FINANCING THE NON-PROFIT RENTED SECTOR IN WESTERN EUROPE[1]

Peter Boelhouwer

ABSTRACT *The degree to which the non-profit rented sector in Western Europe has had to adjust itself toward privatization is the subject of this article. Specifically, we examine how private financing in the non-profit rented sector is implemented in Western Europe. We also trace how these practices affect the way the sector performs in various countries. In the final section of this paper, we shed some light on the diversity of responses to the challenges facing the non-profit rented sector in Western Europe.*

1. Introduction

Housing systems in Western Europe are in transition. This change, which only got started recently, is part of a more general wider trend toward privatization, deregulation, and decentralization. These processes have also affected the function and the position of the non-profit rented sector. One of the big differences with respect to the past decades is that government support and direct object subsidies are diminishing. As a consequence of this development, social landlords have to become more self-reliant and have to operate like "real" entrepreneurs. In some countries, like the Netherlands, this is nothing less than a culture shock for people working in the non-profit housing sector.

The new position of the non-profit rented sector in Western Europe has implications for financial management in general and for the financing of particular projects. The role of the state in making loans available to social landlords has been eclipsed. Now, the providers of social housing have to resort to the capital market, either directly or through mediating organizations. In order to obtain the required financial means in the market, the social landlords are required to develop a financially accountable style of management. Financial continuity, creditworthiness, subsidies, and guarantees are some of the preconditions of responsible financial management.

The development sketched above has spread across Western Europe (Ball,

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1994; Bartlett and Bramley, 1994; CECODHAS, 1994). It is found in virtually every country, irrespective of the differences --which may be considerable-- in their institutional structure and regardless of the role that the non-profit rented sector plays in the provision of housing. Individual countries do differ, however, in the depth to which this transition has gone, as well as in the amount of adjustment that it has required of operators in the non-profit rented sector. This form of adjustment has much to do with the development of the housing system in the past decades. Some countries like the Netherlands, were more regulated than others (for instance Germany). So the adjustment to market forces has a much greater impact in the functioning of the non-profit rented sector in the Netherlands than in Germany. The degree to which the non-profit rented sector has had to adjust in Western Europe is, in fact, the subject of this article. Specifically, we examine how private financing in the non-profit rented sector is implemented in Western Europe. We also trace how these practices affect the way the sector performs in various countries. The objective of this comparative analysis is to highlight the means by which private financing in Western Europe's non-profit rented sector has developed under diverse conditions. At one extreme, we see that the non-profit rented sector has become completely part of the mainstream of the finance market, with all the risks this entails for the management of housing. At the other extreme, some use is made of private financing, but this is almost entirely under the auspices of the government, which provides both guidance and support. In the latter case, the government carries all of the risk and the management style and position of the non-profit rented sector will remain essentially unchanged.

In the final section of this paper, we hope to shed light on the diversity of responses to the challenges facing the non-profit rented sector. First we review the ways that private financing has developed in seven West European countries: The Netherlands, Belgium, England, Denmark, Germany, France, and Sweden. These countries differ widely with respect to the position of the non-profit rented sector as well as in its form and function. These differences reflect the long history of the non-profit rented sector that is specific to each country.

In Section 2, we scrutinize these differences and similarities. We show that despite the differences between the countries studied here --and in some cases these differences are large-- they all have one thing in common: an overall trend toward privatization. In the wake of this general trend, private financing has penetrated the non-profit rented sector in each of the seven countries. In Section 3 we focus on the types of lenders, the market share of these lenders, and on some characteristics of the loans. In the next two sections, we deal with risks and supervision. The risk and guarantee structure is critical to arranging loans on the capital market. Some countries have worked out highly sophisticated systems to minimize the risk for banks and building societies that are lending to housing associations. Such approaches are closely linked to the questions of supervision and auditing. The final section then brings the insights together and clarifies the degree to which the non-profit rented sector has become less dependent on the grip of government and set out on a more independent and managerial course for the future.

2. Institutional structure, source of funding and volume of demand for financing

When comparing the institutional structure of the non-profit rented sector in the seven countries under study, the most striking finding is the great discrepancy between the size of the sector in the different countries (Table 1).

