spain, the resale price caps on owner-occupied affordable housing are time-limited to 30 years. The German system has traditionally subsidised private developers to build housing that must be let at social-rent levels for a period (much shorter than 30 years), after which it becomes part of the private housing stock. In France subsidised loans for higher income groups (*Prêt Locatif Social,* PLS) also work in this way, with the minimum social-rent period ranging from 9 to 30 years.

In France, funding relies on a cheap resource consisting of household savings in tax-free accounts collected by financial institutions and partly centralised at the *Caisse des Dépôts et Consignations*. This system makes it possible transform liquid resources (regulated savings) into very long-term loans (up to 50 or 60 years), since it is uncertain that the banking sector could assume such a risk under the same conditions. Insofar as the banking system as a whole would in principle be more profitable if it could use those funds at its own discretion relative to the 0.6% annual fee it receives (1.12% before the 2008 Modernisation of the Economy Act), the mechanism amounts to a tax on the banking system, but this combination of an implicit tax and tax breaks on savings accounts is probably inefficient. In the longer term, such an approach may distort both funding allocations and financing. In return for cheap loans, social housing providers undertake to charge significantly lower rents than in the private sector. France is also unusual in specifying categories of loans and associated grants which provide different levels of assistance for three types of social housing: standard loans, financing loans for social housing that can accommodate persons with higher incomes, as well as loans for housing targeted at the 'very poor'. Laferrère (2006) estimates that more than a third of the benefit of social housing accrues to the wealthier half of the population. This faulty targeting produces a poor allocation of low-rent housing. In other countries, assistance is mostly targeted at particular areas, rather than at the type of production.

The special regime for financing social housing in France has served the sector relatively well in the past. However, there is a strong case based on European experience for a detailed review of its costs and benefits in light of the distortions it may induce in macroeconomic terms and the somewhat overly detailed targeting by type of scheme. Moreover, HLMs are particularly "localised" and may often not achieve either the economies of scale nor the management efficiency of the larger, less localised providers that have evolved in some other European countries. A concentration of HLMs at the inter-communality level would be beneficial to the sector. Encouraging HLMs to co-operate also constitutes one of the guidelines for the current policy, with a view to strengthening their ability to meet needs by rationalising the allocation of resources among them.

Social sector rent determination

Rent determination in welfare states has traditionally been geared to ensuring the financial viability of the housing provider. Rental income is expected to cover the provider's costs, including direct interest charges and expenditure on management and maintenance. The rent calculation may be based on income and expenditure at the level of the estate (Denmark), the municipality (the United Kingdom and Sweden) or the organisation (the Netherlands; UK RSLs, registered social landlords; France HLMs). As a result, rents for individual units can differ greatly depending on when they were built or renewed, and similar properties can have very different costs to tenants depending on past financing regimes. In countries where there has been a shift towards private debt finance, the provider's annual costs will be closer to current costs than to historical costs (Whitehead and Scanlon, 2007; Whitehead, 2008). The most important trends, especially over the last decade, have been moves towards relating rents to property values, rather than costs (the Netherlands, England and parts of Norway), or using rents in the private rental sector as a comparator (Sweden and Germany).

Rents in France are based on costs at the level of either the owner or the site. Thus, rents are limited and vary depending on the financial regime in place at the time of construction, rather than reflecting current values. France is also atypical in that central government sets maximum rents, and the extent to which rents are below market varies immensely across the country. Older dwellings which received high bricks-and-mortar subsidies will generally have lower rents, even if they are in good locations and have particularly desirable attributes. Who receives what assistance is ultimately determined by past investment financing and allocation principles. Even though rents in the social sector are not totally out of line with market levels,[29] it is difficult to make the case for social rents so far below and unrelated to market rents, when there is already a relatively generous housing allowance available to low-income households. This is particularly true given the high income limits for access to the French social sector. Elsewhere in Europe it has been shown that providers who can charge higher rents are able to raise more funding at lower cost, backed by their own assets and thus reduce their call on central government. Rent adjustments over time can also encourage greater mobility among social-sector residents and therefore allow the sector to house more vulnerable households. Recent measures in France are going in the right direction. Since 2009, means-tested income limits have been lowered and the rent supplement scheme has been strengthened. HLMs are now required to conduct regular surveys on tenants' incomes, and if they are over the limit, to raise rents to levels that encourage the better-off tenants to leave the social housing system.

