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Maintaining an Efficient
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Market in Belgium

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MAINTAINING AN EFFICIENT AND EQUITABLE HOUSING MARKET IN BELGIUM

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By Sanne Zwart

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ABSTRACT/RÉSUMÉ

Maintaining an Efficient and Equitable Housing Market in Belgium

Housing conditions in Belgium are among the best in OECD countries according to the Better Life Index, as dwellings are of high quality and large, and housing costs are average. However, the steep increase in house prices since 2003 has put market access for first-time buyers under pressure. Housing affordability is also deteriorating for the poor, as demand for social housing has not been met while the private rental market has become expensive. As a result, access to housing is at risk of becoming less equitable if the young and poorer people are priced out. Affordability for poorer people could be improved by expanding the regional rental allowance schemes. In parallel, scaling down the disproportional support for homeownership would free up public resources and reduce the bias towards homeownership. Other challenges to the efficiency of the housing market are posed by the high level of greenhouse gas emissions due to the old age of the housing stock and the low residential mobility, which harms the labour market and contributes to congestion and air pollution. To maintain an efficient housing market, policies should aim at increasing building densities in residential areas. Tilting taxation from transaction to recurrent taxes would lower barriers for residential mobility and contribute to labour market flexibility.

This Working Paper relates to the 2015 *OECD Economic Survey of Belgium* (www.oecd.org/eco/surveys/economic-survey-belgium.htm)

JEL classification: G21, H24, H71, O18, Q53, R21, R31, R52

Keywords: Belgium, housing market, housing prices, housing policies, housing subsidies, mortgage markets, property taxation, rental market, rental allowances, land use, residential energy efficiency.

Préserver l'efficacité et l'équité sur le marché du logement en Belgique

Selon l'Indicateur du vivre mieux, les conditions de logement en Belgique sont parmi les meilleures de la zone OCDE : les habitations sont grandes et de bonne qualité et les coûts de logement se situent dans la moyenne. Cependant, la forte hausse des prix de l'immobilier enregistrée depuis 2003 rend l'achat de plus en plus difficile pour les primo-accédants. La capacité financière d'accès au logement se dégrade également pour les pauvres, dans la mesure où l'offre de logements sociaux est insuffisante pour répondre à la demande et le marché locatif privé est devenu cher. Par conséquent l'accès au marché du logement pourrait devenir moins équitable si les jeunes et les pauvres en sont exclus à cause des prix. Il est possible d'améliorer l'accès des personnes pauvres au logement en développant les systèmes d'allocations de logement régionaux pour locataires. Parallèlement, la réduction du soutien à l'accession à la propriété, actuellement disproportionné, libérerait des ressources publiques et atténuerait le biais en faveur de la propriété de la résidence principale. L'efficacité du marché du logement est confrontée à d'autres défis : le niveau élevé des émissions de gaz à effet de serre, dû à l'ancienneté de l'habitat, et la faible mobilité résidentielle, qui pénalise le marché du travail et contribue à l'encombrement routier et à la pollution atmosphérique. Pour préserver l'efficacité du marché du logement, il faudrait accroître les densités de construction dans les zones résidentielles. Une réorientation de la fiscalité des taxes sur les transactions immobilières vers les impôts récurrents contribuerait à abaisser les obstacles à la mobilité résidentielle et à améliorer la flexibilité du marché du travail.

Ce Document de travail se rapporte à l'Étude économique de l'OCDE de la Belgique, 2015 (www.oecd.org/fr/eco/etudes/etude-economique-belgique.htm)

Classification JEL: G21, H24, H71, O18, Q53, R21, R31, R52

Mots clefs: Belgique, marché du logement, prix des logements, politiques du logement, aide au logement, marchés hypothécaires, fiscalité immobilière, marché immobilier locative, allocation logement, aménagement du territoire, efficacité énergétique résidentielle.

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MAINTAINING AN EFFICIENT AND EQUITABLE HOUSING MARKET IN BELGIUM

By Sanne Zwart¹

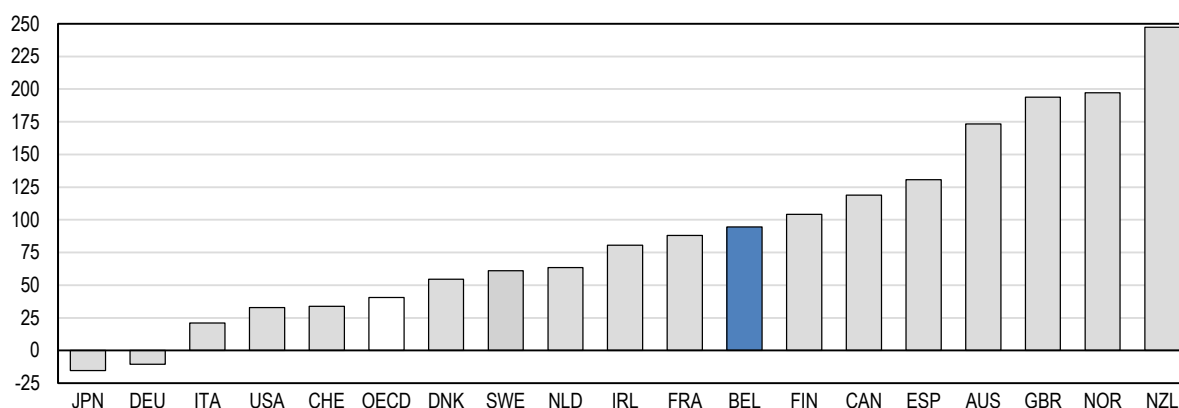
The affordability and adequacy of the housing market is deteriorating

After a steep increase, house prices remain at an elevated level

Belgium experienced a steep increase in property prices; real prices in 2013 were almost twice as high as in 1980 (Figure 1). In contrast with many other European countries, the recent crisis had a small effect on the housing market as prices continued to rise, albeit at a slower pace. The comparable increase in the value of land points to a growing scarcity of building opportunities at good locations (Figure 2). Construction costs did not contribute to the fast rise in house prices as they increased broadly in line with inflation.

Figure 1. **Real house prices have significantly increased¹**

Per cent, 1980-2013

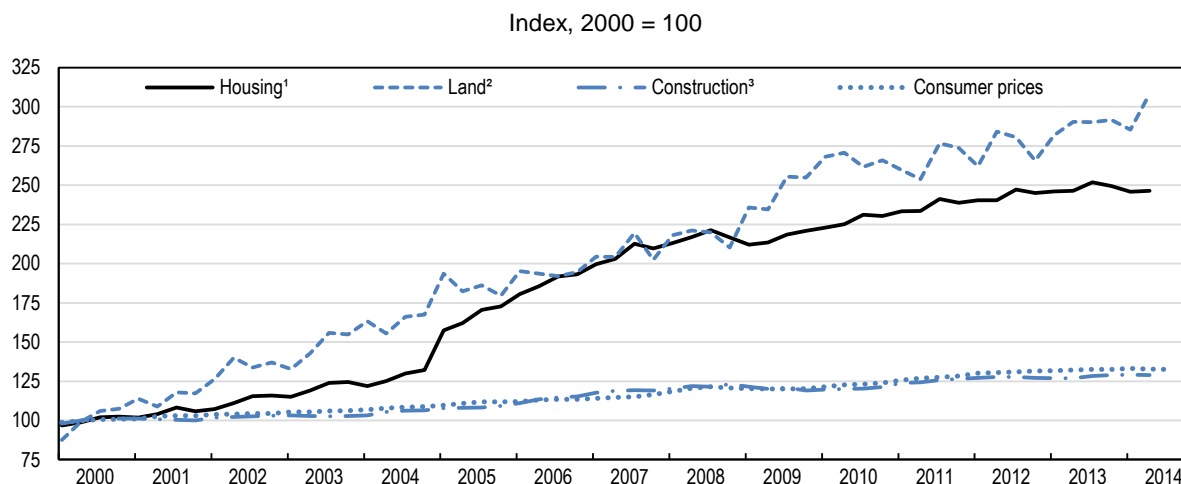


1. Based on annual averages of quarterly house price indices. Nominal prices deflated by the private consumption deflator.

Source: OECD (2014), *OECD Housing Prices Database*, Economics Department, November.

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Figure 2. House and land prices have outpaced construction prices



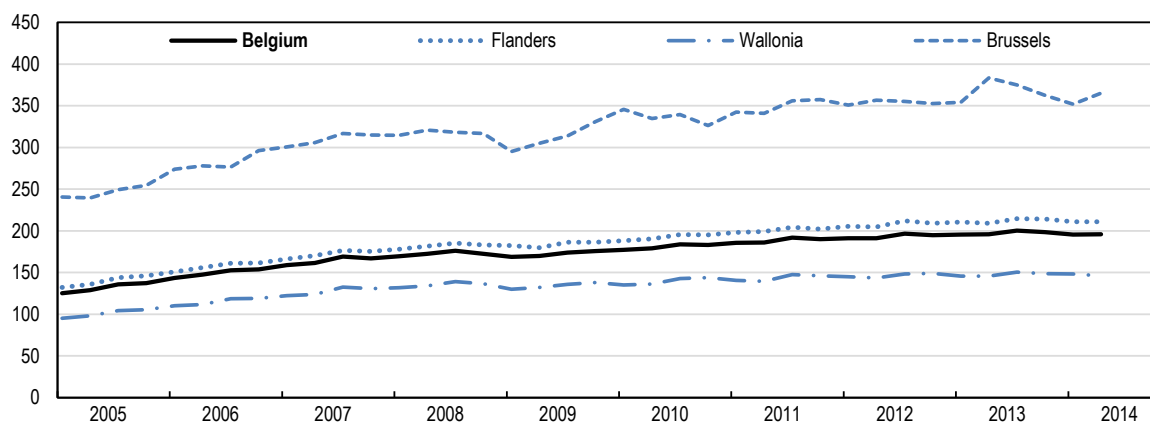
1. Average price of a single family house (*maison d'habitation ordinaire*).
2. Price of building plots.
3. Construction cost for new residential buildings (excluding community residences).

Source: Statistics Belgium (2014), *Tableaux téléchargeables*; Eurostat (2014), *Eurostat Database* and OECD (2014), *Main Economic Indicators* (database), November.

Property values in the Brussels-Capital Region are considerably higher than in the other Regions due to a more limited housing supply, and the difference continues to widen (Figure 3). Relative price developments in all Regions are comparable though. In all price segments values are above their pre-crisis levels, but the cheapest housing saw the largest relative increases (Figure 4). The most expensive properties, often villas in semi-rural areas, have recently started to decline in value as their high price and maintenance costs started to weigh on demand. This shift in demand towards cheaper housing can be observed in all Regions, but is strongest in Brussels.

