# Towards a sustainable private rented sector


## The lessons from other countries

LSE London

## Preface

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LSE London

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# 1. Introduction: the need for a sustainable private rented sector

*Kathleen Scanlon and Christine Whitehead*

In many European countries there is increasing interest in developing better operating and larger private rented sectors. This is particularly true in the UK where the post war decline in private renting has been dramatically reversed in the last 20 years. The growth of owner-occupation and social renting had squeezed out private renting to the point where fewer than 9% of households in England rented privately in 1988. Since then the decline has been reversed, initially slowly, but after the introduction of buy to let mortgages in the mid 1990s much more quickly. On the latest statistics private renting now accounts for 17% of homes in England and it is rising rapidly, mainly because households have increasing difficulty in accessing owner-occupation.

This very rate of growth is a matter of concern because so many landlords and tenants are perceived to be reluctant; because

- rents continue to rise rapidly especially in London causing affordability problems for tenants and reducing our competitive edge;
- renting still does not provide an adequate rental rate of return for many private landlords who expected continuing capital gains when they purchased;
- the sector is having to fill not only the gap with falling home ownership rates, but also with the shortage of social housing provision – where waiting lists are increasing rapidly.

The story is similar in many parts of Europe especially where social housing has historically played an important role in general needs housing provision. In particular a well-operating private rental sector is now seen as a necessity for post industrial economies worldwide as households have become less ‘traditional’, mobility and migration have grown and the labour market increasingly requires a flexible workforce.

In this context, the Higher Education and Innovation Fund at LSE agreed to fund a series of seminars to enable us to examine how private renting is operating in countries with similar housing requirements and to identify potential lessons which could ensure that private renting in the UK meets emerging needs effectively. During the first half of 2011, LSE London hosted a series of four events that identified the key issues in the UK, and clarified how they were addressed in a range of industrialised countries. Of particular interest were questions of ownership and management in the sector and the capacity to provide good quality longer term housing for middle-income households as well as to meet the needs of more mobile households. In addition, housing experts in 15 developed countries responded to a detailed questionnaire about private renting in their countries which provides basic comparative information on how different systems operate and for whom.

## This book

This book reflects these discussions and the responses to the questionnaire, and contains country-specific chapters written by national experts. The final section identifies the most important issues for UK policy and draws some preliminary conclusions as to how the sector might be effectively developed in a rapidly changing environment.

## The UK context

Rent control from 1915 through to the 1950s and the massive slum clearances of private rented housing in the 1950s and 60s, together with the large scale transfer of property into owner-occupation as it became deregulated, left the UK with only a tiny segment of easy to access private rented accommodation. There was a lack of interest from investors and consumers who generally saw private renting as a third-class tenure.

Since the 1980s but particularly since the late1990s this situation has changed – in part because of demographics; in part because of increasingly limited access to social housing; and latterly particularly because of difficulties in buying and selling in the owner-occupied market.

The owner-occupation rate in England has fallen from a peak of 71% in 2003 to 68%. and is likely to fall still further. The global financial crisis has led to a squeeze on mortgage credit—lenders have become more conservative, and the Financial Services

Authority (FSA) has announced plans for regulations that will further constrain access to owner-occupation for first-time buyers. At the present time it is estimated that over a million households who would otherwise have become owner-occupiers have not been able to do so — and most are therefore now renting. Many who aspire to home ownership may have to live for a longer period — or even permanently — in private rented housing. The FSA recognises that this will require a paradigm shift, and says it may be necessary to 're-educate consumers away from the idea that renting is bad and home ownership good, and away from seeing property as an investment'. The current Coalition government, like the last Labour administration wants to bring about a step change in the attractiveness of the private rental sector to households as well as to increase landlords' professionalism so that a better product is on offer. The policy focus has been on encouraging the participation of institutional investors in the sector, following the model of the USA — but so far with little success.

At the lower end of the market, private renting is playing an increasing role in accommodating those who might otherwise be housed in the social rented sector as an answer to ever-growing waiting lists and problems of accommodating homeless households. In recent years the sector has thus increased its role as a provider of housing for young people and low-income households. Accessing the sector remains problematic however, and concern has focused particularly on difficulties with housing benefit (which is being further restricted), and on those who are unable to pay the deposit usually required. Landlords involved in this part of the market are often very different from those letting to better-off employed households.

Since the 1960s, the British market in private rented housing has been dominated by individual landlords with small property portfolios providing short-term lettings. This is in contrast to the USA, for example, where institutional investors (dedicated property companies, pension funds, etc.) own enormous portfolios, often dominated by purpose-built single-tenure rental developments. The US experience is often cited as a model, but European models of private renting can also offer lessons. In France, Germany, Sweden and Austria, private renting is often a normal long-term tenure choice even for middle-income households and the landlords tend to be private individuals owning a few properties. In all these countries the sector is larger than in the UK, but only in Switzerland is it dominated by institutional investors.

The buy-to-let market itself took a hit in the recession but has not suffered to anything like the extent predicted. Letting is easy and rents are rising. The longer-tem issue is whether this is enough to keep existing landlords in the market if and when owner-occupation starts to recover and alternative investments become more attractive.

Equally the development industry has had to address the issue of how to modify output and financing arrangements to boost this part of the market which had for a number of years provided a ready demand and up-front funding. Now some major developers are entering what has been dubbed the 'build-to-let' market. They intend to retain entire developments on their books and rent the units privately—a model familiar in many countries but not seen in the UK on a large scale since the 1930s. On the evidence of the last recession however it is quite as likely that they will look to sell on once investors can be identified. More generally many developers still have overpriced land on their books and an inadequate capital base from which to make innovative moves in the context of private renting.

**What are landlords and tenants looking for in the private rented sector?**

*Landlords*

On the supply side, it is usually argued that private providers are looking for a mix of profit and risk, which enables them to achieve the desired rate of return given the risks involved. This may well be too simplistic a view especially given the range of private landlords in the market (Rhodes 2007). Many individual landlords — and even many companies—did not become landlords intentionally but more by accident or slow response for example because of inheritance, takeover etc. Others are there because they want to provide for family and friends rather than maximise profit. Yet the majority are undoubtedly looking for a return based on rental income and capital gains.

At one extreme, some landlords see investment in housing as a long-term decision, treating it rather like an investment in a utility with income likely to grow with the economy and risk reduced by the scale of holding and diversification (Kemp & Koffner 2010). Such landlords may wish to manage their own properties but in many cases will employ specialist agents to manage and maintain the properties, control costs and deal with tenant concerns and turnover. This is probably the model that government has in mind as the most efficient means of realising economies of scale and ensuring professionalism. It is certainly not the model which predominates in the UK.

At the other extreme is the individual landlord who owns (and probably manages) a single property. Such landlords are subject to the specific risks associated with the ownership and use of individual properties. The growth of the buy to let market has extended this model and now many landlords own a number of units and may be more likely to employ professional managers. In the environment that prevailed from the mid 1990s to 2007 when house prices consistently rose it is hardly surprising that the potential for capital gains as well as rental income was seen as a major reason for investing in rental housing – as were lower expectations of growth in the stock market and other possible investments. It is this model that has dominated the growth in the UK private rental sector over the last decade.

The types of landlords and how they are financed varies enormously between different countries, as do the conditions that investors require with respect to risk and return. In the UK, the USA, Australia and some European countries for instance rent and security regulation are seen as important impediments to investors. In other countries notably Germany, Switzerland and Austria they are seen as stabilising the system and reducing the risks for both parties. It is these types of questions as much as the different sources of finance that we wished to clarify, to enable us to understand how they contributed to effective private rented sectors across countries.

*Households*

Survey evidence suggests that many moves into the PRS are associated with a change in circumstances such as divorce or a change of job (DCLG 2009). The main features of the PRS that attract households include:

- Ease of access and low costs of moving – so those who expect to be mobile and those who have sudden changes in housing situation such as separation from a partner often move to the sector.
- Ease of exit, making it useful when people are uncertain about future behaviour. For instance, households often live first in rented accommodation when they move to a new area for employment.
- Availability to students – it is the major tenure of students living away from the parental home.

For these reasons the PRS is often associated with the early stages in a housing career. However the evidence also suggests that it does house substantial numbers of households and families in the middle age groups, especially in London. The proportion of households in their late twenties and early thirties in the sector has increased particularly in the last 15 years (DCLG 2009; Rugg & Rhodes 2008). The ease of access also means that the sector is particularly popular with recent migrants and houses a substantially higher proportion of people born outside the UK than any other tenure (DCLG 2009).

Good quality management and maintenance are important to all renters, and there is evidence that private renters value landlords who respond quickly to problems (DCLG 2010). They also value the lack of responsibility for maintaining the home themselves and the resultant costs that owners incur (Clegg et al 2005; Edwards 2005). Tenants also want transparent and enforceable contracts with their landlords. The Rugg review highlighted concerns in some areas about 'retaliatory evictions': tenants tried to enforce their rights to get repairs carried out, but their landlords could evict them in response without having to give a reason.

Private rented housing contains a higher proportion of flats than other tenures, suggesting that private renters are more flexible in their space requirements and/or the need for a garden than owners. It is often concentrated in the centre of cities, and in particular in London, suggesting that location may be more important than size of dwelling for tenants.

A final point to note in the context of who wants private renting is that survey evidence in England continues to suggest that the proportion of households who report that they would prefer to live in another tenure is largest in private renting, and that private renting is rarely the long-term tenure of choice (Clegg et al 2007; Ecotec 2010; Harries et al 2008; Edwards 2005). This is partly about the reality of private renting in the UK – what is available, its cost and terms and conditions. But it is also about more fundamental issues of the nature of tenure.

In this context it isworth clarifying the attributes of tenure and asking where private renting, as currently provided, falls short of what is required. Table 1 sets out a selection of the main positive and negative attributes for each of the three main tenures and ranks them on a high, medium or low scale according to the extent to which the attribute is present. It illustrates the potential advantages and disadvantages of these tenures and helps to explain why any individual household might prefer one tenure over another because of the importance they attach to different attributes.

