

International measures to channel investment towards affordable rental housing: Austrian case study

authored by

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for the

**Australian Housing and Urban
Research Institute**

RMIT Research Centre

on behalf of the

Government of Western Australia

December 2012

ISBN: 978-1-922075-31-4

ACKNOWLEDGEMENTS

This material was produced with funding from the Western Australian Government and the Australian states and territories. AHURI Limited gratefully acknowledges the financial and other support it has received from the Australian, state and territory governments, without which this work would not have been possible.

AHURI comprises a network of universities clustered into Research Centres across Australia. Research Centre contributions, both financial and in-kind, have made the completion of this report possible.

The research was coordinated by Dr Julie Lawson, AHURI RMIT Research Centre, with key contributions from Professor Dr Edwin Deutsch, EOS, Vienna University of Technology, and Mag. Andreas Oberhuber, Forschungsgesellschaft für Wohnen, Bauen und Planen (FGW) Vienna. Julie Lawson is a Senior Research Associate with the AHURI RMIT Research Centre, and is also based in the Netherlands at OTB, TU Delft. She has been researching the relevance of the Austrian model to Australian conditions since 2006. Edwin Deutsch is a housing economist with an interest in the long-term outcomes of Austrian housing policy for generations of households. Andreas Oberhuber is a housing finance specialist who has researched the role of the housing banks and housing bonds in Austria. The case study has drawn on a wide range of sources and the authors are particularly grateful for assistance from the following practitioners, policy-makers and researchers, for their expertise shared in interviews and presentations as well as their published research:

- Dr Wolfgang Amman, Institute for Real Estate Construction and Housing, IIBW
- Mag. Eva Bauer, Federation of housing cooperatives and limited-profit organisations (GBV)
- Dr Margarete Czerny, Austrian Institute of Economic Research (WIFO)
- Mag. Alois Feichtinger, GBV
- Mag. Dr Sandro Forst, Housing and Urban Subsidy Programs, Vienna City
- Dr Wolfgang Förster, Vienna Housing Research, City of Vienna
- Dr Astrid Kratschmann, s BAU Housing Bank
- Prof Dr Herbert Ludl, Sozial Bau AG, Vienna and GBV and ICA
- Dr Michael Ludwig, Vice Mayor of Vienna, Housing, Construction & City Renewal
- Prof Dr Klaus Lugger, Neue Heimat Tirol, GBV and CECODHAS
- Dr Gunther Neuwirth, Bank Austria—Member of UniCredit Group
- Dr Karl Ecker, Bank Austria—Member of UniCredit Group
- Dr Joseph Schmidinger, s BAU Housing Bank
- Dr Andreas Sommer, Federal Ministry for Economics and Labour Affairs
- Dr Karin Wagner, Austrian National Bank
- Professor Dr Michael Wagner-Pinter, Synthesis Research Institute

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ACRONYMS

AG	Aktiengesellschaft –a corporation that is owned by shareholders
AHNRC	Affordable Housing National Research Consortium
AHURI	Australian Housing and Urban Research Institute Limited
BA-CA	Bank Austria–Creditanstalt
BAWAG	Bank für Arbeit und Wirtschaft
BAWAG PSK	Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse AG
BP	Basis Points
BUWOG	Bundesegene Wohnungsgesellschaft or Bauen und Wohnen Gesellschaft mbH–Federal Housing Corporation
CA	Creditanstalt Bank
CECODHAS	Comité Européen de Coordination de l'Habitat Social–European Co-ordination Committee for Social Housing
CPI	Consumer Price Index
ECB	European Central Bank
ENHR	European Network for Housing Research
EU	European Union
EURIBOR	Euro Interbank Offered Rate
FGW	Forschungsgesellschaft für Wohnen, Bauen und Planen–Research consultants for Housing, Construction and Planning
FOH	Federal Office of Housing, Switzerland
GBV	Limited Profit Housing Association
GFC	Global Financial Crisis
GWB	Gesellschaft für den Wohnungsbau–Housing Construction Companies
HCCB	Housing Construction Convertible Bonds
ICA	International Cooperative Alliance
IIBW	Institut für Immobilien, Bauen und Wohnen GmbH–Institute for Real Estate, Construction and Housing
ICRR	Interdisciplinary Centre for Comparative Research in the Social Sciences
LP	Limited Profit
LPH	Limited Profit Housing
LPHA	Limited Profit Housing Association
MRG	Mietrechtsgesetz–Rent Law
RWBB	Raiffeisen Wohnbank Aktiengesellschaft–Housing Bank of the Raiffeisen Bank

s BAU	Housing Bank of the Erste Bank
SWL	Steuerliches Wohnbauförderungsgesetz–Federal Law concerning measures to promote residential construction
WBF	Wohnbauförderung–Housing Promotion Budget
WEG	Wohnungseigentumsgezetz–Law concerning individual home ownership
WGG	Wohnungsgemeinnützigkeitsgesetz–Law on common good housing
WIFO	Österreichischen Institut für Wirtschaftsforschung (Austrian Institute of Economic Research)

EXECUTIVE SUMMARY

This report is part of a research project that has been commissioned by the Western Australian Government. The project reviews international models that use public subsidies and incentives to attract large scale commercial finance to supply affordable housing. This report provides the findings of stage 2A of the research. It has engaged key local experts; interviewed financiers, providers and policy-makers and analysed evidence to assess the effectiveness of private finance in Austria.

Affordable rental housing plays an integral role in Austria's urban housing markets, especially in Vienna. It is provided by limited profit housing associations (LPHs) and cooperatives and municipal housing companies as well as private landlords. The mission of LPH is the provision of affordable rental housing, which is managed cost effectively, ensures assets are used appropriately, limits profit-making and is accountable to key stakeholders. Furthermore, it must compete for sites and subsidies with all potential developers of housing, committed to the principles of limited profit, cost rent housing.

The affordable rental sector plays a positive role in many Austrian housing careers; it is not a stigmatised or residualised tenure, but rather a stepping stone, oasis and launch pad for a chain of housing moves. The sector caters for the young, when they enter the housing market; it also provides a stable home for established households and a refuge during periods of stress. Finally, it caters for the elderly who are attracted by the convenience of compact housing and the proximity of urban services. Austrians do move from the social rented sector to ownership, but they also move back by choice and when circumstances require.

Austria has long pursued a supply orientated housing strategy—yet declining and now untied federal transfers and varying provincial programs may weaken this. Affordability has been promoted by reducing the cost of housing through low interest public loans and grants to ensure appropriate supply outcomes and relies far less on demand assistance than other systems. Today, public loans secure increasing levels of private finance to bridge the gap.

To reduce private financing costs, Austria has developed a unique mechanism embedded in the private banking sector, but making use of regulation and tax incentives. Housing Construction Convertible Bonds (HCCB) are sold through subsidiaries of six competing banks. These special purpose bonds are attractive to purchasers because of their low risk and progressive tax benefits. Funds raised must be channelled towards cost rent developments. This report provides extensive detail on how this works and its outcomes.

The Austrian model has many interesting features of interest to Australian policy. We recommend collaborative investigation of the following:

- Business modelling to determine the nature and level of supply subsidies required to attract stable and low cost finance that will result in affordable rents for moderate income earners, provided under limited profit cost rent conditions.
- The demand assistance required to enable low-income households to achieve access to this housing.
- The capacity of land development agencies to promote a competitive market for the development of affordable rental housing to meet planning goals and housing needs.

- The design of a housing supply bond addressing investor demands, specifying the purpose of raised funds, and incorporating necessary regulatory and taxation instruments.

A genuine interest in cooperation with Australia was expressed by the Vienna Government, the housing bank sector, and the limited profit housing organisations on these issues.

1 INTRODUCTION

Encouraging an adequate flow of investment into the supply of affordable housing in Australia is a major challenge for all governments and for the housing industry. This research project aims to inform the development of policies, institutions and instruments that could promote reliable levels of investment at sufficient volume to address the need for affordable housing by examining a variety of models that have been used successfully by international governments for that purpose.

The project is being undertaken in two stages:

1. Analysis of a variety of mechanisms that are being used successfully to attract private investment towards affordable rental housing in the Netherlands, France, UK, Switzerland, Austria and the US.
2. In depth case studies of the design, operation and performance of the Austrian and UK models (chosen in consultation with the client).

This report addresses the requirements of stage two part A concerning the Austrian model of limited profit cost rent housing that employs public grants and loans combined with low interest commercial loans, raised by tax privileged Housing Construction Bonds. A second case study concerning social housing grant, housing benefit and bank finance in England is the subject of report 2B by Tony Gilmour, Mark Washer and Julie Lawson.

1.1 Approach

1.1.1 Focus

The report concerns the Austrian approach to promoting the supply of affordable rental housing. This approach has many interesting attributes, including its competitive role promoting innovative and affordable housing, its cost rent regime promoting operational efficiencies, and its complementary role of bond financing instruments which extend the capacity of public subsidy programs. This case study builds on and significantly deepens the review provided in Chapter 7 of the stage 1 report.

In this model of housing provision, public grants and loans as well as landlord and sometimes tenant equity are combined with commercial loans to finance affordable rental housing and its renovation. To ensure the lowest possible interest rate on commercial loans, a special bond instrument can be sold in the private banking sector, which offers a tax incentive to investors.

This report focuses on how this mechanism works in practice and its role in supporting the supply of affordable rent housing in Austria. This study focuses upon the role of tax privileged Housing Construction Convertible Bonds (HCCB), which are sold by special subsidiaries of established private banks. These private financial intermediaries have been successfully channelling investment towards the affordable rental sector in Austria since 1993.

1.1.2 Structure

In order to provide a comprehensive description of this system, the following dimensions, requested by Western Australian governments have driven the research strategy of this case study.

- The fiscal, legal, organisational and professional structures and processes developed to allow for private sector investment.

- The structure of financing projects (grants, public loans, commercial loans etc.).
- The cash flows associated with schemes including construction, finance and operating costs, eligibility requirements and allocation profiles, and available demand assistance.
- Portfolio of assets and revenue flows that support the loan obligations.
- The asset management strategies to ensure financial continuity and ensure achievement of social task (cross-subsidisation, tenant equity, let to buy schemes).
- Yields permitted and achieved by investors.
- Key challenges in each scheme—how they have been/could be overcome.
- Outcomes—volume of housing produced, its allocation and its value for government funding.

Every effort has been made to address these issues within the timeframe permitted. The specific qualities of the case study have lent itself to a more integrated approach, with a focus on the role of housing bonds in the provision of affordable rental housing in Austria. The researchers have combined key research dimensions above, where appropriate into their description of the Austria case study—to best communicate the interwoven principles that underlie this system.

1.1.3 Methods

To address these issues, 16 days of research were undertaken in November and early December 2009. This involved the preparation of a contributing report by Dr Edwin Deutsch and Mag. Andreas Oberhuber, drawing on their strategic local expertise in the Austrian housing sector, with a focus on housing finance and housing outcomes. This work was complemented by face-to-face semi-structured interviews with key experts in housing finance, limited profit management, housing outcomes analysis, public finance, and banking research undertaken by Dr Julie Lawson in Vienna in November 2009. A strategic review of literature recent annuals reports, policy statements and evaluative research was also undertaken by Dr Lawson for the preparation of this report. Thus, this final report is very much a collaborative effort, coordinated by Dr Julie Lawson within very tight time constraints.

1.2 A brief introduction to the Austrian housing system and model for promoting affordable rental housing

Austria is a small regionalised federation of nine Länder or provinces, including Vienna, and numerous municipal governments (around 2400). In urban areas, households typically rent apartment dwellings from municipal landlords, limited profit housing (LPH) associations and private landlords. However, in rural areas, detached home ownership predominates.

Unlike many European housing markets, the Austrian system of housing has provided relatively stable and affordable housing conditions and has not experienced major price booms amidst stagnating production levels, unlike many countries in Western Europe (Czerny et al. 2007; Lawson & Milligan 2007). One of the important reasons for this is the role of limited profit rental housing, which has provided cost rent housing to a wide range of households over many decades.

This case study report will focus on limited profit housing, known locally as 'gemeinnützige Bauvereinigungen' or 'common good housing'. This tenure is based on the cost capped, cost rent, limited profit provision of decent dwellings and has become very well established in Austria. It represents a considerable 22.4 per cent of

the total housing stock across the nation and contributes almost half (48%) of all dwellings in Vienna (Rheinprecht 2007). LPH housing is provided by almost 200 associations and municipal housing companies, with an average of 3900 dwellings. Most recently, private developers are also providing LPH. The following subsections provide more detail on the origins, contemporary developments and key providers of affordable rental housing in Austria.

1.2.1 The origins of affordable rental housing and recent developments

The origins of many social housing systems in Europe, with their different institutional structures, markets and forms of governance, stem from a very active period of social reform and upheaval during the late liberalism of the late nineteenth century and early twentieth century. Key housing institutions were influenced by various social movements carried by a broadening electoral franchise, growth and power of health professions, the self-help and cooperative movement, and municipal activism. The relative successes of their efforts were mediated by boom times and depression, Fascism and civil unrest as well as international efforts to rebuild entire national economies and their societies after the destruction of the Second World War. In different ways, these influences cumulatively shaped the social housing systems we have today, defining the nature of property rights, taxation arrangements, flow of savings and investment into different tenures; shaping relations between landlords and tenants, and defining the nature of social housing as narrow targeted welfare or a broader social and economic resource (Lawson 2010).

In Austria, early forms of social renting emerged in the nineteenth century and were mostly driven by charitable or entrepreneurial initiatives. Legal state intervention to attract private capital by tax rebates and incentives started as early as 1865. State assistance to communities and common good providers through the creation of a public loan fund was endorsed in 1910. The allocation policies targeted the working households via various kinds of means-testing. Although most private rental dwellings would not be considered social in today's sense and remained rather poor in quality, it was already well understood that housing policies needed to rely on the appropriate interplay of a range of instruments.¹ This principle remains an important justification of Austrian housing policy today.

Social renting in its modern form emerged with the large municipal housing program of the City of Vienna during the mid-1920s. This was financed by the transfer of specific forms of taxation revenue to a public housing fund. The apartments were designed during a period of innovation in architecture, integrating a much higher standard of dwelling amenities and incorporating a range of collective services for residents unheard of in the era of *laissez faire* liberalism.

Other Austrian cities followed with municipal rental construction on a minor scale. However, it was only after the Second World War that the implementation of the common good sector, synonymous with the non-profit sector or the GBV for short,² paved the way for Austrian social renting as it is known today. Municipal and GBV housing developed in parallel until the 1980s, but—with the exception of Vienna—the dynamics came undoubtedly from the latter. The objective of the GBV was to promote economic welfare with a social emphasis through the supply of affordable rentals for a

¹ An interesting collection of housing laws and parliamentary discussions has been compiled by W. Fuchs and K. Lugger, 'Wohnungspolitische Vorschriften in Österreich 1782-1940', Manz 2008. Of course these are in German, but provide a key source for researching the origins of the Austrian housing model.

² In German. 'Gemeinnützigkeit'. This is a general notion that applies not only to housing providers but also to socially committed bodies of various kinds. To avoid any confusion, we therefore use the acronym GBV that stands for 'gemeinnützige Bauvereinigungen' (common good housing providers).

variety of segments in society, among them public sector employees. Thus, in Vienna, unlike many Western housing systems, there was a shift away from public housing towards the broader notion of social housing.

1.2.2 *The contemporary context*

During the mid-1980s there was a major regime switch in federal-state relations, as housing policies became regionally decentralised, through a constitutional shift of legal responsibility from the federal authority to the Länder (regional) governments.³ In the aftermath, much of the Austrian municipal stock was handed over to the GBV sector, which since that time has undertaken most of the social rental construction and modernisation.

In that development, Vienna took an exceptional role. Being a Länder (province) and a community at the same time, the City did not transfer its municipal stock to the GBV sector, but kept it in public ownership. Today, management, development and modernisation is undertaken by a special agency, *Wiener Wohnen*.⁴ Vienna's municipal stock has grown continuously, with 225 000 dwellings in 2009. The City considers this stock to be an indispensable reserve, and declines any attempt at privatisation, neither on a large scale nor on the micro scale of right-to-buys.

This is in marked contrast to the right-to-buy of newly built non-profit units that was introduced on behalf of GBV tenants in 1993. The right-to-buy largely replaced the previous mode of social ownership construction by the GBV. Since the issue is important, it will be dealt with later on in this study. Otherwise, large-scale privatisation of the existing non-profit stock is uncommon in Austria, and only occurred in 2004 when the Federal Government sold the federal ownership stock to private for-profit institutions.⁵

1.3 The key providers of affordable rental housing

Affordable rental housing plays a strong role in Austria's urban housing markets, such as Vienna. There affordable rental housing is provided by limited profit housing associations and cooperatives and municipal housing companies, and more recently private landlords. In Austria, medium to small social landlords with 200—4000 dwellings, provide housing on a cost rent limited profit regime to a broad range of tenants, including lower-income households. Their mission in the provision of affordable rental housing, which is managed cost effectively, ensures assets are used appropriately, limits profit making, and are accountable to key stakeholders. As mentioned in Section 1.1.2, the limited profit sector is now the primary vehicle for expanding affordable rental housing, using a mixed funding regime of public subsidies, developer and tenant equity, and capital market loans.

Seen from the legal and institutional angle, the Austrian social rentals now consist of two categories:

→ The municipal rentals ('Gemeindewohnungen') owned by non-profit municipal bodies that fall under the general rent law MRG.⁶

³ Austria has a three-tier system of authorities (similar to Germany), federal, regional, communal (Bund—Länder—Gemeinden).

⁴ The special agency 'Wiener Wohnen' is under full control of the municipality.

⁵ In 2004, the conservative government sold some 60 000 units to private real estate companies. The largest sale was the BUWOG (formerly bundeseigene Wohnungsgesellschaft, a non-profit institution created for public employees, today Bauen und Wohnen, while keeping the same acronym).

⁶ The Austrian housing laws split into three categories: the general rent law MRG (Mietrechtsgesetz), the common good law WGG (Wohnungsgemeinnützigkeitsgesetz) and the individual ownership law WEG (Wohnungseigentumsgesetz). Individual ownership in mixed property blocks is further controlled by the

- The non-profit rentals owned by the GBV providers ('gemeinnützige Bauvereinigungen') that fall under the common-good housing law WGG.

The remaining housing categories include:

- The private rentals owned by private landlords, which are either for-profit corporations, limited liability companies or individual landlords. They fall under the general rent law.
- Individual ownership of condominiums (dwellings in multifamily blocks of at least three units, semi-detached homes included), which falls under the ownership law WEG.
- Individual ownership in detached family homes, without a specific law, but subject to the regional laws on construction and maintenance.⁷

The social landlords are corporate-tax exempt. No corporate-tax exemption is granted to the private for-profit landlords.

MEGs (Miteigentumsgesetze), which for reasons of facility management are submerged into the MRG and the WGG, depending on the type of mixed properties. In 1993, the Parliament tried to unify the housing laws, but the initiative failed because the material turned out to be too complex.

⁷ In German 'Bauordnungen'. Curiously enough, every region has its own laws, which apply to any type of housing. The high administrative cost of that regionalised system is under constant debate.