Figure 3. House prices are highest in Brussels

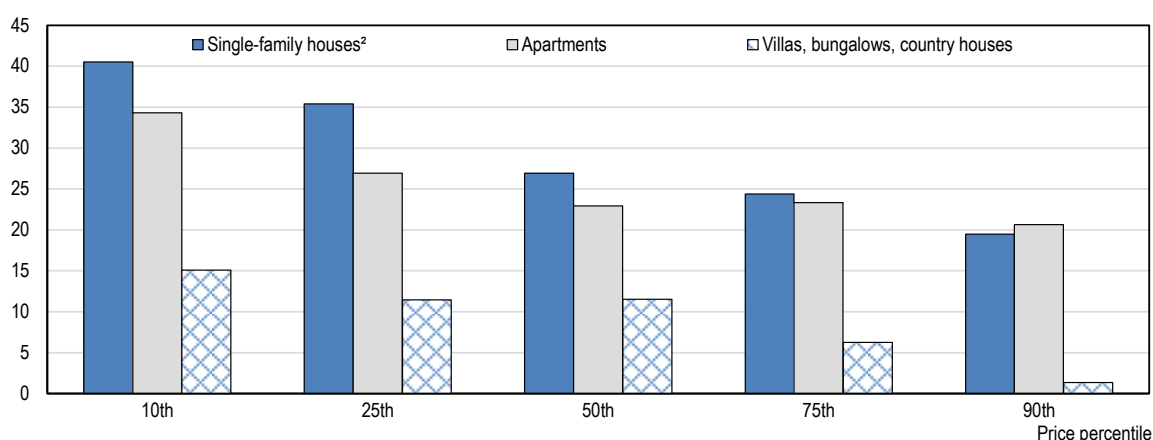
Single-family houses by region, thousand EUR¹



1. *Maisons d'habitation ordinaires*. Nominal prices deflated by the private consumption deflator.

Source: Statistics Belgium (2014), "Ventes de Biens immobiliers (1990-2014)", *Tableaux téléchargeables* and OECD (2014), *OECD Economic Outlook: Statistics and Projections* (database), November.

Figure 4. **Price of cheaper houses has increased most**
Real prices by type of dwelling and price segment, percentage change 2005-13¹



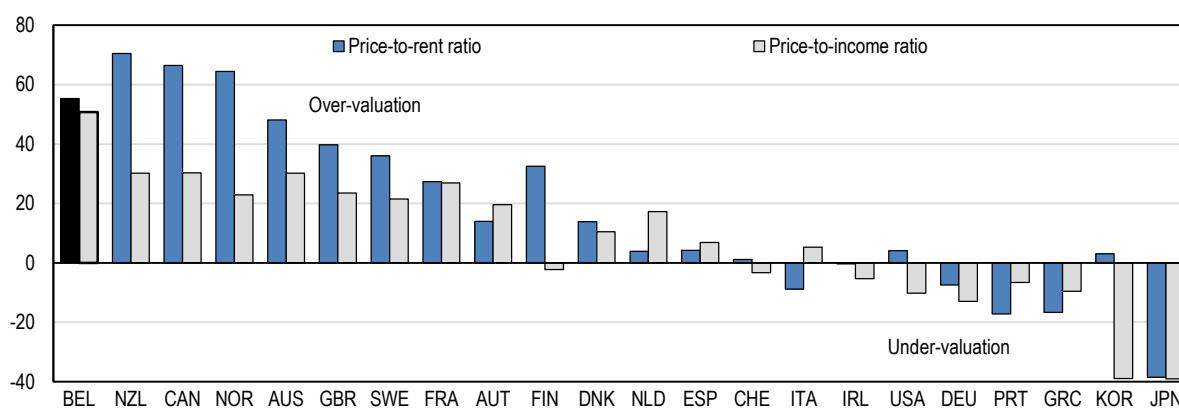
1. Average prices deflated by the private consumption deflator.
2. *Maisons d'habitation ordinaires*.

Source: Statistics Belgium (2014), "Ventures de Biens immobiliers (1990-2014)", *Tableaux téléchargeables* and OECD (2014), *OECD Economic Outlook: Statistics and Projections* (database), November.

How to read this figure: This figure shows the price evolution for selected price percentiles for three categories of dwellings; for example, the 50th percentile represents the evolution of the price of a median house (i.e. a house for which 50% of other houses are cheaper and 50% are more expensive). For median houses, the cumulated price increase since 2005 was about 25% for a single-family house. For more expensive houses (75th and 90th percentiles), the cumulated price increase has been lower while for cheaper categories (10th and 25th percentiles) it has been much higher.

Traditional measures suggest that overvaluation in the Belgian market is second highest among OECD countries, with prices about 50% above their long-term average relative to income and rents (Figure 5). However, these indicators do not provide the full picture as the cost of a house for a household does not depend only on its price, but also on other factors which can make it easier for the household to purchase a house, such as the level of allowed indebtedness and associated interest rates. Hence, the actual overvaluation falls to 28% when accounting for the current low interest rates and to 5-15% when also assuming a continuation of the other relatively lenient financing conditions, although changes in these factors could dramatically alter the assessment (Box 1).

Figure 5. **Some indicators point to a large overvaluation of the housing market**
Per cent of over or under-valuation relative to long-term averages, second quarter of 2014¹



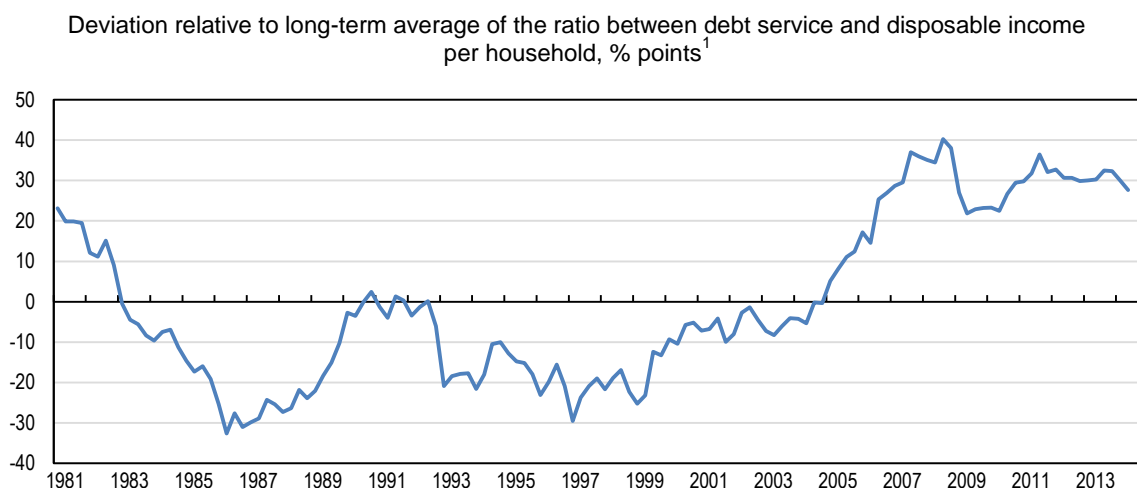
1. Countries are ranked by the average of the two indicators, from highest to lowest. The long-term average covers the period from 1980 (or earliest available date) to the latest available quarter.

Source: OECD (2014), *OECD Housing Prices Database*, Economics Department, November.

Box 1. Valuation of the housing market

Traditional indicators suggest that Belgian real estate is strongly overpriced, but when house prices are translated into effective housing costs, the overvaluation appears much smaller. Housing costs depend on house prices, but also on other factors, most notably the interest rate to be paid on mortgage loans, the duration of the mortgage loan and the maximum amount that can be borrowed relative to the house price. The effect of the interest rate is particularly large, and the overvaluation based on an interest-adjusted index of housing costs drops to 28% from about 50% for loan-to-income or loan-to-rent ratios (Figure 6). Housing costs also benefited from a gradual increase in the repayment period of mortgage loans. First-time buyers now obtain mortgage loans with an average maturity over 25 years, which is seven years longer than in 1996. The reform of housing taxation in 2005, with a widened tax deductibility of interest and capital repayments, provided additional incentives to borrow. This is one of the main reasons that house prices in Belgium increased more than in any other OECD country during 2005-08 (Vastmans et al., 2014). Hence, accounting for these developments in the financing of housing lowers the scope for overvaluation, provided of course that these underlying factors do not change.

Figure 6. Debt-service costs are high despite low interest rates



1. Debt with a fixed maturity of 20 years, all dwellings. This indicator is based on an interest-adjusted-affordability index discussed in National Bank of Belgium, *Report 2013: Economic and Financial Developments and Financial Stability Review 2014*.

Source: National Bank of Belgium and OECD calculations.

Econometric models also point at a more moderate overvaluation. The European Central Bank (ECB) regularly performs a cross-country econometric analysis to explain changes in house prices by changes in affordability. It also derives a measure of imbalances from a model that assumes equal costs of owning and renting in the long-run. These model-based approaches indicate that the housing market is fairly balanced (ECB, 2013). The International Monetary Fund (IMF) arrives at an overvaluation of 5-15% based on an interest-adjusted affordability regression analysis (IMF, 2014). The latter finding is consistent with anecdotal evidence of limited speculation based on the belief of further increases in house prices.

Perhaps as important as an estimate of the overvaluation is the awareness that changes in financing conditions or the fiscal treatment of housing may have important effects on the level of house prices. Assuming unaltered conditions, a price correction might occur, most likely through a stabilisation or a modest decrease in real house prices. However, some segments of the market and parts of the country might experience more pronounced declines. Prices for villas in semi-rural locations have already been falling for some time, while prices for the upper segment in general came to a standstill. High demand and limited supply will continue to support housing prices in the lower segments and more so in Brussels than in the other Regions.

References:

ECB (2013), *Financial Stability Review*, November, European Central Bank.

IMF (2014), "Article IV Consultation – Staff Report", *Country Reports*, No. 14/76, International Monetary Fund.

Vastmans, F. et al. (2014), *Woningprijzen: woningprijzen-mechanisme en marktevenwichten. De logica, nood en valkuilen van betaalbaarheid als woningprijzen determinant* (Housing prices: housing prices mechanism and market disequilibria. The logic, need and pitfalls of affordability as housing price determinant), Steunpunt Wonen (Policy Research Centre Housing).

Risks for the economy related to residential properties will depend first on the likelihood of a price correction, second on the ability of borrowers to withstand a fall in price, and third on the capacity of banks to absorb potential losses on mortgage loans. The first risk (a significant fall in prices) does not appear immediate as the possibility of considerable changes in underlying determinants seems remote. However, house prices warrant close monitoring given that some estimates point at a large overvaluation and a fall triggered by a change of expectations cannot be ruled out. Such a change could originate, for example, from the necessary reform of the mortgage tax relief, which emphasises that adjustments should be made gradually.

