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HOUSING FINANCE REFORM IN THE NETHERLANDS

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Abstract

The current housing finance system in the Netherlands is a poor reflection of the government's policy priorities. It does not safeguard affordability for low-income households, it fails to produce sustainable and energy-efficient housing, it stimulates over-consumption in the owner-occupier sector, it is far from tenure-neutral, and it obstructs mobility on the housing market and the labour market.
The Dutch government refuses to even consider reforms. In 2007, a report issued by the VROMRaad (Council for Housing, Spatial Planning and the Environment) which advocated changes to the housing finance system was welcomed by key stakeholders. At the moment, a team of experts from the Social Economic Council (*Sociaal-Economische Raad / SER)* is preparing a new proposal, which will elaborate and refine the VROM Council report. This team – of which the author of this paper is a member – hopes to publish its recommendations in the second half of 2009.
This paper explains how the current Dutch housing finance system works and analyses its weaknesses against the backdrop of a free housing market and the national policy goals. It discusses a number of policy alternatives and specific policy dilemmas. It ends with conclusions on the potential relevance of the analysis for other European countries.

Keywords: Housing finance, tenure-neutrality, housing policy, mortgage interest relief, housing voucher, the Netherlands.

HOUSING FINANCE REFORM IN THE NETHERLANDS

1. Introduction

Since World War II successive governments in the Netherlands have tinkered with the housing finance system. Anyone who thought that the housing finance system would improve progressively over the years must be feeling rather disillusioned. Any modicum of logic or consistency that ever existed in the system has disappeared and what remains has very little in common with the current government priorities; for example, it does not safeguard affordability for low-income households, it stimulates over-consumption in the owner-occupier sector, it fails to produce sustainable and energy-efficient housing, it is far from tenure-neutral, it leads to long waiting lists in the rented sector, it encourages owner-occupiers to take risks on the financial markets and it hampers mobility on both the housing market and the labour market.

The current coalition behind Cabinet Balkenende IV has refused even to consider changes to the housing finance system, despite advice to the contrary from the VROMRaad (Council for Housing, Spatial Planning and the Environment) in 2007. The report by the VROM Council was welcomed by a surprisingly broad group of stakeholders, including the Tenants' Union, the Association of Owner-Occupiers, Aedes (the umbrella organisation of housing associations), the construction industry and private developers.
At the moment, a team of experts from the Social Economic Council (SER) is preparing the next (and decisive?) reform proposal for housing finance elaborating and refining the VROM Council report. This team – of which the author of this paper is a member – hopes to publish its recommendations in the second half of 2009.
Section 2 explains how the current Dutch housing finance system works and analyses its weaknesses against the backdrop of a free housing market and national policy goals. Section 3 presents the arguments and proposals of the VROM Council. Section 4 discusses a number of strategic choices for reform and Section 5 offers some building blocks for a housing finance reform. Section 6 draws conclusions about possible lessons for other European countries.

2. The current housing finance system in the Netherlands

The foundations of the housing finance system were laid during and after World War II, when the Netherlands was plagued by a huge housing shortage. They consisted of a rigid rent policy starting with a rent freeze between 1940 and 1951, followed by a system of differentiated rent regulation, which applies to 95% of the rented stock to this very day. In the hope of encouraging contractors to build new homes, an elaborate subsidy system was developed for the vast majority of new rented dwellings. Housing associations and commercial landlords could claim these subsidies if their projects met certain government-imposed conditions. Both the municipalities and the housing associations played a dominant role on the house-building market from the 1950s through the 1980s. When the Dutch economy gathered strength and long-term interest rates dropped, the conditions for owner-occupiers gradually improved. In the years between 1945 and 1990 there were two winners: social rented housing (mainly via new dwellings) and owner-occupation (via new dwellings and the sale of rented dwellings). The big loser was the commercial rented sector. In 2008 the tenure in the total housing stock consisted of approximately 55% owner-occupied housing, 32% social rented housing and 13% commercial rented housing.

Since the 1960s Dutch housing associations were gradually becoming more autonomous (Gerrichhauzen, 1990; Faber, 1995). In 1995 this process suddenly accelerated, when all property subsidies in the rented sector were stopped (Priemus, 1995). Instead, the housing associations received the present-day value of the subsidies which the government had pledged for the coming decades. In the same year the housing associations had to convert their public loans into private loans and to accept many of the financial risks that had hitherto been borne by the government. After 1995, social housing administrators could add treasury management to their task portfolio. The trend in interest rates after 1995 was much more favourable than had been assumed during the Grossing Operation. As a result, the housing associations grew richer. They also started selling more dwellings, which added to their wealth. The entrepreneurial spirit spread like wildfire throughout the social rented sector, where the mergers had been coming thick and fast since the 1990s. The largest housing associations (Ymere Amsterdam, Vestia The Hague/Rotterdam and the Alliantie Amersfoort) currently own about 60,000 dwellings each.