Private renting clearly works better than other tenures for the young and mobile and those that do not wish to take house-price risk (perhaps a growing proportion in current circumstances). Increasingly it provides a range of options in terms of location and dwelling type. In the context of financial flexibility it allows households to choose lower standards and smaller /shared units not available in other tenures. On the other hand it restricts their investment opportunities. For those facing uncertain incomes however it does give comfort because tenants have access to income-related housing support. The most negative aspects are undoubtedly those relating to control over

**Table 1 The major attributes of tenure for the individual**

| | Owner occupation | Private renting | Social renting |
|---|---|---|---|
| 1. Control | H | L | L |
| 2. Security/stability | H | L | H |
| 3. Wealth accumulation | H | L | L |
| 4. Choice | H | M | L |
| 5. Protection from rent risk | H | L | M |
| 6. Financial flexibility | M | M | L |
| 7. Ease of access and exit/mobility | L | H | L |
| 8. Protection from house-price risk | L | H | H |

H=high; M=medium L=low
Source: Monk & Whitehead 2010 chapter 2 (modified)

the dwelling, security of tenure and uncertainty about future outgoings. These are better provided in owner-occupation, especially for those with adequate incomes, because they are simultaneously their own landlords and tenants.

Typologies based on other countries' experience would look rather different because of differences in provision, regulation and support as well as the availability of alternatives. It is these differences that may help us to identify lessons for the UK from overseas experience.

The survey results and reports from the different countries included in this book highlight different approaches to issues such as regulation, with respect to rent and security of tenure and more broadly in the context of flexibility of dwelling tenure, management and registration. Fiscal measures have also affected the way the private rented sectors have operated. The conclusions consider how some of these ideas might be applied in the UK. However policies and interventions can seldom be transplanted directly from one country to another. Their impact depends not only on the policies or regulations themselves but on each individual country's legal, institutional, cultural and historical background which can take a long time to change.

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# 2. Private renting in other countries

*Kathleen Scanlon, LSE London*

This chapter draws on the questionnaires answered by country experts in Europe and in a number of other countries with relevant experience to clarify similarities and differences and to draw out some implications for the UK.* It starts by asking whether countries define private renting in comparable ways; gives the size of the sector as compared to other tenures in different countries as well as the types and locations of properties that are privately rented and who owns them; identifies the role of the sector in accommodating different household groups; and describes how rents and rates of return vary. The chapter then goes on to look at how government affects the operation of the private rented sector in terms of regulation, taxation and subsidy and its treatment as compared to other tenures.

## 1. Defining private renting

The private rented sector encompasses slightly different categories of housing and households in different countries. In more than half of the countries surveyed there was no official definition of the tenure, and experts instead defined it with reference to popular understanding, statistics or legislation. In some countries, notably the UK, the only available definition with respect to the housing stock is private versus social ownership, since tenure is only defined with respect to households.

Across countries, the PRS is defined in one or more of the following general ways:

- By reference to landlord type (i.e., as housing owned by a profit-making, non-municipal and/or non-housing association landlord)
- In contrast to owner-occupation (i.e., any housing that is not owner-occupied)
- By reference to the type of tenancy (i.e., housing that is occupied under a particular form of contract)
- By the way in which households secured their dwelling (i.e., any rented housing allocated purely on the tenant's ability to pay market rent).

*See the end of this chapter for the list of respondents.

**Table 1 Definitions and descriptions of the private rented sector**

| | |
|---|---|
| **PRS described by type of landlord or ownership** | |
| **Australia** | Profit-making |
| **Austria** | For-profit: personal or corporate ownership; not owned by municipalities or limited profit companies dedicated to 'the common good'. |
| **Denmark** | Not owned by municipality or housing association; not owner-occupied. 'Real' private rented sector in Denmark considered to comprise blocks of three or more units in single ownership. |
| **Germany** | Renting from: non-public landlords (small private; private housing corporations; non-profit oriented landlords like housing cooperatives and residential housing corporations owned by churches); non-profit institutions serving private households; and small/amateur private landlords. |
| **Hong Kong** | Profit-making (and property purchased at full market price) |
| **Switzerland** | Profit-making landlords and state-regulated institutional investors (pension funds) |
| ***UK*** | ***All rented dwellings not owned by local authorities or housing associations*** |
| **USA** | Private for-profit or non-profit entities, whether or not tenants receive housing vouchers or dwelling was subsidised |
| **Netherlands** | Organisations, private persons or families |
| **Norway** | Not owned or controlled by municipalities |
| **Private rented sector described by tenancy type** | |
| **Spain** | Tenancy meets certain legal conditions |
| **France** | Dwellings whose rents are not subsidised or regulated (i.e., not subject to legislation governing HLMs) |
| **Private rented sector described by use of dwelling** | |
| **Finland** | Dwellings leased for residential purposes |
| **Private rented sector described by method of allocation to tenants** | |
| **Hong Kong** | Rental dwellings allocated purely on tenants' ability to pay market rent |

Source: Country experts

Table 1 summarises the definitions of private renting in the countries studied. In some countries only dwellings owned by profit-making landlords are considered to belong to the PRS, but in most countries the definition also includes housing owned by non-profit organisations such as charities and churches, as long as it is allocated by the market. In countries where the PRS consists of dwellings owned by profit-making landlords (including Australia, Austria, Hong Kong, Netherlands and Switzerland), these landlords run the gamut from individual persons and families to corporate organizations (insurance companies and estate agents) and state-regulated institutional investors (pension funds). In Switzerland, which has a very large private rented sector, pension funds play a particularly important role because they are required to hold real estate as part of their portfolios, and private rental apartment buildings are a popular asset class for pension fund managers.

The PRS is often defined by what it is not: for example, units that are not owner-occupied (Denmark, United States); not owned by municipalities or housing associations (Denmark and Norway); not in social rental (Austria) or not subsidised or regulated by specific legislation (France). This reflects the fact that there is no official definition for the PRS in some countries, while the social rented sector is usually well defined.

At the margins, certain types of housing are considered to be part of the PRS in some countries and not in others. These include student residences, furnished rentals, bed-and-breakfast accommodation and hostels; in Hong Kong even bed spaces are included in PRS statistics. The treatment of second or vacation homes also varies; in some countries (e.g. Denmark) they are not considered to make up part of the year-round housing stock. Despite the different approaches to definitions, however, the great bulk of the tenure would be counted as PRS anywhere.

## 2. The size of the private rented sector

Over the past century, private renting has moved from being the majority tenure to one that houses only a minority of households. This occurred in the UK and in most developed countries, with Switzerland being the main exception. This long-term secular decline was an outcome of both the growth of owner-occupation in response to household preferences and improvements in housing finance, and to the creation of social rented sectors in the 20th-century welfare state.

According to the latest figures available, about 17% of dwellings in England were in the PRS. Table 2 shows that the English PRS is still relatively small as compared to those of Germany, Switzerland, Australia, the USA and France (although it should be noted that all these countries except France have much smaller social rented sectors). It is not out of line with many other continental European countries, though, and there are several countries not shown in this table with very high owner-occupation rates (particularly in Eastern Europe) where the PRS is insignificant.

The size of the private rented sector in England could be seen as an indication that the sector here functions less well than it does in some other countries. If Germany and France can house such a high proportion of households in the PRS, why don't/can't we? But both these countries have much lower owner-occupation rates than ours, and a steep reduction in homeownership in England would be both unlikely and undesirable. Also, England's social rented sector is still larger than its private rented sector, which is the case in few other European countries—the Netherlands being the most significant example.

**3. Growth versus shrinkage**

Although the PRS in England is smaller than its counterparts in many countries, it stands out because it is growing quickly, while in most other countries the tenure is continuing to shrink. Table 2 shows the change in size of the PRS since the early 1980s for seven countries. The size of the sector has almost doubled in percentage terms over the last 20 years in England, and the number of PRS units grew from 1.8million in 1991 to 3.9million in 2010 (CLG Live Table 104). In Europe, only Ireland has experienced a similar rate of growth in the last decade. In most developed countries, the private rented sector has shrunk steadily over the last 30 years.

These different trajectories of the sector reflect the particular regulatory and economic situations of each country. In the Netherlands, for example, the PRS has been shrinking in part because of the elimination of bricks-and-mortar construction subsidies, which were available to both private and social landlords. In many countries the decline was attributable to increased accessibility of owner-occupation (which impacted on demand) and uncompetitive returns compared to other asset classes (which affected supply).

**4. Demographics of the PRS**

The private rent sector in the UK broadly houses the young, the mobile (including migrants), and low-income households that do not qualify for social renting. The share of this last group of households is shown by the fact that about 35% of households in the PRS in England receive housing benefit (now local housing allowance).

**Table 2 Development of the private rented sector as % of housing stock since 1980**

| Country | **Private rented stock as % of housing stock** | | | | **Change since 1980** | **Change since 2000** |
|---|---|---|---|---|---|---|
| | **early 1980s** | **early 1990s** | **early 2000s** | **latest** | | |
| *Size of sector increasing over last 30 years* | | | | | | |
| ***UK (England only)*** | **11** | **9** | **10** | **17** | **Up** | **Up** |
| **Australia** | 21 | 22 | 23 | 25 | Up | Up |
| *Size of sector fell after 1980 but increased since 2000* | | | | | | |
| **France** | 25 | 21 | 21 | 22 | Down | Up |
| **Hong Kong** | 24 | 14 | 15 | 16 | Down | Up |
| **Ireland** | 13 | 10 | 7 | 10 | Down | Up |
| *Size of sector about the same over last 30 years* | | | | | | |
| **Germany** | About 60 | About 60 | About 60 | About 60 | Same | Same |
| **USA** | 33 | 35 | 32 | 32 | Same | Same |
| *Size of sector fell after 1980 and stabilised after 2000* | | | | | | |
| **Sweden** | 21 | 20 | 17 | 17 | Down | Same |
| **Norway** | 27 | 18 | 17 | 17 | Down | Same |
| **Switzerland** | 59 | 59 | 56 | About 56 | Down | N/a |
| *Size of sector falling over last 30 years* | | | | | | |
| **Austria** | 25 | 21 | 18 | 16 | Down | Down |
| **Belgium** | 27 | 24 | 20 | 18 | Down | Down |
| **Finland** | 22 | 12 | 17 | 16 | Down | Down |
| **Denmark** | 22 | 18 | 18 | 16 | Down | Down |
| **Netherlands** | 19 | 13 | 13 | 10 | Down | Down |
| **Spain*** | 19 | 15 | 11 | 7 | Down | Down |

Source: Country experts questionnaires
*% of occupied principal residences.There are also large numbers of holiday and vacant dwellings.