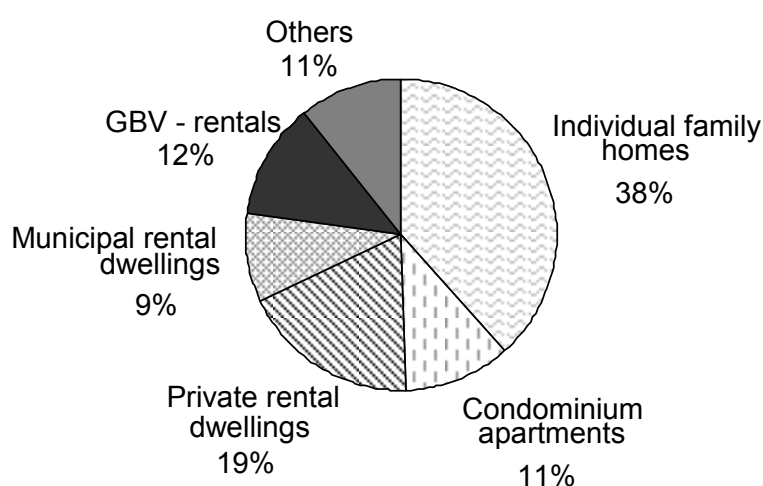
Table 1: Type of landlords and number of dwellings

Type of Landlord	Number of dwellings ('000)	Total social housing	% of rental stock	Total housing stock %
Cooperatives	238			5+
Limited profit companies	267			7+
Municipal landlords	300			9
Social sector		805	57%	(21)
Private landlords	600			20-
Total rental sector	1,405			41%

Source: GBV 2009

The following graph illustrates the Austrian tenure shares in 2003.⁸ In common, the social providers covered 21.2 per cent of the housing market, which is near to the long-run average.

Figure 1: Divisions in Austrian tenure forms 2003



Source: Census survey Statistic Austria, calculations by Deutsch

Returning to social renting, the GBV-sector can further split into two classes of providers:

- The non-profit corporations (gemeinnützige Kapitalgesellschaften).
- The housing associations (Wohnbaugenossenschaften).

The housing associations are an old concept, dating back to the nineteenth century. The basic principle is shared ownership among the interested tenants. Instead, the principle of the common good providers is based on corporate ownership. The idea developed in the aftermath of the depression in 1929 to shelter the companies from boom and bust on the capital markets so they could build up their assets in a smooth and socially committed way. The dominant feature of the Austrian common good housing law enacted in 1948 was indeed the non-profit corporate company, while housing associations continued to exist but were submerged into that law.

⁸ Tenure shares comparable with the past are available only up to 2003, compare with footnote 6.

Nonetheless, important principles of the historic housing associations entered that law, foremost of these were non-speculation, cost-based accounting, restricted asset trade, auditing by special bodies, and decision-making involving tenants (Mietermitbestimmung)⁹ Housing associations can be founded and later be dissolved in the interest of the parties, but in the normal case they are permanent bodies just like the corporations. For that purpose, the associations are usually founded by outside members (various committed social institutions or associations) to protect the inside members (the tenants) against undesired changes in the ownership structure. Tenants in corporate social rentals do not dispose of such decision rights. For a long period, the advantage of the corporations was that they were easier to refinance from the capital market, but since 1993 that problem has been solved for the entire GBV-sector by the creation of the HCCB (Wohnbaubanken). Much of the present study will be devoted to describing the mechanism to channel private finance towards affordable rental housing.

Figure 2: Proposed development, Vienna (City of Vienna/Ludwig 2009)



Figure 3: Existing 1950s limited profit housing in Vienna (Lawson 2008)



⁹ Details are given by H. Ludl, in Lugger and Holoubek 2008.

Figure 4: Recently completed redevelopment of disused rail yards in Vienna (Lawson 2008)



2 FINANCING AFFORDABLE RENTAL HOUSING

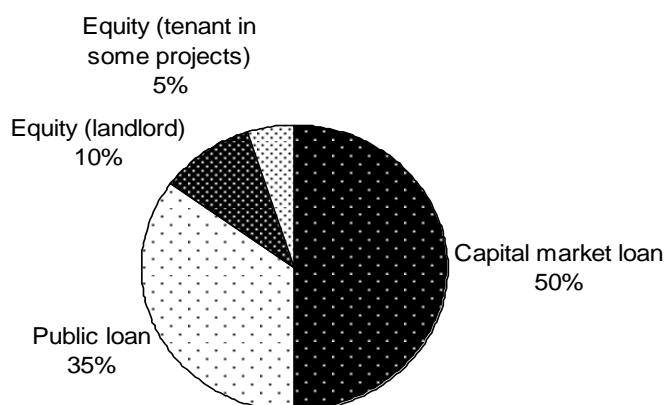
2.1 A supply orientated strategy

In Austria's cost rent regime, affordability is produced by reducing the cost of housing supply and does not heavily rely on demand side assistance to reduce rents. Critical in achieving is well regulated limited profit organisations building cost capped modest size projects (150 square metres). Demand assistance currently plays a modest role in Austrian affordability. It is available for those receiving social security in social and (more recently) private rental housing. A second form of assistance may also be available depending on the type of dwellings occupied and varies across provinces (Amman, Lawson & Mundt 2009).

2.2 Components which finance supply

Austrian affordable rental housing finance consists of a number of different layers as illustrated below in Figure 5. As the funding contribution varies in scale, a typical project is difficult to specify. Nevertheless, the volume of conditional public loans has a strong influence on the volume of affordable rental dwellings supplied. Adjustments to subsidy schemes are closely monitored by developers of rental housing. Tenant equity has become more important to GBV developers over the past 15 years and plays an increasing role in their development strategies. This issue is discussed further in Appendix 5.

Figure 5: Components of financing social housing projects in Austria



Source: Interviews conducted with providers and their representatives

It has been argued that the specific quality of each layer and their interaction contributes in a significant way towards strong performance of the Austrian housing system (Amman, Lawson & Mundt 2009). The following Table 2 specifies in more detail the nature of these components.

Table 2: Typical financing arrangements for limited profit housing projects in Austria

Funding	Characteristics	Typical share of project
Public loan	30 years maturity, with various 1 per cent fixed interest rate	30–40%
Commercial loans	20–30 years maturity, Euribor + 0-30 BP, fixed or variable interest rate	40–60%
Equity of developer	Mostly for land purchase or construction financing (temporarily)	10–20%
Tenant equity	Upfront payment of tenants	0–10%

Source: Adapted from Amman, Lawson and Mundt 2009

2.3 Public loans and subsidies

Public assistance for affordable rental housing is in the form of loans and grants is known as Wohnbauförderungsmittel, the Austrian fund for housing construction and modernisation (WBF). This is funded by a variety of sources. In total, the Austrian assistance budgets oscillate around 2.5 billion Euros. The federal contribution amounts to 1.78 billion Euros fixed in nominal terms, hence in real decline. Around 60 per cent of this sum originates from direct taxes and the rest from a duty taken from wages.¹⁰ Combined, the Austrian Government spends approximately 0.9 per cent of GDP to achieve its housing goals, which is mid-range in terms of European levels.

Housing budgets are endorsed for five years by agreements between the Länder and the Federal Government. Nearly 75 per cent of the total budget is refinanced from the federal authority with the remainder covered by regional sources. These include the repayment from public loans, certain local duties and, in case of strong demand, the Länder makes a direct contribution from its own budget. In times of excess demand, the Länder authorities adjust the housing assistance budget to the expected demand.

WBF is characterised by a variety of instruments and channels. In that way, it services different dwelling types and housing needs. These funds are dedicated to a range of housing objectives: social solidarity by the promotion of decent housing reducing housing costs and thus wage demands, economic growth and stability of labour markets, particularly construction, and most recently improvement of housing quality and thermal protection to reduce the emission of greenhouse gases. Promotion of these objectives has occurred through public loans and subsidies for the construction and renovation of housing; preferential public loans to enable individuals to raise funds to purchase a dwelling, mortgage interest relief for home purchasers, and specific funds for housing rehabilitation and renovation (Lugger 2007, p.62).

To finance new dwellings and their renovation, each province designs subsidy schemes reflecting local policy preferences, providing long-term low-interest public loans with various conditions and target groups that differ across the provinces. Typically, these loans begin with very low rates of interest and gradually grow in predictable steps over time. In turn, loan repayments and interest are reinvested into revolving funds for housing purposes in the provinces.

Various sources of taxation revenue and contributions are dedicated towards subsidisation programs for the refurbishment of older dwellings and the development of new residential buildings (92%) and a small budget for demand assistance (8%).

¹⁰ In German 'Wohnbauförderungsbeitrag'

Non-profit developers also benefit from corporate tax exemptions, as do purchasers of housing related bonds. However, accounts estimating these indirect subsidies are not available.

Provincial governments rely on a range of sources to supplement federal transfers, including the repayment of public loans, certain local duties and, in case of strong demand, the government allocates a part of its own budget to the task. In this way the Länder authorities adjust the housing assistance budget to the expected demand—which largely comes from municipalities and the GBV sector. However, their tendency to do so varies across the country, some governments strongly support affordable rental housing and others the promotion of home ownership. Some regions are very responsive to developments in the housing market and carefully adjust the size of their programs to promote stability and prevent either over or under supply.

It is important to note that while the Länder design housing programs, they do not implement these themselves. Rather, they are carried out by local authorities and driven by the GBV's commitment to develop new dwellings. Thus, the housing subsidy system is quite decentralised and demand driven. Furthermore, competitions conducted between proponents aim to promote development according to local planning and housing objectives. These competitions can be a mechanism for improving environmental quality, promoting socially inclusive design, encouraging innovation and transparently reducing costs, as is the case in Vienna. In this sense, the Austrian subsidy system is demand driven and in major urban areas promotes a very unique form of competition between both private and GBV developers.

Many of the dwellings in Vienna require renovation to meet modern standards of comfort and energy efficiency. Public loans and subsidies provided by the City can be used for renovation as well as new construction to meet these standards.

Figure 6: Renovation of older apartments in Vienna (City of Vienna/Ludwig 2009)



Figure 7: Nominal Austrian public revenue for housing promotion 1996–2008

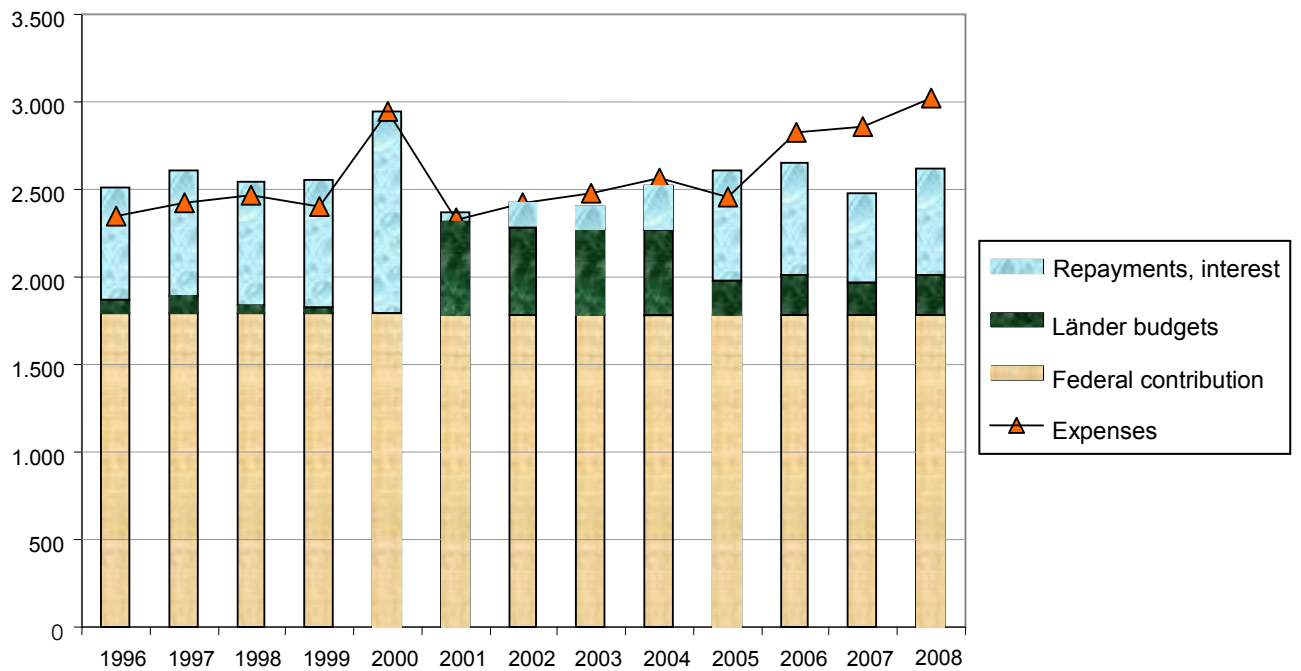
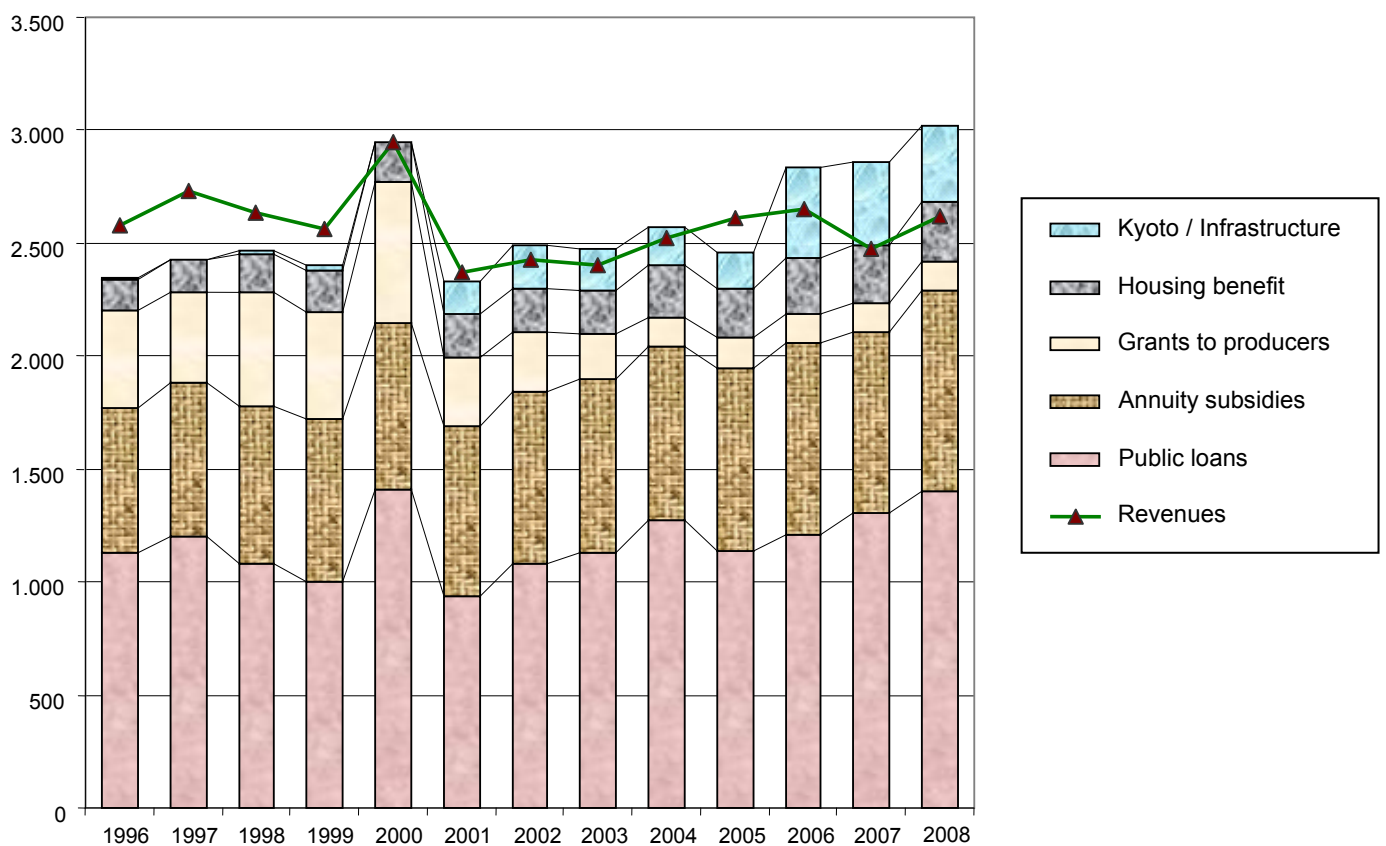


Figure 8: Nominal Austrian public expenditure for housing promotion 1996–2008



Sources: Figures 7 & 8: Subsidy reports of the Länder, Ministry of Finance, FGW

It is estimated that around 80 per cent of all subsidy expenses are producer subsidies; the remaining 20 per cent are demand-side subsidies and means-tested benefits. However certain production items, such as interest subsidies, are subject to strict means testing. Further, subsidies for the development of homes for ownership in regional towns and rural areas are granted to lower-income households, and can therefore be considered as demand-sided subsidies. As seen from the graph, the subject-benefits in the strict sense expanded gradually, with the objective of preventing the regressive effects that occurred in the past.

2.3.1 Recent directions in public subsidies

Since 1988, the Austrian Federation has been undergoing a period of devolution leading to potential decline and differentiation in provincial housing programs. Over the past decade, the Austrian housing assistance budgets (WBF) have oscillated around €2.5 billion (\$AU 4 billion).

The flow of Federal Government tax revenue for housing programs was capped between 1996 and 2008 at around €1.78 billion (\$2.8 billion), hence a decline in real terms. Repayments on loans and provincial contributions have become increasingly more important, but inadequate to maintain budget levels to meet expenses (Figures 7 & 8). This has necessitated an increasing role for private finance in order to meet the demand for affordable rental housing. Fortunately, the potential cost effect was mitigated by falling interest rates on borrowings over the same period.

The jump of repayments and expenses in 2000 does not arise from a specific housing program. In order to escape the Maastricht rules that would raise the total deficit, the Länder authorities counted the present value of expected repayments already in 2000. Once again, it should be noted that the figures given in the graphs above are all in nominal terms. In real terms, at 1996 prices, the values in 2008 are only 80 per cent of the nominal ones. For this reason, the support of the HCCB loans and other types of low interest private loans, have become even more important.

Recently, the Federal Government untied revenue transfers for housing programs, allowing provincial governments to allocate revenue towards non-housing expenses. This autonomy is likely to influence the level and focus of regional housing programs and key stakeholders are monitoring developments closely. While Vienna has sustained and recently increased its efforts, several other regions (Styria, Corinthia) may withdraw from housing promotion.

However, since 2008, provinces have received relatively unconditional transfers from the Federal Government, but they nevertheless must achieve self-defined benchmarks of housing outcomes.

The response of the Austrian Government to the Global Financial Crisis (GFC) via its housing budgets has been modest, partly because problems in the housing market were not perceived to be large, despite the demands of the GBV sector. This matter is discussed in Section 8 concerning contemporary challenges to the system.

2.4 Private sources of funding

In addition to conditional public loans, social landlords must increasingly access private funds, such as their own equity, tenant equity or debt finance. However, they are subject to strict maximum rent levels, which contain overall project costs—including financing costs. This forces promoters of new projects to seek the most efficient and cost effective mix of finance.

Private finance, assisted by the establishment of the tax-privileged bond finance circuit delivered by nominated banks, has been targeted to limit profit cost affordable

rental housing developments (LPHA) since 1993. The use of tenant equity to finance projects increased over the past two decades in more expensive cooperative housing developments. There have also been broadly unpopular experiments involving the privatisation of public housing. However, strong LPHA regulations, concerning the tie up of housing assets and political opposition to privatisation have mitigated against further transfer of social stock out of the public sector. Today, there remains a sustained focus on the cost rent model of cost capped affordable rental housing provided by limited profit housing associations in Austria, however direct provision of municipal housing is only common in Vienna.

3 THE REGULATORY ENVIRONMENT

3.1 The legislative framework

As mentioned earlier, Austria is a Federation of nine provinces, which must share resources and cooperate in order to deliver key services to the populous. Responsibilities relating to housing promotion are allocated across this structure of government, as described by IIBW (2008) and Bauer (2004).

The legislative and regulatory framework defines the market rules and influences the competitive environment in which affordable rental housing is provided. For Austria, this regulatory regime defines the:

- Realm of permissible activities, which restrict them to limited profit cost capped housing on moderate but adequate standards.
- Rules for setting rents and the principles of rent contracts.
- The compulsory re-investment of profits into construction and renovation.
- Limits on administration costs, including income ceilings for managers.
- Interest limits on financing provided by the capital market.
- The decision-making and management process that involves tenants.
- The auditing of LPHA, reporting requirements, as well as enforcement options (Ludl 2004; Amman, Lawson & Mundt 2009).