The rapid growth in owner-occupation increased the concentration of low-income households in the social rented sector (van Kempen & Priemus, 2001; 2002), although there is still a relatively broad socio-economic differentiation of tenants in Dutch social housing (Dieleman, 1999).
Since the 1970s, financial support in the rented sector has taken the form of housing allowances (Priemus & Kemp, 2004; Priemus *et al.*, 2005; Kemp, 2007; Priemus & Elsinga, 2007). Little more than a tiny scheme to begin with, the housing allowance developed into a robust policy instrument, accounting for some 2 billion euros in the annual budget of the Housing Minister (by far the largest item).
The owner-occupied sector is supported first and foremost by mortgage interest relief. Mortgage interest is tax-deductible for thirty years and is combined with a very low imputed rent, which is added to the taxable income of the household. In 2005, 3.7 owner-occupier households added an imputed rent of 4.5 billion euros to their taxable income and deducted 25.9 billion euros from their income tax (VROMRaad, 2007: 106).
Finally, when a housing unit is sold, a transfer tax of 6% of the total price must be paid. Transfer tax generated 2.5 billion euros for the tax authorities in 2004 (VROMRaad, 2007: 110), but it seriously obstructs mobility on the housing and labour markets.

Social rented housing accounts for a larger share of the housing stock in the Netherlands compared with many other European countries while commercial rented stock accounts for a relatively limited share (See Table 1, borrowed from Whitehead & Scanlon (2007).

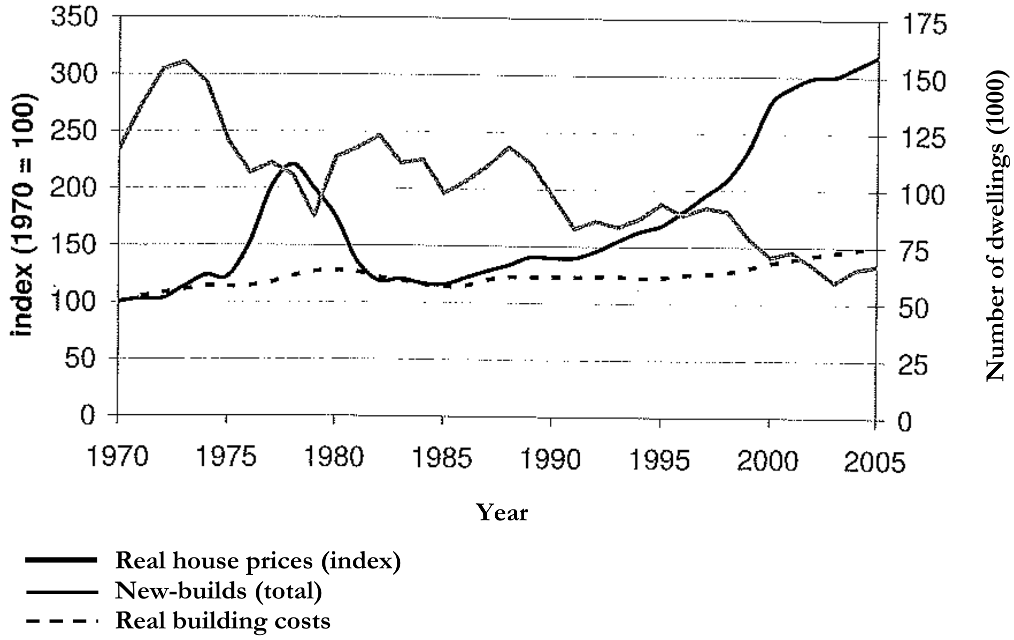
Table 1: Tenure of housing stock in nine European countries (horizontal %)

	Owner-occupied sector	Commercial rented sector	Social rented sector
Netherlands	54	11	35
Austria	55	20	25
Denmark	52	17	21
Sweden	59	21	20
United Kingdom	70	11	18
France	56	20	17
Ireland	80	11	8
Germany	46	49	6
Hungary	92	4	4

Source: Whitehead & Scanlon (2007); Besseling *et al.* (2008: 14)

Besseling *et al.* (2008) point out that, because of inelasticity of the supply, subsidies and mortgage interest relief are not stimulating supply but merely pushing up prices (see Figure 1).

Figure 1: Number of new dwellings per year and index of real house prices, 1970 - 2005



Source: Besseling *et al.* (2008: 28).

Table 2 presents an overview of the implicit and explicit subsidies in Dutch housing policy in 2006. The effects of rent control (transfers from landlords to tenants) are erroneously entered as subsidies.

Table 2: Implicit and explicit subsidies in Dutch housing policy (2006)

	Total (billions of euros)	Average household	
		(Euro x 1,000)	(%)(b)
Owner-occupiers	14¼	3¾	22
Mortgage interest relief (a)	11¾	2¾	18
Box 3 Exemption surplus value	7½	2¼	11
Imputed rent for home-owners	- 2	- ½	- 3
Transfer tax	- 3	- ¾	- 5
Tenants(c)	14½	4¾	49
Rent regulation	8	2¾	26
Landlords	4½	1½	15
Rent allowance	1¾	½	7
Real estate tax			
Owner-occupiers	- 2¼	- ½	- 3
Tenants(d)	p.m. entry	p.m. entry	p.m. entry

(a) Including exemption capital redemption insurance and the mortgage costs.
(b) In percentages of the 'market rent' for tenants and the 'imputed rent' for owner-occupiers.
(c) The subsidy for tenants means that the government spends less on the housing allowance. A small part of the tenants' benefit therefore eventually ends up in the government coffers.
(d) It is not entirely clear how much of the (increase in) real estate tax the housing associations charge to their tenants. The property valuation system does not award points for real estate tax. In addition, some of the real estate tax is implicitly returned to the housing associations if the municipality releases land at a lower price. Any increase in housing costs occasioned by real estate tax that is actually incorporated in the rent is offset by the decrease occasioned by the rent policy.

