On Efficient Social Housing Finance

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Abstract

The problem of efficient social housing finance cannot be reduced to the well-known tradeoff between supply-sided and demand-sided subsidies. Equally important is the design of capital-market based special purpose vehicles that support the finance of residential construction in the sphere of social housing. The current financial crisis raises several questions relating to a sustainable design. In particular, are the modes of public support adequately synchronised with the repayment terms of the mortgages ? To which extent can the implementation of a right-to-buy stabilize the liquidity position of the social landlords, does it fit to demand over the life cycle ? This paper discusses the issues with examples drawn from Austrian social housing finance.

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1. Introduction

The paper is about efficient social housing finance. Starting from well-known approaches the paper sheds light on modes of finance that imply some sort of profit and risk-sharing between individuals and non-profit providers. The profit sharing becomes relevant in right-to-buy schemes which are discussed at length. Although many arguments draw from Austrian social renting the discussion extends to international evidence where appropriate and feasible.

The notion of social renting is understood from the institutional angle of social landlords. These are the municipal housing companies and the non-profit providers which by law are committed to supply rentals to eligible households. Starting from that definition the paper emphasizes the basic principles and functions of a social rented sector within an integrated housing market. The first principle is sustainability that aims at a steady supply. Against that benchmark the integrated market permits to value alternative housing choices. The essential feature, rarely considered in the literature, is incentive compatibility. Under proper financial designs, the integrated market stimulates the households to choose that tenure which fits their true preferences and needs. Using that feature the paper investigates the impacts of the financial mix including various modes of subsidies, and shows how the "necessary" size and scope of social renting gets a precise meaning.

The functions predetermine the terms and conditions of efficient financial designs. The financial mix has to be tuned properly to secure affordable rents and timely choices. The mix encompasses the landlords equity, the supply sided and demand sided subsidies, and the mortgages provided by special purpose vehicles (banks). While the demand sided subsidies must remain within limits if incentive compatibility is to be preserved, the supply sided subsidies can be downsized if the private mortgages take the substantial part. Sustainability then means that the non-profit landlords can recover just that return which is needed for the acquisition of plots, for new construction and for modernisation. Then they can successfully participate as institutional partners in fostering the social mix in local neighbourhoods, especially in urban areas where the influx of labour requires suitable housing opportunities.

With these ideas in mind, the paper turns to the right-to-buy of social rentals. To set up an efficient design, the notion of profit and risk sharing in integrated markets put forward by Kemeny, Thalmann and Kersloot (2005) proves to be relevant. Indeed, proper financial designs require some profit sharing between the non-profit providers, if their strategies remain sustainable, and the tenants, who engage in delayed ownership acquisition only if the design promises value gains and easier access conditions.

In sections 2 and 3, the paper discusses the integrated housing markets, and the principles and functions of a social rented sector. The sections 4 and 5 turn to the financial designs, their properties and problems. References are given at the bottom.

2. Integrated housing markets

In a number of Continental European countries, notably in the rich countries Austria, Netherlands, Sweden, and to certain degrees also in Switzerland, France, Germany and elsewhere, social housing forms part of an integrated housing market, some regime shifts in history notwithstanding. Much of the following presupposes the existence of an integrated rental market.

Starting from the examples of Sweden and Germany, the framework of unitary and integrated rental markets was put forward by Kemeny (1995), later on reiterated by Kemeny, Thalmann and Kersloot (2005). In principle, a social rented sector is termed unitary if there are no barriers that impede social landlords to compete with other modes of housing provision; in a more advanced state, the social rented sector is called integrated if rents are not only competitive with other cost structures but social rental supply is sufficiently diversified so that consumers may choose between alternative types of housing, depending on access conditions in the various market segments. Since the main competitors are private renting and individual ownership, we might better speak of integrated housing markets than of integrated rental markets alone.

In contrast, dual housing markets split into a free and a social segment that are fully separated. By its nature, the social segment is controlled by public bodies, in particular municipalities or municipally owned companies. Regulatory instruments isolate social renting from the rest of the housing market. For that reason the dual markets will be excluded from the present paper, especially because public housing does not allow for financial risk sharing arrangements between landlords and tenants. Instead we draw attention to arrangements like the right-to-buy which presumes choices between alternative cost structures.

