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Housing the Middle Classes:

Supply, Demand and Equilibrium of the Housing Market in France

Report by Jacques Mistral and V  lerie Plagnol

1. Overview of the housing market

The current problems plaguing the housing market in France should not distract from the fact that the housing policy in place since the end of World War II has been able to accommodate the profound changes in society and that, on average, housing conditions have never been so good. As the population has grown by 40% in the last fifty years, so property has doubled to stand at 32 million homes in 2006. The number of owners of their primary residences has grown, reaching almost 57% today, and the quality of living conditions has improved, with the proportion of homes with no sanitary facilities dropping from close to 40% in 1954 to 2.6% in 2002 and the average surface area of primary residences increasing to 90m² in 2002. Finally, unlike its European neighbours, France has opted for a varied form of supply, where private ownership and private and public renting coexist. This diversity in France's property market, which combines the flexible supply of an increasingly mobile population with the property investments of a wealthier and more mature society, is a comparative advantage which lacks its rightful recognition.

Yet despite these positive points, France's housing market has been the victim of numerous problems since the 1990s:

1.1. Constant increase in housing costs

Housing prices in France have risen by close to 40% since 2004. This sharp increase, which is in marked contrast with that of household income, stems from insufficient supply on the back of the slowdown in the construction of council housing between 1996 and 2006; the difficulties in obtaining the land on which to build (*see below*); the strong demand stimulated by sustained demographic growth and advantageous forms of financing (longer repayment periods, low interest rates). While the rise in interest rates and tighter lending conditions triggered by the economic crisis of the summer of 2007 put a stop to rising prices, they also put a halt to construction, thereby simply accentuating the tensions on the housing market.

1.2. Deeper inequalities

This deterioration in the solvency of borrower households widens the inequalities in purchasing property for the middle classes. On the one hand, the slowdown in property market turnover is penalising middle-class first-time buyers, and on the other, these social categories are affected by numerous forms of «eviction» (more limited access to council housing and government aid, limited savings following the increase in rent, etc.). In addition, insufficient council housing has also resulted in deeper inequalities in its

geographical spread and a slump in living conditions in those areas inhabited by the most fragile sections of the population.

1.3. Insufficient and ill-suited supply

Despite the upturn in construction in the past few years (286,000 homes per year between 1996 and 2000, 332,000 between 2001 and 2005, 438,000 in 2006 and 435,000 in 2007), there is still a need for approximately 250,000 new homes and, by 2020, this figure could reach as high as 500,000 per year. The same applies to council housing: the number of council houses and flats built since 2007 (100,000 with a further 120,000 to be built in 2008, compared with 51,000 in 2005), is enough to cover the needs for the year, but not enough to make up the backlog. Added to this are the extremely low vacancy and turnover rates in council housing (only 50,000 new applicants can be accommodated each year despite there being 4 million council houses and flats).

This inadequate offer, in the private and public sectors alike, is the result of the delay in construction following the economic crisis at the start of the 1990s and the continued underestimation of the needs of the population. It also derives from the restrictive policies implemented by numerous local authorities in issuing building permits. Faced with growing urbanisation and in a bid to meet

the expectations of their citizens and preserve their environment, the small communes bordering the major agglomerations are increasingly reluctant to free up their land. Added to this are quality problems, with housing market supply failing to meet the evermore exacting requirements of households. Indeed, meeting households' preferences for individual homes has resulted in the fragmentation of today's urban fabric and therefore in the social mix. While the surface area of housing is still big, even increasing, recent social trends mean a growing number of families do not live together. Finally, although stricter environmental requirements via the multiplication of building standards suppose a better quality of offer, they also prompt an increase in costs thereby limiting the capacity to satisfy needs.

1.4. An institutional framework that is slow to react

Housing is a heavily regulated sector (government housing subsidies in France total € 34 billion, i.e. 2% of GDP); its institutional framework is both complex and badly adapted to today's needs. Many of the bottlenecks on the housing market stem from the current organisation of the public authorities, a large part of which have been clumsily decentralised as the fact that council housing is managed by close to 850 operators clearly illustrates. Furthermore, the increasing number and congealing measures governing housing makes them difficult to comprehend and questions their effectiveness, particularly as many subsidies are not precisely evaluated. The proliferation of taxes linked to property and housing and their numerous different purposes render government policy even more complex; generating inconsistencies, contradictions and additional grounds for bottlenecks. The report focuses on this area in particular, underlining the perverse effects of measures to incite investment in private leasing such as the Robien and Borloo laws. These fiscal stimuli have indeed led to an increase in

private leasing (300,000 houses and flats have been built in seven years), but they have also led to excesses that are contributing to the imbalance of the market: buildings in areas with no potential, depreciation in value for landlords that lease their property, increase in the cost of real estate in construction areas.