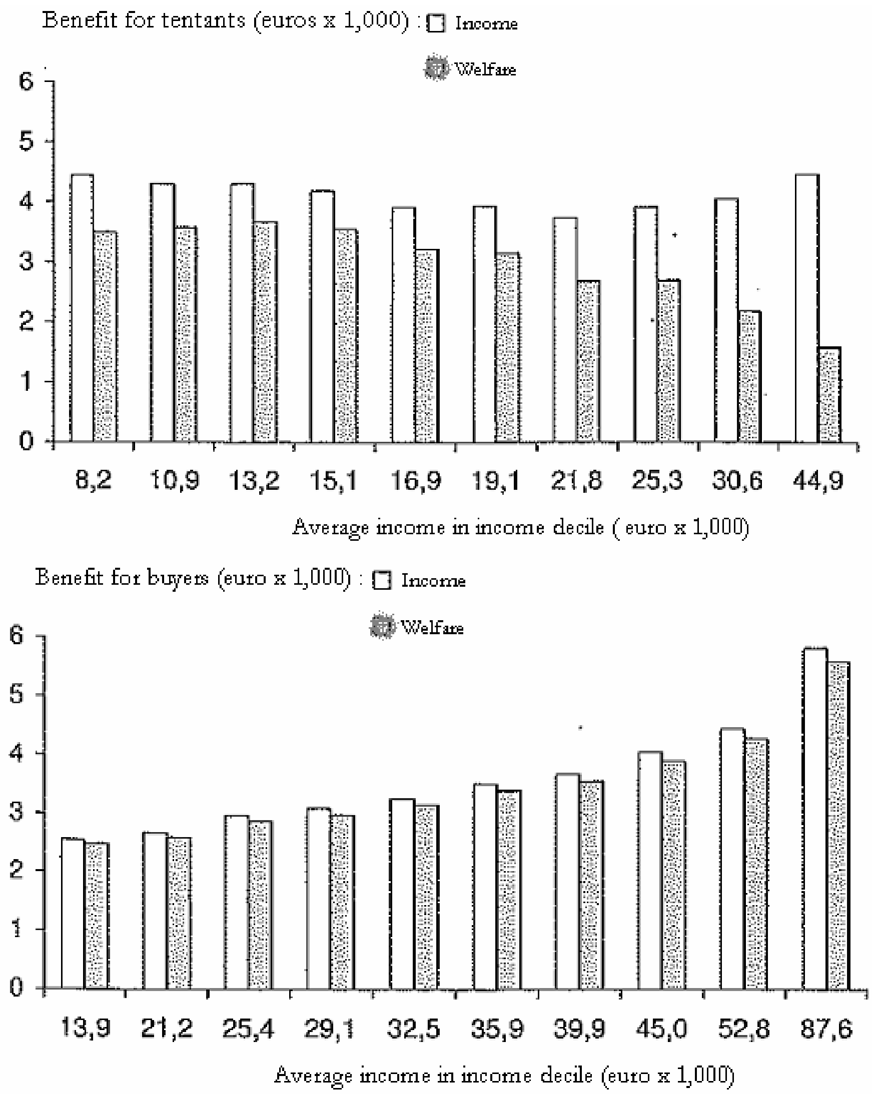
Source: Besseling *et al.* (2008: 50).

The distribution of the implicit and explicit housing subsidies across the income deciles is strange to say the least. Though the housing allowances in the rented sector end up largely with low-income households, in accordance with the purpose of the scheme, it is the middle-income groups that reap most of the benefits of rent regulation. On balance, the distribution of subsidies in the rented sector is mildly progressive.

Whereas state support is higher in the rented sector when the household income is lower, it is higher in the owner-occupier sector when the household income is higher (Aaron, 1972; Ritzen *et al.*, 1977; de Kam & Priemus, 1979).

In the owner-occupier sector it is the high-income groups that profit most from the tax benefits. Figure 2 shows the wide divergence in state support across the income deciles in the rented and owner-occupier sector (Besseling *et al.*, 2008: 55). All in all, the subsidy system and the tax regime are causing strong distortions on the housing market (ter Rele & van Steen, 2001).

Figure 2: Distribution of explicit and implicit housing subsidies among tenants and owner-occupiers



* The figure shows only the benefits for residents. These have not been offset by the drawbacks for the treasury or landlords.

Source: Besseling *et al.* (2008: 55).

The welfare effects of housing and tax policy manifest themselves not only on the housing market but on the labour market as well (Besseling *et al.*, 2008: 59).

Table 3: Impact on welfare from implicit and explicit housing subsidies

	Tenants	**Owner-occupiers**	**All households**
	(billions of euros)		
Direct welfare effects of disruptions in the choice of housing	3.9	1.2	5.1
Reduction in housing costs	2.5	0.5	3.0
Transfer tax	1.4	0.7	2.1
Labour market	09.0	0.3	1.2
Inefficient consumption package	0.3	0.1	0.4
Inefficient matching housing market	0.1	0.0	0.1
Inefficient matching labour market	0.5	0.3	0.8
Productivity	0.4	0.2	0.6
Labour participation	0.1	0.0	0.1
Agglomeration benefit	pm entry	pm entry	pm entry
Rent-purchase decision/portfolio composition	pm entry	pm entry	pm entry
Total	4.8+pm entry	1.5+pm entry	6.3+pm entry

Source: Besseling *et al.*, 2008: 59.