Similarly in other countries PRS tenants are more likely to be

- young or old,
- low-income,
- singles without children,
- single parents and sometimes
- immigrants.

In Denmark, for instance, the average PRS tenant household is more likely to be out of work and less likely to own their own business, as well as having an income 30% below the Danish average in 2000. In Belgium, low-income households, singles, single-parent families and the unemployed are overrepresented in the PRS. In Australia and the UK, recent immigrants are also more likely to live in rental occupation compared to the population as a whole. In Hong Kong, strong restrictions on access to public rental housing mean that new low-income immigrant families from mainland China tend to rent privately (with an original tenancy period of two years). In Austria there is a geographical divide: the PRS has a better reputation in western than in eastern parts of the country, and ethnic clusters dominate certain districts of Vienna. In the Netherlands, different landlord types cater for different types of tenant: those aged 65 and above are overrepresented in the housing owned by institutional landlords, while those under 30 (many of them students) live disproportionately in dwellings rented from individuals.

The composition of the bottom end of the PRS varies across countries. In Australia, for example, vulnerable and older tenants are seen as the major problem in the PRS, while in the UK they are mainly housed in the social sector. In France, selection procedures for social renting can work against the most deprived households, who end up in large numbers in the bottom of the PRS. This is also true in countries where the social rented sector houses a range of income groups, such as Austria and some Scandinavian countries.

In all developed countries, most middle-income families with children aspire to own their homes. In the UK the great majority have up to now succeeded, while a greater proportion are renters in France, Germany and Switzerland. Outside Switzerland this is mainly an outcome of later entry into owner-occupation. Switzerland is clearly an outlier, with many high-income households in the PRS (which is Europe's largest). The Swiss tax system works against homeownership by taxing the imputed rental income of homeowners, and protects tenants with strong rent-control measures. In addition, and probably most importantly, institutions are required by law to invest in real estate, and residential properties form an important part of their holdings.

**5. Physical stock and its location**

The physical form of the dwelling stock has a bearing on tenure. In the UK most rental housing—like most housing generally—is in the form of houses, even in large urban areas. However, flats are overrepresented in the private rented stock. In 2007, 82% of England's dwelling stock was houses and just 17% flats or maisonettes—but some 42% of private rented housing was in the form of flats. In London, where 43% of dwellings are flats, they account for 70% of private rented housing (CLG statistics; Census statistics 2001).

Private rented housing is disproportionately located in the UK's metropolitan areas and particularly in London. This in turn reflects the distribution of both the client group for the sector and the dwelling stock—the small flats that are more likely to be in the PRS are less common in small towns and rural areas. The pattern is similar in other countries. In Vienna, for example, PRS dwellings make up 40% of the housing stock—more than twice the proportion for Austria overall.

The USA presents a striking contrast in terms of the physical form of rental housing. Most new rented housing is built specifically for rental, and the entire building or complex of buildings remains in the ownership of a single landlord. In 2001 over 26% of rental dwellings belonged to properties containing 50 or more units. These properties might consist of single high-rise blocks or, more commonly, low-rise 'garden apartment' complexes with several buildings. The average number of units in these large properties was 135.

In Denmark, most private rented housing is in buildings of four or more units, owned by a single landlord. While there is no restriction on renting out other types of housing (e.g. single-family homes), dwellings in single-owner multi-unit buildings are considered the heart of the PRS, and policy discussion and regulation centres around them.

The Norwegian rental stock is distinctive in a different way, as 30% of units are basement or ground-floor dwellings in houses where the owner also lives, reflecting the fact that the rent on such units is entirely tax-free.

## 6. Who are the landlords

Rhetoric in the UK has for years — even decades — been directed at securing an increase in institutional investment in the private rented sector. The thinking is that such investors would increase professionalism and drive down costs because large holdings will produce economies of scale and lower risk; it also may reflect a certain persistence of the view that individual landlords can be rapacious scoundrels and that other countries manage better because institutional investors help stabilise the market. The various policy initiatives attempted over the last 20 years to increase institutional investment in the UK PRS have not had much success, and individual landlords continue to own the great bulk of the private rental stock. The most recent budget did contain a change in the way Stamp Duty Land Tax is calculated on large housing transactions, which will help large-scale investors, and the government is consulting on a relaxation of the regulations governing Real Estate Investment Trusts (REITS).

The issues are not just about finance and institutions but about how fast the stock turns over and the reasons landlords are in the market. Evidence has shown that some individual landlords in the UK enter and exit the market quickly, compared to landlords elsewhere, and that this is linked to the availability of capital gains. Buy-to-let landlords are seen as a potentially unstable part of the market, although the evidence of the last few years shows that they were not as quick to leave the market in a downturn as many had feared.

The international evidence shows that in fact individual landlords dominate in almost all countries (Table 3). It is important to note that the 'company' category in Table 3 is not synonymous with institutional investment – and indeed if certain changes were to occur in the UK regulatory framework, many individual investors would adopt company status. In Australia, individuals and couples own the vast bulk of private rental housing, some through private companies or trusts. Other types of landlord are virtually nonexistent, except for some employers providing housing for their workers. Similarly, in France an overwhelming 95.5% of landlords are individuals or couples. In Ireland 'small investors who own one or two properties' make up 90% of private landlords. Individual landlordism in Ireland went through a huge boom in the early 2000s, with a rise in speculative investment funded by buy-to-let loans. The proportion of buy-to-let mortgages in the outstanding mortgage stock went up from 18.8% in 2004 to 26.9% in 2008, before dropping dramatically in the wake of the global financial crisis. Even in Switzerland, private individual landlords are in the majority.

**Table 3 Percentage of PRS dwellings owned by various types of landlord (highest-lowest 2nd column)**

| | % of dwellings in the private rented sector owned by | | |
|---|---|---|---|
| | **Individuals or couples** | **Institutional landlords** | **Other** |
| **France** | 95.1 | 3.3 | 1.6 |
| **Ireland** | Most | Very few | |
| **Australia** | Most | None | Some employer |
| **Belgium** | 86 | 14 | |
| **Spain** | 86 | 6.7 | 7.2 State-owned bodies |
| **Norway** | 78 | 22 | |
| **USA** | 78 | 13 (Corporations, including REITS) | 5 Cooperatives and non-profits<br>4 Other |
| **UK** | 75 | 25 | |
| **Switzerland** | 63 | 23 | 12 |
| **Germany** | 61 | 17 | 9 Cooperative businesses<br>1 churches and others |
| **Finland** | 60 | 37 | 3 |
| **Netherlands** | 44 | 37 | 19 (includes renting from family) |
| **Denmark*** | 8 | 10 | > 50 Professional landlords |
| **Austria** | Very few | Most (corporations, municipal bodies) | |
| **Sweden** | Very few | Mostly companies (including personal companies) | |

*'Professional landlords' includes individuals and couples who are full-time landlords
Sources: Spain: Survey on Rental Housing 2003; Germany: GDW 2008 (from 2006 figures); Netherlands: WoON 2009 calculations by TU Delft/OTB; Denmark: Andersen 2010; Switzerland: own calculations from Statistik Schweiz. Other figures from country experts' questionnaires.

Even in the USA, which has been held up as a model of institutional investment in the sector, individuals own most of the stock. However, ownership varies by property size—individual investors own 83% of single-unit properties in the USA, but only 13% of properties with 50 units or more. Institutional investors (REITs and other corporations) own 24% of these large properties. The size distribution of rental property in the USA is further discussed below.

At the other end of the spectrum, Sweden and Austria have the smallest share of individuals or couples as landlords, although good statistics were not available for these countries. In these countries corporations tend to own mostly multi-story rental buildings, while single units in individual ownership make up only a minor part of the private rented stock.

In some countries other types of private landlord are also important. These include

- cooperative businesses (who own 9% of the PRS in Germany),
- churches (1% in Germany),
- HLMs and state and local authorities (these mainly social landlords also own 1.6% of the PRS in France),
- housing companies (3% in Finland) and
- state-owned bodies (7.2% in Spain).

Research in Ireland has identified important barriers to entry to institutional private residential landlords, many of which apply in other countries as well. They include:

- greater management costs for residential than commercial property not covered by rental income;
- limited possibilities for reducing management costs because residential purchase opportunities are generally modest in size (individual apartments rather than apartment blocks);
- individual investors can access special mortgage offers (e.g. buy-to-let mortgages);
- inadequate data on rent yields and
- a poor legislative framework for governance of the private rented housing

## 7. Finance and taxation

In the UK the term 'buy-to-let' is used as a generic description for individuals investing in rented property. (The name comes from the 'Buy-to-Let' mortgage, developed as a brand in the mid-1990s by the UK's Association of Residential Letting Agents.) This is seen as a separate segment of the mortgage market in the UK, and in early 2011 accounted for about 8% of new loans by value (down from 12% in early 2008), according to CML figures. The underwriting of buy-to-let mortgages takes into account the potential rental income from the property, rather than requiring the landlord to demonstrate the ability to repay the mortgage out of personal income. Normally the interest rate is slightly higher than for conventional owner-occupation mortgages. Individuals and couples generally borrow with buy-to-let mortgages, while corporations finance their property acquisitions with commercial loans.