A brief look onto the scope of integrated markets is useful. Such markets are not so much the product of constructivist designs but rather the outcome of path dependencies, to use the notion put forward by Bengtsson (2004), with all kinds of institutional differences that shape the country-specific housing markets, see also the survey volume edited by Scanlon and Whitehead (2008). There is nonetheless a common development during the decades after the Second World War that are named the "Trente Glorieuses". Continental European social renting moved away from public towards social housing, with strong emphasis of social ascent and social mobility in an emerging middle class. That role of social renting culminated around the sixties. The German notion "Soziales Wohnen" and the French "Habitat à loyer modéré" still witness its popularity, not to speak about the Swedish perception of an universal social rented sector that is open to everyone.

Later on, say from the beginning eighties, driven by individualisation and the rise of personal wealth and ownership, social renting came under pressure. It responded with an increased focus on marginal strata and foremost with a noticeable drift in targeting a growing middle class at risk, documented for Austria by the author in Deutsch (2009).

A stronger focus on the needy was certainly overdue, not least because generous access conditions to social renting had provoked rent seeking attitudes. The most pronounced regressive effects date back to the period of political corporatism around the sixties. In the meantime however, in many countries much of the former regressive effects were mitigated by reduced public assistance schemes or by an appropriate mix of supply and demand subsidies, further also by guarantee instruments, to which we turn later on.

It is therefore unfortunate to see that the present political discussion about the rationale of social renting often turns back to perceptions of a dual market. The economic mainstream is indeed suspicious against any wider role of social renting. Instead it is advocated that social renting should be limited to a safety net for the poor. Such views did probably influence the European Commission on Competition Policy which fears that social renting could hamper the free housing market by distorting the price system. Consequently, it wants the social rented sector not to expand "beyond necessity" - a statement somewhat at odds with the Commission on Social Affairs that views the right to decent and affordable housing as a cornerstone for the future development of the Union, for more about that unresolved conflict see the elaborated discussion in Ghekière (2007).

The blurred notion of "Necessity" could well stand for the unavoidable; if understood in that negative sense, it is hard to miss some overtone of resentment. Nevertheless, the guidelines of the European Union aim at restricting the subsidisation of social renting to the necessary. This gives rise to reflect some socio-economic principles, which are at the root of integrated markets. A closer look onto such markets permits to clarify the problem.

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In their reassessment of the integrated rental market Kemeny et al. put strong emphasis on the institutional settings and on the strategies pursued by profit and non-profit providers. They discuss to what extent the profit and non-profit motive may generate a rent structure such that private and social rental supplies can coexist in a competitive manner. They rightly argue that cost-based non-profit rents are not necessarily lower than for-profit rents, for instance if the rental quality and the locational advantages impose higher cost. Since the debt burden of new residences decreases over time, the bandwith of actual rents then depends on the time horizon over which the returns on initial investments are recovered by the landlords.

By and large, private for-profit landlords have shorter horizons than the non-profit landlords. The latter are bound to set cost based rents that impose rather strict rent levels over the credit term, and besides the right-to-buy they have to keep the stock in their portfolio. Instead the private landlords can realize future value gains what makes them more flexible than their non-profit counterparts. Thus, depending on circumstances and regulations, private rents can initially be lower than the cost-based rents.

Most interestingly, Kemeny et al. point to social rent levels that result from profit-sharing between landlords (at imputed returns) and tenants (at opportunity cost). When such a scheme is permitted by regulatory instruments, the authors speak of a limited-profit rule. Such schemes become relevant as soon as the initial debt burden has been serviced and the stock approaches maturation (in the sense of Kemeny). From then onwards the landlords may downsize the rent level both to sitting and to entrants, either by discretionary actions or by administered controls. Then the landlords can recover some warranted return while the tenants enjoy lower cost. Plainly, the larger the matured stock, the greater the total of profits accrued by the non-profit providers, and the easier they can comply with regulations that control the proportion of the near-liquid reserves relative to the value of the stock.