Table 4 summarises the net subsidies in the owner-occupier sector.

Table 4: Net subsidies in the owner-occupier sector, 2006 (x billions of euros)

Mortgage interest relief(a)	11¾
Foregone return on capital levy	7½
Proceeds from home ownership	- 2
Transfer tax	- 3
Net subsidy on home (State)	14¼
Real estate and other local taxes	- 2¼

(a) Including exemption capital sum insurance.
Source: Koning *et al.*, 2006: 10; Conijn, 2008: 157.

Conijn (2008: 157) has this to add (in translation):

> "Mortgage interest relief pushes up property prices in the owner-occupier sector and has profound implications for the workings of the housing market. On the one hand, mortgage interest relief lowers the price of the housing; on the other, it raises the price of housing services. As most of the tax benefits are enjoyed at a higher price level, they have little or no effect on the demand for housing services either in the case of first-time buyers or movers on the owner-occupier market. A reduction in the mortgage interest relief would lower prices and trigger a disproportionate fall in the capital invested by the owner-occupier in the dwelling. After all, a fall in prices would do nothing to bring down the housing debt. The more the dwelling is financed with a mortgage, the stronger the relative fall in equity. If mortgage interest relief were to be cut, the negative impact on equity would affect the demand for housing services. Finally, the price increases that mortgage interest relief has caused in the owner-occupier sector have a deep impact on the workings of the rented market".

Another shortcoming in the Dutch housing system is the obscurity surrounding the position of the 450 housing associations. These organisations manage around 2.4 million housing units and are accused of illegally accepting state support and undermining fair competition with commercial landlords (Dormal Marina, 2005; Smits, 2005; de Jong *et al.,* 2005; Priemus, 2006a; Gruis & Priemus, 2008). In 2005 housing minister Dekker suggested that this problem could be solved by splitting housing associations into a legal entity with a social profile and a legal entity with a commercial profile (Dekker, 2005b; Dekker, 2005c; Dekker, 2005d; Priemus, 2006b). The Dutch government did not take a decision on the proposal.

Meantime, more and more questions are being asked about the exact remit of the housing associations. Some people complain that housing associations have become too far removed from their public framework. At all events, the results of the social remit seem difficult to gauge (van der Zon, 1995; Walker & van der Zon, 2000; Nationale Woningraad, 1996). Finally, questions are also being raised about the efficiency of housing associations, which are, after all, underexposed to the discipline of the market (CPB, 2002; Hakfoort, 2002; de Graaf & De Winter, 2001; Wolters & Verhage, 2001; Hakfoort *et al.,* 2002; Priemus, 2003a; 2003b) and have been accused of goldplating: in 2007 no fewer than 110 housing association directors earned more than the Prime-Minister (de Jong, 2009).

3. The VROM Council proposals

In 2007 the VROM Council presented a report (226 pages + appendices) containing an elaborate analysis which we cannot reproduce in full in this paper. We shall therefore make do with setting out the proposals for housing finance reform. The VROM Council wants to see more tenure-neutrality in housing finance policy, with lower public spending and less of a gap between renting and owner-occupation. The proposals are set out below (VROMRaad, 2007: 53-57):

> *"Housing policy reforms are urgently needed"*
> The housing market is underperforming and the government's current policy in this area is neither consistent nor effective. There are not enough dwellings to go around. It takes time to build new dwellings and the potential is influenced by spatial policy, quality policy and land policy. At the same time, strong support for the demand side of the market is leading to tension and higher prices. Continuation of the policy in its present state would generate heavy risks. For the government these risks lie in a tied market and the knock-on effects on the housing supply and economic growth. The quality of urban districts will come under pressure and more and more constraints will be put on government expenditure. High prices and high debt levels are placing households at risk. It is difficult for first-time buyers to get a foot on the property ladder and there are long waiting lists in the rented sector. Employment and continuity of production in the house-building industry are being jeopardised. Housing associations are finding it increasingly difficult to fulfil their social remit.

Government intervention in the housing market is and continues to be necessary
If the housing market is underperforming it is the government's responsibility to do something about it. There is plenty of justification for government policy in housing. The Council interprets this in terms of correcting market flaws and 'negative external effects' (in wildlife, the environment and social segregation). But there are other arguments as well, relating to sustainability, a focus on the future and – no less important – social justice. Lower income groups should be able to share in higher standards of housing as much as any other income group.

Recommendations
The Council recommends a more neutral approach to renting and owner-occupation, an active supply policy and more targeted support for the housing needs of low-income groups. The government must adopt a more neutral approach to the rented and owner-occupier market, i.e. it must treat households with the same income in the same way in both the rented and the owner-occupier sector. The government should guarantee quality, affordability and access to housing by regulating part of the market. Secondly, clear rules and guarantees should be drawn up for all parties.

The VROM Raad (2007) defines the characteristics of an efficient and resilient housing market as follows:

- "Stability: avoids peaks and troughs, financial and other risks (for government, market players and households) and discontinuity in the production of housing;
- A good quantitative and qualitative balance between supply and demand;
- A good basic standard of housing, also for the people without purchasing power;
- Fair chances for both *insiders* and *outsiders*;
- Flexibility to be able to respond to unexpected and uncertain developments in the future".

