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TECHNICAL BRIEF

SOCIAL AND AFFORDABLE HOUSING



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The working paper is printed in this form to communicate the result of an analytical work with the objective of generating further discussions on the issue.

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Executive summary

- ✓ Affordable housing has become a key challenge in many European cities.
- ✓ Demand for affordable housing now includes more diverse groups of population than seen in the past in addition to the most vulnerable population. Soaring prices and shortage of housing in many European cities mean that young people, middle-class employees, workers in non-secure jobs and elderly are increasingly priced out of the housing market.
- ✓ Social housing projects are capital intensive. New models of financing are emerging to cope with funding gaps and increase affordability and sustainability for final beneficiaries and municipalities.
- ✓ Council of Europe Development Bank (CEB) target countries[1] lag behind both in terms of supply of social housing and quality of legislative and implementation mechanisms.

The objective of this technical brief is to share information on cross-country learning from Technical Assessment and Monitoring (TAM) field missions, reports and the CEB monitoring data on 13 on-going or recently completed (post-2011) social housing loan operations in seven CEB member countries. This note focuses on countries which share similar challenges in the social housing sector, but also presents practices from other countries that could be adapted, and proposes some project schemes for the CEB to tackle housing affordability issues[2].

Main characteristics of the sampled projects

13 projects in Albania (1), Bosnia and Herzegovina (3), Republic of Moldova (2), Montenegro (2), Romania (2), Serbia (1) and "the former Yugoslav Republic of Macedonia" (2).

Total cost of the projects €760 million, out of which 55% financed by the CEB.

Eight projects are for rental housing, half of which have been completed. Five projects are for ownership, of which two completed.

In terms of ultimate beneficiaries, 66% of the projects target vulnerable groups, 30% young professionals, and the remaining 4% civil servants.

The objective of the sampled projects is to provide, in total, 30 000 housing units: for the six completed projects, almost 23 000 families have already benefitted from increased availability of housing.

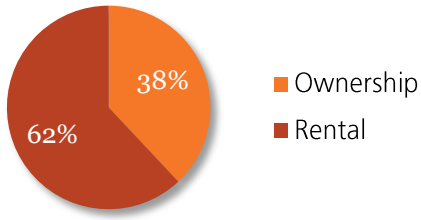
On average, the income of ownership beneficiaries is capped at €1 100 per family; a family would typically pay a subsidized rent of €20/month.

[1] As at 31 December 2016, 22 Central, Eastern and South Eastern European countries, forming the CEB Target Group countries, are listed among the 41 Bank's member states, namely: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Hungary, Kosovo, Latvia, Lithuania, Malta, Moldova (Republic of), Montenegro, Poland, Romania, Serbia, Slovak Republic, Slovenia, "the former Yugoslav Republic of Macedonia" and Turkey.

[2] A long version of this brief provides detailed findings on the sampled projects and puts forward some recommendations for the delivery of housing projects on four aspects: 1) beneficiaries; 2) tenure and financial schemes; 3) governance and implementing mechanisms; 4) costs and technical aspects.

Financing affordable rental housing

Type of tenure in the 13 sampled projects



Financing modality heavily depends on the housing tenure: rental or ownership. Of the 13 projects considered 62% were for rental and 38% for ownership.

Rental housing projects: the CEB provides the loan to the Ministry of Finance, which then on-lends to the subsidiary administrative units or municipalities, which in turn become responsible for the implementation and repayment of subsidiary loans.[3] In the countries considered, local governments that provide rental social housing, face three main challenges:

1. Limited fiscal capacity to plan and provide adequate and affordable social rental housing.

2. The social housing stock in target countries is limited (on average it represents only 2% of the housing stock). The municipalities need to increase the supply of newly constructed housing while land availability is challenging, and they face increasing costs of public spending on housing services (including maintenance of the buildings over time).

3. The planning and implementation of social rental housing is still predominantly public and under the remit of the municipalities. In countries with a mature housing market, instead, (e.g. the Netherlands), a robust non-profit sector (housing associations) competes with the private sector in the rental housing market. They also provides social housing to a broad range of beneficiaries, creating mixed-income neighbourhoods, and contribute to financial affordability for municipalities to provide social housing.

What can be done to address these challenges?

- Encourage supply of rental social housing stock through social housing associations. This system mirrors the CEB's practice in non-target countries; for example, the CEB social housing programs in Ireland are, to an extent, implemented through housing associations[4]. Also, the recent pipeline of social housing projects in Germany seeks lending to, and implementation of, the projects through the municipal housing promotors. Where the associations in the targeted countries do not exist, it could be encouraged to cluster municipal housing departments within the same administrative region to reach some economy of scale.

- Consider public-private partnership (PPP), involving municipalities partnering with the private sector to increase available funding for social rental housing.[5] The CEB could provide assistance for PPP development, building on the experience gained in other countries with strong social housing.

- The CEB might consider a "Towards Zero Energy Social Housing" project scheme which would aim at social housing developments with zero net energy consumption. Where and when possible, these investments would have direct benefits (e.g., reduction of energy bills), and indirect benefits (e.g., healthier beneficiaries resulting in lower health care public spending), thus creating a financial space to affordable rents or housing mortgages. These projects could be attained through policy packages that include social housing and energy efficiency programmes.