Irish and US lenders also offer specialist mortgages for landlords, which bear an interest rate premium compared to mortgages for owner-occupation. Some other countries do not have such specialist financing vehicles for rented property, which is financed with conventional mortgages or commercial loans.

In the UK, income from private rented properties is taxed at the landlord's marginal tax rate. Rental losses can be set against other rental income, but not against the landlord's income from other sources. There is no depreciation allowance for residential dwellings as property is regarded as a perpetual asset for tax purposes. On purchasing a property landlords, like owner-occupiers, pay a transactions tax in the form of Stamp Duty Land Tax; the rate depends on the value of the property. Until April 2011, landlords who made large-scale investments were liable for this tax on each unit, but the 2011 Budget changed this for bulk purchases to a tax based on the mean value of all units bought. Landlords pay capital gains tax when a dwelling is sold.

The details of taxation vary in other countries, but in many the tax regimes are rather more favourable to landlords (Table 4). Both depreciation and the setting of rental losses against other income (often called 'negative gearing') are allowable in Germany, France, the USA and Australia, albeit subject to some limits. The capital-gains tax treatment of residential rental property varies widely. In Australia there is a 50% discount on assessable capital gains on the sale of rental property. In some countries the rate of capital gains tax falls the longer the asset is held, to encourage long-term investment, which is not the case in the UK. In Austria and Germany, private individual landlords can sell residential rental property tax-free after ten years or, in Germany, if the proceeds are reinvested in real estate within four years.

**Table 4 Income tax treatment of residential rental income in various countries**

| | Lower tax on rental income | Mortgage interest deductible | Costs deductible | Depreciation allowance | Rental losses offset against other income types |
|---|---|---|---|---|---|
| **UK** | N* | Y | Y | N | N |
| **Austria** | N | Y | Y | **Y; accelerated depreciation for low-rent units** | N |
| **Australia** | N | Y | Y | **Y – only new properties** | **Y** |
| **Belgium** | **Y** | Y | Y | **Y** | |
| **Denmark** | **Y institutions only** | Y | Y | N | **Y** |
| **Finland** | **Y** | N | Y | **Y for institutions** | **Y** |
| **France** | N | Y but cannot lead to loss | Y | N | Y up to Euros 10,700 |
| **Germany** | N | Y | Y | **Y** | **Y** |
| **Hong Kong** | N | Y | Y rates only | N | N |
| **Ireland** | N | 75% of interest deductible | Y | **Y** | N |
| **Netherlands Business** | N | Y | Y | **Y** | **Y** |
| **Not business** | N** | N | N | N | N |
| **Norway** | **Y if renting part of your home or short term** | Y | Y | N | **Y** |
| **Spain** | Y | Y | Y | N | **Y** |
| **Sweden** | N | Y | | **Y** | N |
| **Switzerland** | N | Y | Y | **Y** | **Y** |
| **USA** | N | Y | Y | **Y** | **Y with limits** |

*Bold indicates more favourable tax treatment than in UK
Except for 'rent-a-room' allowance **An imputed return of 4% of net wealth is taxed at a rate of 30%—i.e. effective income tax rate of 1.2% of equity Source: Country experts

Some countries have devised special tax-efficient vehicles to encourage investment in real estate. These funds are known in the USA, where they originated, as real estate investment trusts. They must distribute most of their income to shareholders, who are taxed on this income at their own personal or corporate rate; the funds themselves generally do not pay tax. Proponents for many years encouraged the UK government to permit something similar here to incentivise institutional investment in the private rented sector. British REITs were launched in 2007. As of April 2011, the British Property Federation listed 23 REITs on its website; only one of these invested in residential property. Similarly, in the US as of end-March, only about 15% of REIT funds were invested in residential property. Apart from the USA and UK, Finland and Spain have also passed legislation to allow REIT-type vehicles.

## 8. Subsidies to tenants and landlords

About 35% of private tenants in the UK receive government subsidy for their housing costs, either in the form of housing benefit or (for those who have claimed or moved since 2008) Local Housing Allowance. This has dropped to 30% for new tenants. Many more are eligible for it but do not claim. LHA subsidies are based on the median rent in the local area, and are subject to a nationwide cap that depends on the size of the dwelling. This has led to fears that LHA recipients will be priced out of high-cost areas, including much of inner London. The government has countered by offering the possibility of paying LHA directly to landlords—temporarily—as an incentive to reduce rents to within the ceiling. In addition, the government has announced that rents for new tenants in social housing will rise to 80% of market rents for the area. But market rents may themselves be affected by the operation of the LHA, particularly in areas where many private tenants receive the benefit. Equally the incentive to let may be affected.

Private landlords are eligible for some minor government subsidies in the form of small-scale improvement grants, although some local authorities limit these to owner-occupiers. There are no subsidies or tax breaks specifically to encourage construction of private rented housing, since new dwellings in the private sector are not tenure specific. Government funding instead is channelled through the Homes and Communities Agency to housing associations to provide social rented and intermediate housing – although many private sector developments have been helped in the last two years. The shift to intermediate (80% market) rents in the social rented sector means there is increased overlap between the social and private rented markets. In other countries, supply-side subsidies to the private rented sector generally focus on the provision of affordable housing or improvements in energy efficiency (Table 5).

**Table 5 Availability of government subsidies to the private rented sector**

| | Soft loans | Refurbishment subsidies | Housing allowance for low-income tenants in private sector | Other |
|---|---|---|---|---|
| **UK** | N | In some local authorities | Y (30-35% of PRS households receive) | |
| **Australia** | N | Only for energy-saving | Y | Tax credits for providers of affordable dwellings |
| **Austria** | Y if rent on units is kept low during repayment period | Generous subsidies for energy-saving modernisation | Y | Accelerated depreciation of dwellings let on 'appropriate leases' (below free-market levels) |
| **Belgium** | N | N | Y | 'Social rental agencies'take PRS housing on long-term leases and use as social housing |
| **Denmark** | N | Y from urban renewal | Y | |
| **Finland** | Y government guaranteed loans for new construction | N | Y | |
| **France** | Y for energy saving investment | Y | Y (36% of PRS households reeive) | Tax incentives for purchase of new low-rent dwellings; greater incentives for lower rent ceilings |

| | Soft loans | Refurbishment subsidies | Housing allowance for low-income tenants in the private sector | Other |
|---|---|---|---|---|
| **Germany** | Y in most federal states for low-income housing | Y for energy-saving investment | Y for unemployed tenants only | |
| **Ireland** | N | N | Y | Local authorities take PRS housing on long-term leases and use as social housing |
| **Hong Kong** | N | N | N | |
| **Netherlands** | N | In some local authorities | Y | Urban renewal subsidies |
| **Norway** | N | N | Y | |
| **Spain** | N | In some regions | Y | |
| **Sweden** | N | N | N | |
| **Switzerland** | Y for low-rent units | N | Y in some cantons and communes | |
| **USA** | Not usually | Not usually | Some | Low-Income Housing Tax Credit funds construction of affordable private rented housing |

Several countries subsidise the construction of private rental housing for low-income households – i.e., private-sector 'social' housing. Subsidised loans or tax credits are available in the USA, Australia, France and Germany. Restrictions on tenant income and rent levels apply to the housing funded by these subsidies. These restrictions generally last for a limited period (say, 15 to 30 years), after which the housing can be rented on the open market. In France, for example, the 'Scellier' scheme provides an income tax reduction of 13 to 22% of the price of new rental dwellings. Rent ceilings apply (which are rather high), and the dwelling must be let for at least nine years. More generous tax incentives are available if the landlord meets tighter conditions: the building must be let at a lower rent ceiling to tenants under a certain income level, and the dwelling must be let for at least 12 years. In Germany, individual states provide low-interest loans for investment in private rental housing, on condition that the housing is let at low rents to low-income households or those with particular needs such as former prisoners, homeless people, etc.

In Denmark there is a tax break designed to incentivise institutional investment in the private rented sector which is not tied to low rents. Since 2002, the profits of pension funds and insurance companies from PRS investments are taxed at 15% rather than the normal corporate rate of 30%.

**9. Rents and rent regulation**

Historically Britain, like many other countries, controlled both the initial rent that landlords could charge and any subsequent increases. Rent control was introduced during the First World War and the tightening of the regime after 1939 meant that landlords were unable to make an economic return; this was a key factor in the dramatic shrinkage of the sector. A series of post-war revisions to the regulations were intended to bring permitted rents more into line with market prices. The rules were finally swept away entirely by the 1988 Housing Act, although a few private-sector tenants—about 4% in 2008—are in pre-1988 tenancies and still have regulated rents

In much of Europe, by contrast, rents are still controlled by governments in some way (Table 6), although there has been a general trend towards deregulation since the 1980s. The deregulation of rents on new leases or tenancies can rapidly change rent levels across the private rented sector, particularly in countries with low security of tenure as in the UK. However many countries deregulated only the rents on new buildings, not new leases, so the majority of tenancies are still subject to rent control. This is the case for example in the Netherlands and Denmark. In the Netherlands about 75% of the PRS stock still has controlled rents. In Denmark, dwellings in pre-

1991 multi-unit buildings are subject to a bewildering array of different rent regimes that depend on their year of construction, size and location.

In many countries the initial rent setting is free but subsequent rent rises are controlled. This is the case in France, Spain and Norway, for example.

**10. Security of tenure**

Rent regulation is closely tied to security of tenure. Since 1997, the default form of tenancy in the UK has been the assured shorthold tenancy. This generally runs for an initial fixed term (six months or one year), after which it becomes a periodic (month-to-month or week-to-week) tenancy. After the fixed period the landlord can evict the tenant with two month's notice; there is no requirement for the landlord to give a reason. Private tenants here thus have much less security of tenure than those in countries such as the Netherlands, where tenancies are for indefinite terms and landlords can only terminate them for specific reasons set out in the law. The assured shorthold tenancy is not, however, the only form of tenancy permitted in the UK. Other forms of tenure including lifetime security or simply longer terms are enabled in the legislation.

