Livret A accounts – drowning in criticism

By Pierre Madec

As the Governor of the Bank of France and the Minister of the Economy and Finance announced a further (probable) reduction in the interest rate on Livret A accounts for August 1st, the rating agency Standard&Poor's (S&P) released a study of the French banking system. The U.S. agency argues that Livret A accounts, and regulated savings more generally, "penalize French banks" and are at the root of "distortions in the banking market". This debate, which is hardly new, has been the subject of a number of reports: Duquesne, 2012; Camdessus, 2007; Noyer-Nasse, 2003, and more. Some ardently defend the peculiar French approach represented by Livret A, while others advocate, on the contrary, a deep-going reform of a system they describe as "lose-lose".

So what's the actual situation? Do Livret A accounts really threaten the French banking system? How are the household savings deposited in them used? What has been the impact of the series of increases in the ceilings on deposits? What will be the impact of the (probable) new rate cut proposed by the Minister of Economy and Finance, Pierre Moscovici, both for savers and for the financing of social housing? We provide a few answers below.

What are Livret A accounts?

Livret A accounts date from almost 195 years ago. They are a regulated investment that gives the right to a fiscal benefit (exemption from all taxation and social charges), with guaranteed deposits at a rate set by the State [1].

In 2011, the French savings rate was 16% on average, which was 1.1 points higher than in 2006. The increase in the savings rate went largely into regulated savings, and especially into Livret A accounts, which are held by 63.3 million French people, with total savings of 230 billion euros in April 2013, twice the level of January 2007. Three successive developments contributed to this massive increase in total holdings: the financial crisis, which redirected a portion of household savings into risk-free investments; the widespread distribution of Livret A passbooks to all banks after 1 January 2009, under the Act to modernize the economy [2]; and finally, the 50% increase in the ceiling on Livret A accounts, which took place in two stages (in October 2012 and January 2013). This growing attraction for Livret A is also due to the full liquidity of the accounts and the deposit guarantee – neither of which is available, for example, for life insurance.

What is the role of Livret A accounts?

One of (many) specific features of the French model for financing housing is (among others) that providers of social housing do not draw on the bond markets (Levasseur, 2011). Social landlords are therefore financed mainly (73% in 2012) by the Caisse des Depots et Consignations (CDC), where a portion of household's Livret A savings are deposited. The CDC operates a savings fund that centralizes 65% of Livret A holdings, which in April represented more than 150 billion euros (Banque de France). The deposits made available are used primarily for lending for social housing and urban policy [3]. These borrowings are largely used for the construction, acquisition and rehabilitation of social rental housing by social landlords (*HLM bailleurs*), but they can also be used to finance specific housing operations and urban policy measures such as the National urban renovation plan ("NERP"). In order to secure the deposits and ensure the savings fund has the amounts needed, the amount of deposits centralized under Livret A funds must always be greater than or equal to 125% of the outstanding loans for social housing and urban policy granted by the CDC.