The allocation of affordable housing across areas

In France, as in most Northern European countries, the social sector expanded in the post-war period to address the pressing need for more housing to replace urban slums and to ensure adequate accommodation for lower-income working households. The resultant mono-tenure estates originally provided housing of a higher quality than what they replaced, but standards of dwellings and neighbourhoods have not kept pace with modern requirements. One result is that the problems of social housing are often seen as synonymous with those of big, homogenised, industrially built estates constructed after the Second World War. The spatial concentration of social housing means that there is inadequate affordable housing in many parts of the country. It also means that there is an overwhelming need to remould and rehabilitate existing estates in ways that will make social housing acceptable in the

29. Maximum rents are set on the basis of the location of housing units according to a division into four zones reflecting the level of pressure on the rental market and thus implicitly the level of market prices. Social landlords are able to raise the level of rents annually by a higher amount than the reference index applicable to the private sector. They have considerable leeway to raise rents for new tenants within the maximum allowed limits, which are themselves revalued on the basis of national rent trends in the private sector. Consequently, there is not necessarily a widening gap with market rents.

twenty-first century. These requirements have been addressed in many Northern European countries by targeting investment on localities with particular needs and by different forms of privatisation that have enabled new owners to borrow to improve the existing stock.

French policy on both issues is clear-cut: first, all larger communities are expected to move towards having social housing make up 20% of their total housing stock; second, the government has identified a number of ‘sensitive urban zones’ (ZUS; there are 751 of them with 4.4 million inhabitants), where using the employers’ 1% contribution it will fund programmes of demolition and regeneration intended to change the nature of these neighbourhoods. The 20% policy is unusual in that it applies a standard percentage across all communities with populations of more than 3 500 (provided that their population is not declining and they are not exposed to natural or technological risks). It raises two questions. What is the basis for requiring a level of provision in every area that is above the current national average? How can the policy be implemented and enforced?

The requirement for all municipalities to have the same percentage of social housing is out of step with practice elsewhere. Subsidies for construction of new social housing are sometimes allocated to sub-national governments or administrative units on a per capita basis (*e.g.* the LIHTC in the United States). But the equal distribution of subsidies for *new* social housing does not address an uneven distribution of *existing* social housing. Other countries use approaches based on assessing local circumstances and existing provision. In England, for instance, all local authorities have been required to identify the need for additional affordable housing in their area (Department of Communities and Local Government, 2006).

In those French municipalities that currently have little social housing, meeting the 20% requirement would necessarily entail either large-scale construction of new social housing or the lease or purchase of dwellings from the private sector to use as quasi-social housing. There have been no large-scale attempts since the 1970s in Europe to transfer stock into social housing; rather, the trend has been in the opposite direction. If the 20% were to be met through non-profit provision, the main mechanism would necessarily be through new construction. The most important policy development elsewhere with respect to new construction has been that a number of countries, including England, Germany, Ireland, Spain and the United States, now require residential and commercial developers to provide affordable dwellings, or land/financial contributions for the construction thereof, as a condition for being allowed to supply commercial space or build homes for the private market. The affordable housing may take the form of either social rented housing or low-cost owner-occupied homes, often aimed at key public-sector workers.