1.5. Property loan conditions that are too restrictive

Certainly, France's system of financing housing – based on personal loans – has meant it has been able to avoid the excesses seen elsewhere (notably the United States during its subprime crisis) and to protect borrowers and banks from the problems linked to the imprudent granting of property loans. But this system, which is based upon the strict assessment of a borrower's capacity to repay a loan, has its own weaknesses. In too often turning away mortgage applicants, practices in France prevent many candidates from getting a foot on the property ladder – despite their being solvent – because they appear to not be able to offer adequate guarantees or do not meet the very strict eligibility criteria imposed by banks (applicants with low incomes, with independent professional status or irregular income, applicants suffering from health problems).

2. Proposed reforms

Given the above, the report proposes seven potential areas for reform.

2.1. Loosen physical constraints on supply

In order to revive the construction of new housing, the authors propose:

- introducing incentives to free up land. This could for instance consist in discouraging the unproductive retention of land that has not been built on by imposing heavier taxes on the land in question. A second idea is to capture the capital gains to be had on real estate which becomes available for construction by assigning them to local authorities, as is already the case in Germany or Switzerland;

- increasing the capacity of existing urban council housing stock by renovating their construction. Insofar as the increasing urbanisation of new areas is detrimental for sustainable development as it tends to imply an increase in the use of cars rather than public transport, housing capacity should only be increased on land that is already built on, notably via the construction of apartment blocks.

2.2. Reform the manner in which housing policy is governed

In the opinion of the authors of the report, an urbanisation and housing – particularly council housing – policy is not viable at a local level. To be of general interest, its appropriate scale is by conurbation. Accordingly, one of the recommendations in the report is to regroup all urban and housing services (and therefore all decisions as to the manner in which land is used) by urban zone and not at a district level. The new governing structure proposed would also mean the redefinition, at a State level, of the conditions regulating urban planning. Giving each prefect the option of increasing land use coefficients (COS) that are too restrictive or authorising the State to repatriate land are examples of the measures proposed by the authors to reintroduce the State in the governance of housing policy.

2.3. Give greater impetus to the management of council housing

Because council housing is a major issue in France's housing policy, further construction and improved management are needed. For that to happen, the authors recommend that the manner in which housing is granted be more equitable. This notably implies the application of the law governing the review of rents if tenants benefit from an increase in income; the differentiation of ceilings on income; and even the replacement of the existing right of other tenants to remain in the assigned premises with the right to housing elsewhere in order to ensure that premises are adequately occupied. Finally, greater impetus means

improving the governance of council housing service departments. This could be achieved by regrouping them and bringing their status' into line, thereby allowing for greater transparency in the appointment of directors or for the management of housing in collaboration with private partners. However, the sale of council houses or flats to tenants which often dominates the debate is, in the opinion of the authors, a non-negligible method of acquiring property.

2.4. Streamline government subsidies for housing

In the last thirty years, loans and subsidies have multiplied despite the fact that their initial purpose has not necessarily been met. As budget constraints heighten, the different conditions governing the allocation of housing loans and subsidies need to be evaluated and overhauled if they are to become more efficient. Here, in order to encourage rental investment and ownership in council housing, the authors propose an analysis of the distribution of residential construction subsidies and housing benefits in order to focus subsidies and tax benefits on areas under tension. They also recommend reviewing the manner in which the housing savings plan is used and even putting an end to it in order to focus on zero-rate loans which would be subject to regular review. In this respect, the authors underline that the announced review of France's 1% housing loan, along with the measures to reduce the ceiling on income when granting council housing and the indexing of council housing rents, seem to be a step towards the more efficient management of subsidies and housing policy. Ever in a bid to evaluate these measures, the authors recommend an assessment of costs vs. benefits in order to ensure the effective management of council housing which should follow on from the adoption of the Grenelle law linked to the environment (incentive regulations and/or mechanisms aimed at making the standards governing energy savings and sustainable development more

strict). Finally, in terms of taxation, the authors object to the taxation of empty premises and recommend that it be revoked. They also propose that primary residences not be factored when calculating wealth tax and in exchange that inheritance taxes be raised.

2.5. Reduce the cost of transactions

In France, transaction costs in the acquisition of housing are higher and often in greater proportion than in other OECD countries, notably as a result of agency fees. To remove this obstacle to a greater number of transactions, the report recommends that property transfer taxes be reduced and even eliminated and that intermediary margins be reviewed to make them more transparent for sellers.