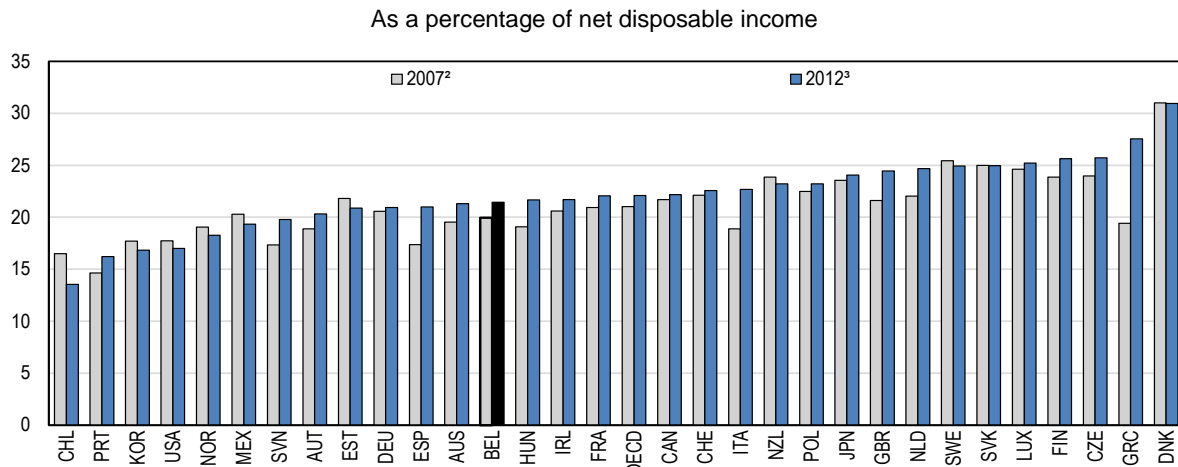
In case of a fall in house prices, the impact on the economy will then depend on households' reaction to it. Wealth effects are limited in Belgium (Eugène et al., 2003), so the impact should not be major on consumption. However, consumption could be hurt if a significant share of households becomes "underwater" (i.e. the value of the house becomes lower than the loan they subscribed to purchase their property), which could force them to raise their precautionary savings to protect themselves from a loss in the event they need to sell the house. This risk is not negligible as one third of the new mortgage volume in 2013, and 15% of the outstanding mortgage loan stock, had a loan-to-value ratio of more than 90% (NBB, 2014). Together with the often high debt-service ratios this could lead to problems in case of a sizable correction in house prices. A normalisation of interest rates could put pressure on house prices as smaller new mortgage loans would reduce support for the current price level, but the direct effect on household spending seems limited as almost 60% of outstanding mortgage loans have fixed interest rates while adjustments to variable-rate mortgage loans are capped.

The third main risk is how banks could weather households' payment difficulties. Default rates on mortgage loans are very low, even for recent vintages, and capital buffers of the main banks are sufficient to absorb a moderate increase in defaults according to the stress test recently conducted by the European Central Bank. However, the share of domestic mortgage loans on the balance sheet of Belgian credit institutions is large, which prompted the National Bank of Belgium at the end of 2013 to take several prudential measures to strengthen banks' resilience, most notably an increase in banks' risk weightings for Belgian mortgage loans. Further growth of borrower segments with very high levels of risk should be avoided by imposing maximum limits for new mortgage loans on loan-to-value and debt-service-to-income ratios when appropriate in view of housing market dynamics.

Housing affordability varies widely across tenures and Regions

Despite the steep increases in property prices, average affordability of housing only decreased slightly (Figure 7), as rising house prices did not affect existing owners while for first-time buyers the impact was cushioned by falling interest rates and longer repayment periods. A cross-country comparison of housing costs, although hampered by the lack of a uniform calculation method, shows that Belgium belongs to the middle bracket of OECD countries.

Around 10% of the population lives in a household that spends more than 40% of its disposable income on housing, which is slightly below the EU average (Table 1). Housing cost overburden is higher than some years ago, but the small increase understates the growing problems related to affordability. The situation deteriorated considerably for renters, who are already much more frequently overburdened, while on the other hand fewer homeowners were facing excessive housing costs (Figure 8). Around one out of seven social renters are now overburdened by housing costs and for private tenants, most of whom do not benefit from rental support, it is even one out of three.

Figure 7. Household spending on housing has increased moderately¹

1. Housing, water, electricity, gas and other fuels. The OECD aggregate is an unweighted average of data shown.
2. 2008 for Chile.
3. 2011 for Greece, New Zealand and Switzerland.

Source: OECD (2014), "Detailed National Accounts", *OECD National Accounts Statistics* (database), October.

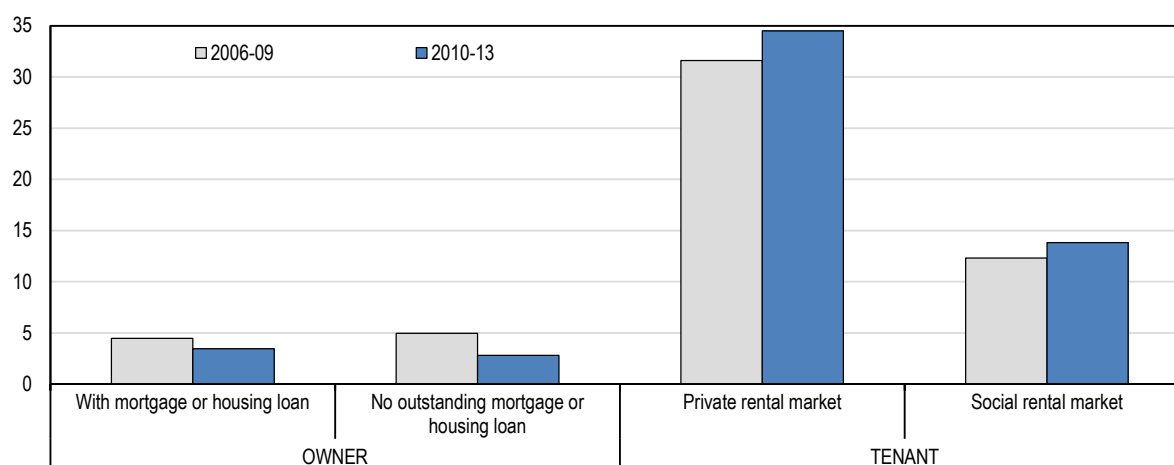
After a long period of rising rents and weakening income profiles of tenants, the affordability of housing has become a structural problem for large groups of the population. In Flanders, the share of disposable income spent on housing increased more rapidly for tenants than for homeowners during at least 20 years (Heylen et al., 2007). Income differences became more pronounced as those who could afford a house saw their real earnings rise while tenants experienced a decline between 1992 and 2005. This decline is partly explained by better-off tenants becoming homeowners, which confirms the increasingly residual character of the private rental market. In Flanders, the divergence in incomes came to a halt recently (Heylen and Winters, 2014), probably due to deteriorating overall labour market conditions.

Table 1. Housing cost overburden is high for lower-income groups¹

2010-13					
Income quintile	First (bottom 20%)	Second	Third	Fourth	Fifth (top 20%)
Belgium	35.4	10.2	3.3	1.0	0.4
European Union (28 countries)	34.9	11.5	5.4	2.9	1.6
France	17.8	4.9	1.9	0.9	0.2
Germany	43.0	16.6	9.3	6.5	4.2
Netherlands	34.2	16.1	10.4	7.2	5.5

1. Percentage of the population living in a household where the total housing costs (net of housing allowances) represent more than 40% of the total disposable household income (net of housing allowances). For example, in Belgium 35% of persons earning the lowest 20% of income pay over 40% of this income on housing.

Source: Eurostat (2014), "Income and Living Conditions - Housing Cost Burden", *Eurostat Database*, November.

Figure 8. **Tenants are most affected by housing cost**Housing cost overburden, per cent of relevant population¹

1. Share of people living in a household that spends over 40% of disposable income on housing.

Source: Eurostat (2014), "Income and Living Conditions - Housing Cost Burden", *Eurostat Database*, November.

Shortages in the provision of social housing contributed to a deterioration of the price-quality ratio at the lower end of the private rental market. The social rental market amounts to 6% of the dwelling stock, which is low compared to other OECD countries (Andrews et al., 2011), but also relative to demand. In Brussels, more households are on the waiting list than living in social rental housing. In Flanders, demand is 70% higher than supply, and in Wallonia 40%. Many people who would qualify for social housing based on their financial means have to resort to the private rental market, and the higher rents weigh heavily on their budgets. Affordability problems are most severe in Brussels, where the share of households with housing cost overburden is above 21%, compared to around 10% in Wallonia and 6% in Flanders (Winters and Heylen, 2013). The difference between the capital and the other Regions reflects both the higher cost of accommodation and the much higher share of the population at risk of poverty.

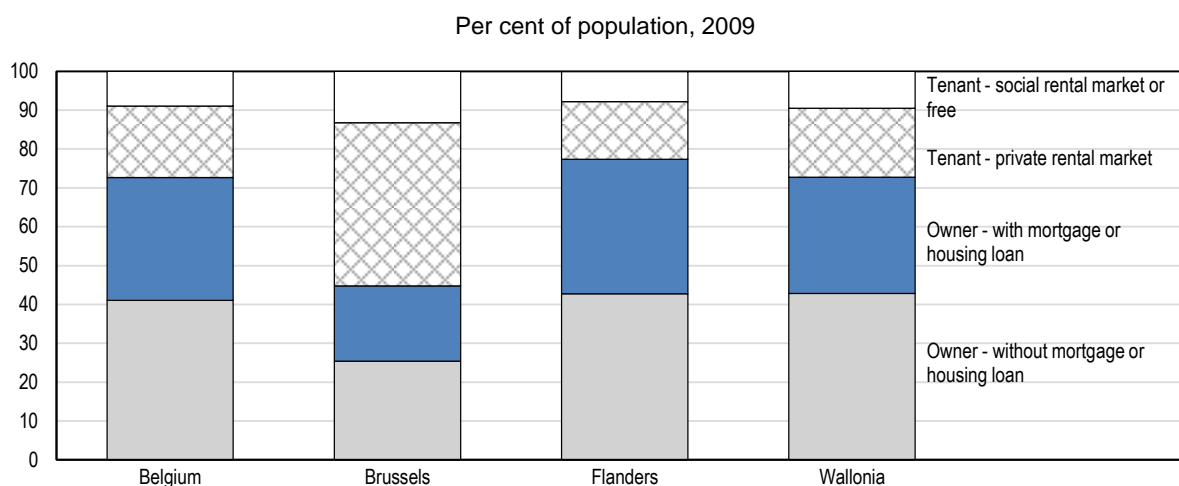
The small and falling share of homeowners experiencing affordability problems hides the growing challenges for first-time buyers to buy a house. The recent low interest rates have a tempering effect on mortgage costs, but their decline over a longer period has merely led to higher prices. The average downpayment has increased rapidly from around EUR 20 000 in 2004 to some EUR 50 000 in recent years (Albrecht and Van Hoofstat, 2011). When including the substantial transactions costs, a buyer needs on average around EUR 75 000 in cash, which is around a third of the house price, to acquire a house. The surge in required own funds makes it increasingly difficult for first-time buyers to follow the traditional model where young people, soon after starting to work, acquire a house with the intention of staying there for the rest of their life (Meeus et al., 2013). In addition, debt-service costs of young households are often very high relative to income (Du Caju et al., 2014). Without financial support from parents, many first-time buyers can no longer afford housing of the same quality and quantity as a decade ago (Heylen and Winters, 2011). The growing financial challenges of first-time buyers are one of the reasons for the recent modest fall in homeownership rates (Heylen and Winters, 2014), which bucks a long-standing trend.

Adequacy of the housing supply is challenged by rising and changing demand

After an extended period of increases, over 70% of the population lives in owner-occupied housing (Figure 9), which is among the highest observed in OECD countries (Andrews et al., 2011). The high share of owners reflects that homeownership is traditionally viewed as the ideal housing tenure as it is perceived

to provide the highest degree of housing security, privacy and self-determination and to reduce housing costs after retirement. Tax deductions provide further financial incentives, especially after the tax reform of 2005 (Winters, 2013). Increasing house prices and the growing difference with rents slowed down acquisition by especially lower income groups, and since 1976 only the two richest income quintiles in Flanders have been contributing to the overall growth in homeownership.