The VROM Raad (2007) wants to see more targeted support for demand:

- "The support must not be generic, but specific and directed at people without purchasing power;
- Convert mortgage interest relief, imputed rent and the rent allowance into a more tenure-neutral form of support;
- Base this support on income, housing costs, and the type and size of household, and differentiate according to regional market conditions; select a model that strikes a happy medium between the current rent allowance system and a voucher system; define the basic level of quality and the maximum housing expenses;
- Phase out mortgage tax relief and imputed rent. Use some of the freed-up resources to phase out transfer tax. Use the rest to finance the tenure-neutral housing allowance, to intensify the location subsidy policy and to finance a direct tax reduction;
- Draw up an efficient transition plan for phasing-out mortgage interest relief, imputed rent and transfer tax".

The VROM Raad (2007) does not want to see totally deregulated rents. The aims of the housing policy must be safeguarded by regulating part of the market:

- "Retain rent regulation (standardise annual rent adjustments and maximum rents on the basis of quality) for part of the rented market in order to guarantee choice, affordability and security for low-income households;

- Organise within the regulated sector a better match between price and quality: create possibilities for more rent differentiation between regions (regional differentiation of the maximum allowable rent) and in the rent patterns within regions (a stronger emphasis on the popularity of the neighbourhood); allow differences in energy performance and comfort to be better expressed in the maximum allowable rent;
- Create space in the policy for lower rents in order to enhance choice and affordability for lower income groups;
- Use a welfare-determined rent policy as the starting point. Upward and downward rent adjustments should be permissible only when the ratio between price and quality is uneven;
- Aim to gradually enlarge the non-regulated rented sector; in principle, allow rent deregulation only in the event of change; differentiate deregulation according to the region;
- Consider a higher rent adjustment in the longer term in areas where the non-regulated sector is not growing fast enough. This would apply only to dwellings with a quality above the deregulation limit and a rent below the deregulation limit".

The VROM Raad (2007) sketches the contours of a new housing policy, presenting a broad vision that required further research in various areas. It is up to the politicians to start the preparations for a comprehensive and gradual reform of the housing policy. In the coalition agreement Cabinet Balkenende 4 unequivocally stated that it will not consider any such reform.

4. Strategic choices

The SER Commission of Social Economic Experts is expected to continue along the same route as the VROM Raad (2007) and may submit even more radical proposals for the rented sector. First, however, some strategic decisions need to be taken across the whole spectrum.

Investment good or consumer good
The first crucial decision that needs to be taken upon the instantiation of any housing finance reform is whether a home is considered as an investment good, a consumer good, or a combination of the two.

a. If the home is treated as a *consumer good,* any returns will fall outside the tax regime. In a tight housing market this gives home-owners an implicit advantage over tenants. Moreover, if the mortgage interest, as in the case of any other 'consumptive' loan, continues to be tax-deductible, this will benefit all home-owners – wealthy and otherwise – who have not yet repaid their mortgage.

b. If the home is treated as an *investment good,* the returns are treated in the same way as returns from any other form of capital. In the past, property prices have been known to increase by well over 4% in a year. But that is no indicator for the future, especially if the supply could be increased. In addition, it would be difficult to tax the annual returns on owner-occupier property as they are tied up in the dwelling until it is sold.

c. The alternative is to treat the dwelling as a *mixed good*. Imputed rent would then remain, but the assumed returns would be lower than for other – more liquid – forms of capital.

This decision would determine the way in which the mortgage interest relief would be phased out over a period of several years (van Eijk *et al.*, 2006).

Income-based support

The second crucial decision relates to income-based support. This would give households with a modest income a chance of affording a reasonable home within a basic range of choices.

There are various options:

(a) Should the government provide income-based support?

(b) If so, should it be linked to housing (independent dwelling required)?

(c) If so, should it be only for tenants or for tenants *and* owner-occupiers?

(d) And if so (b): should the amount of subsidy be linked to the rent of the dwelling or to the regional or national level of rents?

A free rental market?

The third crucial decision is whether the rents should be deregulated and, if so, to what extent. The VROM Raad (2007) does not propose full deregulation. In a country like the Netherlands, where 95% of rents are regulated, deregulation is a strategic question. The Netherlands has both dynamic growth regions and stagnating shrinking regions. Because rents have been regulated since 1940, no-one knows the exact level of free market rents. Romijn and Besseling (2008) reckon that it is, on average, twice as high as the regulated rents, but their findings are contested by Boelhouwer (2008) and Priemus (2008), who point to the slowdown effects of the demand (low incomes), the regional differences and the price-enhancing effect of mortgage interest relief.

Rent deregulation would reveal the rent level for each region and housing category (e.g. single homes/flats). A trend towards free market rents could easily be accompanied by a regulated rent adjustment policy, in which the government sets a maximum percentage for annual adjustments to the rents of occupied dwellings. Important contributory factors are the level of allowable annual adjustments and the pace of change of the housing allowance. The deeper and broader the housing allowance, the higher the rents in the free market.

Status of housing associations

The fourth strategic decision relates to the status of the housing associations. Should the housing associations be stripped of their special status and become 'normal' commercial market players? Or should the status – hybrid or otherwise – of the social landlord be retained? (Priemus & van der Zon, 1998; MDW werkgroep Woningcorporaties, 2000; Priemus, 2002; Conijn, 2005a; 2005b; Bertram & Helderman, 2008). In the latter case there may be different ideas about the desired market share of the housing associations in the longer term: 32% (current market share), 25% or lower? It is important that housing associations in the Netherlands continue to lead and dominate the unitary rental market (Kemeny *et al.*, 2005). For this, they need to be made Brussels-proof; in other words, they need to meet the criteria of the EU competition policy. A sharp division must be drawn between the social and commercial activities of hybrid housing associations (Priemus & van der Zon, 1998) in order to eliminate cross-subsidisation as far as possible. Needless to say, housing associations should not receive illegal state aid illegal (Priemus, 2006a; Gruis and Priemus, 2008; de Jong *et al.*, 2005).