The assured tenancy is similar to the arrangements in Europe: the tenant has the right to remain in the property unless the landlord can prove grounds for possession, and the landlord does not have an automatic right to repossess the property when the tenancy comes to an end. This arrangement is much more favourable to the tenants, particularly those who intend to remain in a property over the long term. But in 2007/08, according to the English Housing Survey, only 15% of tenancies were assured—either because tenants did not request assured tenancies, or because they were unsuccessful in convincing landlords to grant them. There currently appears to be no price acceptable to both landlord and tenant for longer leases.

Table 7 divides countries into three groups by the strength of security of tenure. In countries with strong security of tenure, the tenant has a right to remain in the dwelling as long as they comply with the terms of the lease and the landlord has very limited opportunities to evict. Germany, Austria and the Netherlands have very strong security of tenure with initial long-term (up to indefinite) contracts. In Germany, tenancies for family households and the elderly are particularly secure and, as in the Netherlands, are governed by regulated rents. In Germany, the Netherlands and Belgium the sale of a rented unit does not affect the tenancy, which binds the new owner.

**Table 6 Rent regulation in the private rented sector**

| Country | Rent regulation | | | Landlord can pass on cost increases | Tenant has first refusal on sale of unit |
|---|---|---|---|---|---|
| | on first renting | on new tenant | of rent rises on existing leases | | |
| **UK** | N** | N | N but review periods should be set out in lease | Y | N |
| **Australia** | N | N | N but subject to 'fair rents' in some states | Y | N |
| **Austria** | Y if subsidised | Y if pre-1953 or subsidised | Y: CPI | Y in case of modernisation under public supervision | N |
| **Belgium** | N | N | Y | Y | New owner bound by tenancy |
| **Denmark** | Y for pre-1991 buildings | Y for pre-1991 buildings | Lease must specify or based on inflation | Y | Y |
| **Finland** | N | N | Y | N | N |
| **France** | N | N | Y | Y for refurbishment or energy efficiency improvements | Y |

| | | | | | |
|---|---|---|---|---|---|
| **Germany** | Y if subsidised; usury law applies | Y if subsidised; usury law applies | Y: not more than 20% in 3 yrs | Only within normal rent increase limits; extra rules apply for energy saving measures | New owner bound by tenancy. |
| **Hong Kong** | N | N | N | Y in new lettings or renewal of tenancy | N |
| **Ireland** | N | Y: must be 'market rent' | Y | Y | N |
| **Netherlands** (following applies to dwellings with rents less than €652/month—72% of PRS) | Y based on points system | Y based on points system | Y limited to inflation | Y | New owner bound by tenancy. |
| **Norway** | N as long as not 'unreasonable' rent | N as long as not 'unreasonable rent' | Y by CPI; every 3rd year higher increase allowed | N | N |
| **Spain** | N | Y | Y: CPI | N: only CPI unless contract provides otherwise | N |
| **Sweden** | Rents for PRS dwellings cannot be more than 105% of rents in similar apartments owned by the municipal housing company. | | | | |
| **Switzerland** | Y | Y | Y | Y | N |
| **USA*** | N | N | N | N | N |

*Rent controls apply in some cities (e.g. New York City)
**Rent caps apply for beneficiaries of Local Housing Allowance

**Table 7 Leases and security of tenure**

| | **Typical lease term** | **Tenant notice period** | **Landlord notice period** | **Permissible reasons for eviction** |
|---|---|---|---|---|
| *Countries with high tenure security after lease period* | | | | |
| **Austria** Following applies only to units in multi-storey buildings | 3 year minimum, converted to indefinite on renewal. Rent on non-indefinite leases discounted by 25% | 3 months, earliest 1 year after contract | 1 month after court decision | Vandalism, breach of peace, rent arrears over 3 months. Court must approve all evictions. |
| **Belgium** long-term leases | 9 years | 3 months | 6 months | 'exceptional circumstances' |
| short-term leases | 1-3 years | | | Non-payment of rent |
| **Denmark** | Fixed term (houses or individually owned flats) or indefinite (dwellings in multi-unit blocks in single ownership); latter more common | | | Owner wants to use personally; building to be demolished or renovated; serious tenant misbehaviour; employer-owned dwelling and tenant no longer employed |
| **Germany** | Usually unlimited | 3 months | Depends on how long tenant has been in place: if <5 years then 3 months; if 5-8 years then 6 months; if longer 9 months | Personal use, non-payment for more than 2 months, subletting without permission, damaging interior. Usually a prior warning required before landlord can take action. |

| | Typical lease term | Tenant notice period | Landlord notice period | Permissible reasons for eviction |
|---|---|---|---|---|
| **Netherlands** | Normally indefinite but sometimes 1 year | 1 month | | Set out in law: Misbehaviour; landlord needs for own use; expiry of fixed-term lease. |
| **Sweden** | Indefinite | 3 months | 3 months | Non-payment of rent, disturbance |
| **Switzerland** | Normally indefinite | 3 months | Expiry of lease or sale of house | Sale of dwelling, non-payment of rent |
| *Countries with medium tenure security after lease period* | | | | |
| **Finland** | 1 year initially, then month-to-month | 1 month | 3 months in 1st year, thereafter 6 months | Non-payment of rent, illegal sub-letting, non permitted use, disturbance, poor maintenance or safety violations |
| **France** | Unfurnished: 3 years (individual landlord) or 6 years (institution) Furnished: 1 year | Unfurnished: 3 months Furnished: 1 month | Unfurnished: 6 months before lease term Furnished: 3 months before lease term | 'Serious or legitimate' reason: rent arrears, deterioration, nuisance. Lawsuit necessary |

| | Typical lease term | Tenant notice period | Landlord notice period | Permissible reasons for eviction |
|---|---|---|---|---|
| **Ireland** | After 6 months tenant entitled to 3 1/2-year lease | 28 days during 1st 6 months, then increases | Same as for tenant | Sale of property, property needed for family reasons, major refurbishment, anti-social behaviour, non-payment of rent |
| **Norway** | Unlimited or 3 years | 1-2 months | | Ending of fixed-term lease or noncompliance with lease terms |
| *Countries with low tenure security after lease period* | | | | |
| **UK** | Normally 6 months although longer possible | Fixed term: end of tenancy or by agreement Not fixed term: 4 weeks | 2 months after 1st 6 months of tenancy | Before expiry of lease: non-payment of rent (2 months), nuisance, neglect |
| **Australia** | 6 months | 30 days | 30 days | Any |
| **Hong Kong** | 2 years | 1 month after 1st year; not allowed before | 1 month after 1st year; not allowed before | None in 1st year; no restrictions after that |

| | Typical lease term | Tenant notice period | Landlord notice period | Permissible reasons for eviction |
|---|---|---|---|---|
| **Spain** | 5 years | 30 days (plus compensation payment) | On lease expiry only | Non payment or breach of contract. |
| **USA** | 1 year (2-year, month-to-month also available) | End of lease | End of lease | Varies by state: non-payment of rent, criminal activity, repeated nuisance, etc. |

Source: Country experts

The degree of tenure security affects length of stay in a tenancy. In the Netherlands, where tenure security is high, private tenants tend to stay for an average of 11 to 13 years in the same dwelling. In contrast in Norway the PRS is considered to be a short-term option, with 60% of private tenants planning to move to home-ownership within three years or less.

In general continental European countries have much stronger security of tenure than the UK, which has more in common with the USA and Australia in this regard—indefinite leases are not common and the landlord has no legal obligation to renew the tenancy or to re-let at market rates or otherwise.

### 11. Legal restrictions on changing the tenure of dwellings

In some countries the tenure of dwellings, especially blocks of flats, is legally fixed. In a number of countries (e.g., the Netherlands), dwelling tenure is fixed when the property is built – unlike the UK where tenure is not a part of planning permission. In these countries there are often strong restrictions on change of tenure. For example, in Denmark and Sweden it is not legally permissible to split the ownership of multi-unit buildings; this was also previously the case in Switzerland. In Denmark and Switzerland such buildings they can only be converted to co-operative dwellings or stay permanently in the private rental sector. In the period 1990-2001, about 13% of all dwellings in Stockholm municipality were converted from rented to co-operative (although some were public rather than private rental).

In the USA, some cities including San Francisco have restricted so-called condo conversions, or the sale of individual units of rental apartment buildings into owner occupation. The aim of these restrictions is to prevent the loss of affordable rental units, as municipal rent control legislation keeps rents low for sitting tenants but limits landlords' returns. In the UK, by contrast, there are no restrictions on the movement of privately owned dwellings from one tenure to another; the tenure depends on the household rather than on the dwelling itself. This means that increases in the stock of private rented housing cannot be regarded as permanent; they can leak away into owner occupation when market conditions change.

## 12. Other forms of regulation

There is a complex range of other regulations relating to landlord registration, homes in multiple-occupation, etc., which affect the incentive for formal and larger institutions as well as individuals to act as landlords, as they can increase both costs and uncertainty. Little is written about these issues from a comparative perspective. Across countries, as in the UK, there is a view that regulations tend not to be enforced as effectively at the bottom end of the market and in lower-income areas where issues of quality, upkeep and contractual arrangements tend to be at their worst.

## 13. Management

Most UK private landlords maintain their properties themselves or engage an estate agent to do so. There are few specialist maintenance firms, and few rental-only developments large enough to have their own maintenance staff (as is common in the USA, and on social housing estates in the UK). The quality of management varies hugely but is often regarded as substandard. More professionalism would help, but it is difficult to achieve economies of scale because most rental properties here are single dwellings rather than large multi-unit blocks or estates.

