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The Austrian model of limited-profit housing – an example for other sectors of the economy?

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Abstract

Much of popular economic analysis and policy making in recent decades have been based on the belief that profit-maximisation of economic actors under (perfect) market conditions lead to the best outcomes in terms of resource allocation of products and services to society at large. It is becoming increasingly obvious that this theoretical model of economic rationality does not live up to its empirical reality and formulated policy goals have hence not crystallized. The Austrian housing market provides a good backdrop against which these assumptions can be tested and put into question.

Over previous decades the Austrian housing market has institutionalised an economic model, which goes beyond the profit-maximisation assumption and has enabled housing providers to integrate other factors into their decision-making processes. Specifically, this economic model is present in Austria's housing market via limited-profit housing associations and their economic governance regime. The key element of this limited-profit sector is a cost-based price setting mechanism instead of one based on profit-maximisation, which applies to homes for rent and sale. The cost-based segment accounts for almost a quarter of Austria's housing market and has proved successful, both in terms of its financial viability and its impact on society and the economy. In fact, the Austrian model of housing has attracted increasing international attention and has been referred to as a best-practice example, in particular in the context of the ongoing crisis of affordability in many cities across Europe. This attention is reflected in a number of recent reports by the OECD (2020a, 2020b, 2021), the IMF (2021) or Housing Europe (2021), to name a few. The positive effects of this model have not only been evidenced for individual households by providing them with affordable homes, but research has also highlighted the economic impacts of it on macro-economic stability, innovation, and sustainability.

This paper will discuss the key elements of Austria's model of limited-profit housing, their effects on the wider housing market and it will do so by taking a comparative European approach. Two main angles that will be highlighted are a comparison of the share of housing costs in total household expenditure and the public expenditure on housing. The paper will argue that Austria's system of cost-based housing has both had a beneficial impact on individual households and on state budgets, with less need for the state to support households with housing costs (via e.g. housing allowances). Moreover, the paper will demonstrate the impacts of these two factors on purchasing power and economic output.

The paper will conclude by drawing lessons from the discussed instruments to other sectors of the economy. This is particularly pertinent given the ongoing supply-chain issues and shortages of important goods and services post-Covid. As such, the paper aims to contribute to the discussion of the scope of economic action, in particular insofar as it concerns the provision of the population with essential goods and services.



Keywords: affordable housing, cost-rent, limited-profit, revolving funds

Expanded abstract

The Austrian model of limited-profit housing – an example for other sectors of the economy?

1. Introduction

Much of popular economic analysis and policy making in recent decades have been based on the belief that profit-maximisation of economic actors under (perfect) market conditions lead to the best outcomes in terms of resource allocation of products and services to society at large. It is becoming increasingly obvious that this theoretical model of economic rationality does not live up to its empirical reality and formulated policy goals have hence not crystallized. This is specifically relevant for housing markets. Many European countries and in particular cities have experienced a shortage of affordable housing and increased house prices, resulting in a growing share of the population that is overburdened by housing costs or experiencing deteriorating living conditions (e.g. regarding the size of homes). This has had consequences not only for individual households but also for state budgets, as households increasingly needed to resort to housing allowances to cover expensive housing costs in the for-profit sector. The Austrian housing market provides a good backdrop against which these assumptions can be tested and put into question.

Over previous decades the Austrian housing market has institutionalised an economic model, which goes beyond the profit-maximisation assumption and has enabled housing providers to integrate other factors into their decision-making processes. Specifically, this economic model is present in Austria's housing market via limited-profit housing associations (LPHA) and their economic governance regime. The key element of this limited-profit sector is a cost-based price setting mechanism instead of one based on profit-maximisation, which applies to homes for rent and sale. The cost-based segment accounts for almost a quarter of Austria's total housing market and 40% of the rental market and has proved successful, both in terms of its financial viability and its impact on society and the economy. In fact, the Austrian model of housing has attracted increasing international attention and has been referred to as a best-practice example, in particular in the context of the ongoing crisis of affordability in many cities across Europe. This attention is reflected in a number of recent reports by the OECD (2020a, 2020b, 2021), the IMF (2021) or Housing Europe (2021), to name a few. The positive effects of this third sector as it was called recently by OECD economists have not only been evidenced for individual households by providing them with affordable homes, but research has also



highlighted the economic impacts of it on macro-economic stability, innovation, and sustainability.