The legal environment affecting the provision of affordable rental housing in a Federal system has been described by Bauer (2004) and most recently by IIBW for the Federal Ministry of Economics (IIBW 2008, currently in German undergoing translation 2010).

The role and responsibilities of the Federal Government ministries, and the provincial and municipal governments is outlined in Table 3.

Table 3: Allocation of housing related responsibilities across the Austrian Federation

Federal government	Provincial government (9)	Municipal government (2378)
Ministry of Economics, responsible for international representation related to housing policy and the law on limited profit housing.	Design of and contribution towards programs relating to the promotion of housing policies.	Building law. Planning regulation.
Ministry of Justice, responsible for the Rent Act and the Home Ownership Act (also concerning decision-making on condominiums).	Implementation of the law relating to the limited profit housing.	Policies on the use of land and its allocation for housing purposes.
Ministry of the Environment, responsible for climate arrangements, together with provincial governments.	Together with the Ministry of the Environment, implementation of the climate programs.	Policies on the allocation of subsidised dwellings.
Ministry of Finance, responsible for tax law and jointly with provinces determines the equalisation of tax revenue distribution between the provinces and formerly allocated specific funds for housing programs.		

Source: Adapted from IIBW 2008

We now turn to specific forms of regulation affecting the supply and demand of dwellings.

3.2 Supply side regulations

3.2.1 Role of planning and land policy

Land banking strategies and urban planning policy play an integral role in affordable housing development and there is a legal obligation for municipalities to find suitable development sites for housing. For many decades, Vienna has promoted affordable rental housing developments not only through planning policy but also by playing a strong role in the land market; channelling grants and loans to specific housing forms on suitable sites; and, since the 1990s, promoting more direct competition between developers for available sites in order to maximise public outcomes.

Vienna's urban strategy plan specifies a commitment to building 6000 dwellings annually until the year 2020. The rationale for this is provided in their Strategic Plan:

- A wide variety of housing types would make Vienna even more attractive as a residential location—also for new residents.
- Equilibrium between supply and demand promotes affordable prices—also in historic buildings.
- Urban renewal, urban enlargement, and inner urban development should be carried out in parallel. The concept of soft urban renewal should continue to represent a focal point for housing policy in addition to the necessary construction of new residential housing.
- Urban areas require a meaningful mix of uses for residential and economic purposes. In newly settled areas, it is crucial to have a minimum share of housing units.
- Residential construction secures jobs in Vienna (City of Vienna, 2005).

Furthermore, the Strategic Plan also specifies its commitment to affordable housing in higher land value areas:

To continue guaranteeing affordable housing in Vienna up to contemporary standards, an adequate supply must be ensured through the construction of subsidized housing units; otherwise it might not be possible to satisfy demand for affordable housing. Based on current projections of demand for housing, a plan was adopted to build some 28 000 subsidized housing units over the next five years. There are also plans to subsidise the construction of housing units in the older Gründerzeit districts. Even though property prices are higher in these districts, it is possible to use the existing infrastructure and encourage a social mix. (City of Vienna 2005, p.43)

In addition to land use regulation and conditional loans for affordable rental housing development, Vienna has played a strong role in the urban land market, driven by a commitment to reduce land costs and prevent speculation that could impede quality, affordable housing outcomes.

This role emerged with the reaction to speculation in the housing market and the property collapse in the early twentieth century, and was revised during post-war efforts culminating in the establishment of a land bank Wohnfund in the 1980s.

As mentioned above, competition between developers is also an important goal of the City. All development proposals on Wohnfund sites are submitted to competitions or Bauträgerwettbewerbe and publicly assessed by an interdisciplinary jury. The jury assesses planning qualities, costs of construction, the rent level guaranteed by the developer, future maintenance costs and environmental sustainability (building materials, energy consumption). The Vienna Government claims that developer

competitions have been able to achieve considerable improvements in the energy rating of dwellings, the quality of open space and communal facilities and improved cost efficiencies by 20 per cent through intensified competition.¹¹

3.2.2 Taxation and the social task of LPHA

The social task of LPHA is defined in the Limited Profit Housing Act concerning the compulsory reinvestment of its own funds for limited housing activities, the setting of rents according to cost rent principles, and adherence to public supervision and auditing processes. For these tasks, the LPHAs are exempt from corporate tax. LPHA are also able to undertake for profit housing activities, including commercial space in developments or social facilities. These activities are subject to corporate tax and appropriate government approval must be sought to construct non-housing facilities, such as kindergartens and schools (Lawson & Elsinga 2008).

3.2.3 Conditionality of public loans and subsidies

The Austrian housing assistance system is characterised by a variety of instruments and channels so it can adapt to different dwelling type and housing needs. New construction is highly influenced by extensive, mostly supply-side, housing subsidy schemes, designed by regional governments (Czerny et al. 2007). These programs vary across the country to respond to local housing needs and priorities.

The subsidy authorities deal with the compliance of GBV-companies with the subsidy rules. They audit the cost estimates and final bills, that is, the construction cost including extra cost (equipment, service units and the like) within the prescribed ceilings, and they check the correctness of rent settings. More information on this is contained in Section 3.2.4.

3.2.4 Auditing and compliance with regulations

LPHA are both self-audited and publicly regulated. An umbrella organisation audits and regulates individual associations and represents them in negotiations with the government, while regional governments also act as external supervisors. This arrangement improves the creditworthiness and, importantly, the financial rating of the sector (Czerny et al. 2007).

Auditing is performed by various bodies inside and outside the GBV-sector. Essentially, the bodies are:

- Internal control by departments of the company.
- Auditing and control by the Revisionsverband, a special body within the umbrella organisation of the GBV-sector.
- Auditing by the supervision departments of the Austrian Länder.
- Project auditing carried out by the subsidy authorities of the Länder.
- Reviews by courts in specific cases.

There are general tasks of auditing that concern all the bodies listed above. The most important issues are tenant's protection with regard to prices and rents, the quality of rentals supplied, and tenant protection against undesired or unlawful management activities.

Other issues concern either a single body, or they concern two or more of them, which is the usual case. For example, tenant protection against unjustified notice is both a

¹¹ A description of this process is available in English on web site <http://www.wien.gv.at/english/housing/promotion/pdf/socialhaus.pdf>

case for internal control and for an outside court. Many cases are much too complex to be illustrated in this study, so we confine ourselves to the main tasks of the Revisionsverband and the public authorities.

The Revisionsverband audits, among others, the finance and the cost-adequacy of green land or urban brownfields, then the correctness of calls for tender and awards of contract, and the observance of cost-based calculation and utility regulations. The reports of the Revisionsverband must be delivered to the supervisory authorities of the Länder, who have the right to order additional checks. In case of faults, they can set sanctions (removal of faults, withdrawal of public assistance and, in the worst case, dispossession of the GBV-status).

The subsidy authorities deal with the compliance of GBV-companies with the subsidy rules. They audit the cost estimates and final bills, that is, the construction cost including extra cost (equipment, service units and the like) within the prescribed ceilings, and they check the correctness of rent settings. A special commission is endowed to state the 'users value' of the dwellings in a given block, and to determine the number of units that the authority withholds for allocating low-income or high needs households. The commission gives the permission to differentiate the rents according to quality and location within the block, within certain limits. That procedure enables some cross-subsidisation to make the allocation of low-income households feasible. In case of non-compliance, the subsidy authority has the right to decline or to recall the granted subsidies.

3.3 Demand side regulations

3.3.1 Cost rents

Austria has developed a strong and stable regulatory system based on the delivery of cost rent housing to a broad range of households, supplemented by demand assistance for those households unable to pay for decent housing. National legislation (Limited Profit Act & Promotion Act) outlines principles for the setting of rents according to the goal of cost coverage.

Cost rent involves the establishment of a maximum and minimum allowable rent, related to the original cost of land and construction, the age of the building and the dynamic financing costs of the project. Landlords can lower base rents by reducing component costs of land, finance, construction, management and maintenance by obtaining land at the lowest possible price, bringing their own equity, accessing low cost loans, and applying for subsidies and public loans, capping project management and construction costs, using cost effective building techniques and innovative designs that meet decent home standards; and ensuring cost efficient management of the associations and their building assets. National regulations also specify the requirements for periodic maintenance and timely repair of dwellings as well as the renewal of dwellings over longer time periods (e.g. new kitchens and bathrooms). If these investments are not made, tenants must be reimbursed by lower rents. Finally, the LPH Act allows for a 2 per cent margin above cost rents during the repayment period, which must be reduced to 0 per cent when these outstanding costs are reimbursed (Bauer 2004, p.45).

It is interesting to note that management costs are limited to a charge per unit, calculated in rent and indexed to CPI. This functions as an incentive for associations to deliver the most cost effective form of management in order to be able to generate a small surplus to be used as equity in new projects. There are income limits and benchmarks for managers, which from time to time are the subject of discussion. Their incomes are linked to the size of the organisation, with an additional margin for

the number of subsidiaries that must also be managed. The upper limit norm is 50 per cent above the highest paid civil servant.¹²

3.3.2 Eligibility and allocation requirements

Unlike social housing sectors in other countries, Austrian Limited Profit Housing is not only for households with a low income, but includes the broad middle class. Indeed, subsidised housing is not perceived as a mechanism to redistribute housing outcomes and ensure access for the poor. Rather the promotion of Limited Profit Housing aims to ensure quality housing is produced at a moderate price that will meet demand and not inflate wage demands. Rather than target low-income households, social housing is typically available to low and middle income households. Further, subsidies are available to any complying developer, public or private. This is justified on the basis that subsidies are considered an equity substitute in exchange for profit restricting conditions (cost rent, size limits & investment returns) and ensure that such stock is supplied and upgraded as required (Deutsche, personal communication 2007).

Further, cultural norms promote the saving and investing of one's own equity in housing, whether this is for rental or ownership purposes. Even access to subsidised rental housing is often conditional upon the contribution of one's own equity, typically calculated as a flat rate per square metre, which is partly returned by the provision of affordable housing and partly considered a contribution to the overall subsidy system. Those not able to provide their own equity can receive a loan at zero interest rates, in order to pay their equity component.

Nevertheless, public assistance for housing typically comes with conditional income limits for both tenants and owner occupiers. There are formal income limits for access to social housing, but these are high enough to cover 80–90 per cent of the population (Reinprecht 2007, p.39). Municipalities can create their own allocation schemes and provide special emergency dwellings for households in imminent danger of homelessness, mostly within the municipal housing stock. Typically, this housing caters for households with incomes below 6th income deciles (Amman, Lawson & Mundt 2009).

Where municipalities provide land, they may require the right to nominate future tenants. In Vienna, for example, the municipality arranges 25 per cent of tenants through its Housing Service. Specific projects may also aim to address special housing goals and needs, such as promoting ethnic inclusion, combining residential and working spaces, or offering low energy no-car lifestyles. However, the main factor determining the affordability and accessibility of housing for different household types is the founding financial arrangements and rent regulation.

As a result of these broad eligibility criteria, Austrian social housing avoids the risks associated with residualised and vulnerable tenancies in more welfare-orientated systems. Nevertheless, municipal housing companies are more orientated to those unable to afford cost rent housing; hence applicants are subject to income limits and ranked according to need.

3.3.3 Demand side assistance

Unlike neighbouring Germany, the UK and the Netherlands, demand assistance is not the core mechanism of affordable housing policy in Austria. Lower-income households can receive means-tested rent allowances, yet in total this amounts to only 8 per cent of the national housing budget (about €200m). Nevertheless, a drift towards more

¹² Confirmed in interviews with the GBV.

widely available demand assistance is certainly occurring in Austria, albeit from a low base.

Means tested rental allowances and subsidised loans and grants to purchase (also a form of supply subsidy) primarily aim to improve affordability for low-income individuals but are not integral to the financing of LPHA supply (as in the UK). According to Kofler (undated, p.3), three major types of allowances are available:

- Housing allowance (*Wohnbeihilfe*) increases in importance across Austria and functions to balance the effect of the overall decreasing funding rate for low-income households. It tends to have a cumulative effect as it is granted only to residents dwelling in 'object-funded' housing in most federal states.
- In addition, rent benefits (*Mietbeihilfe*) are paid by the Social Welfare authorities to tenants whose rent causes their disposable income to be below the Social Welfare threshold.
- The Ministry of Finance grants rent allowances (*Mietzinsbeihilfe*) to tenants whose rent has been disproportionately raised. Other types of housing-related allowances and benefits vary across provinces.

Furthermore, income eligible tenants can receive a zero interest public loan towards their equity contribution in LPHA, to assist with costs of establishing a tenancy.

4 THE BUSINESS MODEL OF AUSTRIAN LIMITED PROFIT HOUSING

4.1 Organisations for the common good

Non-profit organisations, which are admitted to perform common good activities within the laws and decrees of the WGG (Law on common good housing Wohnungsgemeinnützigkeitsgesetz) are regulated in strategic ways. Being subject to the general entrepreneurial law that regulates the business activities, the GBV (Limited Profit Housing Association) have to subordinate their activities to the prescribed business targets, company organisations and auditing rules within the special regulations of the WGG. The overarching goal is the fulfilment of socially agreed welfare targets and the provision of housing to individuals in housing need.

Concerning the role of profit, the GBV can be considered as limited rather than non-profit. Under the principle of cost-based pricing, the GBV must comply with the rent- and price ceilings that are imposed by the subsidy authorities, such that the net operating income (after allowing for maintenance and administrative cost) is only sufficient for the fulfilment of future tasks. This directly concerns the amount of available liquid or near-liquid reserves and the interest earned on financial assets, together with the choice of appropriate portfolios to earn interest on reserves under limited risk.

To achieve these goals, a variety of regulations have been implemented in the WGG:

- The principal objective of profits is the internal refinancing and stabilisation of equity.
- Distributed profits to the GBV-owners are limited, as the return on injected capital must not exceed an administered interest rate level.
- Speculation on the company value is prevented as shareholders that leave the company recover (at most) their injected capital plus administered compounded interest, but not more; the same holds true in case of liquidation of a company.
- Mergers of GBV-companies with non-GBV companies are unlawful, holdings or partnerships with non-GBV companies are feasible but limited.
- The GBV-employees are not permitted to perform outside activities in the housing or construction sector, the salaries of top managers and other employees must not exceed some administered ceiling.
- The reserves out of profits have to be reinvested within five years, which is the time horizon set by law up to which the company has to undertake reinvestments into new residences or in modernisation.¹³

The GBV are subject to regulative principles. In the WGG-law, these principles are classified into four groups, cost-based rent setting, cost of capital services, cost of maintenance, and equity formation. These principles are described in the following subsections.

4.1.1 Principle of cost based rent setting

The GBV are obliged to set adequate rents. These rents must not exceed the level necessary for management and construction, together with a return to undertake future projects. The rent components are listed in a catalogue of admissible items.

¹³ In German 'Bauzwang', that means coercion to continue with residential construction.

The rent ceilings set by the subsidy authorities are tight, but the authorities expect that the GBV can operate within these ceilings.

In practice, the limits are achieved by choosing cheaper sites in less preferred locations. Amidst fluctuating construction costs, architects must constantly adapt and innovate in order to deliver the quality standards required by the Lander and meet cost rent and cost price limits. In some cases it is possible to deliver a higher level of amenity, but facilities such as swimming pools etc. are typically in high-volume projects.¹⁴

Initial rents define a rental cost per square metre that can be increased each year with CPI, and revenues should be sufficient to repay the annuity of the capital market loan as well as the interest on the public loan. When these are repaid, rents can be lowered. Typically rents are fixed annually and balanced at the end of the year, with tenants either receiving a return or making additional payments to cover financing and operating costs.

4.1.2 Cost of capital services

The cost of capital arises from the financing portfolio of the residential unit. Firstly, they consist of the annuities of the loans in the financing portfolio. Secondly, the equity of the developer (share in the acquisition of plots, equity injected for construction) can be remunerated with adequate interest. Since 1999, the interest ceiling amounts to 3.5 per cent per annum. In situations of tight capital markets with high secondary market rates the ceiling can rise up to 5 per cent maximum. Alternatively, the developer can offer upfront down payments to the entrants. Upon termination of a rent contract, the down payments for construction are refunded to the tenants, although linearly devalued with 1 per cent deduction per annum. The down payments for the plot are refunded at market values upon entry. These rules normally entail real losses and are considered in more detail in the section on right to buy in Appendix 5.

4.1.3 Cost of utilities and maintenance

There are extra cost components that do not form part of the cost-based rent from finance or 'cold rent', but add to the cold rent to total the 'gross rent'.¹⁵ They include the cost of utilities that the GBV have to calculate at true purchasing prices. For servicing, the GBV are allowed to impose lump-sum administration costs that are prescribed by law. For maintenance and improvement, the GBV are permitted to raise lump-sum amounts, depending on the square metres and age of the building.¹⁶ These items have to be used up within 10 years; otherwise they must be repaid to the tenants, appropriate interest included. The GBV are obliged to report the bills to the tenants.

4.1.4 Ownership of assets and share holdings

LPHA equity and assets must be dedicated towards housing and related tasks. Income from equity, which is not used for this purpose, is subject to corporate tax if not used for affordable housing within five years.

In the recent past, privatisation has threatened the existence of publicly-owned housing companies. Several were sold by the Federal Government, which exempted itself from legislative requirements, and the proceeds of the sale were used for other

¹⁴ GBV interview notes.

¹⁵ Cold rent: in German 'Kaltmiete'. The total of cold rent plus the cost of utilities and maintenance is called the gross rent or 'Bruttomiete'.

¹⁶ In German EVB: Erhaltungs-und Verbesserungsbeitrag.

public priorities. It is neither legally possible nor commercially attractive for the LPHA to be stripped of its assets. By law, the shareholders of such organisations can only receive their initial contribution and the use of dividends is highly restricted to limited profit affordable housing investments. In this sense, the assets belong to the association and not to the individual shareholders.

The sale of affordable dwellings has been a legitimate role for some non-profit housing associations. There is also a growing rent to buy segment of the market. Indeed, co-financing tenants do have the right to buy their LP apartments after 10 years. However, in practice this has not been popular among social landlords, where multiple ownership within residential buildings is considered troublesome and inefficient. According to Bauer (2004, p.46), such tenants are returned their initial contribution in the form of a reduced sale price. However, there is much debate over the model for assessing the sale price of the dwelling and concerning the claw back of public subsidies, the method for calculating the value of the dwellings and consideration of rent paid (see Appendix 5).

4.1.5 Equity formation

The law commands a profit margin of 8 per cent on the company's equity. Within the rent ceilings of subsidisation, such a margin cannot be achieved from new projects alone. Instead, it can be achieved by GBVs that dispose of a mature rental stock, for the following reasons. Mature means that the loans have been repaid, so that the rents are set at some lower cost-based level. Now, over a certain period after the annuities expired, the Austrian GBVs are permitted to continue with the initial cost-based rent, which allows for larger profit margins. After that period, the cold rent has to be reduced, but even then there is some leeway to comply with the profit margin rule. In practice, the effective yield varies between 5–20 per cent. Because the GBVs are often specialised into certain types of projects, the necessary reserves vary as well, so that no meaningful benchmark can be given.

However, it should be noted that the commanded return on equity refers to the balance, but it says little about the actual state of liquidity. If the returns are reinvested immediately and frozen in real assets, the liquidity remains limited. To overcome that problem, the law permits GBV to accumulate liquid reserves up to 2 per cent per annum of the refinancing items. The reserves have to be injected into new projects within a time horizon of five years.

Another opportunity to improve the equity base is through tenants contributions towards their right-to-buy (see Appendix 5).

In such a system, specialised auditing is an essential task and is performed by various bodies inside and outside the GBV-sector.