In most countries the maintenance of private rented housing is mainly the landlord's responsibility (Table 8). The US, Dutch and French experts were the only ones explicitly to mention the tenants' shared responsibility for maintenance. In other countries the quality of maintenance of the PRS is not necessarily seen as generally problematic, although in most countries such problems as do exist are concentrated in the older and low-rent parts of the stock. In the US and the Netherlands, for example, maintenance was generally decent but there are problems in the pre-1945 stock and,

**Table 8: Quality and organisation of maintenance in the private rented sector**

| Country | **Quality of maintenance (from very poor to very good)** | **Who carries out maintenance (landlords, tenants, contractors or management firms)** |
|---|---|---|
| **Austria** | Very good | landlords and contractors |
| **Australia** | NA | 50% landlords, 50% contractors |
| **Belgium** | Poor | landlords |
| **Denmark** | NA | 25% of landlords (largest ones) use contractors<br>75% of landlords do it themselves |
| **France** | Most good, some poor | For minor repairs: tenants<br>For major repairs:<br>33% of landlords use contractors<br>67% do it themselves |
| **Finland** | NA | Mostly contractors |
| **Germany** | Good | landlords and contractors |
| **Hong Kong** | Varies | landlords and contractors (hired collectively by owners' committees) |
| **Ireland** | Poorer than owner-occupied | NA |
| **Netherlands** | Vary, mostly good | 28% contractors<br>37% tenant/family/friend<br>34% firm (hired by owner's association) |
| **Norway** | Very poor | NA |
| **Spain** | Very poor | tenants (mainly) and companies hire contractors |
| **Sweden** | Good | contractors |
| **Switzerland** | Very good | contractors |
| **USA** | Good | landlords (mainly), tenants (some) and contractors (for major works) |
| **UK** | Poor to good | landlords (mainly), tenants, contractors for major works |

in the Netherlands, in multi-family units.

The quality of maintenance is not necessarily linked to the use of professional management organisations. In the case of Belgium, the poor physical state of dwellings is attributed in part to the large number of older landlords (over 60's). In Sweden, on the other hand, the stock is well maintained irrespective of maintenance regimes—professional landlords are known for their very good maintenance, but small landlords are not notably worse. In Germany, while both private and professional landlords keep housing stock in good shape, small private landlords are considered to do the best job. Austria's PRS is controlled by municipal bodies and receives generous subsidies for energy-saving modernization. Moreover, private landlords are legally required to put aside a percentage of gross rent to build a reserve for equity finance of maintenance and repair. This covers repair costs carried out by either individual owners of detached homes (mostly in the countryside) or, more typically, by professionals from CEE countries. These examples suggest that the quality of maintenance depends not on how or by whom the work is done, but rather may reflect cultural imperatives or fiscal incentives or benefits.

Several countries, including Norway, Spain, Ireland and Belgium, reported poor PRS maintenance and quality of stock. The indicators cited for poor dwelling quality included occupied households without central heating (17.3% of rented stock in Ireland, and 66% of total rented houses in Spain), as well as old age and lack of water.

Finally, Hong Kong is an interesting case particularly because most of its PRS stock is in high rise buildings. A system has developed where landlords collectively engage property management companies to look after common areas, services and facilities.

**14. Policy and developments in the sector**

Having set out the main characteristics of the PRS in 16 countries, we now turn to current policy issues. In our questionnaire, we asked how the following had affected each country's PRS over the past five years:

- changes in the general economy,
- financial market developments,
- housing policy changes,
- land use or planning policy changes and
- changes in tenancy and rent regulations.

Most experts felt that changes in the general economy had the most influence on the PRS; these were closely linked to financial market developments. The PRS was particularly affected in those countries worst hit by the global financial crisis including Ireland, Spain and the USA. In Ireland from 2007 to 2009, employment fell by 8.3%, while private sector rents fell by about 30% over the same time period. Since the country's economy's contraction in 2008 banks have been shut out of the international credit market which has led to a substantial fall in the number of new mortgages issued. Buy-to-let investors have been negatively impacted by this sharp decline.

The turmoil in the US housing markets mainly affected the owner-occupied sector, with waves of foreclosures concentrated particularly in sunbelt states such as California, Nevada, Arizona and Florida. Demand for private renting has grown, particularly at the lower end of the market. The limited availability of demand-side housing subsidies means that affordability problems are severe by European standards—in 2009 about 26% of US renters, some 10.1 million people, spent more than half their pre-tax household income on rent and utilities. These problems may grow as state and federal governments, under pressure to further cut spending, reduce such subsidies as there are.

In Spain returns on rental investment funds fell after the crisis and many investors withdrew their money, but the supply of rental units increased as owner-occupiers could not sell. An astounding 15% of the total housing stock is empty, and the government is trying to encourage owners of empty homes to rent them out. Regional and central governments created so-called public rental agencies to act as intermediaries between private landlords and social tenants, providing a degree of protection for the landlord, but to date they have had little impact on the market.

Even in Australia, which was less affected by global financial events, financing problems facing developers contributed to an inadequate supply of new building. But in the Netherlands, Germany, Austria and Switzerland the PRS markets have been relatively unaffected - the decline of the market share of PRS in the Netherlands and long downward trend in construction activity in Germany were already evident before the crisis.

In the UK and elsewhere, the sudden tightening of credit markets affected developers, and in some cases construction came to a stop. The UK government offered targeted subsidies to help restart developments, including some high-rise buildings in London that were mostly destined for private rental. Finland introduced a rental housing construction subsidy during the 2008-2010 period with a government-guaranteed loan that included an interest subsidy for the first 10 years, and in 2008 France made its fiscal incentives for investment in rental housing more generous in an attempt to sustain construction activity. In Denmark the financial crash led developers to sell newly built apartments for rental rather than owner-occupation.

The affordability of rental housing is an issue not only in the USA. In Belgium there is a longstanding policy concern with provision of affordable housing, and Hong Kong, Norway and Australia also identified affordability as being high on their policy agendas.  In France there are proposals to reintroduce regulation of rents on new tenancies. In none of these countries does strong rent control apply.

In countries where rent is controlled, policy discussions centre less on affordability than on the specifics of rent regulation. In Sweden, private landlords cannot charge market rents but must base their rents on those that obtain in the municipal housing sector.  In Switzerland there are discussions about whether rent rises should reflect increases in the mortgage interest rate or the cost of living.  In Denmark as well, rent control is a topic of discussion.  Rents were decontrolled on dwellings in buildings built after 1991 but this did not lead to a surge in new supply, and the bulk of the private rented market is still subject to a confusing welter of rent regulation.

**Conclusions**

The answers to the questionnaires show the enormous variety of private rented sectors in Europe and elsewhere. To a significant extent these differences relate to how other sectors, both owner-occupation and social rental, are treated by governments in terms of tax, subsidy and regulation. But there are also more fundamental issues to do with built form, the relative importance of urban areas, and the history of tenure over not just decades but centuries.

Further up the income scale household choice tends to be between private renting and owner-occupation – with younger, more mobile households, students and particularly migrants in private renting while stable middle - and upper-income households tend to become owner-occupiers.  But these tendencies are mediated by government policy and generate very different sized sectors even among these groups — ranging from Switzerland at one extreme to Ireland, Norway and Spain at the other.

Further down the income scale the relevant choice is between private and social renting and is heavily dependent on the size of the social sector and allocation rules. Below-market-rent social housing generally goes to those less able to afford adequate housing while private renting is normally seen as second best for less mobile and particularly family households. In some countries however, notably France and Germany but also Denmark, very vulnerable households are often accommodated in the private rented sector although with municipal support.

One particularly important issue is the types of landlord in the sector and the extent to which they invest over the longer term or move in and out of the sector in response to short-term pressures, which has tended to be the norm in the UK. Institutional landlords are rather less important even in countries such as Germany and the USA where opportunities for large-scale investment clearly exist. They are most common in Switzerland where institutions are required to invest in property. On the other hand, unlike the UK in the last few decades – but exactly as the UK in the 1960s and earlier — there are many countries where companies have significant holdings and tend to maintain these into the longer term.

Many issues to do with regulation, not only with respect to rent and security of tenure but also more broadly in the context of flexibility of dwelling tenure, management and registration were also raised in the responses to the questionnaires and clearly impact on the role and quality of the sector.

Finally, most country experts pointed to the need to maintain and improve the private rented sector to accommodate the increasing numbers of mobile and migrant households and to support labour markets more effectively. The financial crisis has reinforced these pressures as owner-occupation has become more difficult to access and more risky.

Overall therefore the questionnaires point to some fundamentals about the effective operation of the sector as well as to a large number of complexities that affect its suitability both for different types of households and for investors. In the next few chapters we look in more detail at countries that have particularly relevant experience from which the UK can learn.

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# 3. The private rented sector in Germany

*Peter Westerheide*

## Introduction

The private rented sector in Germany has some unique characteristics compared to other countries. In particular, renting is not seen as an inferior housing option but as a fully accepted alternative to owner occupation. This is particularly the case in cities where the majority of private households live long periods of their life or even their whole lives in a rented apartment or house. German households' propensity to rent can be partly explained by a strong regulatory framework, which gives tenants a high degree of security but also by a long tradition of renting as 'the standard option' amongst all groups in the population.

## The current position of private rented housing: definition, scale, property types, location

The private rented market in Germany can be defined in different ways. Broadly it can be defined as that part of the rented housing stock not owned by the public sector as defined by the National Accounts. This wide definition includes housing owned by professional residential property corporations and cooperatives as well as by individual landlords with one or two dwellings. A narrower definition of the private rented sector just includes the latter group of private non-professional landlords – sometimes also called 'amateur landlords'. The main characteristics of this group of landlords are that rental income is usually not their main source of income and that they own not more than 15 dwellings, usually much less. Although exact figures on the distribution of dwellings among private landlords are not available, the income and expenditure survey reveals that only 1.017 million private households own multi-tenanted houses with three flats and more (Statistisches Bundesamt 2009a p7).