The limited-profit rent setting is not the only example. As will be seen from the Austrian case, profit sharing does also occur when options for the right-to-buy get exercised. Then, in contrast to matured rent setting, some modified device of profit and risk sharing is needed. Altogether, limited-profit strategies form an important tool that enables the non-profit providers to operate on the housing market continuously, in particular to dispose of sufficient equity to purchase plots and to start with the construction of new residences. For instance, in Austria the non-profit providers have to achieve an administered return of 8% on the annual rent revenue (plus net revenues from exercised options), which forms the so-called indispensable reserve, and which by law has to be injected into new projects.

Now, even if we find good arguments how social rental supply can achieve a competitive position, there remains a central question: what makes the integrated housing market running? What might be the socio-economic rationale that a social rented sector coexists and competes alongside other forms of rental and ownership supply ?

3. Principles and functions of Social Renting

If a social rented sector is to offer more than an indispensable shelter for the needy, its structure necessarily becomes gradually more complex, for the simple reason that it has to serve a growing variety of choices. The system of rent laws and non-profit laws sets no more than a framework, but if that framework is sufficiently flexible, the providers can adapt their strategies to a variety of consumer preferences, housing careers and personal situations, unplanned or unexpected events like divorce or unemployment included. The provision of a rental stockat disposal in the long-run is therefore a basic principle on which any sustainable social rented sector should be built.

To achieve that goal a social rented sector needs to be socially accepted; this in turn requires the supply of a sufficiently rich choice set, such that the social tenants can recognize their needs with the units they occupy. The percentage of social tenants in the household population varies across countries, but there is probably some threshold from which social renting as a sustainable sector gets widely accepted. The social rented shares (measured as percentage of social relative to all first residences) in Austria, Denmark, Finland, France, Czech Republic, Sweden and United Kingdom all vary around 20%; the Netherlands with nearly 35% are an exceptional case. It is probably fair to say that in most of these countries social renting gets sufficient acceptance in society (not without democratic discourses or even struggles, of course).

Germany is rather an odd case. After the institutional non-profit sector was dissolved in 1990, the social rented share declined to 6% now. But the share of assisted households is in fact much higher, because Germany switched from an institutional to a resource controlled system, where the institutional tenancies got replaced by a huge manifold of alternative arrangements: fiscal allowances for providers, public-private partnerships for the construction of affordable residences ("Städtevertrag"), municipal companies renting or owning social flats, contracts with private purchasers of municipal units, and finally means-tested transfers to renters ("Wohngeld"). However, staying in the tradition of a "Soziale Marktwirtschaft", the German authorities still receive public support to secure affordable rentals.

The example of Germany is important as it shows that a country can do without institutional non-profit corporations (as Dresden and other cities demonstrate, possibly even without a municipal stock, although it appears premature to derive any judgement about the longer-term). However, seen from the supply side, the advantages of institutional providers are obvious: higher transparency in rent signalling, committed agents to promote the spatial organisation of housing, clear-cut partnerships in attaining an adequate social mix, and last but not least tenant security guaranteed by law.

Looking at the demand side, the motives to become a social tenant need further elaboration. Evidently, the poor households who find themselves excluded from the housing market have no other choice than to find a shelter in social renting. But – at least in the richer Continental European countries - the majority of social tenants are not in such an unpleasant position. Assisted by means-tested benefits or not, they could afford a private rental, but at a high cost. Instead, the social rented sector charges affordable rents, so that the social tenants can preserve their odds to find a more adequate dwelling, in particular to save for ownership acquisition later on.

For Austria, the author of the present study has shown: in the life-cycle of households there are three stages where access to social rentals is most desired: the young who enter the housing market and start their housing career in a social flat; the midlife, when many people search for social rentals because they got divorced or suffer from job uncertainty; and the seniority, when the elderly get attracted by the amenities offered by sufficiently dense and mixed structures, and by the vicinity of health services. Altogether, the author observed an astonishing mobility into and out of social renting, even if some portion of tenants permanently stay in social rentals.

Moreover, Austrian social renting performs the important task to offer residences in areas with better job opportunities, thereby contributing to regional productivity, see Deutsch and Wolf (2008). The most pronounced role is to develop new units in urban areas, where we note a steady inflow of job seeking people from the countryside and from abroad. The Austrians who leave the social rented sector move for the most part into ownership. Some of them return to social rentals later on, but the entrants at different life stages are not the same in general. Hence, the rental share of those who occupy an Austrian social rental at **some** stage of their life exceeds the 21% which are the official figure.