5. Building blocks for housing finance reform in the Netherlands

Any reforms to the housing finance system will be based on the free market and modified to fit government policy goals in areas where the market fails or delivers outcomes that do not suit public purposes (Hof *et al.,* 2006). In a 'normal' market people accept that prices have a rationing effect: people with a limited budget or other preferences will simply have to forgo the product or service in question. This line of reasoning is not accepted on the housing market. In the Netherlands, we recognise the right of every household to (independent) housing, provided the head of the household is aged 18 or over. If the prices on the free market are prohibitive, we turn to income-based support in the form of housing allowances, housing benefits or housing vouchers. In contrast with the US (Priemus *et al.*, 2005), the Dutch system is based on entitlement; it is not a sweepstake.

Technically, this support scheme lends itself to many variations. In Europe, the level of housing allowance usually depends on the household income and composition, the rent and – increasingly – on the household capital. In areas where the government wants to leave scope for a relatively free rent policy, it is tempting to ditch the direct link with the rent of the dwelling in favour of the average rent in the region. The United States has clocked up years of experience of this formula. However, the relationship with public housing policy then becomes fragile: the only housing-related condition for eligibility for a housing voucher is occupation of an independent dwelling which meets some basic criteria. Grigsby and Bourassa (2004) therefore see housing vouchers primarily as an instrument of income policy. Be that as it may, housing vouchers still serve an essential purpose. There is no valid reason to issue housing vouchers solely to tenants and not to owner-occupiers with a relatively low income.
The first reform in the housing finance system to be considered in the Netherlands is to make owner-occupiers as well as tenants eligible for housing vouchers and eventually (a much more contested policy change) to sever the direct connection between the housing voucher and the rent paid to the landlord.

There are no other compelling reasons for subsidising housing in general. The preferences of the consumers must get a chance to manifest themselves on the housing market, but this is mainly a question of providing relevant information on housing services, dwellings and neighbourhoods and of allowing scope for market forces. More and more criticism is being launched at the perverse aspects of subsidisation: it encourages over-consumption, it promotes inefficient use of the available living space and it impedes energy-efficiency and sustainability in the housing stock. This applies not only to explicit subsidies for rented and owner-occupier dwellings but also to implicit subsidies in the form of mortgage interest relief. As mentioned earlier, the deductibility of mortgage interest leads to a bizarre redistribution of assets: the higher the income, the greater the benefit for the household (Aaron, 1972; Poterba, 1984; Stevens, 1989; CML, 1998; van Ewijk *et al.*, 2006; EIB, 2007). Households in the highest income decile benefit far more from mortgage interest relief than other households. There is no justification for this. In addition, mortgage interest relief combined with restrictions on the supply side (land market, spatial planning regulations, house-building market: Swank *et al.*, 2002; Vermeulen & Rouwendal, 2007) appears to have created a situation in which the real estate value of owner-occupier dwellings in the Netherlands is at least 20% higher than it otherwise would have been.

The preferential fiscal treatment of mortgage-holders is having a weird effect. Fewer and fewer households are paying off their mortgage: they prefer to hold on to these fiscally favourable debts and invest any available money in – sometimes – risky ventures. Some owner-occupiers employ this strategy to quickly improve their financial position and, in the process, run huge financial risks which could eventually force them to sell their home. Per capita the Netherlands has now the highest mortgage debt in the European Union (see Table 5).

Table 5 EU residential mortgage markets (2007)

Country	**Value of Mortgage Debt (€ Million)**	**Residential Debt to GDP Ratio (%)**	**Per Capita Mortgage Debt (€ Thousand)**
Austria	65,070	23.9	7.82
Belgium	121,831	36.8	11.53
Bulgaria	2,868	9.9	0.37
Cyprus	6,989	44.8	8.87
Czech Republic	19,554	15.3	1.89
Denmark	211,381	92.8	38.71
Estonia	5,625	36.3	4.19
Finland	61,720	34.3	11.67
France	651,100	34.9	10.17
Germany	1,155,742	47.7	14.05
Greece	69,363	30.2	6.21
Hungary	12,535	12.4	1.25
Ireland	139,842	75.3	32.20
Italy	304,223	19.8	5.13
Latvia	6,726	33.7	2.96
Lithuania	4,849	17.5	1.44
Luxembourg	13,847	38.5	29.03
Malta	2,021	37.6	4.94
Netherlands	558,982	100.0	34.14
Poland	35,966	11.7	0.94
Portugal	101,094	62.1	9.52
Romania	4,253	3.5	0.20
Slovenia	2,670	8.0	1.32
Slovakia	6,529	11.9	1.21
Spain	646,676	61.6	14.51
Sweden	189,426	57.0	20.71
UK	1,745,790	86.3	28.76
EU 27	**6,146,672**	**50.1**	**11.25**

Source: EMF Annual Report Activities 2008, Brussels (EMF): 31.