4.1.6 Limitation on profits and definition of construction constraints

LPHA undertake housing activities that are limited in terms of the size of dwellings (150 square metres) and their quality standards, as well as limits on the cost of managing, planning, building and administration (Bauer 2004, pp.42–43). Other building activities can be undertaken, such as the building of kindergartens etc., but must be approved by the relevant public authority. Income ceilings for managers are defined, as well as cost limits for administration, planning and building. Profits are limited to 8 per cent and there are restrictions on the interest received from the LPHA's own funds. As mentioned above and in the previous section, there are a range of decrees under the *Limited Profit Act* that regulate the operations of the associations:

→ Auditing guidelines for LPH.

- Cost caps for providing accommodation affecting planning, production and management costs.
- Rules for proper business conduct.
- Balance sheet provisions, detailing how accounts should be prepared and presented (Ludl 2004, p.3).

As outlined above and in Chapter 3, housing associations are audited according to the decrees issued under the *Limited Profit Act*, concerning their management efficiency and investment strategies. A significant part of the work of the national Federation of Limited Profit Housing Associations (GBV), of which membership is compulsory, concerns financial supervision. The GBV employs 40 qualified accountants, specially trained to audit non-profit organisations and cooperatives. Every year they generate a financial report on each LPHA that is delivered to the relevant provincial government for approval. Any LPHAs that fail to reinvest its profits in new production, are obliged to merge with another LPHA.

Supervision of municipal housing is undertaken by the Federal Government's Audit Commission (Rechnungshof) and, in the case of the Vienna municipal housing supervision, by the Vienna Lander, City of Vienna Control Department. It is subject to the requirements of the *Rental Act*, not the *LPHA Act*, and, where subsidised, the *Promotion Act*.

4.2 Putting the regulatory and financing processes together

4.2.1 The financial and regulatory relations of provision

The following flow chart (Figure 9) describes the financial and regulatory relations between key players in the Austrian affordable rental system: social tenants, housing providers (GBV), financial institutions and regulators to provide an integrated overview. The chart incorporates the eligibility and application process, which may involve down payment for right to buy, and the payment of initial cold rents and eventually mature rents upon repayment of debt and the build-up of reserves. The development process of planning, site acquisition, financing, and construction as well as revenue management is also outlined for social providers. These processes are mediated by the actions of external financial institutions, regulatory and supervisory bodies, involving approval of the planning commission, meeting conditions attached to public loans and HCCB loans, and auditing standards of the GBVs auditing association Revisionsverband and public bodies, such as the Lander.

Figure 9: The key players and their financial relations of the limited profit housing promotion

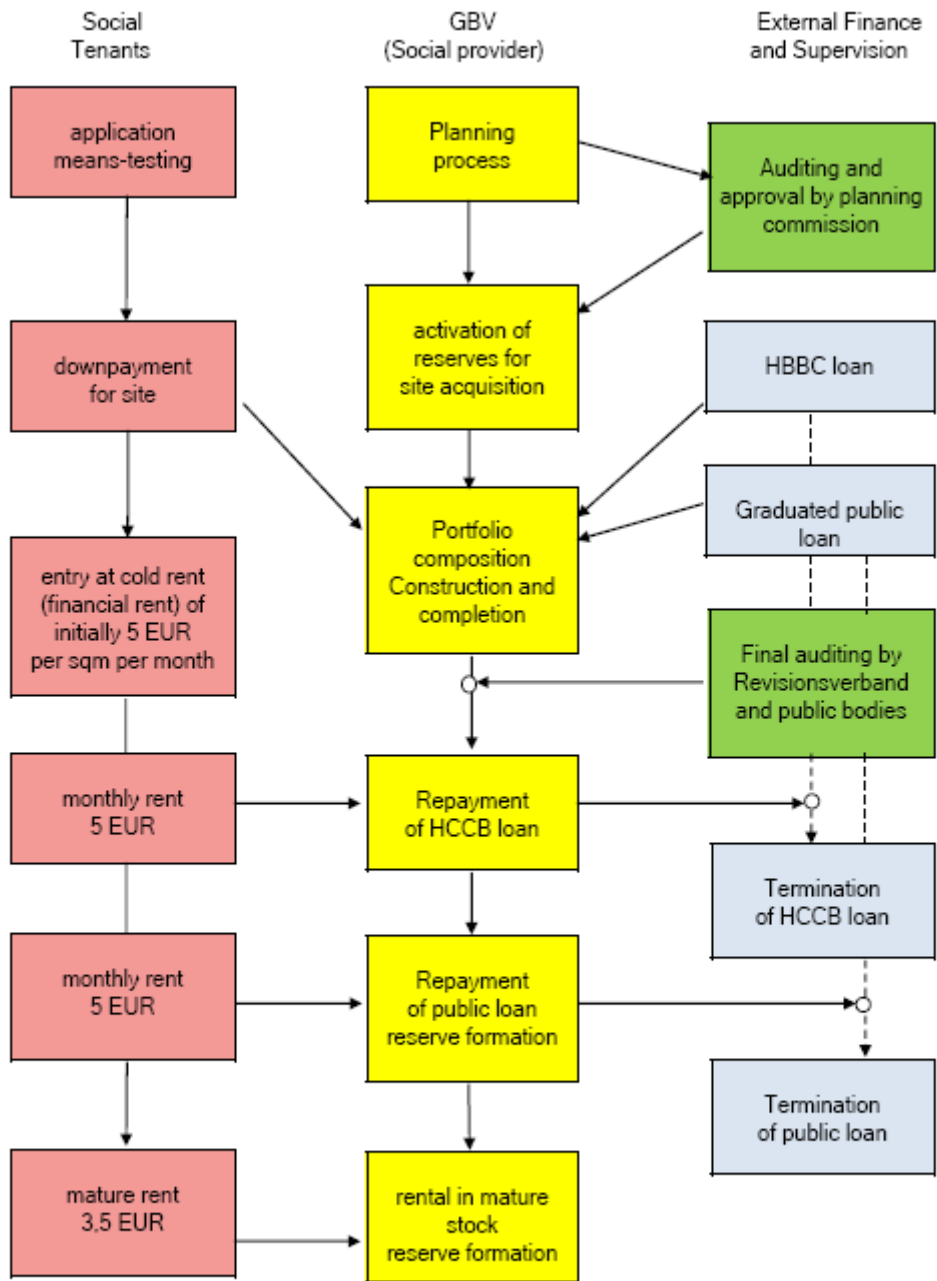


Figure 10: Completed developments at the former cable works site mixed tenure, mixed use neighbourhood involving several LPHA developers in Vienna (Lawson 2008)



Figure 11: The redevelopment of the Gasometer towers in Vienna, shopping complex with a variety of housing tenures (Lawson 2008)¹⁷



¹⁷ For detailed information on the gasometer project see http://www.cse.polyu.edu.hk/~cecspoon/lwbt/Case_Studies/Gasometer_City/Gasometer_City.htm. For an historical photo essay of social housing in Vienna, go to <http://www.demokratiezentrum.org/index.php?id=453&L=1>

5 ASSET MANAGEMENT OF HOUSING PROVIDERS¹⁸

We now turn to the practice of affordable rental provision, taking a closer look at the tasks of social landlords and the relationship between financing arrangements, asset management policies and housing outcomes.

In Sections 5.1–5.6, the activities of two housing providers based in Vienna are outlined demonstrating the diversity of portfolio, allocation and sales policies. Section 5.6 takes a closer look at the assumptions underlying cash flows and project development.

5.1 General characteristics of the selected organisations

Vienna's affordable housing stock is provided by municipal housing companies and limited profit housing associations, illustrated by the following examples. Wien-Süd is a well-established, medium-sized and innovative Building and Housing Cooperative (1910) that primarily provides subsidised rental and ownership apartment and row housing in the South of Vienna, but also Upper Austria (Berndorf), Burgenland (Eisenstadt), and Upper Austria (Linz). It has a total of 23 000 units in 46 municipalities, via a complex of cooperative holding companies that vary from 100–2500 dwellings in size. Sozialbau was established in 1954 as a public housing company with social democratic roots, engaged in the post-war reconstruction, mass building provision, and later dwelling improvement and building renovation for the City of Vienna (Sozialbau AG 2004). It is now the largest landlord in Austria, with 40 000 rental dwellings and 7000 for ownership, and provides arms-length operational services in development, renovation, administration and tenancy for smaller service level cooperatives and companies. Both organisations are governed by tight rules governing the use and ownership of assets and re-investment of profits for housing purposes.

5.2 Portfolio policy

Wien-Süd aims to develop, renovate and renew high quality affordable quality dwellings in attractive living environments both for rent and for rent with option to buy or purchase (Wien-Süd 2007). It also facilitates the provision of social infrastructure on a non-profit cost basis, such as schools and kindergartens, which are commissioned by local authorities. Sozialbau aims to provide long-term affordable housing and enable the provision of appropriate social infrastructure as per the City's own planning requirements. Their stock is older and thus renovation and improvement to meet contemporary quality standards is their focus.

Both organisations rely on the provision of grants and subsidies to produce new and renovate old dwellings, which are dependent on the political will of municipal and regional governments, which has varied considerably over time. Subsidies declined sharply between 2000 and 2007, reducing production from 16 000 to 8000 dwellings under the conservative coalition government, but have revived to produce 15 000

¹⁸ This section is based on field work conducted in January 2009 by J. Lawson (2010 in press), Path dependency and emergent relations: explaining the different role of limited profit housing in the dynamic urban regimes of Vienna and Zurich, *Housing Theory and Society*, and J. Lawson, and N. Nieboer, (2009), The regulation of social housing outcomes: a micro examination of Dutch and Austrian social landlords since financing reforms, presented at the ENHR conference, Prague, 28 June–1 July.

dwellings per year. Unlike smaller, rural cities, the state of Vienna is perceived as a professional and highly competent actor in the field of housing policy and housing finance. However, Federal commitment to its loan programs has been capped and increasingly LPHAs are being encouraged to rely on commercial loans, their own reserves, and (tenant) equity, with consequences for production levels and affordability of housing outcomes.

Both Sozialbau and Wien-Süd have close networks and political ties with the City of Vienna, which plays a leading role determining the overall levels of housing production and land development priorities. The price paid for land is based on the potential yield of a site and is often determined by the City's land banking corporation, Wohnfond. Land is then sold by competitive tender, which aims to reduce building costs and focuses developers on quality outcomes. In 2008, Wien-Süd had €30 million invested in land, regarded as sufficient for its own plans for housing provision in the coming years. However, Sozialbau considered that land scarcity was a major constraint on the level of housing production. The complex conversion of brown field sites closed the cooperation between multiple parties, which was considered to increase costs and undermine integrated planning.

With subsidies capped amidst increasing construction costs, LPHAs must rely on commercial loans; being mature organisations they also have reserves to re-invest. Strict rules channel the cheapest possible funds towards the production and renovation of housing and it is impossible to invest in non-housing ventures. However, interest rate limits for lengthy loan terms are restrictive, binding interest rates to just above the EURIBOR rate, which pose higher liquidity costs for the banks.

As with all LPHAs, Wien-Süd and Sozialbau are subject to annual auditing processes by the Audit Federation of the Austrian Federation of Limited Profit Housing Association (GBV), which reports on their performance to the state of Vienna as it only provides grants and loans to well regulated LPHAs. Inspection involves a three-week visit every year by specialist auditors to examine their accounts, activities and investment plans. Further, Wien-Süd has introduced its own two-year project level evaluation process to inform renovation strategies.

5.3 Sales policy

Like all LPHAs, Wien-Süd and Sozialbau are subject to strict limitations on their generation profits, they are also subject to caps on administration and construction costs and must employ a system of cost rents to manage their revenue, under which rents are low in the early phase of low interest public loans, then rising after five years with CPI. Across Sozialbau's older rental stock, rents are between €3–5 per square metre for older dwellings and €7–8 for new subsidised dwellings. There is little demand for smaller single room units, which are being remodelled, while demand is strong for larger family dwellings, especially those with an affordable rent to buy with option.

Wien-Süd is now specialising in this form of housing, and typically charges €5–7 per square metre rising with CPI, and requires up to €30 000 in tenant equity. While wealthier tenants are able to pay, others must rely on familial support, commercial loans, and use the zero interest equity loan programs available from the City of Vienna. Wien-Süd argues that affordability is threatened, as incomes have not kept pace with rising housing costs or CPI, and this will be exacerbated by the pending recession.

5.4 Allocation

Tenants are increasingly young and ethnically diverse; Vienna attracts migrants from Central and Eastern Europe, and these communities are increasingly present on housing estates. Sozialbau has always maintained an unrestrictive access policy, with Vienna's subsidy programs requiring allocation of dwellings to specific household incomes. For a long period, rules governing income eligibility have remained the same: 50 per cent of newly produced dwellings are offered externally to the general public and 50 per cent is offered internally to existing members and those on the waiting list.

5.5 Outcomes/investment priorities

For the past two decades, Wien-Süd has specialised in the production and 'low impact' refurbishment of low energy and historic dwellings and has institutionalised a system of tenant-based evaluation for every apartment complex. Currently, Wien-Süd is continuing its rent to buy strategy for new developments and actively pursuing international development opportunities in Germany and Central and Eastern Europe, exporting their development and management expertise in low energy affordable housing through a consulting subsidiary. Sozialbau continues to focus on long-term rental housing for low to moderate income households, and produces around 600 dwellings per year. Currently, most of these are for rent or rent with the option to buy, representing around 10 per cent of Vienna's annual target. With regards to refurbishment, it is committed to improving the thermal quality of older apartment buildings and has also established a program to promote social integration and improve neighbour relations on estates.

5.6 Illustrating the financial arrangements at a project level

While published research and annual reports by social landlords tend to provide aggregated housing market and portfolio information, there is little detailed information in the public domain at a micro project level. Attempts to obtain this information from the GBV, which audits providers and Housing Banks, were not successful due to the governing privacy laws. Such an analysis requires detailed organisational case study research with developers willing to provide commercially sensitive information, and financial analysis that involves the development of software to illustrate the dynamic financing arrangements at a project level over time. Fortunately for this study, specialist software has been developed to model the cash flow and requirements for limited profit housing development by a number of providers, financial services and housing specialists.

Care must be taken in the selection of projects, as chosen portfolios and organisations can be both unrepresentative and misleading, thus we proceed with caution to illustrate the kind of assumptions and principles underpinning the financial arrangements of affordable rental projects and stress the need for more detailed research in the future.

The software developed by Deutsch/Spielauer calculates the main indicators that result from the longitudinal analysis of a given project and enables project developers to investigate the feasibility of a portfolio under various random processes of interest rates, inflation rates and sales values (also right-to-buy sales).

5.6.1 Project with right to buy

Building on the logic of Figure 9 showing the key players and the financial relations of the limited profit housing promotion with results from software developed by Deutsch and Spielauer and additional work by conducted for this study, this section provides a closer examination of the assumptions and cash flows associated with project finance involving right to buy options.

Assumptions

A number of assumptions must be made explicit at the beginning and are drawn from current capital market conditions and cost structures in Austria, with special reference to the land procurement process. In Vienna, the housing fund (the Wohnfond) plays a key role in the land market, making sites available for affordable housing development. Thus, any adaptation of this model must fully incorporate local land prices, construction costs, regulatory requirements and capital market conditions.

Figures were taken as input for stylised software of real estate finance, developed by Deutsch/Spielauer. The illustration in Table 4 below is confined to the most essential items as they appear in Figure 9. The plot price refers to outer districts of Vienna and the project incorporates moderate side costs (see expenditures item 3). Any adjustment of the rent level under changing capital market conditions and/or inflation has not been included and profits from future sales of dwellings have also been excluded.

Table 4: Project assumptions—with right to buy

Item	Portfolio shares	%	Expenditure shares	%
1	Tenants' down payment	22.0	Plot (moderate price)	14.0
2	Developers equity	10.0	Raw construction	70.0
3	HCCB loan, 25 years maturity	44.0	Equipment and facilities	16.0
4	Public loan, 35 years maturity	24.0		
Total		100.0		100.0

Characteristics of equity and debt

The equity items in the portfolio consist of the tenants' entry down payments that cover the plot price and some part of construction (Baukostenbeitrag), as well as the developers' reserves injected for construction. The credit conditions refer to a 25-year HCCB loan at a 4.25 per cent loan rate and a 35-year public loan at 1.0 per cent interest rate, graduated at 1.5 per cent per annum.

With an expected inflation rate of 1.5 per cent per annum the graduation implies that the annuities remain constant in real terms, hence, in nominal terms, lower at the beginning and higher towards maturity. Graduated public loans are customary to keep the total of HCCB and public loan annuities within the limits of the regulated rent.

Rent levels and yield

At current price and cost levels the resulting financial rent is five Euro per square metre of the dwelling per month, in accordance with the prevailing subsidy rules. The yield for the developer (that is, the internal rate of return ROE) over the 35-year horizon is 2.9 per cent.

It is important to understand that the 2.9 per cent yield accrues exclusively from the rents paid during the period between the HCCB loan and public loan termination. Besides that, the law permits the GBV to request a separate rent item called 'reserves', which are a 3.5 per cent return on the developer's injected equity. In the

example, they amount to 70 per cent per square metre per month. Legally, the reserves do not form part of the financial rent, but they appear among the items of the 'gross' rent. Functionally, the reserves do nevertheless augment the financial rent. If the reserves are added in this way, the ROE of the GBV rises from 2.9 to 3.7 per cent.

5.6.2 *Project without right to buy*

This section concerns the situation of social entrants without down payment, only the portfolio has to be changed, while the expenditure items remain the same. The entry down payment now reduces to an 8 per cent contribution for construction, which in a subsequent procedure can be subsidised away by demand-sided benefits. To meet the investment cost for low-income households, the public loan is raised to 30 per cent, the developer's equity to 18 per cent. The credit terms are as before.

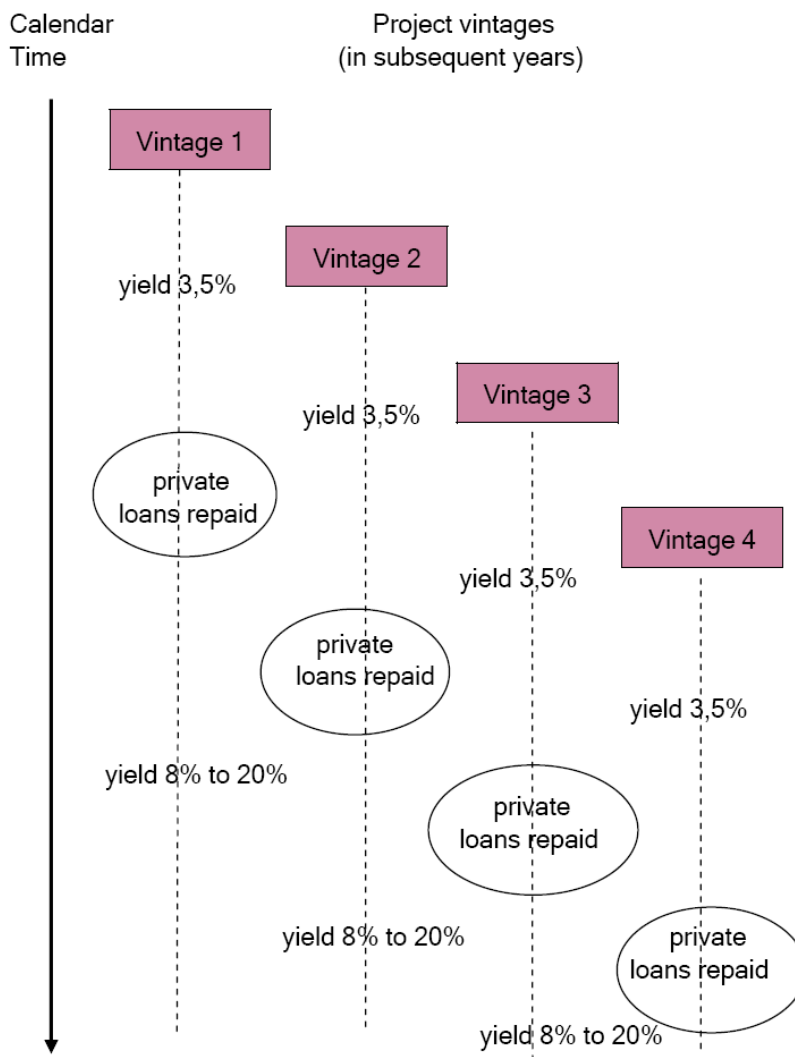
Table 5: Assumptions—without right to buy

Item	Portfolio shares	%	Expenditure shares	%
1	Tenants' down payment	8.0	Plot (moderate price)	14.0
2	Developer's equity	18.0	Raw construction	70.0
3	HCCB loan, 25 years maturity	44.0	Equipment and facilities	16.0
4	Public loan, 35 years maturity	30.0		
Total		100.0		100.0

The modified portfolio permits the same financial rent of €5 per square metres of the dwelling, per month. Instead, the yield for the developer (including the remuneration of equity) declines to 3.4 per cent. In exchange for producer subsidies, the public authority usually reserves one quarter of all newly built units in a given project. These units are assigned to prioritised households in need, which are not subject to site-down payments. Then, if the proportion between entries with site down payments versus without site down payments is 3:1, the overall project yield in the given example is around 3.5 per cent and therefore equal to the administered initial yield of new developments.