Figure 9. Homeownership is widespread outside Brussels



Source: S. Winters and K. Heylen (2013), "How Housing Outcomes Vary Between the Belgian Regions", *Journal of Housing and the Built Environment*, July.

Between 2013 and 2030, the number of households is expected to increase by 540 000, or 11% (Table 2). Two-thirds of the growth is caused by an increase in population, the remainder by a decrease in household size due to aging and more single-parent families. In Brussels, though, the number of households is increasing in line with the population as the already low average household size is not expected to decline further. The overall shift in housing demand extends a long trend: nowadays 65% of households consist of one or two people, up from 58% in 1990. As a result, construction of apartments has surpassed that of new single family houses. The increasing demand for smaller housing provides opportunities for spatial planning as it allows for a greater densification of residential areas.

Table 2. Number of households will grow faster than population in the medium term

	Change 2013-30			
	Belgium	Brussels	Flanders	Wallonia
Population (% growth)	7	10	6	8
Households (% growth)	11	9	11	13
Households (thousand)	540	50	284	206

Source: Federal Planning Bureau and Statistics Belgium (2014), *Perspectives démographiques 2013-2060 : Population, ménages et quotients de mortalité prospectifs* (Demographic projections 2013-2060 : Population, households and prospective mortality quotients), April.

Despite the overall good conditions of the housing stock, a substantial share is of poor quality and energy-efficiency is in general low. The quality of housing is most problematic in cities, and damp problems, for example, are much more widespread in Brussels than in the other Regions (Box 2). The relatively old age of the dwelling stock (Andrews et al., 2011) and the many free-standing houses, make

Belgian residential greenhouse gas emissions per capita the second highest among OECD countries despite recent improvements (Cassilde, 2014). The large and detached houses in semi-rural areas that once catered for the needs of their owners have become expensive in their maintenance and energy consumption. Ageing owners who now want to move to the city centre in order to be closer to facilities and services often struggle to find buyers due to the high costs of renovation.

Box 2. Spatial structure of the housing stock

The housing stock in urban agglomerations is older than in the rest of the country and 36% of the dwellings date from before 1946. Regional differences are stark, with 45% of houses in Wallonia built before the end of the Second World War compared to just 24% in Flanders. This difference is a result of Wallonia's intensive industrialisation and high population growth during the nineteenth and the beginning of the twentieth century, combined with a higher tendency towards renovation instead of demolition. The recent catch-up of Brussels and Flanders regarding renovation activities reflects a growing scarcity of building plots at good locations and the related increase in land prices. When considering the share of dwellings in a bad physical state, there is a clear north-south contrast, but in absolute numbers most of the houses in poor conditions are found in cities.

The spatial structure of the Belgian housing stock is closely linked to the concentration of socioeconomic problems in certain neighbourhoods. In the larger cities, unemployment is high in the areas with nineteenth century working-class houses, as the residents, mostly older Belgian workers and migrants, often have a low level of education (Vandermotten et al., 2011). Former areas with mines or heavy industry, mostly located in Wallonia, are characterised by similar problems. Clusters of social housing can be found in city centres and in more suburban areas and have led to a concentration of weaker households.

The detached home, preferably situated on the edge of the city or in the green, is still the most popular ownership choice (Halleux and Strée, 2013). The share of apartments is low by international standards, both in the country as a whole and in cities such as Brussels. However, the share of apartments in most cities and many suburban communes is growing to cater for an ageing population and younger couples. Social housing is concentrated in urban areas, but is still below 15% of the dwelling stock.

Opposing the long-standing trend of suburbanisation is the gentrification that occurs in several core city quarters. Young people, often single and well-educated, move to certain older parts of the city centre to be in the proximity of cultural life. Their presence revitalises the neighbourhood as they often undertake badly-needed renovations of their houses.

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The physical state of private rental housing remains lower than in the social housing and owner-occupied segments (Heylen et al., 2007). Many rental apartments are owned by older people who are often cash-constrained and put off by the efforts needed to undertake investments. The overall lower standards of rental housing reflect that the majority of dwellings are located in urban neighbourhoods with older houses. Nevertheless, demand for private rental housing is high and leads to a deteriorating price-quality ratio at the lower end of the market. However, landlords often find it difficult to find appropriate tenants, given the long period of weakening income profiles among renters. In Flanders, about a third of the private rental market now concerns socioeconomic vulnerable households in low-quality dwellings (Le Roy et al., 2008; Le Roy and Vandekerckhove, 2011). Better rentals are in general occupied either by young highly educated starters or by older tenants.

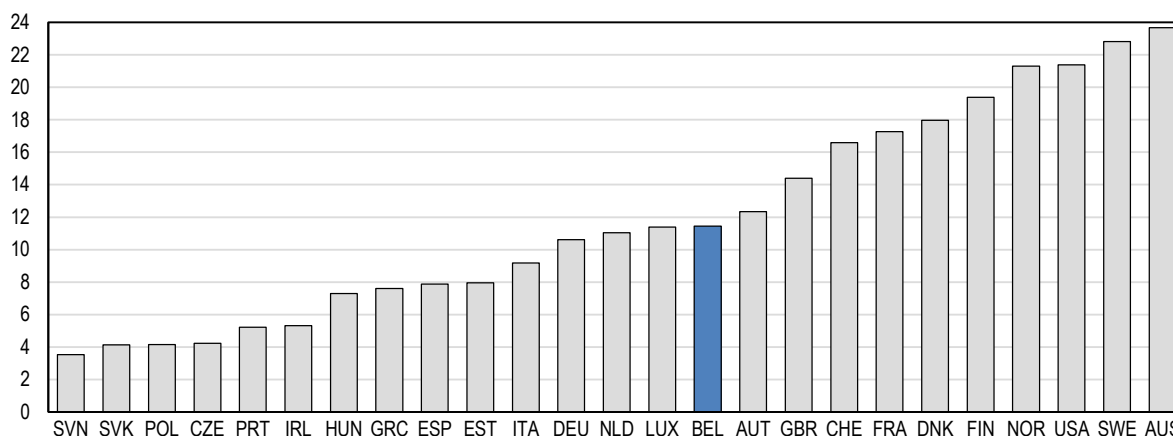
Residential mobility is mediocre, leading to various inefficiencies

High homeownership weighs on residential mobility

Residential mobility is mediocre, with around 12% of households changing residence during a two-year period (Andrews et al., 2011). Even though the relatively small size of Belgium and its linguistically homogenous zones may explain a less acute need for residential mobility, some similar countries, for example Denmark, have a higher residential mobility (Figure 10). The propensity to move differs between tenure types, with private tenants having the highest mobility. Social tenants are less frequently changing residence as they risk losing their subsidised housing. Homeowners are least mobile, but empirical studies for Belgium are inconclusive on the role of mortgage loans (Andrews et al., 2011; Isebaert, 2013). On the one hand, mortgagors can be locked-in by negative equity effects due to the high housing transaction costs, on the other hand they may be more willing to accept jobs that require a change of residence to remain able to meet mortgage repayments. Nevertheless, as homeowners are up to 23% less likely to move residence than tenants, the counterpart of widespread ownership is depressed residential mobility.

Figure 10. Residential mobility is mediocre

Percentage of households that changed residence within the last two years, 2007



Source: D. Andrews, A. Caldera Sánchez and Å. Johansson (2011), "Housing Markets and Structural Policies in OECD Countries", *OECD Economics Department Working Papers*, No. 836.

Long-distance relocations are relatively rare as the vast majority of moves are local. Preliminary research by Roel Helgers shows that in 2013 half of the buyers in Flanders moved to a location less than 4.5 kilometres away from their old home and the median distance in Wallonia was 9.1 kilometres (ERA, 2014). For the majority of relocations, moving to a specific area is not an important objective. In particular, only 7% of households that moved mentioned work as the main reason, while 69% indicated dissatisfaction with the current dwelling and 24% pointed at personal reasons (Winters and Heylen, 2013). Large differences in house prices, especially between Wallonia and Brussels, can be an obstacle for people to relocate over longer distances.

People from lower socioeconomic groups have limited choice when they want to change residence as the supply of rental housing is small and concentrated (Box 2; Le Roy and Vandekerckhove, 2011). In Brussels, massive suburbanisation of high and middle-income households towards the periphery accelerated the degradation of central zones. The cheap, but often old and poor-quality, rental housing in these neighbourhoods led to a high concentration of disadvantaged communities, including many unskilled workers and ethnic minorities. These areas also have the highest unemployment rates, often above 20%, reflecting their residents' lower education levels and a skill mismatch between labour supply and demand.

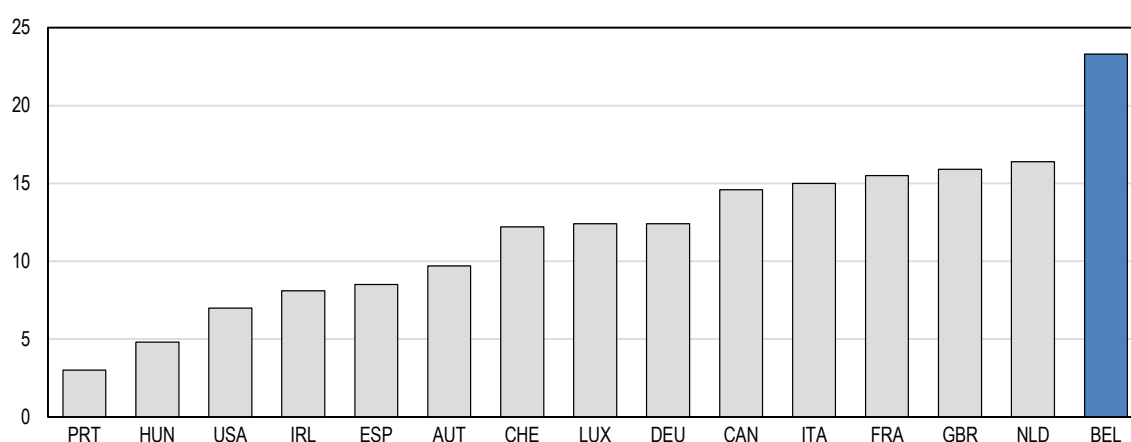
In addition, residential social, economic and ethnic segregation exacerbates unemployment (Dujardin et al., 2008).

Mediocre residential mobility contributes to congestion, greenhouse gas emissions and labour market inefficiencies

As people relocate relatively infrequently, home-work distances and hence commuting times are considerable. Over 18% of the population lives further than half an hour away from their workplace, which is one of the highest shares in the EU (Eurofound, 2011). Despite the well-developed transport system, congestion in Belgium is among the highest of OECD countries for which data is available (Figure 11).