The two different lines of reasoning explained in Section 4 can be applied here. If dwellings are regarded as durable consumer goods, the mortgage interest relief is inappropriate and should be abolished. If they are regarded as investment goods, they enjoy the status of private property that the owner-occupier leases to himself. In that case, the mortgage interest relief can be retained, but we must assume an imputed rent which is a realistic reflection of free market rents. Nowhere is this the case at present. In fact, there is a sizeable advantage in imputed rent. The extent and distribution of this advantage are on a par with the extent and distribution of mortgage interest relief and amount to a grand total of 25.9 billion euros. A phasing-out process would have to begin in a healthy economy and be spread across a period of some twenty years, as happened in

Sweden and the United Kingdom. The value of real estate would then decline gradually, but this would possibly be offset by inflation.

Some of the – not inconsiderable – savings could be used to dispense with transfer tax (total in 2004: approximately 2.5 billion euros; VROM Raad, 2007: 110) and to lower income tax rates. The scientific institute of the CDA (Wetenschappelijk Instituut van het CDA: 2008) (Christian Democrats) suggests the introduction of a flat rate that is not income-dependent (in contrast with the current progressive rate). The scientific institute of the CDA also favours the retention of mortgage interest relief because it sees home-ownership as a prudent policy goal. A flat rate of tax would bring an end to the redistributive effect of the current mortgage interest relief. Tenure-neutrality implies an approach which is different from the one favoured by the scientific institute of the CDA. We propose that the advantage in imputed rent be eliminated by phasing out mortgage interest relief and imputed rent, accompanied by abolishing the transfer tax.

The Netherlands Bureau for Economic Policy Analysis assumes that regulated rents across the board are around half as much as free rents (Romijn & Besseling, 2008). It further assumes that, as a result of the restrictive rent policy in the Netherlands, the tenants collectively underpay around 14.5 billion euros a year and the landlords (housing associations and commercial landlords) forfeit the same amount. In plain terms, the landlords have been subsidising the tenants year after year after year.
The VROM Raad (2007) wants to see rent regulation that reflects the differences in the market. But there is a more spectacular scenario: gradual deregulation of the rents, enabling them to double in parts of the country within, say, twenty years. The annual rent adjustments would, however, still be regulated to prevent tenants with a modest income from being 'smoked out' and to limit transaction costs for both tenants and landlords. Large regional differences would also need to be taken on board, even in a small compact country like the Netherlands. Recently, the Spatial Planning Agency (Visser & van Dam, 2006) concluded that the number of jobs that can be reached within half an hour is the strongest determinant of the price of a dwelling. This will presumably also be the main determinant for the free market level of the rent. The number of jobs that can be reached is ten times greater from a dwelling in the west (Randstad) and the centre of the country (Utrecht/Amersfoort) than in the periphery (East Groningen, North Friesland and Zeeland).
A movement towards free rents will encourage investment by commercial and social landlords and private financiers (van Leuvensteijn & Shestalova, 2006).

All in all, we want to see a housing finance system in which all explicit and implicit general subsidies (including mortgage interest relief) have been gradually wound down. Housing allowances should be available for low-income households in both the rental and the owner-occupier sector. This allowance would be based on the income and not on the rent of the dwelling. At the moment, housing associations in the Netherlands are experimenting with a so-called 'tailor-made renting' programme under which they allocate an income-based subsidy to poor tenants (Vos, 2008). We affirm that this income policy is the clear responsibility of the state.
The only condition that might be set is that the dwelling meet the criteria of the Building Decree. The size of the allowance would be differentiated according to the average price levels in the regional housing market. Tax relief for home-owners and transfer tax would gradually disappear.
The rents would be steered to the – currently unknown – level in the free market. The annual adjustment would be linked to a maximum percentage per occupied dwelling, but

there would be more scope for quality-based differentiation, with a far stronger emphasis on the price of the location, the neighbourhood and the region than at present. Slowly by surely, the pattern for rented dwellings will converge with the pattern for owner-occupier dwellings. The prices of owner-occupier dwellings will probably fall by at least 20 as tax relief is phased out (Kranendonk & Verbruggen, 2008). All things being equal, the free market rents will also fall by at least 20.

This line of argument automatically raises the question of how much space exists in a new housing finance system for housing associations that fulfil specific public tasks. Housing allowances and housing vouchers will be available for all tenants with a low income, regardless of whether their dwelling is owned by a social, a commercial landlord or by themselves. If the rents of housing associations follow the same free market structure as the rents of commercial landlords, perhaps the housing associations should be converted into 'normal' profit-making organisations with no connections to the public sector. This has happened recently in Germany.

This scenario is favoured by some welfare economists (Hof *et al.*, 2006). Other observers point to the rich tradition of the Dutch housing associations, which have been embedded in the public sector as Approved Institutions ever since the Housing Act came into effect in 1901 (Priemus, 1996; 2001; Ouwehand & van Daalen, 2002; Commissie-De Boer, 2005; Commissie-Sas, 2005; VROMRaad, 2005). They defend the relatively high market share that belongs to the social rented sector in the Netherlands (32%), also after fundamental reforms to the housing finance system, by fielding the following arguments:

- Housing associations have a public duty and the commensurate culture to accord priority to households which are unable to independently house themselves. This duty is essential to guarantee choice, also at the bottom end of the housing market. Commercial landlords will always sidestep risks and accord priority to households with stable mid-range or high incomes;
- Thanks to the differentiation in housing stock and tenants, housing associations are not the object of stigma (unlike public housing in the US or council housing nowadays in the UK). As the dwellings are also attractive to middle-income and even high-income households, housing associations make a key contribution to social integration;
- Housing associations are allowed to make profits. These profits have been taxed at normal commercial rates since 2008, but the housing associations are obliged to spend them solely in the interest of housing. If rents were deregulated and housing associations were to continue to sell properties, these profits would grow. National and local governments should consult with the housing associations and consumer organisations to decide the national priorities for reinvesting these profits in housing; for instance, increased investment in the regeneration of unpopular urban districts (where housing associations manage a large part of the housing stock), restructured neighbourhoods in parts of the country with a diminishing population, increased energy-efficiency and sustainability in the housing stock, the production of new housing – also in poor economic climates – and more affordability in rented housing (Bertram & Helderman, 2008; van Dijk *et al.,* 2002).