2. The system of limited-profit housing

Limited-profit housing associations (LPHA) play a significant role in the Austrian housing market, both in terms of new construction and in terms of the overall share of homes. They provide housing to almost a quarter of all households in Austria, either as rented homes or as managed owner-occupied homes. LPHA occupy a distinct Third Sector role in the Austrian housing market, as they are neither profit-driven nor state-owned but operate under a specific limited-profit governance regime, codified in national legislation. The Limited-Profit Housing Act and supplementary legislation¹ form the basis for the business model of LPHA, including the way in which rents are set, what types of activities LPHA can engage in and how their business activity is audited annually. There are 185 limited-profit housing associations (LPHA) in Austria. Legally speaking, LPHAs are private entities, either organised as cooperatives (Genossenschaft) or limited-liability companies (Gesellschaft mit beschränkter Haftung or Aktiengesellschaft). 98 LPHA are cooperatives and 87 are limited liability companies. On average a LPHA manages about 5.000 homes, however with significant variations in size, ranging from large organisations with a stock of 50.000 to small organisations with less than 20 homes.

LPHA play an important role in the Austrian housing market and have established their position as providers of affordable housing over many years. In 2020, LPHA managed over 660,000 homes for rent and 280,000 homes (flats) in owner-occupation. A unique feature of limited-profit housing in Austria in international standards is that their governance is not only evident in the various (historical) missions and purposes of operating on a limited-profit basis but in addition, the business model is also codified in a sector-specific national law, the Limited-Profit Housing Act. This Act sets out the key governance mechanisms and principles of limited-profit housing in Austria.

¹ Including for example the Gebarungsrichtlinienverordnung (GRVO) with additional legislation on the conduct of LPHA, the Entgelttrichtlinienverordnung (ERVO) with additional legislation on rules for cost calculation, and the Bilanzgliederungsverordnung (BGVO), with additional legislation on the setup of the balance sheet and the income statement.



Key principles of Limited-Profit Housing in Austria

The Principles of Limited-Profit Housing The key principles of limited- profit housing are anchored in the WGG, a sector specific law that only applies to GBVs. In return for complying with the rigorous governance and auditing rules codified in the law, limited profit housing associations are exempt from corporation tax in their main and ancillary areas of business. The main principles are the following:

Cost- rent: GBVs calculate on a cost-basis, which means that rents can neither be set above nor below the costs incurred in the production, financing, and management of residential buildings (“cost rent”). Rented homes for which financing loans have been paid off are subject to rent control on a permanent basis, something known as the Basic Rent.

Limitation of profits: Revenue generating components are a constituent part of cost-covering prices. In the case of GBVs, how-ever, these components are clearly defined by the WGG and supplementary regulations which set upper limits.

Revolving funds: Equity is permanently tied up for limited- profit purposes and surpluses are continuously reinvested. This is guaranteed by a limitation to profit distribution among owners and by an obligation to reinvest any surpluses regularly in housing construction. Furthermore, shares in a limited- profit housing association may only be sold off at the nominal value of the initial investment (the “nominal value principle”).

Personnel restrictions: GBVs must be independent from the construction industry, in order to prevent tie-in deals to the detriment of customers. This applies in particular to the functionaries of limited-profit companies. The salaries of functionaries are regulated in the WGG.

Limited business activities: Limited-Profit housing associations must primarily pursue business activities that are within the main scope as stipulated in the WGG, i.e. the construction, maintenance, and renovation of homes, and must do so in their own name. Other areas of business activity such as the construction of business premises, garages or community facilities are allowed but must be secondary in volume. Some other undertakings require the permission of the respective regional government.

Audit requirements: All limited-profit housing associations must be a member of an auditing association and are audited annually by independent auditors. The audit monitors compliance with the WGG, including the efficient and economic use of resources and capital as well as the sound management of the organisation.