Drawing from the literature cited above, and beyond the Austrian case, the functions of an integrated social rented sector can now be postulated as follows (note that points 1-3 are also found in Ghekière, 4 is discussed in Kemeny et al., see also Scanlon and Whitehead op.cit.):

1. to provide a sufficiently rich choice set for residential and labour mobility;
2. to operate on the housing market in cost-efficient and competitive ways;
3. to preserve an adequate social mix in urban renewal and development;
4. to dampen the overall rent and house price level by the supply of affordable flats;
5. to stimulate economic performance by synchronising the regional business expansion with the supply of social housing in the neighbourhoods.

4. Modes of subsidisation and finance

Rarely discussed in the literature, the integrated housing market admits the substantial advantage of incentive compatibility. Under proper designs of finance and cost, the households are able to compare the cost of social rentals with alternative choices. If the relation between cost and characteristics of a social unit fits, the households will decide to apply for social renting. Otherwise, if the unit does not fit the preferred characteristics, that is location, size, quality, neighbourhood and access conditions, the households will turn to private rentals or ownership. Hence, a design that can be termed efficient is preference revealing, as the households will stay away from social renting if the offer does not satisfy.

There is even more to say: if the financial design satisfies certain properties to which we turn immediately, there is an incentive that households will strive for some best choice, including the effort to earn sufficient income. Such is indeed the logic of the Austrian system both in labour and housing markets: unemployment insurances and personal housing allowances are not really generous, because they are disbursed only to limited extents, either over time (maximum 6 month unemployment insurance) or with certain ceilings (as for personal housing benefits).

In theory, the implementation of an incentive compatibility condition for housing benefits is easily demonstrated. The allowance scheme must be chosen in such a way as to avoid confiscatory effects under rising incomes. The disposable income after allowances should not decrease under the combined effect of reduced benefits, rising social insurance and progressive tax. The shape of the allowance scheme then starts at some maximum level that is granted to low income households. If the incomes get larger there is some threshold (say 40% of the median income) from which the allowance has to decrease until it declines to zero for below median incomes (say 80% of the median). Then the mathematical properties of such a scheme imply that the maximum allowances can never cover 100% of rental cost. Quite to the contrary, the support of the allowance scheme is rather tight. In a former study on the introduction of a general rental benefit system in Vienna, the author (1998) calculated a theoretical maximum that amounts to €200 if incentive compatibility is to be preserved.

In practice, most observable allowance systems (including currently existing schemes in Austria) cut the shape to zero at some threshold around the median income. Whilst little cuts cause no problem there are substantial adverse effects if the scheme attempts to cover the full rent for low income households. Cutting the personal allowances scheme is then unavoidable. Such schemes are prone to create poverty traps when it does not pay to earn an income above the cutting threshold, a problem that plagued the British allowance system, but not the Austrian one that disburses only limited amounts.

The implications for finance are shown in the following way. We take the simplest policy rule according to which affordable rents should not exceed 25% of the net median household income. Such a rule amounts to a monthly rent of €400 - €500 in order of magnitude. Serving as a benchmark, we consider a new residence of 70-80 sqm surface completed at €100.000 construction cost, and financed by a fixed annuity loan over 20 years. Then, at 3,5% fixed interest rate p.a., the monthly annuity is about €550; for 4% it is about €600; for each additional 50 points interest rate it rises by further €50. Together with overheads and periodised plot costs, such annuities clearly exceed the affordable rent level. What types of alternative finance are available to curb the rent down to affordability ?

The Austrian and French social rented systems are good examples for mixed finance between supply sided and demand sided subsidies, with the support of special purpose vehicles that offer mortgages at preferential loan rates. The SPVs are special and regulated private investment banks that refinance the mortgages on the capital markets.