Figure 11. **Road traffic congestion is high**

INRIX index, percentage point increase over free-flow, 2013¹



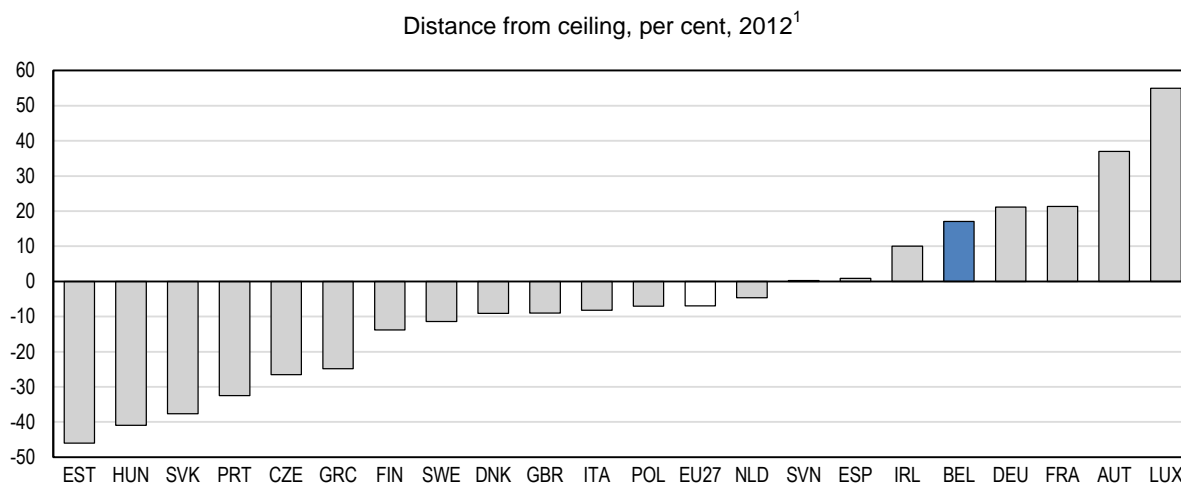
1. Index representing the barometer of congestion intensity. For a road segment with no congestion, the index would be zero. Each additional point in the index represents a percentage point increase in the average travel time of a commute above free-flow conditions during peak hours.

Source: INRIX Inc. (2014), *INRIX Traffic Scorecard*, <http://scorecard.inrix.com>.

Commuting is supported through substantive subsidies for home-work related travel and, by some measures, the most generous tax treatment of company cars among OECD countries (Harding, 2014), but contributes to the high and increasing share of the transport sector in Belgium's greenhouse gas emissions (OECD, 2013). In addition, the role of diesel is higher than in any other OECD country, which results to a large extent from the lower taxation. Although the difference has been reduced, diesel still has 30% lower excises per litre than gasoline. The higher emissions of pollutants such as nitrogen oxide and particulate matter aggravate air pollution, especially in Brussels and Antwerp, and are one of the reasons why emissions are persistently above internationally agreed levels (Figure 12).

Low residential mobility causes labour-market inefficiencies. If people prefer to work closer to home, they might have to take jobs below their level of education and experience, which is a suboptimal use of human capital. Although this phenomenon has not been quantified, it is likely to be relevant for the same reasons as why many recent graduates are overeducated, namely that the likelihood of finding more adequate work is small and that unemployment is financially and psychologically less attractive (Baert et al., 2013).

Figure 12. Nitrogen oxide emissions are above agreed levels

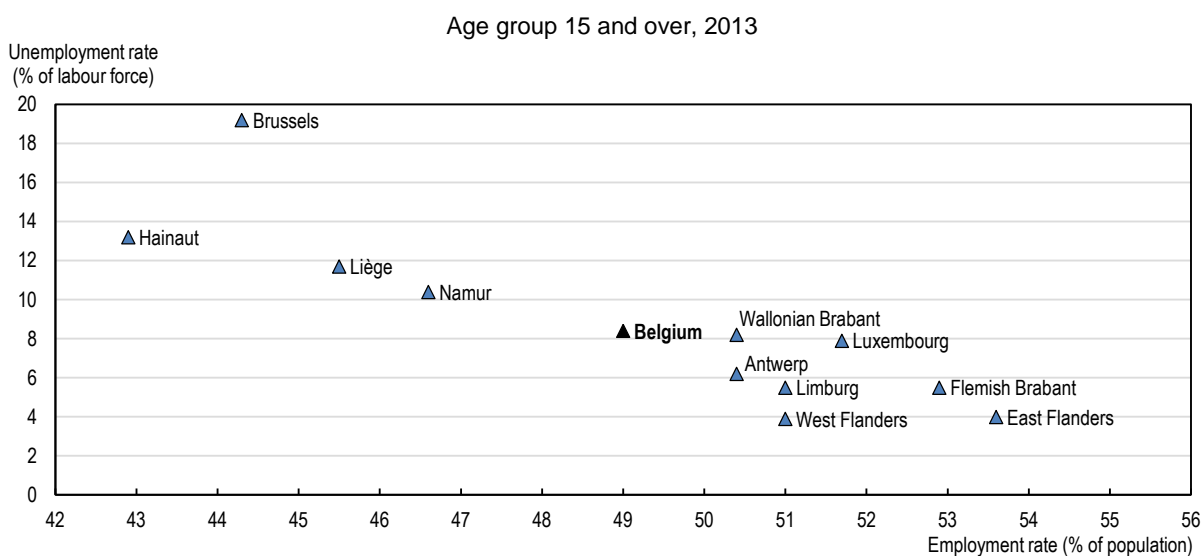


1. Under the National Emission Ceilings (NEC) Directive, EU Member States have individual emission limits, known as “ceilings”, that were to be achieved by 2010 for four different pollutants. The reported national totals of Austria, Belgium, Ireland, Luxembourg, Netherlands and United Kingdom are based on fuel used, all other Member States reported a national total based on fuel sold. The aggregated EU27 emission total is based on data for fuel used and for fuel sold.

Source: EEA (2014), “NEC Directive Status Report 2013”, *Technical Report*, No. 10, European Environment Agency.

Labour market inefficiencies also arise when jobseekers who cannot find suitable jobs in their neighbourhood prefer to remain unemployed, or even withdraw from the labour market, instead of moving to places with higher labour demand. Low residential mobility, which cannot be fully offset by commuting, thus contributes to the large geographical variations in labour market outcomes (Figure 13). Indeed, at the district (arrondissement) level a 1 percentage point rise of homeownership, the tenure type with the lowest residential mobility, implies a reduction in the fraction of people at working age with a job of 0.35 percentage points (Isebaert et al., 2013). More importantly, high homeownership leads to a weaker aggregate labour market performance through various externalities, as for example companies may leave when congestion becomes problematic, although for Belgium the relative importance of the different channels has yet to be studied in detail (Box 3).

Figure 13. Provincial employment and unemployment rates vary widely



Source: Eurostat (2014), “Regional Labour Market Statistics”, *Eurostat Database*, November.

Box 3. Aggregate impact of high homeownership on labour market outcomes

Macro studies between or within countries suggest that high homeownership is associated with low residential mobility and high unemployment as suggested by the Oswald hypothesis (Oswald, 1996 and 1997). Micro-data, on the other hand, tend to indicate that owning a home makes people more likely to be employed than when renting, thereby pointing at a positive effect at the individual level. Recent research highlights the role of negative externalities in explaining these contradicting findings (Isebaert et al., 2014; Laamanen, 2013), but further research is needed to identify the channels and their relative importance. The following factors might play a role in explaining how high homeownership rates can lead to higher aggregate unemployment:

- Traffic congestion: Employment may fall as businesses faced with productivity losses related to the increased duration and unreliability of transportation relocate to other areas. For example, part of the growth in commuting distances between 1981 and 2001 is caused by a loss in spatial proximity between housing and jobs, indicating that there is a growing divergence between the location of jobs and labourers (Boussauw et al., 2011).
- Not-in-my-backyard behaviour: Homeowners might try to prevent businesses from locating in their neighbourhood.
- Rental market tightness: The small rental market might limit worker reallocation, thereby reducing the labour market outcomes of people who would otherwise have been willing to change residence.
- Reductions in consumption: Mortgage loans are associated with increased housing expenditures. Obligatory monthly capital repayments on mortgage loans reduce self-control problems related to saving, while policies supporting homeownership provide additional incentives to spend a larger share of the budget on housing.

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Increasing residential mobility will have positive impacts on the labour market (Estevão, 2002). The effect is likely to be stronger on the regional than on the national level, as labour mobility between the two largest Regions accounts for just 13% of all inter-regional commuting. Clearly, the different languages cause a high degree of labour market fragmentation, but similarities in qualification and skill mismatches play a role as well (Zimmer, 2012). The large lack of high-skilled labourers in Brussels is partially addressed by a high inflow of commuters from Flanders and Wallonia, but these Regions have shortages as well. Measures aimed at increasing mobility should thus be accompanied by labour market policies in order to address geographical differences.

Making the most of the Regions' new competences

Under the Sixth State Reform, competences for housing taxation and rental legislation were transferred to the Regions in July 2014. The new allocation of responsibilities reduces the areas where authorities from different levels have overlapping responsibilities, which led to legal problems and uncertainties. For example, safety, health and habitability norms for rental housing set by the federal authorities were not fully aligned with norms at the regional level regarding the quality of dwellings (Hubeau and Vermeir, 2013 and 2014). With more homogenous responsibilities, regional governments can develop a coherent housing policy that better addresses the specificities in their part of the country.

Regions are now responsible for most, but not all, housing-related matters, although they will increasingly have to take policies in other parts of the country into account. Several aspects remain a federal competency, most notably the tax treatment of non-owner occupied housing, the value-added tax (VAT) rates on construction and renovation, the taxation of rental income, the registration of rental contracts, procedural law and the collection of taxes. In some of these areas, for example regarding the registration of rental contracts, the scope for conflicting legislation has increased, as there is a federal (tax) dimension and an increasingly important regional (security of housing) dimension. At the same time, the transfer of competences allows Regions to set priorities on housing-related issues, as is shown by the different plans regarding the fiscal treatment of mortgage loans and a more strategic use of recurrent housing taxes under consideration in Brussels.

The transfer of housing competences offers Regions a unique opportunity to revise current policies, and the remainder of this paper discusses three areas where reforms can contribute to a more efficient and equitable housing market. Firstly, the rental market requires additional support to address the long waiting lists for social housing and strengthen the private rental segment. Secondly, expansion, modernisation and greening of the building stock are needed in view of the growing and changing demand for housing. Finally, apart from making the tax treatment of housing tenures more neutral, taxation reforms have considerable scope to increase efficiency and remove barriers to residential mobility.

Strengthening the rental market through a shift in public support

Moving towards fiscal neutrality

Housing policy is focused on increasing homeownership, with the rental market, and especially the private segment, receiving relatively little support. For example in 2012, 61% of the Flemish housing budget was spent on the owner-occupied sector, 34% on the social rental sector and only 5% on the private rental market (Haffner et al., 2014). When also including federal subsidies, most notably mortgage tax relief, the average homeowner in Flanders receives 4.3 times more housing benefits than the average tenant (Heylen and Winters, 2012). Increasing homeownership is a policy objective in many countries, motivated by the perception that it generates positive neighbourhood effects and raises social capital. However, the evidence for such effects is weak (OECD, 2011a). In addition, such support tends to be regressive, with 47% of Flemish housing subsidies going to the top 40% of earners, a group for whom housing problems, in terms of affordability and quality, are almost negligible. The regionalising of housing taxation provides an opportunity for a budgetary shift towards the rental sector, which would improve the allocation of housing support.