Of the countries studied, Belgium has by far the smallest non-profit rented sector. That sector accounts for a mere six percent of the country's dwelling stock. This is not surprising, as the Belgian government has promoted the owner-occupied sector for years. Under the stimulus of this policy, low-income groups and especially families with children can count on government subsidies. Many low-income groups in Belgium are forced to rent from private landlords. In Denmark, Germany, and France, the non-profit rented sector comprises about one-fifth of the dwelling stock. It is true that these countries support the development of this sector. But at the same time, they assign the private sector an important function too. In Denmark, there is a deliberate choice for owner-occupancy. In France and particularly in Germany, people prefer private rentals. The Netherlands is exceptional in Western Europe, with 40 percent of the stock in the non-profit rented sector. Unlike the situation in other countries, housing production in the Netherlands was predominantly in the non-profit rented sector up till the early 1990s. In part, this special position can be explained by the pervasive housing shortage in this country after World War II. In most of the other countries, the housing market was already saturated by the 1970s or the early 1980s.

Even though the size of the non-profit rented sector differs considerably in the seven West European countries, the role of the market is extensive in all countries. Generally speaking, the government has retreated from the housing market in deference to the free play of supply and demand. This usually implies a reduction in financial support for the non-profit rented sector. As a consequence, the rents go up. In addition, the operating risks are increasingly passed on to the social landlord, who then has to adopt a more market-oriented approach. This reduction of direct sub-

Table 1 Distribution of the dwelling stock by tenure sector in seven West European countries at the beginning of the 1990s, percentages

	Owner-occupied sector	Private rented sector	Non-profit rented sector	Cooperative sector	Other/ unknown
Netherlands	46	13	40	-	1
Belgium	65	28	6	-	1
England	68	10	22	-	-
Denmark	56	19	21	5	-
Germany	40	40	20	-	-
France	56	21	17	-	6
Sweden	43	17	22	16	2

Source: Boelhouwer, 1997, p. 95.
European Commission, 1994.

sidies is more or less compensated by individual housing allowances. In all of the countries studied, subsidy on rent plays an important role in compensating outlays for housing by households in the lower income groups. Almost all countries provide rent subsidies to the occupants of both the non-profit rented sector and the for-profit rented sector (Papa, 1992; Boelhouwer and Van der Heijden, 1992; Van de Ven, 1995; Oxley and Smith, 1996).

This general trend toward privatization is also manifest in the way financing takes place in the non-profit rented sector. For instance, governments of all seven countries no longer provide loans to finance new non-profit rented dwellings. Germany is the only country where interest-free government loans can still be arranged. Such a loan would cover part of the necessary financing and is only available for dwellings that are subsidized under the program known as the first subsidy system. In all of the countries except England, a portion of the required financing comes from the principal's own funds (Table 2). In England, however, the housing associations sometimes do arrange self-financing, though they are not required to do so.

Especially in Germany (33 percent) but also in Belgium (20 percent), a significant share of the financing of new construction is drawn from the social landlords' own funds. Besides their own assets that they put in, part of the financing costs are covered by lump-sum government subsidies. These are only the lump-sum subsidies that are paid out at the time the buildings are put into operation and pertain to the financing. In addition, most countries also have long-term operating subsidies, such as interest subsidies. The subsidies that are received in the course of operation (as in Sweden and Denmark, for instance) are significantly higher than the amount received at the time operation is started up. Thus, the share of subsidies is often more than 50 percent of the original costs of construction. In the Netherlands, only

Table 2 Source of the financial means needed for investment in the non-profit rented sector (new construction) in the seven West European countries by approximation, 1994-1995 (percentages)

	Own assets	Borrowing	Lump-sum subsidies
Netherlands	9	83	8
Belgium	20	59	21
England	-	58	42
Denmark	2	91	7
Germany	33	49	18
France	3	80	17
Sweden	3	95	2

Source: OTB survey on financing in the non-profit rented sector, 1996.
Boelhouwer, 1997, p. 99.

lump-sum subsidies are still granted, as of January 1, 1995, which puts this country in a very special position (Gruis, 1997). In 1994, the share of financing to be provided in the form of lump-sum subsidies was cut to about eight percent. The non-profit housing associations in the Netherlands are expected to underwrite a share of the costs of new construction. This amount is to be taken out of their operating reserves as a one-time outlay. In this connection, the grossing and balancing operation comes into play, as the balance on loans currently being serviced is canceled out against the amount of subsidy in the pipeline. In this way, the Dutch housing associations have been able to establish their financial independence since the mid-1990s. Thereby, they are supposed to put a share of their assets into unprofitable investments in housing (see also Priemus, 1966).