More detailed results require model specifications that are beyond the scope of the present study. We conclude with the time-dependent relation between the administered initial yield and the effective yield out of the mature stock, as outlined in Figure 12 below.

Figure 12: Long-term financial position of a GBV company



The figure above illustrates a GBV limited profit company with a steadily growing number of vintages. There are two periods:

- During the period from completion to private loan termination: the yield ranges around 3.5 per cent. Private loans are HCCB loans, Bausparkassen loans or other loans.
- Conforming with Figure 9, the subsequent period starts while a public loan is still under repayment. The initial rent of €5 stays until maturity, when it is reduced to €3.5. This is an average figure; providing the dwellings are still in good condition and all financial obligations have been met, the mature rent can be reduced. If the dwellings require modernisation, the GBV can raise the rent again. In practice, the yields in period two range between the administered minimum 8 per cent margin and (in some cases) up to 20 per cent.

Of course, the effective yields depend on the stock that the GBV has accumulated over time, together with the conditions of local rent formation. In each calendar year the effective yield over all vintages can then be calculated. Now, apart from right-to-buys, a GBV does not sell its assets. Hence, as shown in Figure 12, the effective yield must vary with time. Thus, to maintain a time-invariant benchmark yield is logically impossible.

6 ASSETS AND REVENUE FLOWS UNDERPINNING PRIVATE FINANCE

We now turn to focus on the increasing role of housing banks and the issuing of Housing Construction Convertible Bonds (HCCB), which raise funds for affordable rental housing.

6.1 Housing banks and bonds¹⁹

Housing banks were established in Austria as a joint initiative of the City of Vienna (a state province), university economists and the banking sector with the essential cooperation of the Federal Government, in particular the Federal Ministry for Economy and Labour and the Ministry of Finance.

Over the past two decades, banks have seen falling deposits and rising loan obligations, as is common across Europe (ECB 2009). Long-term capital was needed and housing bonds were devised as means to address this liquidity problem. The bonds offer a favourable form of long-term deposits, in the form of targeted bonds, partly bridging the gap between short term deposits and long-term obligations of the banks.

The HCCBs now form an integral part of the complex system of Austrian housing finance. They supplement the system in large-scale multi-storey residential construction, as well as in modernisation. They contribute to the financing of affordable housing, and to the renovation of existing housing to meet social and environmental standards. Together with other factors, they tend to mitigate the house price volatility. It has also been argued that the presence of housing bonds have also stabilised interest rates in the mortgage market more widely (Schmidinger & Kratschmann 2009).

The legal background is the federal law on Specific Measures to Promote Residential Construction that was enacted by the Austrian Parliament in 1993, for short SWL.²⁰ It was passed in the context of strong excess demand and soaring interest rates. At the time, the subsidy fund could not be expanded further and this new initiative aimed to attract private capital through the issuance of housing bonds. The law offered the incentive to waive the capital income tax for the first 4 per cent of the coupon rates, together with a tax deductibility of the purchasing price, in exchange for a minimum 10-year term of the bonds. Normally, returns on obligations pay a 25 per cent withholding tax in Austria. However, with the new SWL, only the returns above the 4 per cent threshold would be taxed. Hence, the tax advantage effectively creates loan interest rates between 60 and 70 basis points below the free market rate; loan operating costs and risk premiums included. This is discussed further below.

6.1.1 The housing banks

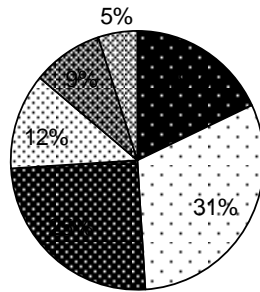
To perform the transactions in the most efficient and competitive way, six special banks were established by the banking sector called 'Wohnbaubanken' (HCCB), to issue Housing Construction Convertible Bonds (HCCB) in order to raise funds to finance loans for housing construction. The following Figure 13 illustrates the market shares held by these Housing Banks over time.

¹⁹ The section draws from studies of the research institute FGW, Vienna, *The Austrian system of housing finance*, part 1: 'The system of Austrian housing banks' by Oberhuber and Götzl (2005), Austrian National Bank's Financial Stability Report (2007), together with a previous study by Riss (2005), which have been updated through further research for this report.

²⁰ 'Steuerliches Wohnbauförderungsgesetz'—SWL, April 1993.

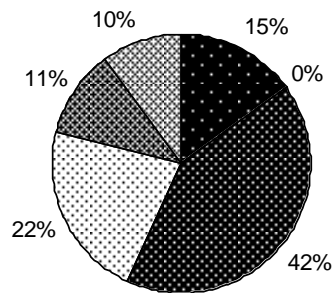
Figure 13: Market share of housing banks in 1996, 2004 and 2008

Market share of Housing Banks 1996



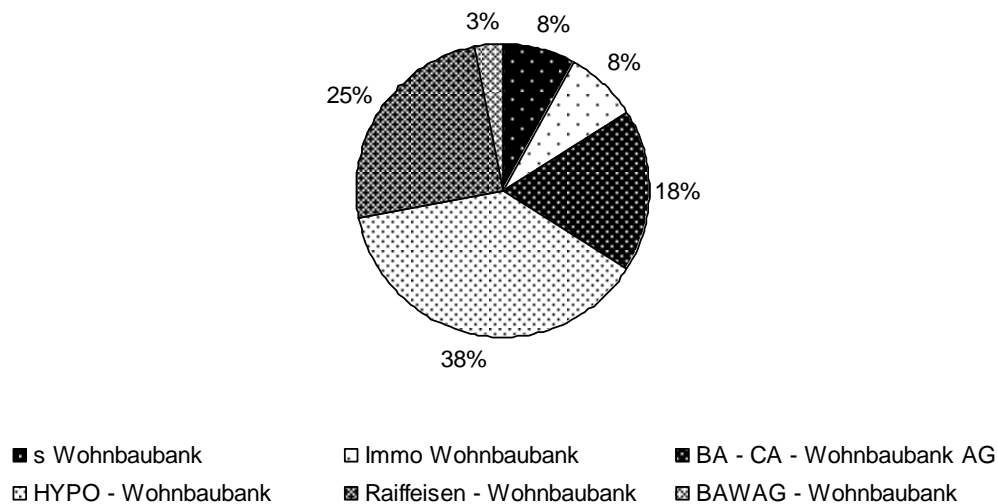
- s Wohnbau Bank
- CA Wohnbaubank
- BA - CA - Wohnbaubank AG
- HYPO - Wohnbaubank
- Raiffeisen - Wohnbaubank
- BAWAG - Wohnbaubank

Market share of Housing Banks 2004



- s Wohnbau Bank
- CA Wohnbaubank
- BA - CA - Wohnbaubank AG
- HYPO - Wohnbaubank
- Raiffeisen - Wohnbaubank
- BAWAG - Wohnbaubank

Market share of Housing Banks 2008



Sources: Austrian National Bank (2007) for 1996 and 2004, annual business reports of the Austrian housing banks, personal communications for 2008

6.1.2 The sale of the bonds

These special banks act as special purpose vehicles, while the retail business remains with the commercial mother or partner banks, which attract individual investors and grant housing loans to the developers, funds and municipalities through the branch network of the mother bank.

In principle, the HCCBs are classic mortgage loan banks with capital market refinance, such that the risk exposure of loan repayments and bond servicing is with the bank (the mortgage is not a pass-through). The HCCBs differ from the classic type of banks as they operate as special purpose vehicles, with organisation and staff kept at the absolute minimum, while the retail business remains with the commercial mother or with partner banks to attract individual investors and grant housing loans to the developers. The HCCBs themselves have to ensure that the funds raised from issuing are transformed into investment within three years after emission.

The retail banks have to verify that the loan customers comply with the HCCB loan regulations, in particular, with rent setting as imposed by the regional subsidisation laws. The loan customers have to use 80 per cent of the net advances for residential investment according to these laws.²¹ The remaining 20 per cent can be invested into complementary facilities within the blocks, such as retail shops, parking facilities, social services and common rooms. Moreover, since 2001, the law admits investments into urban and village renewal, modernisation projects and also the acquisition of plots for new residential construction.

Seen from the side of refinance, the law admits convertible bonds and preference shares. In practice, only a very minor part of bonds has been converted,²² while the

²¹ The HCCB have also to secure that 80 per cent of the reserves accumulated from loan repayments (after bond servicing) are reinvested into residences.

²² For convertible bonds, the SWL-law prescribes that once at the end of each year, or upon termination, the bond can be converted on demand of the purchasers into shares of the issuing bank, which then has

issuance of preference shares remained negligible. The vast majority of investors stayed with the bonds and their tax advantages. For that reason we set the topics of conversion and preference shares aside to describe exclusively the working of the housing bonds.

Besides the tax-free 4 per cent coupon rate, the SWL admits a means-tested tax deductibility of the initial bond price. The tax relief depends on personal income, differentiated by family status, such that the expenses are deductible up to some maximum expense and some income ceiling.²³ However, the ceilings are tight; higher income purchasers of housing bonds are not eligible. The main advantage is indeed the tax relief on coupon rates.

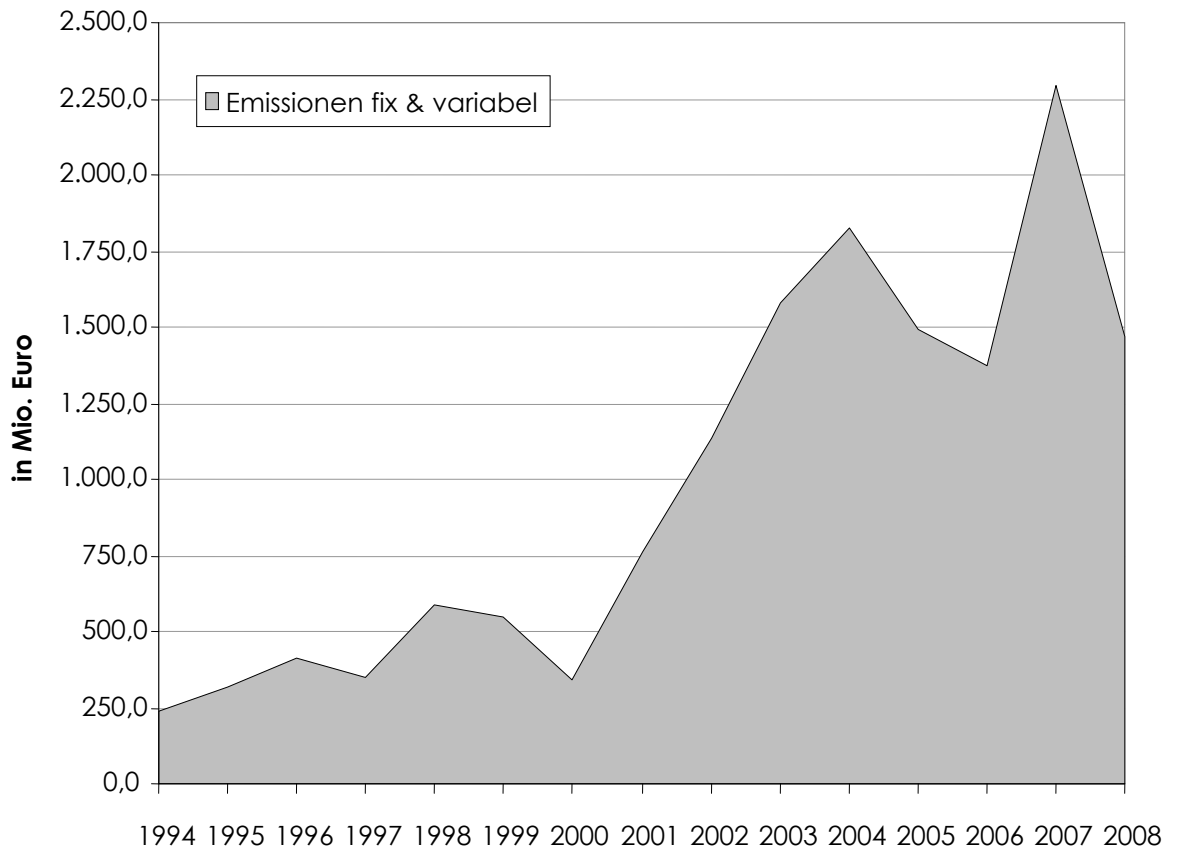
The housing bonds were welcomed by the capital market. While in the early 90s the duration of bonds generally declined to five years and even less, the market agreed to the extended terms of the housing bonds, so that terms of up to 15 years became customary. The benefit for large-scale projects cannot be overlooked. The maturity of loans for such projects is around 25 years. Formerly, the mortgage banks had to issue four subsequent bonds to refinance one project; now the transformation of maturities is reduced to two subsequent bonds only. The new facility reduced the liquidity risk and lowered the risk premiums in long-term finance. To mitigate the interest and inflation risk, the housing banks usually require renegotiable loan rates, in order to adjust their risk exposure to prevailing capital market conditions if required.

Over the 15 years since its foundation, the system expanded steadily and strongly after 2000. Starting from a level of about €237 million, the volume doubled to €586 million in 1998. The peak was reached in 2007, with €2.295 billion. In 2008, the total of emissions has risen to €14.7 billion.

to service dividends. The SWL prescribes that the par value of shares cannot be less than 10 per cent of the face value of the bond.

²³ The maximum amounts deductible from the income tax base are currently €715 for single person households or double income earners, €1.445 for single income earners with dependants, and an additional €365 for households with at least three children. To obtain the net advantage, these amounts have to be multiplied with one minus the marginal tax rate. However, even these limited amounts are granted only up to personal incomes of €36.400 annually, and decline linearly from that threshold until they reach zero for personal incomes from €50.900 annually. In practice, the treasury foregoes much less from tax deductibility than from the total of tax relief on coupon rates.

Figure 14: Total of annual emissions 1994–2008



Sources: Annual business reports of the Austrian housing banks, personal communications

With its expansion, the system created sufficient overlapping loans and bonds to ensure that, in normal times, the risks of lending and refinancing were easily covered. The crisis year 2008 disrupted this steady development, but with certain capital injections from the mother banks, that situation was overcome. Altogether, it can be argued that the SWL law that regulates the HCCB contributed to the robustness of the system in a period of crisis.

Table 6: Annual emissions of HCCB in million Euro 1994–2008

	BA-CA	BAWAG	Hypo	Immo-Bank	Raiffeisen	s WBB	Total
1994	111	0	21	12	29	64	237
1995	149	29	53	15	25	48	317
1996	161	24	81	19	58	73	416
1997	155	41	74	12	36	33	351
1998	207	56	148	15	58	102	586
1999	185	66	150	18	85	41	545
2000	148	47	56	3	13	78	345
2001	312	86	226	18	32	90	765
2002	432	106	255	35	112	194	1.134
2003	627	132	325	69	238	189	1.580
2004	618	55	448	122	249	333	1.825
2005	463	169	437	142	128	158	1.496
2006	326	50	291	66	170	470	1.373
2007	298	494	640	155	358	350	2.295
2008	262	37	564	114	368	123	1.467
Total	4.455	1.391	3.770	828*	1.959	2.343	14.731

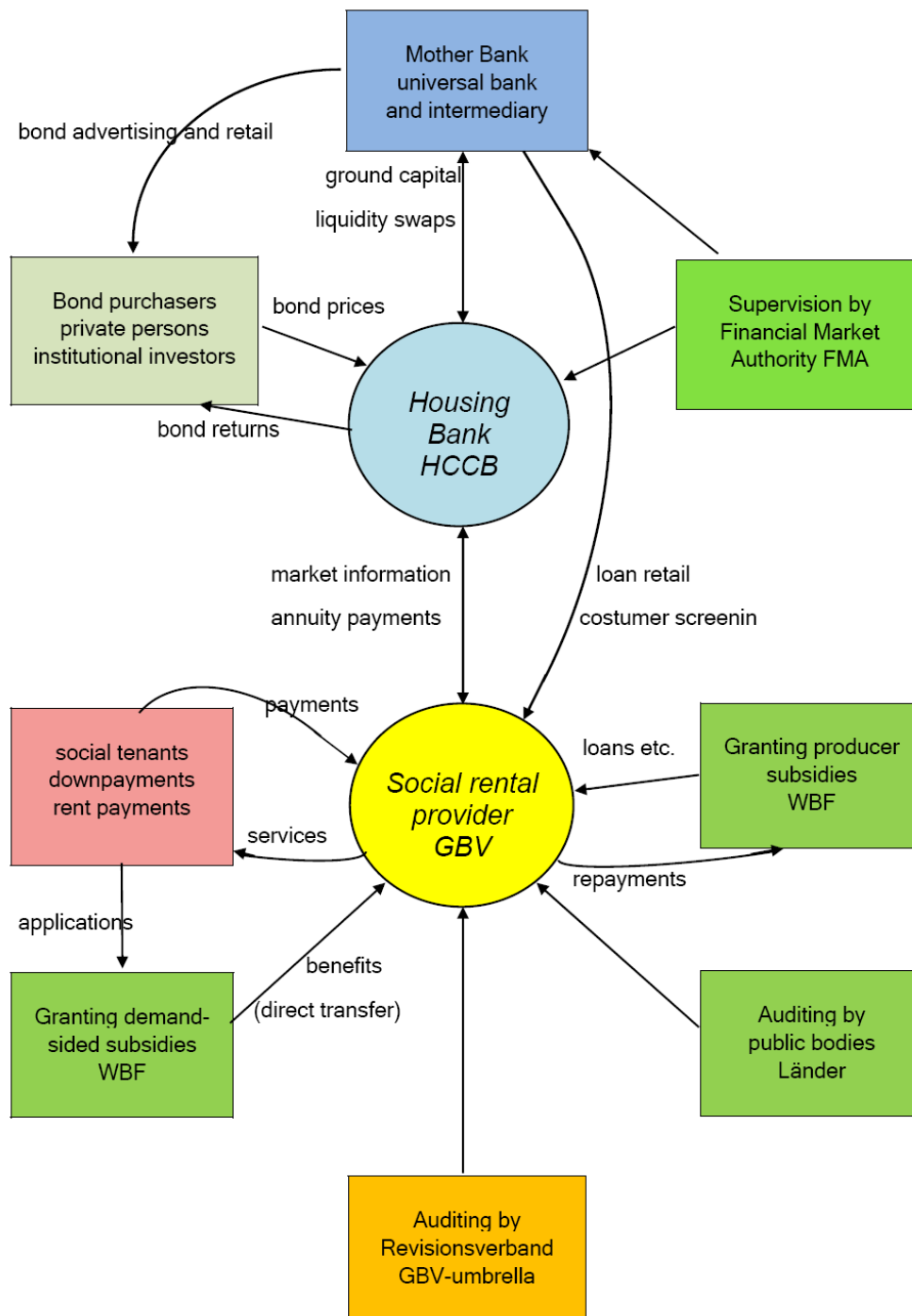
Sources: Annual business reports of the Austrian housing banks, personal communications

As illustrated by Figure 14 and Table 6, the volume of issued bonds has increased steadily and strongly in the years after 2000.