Source: GBV – Limited-Profit Housing Associations, Folder. Available at <https://www.gbv.at/english/>

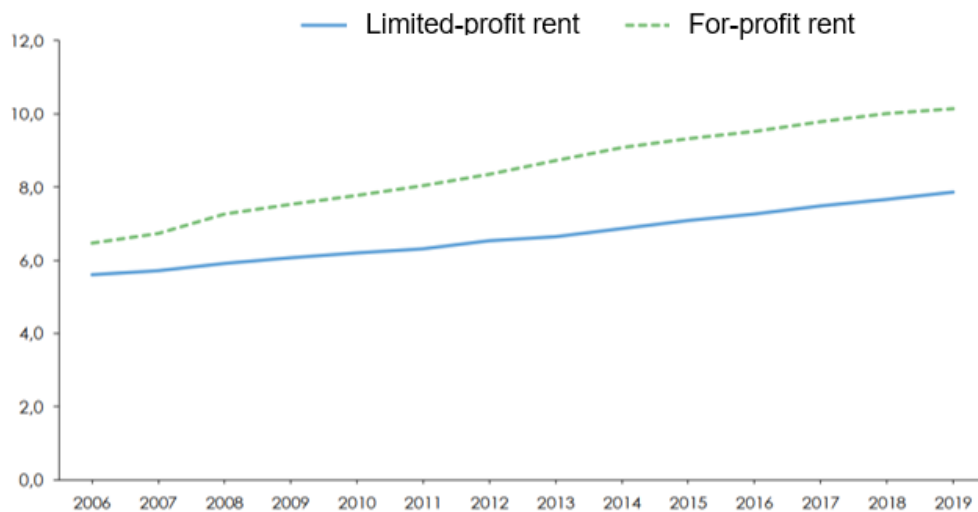


3. Affordability and economic impacts of limited-profit housing

LPHA rented homes are on average 2.3 Euros per square cheaper than rents in the for-profit sector. Moreover, the affordability-gap between the for-profit and the limited-profit sector has grown substantially over recent years. A recent study by the Austrian Institute of Economic Research (WIFO) has quantified the economic effects of limited-profit housing, including the implications on GDP, purchasing power and state budgets (Klien and Streicher, 2021).

Figure: Gross rent per square metre in the limited-profit and the for-profit (private) sector by year, 2006 to 2019

Source: Klein and Streicher (2021)



Q: Statistik Austria (Mikrozensus 2019).

Specifically, for a 70 m² flat the price difference today (2.3 Euro/m²) amounts to 160 Euros less for LPHA renters than for private renters. The difference is particularly pronounced in new builds, in urban areas and in some regions with higher pressures on the local housing market. If all 660,000 households currently renting from a LPHA had to pay private sector rents for the type and size of home they live in, the total additional rent would amount to 1.2 bn Euros in total. Put differently, affordable rents provided by LPHA save (LPHA) tenants more than a billion Euros per year. This has significant impacts on economic output, household, and state budgets.

Taken together the economic model arrives at 640m to 980 m Euros which are added to Austria's GDP every year due to economic effects of LPHA activity (and affordable homes provided). This economic impact can be split up into the following components:



Table: Estimated impact of LPHA activity on economy and state budget

Source: Klien and Streicher (2021)

	Economic activity impacted by LPHA	Estimated impact in million Euros per year
a)	Increased private consumption: better affordability due to lower housing costs result in additional private consumption between 290m and 420m Euros per year.	290 – 420m Euros
b)	Increased public consumption: the public purse saves money (e.g. due to lower expenditure on housing allowances, higher tax income from other consumer goods) and is able to spend more on other areas, which in turn leads to higher GDP. The report estimates this effect to be in region of 400 to 500m Euros per year.	400 – 500m Euros
c)	Increased total investment: higher consumer spending and additional investments into housing are estimated to add between 260m and 730m Euros to Austria's GDP (depending on the scenario).	260 – 730 m Euros
d)	Reduced net exports: Housing is a good that is predominantly produced within Austria. Lower housing costs and as result higher expenditure on consumer goods – often produced outside Austria – mean higher imports (or lower net exports). The model assumes the reduction to be in the region of 440 to 530 m Euros.	440 – 530 m Euros
	Total impact	640 – 980 m Euros

Crucially, the report shows that LPHA are a net-benefit to households, the economy, and the public purse. Contrary to commonly held assumptions about the limited-profit housing sector being a “subsidised sector”, the report provides evidence that the activities of limited-profit housing associations in Austria are not only important in terms of providing affordable and secure housing but also add significantly to economic prosperity and economic stability.



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