2.6. Broaden and make credit more secure

The rise in interest rates and crisis of the summer of 2007 put an end to the highly accommodating loan conditions proposed by borrowers in recent years and raised doubts as to bank securitisation. These combined difficulties could make establishments more prudent even sparing in granting property loans. Given the specific characteristics of French financing, which is based almost exclusively on the provision of guarantees, the authors propose that the use of mortgages be encouraged. This does not mean adopting a «pure» mortgage system –the failings of which are quite obvious today– but opting for a hybrid model for property loans which would factor in the solvency of the borrower but also the value of the property being mortgaged. Steps in this direction would mean a reduction in the costs linked to taking out a mortgage and therefore encourage buyers. In exchange, the authors propose that credit institutions apply stricter conditions when granting property loans

with a higher risk ratio (loans with no amortisation or with very long repayment periods). Broader, controlled access to credit via the increasing use of mortgages would also mean lighter legal procedures for the recovery of assets pledged and reinforcing guarantees in order to reduce lender fears. One of the proposals put forward by the authors of the report is to strengthen the role of the FGAS, the social property ownership guarantee fund. Finally, the authors underline the fact that the development of a mortgage securitisation market is a prerequisite for the development of a mortgage market in France.

2.7. Stimulate private rental investment

Private rental investment is suffering from the withdrawal of private landlords and institutional investors alike (the proportion of private landlords has decreased from 31 to 26% in twenty years and the proportion of institutional investors went from 9% in 1996 to 6% in 2002). According to the authors, this trend is the result of heavier taxation for landlords that lease their property than for owners who occupy their homes. It is also linked to the fact that, in France, tenants are considered to be particularly well protected. As such, the authors propose that, on the one hand, tax incentives on private rental investment be reviewed and, on the other, that measures be taken to better protect landlords. This would notably mean establishing a specific type of insurance for rents against revenue problems or even reinforcing the regulations governing expulsions so as to guarantee that owners are able to recover their property. The report also proposes to attract institutional investors by creating attractive conditions for public/private partnerships, particularly in the building of council housing. Finally, to encourage investment in disadvantaged areas, the authors propose adopting a

French-style Community Reinvestment Act, i.e. one that obliges financial institutions that collect savings to reinvest part of those savings in these areas.

3. Comments

In his comments, **Patrice Lanco** underlines that the report tackles most of the issues surrounding housing policy and reviews the observations and proposals of the authors. He notably questions the longstanding link between housing prices and household disposable income and emphasises that the increase in ownership is perhaps in itself a factor in the decorrelation between housing prices and their fundamentals. He also points out that the increase in prices is fed by their «struggle for space» and that, as a result, the question is not so much whether the middle classes can afford their housing but more their access to more expensive areas. While he agrees with the authors that regrouping urban and housing services by conurbation is an essential element in the new form of governance to be set in place, he raises doubts as to the legitimacy of extending old-fashioned subsidies to the better-off as advocated by the authors which, to his mind, are purely and simply a windfall for them. Furthermore, unlike the authors of the report, Patrice Lanco believes that it is necessary to maintain France's housing savings plan which, in his opinion, constitutes an «apprenticeship» to ownership. As regards the management of council housing, he recognises that it needs to be modernised and recommends drawing inspiration from public services outsourcing contracts. Lastly, whilst he acknowledges that broader access to the credit market is the key to increased property ownership, he believes that guarantees are not the reason why France's mortgage market is underdeveloped so much as the reluctance of its people when it comes to credit.

Étienne Wasmer underlines that exhaustive coverage of the themes dealt with in the report, but regrets that the latter did not focus on priority areas. In his opinion, the report merited a more detailed exploration of the subtleties of economic policy and subsidiarity in order to provide a better grasp of the lack of global supply. He also regrets that the issue of the right to housing was not analysed further by the report and that the evaluation of the effectiveness of the housing subsidies system was not more far-reaching. According to Mr. Wasmer, while the authors sought to propose concrete, and sometimes very detailed, solutions, they nonetheless sidestepped a certain number of core issues. One issue is the importance of the link between housing and income subsidies. Another element worthy of review is the effects of measures to encourage property ownership, notably amongst the underprivileged classes. The highly delicate issue of reconciling the fair allocation of council housing and its social mix also deserved to be covered. Lastly, the report could have looked into the types of regulation to introduce in order to incite private landlords to house low-income tenants. As regards the proposals put forward by the report, Étienne Wasmer agrees on the need to reform the way in which council housing is managed and underlines that the idea of the state control of prices when land becomes available for construction is a very good one. He does, however, raise doubts as to the value of assigning subsidies by area and wonders whether public measures to develop infrastructures or help distribute activity would not be preferable. He also reiterates that alongside measures aimed at improving the mobility of households comes the indexing of tax income to the price of real estate.