The total mortgage tax relief for homeowners, a federal competency until mid-2014, is larger than the rest of the housing budget. Tax relief on debt-financing is close to the OECD average (Andrews et al., 2011), although Belgium is the only country where besides interest also capital repayments are tax deductible (albeit with an overall cap). Apart from influencing tenure choice, tax favouring of homeownership can lead to an excessive amount of capital allocated to housing at the expense of more productive investments. Indeed, to a large extent the increased tax deductibility of debt financing costs since 2005 has translated into higher house prices, and by some estimates dwellings in 2012 are valued 29% (EUR 54 000 on average) higher than in the absence of fiscal support (Damen et al., 2014; Vastmans et al., 2014). For first-time buyers, the direct benefits of mortgage tax relief are thus to a large extent offset by higher prices, while people who already owned a house in 2005 are benefiting from both effects.

The tax relief for homeowners with mortgage loans should be reformed – not least because its costs are set to grow to a level that is unaffordable for the regional governments (Vlaamse Woonraad, 2012). The current low mortgage interest rates facilitate such a reform. Authorities should remove the tax deductibility of capital repayments. In addition, they can decide to subject imputed rental income to personal income taxation or to reduce the tax deductibility of interest payments of mortgage loans. In

practice, the latter reform is easier to implement as it is more understandable and accepted by citizens than taxing imputed rents. The recently implemented reforms in Flanders to limit the tax deductibility are a first step in this direction, as is the decision by Wallonia to slightly reduce the rate of deductibility for new mortgages. Given the likely large effect on prices, changes should be introduced gradually and uncertainty about future measures should be minimised.

Broadening rental allowance schemes to support the weakest renters

Public support for poor tenants in the private rental market is limited as rental allowances target specific groups. All Regions have an allowance for households with low incomes, but on the condition that previous housing was not meeting quality standards. Specific allowances exist for people waiting for social housing, but only if they are on the waiting list for over four years (Flanders) or belong to a priority group (Brussels). Reciprocity of these allowances is low, with for example less than 0.5% of private renters in Flanders receiving any of these allowances (Winters and Vermeir, 2013), while 40% qualify for social housing (Heylen et al., 2007).

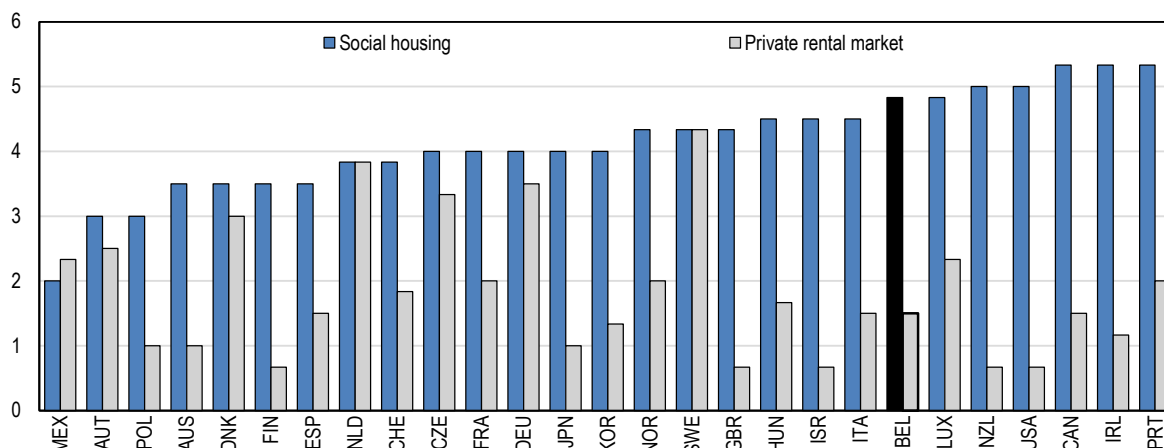
Regions should expand the existing rental allowance schemes to cover all tenants in the private market who qualify for social housing. In many European countries, allowances are becoming more important (Griggs and Kemp, 2012) as they allow rents to be decided by the market, thus contributing to market efficiency, while keeping housing affordable for vulnerable groups. Moreover, more secure yields may also help to raise the supply of rental housing. When allowances can be taken along when changing municipalities, they tend to hinder residential and labour mobility less than the direct provision of social housing. Such a rental allowance would also remove eligibility requirements for social housing based on “existing local ties” (for example already living or working in the neighbourhood), which are used by municipalities in Flanders and Wallonia and can lead to indirect discrimination (CGKR, 2014).

Several potential disadvantages of allowances can be mitigated through good design. As rent levels vary across the country, a uniform allowance risks being either too generous or insufficient. Instead, income and rent ceilings could be set at a sub-regional level, as is the case in for example Finland and Germany (De Boer and Bitetti, 2014). Allowances depending on the actual rent risk to drive up prices, as they provide incentives for tenants to choose housing with rents just within eligibility limits while landlords may raise rents to this level, as happened in the Netherlands. Linking the allowance to the local median rent, for example in the municipality, would limit its capitalisation into rents. Furthermore, low allowance withdrawal rates reduce the effective marginal income tax rate and thereby minimise negative incentives for finding a (better-paid) job.

Raising the supply of rental housing at the lower end of the market

The long waiting lists for social housing and the sharp rent increases at the lower segment of the private rental market point at a shortage of cheaper housing. The problem is partly caused by the low turnover of social rental housing. Contracts for an indefinite period were abolished in Brussels and Wallonia, but many dwellings are still occupied by households which, although they no longer qualify for their current social rental on the basis of income or household size, cannot be easily relocated. For example, around 8% of social tenants have earnings above the eligibility limits for new candidates as a result of raising incomes. There are few incentives to voluntarily leave social rental housing as, due to the high rent control (Figure 14), rents are well below those in the private sector. Shrinking families who stay in too large houses can be penalised in some cases, but often prefer to pay the low fine instead of moving to a smaller place. A stronger enforcement of contractual eligibility requirements and, in Flanders, abolishing unlimited rental contracts would make social housing available to those who need it most.

Figure 14. Rents for social housing are tightly controlled

Indicator with a scale of 0 to 6 (least to most control), 2009¹

1. Composite indicator of the extent of controls of rents, how increases in rents are determined and the permitted cost pass-through onto rents in each country.

Source: D. Andrews, A. Caldera Sánchez and Å. Johansson (2011), "Housing Markets and Structural Policies in OECD Countries", *OECD Economics Department Working Papers*, No. 836.

Better utilisation of existing social housing and the planned new construction would bring supply closer to demand, but are unlikely to fully close the gap. Social housing is mostly provided through associations, which are private organisations in which municipalities are often the main shareholder. Some social housing associations lack personnel and, more importantly, many dwellings are undergoing, or waiting for, renovation works. As a result, 6% of the social housing stock is unoccupied, compared to for example 3.5% in the Netherlands (CBS, 2014). All Regions have ambitious plans for the construction of new social housing. Brussels, for example, aims to expand its stock at twice the current pace. However, targets are unlikely to be met unless progress is closely monitored: four years after the Flemish government set targets for municipalities, half of the local authorities were behind schedule and had no action plan in place to catch up. In general, clustering of social housing should be avoided when constructing new units to minimise segregation effects. Moreover, the construction of social housing should only be directed at the rental sector, as selling dwellings at reduced prices would provide a lifelong benefit independent from income developments to a small minority.

Efforts to raise the supply of private rental housing, especially at the lower end of the market, should be increased. Bringing existing housing, or converted offices if allowed by the local development plan, to the rental market is relatively easy as the dwelling should meet minimum criteria regarding health and safety, but no rental permit is required. However, the combination of minimum quality standards and maximum rents reduces returns on social housing. Making publicly-owned plots available at reduced prices on the condition that it is used for the construction of affordable housing would raise the returns for private investors. The role of social rental agencies, which rent dwellings on the private rental market and let these to households according to housing needs on the basis of priority rules, could also be supported more. Crucially, these agencies assure timely payments to landlords and adequate maintenance of the dwelling (De Decker et al., 2009). However, the agencies are often small, with less than 100 dwellings on average, account for a small part of the rental housing stock (around 1.5% in Flanders) and do not have full geographical coverage (De Decker, 2009 and 2014). With increased financial means, these agencies could strengthen their real estate management without compromising their welfare services.

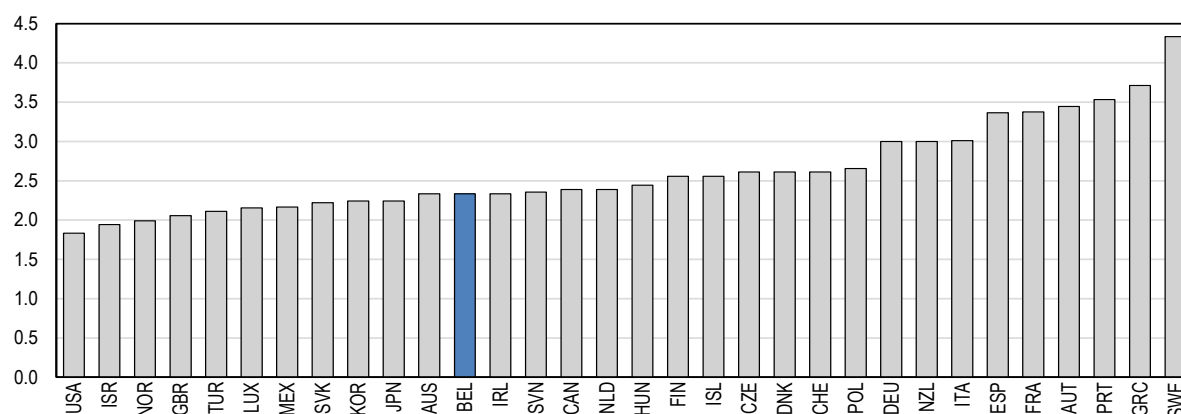
Making renting on the private market a more attractive tenure

Discrimination in the private rental market is widespread. Over 40% of the real estate agents are willing to honour a request by the landlord to not consider foreign tenants, and 60% have no objections in ignoring unemployed tenants (CGKR, 2014). When directly contacting the landlord, women on social welfare, Turkish and Moroccan men and to a lesser extent disabled people and single mothers tend to be discriminated against. Candidates from foreign origin often have to provide additional references and documents, and higher guarantees - sometimes even in cash. Given the scale of the problem, authorities should increase pressure on real estate agents to adopt a binding code that bans discrimination, step-up random checks to avoid that discrimination moves to later stages of the rental process and analyse whether the housing inspection can be involved in the investigation of reported incidents, akin to social inspection agencies that have the competences to investigate both safety and discrimination at the work place.

Tenant-landlord relations seem broadly balanced as shown by the average extent of regulations (Figure 15), but several aspects of the current rental legislation could reduce the attractiveness of the private rental market. Many potential landlords are reportedly deterred from renting their property due to the perceived strong legal protection of renters. Relatedly, the standard legal rental period is nine years, but in practice more than half of the rental contracts are concluded for a period of three years or less. Rent controls ensure that during a contractual period the rent changes in accordance with the cost of living, but they could discourage tenants from relocating if the indexation falls short of market-based increases. More research is needed, for example on rent changes between subsequent contracts and the determinants of the rental period, to understand whether the private rental market has the right balance between flexibility and security, both for the tenant and the landlord, and thus fulfils its role as a tenure complementary to homeownership.