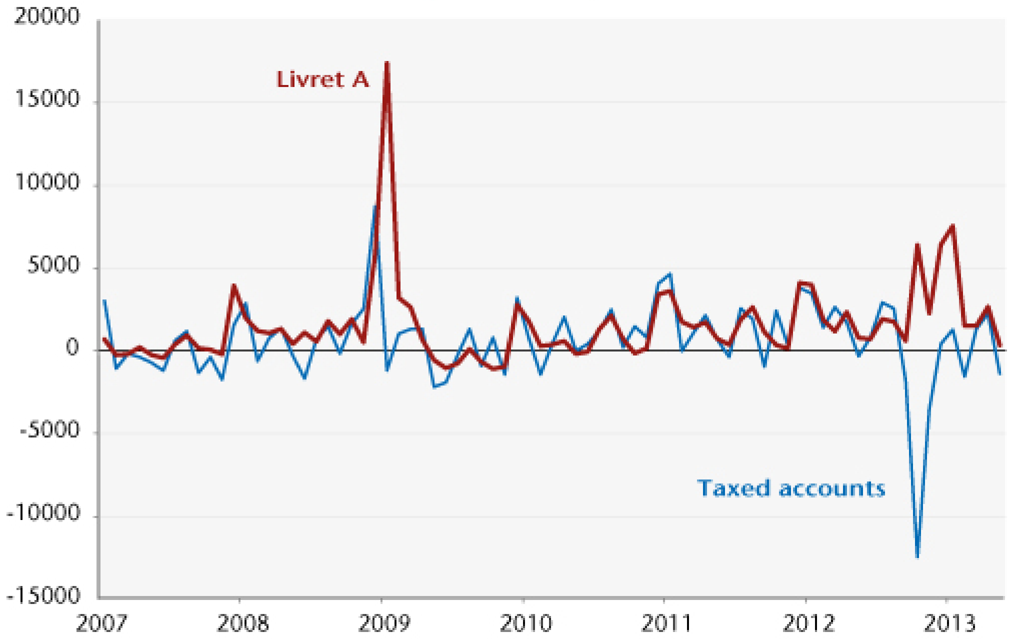
It is obvious that the target of building 150,000 social housing units per year (compared to 105,000 in the year 2012) will give rise to a significant increase in the sector's financing needs [4]. To meet this goal, 13.7 billion euros in lending for social rental housing will need to be granted for one year in 2013, *i.e.* 4 billion more than in 2012.

Finally, the Livret A resources that are not centralized by the CDC (80 billion euros) are subject to a "duty of use". Eighty percent must be used by the banks *for financing SMEs* while 10% must be used *to finance energy savings measures in existing buildings* [5]. Similarly, a certain number of local government investment programmes (Campus Plan, 2012 Hospital plan, Grenelle Environment programme) have benefited from Livret A funds.

Are Livret A accounts endangering the French banking system?

Given the increasing interest of households in regulated savings (especially Livret A), one might think (like S&P) that this type of investment threatens the banking system by depleting bank liquidity, which has already been undermined by the crisis. The higher ceilings established in recent months have indeed led – in essence – to a transfer of savings to tax-exempt investments, whose share in total household financial savings increased by 0.6 percentage point between 2011 and 2012. In October 2012, there was a significant drop in savings accounts subject to tax (-12 billion euros), a drop that can be explained in part by the higher ceilings on Livret A accounts (+6 billion euros) [6] (see Figure 1).

Figure 1. Changes in the Livret A balance and in accounts subject to tax (billion euros)



Source : Banque de France.

It is important to put S&P's alarmist declarations into perspective – on the one hand, because, except for the month of October 2012, the flow from taxed accounts has been relatively stable, and on the other hand, because in 2012 regulated savings, although up significantly, accounted for only 9.5% (6.2% of which for Livret A) of total household financial savings, which amounted to 3,664 billion euros. In addition, if there were a real and lasting lack of liquidity, technical adjustments exist or can be made. According to the latest [annual report of the Cour des comptes]() (French Court of Auditors), at the beginning of the year the coverage ratio of savings deposits was 156% of outstanding loans to social housing and urban policy, instead of the regulatory 125%. This over-coverage represents about 50 billion euros, which are allocated neither to the financing of social housing nor to bank liquidity. Now claimed by the banks, these funds are to be quickly allocated. As the savings fund has substantial liquidity, while leaving unchanged the ratios of coverage and of centralization (the fruit of bitter negotiations), it is clear that a number of temporary transfer mechanisms between the savings fund and the banking sector could quickly deal with any risk of a liquidity crisis. Finally, note that the banks have also benefited from the more widespread distribution of Livret A, notably through the payment by the savings fund of a commission on the amounts centralized. This commission, which is directly drawn on the funds for social housing, took 1 billion euros from the savings fund in 2012. Without drawing any conclusions about what should be done with these counterflows, it is questionable whether a better trade-off could be established between the centralisation rate and the coverage rate, the commission rate and the long-term funding of social housing [7].