Of the seven countries studied here, England has the highest share of the financing costs covered by lump-sum subsidies (42 percent). But such contributions also play a major role in the financing of new residential construction in Belgium (21 percent), Germany (18 percent), and France (17 percent).

In some countries, it is not the government but an umbrella organization that actively solicits the loans and subsequently makes them available to individual landlords. This is the route taken in Belgium by the regional housing societies. They take care of the financing for non-profit rented dwellings built by authorized building contractors. In France, it is the *Caisse des Dépôts et Consignations* (CDC) that solicits the financing for the HLM institutions. In England, Sweden, Denmark, and the Netherlands, however, there is no alternative to the capital market. This topic is explored in greater depth in the next section.

The final point we raise in this section concerns the annual demand for financing. Each of the seven countries has its own particular need for financing in the non-profit rented sector. The breakdown of the demand is determined by the volume of new construction, the average construction cost, and the share of the total financing that is derived from external sources. External financing is the amount that does not come out of own assets or from lump-sum subsidies. Table 3 shows the breakdown for the seven countries considered here. It should be kept in mind that this table is based on estimates of the total financing demand for new construction projects in the non-profit rented sector. Furthermore, the amounts may fluctuate greatly from one year to the next. Financing for other activities --urban renewal, acquisition, and dwelling improvement, for example-- are not taken into account. In many countries, these other activities form a major share of the tasks carried out by social landlords.

As Table 3 indicates, in all countries more than 50% of the housing finance is extracted from the capital market. The total demand for financing in Germany is by far the greatest, at NLG 31.7 billion. One reason is that construction costs in Germany are extremely high, running NLG 400,000 per dwelling on average. The high volume of demand is also caused by the extensive building program, with 162,000 completions per year. In comparison, the demand for financing in the other six countries is negligible. France, the runner up, needs roughly NLG 6.6 billion per

Table 3 Estimated new construction (x 1,000 dwellings), average construction cost per unit (x NLG 1,000), percentage of external financing, and total demand for external financing (x NLG 1,000) in the non-profit rented sector (new construction) in seven West European countries in 1995

	New construction	Average construction cost	External financing	Total demand for external financing
Netherlands	23.8	140	83	2,766,000
Belgium	3.3	151	59	294,000
England	31.6	116	58	2,126,000
Denmark	3	219	91	598,000
Germany	162	400	49	31,752,000
France	62	133	80	6,597,000
Sweden	4.9	225	95	1,047,000

Source: OTB survey on financing in the non-profit rented sector, 1996.
Boelhouwer, 1997, p. 102.

year. Belgium and Denmark bring up the rear, with an annual financing demand of 294 and 598 million guilders, respectively.

3. Providers of capital and some characteristics of the loans

This section covers the types of lenders and their market share. We consider some characteristics of the loans these lenders extend for the non-profit rented sector. In most countries, financing in the non-profit rented sector is provided by institutional investors and banks.

Until some time ago, the state provided loans to the housing associations in the Netherlands. During the 1980s, these state loans were systematically replaced by borrowing on the capital market (Priemus, 1996). In the past, the lenders for residential construction were predominantly institutional investors. This is not surprising, since pension funds and insurance companies have a fairly constant presence in the long-term segment of the capital market (where the life of a loan is longer than ten years). Recently, banks have also joined the investors in this sector. In addition to the investors and banks, municipalities play a (limited) role as lenders to housing associations. Moreover, the associations themselves will start to provide funds for their own sector. In particular, those associations with a surplus of assets will be most interested in investing in the sector (Spijkers, 1994).

The 1988 Housing Act set the framework for bringing private funding into social housing development in England. Mixed funding schemes --whereby public grants are combined with private finance-- are now the norm in financing development. Private finance is now essential to social housebuilding programs. Banks and building societies (mortgage banks) play a major role in housing finance in England. Recent studies on the attitude of the financial institutions toward lending to housing associations identify the two main reasons why banks and building societies have turned to financing the non-profit sector. One is the relatively favorable position of the associations; the other is the good relationship between profit and risk (Pryke and Whitehead, 1995). Between £10 billion and £11 billion in private finance has been raised since 1988. Private finance supports several types of developments financed through the Housing Corporation's Approved Development Programme (ADP) whereby a supplement to central government spending is required. These include schemes which are classified as Mixed Funded Rent, Mixed Funded Sales, Do-it-Yourself Shared Ownership (DIYSO), and Special Needs Housing. Private finance also helps to support schemes involving Local Authority Housing Association Grant (LAHAG). These are transactions where central government funding is paid by the Housing Corporation to registered housing associations. Those associations, in turn, reimburse local authorities for loans. This Housing Corporation expenditure is outside of the ADP cash limit (Oxley, 1997).