Figure 15. **Tenant-landlord regulations in the private rental market appear balanced**

Indicator with a scale of 0 to 6 (least to most protection for tenants), 2009¹



1. This indicator increases with the extent of tenant-landlord regulation within a tenancy. It accounts for the ease of evicting a tenant, degree of tenure security and deposit requirements.

Source: D. Andrews, A. Caldera Sánchez and Å. Johansson (2011), "Housing Markets and Structural Policies in OECD Countries", *OECD Economics Department Working Papers*, No. 836.

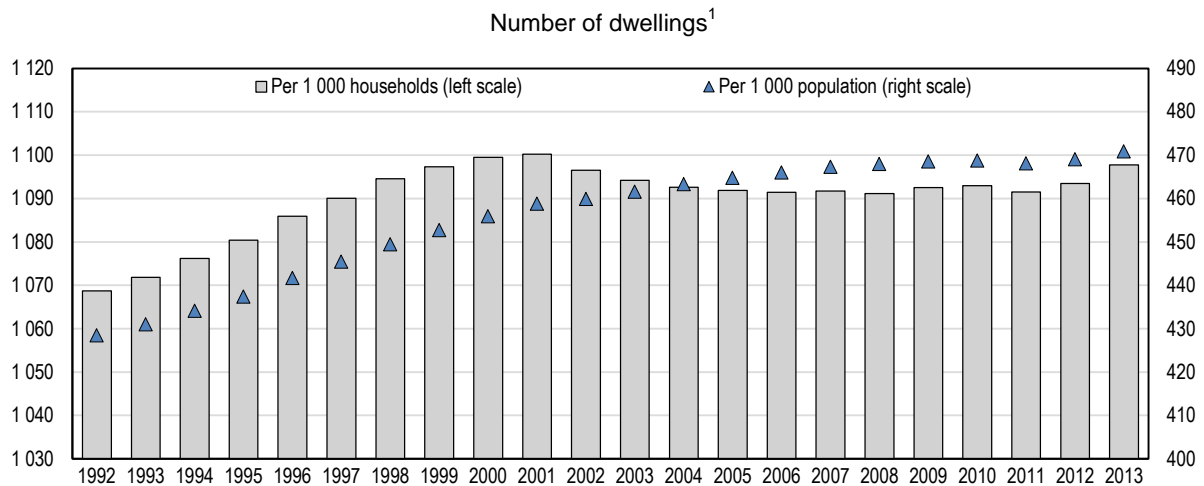
Expanding the housing stock and improving its quality

Meeting rising housing demand through densification

Rigidities in housing supply can lead to price increases when construction fails to keep up with growing demand, but there are, nonetheless, few signs of a housing shortage in Belgium as a whole. The number of houses per thousand inhabitants has continued to increase, while compared to the number of

households it has been broadly stable during the last decade (Figure 16). The steady growth of new houses has thus been able to meet the increased demand, at least to a large extent, which confirms that the past increase in house prices is more related to demand factors than to a structural undersupply of housing.

Figure 16. **Housing stock evolved in line with demand**



1. Number of households for latest years is estimated.

Source: Statistics Belgium (2014), "Statistique cadastrale du parc de batiments", *be.STAT Database* and ADSEI (2014), "Huishoudens per gewest", *Algemene Directie Statistiek en Economische Informatie*, available at <http://data.gov.be>.

However, it will be challenging to expand the dwelling stock at a pace commensurate to the increasing number of households. After a long period with a high level of building activities, it will become increasingly difficult to find available sites, especially close to economic centres. There are already housing shortages in the main cities, and increasingly land designated to non-residential activities is being reclassified as mixed purpose. In Brussels, office buildings in the European quarter are now being converted to houses, reversing a long-standing trend. In addition, more and more high-rises are allowed.

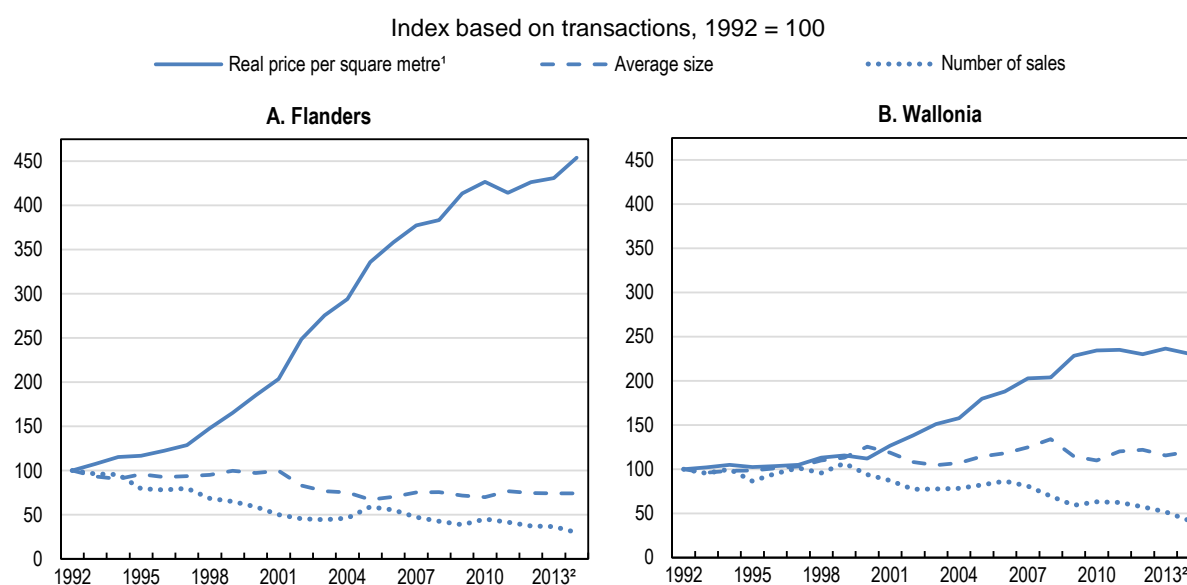
The relatively low urban density of Brussels suggests there is scope for densification. Efforts for identifying new housing possibilities, through re-designating land, converting non-residential buildings and further facilitating the construction of denser buildings, should be stepped-up, while taking into account the environmental and social impact. Municipal authorities can consider using "density bonusing" to facilitate community acceptance of densification, as is practice in several US and Canadian cities: developers are allowed to build above a zone's density or height norms in exchange for cash contributions for social amenities, such as a community centre or a childcare facility (OECD, 2014).

In the two largest Regions there are major mismatches in the availability of building plots and demand. In Flanders, for example, there are still more than 300 000 parcels freely eligible for development, but relatively few are in the neighbourhood of the main cities. In addition, ownership is highly fragmented with 84% of the plots owned by individuals (Loris, 2009). As the majority of owners only possess a single lot, it is often difficult to realise larger housing projects. The scarcity of good plots has led to a quadrupling of real land prices in Flanders during 1992-2013 (Figure 17), while real house prices only doubled. Scarcity of land is also becoming an issue in Wallonia, although not at the same scale as in Flanders.

To meet the high demand for new housing, construction close to centres of economic activity should be stimulated so as to simultaneously reduce energy consumption and commuting time. In this respect, the Regional Spatial Development Perspective for Wallonia, adopted in November 2013, outlines several measures for a densification of villages and towns. Proposals to construct additional housing on underdeveloped parcels should be further explored and incorporated in municipal development plans. The

envisioned minimum building densities for new construction projects and for large renovations will also lead to more compact urban centres and should be made operational. Adding floors to existing buildings could be promoted by streamlining the involved procedures.

Figure 17. **Good building plots have become scarcer**



1. Deflated by the consumer price index.
2. Data for 2014 covers the first semester where the number of sales is an estimate based on double the sales of the first semester.

Source: Statistics Belgium (2014), "Immobilier et utilisation du sol: Statistiques des ventes de terrain à bâtir", *be.STAT Database*, November.

The spatial development plan for Flanders stipulates that 60% of new houses are built in urban areas and 40% in rural areas. These ratios reflect the distribution of the housing stock in 1991 and were introduced in 1997, when construction increasingly took place in rural areas, to avoid further urbanisation. Targets for provinces and municipalities have ensured that the overall ratio has been respected. Raising the bar by setting a more ambitious target would reinforce efforts of authorities at all three levels to facilitate the development of new housing close to areas with high economic activity.

Activating vacant plots and buildings

In general, unused plots, especially in urban areas, could be activated by lowering the profitability of unused land. Regional policies exist to encourage owners to build on their land, while municipalities can impose activation charges and taxes. However, only a minority of municipalities is taxing unused plots and the amounts involved are often small compared to the steadily increasing plot values. Overall, the inventory of empty plots needs to be updated and its coverage extended to all municipalities in Belgium.

Vacant dwellings are also a potential source for additional housing. In Flanders, there are some 15 000 unoccupied houses, 15 000-30 000 in Brussels and at least a similar number in Wallonia for which the last reliable estimate dates from the 1990s. Many of these houses will need major renovations, but others can be used without substantial costs. Municipalities can tax uninhabited houses and buildings, but in practice few do so. This prompted Brussels-Capital Region to introduce a regional charge in 2012. In addition, federal housing taxation provides the wrong incentive by giving a deduction for dwellings unoccupied for over 90 days.

Modernising and greening the housing stock

A wide range of measures is in place to stimulate the renovation of existing housing, especially regarding energy efficiency improvements. Ordinary renovations benefit from the low VAT rate of 6%, as opposed to new constructions for which a rate of 21% applies. Federal support for energy efficiency improvements has been streamlined by phasing out all measures, except for a tax-reduction on roof-top insulation, which is one of the most efficient ways to reduce residential energy consumption. Additional subsidies exist at the regional and local level, the exact amount depending on various criteria, including income and the nature of the work. However, several supporting measures are inefficient, most notably the subsidies for solar panels in Wallonia (OECD, 2011b).

Potentially disproportionate increases in property taxes discourage owners to carry out investments. Substantial renovations should be reported to the cadastre, which subsequently re-estimates the potential value for which the dwelling can be rented (the cadastral income) and on which property taxes are based. Given that the last general update of the cadastre took place in 1975, the re-estimation can lead to a considerable increase in the cadastral income and the related taxes, and hence only rarely renovations are reported spontaneously (Rekenhof, 2013). In addition, the administrative procedure to levy fines is so complex that no sanction has been issued since 2006. However, the procedure is currently being streamlined, which makes non-reporting less attractive in the future. It is therefore increasingly important to address disincentives for renovations related to property taxes, for example by updating the cadastre (discussed in detail below).

Aside from adjustments to the cost of living, landlords can increase the rent during contractual periods only if renovations increased the rental value by 10% or more. Following the Sixth State Reform, Regions are now responsible for rental legislation, which provides an opportunity to stimulate the renovation of rental housing and in particular energy-efficiency improvements. Offering targeted loans to cash-constrained landlords, often older people, would encourage investments in rental dwellings as they could spread the costs over time. Tenants at the lower end of the rental market whose housing conditions are improved should be shielded from too large rent increases through specific subsidies.