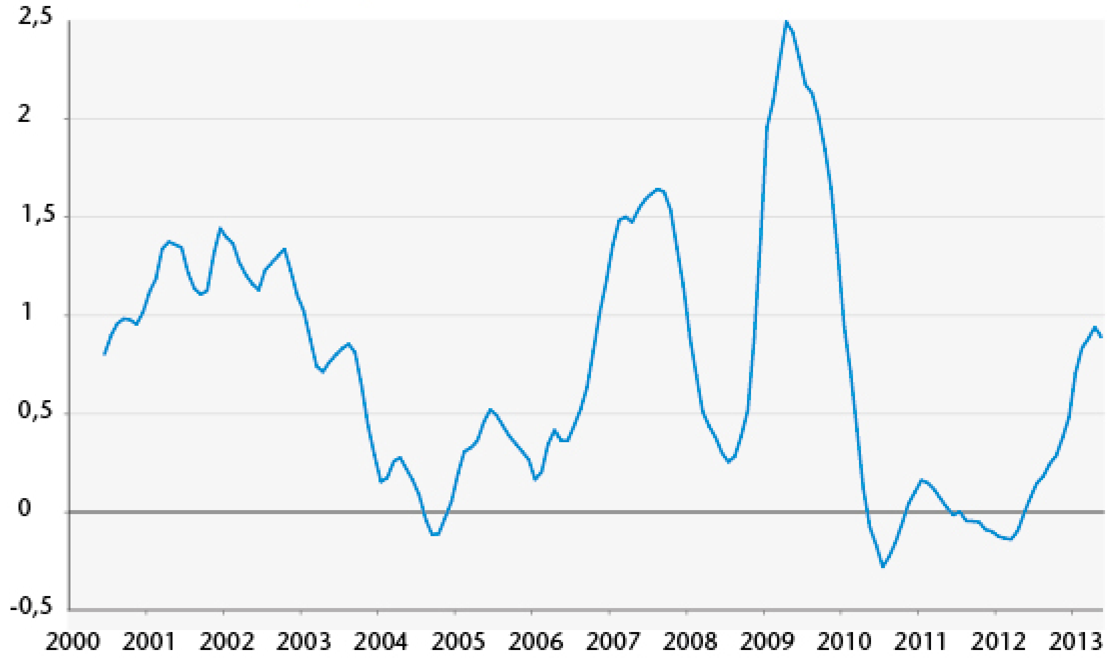
What about the "probable" cut in the rates?

The reduction in Livret A rates, the proposal advanced on June 23 by the Minister of the Economy, Pierre Moscovici, who was echoing the statements made a few days earlier by the Governor of the Bank of France, Christian Noyer, should come into force on August 1, and is the result of a fall in the inflation rate on which it is partly indexed. What effect would this rate cut have on the flow of savings into Livret A accounts, and thus on the financing of social housing?

In May 2013, the interest rate on Livret A was 0.5% in real terms, a relatively low level. Over the period 2011-2012, it even came to an average of zero (see Figure 2). However, the net flow remained stable over the period. This is explained partly by the low rates offered by other investments, in particular taxed savings accounts such as the CEL home savings plan, which have had a negative real net rate since late 2009. Given the trade-offs made by households, in particular the wealthiest ones, in their efforts to obtain the best return on their savings, it is relatively complex to demonstrate a strict correlation between the rate on Livret A accounts (real or nominal) and changes in the total outstandings. Thus, in the second half of 2009, Livret A suffered outflows even though the real rate on it was high; in 2010 and 2011, however, net deposits were high even though the rate was no longer so high.

Given, on the one hand, the lower real net rates offered by comparable investments and, secondly, current social and economic uncertainties, we can expect some stability in the flows during the second half of 2013, despite the decline in the rate of remuneration. This stability will obviously depend on the size of the rate reduction. As the rate is currently 1.75%, it seems unlikely that the high inflows will continue if the rate is revised below 1.25%. As France's Economic commission expects inflation of 1.2% for 2013, fixing the Livret A rate below this would result in a fall in household purchasing power, which would go against the government's commitments.