The Large Scale Voluntary Transfers (LSVTs), where local authority stock is transferred to an existing or a new registered housing association, are 100 percent debt-financed by the private sector. Housing Investment Trusts (HITs) were introduced in the 1996 Finance Act. These HITs will come into being as soon as the London Stock Exchange arranges the regulatory framework. HITs are designed to increase institutional investment in private rented housing (Joseph Rowntree Foundation, 1996).

Financing for the German non-profit rented sector is also provided by a wide range of financiers. Three basic elements make up social housing construction finance in Germany. The first one is the investor's own capital and assets. For most institutional investors, this must be a minimum of 15 percent of construction costs. On this 15 percent equity, investors can receive a return of four percent; for any equity above 15 percent, they may receive a 6.5 percent return. The second element comprises state loans and subsidies. These are channeled through the *Förderungswege*, with additional funding also being allocated by municipalities to target groups. The amount of loan or subsidy provided and the interest rate attached to it vary according to factors such as dwelling size and location and other financial instruments which are included in the "contract."

Finally, investors in social housing construction may also take up finance from the capital market. These are likely to make up a smaller proportion of overall funding and have a higher rate of interest. Interest rates on a public loan are usually around one to two percent but can increase to six or seven percent on a private loan (DIW, 1996). The relaxation of controls in the capital market had a positive effect on investors. Mortgage interest rates were reduced during the early 1990s, thus improving incentives for investing in housebuilding (Gesamtverband der Wohnungswirtschaft, 1993, p. 34).

The main sources for private capital finance for social housing are mortgage bond institutions, savings banks, private and social insurance companies, housing savings banks, and other money lenders. Where capital finance is subsidized, this may be in the form of lower interest rates or security on interest and repayments. Both are aimed at reducing the rents and charges attached to social dwellings.

For individual developments, the balance between these three types of finance can vary considerably. For example, while state-subsidized finance averages around 20 percent of construction costs, for some developments the state may be subsidizing 40-50 percent of the costs. This may be the case, for example, in deprived areas and for special target groups.

The loans that carry an interest subsidy (PLA) in France are provided to the HLM associations by a special non-banking institution (*Caisse des Dépôts et Consignations, CDC*). This intermediary organization takes care of the financing of investments in the public sector and in social housing construction. Thus, the HLM associations do not borrow the money for their new construction activities directly from the capital market. Instead, they put up some of their own equity.

The CDC collects capital from savings banks, pension funds, and other financial institutions. The CDC has the right to review the management of the HLM associations. It has the right to refuse a PLA loan on the grounds of a negative review. If dwellings are built by HLM associations, they are eligible for a PLA loan to cover a minimum of 55 percent and a maximum of 95 percent of the allowable investment costs, depending on which association applies for the loan. The loans are made up of annuities.

In addition to the PLA loans, rental dwellings can also be financed by funds that are built up through contributions of employers, as in the Comptoir des Entrepreneurs (PEEC). This "patronal" scheme has been in existence since 1953. At that time, it was set up in an attempt to resolve the financing problems related to the recovery from war damage. The required contribution from employers is currently one percent of the gross payroll. The patronal scheme only applies to companies with at least ten employees. Loans are made available at extremely low interest rates, but they can only be applied to a maximum of 25 percent of the construction costs. Top-up loans are usually arranged by the municipality and the departements. Furthermore, financing from this fund is also used as a supplement to financing in the form of PLA loans (Papa, 1992, p. 118; Oxley and Smith, 1996, p. 89).