Prospective renters should be given more information about the energy consumption of dwellings. Easily observable energy-saving features are valued by tenants. For example, in Wallonia rents of properties with double or triple glazing are some 10% higher than those with single glazing (Kryvobokov and Pradella, 2014). However, other energy-efficiency measures, such as good insulation, can be assessed less easily, which makes renters reluctant to pay the higher rents. In Brussels the cost of occupancy, which includes both mortgage costs or rents and energy expenses, has to be included in acquisition and operating contracts for public buildings from July 2015 onwards, and the authorities are assessing whether this requirement can be extended to the residential sector. Notwithstanding challenges related to the practical implementation, using the cost of occupancy seems a promising way to raise attention to a dwelling's energy costs and its use should be considered by the other Regions.

Despite the overall support for energy efficiency, energy subsidies are providing the wrong incentives. The widespread use of social energy policies contributes to the high residential emissions (OECD, 2011b). The lower tariffs discourage energy savings and should be replaced by social policies such as lump-sum income subsidies for low-income households to prevent energy poverty. Similarly, the reduction of the VAT on electricity introduced in April 2014 should be reverted. The progressive energy pricing in Brussels and Wallonia, to be implemented in January 2015, will increase incentives for lower energy consumption and raise awareness.

Increasing efficiency and equity of housing taxation

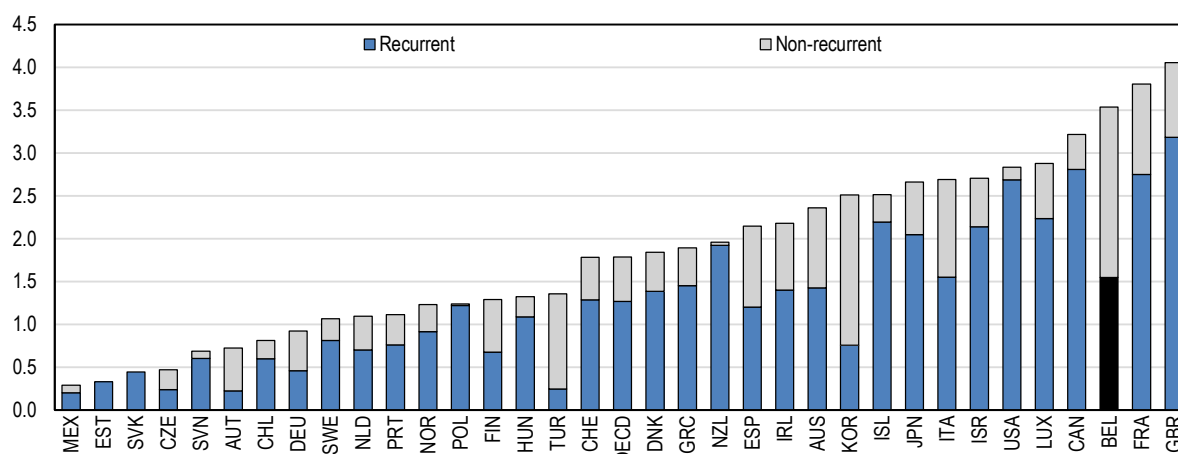
Tilting housing taxation towards recurrent taxes to increase efficiency and mobility

Revenues from property taxes are high in Belgium compared to other OECD countries (Figure 18). They are an important source of income at the local level, accounting for around half of all tax receipts. About two-thirds of property tax revenues come from housing. A high share of total revenues comes from non-recurrent taxation, mainly taxes on inherited dwellings and property transactions. Indeed, transfer taxes are high in Belgium, pushing up the transaction costs for buyers (Figure 19). As in many other countries, tax breaks exist. All Regions have abatements to reduce the taxes, with the higher abatements in Brussels and Wallonia off-setting higher tax rates. In Flanders, previously paid taxes can qualify for discounts when purchasing a new house in the Region – a cumbersome administrative process that is carried out by the federal authorities. Notwithstanding these complex ways of mitigating the high transaction tax rates, Belgium is often mentioned as a country where lowering transfer taxes on property would lead to significant welfare gains (Van Ewijk and Van Leuvensteijn, 2009).

Comparing the origins of property tax revenues of Belgium and OECD countries (Figure 18) indicates that there is scope to tilt taxation towards recurrent taxes. Such a reform would make it less costly to relocate and would take away a barrier to labour mobility (Isebaert et al., 2014). In addition, it would increase tax efficiency as transaction taxes are highly distorting, and the same tax revenue could in principle be obtained at a lower economic cost by a recurrent tax on immovable property (Johansson et al., 2008). As a reduction of transaction taxes would stimulate house prices, it could mitigate negative price pressures resulting from lower tax relief for homeowners. A phase-in mechanism could cushion the impact of the increased tax burden for current homeowners (Slack and Bird, 2014), but may involve transitional fiscal costs.

Figure 18. Taxation of housing is skewed towards non-recurrent taxes

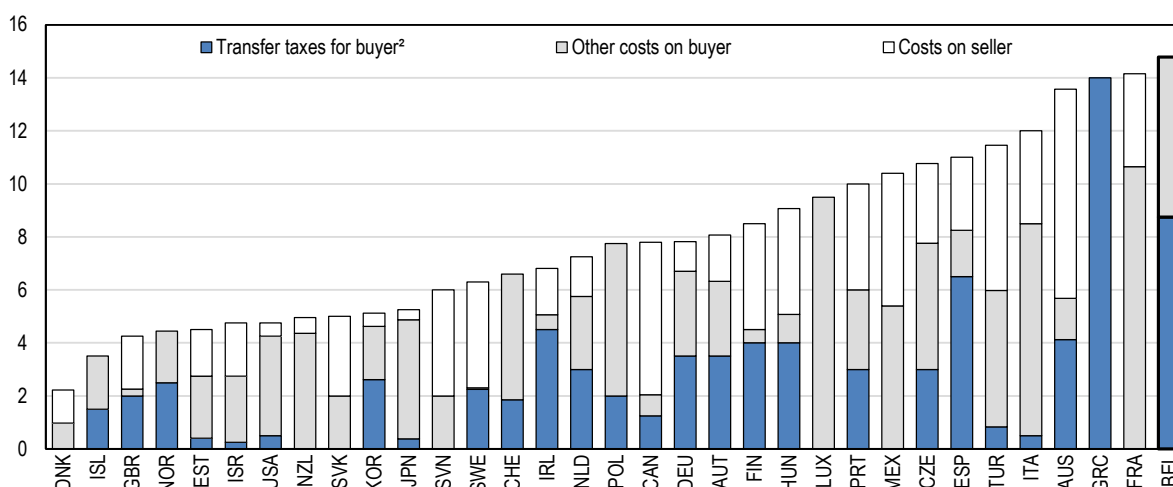
Revenues as a percentage of GDP, 2013¹



1. 2012 for Australia, Estonia, Greece, Mexico, Netherlands, Poland and the OECD average.

Source: OECD (2014), "Revenue Statistics: Comparative tables", *OECD Tax Statistics* (database).

Figure 19. **Transaction costs are high**
Average costs in per cent of property value, 2009¹



1. The estimates do not take into account the various tax breaks for certain dwellings implying that the estimated cost may overestimate the actual cost in some countries, in particular in Italy, where such tax breaks are frequent.
2. Stamp duty for example.

Source: D. Andrews, A. Caldera Sánchez and Å. Johansson (2011), "Housing Markets and Structural Policies in OECD Countries", *OECD Economics Department Working Papers*, No. 836.

Updating rateable values

The cadastral income, an estimate of the potential net rental income of a dwelling, forms the base for many housing-related taxes, including the withholding tax on real estate, a levy on inhabitable buildings and income taxes on non-owner occupied housing. It also serves to determine eligibility for lower transaction taxes. The valuation date of the cadastral income is 1 January 1975, but since 1990 values have been indexed to the consumer price index and increased by 40% to determine the taxable amount. However, this revision method has led to a significant underestimation of rental values. For example, in Wallonia revenues based on the cadastre increased by 74% during 1982-2013 while other revenues more than doubled. An additional problem is the large variation between selling prices of specific properties and their cadastral incomes as standings of areas have changed over time. In general, properties with comparable selling prices have higher cadastral incomes in the main cities.

In setting recurrent taxes, the Regions have full competences except undertaking an update of the cadastral values which remains a federal competence. As the costs of an update are borne by the federal authorities while the benefits accrue to the Regions, a cost-sharing agreement has to be sought. An alternative is to change the base of taxation, a possibility since 2001, by setting up a regional cadastre, as is discussed in Brussels. Either way, the cadastral income should be derived on a good proxy of a property's market value. If administrative capacity is limited, self-assessment of property values by owners, the method recently used in Ireland, might be an option (Slack and Bird, 2014).

An update of cadastral income would raise the taxable rental income on non-owner occupied housing. Although this would merely be a correction of implicit benefits that accrued over the years, the lower after-tax returns on renting could lower the supply or drive up rents. Moving towards a taxation of real actual rental incomes, at least for the rented dwellings, would address this problem, but in analogy of other investments would call for deductions related to the maintenance of the property and, in case of debt financing, interest payments as well as a tax on realised capital gains (CSF, 2014). A full assessment is further complicated by the frequent use of corporations that are specifically set-up by the landlord for tax

purposes. For second residences, the higher taxation would be in line with a reduction in mortgage tax relief for owner-occupied housing.

Recommendations to maintain an efficient and equitable housing market

Policies to limit risks posed by the overvalued housing market

- Take advantage of the current low interest rates to gradually remove the tax deductibility of interest and capital repayments on mortgage loans.
- Impose maximum limits on loan-to-value and debt-service-to-income ratios for new mortgage lending when appropriate in view of housing market dynamics.

Policies to improve the functioning of the rental market

- Expand regional rental allowance schemes for low-income tenants renting on the private market. Make the allowance portable and dependent on local median rents.
- Increase subsidies for social rental agencies and make publicly-owned plots available for construction of affordable housing, notably by the private sector.
- Focus on rental housing instead of selling newly constructed social housing at discounted prices.
- Stimulate higher occupation turnover of social rental housing by a stronger enforcement of contractual eligibility requirements and the abolition of open-ended contracts.

Policies to meet the rising demand for housing and improve the housing stock

- Increase urban building densities by re-designating land and converting non-residential buildings, further easing restrictions on the construction of denser buildings, and increasing the costs of keeping urban land and buildings unused.
- Address disincentives for renovations related to the disproportionate increase in property taxes - in particular for energy-efficiency improvements.
- Allow rent increases during a contractual period when justified by energy-efficiency improvements.
- Offer targeted loans for renovations to cash-constrained landlords, possibly guaranteed by the dwelling.

Policies to make the housing market more dynamic and the private rental market more attractive

- Tilt housing taxation towards recurrent taxes and away from transaction taxes. Reduce transaction taxes through lower rates instead of increasing abatements and expanding portability of previously-paid taxes.
- Update the federal cadastre, financed through a cost-sharing agreement between government levels, or set up regional cadastres.
- Review taxation of rental income to avoid negative effects on the supply of rental housing from an update of the federal cadastre.
- Increase pressure on real estate agents to adopt a binding code that bans discrimination and step up random checks to avoid that discrimination moves to later stages of the rental process.

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