The total rented market comprises nearly 24 million flats. Small private landlords have a formative impact on  the German rented market . They own slightly more than 60% of the rented housing stock (around 14.5 million flats), which is more than one third. Home ownership levels are quite low at about 43% of households

Professional private companies own only a small part of the rented housing stock (around 17%, about 4 million flats) and less than 10% of the total housing stock. These figures are from 2006, the last available year of the four yearly building survey which is part of the annual German micro census. The private corporate share has increased in the meantime because municipalities and other public agencies sold around 555,000 flats to private professional companies between 1999 and 2011. Together with other sales this has led to an almost 1.6% increase in the share of the housing stock owned by private companies. However, the dominance of small private landlords in the German rented housing market remains, because transactions mainly took place between the public and the professional private sector.

### Financing structures

Financial structures in the private rented sector differ significantly between professional corporations, which hold huge portfolios of several thousand apartments in differ-

**Table 1 Ownership structures in the German rented housing market 2006**

| | No. of dwellings (1,000) | Share of rental sector | Share of total housing stock |
|---|---|---|---|
| **Public (Municipal)** | 2,436 | 10% | 6% |
| **Public (Others)** | 206 | 1% | 1% |
| **Individuals/couples** | 14,507 | 61% | 37% |
| **Cooperatives** | 2,217 | 9% | 6% |
| **Private professional corporations** | 4,059 | 17% | 10% |
| **Churches and others** | 301 | 1% | 1% |
| **Rental sector** | 23,726 | | 60% |
| **Total housing stock** | 39,617 | | |

Source: GDW 2008 p94 and own calculations

**Table 2 Housing transactions by different types of owners 1999 to 2010**

| | | Purchasers | | | | |
|---|---|---|---|---|---|---|
| | | **Municipalities** | **Federal govt / states** | **Private companies** | **Others** | **Net result** |
| **Sellers** | **Municipalities** | 151,000 | 27,000 | 192,000 | 14,000 | -222,000 |
| | **Federalgovt/ states** | | 148,000 | 384,000 | | -323,000 |
| | **Private com-panies** | 10,000 | 33,000 | 885,000 | 10,000 | 615,000 |
| | **Others** | | 1,000 | 92,000 | 12,000 | -69,000 |
| | **Net result** | 161,000 | 209,000 | 1,553,000 | 36,000 | |

Source: BBSR, 2011a p5. Only transactions with more than 800 apartments included.

ent locations, and small private landlords who own between one and 15 units. Although detailed statistics are not available, it can be assumed that small private landlords finance their rental housing stock, much as owner occupiers do. Owner occupiers usually take a first mortgage covering not more than 60% of the collateral value – which is around 50% of the transaction value. A second mortgage is often provided by building societies, for up to 80% of the collateral value (70% of the transaction value). The investor's residual equity stake (down-payment) is therefore usually at least 25 to 30% of the transaction value. Interest rates are usually fixed for 10 years, in times of very low interest rates even longer.

Although one might expect to find that rented housing is more highly leveraged than owner occupied housing because the interest paid is tax deductible for landlords, the differences are probably small. On the one hand, refinancing of first mortgages through covered bonds (Pfandbriefe) prevents a higher leverage. These bonds require first mortgages with a loan to value ratio of not more than 50% of the collateral value as their underlying asset. This does not completely explain the low degree of leverage in the German housing finance system because only around 10% of the mortgage volume is funded this way (Kröncke et al 2011 p22), it certainly contributes to it. Furthermore, a survey of private landlords, conducted by the Technical University of Dresden in 2005, revealed that the dominant investment motives were not of a speculative nature (BBR 2007p69). According to this survey, the main reason for investment in the housing stock was provision for old age and retirement, and residential real estate was seen as a safe long term investment. Tax motives were considered less important by the landlords surveyed particularly those in west Germany. In east Germany the situation was different. Tax motives were more important probably because of the strong fiscal incentives for housing investment after reunification.

Different financial structures can be found in professional residential property companies. In general, small and medium sized corporations have a rather high equity ratio (see tables 3 and 4), while particularly some of the biggest and publicly quoted companies have a high share of debt, and also a substantial share of short-term debt on their balance sheets. Some of these firms might have problems in the future if it becomes difficult to roll over short term debt in the aftermath of the financial crisis (Kröncke et al. 2011p30-36).

**Table 3 Equity ratios of professional property companies 2007**

| | Average Equity Ratio (%) | | | | | |
|---|---|---|---|---|---|---|
| **Housing Units** | **Up to 500** | **501 to 2,000** | **2.001 to 5,000** | **5.001 to 10,000** | **10,001 and more** | **average** |
| **Corporations*** | 34.6 | 32.6 | 34.9 | 28.2 | 22.8 | 27.1 |
| **Cooperatives** | 45.5 | 41.2 | 38.5 | 35.5 | 31.5 | 38.6 |

Source: Kröncke et al., 2011 p26, based on GdW Statistics. Figures as of Dec. 31, 2007
*Including public corporations.

**Table 4 Equity ratios of private professional property companies**

| | **Medium sized private corporations** | **Small private corporations** | **Cooperatives** |
|---|---|---|---|
| **Number of companies** | 29 | 96 | 71 |
| **Average total assets (€million)** | 13.7 | 2.5 | 27.3 |
| **Equity Ratio** | 43.7% | 46.5% | 37.5% |

Source::Kröncke et al., 2011 p45 based on Mannheim Enterprise Panel. Data refer to 2008 & 2009

### Tenant and landlord demographics

Home ownership levels among German households are low compared to other countries. The majority of German households are tenants. Furthermore, the home ownership rate has increased only slowly in the last two decades. This change can be attributed almost exclusively to east German households, catching up to the west German standard of living after reunification (table 5). However, the constancy of the home ownership rate in west Germany masks some underlying dynamics. If we compare the different birth cohorts of heads of household between the beginning of the 1990s and the end of the first decade in the 2000s, we observe a significant increase in home ownership among older households (those with heads of household over 65). On the other hand, home ownership rates among younger households decreased over the same period of time (figure 1). To the best of our knowledge this decrease in

**Table 5  Home ownership rates in Germany (% of households)**

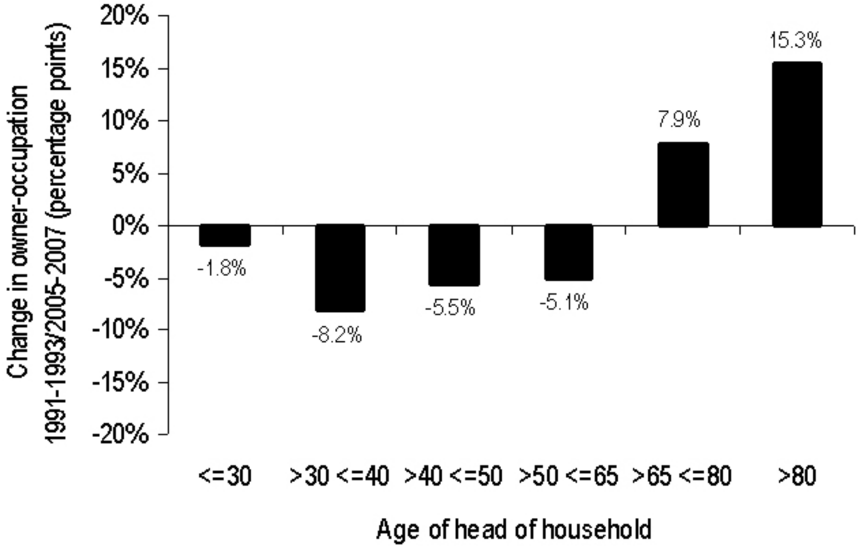
| | All Germany | west Germany | east Germany |
|---|---|---|---|
| **1993** | 39.0 | 45.0 | 19.0 |
| **1998** | 40.3 | 43.6 | 25.9 |
| **2003** | 43.0 | 45.6 | 31.7 |
| **2008** | 43.2 | 45.7 | 32.5 |

Source: Statistisches Bundesamt 2009b p23. East Germany includes East Berlin. Data refer to homeowners as % of all private households.

home ownership rates among younger households has not yet been analysed in depth. Anecdotal evidence suggests that this phenomenon has come about due to longer periods in education, households forming later, and also remote commuting of partners in so called ‘LAT’ (Living Apart Together) relationships contribute. Germany has a number of major office centres (including Berlin, Düsseldorf, Frankfurt, Hamburg, Munich and Stuttgart) which are connected by high-speed trains and many young and highly qualified urban professionals commute weekly between their own rented apartment and that of their partners.

A comparison of average ages and household sizes shows that tenants are younger and households are smaller than that of owner-occupiers. However, as table 6,  7 and

**Figure 1 Change of average home ownership by age from 1991-93 to 2007-09 (percentage points)**




Source: GSOEP, own calculations. Data refer to West Germany.

**Table 6 Household and housing characteristics of tenants and owner occupiers 2009**

| | Average age of head of household | Household size (persons) | Floor space (sq m) | Floor space per person (sq m) |
|---|---|---|---|---|
| **Tenants** | 51.9 | 1.8 | 73.7 | 47.7 |
| **Owner occupiers** | 58.4 | 2.3 | 119.9 | 62.5 |
| **Tenants *vs* owner occupiers** | 89% | 79% | 61% | 76% |

Source: GSOEP, own calculations.