In Belgium, individual construction companies do not take out loans on the capital market. The loans are arranged by the three regional Housing Societies. Direct financing by way of the private capital market is highly unusual. Even though the opportunity exists, there is really hardly any need to look for outside assets in Belgium, because the regional Housing Societies take care of the financing. Nevertheless, part of the financing costs are covered by the construction companies' own assets. At present, this coverage is estimated at roughly 21 percent in Flanders and five percent in Wallonia (Boelhouwer, 1997, p. 27). Of course, wide differences may arise between individual construction companies and specific projects. For Flanders, we can identify which financial institutions were involved in financing of the non-profit rented sector in 1995. Data from the OTB survey reveal the distribution to be as follows:

- Directly from the capital market: 0.3%
- Via the Flemish Housing Society: 30.7%
- Via the region (object subsidies): 20.8%
- Via construction companies (own assets): 20.0%
- Via the emergency program Domus Flandria: 27.6%

In 1992, the Swedish parliament decided to revamp the system of financing for the housing market. Since that year, money for investments in housing production and renovation has to come entirely from the capital market. Of those loans, the lion's share come through mortgage banks. General banks arrange 20 percent of the loans (Boelhouwer, 1997, p. 91). Mortgage bankers act as intermediaries between the non-profit landlords and the lenders, such as the pension funds. In 90 percent of the transactions, the loans are annuities; only 10 percent are linear loans. These loans have to be paid off in either 40 or 50 years. Thus, they are arranged for the whole period during which the housing will be operated. The interest rate is adjusted periodically; usually, the period of adjustment is between one and five years.

The national government guarantees the portion of the loan with the highest risk, which covers between 25 and 30 percent of the production costs. A premium is charged for the guarantee. Without this risk insurance, it is impossible to arrange 100-percent financing on the capital market. It should be kept in mind that, on average, more than 95 percent of the investment costs are financed from outside sources. Furthermore, the amount of equity is generally limited. The figures mentioned by respondents to the questionnaire ranged from two to five percent. The small share of equity reflects the fact that it is difficult for the institutions to build up their own assets. The loans on the capital market are not only taken out for new construction. They are also needed for maintenance and improvement, urban renewal, and the acquisition of property, among other things (Boelhouwer, 1997, p. 91).

Together with the long-term financing of capital goods, financing the construction of housing is part of a strictly regulated market in Denmark. The legal framework for this financing is formed by the Mortgage Credit Act and the Index-linked Mortgage Lending Act (Boligstyrelsen, 1989, p. 80). This legislation stipulates which organizations are permitted to provide long-term loans on real estate, in which manner the capital for these loans is supposed to be obtained, under which conditions these loans may be extended, and how much guarantee is required.

In Denmark, it is common practice to distinguish between the short-term financing during construction and the long-term financing during the period of operation. Short-term financing is generally offered by banks, especially savings institutions. The long-term financing of dwellings, existing loans (especially indexed loans) on rented dwellings, and renovation is largely arranged through mortgage banks.

Financial institutions obtain their capital by special bond issues. The guarantee for these bonds is specified in real commodities (land, buildings, machinery, and so forth), as required by law (Boligstyrelsen, 1989, p. 80). The value of the good that is being financed determines the amount of the mortgage. This differs from common practice in many other countries, where the amount is determined by a guarantee on the person or the organization that takes on the mortgage. As pointed out, the mortgage institutions finance their loans with special bond issues. The law gives the mortgage banks a monopoly on issuance of these special stocks or mortgage bonds. Every time a loan is closed stipulating a nominal interest rate, a life span, and a repayment schedule, the same amount is put up at the same nominal rate of interest, for the same term, and with the same pattern of repayment. This removes the interest risk for these organizations. Also these conditions are legally prescribed.

The mortgage bonds are negotiable paper and as such are traded on the Danish stock exchange. The interest margin, which is the difference between the interest that the borrower should pay and the interest that the mortgage bank reimburses to the holder of the mortgage bond, runs between 0.3 and 0.5 percent. Because the bonds are traded on the stock exchange, the issue price is also important. For example, at an issue price of 89.75, when the nominal amount the borrower needs is DK 1,104,000, the mortgage bonds will be issued at a value of DK 1,230,000 (Boelhouwer, 1997, p. 53).

In order to gain deeper insight in the characteristics of the loans that have been extended, Table 4 highlights the type of loan, the average interest rate, and the difference in interest on loans solicited by non-profit landlords and those solicited by the state. Of course, municipalities can also take out loans on the capital market. Therefore, the table also shows the differential in interest rates between the loans taken out by the state and those taken out by the municipalities on the capital

Table 4 Type of loan, nominal interest rate, the differential between loans contracted by non-profit landlords and government loans, and the differential between the interest rates on loans contracted by the state and the municipalities, in seven West European countries in 1995