Graphique 2. Taux d'intérêt réel sur le Livret A



Source : Banque de France, INSEE, calculs OFCE.

Nevertheless, it should not be forgotten that this re-valuation in the rate is not automatic and in fact depends on a political decision. In the second half of 2009, while the collapse of inflation would have justified a decrease of 1.5 points to reduce the rate to 0.25%, the rate reduction ultimately applied was only 0.5 point, leaving the rate at

1.25%. An additional 2 billion euros was thus distributed to households. Conversely, in February 2012, given the return of higher inflation (even temporarily), the rate should have been lifted to 2.75%. The savings shortfall for households due to not changing the rate is estimated at 1 billion euros.

As with households' choice between safety, liquidity and yields, the public trade-off between household purchasing power and the lending terms for social landlords can prove to be complicated. So while undervaluing the rate significantly benefits beneficiaries of the allocation of funds from Livret A (mainly social landlords) whose loan rates are "indexed" on the Livret A rate, it is disadvantageous for the saver.

While "small" savers are not very sensitive to changes in interest rates, "big" investors, that is to say, those approaching the deposit ceiling, can make rapid trade-offs out of Livret A. However, these 10% of the depositors, with the largest accounts, represent 51% of Livret A deposits. A massive reduction in rates could therefore lead to a significant outflow and subsequently substantially reduce the CDC's capacity to lend to the social housing sector, a sector with ambitious building targets and mounting financing needs. On the contrary, it seems clear that maintaining higher rates during a period of low inflation would push up the cost of lending to social housing, at a time when the State and the housing agencies have committed to the construction of 120 000 social housing units per year between 2013 and 2015.

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[1] For greater detail on the method of determining the interest rates, see Péléraux (2012).

[2] In January 2009, the total balance experienced a historic increase of 12.5%. For comparison, the successive increases in the ceiling in last October and January resulted in increases of 3.1% and 3.5%.

[3] In 2012, total lending of 9.7 billion euros was granted by the savings fund simply for financing the 105,000 social housing units.

[4] This objective corresponds to a campaign promise of the candidate Francois Hollande. It was recently downgraded: 120 000 housing financed per year until 2015 and 150,000 from 2016.

[5] For example, in 2012 Oséo and the FSI Strategic investment fund (*Fonds stratégique d'investissement, FSI*) received, respectively, 5.2 billion and 0.5 billion euros of resources from Livret A.

[6] The transfer was made primarily to the LDD Sustainable development account (*Livret de développement durable*), whose outstandings grew by nearly 14 billion euros in October 2012 following the doubling of the ceiling.

[7] While the commission rate should converge by 2022 to 0.50% for all the distributing institutions, in 2011 it was 0.37% for new distributors and 0.53% for traditional distributors (CDC, 2012).

Rent control: What is the expected impact?

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The decree on rent control, which was published in the *Journal officiel* on 21 July, takes effect on 1 August 2012 for one year. The measure was announced in January 2012 during François Hollande's presidential campaign. It has now been adopted, while awaiting the major reform of landlord-tenant rental relations that is scheduled for 2013.

Difficulties in finding housing and deteriorating living conditions for an increasing share of the population point to growing inequality in housing. This inequality is undermining social cohesion, which is already being hit by the economic crisis. For many people, homeownership is becoming a problematic proposition due to the rising cost of buying, while applications for the allocation of social housing remain on hold for lack of space, and the private rental market is becoming increasingly expensive in large cities because of the soaring price of property. Rent control in these cities is serving as an emergency measure to slow the price increases. This poses a challenge of keeping investors in the private rental market, which is already characterized by a shortage in housing supply and very low rental returns (1.3% in Paris after capital depreciation).