[3] In addition, the CEB has implemented complex financial schemes to respond to the needs of countries with mature housing social markets.
[4] Different social housing programs in Ireland aimed at funding Local Authorities and Approved (voluntary/cooperative) Housing Bodies which are the main providers of social housing to build social houses or retrofit existing rented social housing and the construction of new energy-efficient social housing units.
[5] Traditional systems of PPP could be extended to an advanced form of Social Impact Bond (SIB) financing, linked to social outcome of the project. In the scheme, private investors provide all or partial funds for the project, and if the project successfully reaches specific social outcomes (reduction of unemployment, homelessness, crime rate, etc.), investors get paid back the full investment plus a percentage of government cost savings resulting from achieved social outcomes. SIB scheme, used first time on prison projects in the USA and UK a few years ago, is finding its application in other social infrastructure projects.

- Promote small land infill developments in the urban environment to help overcome the problem of lack of land, reduce ghettoization, and reduce access to the existing utility infrastructure.

- Identify opportunities for municipalities to buy a share of the housing stock from private developers at construction cost, to be then rented to eligible beneficiaries.

- Suggest borrowers to include maintenance fees (proportional to income) in rents, financed through complementary funding from the Borrower or rent revenues from commercial properties if included in the project. Communication and educational material for beneficiaries would also improve the maintenance and sustainability of buildings over time.

Financing affordable housing ownership

Housing ownership projects: CEB loans for ownership projects subsidy the interest rate to intermediary banks (or to the governments which in turn subsidy the intermediary bank's interest rate) which provide the social mortgages for housing purchase to the eligible beneficiaries.

Ownership projects put affordability pressure on the ultimate beneficiaries, who need to have (and keep) a minimum income level for the Bank's mortgage approval criteria and need to be able to afford the cost of housing/life insurance (in some projects, the cost of insurances represents 50% of the housing mortgage repayment).

Usually ownership projects target low/medium income beneficiaries; however, in some of the projects considered, the number of eligible beneficiaries who could afford "ownership" was smaller than the initially planned, due to mismatch of low-income eligibility criteria, cost of the houses, and mortgage conditions.

What can be done to address these challenges?

- Foresee the number of eligible beneficiaries for ownership projects to be at least 2 to 3 times the number of targeted housing units, since the intermediary banks disqualify a good number of beneficiaries due to their weak credit rating.

- Encourage the inclusion of affordable housing modalities, (such as second-hand houses, village houses, self-construction with the professional assistance, etc.) in less expensive locations and innovative measures to reduce the cost of mortgages for the end beneficiaries. For example in the *Housing for low-income persons* programmes, Montenegro managed to reduce the mortgage interest rate from 6.99% to 3.99% through competition among intermediary banks and aims to lower the loan insurance cost through a public selection of the insurance companies. Another positive example is the housing programme with the *Fonds du Logement des Familles Nombreuses de Wallonie* (FLFNW) in Belgium, where the FLFNW has provided financial and technical consultancy to the beneficiaries to purchase affordable homes through the social mortgages.

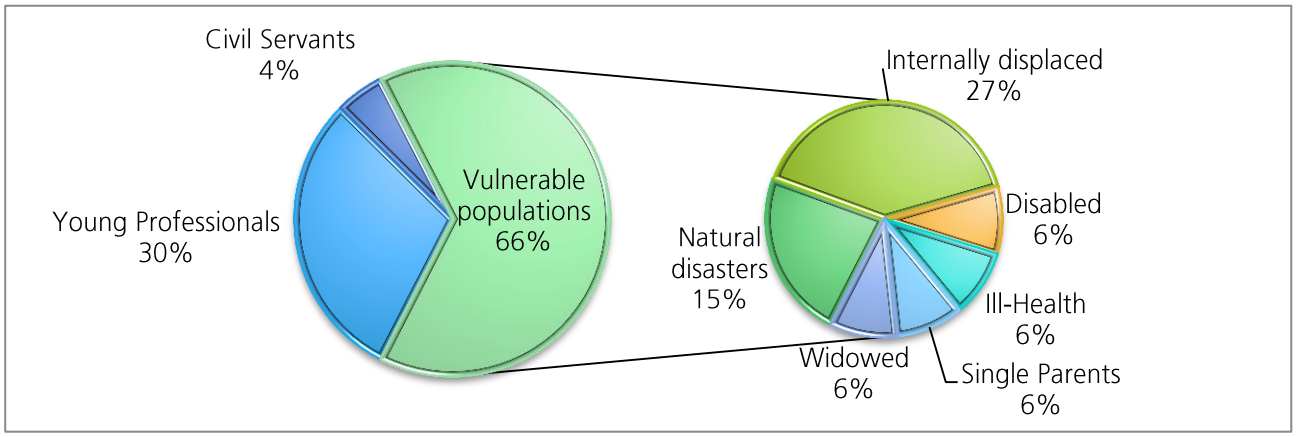
- Raise affordability of housing ownership and decrease the risk of customer default by introducing shared ownership. In a shared ownership scheme, in the United Kingdom and Ireland, families buy an affordable share in a housing unit and pay rent on the remainder which still belongs to the municipality (or to the social housing association). In the case of a sale, the beneficiaries sell their share, and the municipality keeps renting its share. Beneficiaries can gradually purchase part of the house from the municipality over time.