6.1.3 The interplay between the main agents in Austrian social finance

It is important to appreciate the interplay between the different financial institutions and the role of regulating authorities in the financing of social housing. In addition to Figure 9, the following Figure 15 provides an organisational flow chart depicting the relations between organisations engaged in financing social housing.

Figure 15: Interplay between key financial players in Austrian social housing



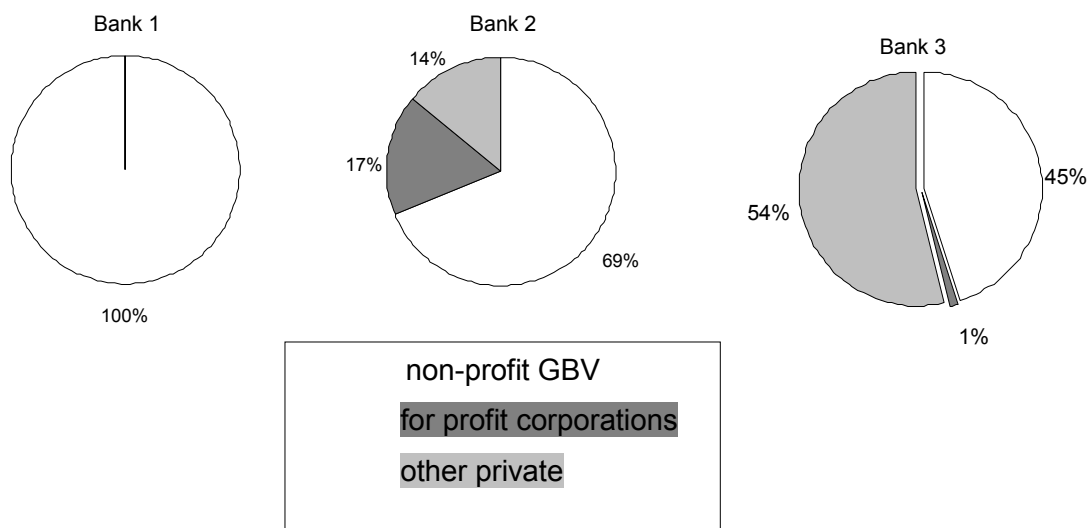
6.1.4 The Housing Banks' customers

Although the GBV are the largest clientele of HCCB loans, the housing banks differ substantially with regard to their customer profiles. The following graph (Figure 16) demonstrates the situation for three anonymous banks.²⁴ Bank 1 finances the GBV exclusively, mostly in the Eastern part of Austria. The customer shares of Bank 2 are 69 per cent GBV, 17 per cent for-profit corporations and 14 per cent other private companies. Bank 3 is specialised and grants 54 per cent of all loans to the other

²⁴ The banks involved in this research are not identified on request.

private companies Overall, one can assume that Bank 2 is representative for the average customer shares. Hence, the GBV absorbs two-thirds of all loans, but the share of for-profit corporations and private companies is important. In that respect, the HCCB services a myriad of rental supply channels, which in turn can meet tenants' distinct needs. Again, the positive welfare effects from diversification are hard to quantify.

Figure 16: Customer profiles of three housing banks 2006



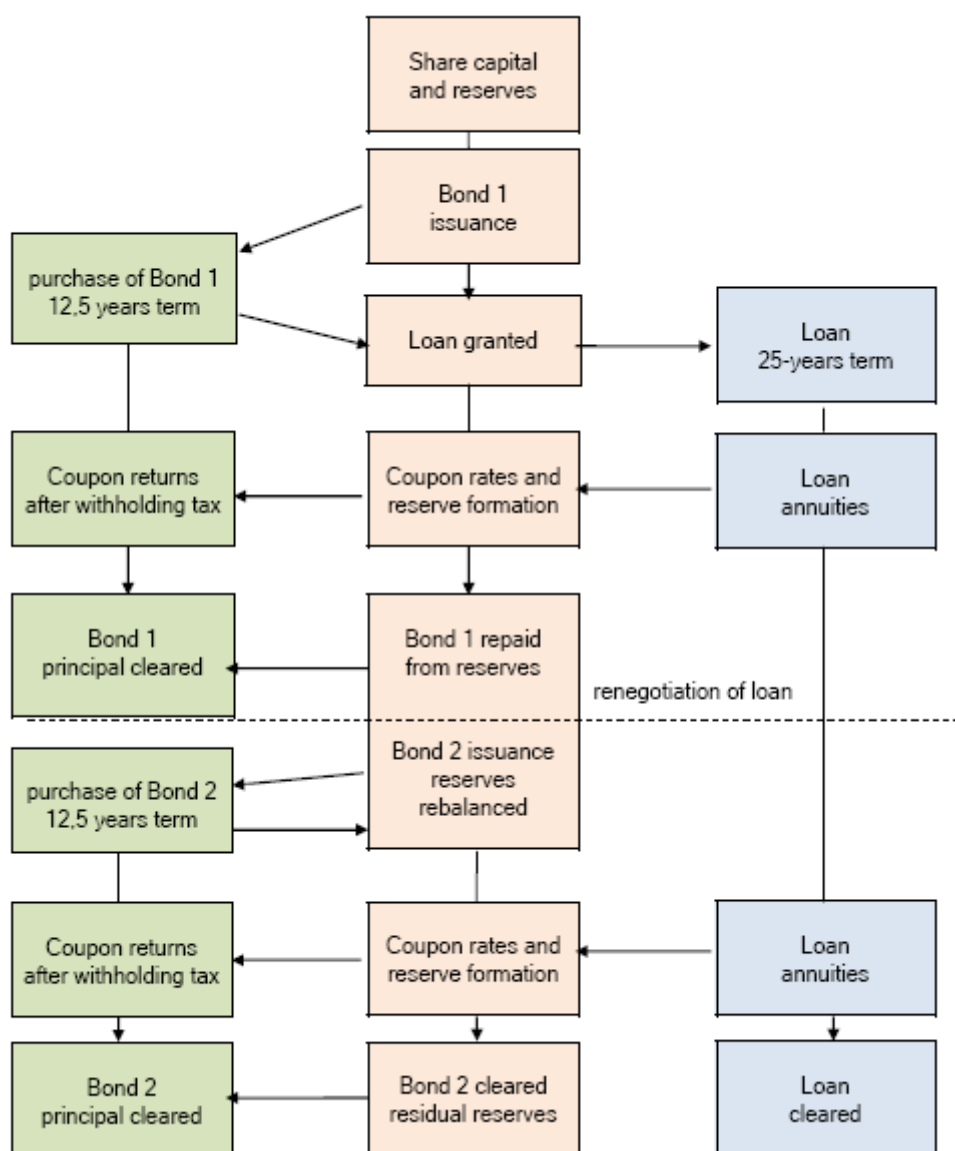
Sources: Business reports of Austrian housing banks, personal communications

6.1.5 The build-up of capital, issuing bonds and granting loans

The housing banks have been highly successful in generating a flow of low cost funds to meet demand for affordable rental housing. How this is achieved is the subject of the following Figure 17. This chart depicts the dynamic role of overlapping bonds in financing long-term loans over time.

As can be seen below, the housing bank requires an initial share capital and reserves to issue its first wave of bonds to investors and be able to grant loans to developers. Repayments on this loan enable the payment of bond coupon rates and, over time, the formation of further capital. With sufficient capital, additional bonds can be issued, loans granted and so on.

Figure 17: HCCB two-stage finance of a single project



6.1.6 Illustrations of a profitable business—housing banks

Housing banks have provided a stable and profitable return to their mother bank as illustrated by the BA-CA Wohnbaubank and the Raiffeisen Wohnbaubank Aktiengesellschaft (RWBB).

One of the first housing banks to be established in 1994 was the BA-CA Wohnbaubank of the Austria Bank. Loan disbursements under subsidised real estate finance, refinanced mainly through BA-CA Wohnbaubank, grew—especially in the west of Austria—and made the construction and renovation of more than 8000 residential units possible. The total issue volume of BA-CA Wohnbaubank rose by 15 per cent to €3.5 billion in 2005 and enabled the co-financing of about 75 000 residential units (BA-CA 2005). The volume continued to grow until 2007, when the total issue volume of BA-CA Wohnbaubank rose by almost 8 per cent to €4 billion co-financing of around 8500 residential units in that year alone (BA-CA 2007).

The Raiffeisen Wohnbaubank Aktiengesellschaft (RWBB) is one of the smaller players in the HCCB market that grew rapidly in the early 2000s. At 31 December

2002, with a total balance sheet of €466 million (€ 353 million in 2001) and equity of €5.5 million (€ 5.5 million in 2001), it delivered a profit on ordinary activities of €0.62 million (€0.76 million in 2001). The bank achieved a return on equity before tax of 11.3 per cent in 2002 (13.8% in 2001).²⁵

By 2008, the RWBB placed issuances with a volume of more than €367 million in 2008. According to the annual report, RWBB had a year-end balance sheet total of €1821 million and eligible own funds of €5.75 million and recorded a profit from ordinary activities of €0.67 million. This resulted in a return on equity before tax of 11.7 per cent (RWBB 2008).

²⁵ http://ar2002.rzb.at/eBusiness/rzb_template1/53101100885211932-53101100885211934_53280810638380620_59361526202434342-59354446754152245-NA-NA-EN.html

7 BENEFITS TO INVESTORS

In Chapter 6, the rationale for the existence of housing banks as subsidiaries of larger banks was established. This section concerns the benefits for purchasers of Housing Construction Convertible Bonds (HCCB).

Housing Construction Convertible Bonds are marketed by housing banks and sold by retail agents offering a range of financial products. Bond purchasers are seeking a secure, low risk form of investment. Most bonds are purchased by individuals, pension funds or municipalities. Existing clients of the mother bank, holding a home owner savings account, are often bond purchasers. An example of HCCB bonds for purchase (in English) is provided in Appendix 3.

HCCB vary in terms of fixed or variable interest rates, with terms from 10 to 15 years maturity. The HCCB interest rate tends to be 1 per cent lower than capital market bonds, but combined with the tax advantage outlined below, offer an attractive long-term low-risk form of investment.

HCCB typically form one of a variety of assets in a personal pension portfolio. One leading housing bank claims that approximately 300 000 Austrians hold HCCB in their portfolio of assets, suggesting a very broad take up of HCCB.

Based on a sample survey on the housing wealth of Austrian households (ANB 2009), 7 per cent of households surveyed held bonds (which could include government, private, HCCB bonds) representing approximately 250 000 individuals. Given the margin for error of the sample survey, the estimate of 300 000 HCCB holders could be possible, but more detailed market research is required.

As mentioned in Chapter 6, in order to ensure an attractive rate of return comparable with other bonds, the Federal Government offers tax relief to HCCB purchasers. This is permitted under the Federal law concerning measures to promote residential construction (SWL).

There are two components to tax relief; the first concerns the exemption from tax of the first 4 per cent of interest from the bonds. The second concerns the limited deduction of the initial purchase price of the bond. These conditions are defined below.

The initial cost is income tax deductible after 10 years for certain income groups and interest coupons—which may be fixed or variable—are exempt from the first 4 per cent of the annual investment income tax charge. In Austria, returns on bonds are subject to a withholding tax of 25 per cent. This is deducted from the bond coupon upon disbursement to institutional and individual bondholders alike.

The cost of the bonds is progressively tax deductible and deduction rates depend on personal income, differentiated by family status, up to a maximum amount for different household incomes. The maximum yearly amount that can be deducted for this kind of special expense is €2920 per person, plus €2920 if there is only one family income and a further additional €1460 where the family has three or more children. This brings the maximum amount that can be deducted to €7300 to a maximum of 25 per cent of the bond purchase.

For households with a yearly income of €36 400–60 000 there is less tax deductibility and none where household income is above €60 000. Thus, higher income groups do not benefit from HCCB tax deductibility but they still have exemption from capital gains tax for the first 4 per cent of returns and most bonds are purchased as safe

long-term investments by municipalities and pension funds rather than by private individuals.

In practice, the treasury foregoes much less from tax deductibility than from the total of tax relief on coupon rates. Higher income purchasers of housing bonds are not eligible for that tax advantage. The main advantage is indeed the tax relief on coupon rates.

In order to estimate the cost to government of these measures, more detailed research is required. Estimates of €120 million have been provided by key stakeholders interviewed, but these estimates have not been able to be substantiated with empirical research based on tax returns.

8 HOUSING OUTCOMES, SYSTEM CHALLENGES AND EFFICIENCY

Austria has pursued a supply-orientated housing strategy, which contrasts with the drift towards more demand-side strategies reliant on rent allowances to achieve housing goals in other European countries. As public subsidies have gradually declined, private finance has become an increasingly important component in the financing of affordable rental housing. Austria has developed a special mechanism to ensure the continuing production of cost rent dwellings using the lowest cost private finance. Housing Construction Convertible Bonds (HCCB) raise funds through special purpose subsidiary vehicles attached to six banks lending to the sector. This section discusses the outcomes of, and the potential challenges to, this system.

8.1 General housing outcomes

Austria performs well in terms of quality and quantity when compared to the housing outcomes of other European systems, particularly in terms of housing cost, security of occupancy and habitable space (Czasny 2004, p.57). Research by Deutsch (2009a) clearly demonstrates the lower rents achieved in the municipal and cost rent sector in Austria.²⁶

8.1.1 Affordability

Austrian households spend on average €420 (\$672) per month or 18 per cent of their household income on housing (using SILC data for 2007, Statistics Austria), relatively low for West European standards. Furthermore, median housing costs across the housing sector are relatively low; with household expenditure on housing being only 20.6 per cent of household income, again representing less of a burden than in other European countries (Czasny et al. 2008, p.819). Consequently, there is a very low proportion of households with rent arrears (2.4% opposed to the EU25-average of 9.1%) and of households that see their living expenses as a heavy burden (14% as opposed to the EU25-average of 28%) (Czasny et al. 2008, p.56, Amman, Lawson & Mundt 2009).

In 2007, the average rent burden in Vienna, across both the private and limited profit sector, for couples with children, was only 20 per cent of household income (Kalmár et al. 2008; Czasny & Bständig 2008), which is very low compared to other West European capital cities. In this city, the cost-capped limited profit housing sector continues to play a very important role across the entire rental sector, where today it provides 48 per cent of all rental housing. Nevertheless, rising construction costs are placing increasing pressure on new cost capped LP projects, with tenants of new dwellings being required to make increasing up-front contributions, albeit with the opportunity to purchase after 10 years.

However, it is important to note that the share of housing costs is much higher among single-parent-households (31%) and single female households (33%). Further, households that are at risk of poverty have to spend 38 per cent of their household income (Statistik Austria 2007). Nevertheless, the burden of housing for these households is substantially lighter than in other European countries and certainly for similar households in Australia.

²⁶ See research by Deutsch (2009), especially tables showing comparative rent levels in the private, municipal and limited profit sector for Vienna which were paid by low-income, median-income and high-income households for different ages of dwellings. See: <http://www.eos.tuwien.ac.at/Oeko/EDeutsch/download/EJHPAppendix.pdf>

8.1.2 *Contribution to economic stability*

Observing the economic role of housing policy, Czerny et al. (2007) emphasised the importance of housing subsidies to not only the construction industry but also to the wider Austrian economy and its key role in employment generation. They claim that residential construction has had a moderating effect on strong fluctuations in non-residential construction sectors and continues to play a stabilising function in the broader economy.

Furthermore, housing assistance not only contributes to economic stability and personal welfare of the low up to middle income households, it also mitigates against excess demand (in the face of scarcity) that would otherwise drive up private rents and property prices.

Unlike the housing market boom bust cycles of many other West European and North American countries, the smoother Austrian cycle has been far less volatile, even in recent months. Price developments have been steadily positive and, between 1999 and 2007, annual percentage growth rates were only 1.2 per cent, compared with 6.1 per cent in the Euro area (ECB 2009).²⁷ New construction is on a stable and relatively high level of 5.4 completions per 1000 inhabitants (45 000 units in 2008, Euroconstruct 12/2008, Amman, Lawson & Mundt 2009).

The Austrian housing finance market has been less affected by the GFC than the UK and the US, and consequently has not received much attention from the government in terms of stability measures. Throughout the 1990s and 2000s, Austria maintained a strict and personal loans culture in the ownership market, reducing risks through high loan to value ratios (80%), and the dominance of Bauspaar loans, which require a conservative 30 per cent deposit. Ten year interest rates have declined from a high of 7 per cent in the mid-1990s to 4 per cent in 2007 and comparable with the Euro zone.

Of course, stability in the housing market has come at a price—including the WBF housing assistance program and the HBBC tax incentive. This amounts to 0.9 per cent of GDP which is moderate when compared across developed economies. The efficiency of the Austria supply-side strategy is discussed in more detail in Section 8.3.

8.1.3 *Production levels*

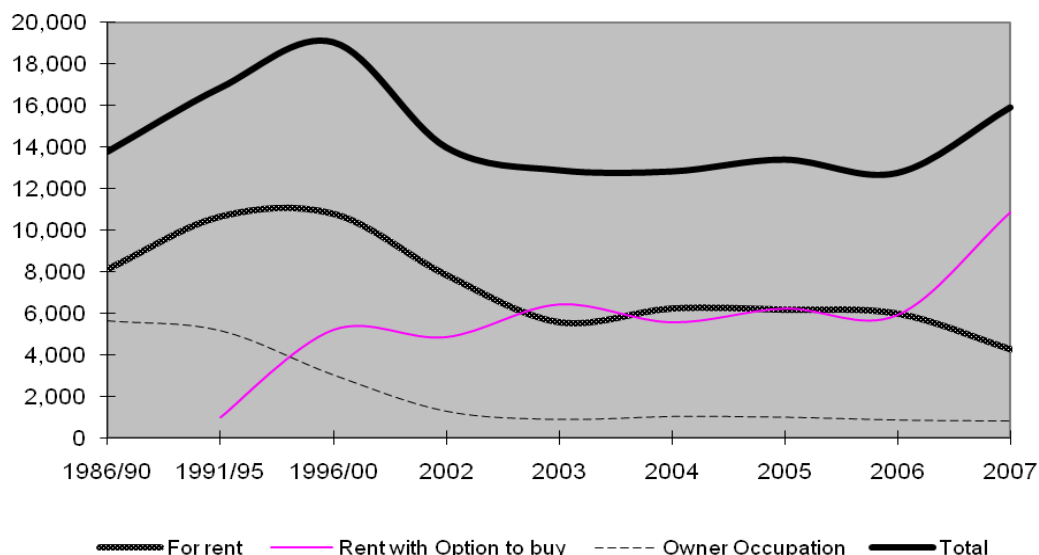
The affordable rental sector in Austria continues to play a key role managing urban outcomes such as urban renewal, affordable housing, promoting innovative design and energy-efficient construction methods. The housing subsidy programs involving grants, public loans and tax privileged private investment, form an integral part of Federal efforts in cross party policies which embrace economic growth, full employment, family welfare and most recently environmental goals. Further, expertise in LPH provision is promoted as a service to sell abroad, especially to the transitional economies of Central and Eastern Europe (Czerny et al. 2007; Amman 2006).

During the 1990s, overall output in residential construction, including the subsidised sector, amounted to approximately 36 000 dwellings annually, rising to nearly 60 000 by the end of the decade. This declined to approximately 43 000 units in the 2000s before rising again with changes to subsidy arrangements in 1989 affecting grant levels and in 2001 capping federal funding (Czerny et al. 2007, p.27). Social housing remains a significant component of house building, providing 13 000 dwellings annually.