France has taken the approach of imposing financial penalties on local authorities that do not meet the 20% target (see note 8). The Solidarity and Urban Regeneration Act seems to be having a positive impact since over the 2005-2007 period 339 communes out of a total of 730 met their commitment to partially close the gap in the construction of social housing. However, penalty rates that could achieve the levels of investment required are unlikely to be politically acceptable, especially as new construction also depends on initiatives by individual HLMs. The 20% requirement appears then to be both inappropriate – in that the share is the same whatever the need – and unenforceable, even over decades. This is both because achieving the target would depend mainly on new construction, and because penalties cannot be adequate to incentivise the very large increases required in many areas. A system that takes greater account of local needs and which provides incentives for delivery and perhaps a requirement to include social housing in all new developments would be more consistent with experience elsewhere. Probably the most cost-effective way of achieving significant increases in affordable provision would be through municipalities or non-profit providers leasing quasi-social housing from the private sector. This is a generally accepted approach across much of Europe, although there are concerns about the extent to which the very vulnerable tend to be concentrated in this type of provision, which probably offers less security than formal social housing (Whitehead and Scanlon, 2007; Levy-Vroelant and Tutin, 2010). At the limit the approach converges to one that depends solely on income-based subsidies to enable households to pay private rents.

The allocation of social housing

In most European countries, formal allocation rules allow access to social housing for the majority of the population, even when there are income limits on entry. France is atypical in setting up different income ceilings for particular types of social housing. These limits have historically been very generous, although the ceiling for the top class of social housing was reduced in 2009 so that only the lowest six deciles of the income distribution now qualify. For example, in Paris at 1 June 2010 the monthly net income cap for social housing eligibility was EUR 2 030 for a single person, and 3 970 for a couple with one child. If tenants' incomes rise to more than 20% above this ceiling they are required to pay a *supplément de loyer de solidarité* (*cf*. supra), as is the case in Germany and Ireland. However, in none of these countries are such increases seen as enough to incentivise tenants to leave. Only in Norway, where social housing is regarded more as a short-term tenure, is there an effective policy to raise rents to market levels when tenant circumstances improve.

Eligibility rules across Europe are generally set by central government but implemented by local government and landlords, often in partnership with one another. France is atypical in that a range of stakeholders, including the mayor, the prefect and employers, play a direct role in allocations. This means that housing providers are subject to political and localist pressures, which can make it difficult to give priority to more vulnerable households. In fact, political leaders are closely involved in the management of the body that represents the interests of HLMs nationally with the public authorities (*Union Social pour l'Habitat*, USH), as is shown by the fact that many of them sit on USH executive boards.

Central government may place particular responsibilities on providers – as, for instance, under the homelessness legislation in England by which local authorities are required to accommodate specified groups of households if they are inadequately housed. In France, each provider, although it is subjet to common objectives of housing low-income and disadvantaged persons while respecting social diversity, in practice has its own allocation rules. Often these do not directly relate to the housing needs of individual households but rather reflect the objectives of a range of local stakeholders. The legislation (*Loi DALO*), which provides for a legally enforceable right to housing, was originally interpreted in a highly restrictive way, as a last resort requiring the government to house or rehouse high-priority individuals who needed housing on an emergency basis. However, from 2012 priority will be given to those who have faced an 'abnormally' long delay in accessing social housing. This could in principle include people who are not poorly housed but who have simply been on the waiting list a long time, thus exacerbating the problems of allocation to the needy. Similar issues arise in other countries; in Denmark, for example, allocation is based on waiting lists, and it is not uncommon for middle-income households to register even if they are not in particular housing need.

Traditionally, 'universalist' systems like France's tend also to accommodate a higher proportion of lower-income employed households than do more targeted systems. On the other hand, in many countries, notably Austria, Denmark, Germany and Sweden, very vulnerable households may be either housed by the municipality or by profit-oriented landlords, rather than by core social-sector providers. The Netherlands and England are examples of countries where the most vulnerable households are accommodated in the social housing sector. In France, although the average tenant's relative income has declined considerably over the years as a result of better targeting, there are still many better-off households in social housing, while a high proportion of vulnerable households continues to be accommodated in the private rented and temporary lodging sectors.

A further matter of concern is that it is difficult for established tenants to move within the sector as they must join the end of the queue, which represents about 1 million requests overall, either to move to a new area or to a different dwelling. Indeed, moving within the social sector is officially possible only when two households, housed by the same landlord and located in the same estate, agree to switch flats. This system is much less flexible than in countries with similar proportions of social housing, where those already in social housing would be given priority to downsize or to move for employment reasons. The merging of HLMs would make it easier for tenants to be more mobile within the social housing system.