We believe that there is enough justification for maintaining and strengthening the position of housing associations after the housing finance system has been reformed. There are good reasons for pursuing rent levels in social housing which are in line with the free market, but are still somewhat lower than commercial rents. This is because tenants in social rented dwellings may expect at least some of their fellow-occupants to come from low-income groups and perhaps to suffer from social problems. In addition, the costs of maintenance and management will be higher if some of the tenants need extra services and supervision. It is essential that rents follow a market pattern, also in the social rented sectors, albeit at a lower level than in the commercial market.

If the demand on the housing market were to move farther in the direction of home-ownership, housing associations could help to meet it by selling some of their properties, mainly in the context of social ownership (Tenant's Choice; Koopgarant; Gruis *et al.,* 2005). The asking price for the property would then be below the market value and the housing association would be obliged to repurchase it if the residents wished or were forced to sell it. When combined with the successful National Mortgage Guarantee system this strategy would bring home-ownership within the reach of low-income households in a much more responsible way than the subprime mortgage system in the USA (Aalbers, 2008). In the future, housing associations could make a more tenure-neutral contribution to housing.

If rents are raised to – almost – free market levels and more dwellings are sold, the surplus capital of both commercial landlords and housing associations will rise sharply and open up a host of opportunities for investment in new-builds, maintenance policy, and renewal of the housing stock in both the commercial and the social rented sector. This will also remove impediments in the supply. The land policy, the spatial planning policy and the environment policy, while retaining their own goals, will have to provide enough space for adapting the housing supply to the demand.

The business of financing in the housing association will have to be autonomised and, to some extent, lifted to a national level. Individual housing associations need to have sufficient resources at their disposal to fulfil the local and regional social housing remit. For many years, resources have been poorly matched to the remit. The introduction of national instead of regional admission of housing associations can, in itself, contribute to a better match. If the income continues to rise, the individual housing associations will accumulate more surplus capital, for which they can no longer find a public use (de Graaf, 2002). Using 'Transparency Methodology' (Conijn, 2004), it is possible to work out the amount of surplus capital held by each housing association. In the spirit of the Housing Act, which assumes that the reserves of housing associations should be spent exclusively on housing, an amount could be set aside for this purpose and deposited in a national fund for housing priorities. The Housing Minister will decide how this money is to be allocated after meeting with the Association of Netherlands Municipalities (VNG), the housing association federation (*Aedes*), the Tenants Union (*Nederlandse Woonbond*) and the association of owner-occupiers (*Vereniging eigen huis*). The money could be used to co-finance the housing allowance, regenerate unpopular urban districts and areas with a diminishing population and improve the energy-efficiency and sustainability of the housing stock.

The strategy of the SER Commission of Social Economic Experts is to define an ideal future situation and to draw up a transition plan that may take about twenty years. If the idea is to scrap tax relief for owner-occupiers entirely, it would make sense to reduce this relief every year by 5% for all owner-occupiers or for all *new* cases. However, if the government announces that it intends to abandon tax relief in 20 years, this in itself may cause the value of real estate to drop immediately by 20%. An added complication is that the next twenty years will bring different governments with different coalitions and changing market constellations of boom and bust. Some sort of broad government commitment is needed to make the reforms 'coalition-proof', but the policy needs to be flexible enough to cope with changing housing market conditions.

6. Relevance for other European countries

Comparative analyses have exposed strong difference between housing systems in European countries (Boelhouwer & van der Heijden, 1992; Kemp, 2007; Burger & Dekker, 2001; van der Heijden, 2002; Kemeny *et al.,* 2005; Pooley, 1992; Priemus & Boelhouwer, 1999; Priemus & Dieleman, 1997; 1999; 2002; Priemus *et al*., 1999). Path dependency plays a key role in explaining the development of housing systems, which are not 'purely' about housing policy, but about tax policies and welfare regimes as well. Nonetheless, the debates on radical housing finance reforms in the Netherlands are also relevant for other European countries. The Netherlands is, in a sense, following in the footsteps of Sweden and the United Kingdom (Stephens *et al*., 2003), which have already come through a long process of housing finance reform. The same goes for Germany, where the reforms went a step farther in one respect, partly because of the scandal around *Neue Heimat*. In Germany the social rented sector was abandoned as a basic institution. The social remit is now supposed to be guaranteed by housing allowances and property subsidies for commercial landlords. The arguments in this paper, which focuses on tenure-neutrality, income-based support and the phasing-out of all tax relief and property subsidies, may be relevant for countries in Eastern and Central Europe as well as Western and Southern Europe. Continuing the role of housing associations, albeit in a more tenure-neutral and more market-oriented form than at present, could safeguard the unique culture of Dutch social housing.

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