The logic of the Austrian SPVs called the "Wohnbaubanken" is described briefly. The SPVs are subsidiaries of major universal banks what relieves them from certain overhead costs in operation and underwriting. Their purpose is pure maturity transformation for the finance of new residences and for modernisations in urban renewal. By issuing bonds the SPVs can transform the invested totals almost one-to-one to mortgages of (mostly) 15-years maturities. The investors have to comply to hold the bond at least 10 years in their portfolio. In exchange they get compensated as the first 4% coupon rates are income-tax exempt. Attracted by the safe longer-term return, they do in fact even comply with bond maturities over 10 years up to 15 years, making finance synchronised along the old principle of congruence between investing and lending. However, the mortgages cannot be granted for arbitrary purposes. The projects have to fulfill the conditions imposed to supply-sided subsidies, that is limited flat surface, income ceilings of tenants, and rent levels that must not exceed administered levels. In that way the Austrian SPVs can lend at mortgage rates that range some 50 points below comparable market rates. It is interesting that the 50 points difference does also reappear in various guarantee systems, see next section.

The major advantage of the SPV-mortgages is to choke off the need for supply-sided subsidisation. Producer subsidies alone could not do the job curbing down the rent to affordability levels, unless subsidisation would reach intensities that cannot be tolerated.

Nonetheless, even with the support of SPV-mortgages the affordability level of €400 - €500 cannot be reached in general. Besides means-tested allowances the remaining gap must still be closed by public loans or interest subsidies for top-up loans (that are often means-tested as well). Depending on Länder laws the outcome is a rather complex bundle of loan components what calls for reforms in the future, in particular with regard to the right-to-buy, see the next section. The most delicate issue are the terms. The Austrian Länder grant public loans at graduated interest rates and maturities between 25 and 30 and even 40 years. The non-profit providers feel uneasy with such terms, because the slow decline of the outstanding debt prevents them from building up sufficient reserves that are needed for the acquisition of plots and for the construction of new residences. To accommodate the mortgage terms with the time-scale of investments is indeed a major task that still waits for adequate responses from the side of the authorities.

The SPV-mortgages offer the advantage that their maturity is moderate, in any case much shorter than the maturity of the public loans. As soon as the SPV-loans have expired the Austrian non-providers have some freedom to reduce the rent level while keeping it above cost for a while, depending on regulations. That opportunity is welcome if new social tenants should be served with suitable packages of rental offers.

It remains to ask to what extent subsidisation might distort the playground of a free housing market.

First of all, one could well dispense of producer subsidies by the supply of low-cost housing. In Austria, the issue of construction cost is indeed under discussion. But there is a common agreement that the quality filtering effect of social renting is not at disposal. In fact, social renting construction today has taken the leadership in providing dwellings at highest environmental standards. That alone prevents to reduce construction cost below some feasible amount. The discussion centers rather on the process of development, where a labyrinth of norms and permissions cause undue waiting times and cost.

Secondly, to fear that social renting could expand beyond reasonable bounds is grossly exaggerated. Social renting sets limits to various amenities that the households better find in ownership, in particular with regard to surface and location. Moreover, the income limits are soft but nevertheless efficient at the date of entry. Thus, seen from the demand side, there will be only some portion of households that are eligible along the income distribution. If we consider the 40%-quantile of the population being at risk and eligible, the integrated market does its job as only half of them become social tenants at the same time. From the supply side, there is always the policy instrument to restrain eligibility; finally, producer subsidies are disbursed to private rental providers and owners as well so that the integrated market mimics free market conditions, albeit at much lower housing cost, for details see Deutsch (2009).

5. Right-to-buy and sustainability

To be sure, the promotion of ownership belongs to the major objectives of Austrian housing assistance. But compared with other countries, ownership finance appears more prudent. In particular, the Austrian system does not foster overinvestment by low income households, which was at the root of the American subprime crisis. Austrian mortgage lending traditionally requires substantial downpayments so that first lien, prime rate mortgages cannot exceed 62% of value. Moreover, in contrast to America and other countries, notably the Netherlands, interest paid on mortgages is not deductible. Tax relief is constrained to some deductible allowance for "newly created homes", which is limited and means-tested. The main avenue today are supply subsidies disbursed to individuals who develop their own detached family home. The non-profit providers can also receive subsidies to develop ownership for low-to median income households, but that mode of provision was almost fully replaced by the right-to-buy that was introduced in 1993, and which is the subject of this final section.