²⁷ This is quite important in a cost rent system, as tenancies of different duration exhibit only marginal cost differences. While rents for new contracts (less than five years) are on EU25-average 27 per cent higher than of old contracts (more than 15 years), this difference amounts to only 10 per cent in Austria (Czasny et al. 2008, p.45).

Production levels in the Austrian social housing sector are provided in Figure 18 below, which shows stable levels of total production from 2001–07. However, there have been changes in the composition of tenure produced. While the production of rental housing has remained fairly stable, dwellings with the option to buy have increasingly replaced those sold at completion. This is due to the introduction of regulations in 1993 allowing tenant equity contributions, the capping of Federal subsidies, and rising construction costs, which have influenced both affordability and tenure since 2005.

Figure 18: Trends in Austrian social housing production



Source: GBV 2009 and IIBW in Lawson and Nieboer 2009

8.2 Challenges on the horizon

Affordable rental housing is financed by a range of sources. The key component is public grants and subsidies. These have been financed by Federal Government contributions (around 60%, but now untied transfers), provincial funds (1–9%), significant returns from the repayment of loans (increasing to 22%) and income from interest on outstanding loans (around 10%).

One of the potential challenges on the horizon stems from the Federal Government’s disengagement with housing promotion. In the past, the national policy of ensuring an affordable supply of (rental) housing for accommodating working families has benefited from decades of predictable and assured public support in the form of a fixed share of revenue from various Federal taxes (Lugger 2007, p.58), but this has been capped for the past decade and is no longer specified in the Federal transfers to provinces, with the exception of funds for energy related improvements to meet Kyoto commitments.

Furthermore, there is no longer any obligation for provinces to reinvest loan returns to the housing promotion budget. Some provinces have chosen to invest these returns in other political priorities and others have sold outstanding obligations to refinance other non-housing promotion loans. However, the majority of provinces have remained committed to housing promotion, maintaining and increasing their housing budgets to meet locally defined housing goals and needs, as in the province of Vienna and Upper Austria.

A third challenge is social change and socio-economic polarisation that will inevitably challenge social landlords. The Achilles heel is not the assistance rate as such, but rather a potential overinvestment into high cost rentals. Although the demand for social renting is unlikely to decline, social providers may be faced with undue cost pressures if rent revenues are undermined by social change.

The global financial crisis did not affect the Austrian housing finance, construction and consumption market dramatically. The Australian Government has taken measures to boost employment in the construction sector generally and has provided subsidies for home owners to improve the thermal quality of their dwellings.

To support the economic situation in Vienna, the City has been more active in establishing measures within the field of housing to maintain construction, secure employment levels, and enhance the environmental performance of new construction and redevelopment (City of Vienna 2005, 2009; Forst 2009).²⁸

8.3 Efficiency of the Austrian financing system for affordable rental housing

At first glance, the Austrian system of finance may appear rather complex, but it has undoubtedly contributed to high housing standards and to price stability in the economy²⁹ and the housing market in general. The Austrian housing assistance rate today amounts to 0.9 per cent of GDP, which is moderate in international terms and, contrary to many other systems, is supply-oriented.

Whether the system may be termed efficient or not, depends on the relation between cost and value. Of course, there are many notions of value, ranging from levered real estate finance to overall social welfare, and not all of them can be easily quantified. In the following, we will therefore focus on two specific notions:

- The leverage effect from income tax relief for housing bond investors on the volume of induced residential investments.
- The leverage effect from the WBF (the public housing fund) to the volume of units supplied.

In a previous study, the author E. Deutsch (2005) demonstrated a leverage effect from housing bond tax relief of more than 1:20. This means that one Euro of foregone tax revenue due to the privileges attached to housing bonds induces 20 Euros of residential investment. An overall assessment needs to consider the effects of both instruments as they complement each other. The HCCB is used to attracting private capital at the lowest possible rate and the WBF offers low cost public funds that also secure this private capital. Deutsch (2005) calculated that one Euro of WBF induces 2.5 Euros of residential investment.

Housing banks continue to assist the financing of new housing and refurbishment, and have generated approximately €1.5 billion of investment annually for more than a decade. Loans issued under bond issues cover more than 45 per cent of total construction costs, with the balance met by housing subsidies and provider contributions.

²⁸ These measures include: issuing of a government bond (amount €200 million.) to promote investment in thermal redevelopment as well as new construction; adopting decrees affecting redevelopment and new construction, which demand stricter ecological standards and in return offer grants and loans to the value of €30 million per year; 'Wiener Wohnen', the property management arm of the State of Vienna, which has 220 000 housing units, has increased its investments from €560 million in 2007 to more than €600 million in 2009. Furthermore, in 2009 an extra €10 million has been allocated from the finance administration group to invest in state owned houses (offices and flats) (Forst 2009).

²⁹ The arguments for price stability are found in the authors publication E. Deutsch (2009).

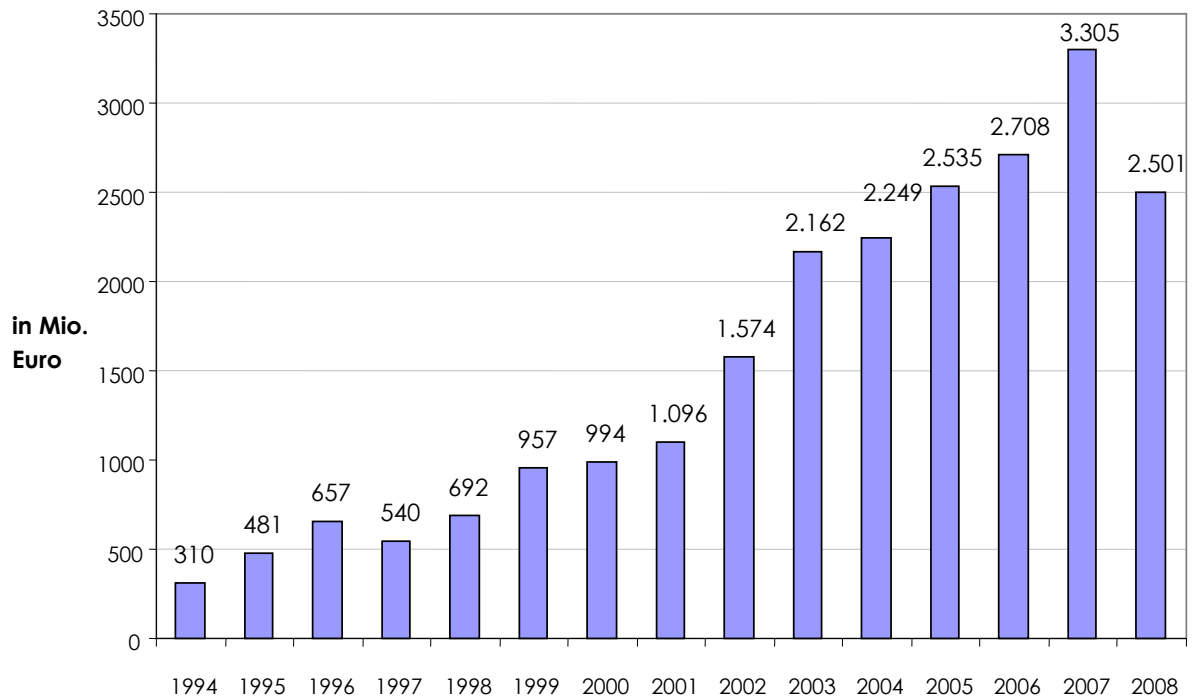
In the context of declining WBF and the GFC, HCCBs have been very successful in sustaining the level of investment in affordable housing. However, the recent provision of a guarantee on savings deposits in response to the global financial crisis has certainly disrupted rising demand for HCCBs and led to some early buy outs of bonds that were nevertheless able to be covered by the mother banks (Schmiddinger & Kratchmann 2009).

The figures below in Figure 19 are in nominal terms. From 1994–2007 the volumes of HCCB have grown more than 10-fold; in real terms the increase was still 8-fold. The figures can also be compared with the Austrian GDP, which in 2007 was €272 billion. Hence, the production volume of the levered residential investments was 1.2 per cent of GDP.

Although the leverages cannot be compared directly, it is interesting to note that the public assistance fund WBF, producer and demand-sided subsidies included amounts to only 0.9 per cent of GDP. Thus, the Austrian housing subsidies, despite their strong role in subsidising supply, are moderate in size when compared across Europe, and the HCCB play a significant role in channelling investment towards housing policy goals.

Furthermore, there is a positive impact on the entire mortgage loan system, as the HCCB contributed to lower overall loan rates. While this side effect is difficult to capture in economic evaluations and welfare comparisons, it is nevertheless present.

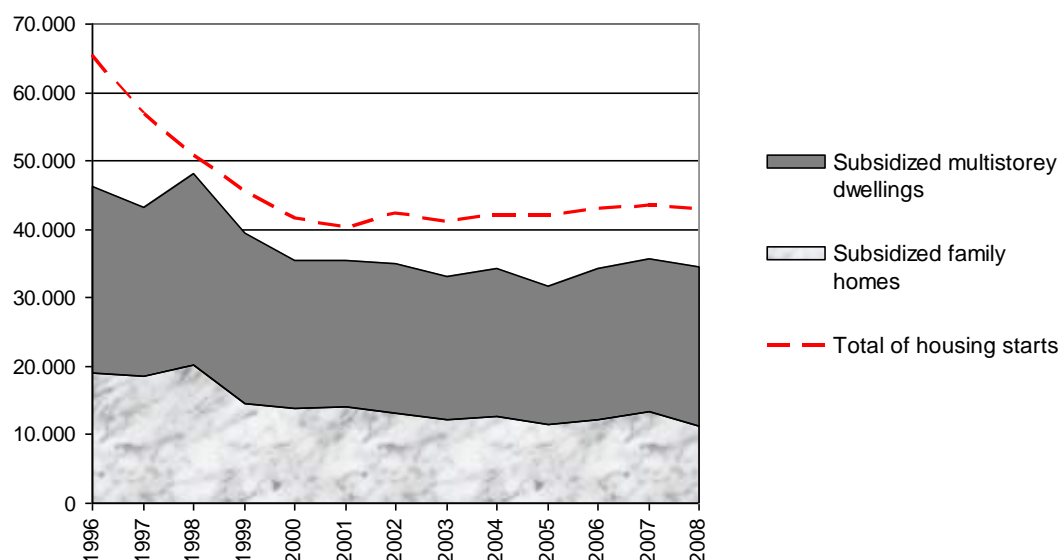
Figure 19: Annual volume of construction induced by HCCB 1994–2008



Source: Annual business reports and personal communication, own calculations

It is fair to mention that the volume of residential construction declined in the crisis year 2008. The HCCB responded with a decline in new emissions. In 2009, the emissions remained at lower levels as well. However, given the demographic situation in Austria, the expected future inflow from the Eastern European countries will likely drive up housing demand again, although not at the growth rates that arose with the demographic influx during the 1990s. Previous growth rates of HCCB-emissions are unlikely to be attained, but this perspective does not give rise to pessimism. Quite the contrary, one can reasonably expect that the system will attain a smooth and nearly stable path in the future.

Figure 20: Subsidised housing starts and numbers of units



Notes: data after 2003 are estimates, total starts: all dwellings, with and without subsidisation, first and second residences

Sources: Ministry of Finance, Subsidy authorities of the Länder, Statistics Austria, FGW

According to Deutsch and Oberhuber (2010), the Achilles heel is not the assistance rate as such, but rather a potential overinvestment into high cost rentals and scattered ownership settlements. Although the demand for social renting is unlikely to decline in the future, social providers may be faced with undue cost pressures if the rent revenues are undermined by social change (higher risk, lower-income tenants). Another concern is the sluggish progress in ownership among lower-income households. The authorities and banks considered a forced promotion of low-income ownership formation as too risky. In view of a rising volume of second hand ownership transactions, some Länder have already reduced the budgets for ownership formation. Such concerns are all too well confirmed by the recent crisis on real estate and capital markets in the US and the problems of shared equity in the UK.

To achieve the target of an adequate social mix in urban neighbourhoods and to foster the ownership rate at the same time, the Austrian housing law implemented the GBV-sector as a transactor, by attracting households with better income prospects that have a preference for a right-to-buy option upon entering new and high-quality non-profit dwellings (as outlined in Appendix 5).

8.3.1 Stability considerations a synopsis

When reflecting on the stability of the Austrian system, Deutsch, as co-author of this study contends that sustainable systems of housing provision rely on a variety of policies and instruments to serve different social strata and their needs. The recent literature has shown that housing provision on integrated rental markets (Kemeny et al. 2005; Deutsch 2007, 2009a, b) can widen the choice of households, and therefore can be considered more efficient than policies that operate on fragmented and sheltered markets and provide little choice for households.

The Austrian system of housing provision operates as an integrated market, as it allows for a wide range of tenure options through the interplay and synchronisation of institutions and instruments. In that system, the social rented sector forms an important centrepiece. To some extent, it owes its long-term sustainability to

constitutional laws, yet this alone would not guarantee its economic survival. The striking point is that, in spite of many regulations, the common good law still admits a variety of supply strategies in a rather flexible manner, which also receives active support from public bodies and the banking sector. The creation of the HCCB—Wohnbaubanken in the early nineties, permitted the introduction of efficient capital market refinance in a mortgage banking system that appeared outdated at the time.

Seen from that angle, the self-evident question is how social renting finance can be built on complementary and synchronised instruments. What terms and conditions are required to synchronise tenants down payments, private loans, public loans and means-tested personal benefits so that households get access in time? In order to assess the viability of such instruments, it is indispensable to find the right economic indicators that can serve as a benchmark. However, what kinds of benchmarks are appropriate?

It is argued that to understand the logic of the non-profit sector, one has to start with the treatment of equity. Profits must be reinvested, so that liquid or near-liquid assets can be held only over a limited period (in Austria, maximum five years), to be eventually injected into portfolios of new projects. Except for limited and administered profits disbursed to the company owners, there is no shareholder value to be maximised. It would therefore be misleading to search for indicators as if non-profit companies could simply mimic the profit enterprises. A good example is the ROE-target of 20 per cent; it makes sense in the private profit sector where the companies can fully dispose of their assets, but it is of little use in the non-profit sector where the trade of assets is restricted, and where the companies are committed to engage in projects that cannot satisfy the profitability criteria used elsewhere.

The right approach would address local financing conditions by considering the following questions: What is the adequate size of reserves that permit a steady flow of developments and modernisations? Which are the most important risk factors that could threaten the long-term service of repayments, beginning with the ability of tenants to pay their rents, then also from loan and bond repayments? What size of equity is adequate to absorb possible shocks? What can be said about the risk position of the public sector in that respect?

The recent financial crisis stimulates a few ideas. To start with, the HCCB, the Wohnbaubanken proved to be quite robust in difficult times, at any rate more robust than the (hardly comparable) mortgage bond securities market. Nevertheless, the Austrian HCCB had to absorb some capital withdrawal that required liquidity swaps from their mother banks. The basic question for the future is simple: To what extent might shocks from other parts of the economy spill over again? Is accumulated equity big enough to service the bondholders if the demand for loans slows down and new issuances are deferred?

In that respect, it is certainly an advantage that the HCCB-loans can be granted to any developer who complies with the rules, be it a non-profit company or a for-profit one. The public subsidy system supports the variety of customers through its policy of tenure-neutrality as it offers support to any kind of supplier whenever the subsidisation rules are fulfilled. One might even consider the weak-tenure neutrality as an important stabiliser, as it not only adds to housing welfare, it also contributes to the functioning of the financing system in the background.

The non-profit companies themselves are faced with a much smoother housing demand today. However, they are also aware of new tasks to be confronted. The most important of these, and one that will probably occupy them for years, is modernisation by energy saving and residential construction in fulfilment of the Kyoto

targets. Another aspect is that urban areas are growing (while rural areas lose population), adding to the demand for social rental housing. The problem is how to finance the environmental strategy for a population that is increasingly faced with job and income risks.

It is fair to say that these questions are far from being answered at the current state of research in Austria. But they will certainly challenge the traditional players in the housing provision sphere, and may even contribute to conflicts in the distribution of resources. For that reason they are on the agenda if public authorities plan to improve their instruments of social renting (Deutsch & Oberhuber 2010).

To conclude, social rental housing plays a central role in many Austrian housing careers; it is not a stigmatised or residualised tenure. Cost rent housing is available in sufficient quantities to promote affordability across the housing sector. Households access social rentals at various times, often returning later in life. It caters for the young when they enter the housing market; during periods of stress due to family breakdown and loss of income, and when elderly, attracted by the convenience of compact housing and nearby services of social rental housing in urban areas. Deutsch (2008) has researched 'astonishing mobility into and out of social renting', even if some tenants remain in social rentals for the long term, and notes that social renting is able to offer well located accommodation for key workers close to employment, contributing to regional productivity. Austrians do move from the social rented sector to ownership, but sometimes they also move the other way (Deutsch 2008).

Table 7: Evaluation of the Austrian housing bonds and housing banks

Cost effective	During the 2000s the HCCB quickly established itself as a mainstream investment choice for individual households. While the take up of bonds are considerable (est. 300 000), the main cost to government in terms of tax deductions is modest, but more evidence is required to substantiate estimates. The low rate loans able to be issued from the bonds are targeted to the cost rent cost capped rental sector.
Cost reducing	Tax privileges make low return bonds attractive to investors, consequently allowing for low interest loans at up to 1 per cent below market rates. There are regulations that require LPHA to use loans under a defined BP limit above the EURIBOR rate.
Rent reducing	Under the cost rent system, lower financing costs have a direct impact on rent levels. Any landlord can use the funds raised by the bonds, providing the conditions of cost rent cost capped housing are met. HCCB financed loans contribute 50 per cent to the project cost, thus their capacity to reduce financing costs is significant.
Equitable	All investors receive a basic tax benefit on the first 4 per cent of returns. The deduction of the cost of purchasing the bond is capped and only applies to individuals and the amount that can be deducted increases as their incomes decline. New housing increasingly relies on the developer's own asset base to provide equity and/or additional tenant equity. There are preliminary trends that rental housing production is declining in preference for rent to buy, promoting the necessities of financing and the declining role of public loans.
Appropriate risk allocation	There is no formal guarantee in the base of default by LPHA, which is given by the government to the banks for the loans based on HCC Bonds. This is not considered necessary, given the role of public loans in project finance.
Impact on public finances	The Austrian Government, at all levels, plays a key role in subsidising social housing estimated to cost 0.9 per cent of GDP. Federal Government indirectly subsidises social housing via HCCB's tax exemptions at an estimated €120 million (\$192 million) per annum. State governments provide subsidy programs and local governments play an important role facilitating access to land.
Robustness	The housing banks, coupled with subsidy programs and cost rents, have provided a tool for countercyclical construction activity, stabilising housing markets and moderating rents in a growing city. However, the provision of a guarantee on regular savings products during the GFC has drawn investors to supposedly safer investment products.
Feasibility	Declining public loans and the strict cost rent limits required a joint approach by the Federal Government and banks. The HCCB is a mechanism supported by private banks that compete for LPHA business.
Effective delivery	Five Housing Banks, subsidiaries of bank groups, compete to fund the LPHA sector, increasingly with competition from commercial banks. They have strong expertise in assessing proposals within the cost rent regime. There are cost efficiencies being located within the mother bank.
Enhances capacity	Given the increasing reliance on commercial loans, the housing bond and housing banks play a crucial role in reducing the volatility and level of interest rates affecting mortgages.

9 RELEVANCE TO AUSTRALIA

The Austrian model is interesting for policy-makers and financiers not only because it has been successful and resilient in stabilising housing markets and has provided quality housing outcomes, but also because it provides lessons for countries seeking to reform, reinvigorate or establish new social housing systems, as in Australia.

9.1 Drawing lessons from the Austrian model

In order to draw lessons from the Austrian model, it is important to abstract the qualities of the Austrian system that have made it so successful.