The decree aims to significantly lower market rents [2], which are being driven up by rents at the time of re-letting, *i.e.* during a change of tenant. Unlike rent during the lease period or upon renewal of a lease, which are indexed to the IRL rental benchmark, until 31 July 2012 rents for new tenants were set freely. In 2010, this applied to nearly 50% of re-lettings in the Paris area (60% in Paris). Now, in the absence of major renovations, these will be subject to control. Only rents for new housing that is being let for the first time or renovated properties (where the renovation represents more than one year’s rent) will remain uncontrolled (Table 1).

Table 1. The method of setting rent under current law

Legal framework set by	Renewal of lease	Re-letting	First letting and new housing
Act of 6 July 1989 as modified	- Indexed to the IRL - In case of obvious under valuation, re-evaluation over 3 years or 6 years if the difference is greater than 10% - In case of renovations, increase agreed in advance between the landlord and tenant	Uncontrolle	Uncontrolle
Decree for the Paris region	- Indexed to the IRL - In case of obvious under-or renovation for an amount at least greater than 1 year's rent, authorized increase of half the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.)	Uncontrolle	Uncontrolle
Decree of 21 July 2012 (applicable in the relevant municipalities	- Indexed to the IRL - In case of obvious under-valuation or of renovation for an amount at least greater than 1 year's rent in the private or common areas, authorized increase of either half of the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.)	- Indexed to the IRL - In case of an obvious under-valuation or of renovation for an amount between 6 month's rent and 1 years' rent in the private or common areas, authorized increase either of half of the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.) - Uncontrolled if renovation of at least 1 year's rent	Uncontrolle

By using the data from the Observatoire des Loyers de l'Agglomération Parisienne, along with the hypotheses set out in the *OFCE Note (no. 23 of 26 July 2012)*, "Rent control: what is the expected impact?", we evaluated the impact this decree would have had if it had been implemented on 1 January 2007 and made permanent until 2010. According to our calculations, this decree would have resulted not only in sharply slowing increases in rents for re-lettings during the first year it was applied (+1.3% in the Paris area, against 6.4% observed), but also in stabilizing or even reducing rents at the time of the next re-letting, *i.e.* in our example, three years later (in 2010, 0% in Paris and -0.6% in the Paris region). Finally, in 2010, rents would have been 12.4% lower in Paris and 10.7% lower in the Paris region than they would have been in the absence of the measure. This means that in Paris, rents would have been about €20.1 per sq.m instead of the rate of €22.6 per sq.m actually observed (Table 2). For an average size dwelling (46 sq.m) re-let in Paris, the monthly rent would thus have been €924 instead of €1,039, a savings for the tenant of €115 per month. For the Paris region as a whole, using the same assumptions, the rent upon re-letting would have fallen on average to €15.9 per sq.m, instead of the actual €17.8 per sq.m. For an average rental area upon re-letting of □□50 sq.m, the gain would be €95 per month!

Over the longer term, the decree would make it possible to reduce the gap between sitting tenants in place for more than 10 years and new tenants (a gap of 30% in 2010 in the Paris region and 38% in Paris itself), and to improve market fluidity.

Currently, what possibility is there of moving if the mere fact that a couple has children increases the price per sq.m by over 15% in the Paris region? Similarly, the financial incentive to move for a couple living in a four-room 80 sq.m dwelling whose children have left home is zero, because the rent for a 60 sq.m unit with 3 rooms would cost just as much. This premium on being sedentary increases the pressure on the rental market and encourages households to stay in properties that are not suited to their needs, and even hampers labour market mobility.

Can this measure encourage mobility and restore household purchasing power? In the short term, it will certainly benefit the most mobile households by limiting the increase in the share of their budget spent on housing [3]. But these are the households facing the least constraints on income, that is to say, those with high incomes or a relatively low share of income spent on housing. It will also benefit households that are forced to move or those who are running up against the limits on their finances. For all these households, the increase in the share of income on housing will be lower than it would have been without the decree. In contrast, for low-income households whose share is already high [4], the decree won’t change anything, because they can ill afford the additional cost of re-letting.