In principle, ownership acquisition can do without producer subsidies. The alternative are guarantee funds that permit mortgage rates some 50 points below market rates, as achieved in America, the Netherlands and other countries, for an international comparison see the recent contribution of Elsinga, Priemus and Cao (2009). Austria has never turned to such a system. The official argument is that public guarantees increase the Maastricht-relevant public debt, whilst public loans reduce it by augmenting the public assets. The Netherlands circumvent that problem as the Dutch ownership guarantee fund is a private organisation. A similar fund could be equally implemented in Austria, but the guarantees can hardly work without substantial tax reliefs. In fact, the Dutch tax allowance scheme is generous, raising the implicit rate of housing assistance to 3% of GDP. In contrast, Austria permits only little tax relief, while the Austrian subsidy rate of less than 0,9% of GDP appears rather modest.

A further argument is price stability. Austria has a long tradition in corporate policies that work against price bubbles and busts. Indeed, the American experience of the subprime crisis demonstrates how extreme house price fluctuations exert substantial real effects. The liquidity interventions of the FED, if only partially assigned to housing, raised the subsidy rate ex-post to temporarily unprecedented levels. The Netherlands were also exposed to marked fluctuations in house prices. Although the very reasons of the causes of house price movements remain still unexplored, one can rightly maintain that overinvestment is a major driving force for sharply rising house prices. Guarantee systems are prone to stimulate such a situation, for the simple reason that there is some intrinsic moral hazard as economic agents take too much risk when loan guarantees get granted. The Dutch guarantee system mitigates that problem by imposing rather tight loan selection criteria. Consequently, the lower income Dutch households remain excluded from the guarantees, see Elsinga et al.

The Austrian framework for property acquisition aims at preventing price fluctuations; indeed, since the turn of the century, Austria (together with Germany) is found at the bottom of the house price growth ladder in Europe. This is remarkable as the Austrian land market is completely unregulated. Land prices move freely depending on locations and expectations. To a large degree, homebuilders evade the high price locations and develop their houses in suburban and more remote areas. Among them one finds a great number of low income households who inject personal effort in developing. The real problem are the urban areas where ownership acquisition requires sufficient income or savings. If below median households do not dispose of inherited or saved wealth, the purchase of urban ownership units is out of reach.

Here is the point where the right-to-buy steps in. The Austrian non-profit law amended in 1993 prescribes that entry downpayments into social rentals perform the role of options to acquire the occupied unit after 10 to 15 years renting. That scheme fits to lower income households with sufficient income prospects to save and to buy later on. Thus, by smoothing the process of ownership acquisition over time, overinvestment among lower income households is attenuated. But when describing the Austrian right-to-buy (the "Kaufmiete") in detail, we unfortunately meet again some disparity between theory and practice.

In theory, the right-to-buy may sensibly be based on the principles of profit sharing and sustainability. The non-profit provider acts as a transactor that performs an intertemporal substitution of resources, by supplying a new social rental now and by selling it to the tenant later on . The tenant pays some downpayment upon entry, which gives the right to exercise the option that the unit will be converted into his or her ownership. The purchasing price at the date of conversion is the book value of the unit. There are two alternatives: the non-profit provider either receives the full price and clears the outstanding debt; then the purchaser has to take a mortgage if the intermediate savings do not cover the remaining debt. Or the non-profit provider receives only the difference between book value and the outstanding debt, such that the latter has to be shifted into the owners portfolio.

The gain for the non-profit provider is the difference between book value and outstanding debt. The gain for the customer is the increase in the property value over time, plus (according to Austrian fiscal laws) the cancellation of 20% value added tax that is waived after 10 years holding, and which would be due upon any immediate property acquisition. However, depending on Länder laws, the new owner has also to pay back some part of the subsidies because ownership is less subsidised than social renting.

The right-to-buy therefore entails opportunities and risks. The non-profit provider can attract customers with sufficient income prospects, which stabilizes the social mix in urban developments. The provider does also preserve the opportunity to replenish the stock by developing new residences out of the sales revenue. The tenant gains the opportunity to acquire ownership which would be too expensive at the date of entry.

The risks cannot be overlooked: the non-profit provider has to implement financial designs such that the outstanding debt has sufficiently decreased at the date of conversion, so that the sales revenue can indeed cover the equity needed for further developments. For that purpose the terms of the initial SPV-mortgage could preferably be set in accordance with the expected conversion date. But even then there is no guarantee that the planned profit will indeed realize. The tenant bears the risk that the ownership unit turns out to be inadequate, or that he or she might be unable to finance the unit upon conversion.