As mentioned earlier, the viability of Austrian social landlords is secured by using cost rents, with projects financed by own equity, tenant deposits, public loans and low cost capital market loans. This business model does not depend on income related rents—which greatly increases the risks to landlords that rents are too low and politically determined and assistance inadequate to address the gap between rents paid and the cost of provision.

Rather, the Austrian rent regime is based on cost rents, open to a range of incomes including low-income households—thus avoiding the concentration of social disadvantage that plagues larger public housing projects which have pursued narrowly targeted allocations. Furthermore, rent assistance is available to those who cannot afford the cost of decent housing. Thus, the housing system is not expected to compensate for inadequate incomes or meagre social welfare. Rather, its role is to provide decent housing in the most cost effective manner that in turn reduces the burden on wages and welfare.

Given the well substantiated need for affordable rental housing in Australia, there is certainly demand for a professional, well-regulated rental market that can provide a substantial supply of long-term and secure tenancies. For such a market to be affordable, supply subsidies and privileged financing streams could be used to induce investment and reduce rents. However, it must be supplemented by adequate demand assistance to assist households with low or sudden loss of income when required.

The delivery of cost rent housing relies on the effective and efficient management of costs. The Austrian model provides a regulatory framework that aims to improve efficiency in the land, building costs, financing costs and administration, while ensuring quality standards through both regulation and well-functioning competition to promote efficiency and innovation in the housing services provided.

Social housing organisations are subject to quite specific financial regulations regarding their realm of activities, investments and profits. Surpluses where generated must be reinvested in affordable housing and they must continue to supply dwellings or merge with an organisation that does. While they are self-audited, they are clearly accountable to subsidy providers at both the municipal and provincial level. Furthermore, competitions for available sites and subsidies promote transparency and efficiency in project proposals.

This arrangement improves not only their strategic role and efficiency, but also their credit worthiness and low risk for lenders of credit.

An important operational aspect, and the focus of this report, is the way that government has steered private tax favoured investment into required housing construction. Rather than enable financial markets to determine the level of housing investments and indeed housing costs, this mechanism ensures an adequate supply

of decent affordable housing by co-financing bond financed developments with public loans (Amman, Lawson & Mundt 2009).

Thus, special agreements have been established with six housing construction banks to sell bonds which ensure that capital raised is directed towards approved affordable housing projects that are eligible for public support. Many of these banks have a long standing relationship with developers of affordable rental housing and understand their business needs and thus provide a constructive role in meeting their financing needs.

Importantly, in the spirit of tenure-neutrality, loans financed by HCCBs are granted to municipal, non-profit and for-profit providers on identical terms, providing the recipient is willing to operate under prescribed affordability constraints, that is, rent levels must not exceed the ceilings set by the Länder subsidy schemes. Private providers are still able to make profitable returns on their investment using long-term sales strategies, such as let to buy schemes, while remaining within the income limits of approved schemes (Deutsch, personal communication).

9.2 Potential relevance to Australian conditions

As mentioned in the stage 1 review of international financing mechanisms completed for this project, isolated policy instruments cannot be transplanted from one country to another without careful evaluation of the host context and appropriate adaptation. Policy development does not take place in a vacuum. However, increasingly the Australian housing policy-making environment is well informed, reflective and critical of models elsewhere. The next stage is to employ insights from practice in Australia and overseas to build the kind of financial arrangements that will work in this country and respond to its housing needs. Towards this goal, this section identifies several requirements for the establishment of an Australian housing bond finance system.

To begin, we recommend a number of foundations or pillars that need to be consolidated. First, an established and financially sound social/affordable housing sector, which not only targets low-income tenants but is open to a mix of household incomes, is socially accepted and inclusive with appropriate subsidies for income constrained households. Second, a national agency or federation will be required to accredit, audit and regulate the affordable housing sector, and promote its financial continuity and credit worthiness. Third, there must be a willingness among long-term institutional investors to invest in the sector, which implies adequate returns to investors and financial viability for providers. This can be addressed either by subsidies to investors/providers, as in the Austrian case, or by subsidies to tenants as used in several other countries. From the limited comparative data available to us on national housing expenditure, the Austrian model appears to be very cost effective. Fourth, tax rulings should be made at the start of the scheme so that each bond offer does not require an individual ruling. Finally, there must be a national institutional structure to sell bonds, such as the Austrian legislation which sets out a framework for their sale by subsidiaries of private banks willing to lend to the sector.

Furthermore, the Austrian model illustrates key dimensions for the development of a quality, affordable rental tenure that is accessible for low and moderate household incomes and consequently is socially accepted. Such a model in Australia could be based on the following attributes:

- Business model—rents must cover costs, profits are limited and any assets accumulated with the benefit of public loans, grants and tax privileged private investment must be retained in the affordable rental sector; any surplus

accumulated from subsidised dwellings must be ploughed back into new supply or major renovations.

- Co-financing—well managed, adequately regulated and viable limited profit associations, reliably co-financed with very long-term low interest public loans as well as own equity, to ensure the most favourable terms and conditions for private finance.
- Land, construction, finance and management costs are carefully managed and, where possible, reduced by strategic subsidies and positive forms of competition—to ensure efficient and cost effective management and construction of well-designed homes built to meet a decent standard.
- Rent regime—cost rent to cover finance, operational and construction costs, with provision for planned maintenance and planned periodic upgrade to ensure that quality and value is maintained, indexed to changes in CPI.
- Subsidy model—balanced use of supply and demand-side subsidies, both direct and indirect, fair and transparent competition in access to development opportunities; taxation privileges tied to requirements of social task of landlords, conditional public loans and grants to ensure that local housing and urban planning objectives are achieved.
- National legislation—established regulations governing the limited profit cost rent business model, outlining auditing standards and reporting arrangements and specifying the conditions for the sale of bonds and their tax treatment to raise investment for cost rent affordable rental housing.

These requirements are consistent with advice provided to governments in Australia about how to establish a successful private financing model for affordable housing (e.g. Lawson et al. 2009; AHNRC 2001; Yates 1994). There is no quick fix to solve the problems that have become inherent in the Australian system of housing provision, nevertheless it is imperative that policy-makers begin to build the financial institutions and delivery mechanisms required to supply an adequate level of socially inclusive, affordable and quality housing options for the next generation of Australian households.

9.3 Recommendations

The Austrian model has many features of interest to Australian policy. A genuine enthusiasm for cooperation with Australia was expressed by the Vienna Government, the housing bank sector and the limited profit housing organisations on these issues. Flowing from the above discussion, we recommend collaborative investigation of the following:

1. Business modelling to determine the nature and level of supply subsidies required to attract stable and low-cost finance that will result in affordable rents for moderate income earners, provided under limited profit cost rent conditions.
2. The demand assistance required to enable low-income households to achieve access to this housing.
3. The capacity of land development agencies to promote a competitive market for the development of affordable rental housing to meet planning goals and housing needs, drawing on the innovations presented by Wohnfund.
4. The design of a housing supply bond addressing investor demands, specifying the purpose of raised funds, and incorporating necessary regulatory and taxation instruments, drawing on the innovations presented by the HCCB.

5. A focused capacity building event involving key experts directly involved in the investment, development and management of limited profit cost rent affordable housing in Austria to enable their engagement with key stakeholders in the Australian context.
6. The publication of this study to promote the exchange of knowledge, discussion and reflection.

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APPENDICES

Appendix 1: Housing promotion budget

Table A1: Housing promotion budget 1980–2005

	Federal funds	%	Provincial funds	%	Returns	%	Income from interest	Total*
1980	828	80	72	7	128	12	3	1031
1981	929	80	94	8	127	11	3	1153
1982	965	76	133	1	167	13	3	1268
1983	1.015	78	128	1	151	12	5	1299
1984	1.023	76	150	1	165	12	4	1342
1985	1.140	76	1	1	178	12	5	1324
1986	1.212	76	187	1	196	12	5	1600
1987	1.242	77	146	9	219	14	4	1611
1988	1.532	80	39	2	338	18	1	1910
1989	1.308	75	54	3	377	22	4	1743
1990	1.294	80	55	3	239	15	26	1614
1991	1.444	81	84	5	238	13	18	1784
1992	1.581	75	26	1	469	22	20	2096
1993	1.654	73	64	3	541	24	21	2280
1994	1.622	68	263	1	478	20	19	2382
1995	1.779	74	195	8	488	20	10	2472
1996	1.792	70	185	7	594	23	8	2579
1997	1.798	66	270	1	653	24	13	2734
1998	1.795	68	104	7	570	24	17	2486
1999	1.795	68	94	6	621	25	15	2525
2000	1.794	66	-33		927	34	27	2715
2001	1.784	65	222	8	745	27	13	2764
2002	1.781	72	162	7	531	21	11	2485
2003	1.781	69	201	7	585	23	8	2575
2004	1.781	66	197	7	656	24	9	2643
2005	1.781	64	194	7	781	28	10	2766

* Excluding income due to the sale of receivables

Source: Luggner 2007, drawing on annual statistics produced by GBV and Bauer

Appendix 2: Housing promotion expenditure

Table A2: Housing promotion expenditure 1980–2005

	Building loans/ subsidies	%	Loans to assist individual purchase	%	Housing benefit	%	Mortgage- interest relief	%	Renovation and rehabilitation loans/ subsidies	%	Total
1980	766	76	46	5	65	6	110	11	24	2	1011
1981	874	74	56	5	76	7	129	11	38	3	1173
1982	923	73	53	4	92	7	161	13	35	3	1264
1983	973	71	61	5	104	8	173	14	28	2	1339
1984	935	71	52	4	116	9	169	13	49	4	1321
1985	996	70	52	4	121	9	186	13	65	5	1420
1986	976	69	46	3	122	9	178	13	90	6	1412
1987	1092	69	48	3	127	8	172	11	134	9	1573
1988	1160	72	54	3	132	8	157	10	105	7	1608
1989	1173	68	49	3	123	7	146	8	235	14	1726
1990	1144	66	37	2	111	6	176	10	272	16	1740
1991	1123	63	39	2	103	6	184	10	327	18	1776
1992	1334	65	22	1	107	5	182	9	404	20	2049
1993	1547	65	24	1	92	4	201	8	421	18	2285
1994	1672	66	29	1	128	5	197	8	509	20	2535
1995	1605	65	30	1	136	6	197	8	495	20	2463
1996	1435	61	31	1	138	6	236	10	519	22	2359
1997	1412	59	27	1	151	6	286	12	607	25	2483
1998	1477	59	23	1	138	6	290	12	589	22	2517
1999	1264	54	30	1	152	7	332	14	569	24	2347
2000	1763	61	26	1	145	5	379	13	594	20	2907
2001	1035	47	15	1	177	8	403	18	576	26	2206
2002	1156	50	0	0	195	8	442	19	536	23	2329
2003	1152	50	0	0	197	8	470	20	501	22	2320
2004	1194	50	0	0	201	8	468	20	534	22	2397
2005	1050	46	0	0	193	8	500	22	557	24	2300

Source: Lügger 2007, drawing on annual statistics compiled by Bauer, GBV

Appendix 3: Housing bond announcement

NEW BAWAG P.S.K. WOHNBAUBANK CONVERTIBLE BOND (24.01.2007)

New BAWAG P.S.K. Wohnbaubank Convertible Bond with Top Yields

Variable Bond with No Price Risk

Demand has been high for the recently issued new BAWAG Wohnbaubank bond. Which is no surprise considering that the bond offers significantly higher yields than available from any comparable competitor product.

The bond is currently being offered in two forms:

- An 11-year fixed-interest bond with a coupon of 4 per cent per annum .
- An 11-year variable interest bond with a EURIBOR-linked coupon; the nominal interest rate for the first period is 3.5 per cent per annum.

The variable-interest version of the Wohnbaubank bond offers an additional incentive: BAWAG P.S.K. has issued the bond with a guaranteed fixed redemption price of 100 per cent at every interest rate adjustment date (quarterly). This makes the bond especially ideal for investors seeking to reap the tax benefits of a bond from a residential construction bank, but who also want to invest with **no price risk**.

The bonds can be subscribed at any BAWAG branch or post office.

For further information, please contact:

BAWAG P.S.K. Press Office
Georg Coch Platz 2
A-1018 Vienna
Thomas Heimhofer, Phone +43 / 1 / 534 53 / 31210

Source: BAWA Wohnbaubank Available online:

http://www.bawag.com/bawagpsk/BAWAGPSKGruppe/Oesterreich/nav_en,setId=bawagpsk,path=2A126880_2A_2F126868_2F126880_2F127424_2F120994_2F121002_2F193972.html

Appendix 4: Valuing the assets of Limited Profit Housing

It is important to distinguish between GBV-finance and for-profit providers, namely the treatment of equity. Profits have to be reinvested, so that liquid or near-liquid assets can be held only over a period of maximum five years, to be injected into the portfolio of new projects. The composition of such a portfolio can vary, but the leverage effect geared by equity is limited as risky speculation with liquid reserves is forbidden and site values can enter the portfolios only at the prices of acquisition, certain limited compounded interest and revaluations notwithstanding. Hence, in contrast to for-profit real estate funds and developers, speculation with excessive leverages through overvalued assets remains excluded in principle.

The rules imposed on equity do indeed govern the choice of the instruments in Austrian social renting finance. Its logic can be characterised by a project portfolio that typically consists of the following items:

- Equity from the social developer, either liquid assets or plots or both.
- Equity from the tenants, depending upon the type of dwelling.
- Public assistance in the form of grants or public loans, disbursed by the Länder governments.
- Capital market refinanced HCCB first lien loans at preferential rates.
- Alternatively, other first lien loans like Bausparkassen-loans, which are not discussed in the present study.

The stylised portfolio does not only apply to the GBV-sector, it also applies to municipal rental finance, in particular in Vienna, where the developing agency is subject to the same modes of finance as the GBV. It also applies, with certain modifications, to for-profit developers who supply social rentals in the sense described below. The Austrian social rented sector is therefore embedded into an integrated market where social renting competes with other types of housing supply.

The capital-market refinanced loans cannot exceed some 62 per cent of total value. Since equity usually does not cover more than 20 to 25 per cent of total value, the remaining gap has to be closed by public assistance from the Länder governments (public funding or WBF). In fact, virtually all social rental units in their proper sense are developed with the aid of that fund.

The public funds are disbursed to ownership and social renting, the majority of Länder also support profit developers. The disbursements are granted as public loans, annuity or interest subsidies, depending on Länder laws. The subsidies are designed in such a way that the hierarchy of an otherwise market-determined cost structure remains unaltered. The Austrian WBF can therefore truly be termed 'weakly tenure neutral' along the lines of Thalmann (2007).

Any subsidised developer has to comply with rent ceilings, limited profit rules and maximum dwelling surfaces. Quality, and recently also ecological, standards, are mandatory. In that sense, the subsidy system aims not only at social welfare, but also at continuous quality filtering. In fact, the social providers today are leading in environmental standards, which obviously imposes cost.

Households are eligible for social rentals whenever their current income exceeds a ceiling somewhere between the median and the mean household income. The aim of this 'soft' targeting is to foster social cohesion through a mix of tenants, ranging from the poor to the middle class with better income prospects. Thus, in his survey about social renting in Europe, Ghekière (2007) has positioned Austria among the systems

of generalist type (means-tested access). But the system can also be termed universalist (no access restrictions) because it does not exclude households with accumulated savings (often transferred from the family or inherited). That liquidity is needed to cover the tenants' down payments into flats where required.

The HCCB-loans are granted to any social rental provider and for-profit provider whenever the company complies with the subsidisation rules that are prescribed by the Länder, regardless of whether a subsidy is actually granted in parallel or not. After the loan has been repaid, the subsidy restrictions tied to the loan are lifted. During repayment, the for-profit rentals are therefore also 'social', but after repayment the for-profit providers can fully dispose of their real estate asset (unless a public loan is still in repayment). Instead, the social providers have to continue with rent setting within the ceilings prescribed by the MRG and WGG laws.

The final remarks concern the equity components in the portfolio. While the really poor are allocated without down payment in the existing older social stock, down payments for entry into the existing high quality stock are mainly demanded by associations. The portfolio issue outlined above refers to newly built or thoroughly modernised units.

The social providers have to calculate with cost based rents, and what will keep internal finance and liquid reserves within bounds. Consequently, the liquid assets of the GBV are often rather tight. Only the companies with revenues from a large and mature rental stock dispose of sufficient equity. Since the acquisition of plots often absorbs much of the disposable reserves, the city of Vienna has created a 'land provision fund' that supplies urban sites at prices that can be absorbed within the rent ceilings. In other parts of Austria, cheap land depends on the support from local communities.

Since site procurement absorbs much of available reserves, the construction itself must be financed from other sources. The producer subsidies serve as an equity substitute, but they cannot close the financing gap for all dwellings. For that reason, various risk sharing arrangements between the providers and the tenants have evolved. The most important arrangements are entry down payments into newly built social units, which cover part or all of the unit plot price. The down payments apply to municipal dwellings in Vienna and to the GBV, but for low-income households they are not mandatory.³⁰ To compensate the tenants who can afford a down payment, an amendment passed in 1993 now obligates the non-profit providers to trade the equity of tenants against a right-to-buy, as dealt with in the following Appendix 5.

³⁰ Social providers are obligated to comply with an administered share of lower-income households, which in exchange for subsidisation are allocated by the local authorities, in Vienna, over 30 per cent of newly built units. Usually they do not pay a down payment, but only a smaller amount for unit insurance.

Appendix 5: A focus on the right to buy

To achieve the targets of an adequate social mix in urban neighbourhoods and to foster the ownership rate at the same time, one avenue considered in Austria is to use the GBV-sector as a transactor, by attracting households with better income prospects that have a preference for a right-to-buy option upon entering new and high-quality non-profit dwellings.

In theory, the right-to-buy may sensibly be based on the principles of profit sharing and sustainability.³¹ The author has offered a theoretical underpinning using the recent contribution of E. Deutsch (2009b). In theory, the right-to-buy may sensibly be based on the principles of profit and risk sharing, together with sustainability. The social 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 down payment upon entry, which gives the right to exercise the option that the unit will be converted into his or her ownership later on.

In practice, an amendment passed in 1993 now obligates the non-profit providers to trade the down payments of entrants into new social residences against a right-to-buy. The down payment serves as a call option to buy the unit after 10 to 15 years. If the dwelling is not converted, the option is lost. At the current state of the law, the later purchasing price must be set at book value upon conversion, minus outstanding debt plus some share of initial subsidy, depending on Länder laws. This results in a call option price of 5 to 20 per cent of initial value. While the option price is lost, there remains a substantial gain because the value added tax of 20 per cent on property acquisition is waived after the 10 years waiting time. The first waves of exercised options are currently under way. Expert interviews point to two major obstacles: one is the repayment of subsidies, the other one is the non-tradeability of the option.

Firstly, the many subsidy channels make the Austrian right-to-buy schemes rather a patchwork than a device derived from principles. In fact, the schemes were repeatedly adjusted to prevailing accounting and subsidy rules. That makes 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 about how to improve that situation. One simple solution was to waive the repayment of subsidies for first time buyers. Indeed, the Länder that performs this practice acknowledge a higher share of converted units than the City of Vienna and Styria where repayments are still mandatory.

Secondly, to enlarge the scope of choices, the right-to-buy could be amended by trading the option against ownership units in the neighbourhood or elsewhere, under new forms of cooperation between the non-profit providers and the financial institutions. The author proposed a procedure that 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), while paying out some portion of the capitalised return from renting to the cooperating company (which imposes cost); the cooperating company will then offer an ownership unit to the tenant. An adjustable option necessitates it to build up liquidity reserves, which makes the provision of alternative units later on feasible. The efficiency gains for the households and the social rented sector could nevertheless be substantial. In particular, the down payments would improve the liquidity position of the providers, so that the units lost by the right-to-buy could be steadily replaced.

³¹ The author has offered a theoretical underpinning in the recent contribution of E. Deutsch 2009b.

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