Table 2. Simulated change in rents upon re-letting in the Paris region using the hypothesis that the decree took effect on 01 Jan 2007

	Rents noted letting on 31/12/2006	Rents after re-letting on 01/01/2007	Change in 2007	Rents on 31/12/2009 after indexing to IRL and before re-letting	Rents on 01/01/2010 after letting	Change in 2010	Gap between observed and simulated rents upon re-letting in 2010
PARIS		19 €/m²	2.2 %	20.1 €/m²	20.1 €/m²	0 %	-12.4 %
Actual	18.6 €/m²	(20.1 €/m²)	(+ 8.3 %)	(20,9 €/m²)	(22,6 €/m²)	(+8,3 %)	
PARIS REGION		15.4	1.3%	16 €/m²	15.9 €/m²	-0.6 %	-10.7 %
Actual	15.2 €/m²	(16.2 €/m²)	(+ 6.4)	(16.9 €/m²)	(17.8 €/m²)	(+5.7 %)	

What are the risks?

While there are real benefits to be expected, these would still need to be made viable by the application of this decree, or at least by the next Act. Besides the difficulty of implementing the decree (absence both of reliable mechanisms to monitor rents in the areas concerned and of a legal framework to allow tenants to assert their new rights), the impact of this measure will be positive for tenants only if the rental supply does not shrink (by maintaining current investors in the market and continued new investment) and if landlords do not seek to offset future rent control by raising the rent at the time of the first let.

Likewise, the realization of improvements in line with the Grenelle 2 environmental consultation or simply maintenance work could wind up being abandoned due to the lengthening of the amortization period for landlords compared with the previous situation. Conversely, some owners might be encouraged to carry out major renovations (in excess of one year’s rent) and “to upgrade the dwelling” in order to be able to freely determine the rent. This would give the landlord a margin of safety to offset any subsequent shortfall. These increases, if they occurred, would penalize less creditworthy tenants and would promote the process of gentrification already at work in the areas under greatest pressure. We could then see increasing differences between the market for “rundown housing” and that for renovated housing.

This decree should in the short term limit the extent of disparities in the areas under greatest pressure, at no cost to the government. But it will not solve the problem for the poorest households of the share of income going to housing: to do this, it is necessary to increase the stock of social housing, to improve its fluidity and to significantly upgrade housing subsidies [5], which would require a major financial effort. The fundamental problem remains the lack of supply, particularly in urban areas, where by definition the available land is scarce and expensive, with higher rents simply passing on the price of property. However, to ease housing prices, more land needs to be available, with a greater density where possible, transport needs to be developed to facilitate the greater distance travelled between residential areas and workplaces, and so on. These are the levers that need to be used if we are to improve the housing conditions of less well-off households.

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[1] The decree applies in municipalities where the rent increases seen over the period 2002-2010 were more than double the increase in the IRL benchmark (*i.e.* 3.2% per year) and the market rent per sq.m exceeds the national average outside the Paris region (€11.1 /sq.m) by 5%. This includes nearly 1,400 communes in 38 cities (27 in metropolitan France and 11 in overseas departments).

[2] There are two types of rent: the average rent is the rent of all rental housing, whether vacant or occupied; and the market rent is the rent of all dwellings available on the rental market, *i.e.* new rental accommodation and re-lettings. This is very close to the rent for re-lettings, as residences for first-time lets represent only a small portion of the

available supply.

[3] This share has increased for 15 years for households in the private rental sector, and particularly the less well-off.

[4] In 2010, more than half of private sector tenants spent an income share on housing (net of housing benefit) of over 26.9%, but above all, the share was 33.6% for the poorest 25% of households.

[5] According to the IGAS report "Evaluation of personal housing assistance", in 2010, 86.3% of rents in the private rental sector were greater than the maximum rent taken into account for calculating housing benefit. Any increase in rent is thus borne entirely by the tenant.