Affordability and beneficiary groups

The CEB's eligibility criteria for social housing beneficiaries include: low income population defined according to the national legislation (although the handbook also refers to the population below 60% of average country income as poverty threshold) and vulnerable groups such as abandoned children, children in vulnerable situations, persons with disabilities, refugees, migrants, displaced persons, and victims of ecological disasters.

About 66% of the sampled projects target vulnerable populations as eligible beneficiaries (of which 27% internally displaced people, 15% victims of natural disasters and the remaining 24% disabled, ill-health, and single parents or widowed); 30% of the sample projects target young professionals and the remaining 4% being civil servants.

Categories of beneficiaries in the 13 sampled projects



Rental beneficiaries include mainly socially vulnerable people at high risk of social-economic exclusion. Ownership beneficiaries are first-time buyers, often young professional and civil servants with low/medium income, who are, to a certain degree, socially and economically integrated.

There is a definite income difference between ownership and rental beneficiaries. In the sampled projects, the average earning of ownership beneficiaries is eight times higher than that of rental beneficiaries.

The low-income eligibility criteria may hinder the economic mobility of beneficiaries in the long run, if the increase of income above certain threshold triggers non-eligibility or tenure for the social housing. The upward economic mobility of beneficiaries should be one of the objectives of social housing as to ensure social integration of beneficiaries and financial sustainability of the system.

The beneficiary selection criteria do not always support the overarching objectives of the projects. In some cases, for example, the eligibility criteria have proven to be too restrictive for the local population, either in terms of income or other characteristics (e.g. age, profession).

What can be done to address these challenges?

- Assess the distribution of potential beneficiaries at the very local level and ensure that the eligibility criteria do not exclude some of the target populations.

- The CEB might consider a "Social housing in transition" project scheme that would favour economic mobility of vulnerable groups to afford social renting and eventually ownership, in response to the tendency of beneficiaries to stay off the job market once considered eligible for social housing. The concept would treat employment as a motivating factor rather than a threat to eligibility for social housing, and would create the expectations from the Borrower to ultimately help beneficiaries to get employment.

Affordability and implementation

Rental projects are complex to implement as they involve a large number of stakeholders and target the most socially vulnerable groups. For the sampled projects where this information is available, it takes on average almost eight years to implement the rental projects; this includes 4.3 years initially foreseen as the implementation period plus a 3.4 years extension. The average implementation period for the ownership projects is 3 years, and these projects are usually not subject to the extension.

In most of the rental projects reviewed, the beneficiary selection is still a paper-based process which, combined with the vulnerability of the beneficiaries, is one of the causes of delay. Often Project Implementation Units (PIU) struggle with adequate levels of staffing and managerial and staffing discontinuity stemming from national and local political changes.

In general, costs envisaged for the projects are appropriate and represent good value for money; although national building standards and design norms, when compared with the standards in Western European countries, may lead to overcrowded apartments. A recurring cause of delay is the mechanism to exempt VAT, which is not well developed and standardized in the target countries.

What can be done to address some of these challenges?

- Digitalise beneficiary selection; IT-based process and technical assistance to local authorities to prepare manuals for standard procedures should be part of the project scope where the beneficiary selection is complicated.

- Ensure that the PIUs receive adequate funding to hire high-quality staff to handle project workload. Tailor-made technical assistance would facilitate the transfer of know-hows and strengthen implementation weaknesses.

- Set out minimum design standards in the project proposal to avoid substandard housing developments. Design competitions are a good practice to get better designs at affordable prices. The competent staff of the PIU should review engineering designs before tendering.

- Define well scope and cost estimate in the project proposal. Cost estimates should be based on an accurate evaluation of the real estate market.

- The CEB might consider a "Social housing plus" project scheme. Coordinated measures would help increase the economic sustainability of social housing. Social housing projects would be financed together with a bundle of income-generation and social inclusion measures aimed at transforming neighbourhoods and fight risk of social segregation. This modality requires collaboration between national and local governments as well as with the private sector which can help develop/manage income generation measures.

Conclusion

Access to affordable housing remains a priority in most cities to improve quality of life and social inclusion. Improvements in project designs and funding mechanisms are necessary to make sure that social housing projects contribute to fighting segregation in cities, offer economic mobility to beneficiaries, and improve sustainability of urban infrastructure.

This technical brief summarises the finding from 13 CEB social housing projects in target countries and draws some lessons. It also includes three possible project schemes for the CEB to reframe under the umbrella of social housing: *Social housing in transition* to favour economic mobility of vulnerable groups, *Social housing plus* to integrate social housing with other investments to increase urban social inclusion, and *Towards Zero Energy Social Housing* to create synergies with energy efficiency programmes and increase sustainability of the housing stock.



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