	Type of loan	Interest rate (%)	Differential with respect to government loans (%)	Differential governm. loans to municipal loans (%)
Netherlands	annuity (70%)/fixed (30%)	7.5	0.25	0.15
Belgium	annuity	7.1	0.14	not applicable
England[1]	annuity/linear	8.0	1.3	0.8[2]
Denmark	index	3.6	not applicable	not applicable
Germany[1]	annuity	7.0	1.5	0.15
France	annuity	5.8	2.0	0.5
Sweden	annuity(80%)/linear (20%)	10.7	1.73	0.5

[1] 1994
[2] Estimate
Source: OTB survey on financing in the non-profit rented sector, 1996. Boelhouwer, 1997, p. 103.

market. The risk is limited in all the countries studied and, in many cases, the loans are guaranteed. Under these conditions, the social landlords are able to arrange financing on the capital market at fairly reasonable rates. In most cases, the interest differential between the contracted interest rate and that charged on government loans) is merely a few tenths of a percent higher than the interest on loans that are contracted by the state. It is not easy to give an unambiguous explanation for the differences between the countries studied here. The reason is that the interest differential is determined by two situations. First of all, the degree to which the risks are assessed by the lenders plays a significant role. Secondly, the efficiency, competition, and structure of the money market in the various countries exert an influence. If only a few lenders are active in a country, the chance of relatively expensive loans increases sharply. When the competition between diverse lenders is stiff, however, the interest rates will generally be calculated with the consumer in mind. Such a situation exists in the Netherlands, for instance. In nearly all of the countries studied, this external financing is arranged by way of annuity loans.

The exception to this pattern is Denmark. There, indexed loans are required. Sweden and England still have the linear loan alongside the annuity loan, although the linear loan is becoming scarce. The fixed loan is specific to the Netherlands. With a fixed loan, only the interest has to be paid in the course of the loan. After the contract expires, the principal is paid off in its entirety.

4. Supervision and auditing in the non-profit sector

In all seven countries, forms of supervision and control have been developed in the course of time. These measures pertain to the way the non-profit institutions perform. The reason to develop such measures is that the government still considers itself to be responsible to some extent for the provision of housing for low-income groups. Because of diminishing direct financial support, this commitment is much weaker than it used to be in past. In the Netherlands, France, England (with the exception of the housing associations), and Sweden, the supervision is first and foremost the task of the municipality.

In the Netherlands, it is the government that decides whether or not to intervene in the management of a housing association. Responsibility for oversight of the associations is vested in the municipalities and is retrospective. The municipalities are not entitled to set performance standards. The statute assumes that the associations and the municipalities that have to judge their performance are in agreement on the desired performance. If the municipality is dissatisfied, it may report its assessment to the Minister of Housing, Spatial Planning and the Environment (VROM). Only the Minister has the power to impose sanctions on associations in the context of this oversight. The housing associations that also operate outside the municipal boundaries are supervised directly by the Minister (NWR, 1993).

The situation is quite different in the other countries. In France, for example, the regional representative of the state, the préfet, holds sway. And in view of the fact that Sweden and England have municipal housing authorities, it is no surprise that control over these companies is carried out by the town council. In Belgium, supervision is carried out by an intermediary umbrella organization, namely the regional Housing Society. Similarly, the umbrella organization charged with supervision in England is the Housing Corporation. The mission of the latter is "to support social housing in England by working with housing associations and others to provide good homes for those in housing need" (Housing Corporation, 1994, p. 1).

In Belgium, however, the activities of local building societies ultimately fall under the supervision of the regional government. The regional Housing Society takes care of the daily supervision. The supervision of the non-profit institutions in Denmark, in contrast, is spread over a number of parties, as befits a social democracy. These parties are the municipality, the personnel, and the renters.

The country where supervision is least developed is Germany. This is partly because dwellings in the non-profit sector can also be rented out by private parties, who are only obliged to comply with the subsidy conditions. Those non-profit landlords who are affiliated with the *Gesamtverband der Wohnungswirtschaft (GdW)* fall under the supervision of this umbrella organization. Because of the great diversity among the landlords of social rented dwellings, the task of supervision is difficult. This problem drew attention when the biggest non-profit landlord in Germany, called Neue Heimat, went bankrupt at the end of the 1980s (Smith, 1997).

5. The risk and guarantee structure

This section deals with the risk and guarantee structure in the non-profit rented sector in the seven countries under study. Special attention is given to the conditions posed by the financiers. Of course, the risk structure is strongly linked to the institution that ultimately solicits the loans.