In practice, the Austrian right-to-buy schemes form rather a patchwork than a device derived from the principles of profit and risk sharing. In fact, the schemes were repeatedly adjusted to prevailing accounting and subsidy rules. The many subsidy schemes make any evaluation of regional right-to-buys difficult although the Länder authorities strive to learn from best practice designs. There is currently a lot of discussion how to improve that situation. Without going into details, we confine ourselves to mention some major issues.

The freely accessible web-site of the City of Vienna presents an overview over current offers of Kaufmieten. For a social flat between 70 and 80 sqm, the monthly cost based rents range around €510 in average, with downpayments around €38.000. Thus, the downpayments make approximately 20% of total value. These are the current figures. From the past entries, the first waves of options have recently been exercised. The acceptance was limited however. Only a minor portion of all available units were indeed converted in Vienna, while the conversion rate was higher only in a few Länder where the subsidies were not recalled.

Various factors contributed to that unsatisfactory outcome. Firstly, income uncertainty has increased over time; that fact, together with changes in family status and job security may have diverted from purchasing. For these and other reasons, the occupied units may not anymore fit the customer needs upon the date of conversion. Secondly, some shortcomings can be attributed to improper designs. The different modes of the repayment of subsidies make the net gain from converting intransparent; as a consequence, some 5% to 20% of the initial downpayments are lost what makes the advantage from purchasing doubtful; finally there is some lack of cooperation between the social providers and financial institutions so that many tenants did not find optimal savings plans to finance the conversion later on. If the option is not exercised, the initial downpayment is lost.

Various experts have therefore argued for reforms. The author of the present study wants to emphasize the following issues. Firstly, the authorities could waive the repayment of subsidies if the conversion is undertaken by first-time buyers. Secondly, the current option applies to the occupied unit alone. One might better implement an adjustable option in the sense that the non-profit providers offer some alternative unit later on, depending on tenants preferences and subsidy regulations. Such a procedure could much better fit the changing needs over the life course.

To offer some alternative unit by the same provider should be relatively easy to implement, but only the larger companies are in the position to supply such alternatives. The real problem arises with the small providers. To meet the demand for adequate units they will have to cooperate with other providers that dispose of adequate units. We suggest a procedure which is open to debate. If the option is exercised with another provider, the original provider can keep the former rental unit in its portfolio (which is an advantage), whilst paying out some portion of the accumulated return from renting to the cooperating company (which is some disadvantage). Hence, an adjustable option necessitates to build up liquidity reserves which make the provision of alternative units later on feasible.

Parallel to the SPVs discussed before, one might think of a provision fund which accumulates the required reserves. The consumers as interested parties could contribute to that fund, either by their own savings or by some overhead over current rents. The available equity at the date of conversion then totals the accumulated savings plus some share of the accumulated non-profit returns. Whatever solution may evolve, to obtain a higher acceptance rate of the right-to-buy the non-profit providers cannot stay with their traditional role of rental suppliers, but will be called to engage in cooperations with suitable financial institutions.

6. Conclusions

The paper discussed the principles and functions of social rental providers in an integrated market. The incentive compatibility was given special attention. It secures that households choose their tenures according to true needs, preferences and income situations. To become viable in the social rented sector, the financial designs need to be based on special purpose banks such that the producer subsidies can be downsized to close the remaining gap to median affordability levels, whilst individual affordability can then be reached through the provision of means-tested personal benefits. With that in mind we argued that an appropriate mix of social renting finance can address a household population which recognises their needs in a sufficiently rich package of offers, without fear that the social rented sector increases beyond a level which may be considered as market distorting.

In such a social rented sector the opportunity of purchasing an option for the right-to-buy along the Austrian Kaufmiete can favour the below median households who dispose of more optimistic income prospects. The actual designs of the right-to-buy can preferably be derived from the principles of limited profit and sustainability, because they aim at the mutual advantage of social providers and tenants. To foster the acceptance of the right-to-buy, the paper finally addressed the problem of options which do not only apply to the occupied units but which are adjustable to permit alternative choices. The implementation of such options requires suitable cooperations between providers and financial institutions.

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