Overall, the French system can be characterised as a universalist system in transition. It has unusually detailed rules relating to funding allocation by type of social housing and to regional maximum rents. On the other hand, it is atypical in that central government is involved in allocation procedures only by defining general priorities. In the main the system is based on financial (historic cost) rather than economic (current cost) incentives, and there is little capacity to direct resources to the areas and households where need is greatest. Other countries with similar social-housing objectives have addressed these issues by moving away from direct government support towards at least some market-based efficiency measures.

Box 4. **Recommendations in the field of housing policy**

Limit distortions and make the housing market more fluid and transparent

- Reduce the segmentation of the rental market by: reducing the differences in rent between the social and private sectors while increasing means-tested personal housing subsidies and at the same time cutting financial subsidies for social housing; and indexing rent over the life of contracts on the basis of a published index reflecting rent trends for new contracts, preferably at a sufficiently localised level.
- Update the registry of rateable values and implement a mechanism for periodic revaluation.
- Ensure greater tax neutrality by: *i)* eliminating taxation of rental incomes and offsetting this by increasing the property tax (*taxe foncière*) nationwide to the same level of taxation as on other assets; *ii)* implementing capital gains tax, though deferring the taxation on primary residences provided that these gains are reinvested, but only until the owner's death; *iii)* applying the normal VAT rate to maintenance and renovation expenses, and only once to all new construction; *iv)* eliminating tax advantages for home savings plans.
- Reduce transactions costs by shifting transactions taxes to property taxes.
- Broaden the responsibilities of *intercommunalités* (intercommunal groupings of municipalities), in particular with regard to building permits and local land-use plans, raise land-use coefficients and consider broadening the scope of application of the taxes on vacant housing.
- Rebalance landlord-tenant relations: by strengthening prevention through monitoring situations of vulnerability and early reporting by landlords of unpaid rent to the administration and insurers; by reducing pressure on the housing market through development of temporary affordable accommodation; by shortening the time required for owners to recover their property in exchange for a reduction in the guarantees they can require. This overall approach could be tested initially in a few local experiments.
- Improve statistical information by allowing free access to data collected by notaries that have been checked for privacy concerns, and by facilitating the construction of an index of the price of new housing. Produce studies evaluating housing policies and present these to parliament on a regular basis.

Increase competition

- Evaluate to what extent the definition of usury, which serves as a maximum borrowing rate, actually restricts access to credit.
- Reform the market for housing credit guarantees by: reducing the effective costs of taking out a mortgage by eliminating mortgage-related taxes and charges and by facilitating debt recovery, even when the default involves a primary residence; decoupling the guarantee from the loan, as was recently done for repayment insurance (*cautionnements*); and including loan transfer clauses explicitly in the initial contract.
- Eliminate the *numerus clausus* for notaries, reduce transaction delays between pre-contract signature and finalised sale and remove the current system of administered fixed prices.
- Improve the transparency of real estate agency fees and of the services provided; eliminate the tacit renewal of exclusive contracts; require real estate websites to allow listings from individual sellers, not just registered agents; improve regulation of the method of remunerating property management companies, and encourage them to meet their obligations by implementing incentive contracts.

Reform social housing

- Merge HLM companies at a supra-municipal level in order to achieve economies of scale; remove social housing from local pressures, including in the allocation of housing; and reduce mismatches between needs and new construction.
- Evaluate the way social housing is financed in France through a cost-benefits analysis taking into account the probably significant distortions that it may generate in the allocation of savings, investment and the structure of rents. Open up the social housing market to private providers subject to appropriate regulations.
- Bring rents closer to market values rather than linking them to costs at the time of construction. Continue to target the allocation of social housing toward the most disadvantaged households, and increase the exit from social housing of households with above-median income, in particular by strengthening the existing rules on extra rent charges and ensuring that they are enforced strictly. Relax the provisions governing mobility within the entire social housing stock.
- Revise Article 55 of the Solidarity and Urban Renewal Act ("*loi SRU*") to make it more realistic by gearing the percentage of social housing to needs at the local level, rather than setting a uniform objective, while making the penalties more dissuasive.

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