In Belgium and France, intermediary organizations are responsible for the loans that are solicited on the capital market and subsequently passed on to the social landlords. If a French HLM institution wants to take out a subsidized loan, the organization is obligated to subscribe to a guarantee system. This system is set up as an insurance scheme. It kicks in when an HLM is unable to meet its financial obligations. The guarantee institution for the non-profit rented sector is managed by the CDC and is under the supervision of an administrative board (Oxley and Smith, 1996). In Belgium, the intermediary housing societies are supervised by the regional Ministers of Finance and Housing. In practice, supervision is carried out by two regional commissioners, who are nominated for appointment by those ministers. As far as we know, there are no instances of building societies that are in financial trouble. The way in which the operation of the non-profit rented sector is organized gives little reason to expect financial difficulties. It is the Housing Societies rather than the building societies that carry the risks entailed by refinancing the loans.

In countries where the social landlords have to turn directly to the capital market, the risks are different, of course. In the Netherlands, an extensive guarantee system has been developed in order to limit the risk. The Guarantee Fund for Social

Housing Construction (WSW) plays a crucial role in that system. Housing associations that borrow with a guarantee by the WSW can count on a three-pronged security package. The primary security is formed by the financial resilience of the housing association itself and the backup is provided by the Central Housing Fund. The secondary security consists of the assets of the WSW. Those assets are formed by a lump-sum deposit made by the state and the contributions that associations make to the WSW in exchange for the guarantee. The tertiary security is formed by the state and the municipalities, which provide backup support on a fifty-fifty basis. Lenders have great confidence in the fund, which is reflected in the favorable interest rates on the loans that carry a WSW guarantee (Van den Dolder, 1994; WSW, 1994).

In Denmark, the state and the municipality jointly guarantee the building loans that non-profit institutions solicit from specific mortgage banks. To finance dwelling improvement, the umbrella organization of non-profit landlords provides a guarantee for the share of the financing that is not guaranteed by the municipality.

In Germany and Sweden too, the government plays a key role in guaranteeing loans for social housing construction. Virtually all the risks are covered in this manner. In Sweden, the landlords do have to pay a premium for the state guarantee. Without this risk insurance, it is impossible for non-profit landlords to get 100-percent financing on the capital market.

In view of the contractual arrangements that surround the financing of social housing developments in Germany, it is clear that the government bears a significant amount of risk in addition to acting as guarantor. The amount of risk does vary, however, with the types of subsidy being provided by the state. If the subsidies are in the form of current allowances, the state will usually insure the second mortgage. But if the state provides a public loan, a second loan from the capital market will have a higher interest rate, for which the bank bears the risk (Hubert, 1992, p. 14). However, because the whole package of financing is arranged to cover construction costs and determines cost-rent levels, and because subsidy is calculated by taking into account the cost of all finance, a form of state guarantee is effectively written into most social housing construction contracts. The *Förderungsanstalten* of the Länder can also operate as a guarantee for social housing organizations who borrow on the private capital market.

The financing system has been extremely generous to investors. The system has drawn some criticism, however. It has been suggested that investors can "profiteer" with social housing programs (Hubert, 1992, p. 5). That perceived abuse has prompted proposals to reform the system. It has also been noted that, "they (social housing programs) are expensive, providing housing for below market prices and shifting investment risks largely to public budgets" (Tomann, 1994, p. 17). Tomann goes on to say that the state bears too much of the market risk on capital, which should be shifted instead to investors and their creditors (Tomann, 1994, p. 18), and calls for the design of new financial instruments for housing. Reforms in social housing finance and subsidization continue to be debated in Germany.

Unlike the other countries, the loans of the English housing associations are not guaranteed in a formal sense. Nevertheless, the regulation of the Housing Corporation and the political support ensure that the loans to housing associations have a low risk profile. In this way, assets can be accumulated that financiers will consider acceptable as collateral for the loans. In addition, the public subsidies are secondary to the private financing. In other words, if it is necessary to draw upon the collateral, the private lender will be reimbursed first, before the housing corporation gets back any portion of the subsidy. The attraction for private financiers lies in a solid, risk-reducing government subsidy, a steady cash flow, and a good reputation. That reputation is guarded by the Housing Corporation, in its supplementary role as controller of those organizations in which it invests.

In sum, it appears that in most of the countries studied, similar guarantees are provided for loans that are arranged by social landlords on the capital market, either directly or indirectly. England forms the exception. Furthermore, it appears that the risk to lenders is very limited.

6 Conclusions

In this article, we provide an overview of the waves of change engulfing the non-profit rented sector at the end of the 1990s. This transition has been studied in seven West European countries. In all seven, we observe a declining role of government and a growing dependency on the capital market. Specifically, we found that the non-profit landlords are dependent on private lenders for financing, especially for their new construction activities. We also found that the government had retreated almost entirely from the arena. The one exception to this rule is Germany. There, at least for the time being, part of the demand for financing is covered through the program known as the first subsidy system and makes use of government loans.

Furthermore, on the grounds of the discussion of the way private financing has taken shape in the seven countries, it became clear that there is a wide spectrum of options for financing. And the shape it takes in a given situation depends strongly on the institutional structure prevailing in each of the countries. Then too, there is also a wide range of ways in which the non-profit rented sector has been able to free itself from government interference and pursue its own direction towards greater independence and a managerial approach.

Most of the countries studied here have a sound basis for guaranteeing loans. Those loans are taken out by the non-profit landlords directly or indirectly on the capital market. The loans are arranged such that the financiers bear very little risk. The one exception is England. There, partly because of regulation of the Housing Corporation, the housing associations enjoy a relatively low risk profile in comparison to the more commercial companies. Nevertheless, it is the social landlords that are most accountable for their activities. For the most part, they are indirectly accountable, reporting to the Housing Corporation. Of the seven countries studied here, England is the one that puts most emphasis on value for money. Performance and management are subjected to a thorough audit and efficiency checks. In this manner, private financiers have access to information with which they can evaluate and compare the performance of individual non-profit landlords.

A somewhat similar situation is found in the Netherlands. There too, non-profit organizations have adapted their operations in accordance with the requirements of the marketplace. In order to limit the risks, the sector has developed an extensive system of guarantees. Therefore, the adjustment process has been less rigorous than in England. Nevertheless, the guarantee institutions set definite criteria with respect to the way non-profit landlords operate. For that reason, the financial management on the part of the housing associations is becoming increasingly important. The need for sound financial management is reinforced by the privatization wave that has engulfed the sector over the past several years. In its wake, the non-profit housing associations have come to stand more firmly on their own feet than they had in the past.

But a transition is also visible in other countries, such as France and Belgium, where an intermediary organization is in charge of arranging loans that are drawn from the capital market. There too, specific criteria are imposed on the way non-profit landlords operate their rental properties. These criteria are less stringent and the supervision of the organizations is less strict and less formal than in either England or the Netherlands. For instance, the *Caisse des Dépôts et Consignations (CDC)* in France exercises financial supervision over the HLM associations. The CDC reserves the right to audit the management of the HLM associations. If found to be deficient, the CDC can even refuse to extend a loan. In Belgium too, the Housing Societies watch over the financial stability and health of the local building societies.

In Sweden and Germany, the government plays a key role in providing guarantees for loans to non-profit landlords. This makes it even less imperative to operate efficiently, as the commercial interests would like to see. Furthermore, the task of auditing and supervising the social landlords has not been performed expediently in Germany. Once again, this became painfully obvious when the biggest social landlord, Neue Heimat, went bankrupt at the end of the 1980s. Nor has Sweden put much pressure on the non-profit landlords to adapt their management style to please the financial institutions. Thus, it is the national government and the municipalities that have to guarantee the viability of the non-profit landlords. Actually, these institutions are not private organizations --as they are in most other countries in Western Europe. Nonetheless, as municipal housing corporations, they can still be counted as part of the public sector. According to the respondents to the OTB survey held in 1996, however, the financial management and the risk analysis are fully integrated in the operations of the Swedish organizations.

In Denmark, the national government and the municipalities guarantee the loans taken out in the private sector. Therefore, this country has adapted least to the demands of the market. In fact, the Danish non-profit landlords still perceive financial management mainly as a bookkeeping activity. Only the biggest associations have made an effort to integrate their financial management and risk analysis to some extent across their entire organization.

Note

[1] This article is based on the study "Financing the non-profit rented sector in Western Europe", published in the series Housing and Urban Policy Studies. This project was carried out by the OTB Research Institute for Policy Sciences and Technology of Delft University of Technology, in cooperation with the School of the Built Environment of the De Montfort University in Leicester (UK). This cooperation forms part of the Centre for Comparative Housing Research.

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About the author

Peter Boelhouwer is a senior researcher at the OTB Research Institute for Housing, Urban and Mobility Studies, Delft University of Technology. His research focus has been on general housing policy, housing finance and comparative housing research.