**Table 7 Annual disposable incomes of tenants and owner occupiers (€) 2009**

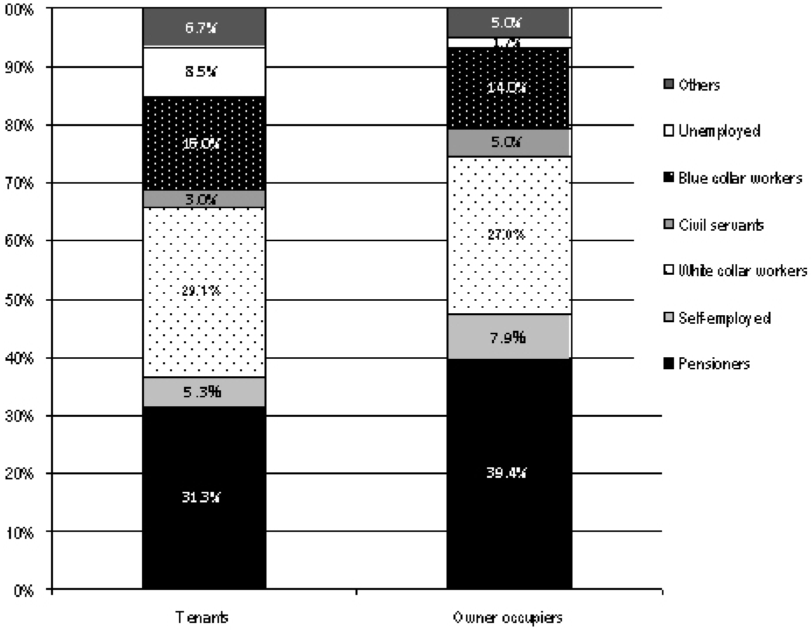
| | **Household size (persons)** | | | | | |
|---|---|---|---|---|---|---|
| | **1** | **2** | **3** | **4** | **5 and more** | **all** |
| **Tenants** | 17,833 | 28,551 | 33,068 | 40,493 | 37,407 | 24,811 |
| **Owner occupiers** | 21,667 | 40,560 | 47,966 | 50,568 | 56,545 | 38,888 |
| **Tenants *vs* owner occupiers** | 82% | 70% | 69% | 80% | 66% | 64% |

Source: GSOEP, own calculations.

8 show,  the differences are not very large. This is also true for the floor space: while overall the floor space available to tenant households is slightly more than 60% of that available for owner occupier households, the space per person is around three quarters. There are significant differences in average household incomes; tenants' average incomes are 64% of the incomes of owner occupiers.  After controlling for household size the differences are much smaller – around 70% and 80% for the most common household types. There are some differences in the occupational status of tenants and owner occupiers – in particular a higher proportion of pensioners and self-employed heads of household are among the owner occupiers. Nevertheless, the structure of both groups is not too dissimilar. Generally, it can be concluded that a broad social spectrum – including all income classes and occupational types – lives in rented apartments and houses as well as in owner occupied housing.

The group of small private landlords in Germany is dominated by pensioners, self-employed individuals and white collar workers (see figure 3). Together they account for more than 80% of all landlords. By far the biggest group is made up of pensioners who use rented property as a supplementary source of retirement income. Comparing households with and without rental income, it is clear that landlords are on average better off but also substantially older than households without rental incomes. Landlords' disposable income is on average twice as a high as that of the other group, though this can be partly explained by a higher average age and larger households.

**Figure 2 Occupational status of tenants compared to owner occupiers**



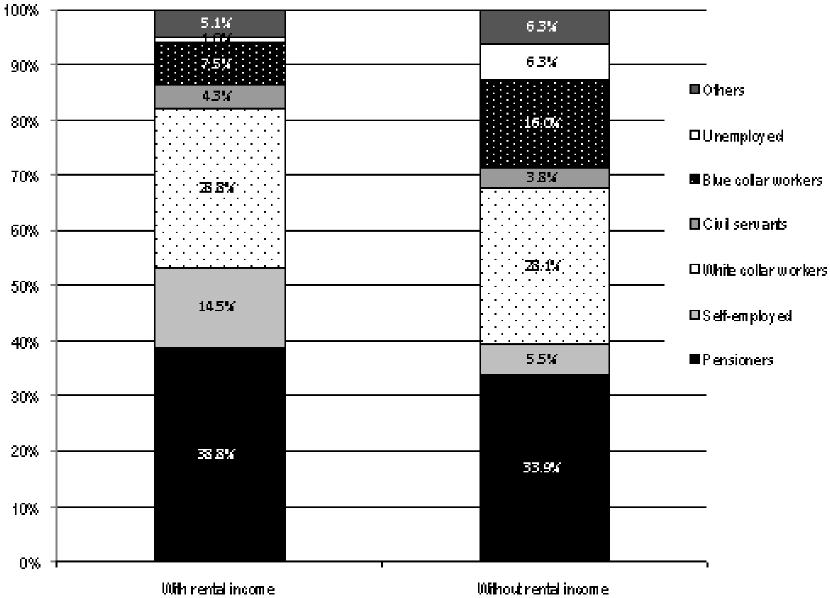

Source: GSOEP, own calculations.

**Table 8 Households with and without rental income 2009**

| Households | Age head of household (years) | Household size | Disposable income (€ per annum) |
|---|---|---|---|
| **with Rental income** | 59.1 | 2.3 | 55,158 |
| **w/o Rental income** | 53.8 | 2.0 | 27,775 |
| **Tenants *vs* owner occupiers** | 91.2% | 88.9% | 50.4% |

Source: GSOEP, own calculations.

**Figure 3 Occupational status of households with and without rental income**




Source: GSOEP, own calculations.

## Legal and regulatory framework, taxes and subsidies

*Regulation*

German tenants benefit from a strongly regulated rented market giving them a high level of security. This includes security against eviction by the landlord as well as strong protection against unexpected rent increases.

Leases on rented housing are usually unlimited in Germany, therefore the renewal of the contract after a fixed period is not necessary. To evict a tenant, a landlord has generally to prove a 'legitimate interest'.Tenants may only be evicted if they have not broken their contractual obligations by defaulting on rent payments (by at least 2 months), subletting the dwelling without the landlord's prior permission, damaging the interior, neglecting contractual refurbishment obligations, etc. Usually a prior warning is required before the landlord can take action.

In principle it is also possible for landlords to claim back a rented dwelling for use by themselves or their relatives. However, in this case the landlord would have to prove a legitimate interest as well, which will be questionable for those living in owner occupied property. Even if a landlord was himself living in a rented flat, he would have to prove that his own rent payments were substantially higher than the rental income from the tenant in order to secure eviction. It is simply impossible to evict a tenant in order to get another who pays a higher rent. Also if the property is sold, the existing lease is not terminated and it remains binding on the new landlord.

To terminate an unlimited lease, the landlord has to give notice which depends on how long the contract has been in place: it is a minimum of 3 months for leases that have run for less than 5 years, a minimum of 6 months for contracts between 5 and 8 years old, and a minimum of 9 months for contracts with a longer duration. The tenant on the other hand has to give only three months' notice, which is not related to how long they have lived in the property.

Rents on new leases are in principle freely negotiable as long as they do not exceed the limit which would be classed as usury, defined as 50% above the average local rent. Rents on new leases are regulated, usually for a period of 12 years, only if the construction or purchase of the dwelling was subsidised and was dedicated to particular target groups such as low income or disabled tenants.

Rent increases are also strictly limited on existing leases. The rent cannot be increased by more than 20% in three years and not above the average local rent, according to the local rent index. This local rent index is calculated on the basis of the average rent from new leases or leases with rents agreed in the last four years, and is usually broken down by the age of the building as well as quality and location.

According to current regulations, only 11% of the refurbishment costs for energy saving measures may be passed on to tenants each year. However, these rent increases limit the scope for regular rent increases because the local rent index level may not be exceeded. This limitation often means that energy saving refurbishment is unprofitable, although increasingly tighter regulation is requiring investment in additional energy saving measures in the building stock.

### Taxes and subsidies

#### *Income tax*

In Germany, owner occupied and rented dwellings are treated differently by the tax laws. Property that is rented out is taxed as an investment, but owner occupied dwellings are taxed as an item of consumption. This means that landlords can deduct the mortgage interest, allowances for depreciation and expenses incurred on the administration and the refurbishment of a dwelling can be deducted from their total taxable income. The German income tax laws allow for linear deductions for depreciation of 2% of the purchase price each year. Income tax rates are progressive up to a top marginal tax rate of 44.3% on an annual income exceeding €52,552 and a top marginal tax rate of 47.5% for annual incomes exceeding €250,401 which include the 'solidarity surcharge' introduced for financing the recovery process in east Germany.

The tax treatment of profits and losses after a sale of a dwelling depends on the legal status of the owner. If the owner is a private individual, capital gains are not taxed after a minimum holding period of 10 years. If a property is sold earlier, the capital gains are fully taxed, while losses are fully deductible from other capital gains which are liable to income tax. For private corporations this regulation does not apply: capital gains are always liable to corporate income tax, and losses are always deductible from the tax base.

*Inheritance tax*

Inheritance tax is incurred on the intergenerational transfer of dwellings. The tax rates and the amount depend on the value that is transferred and on the relationship of the beneficiary to the deceased person. If the beneficiary is the spouse of the deceased person, a personal allowance of €500,000 applies. The amount above that level is liable to inheritance tax at a progressive rate between 7% and 30%. If the beneficiary is a child, the personal allowance is smaller (€400,000), but tax rates are the same. If the beneficiaries are distant relatives (such as nephews), personal allowances decrease drastically (to €20.000) and tax rates vary between 30% and 50%. The tax base is 90% of the rental value of the dwelling. Table 9 illustrates the inheritance tax burden for a number of typical cases.

*Property tax and property acquisition tax*

The annual property tax is 3.5 per thousand of the value of the property (for a multiple dwelling unit with more than two flats) times a local multiplier which is defined by the municipalities (between 240 and 810% in a sample of all German cities with more than 50.000 inhabitants (DIHK 2011).The tax is not calculated on the basis of the transaction value but the so-called 'standard value' which reflects average property values from 1964 in west Germany and 1935 in east Germany. Property acquisition tax is a minimum 3.5% of the transaction value, in some states it is up to 5%.

**Table 9 Inheritance tax on rented dwellings: calculation examples**

| | Value of the dwelling | | | |
|---|---|---|---|---|
| | €500,000 | | €1,000,000 | |
| **Beneficiary** | **Inheritance tax (€)** | **Effective tax rate** | **Inheritance tax (€)** | **Effective tax rate** |
| **Spouse** | 0 | 0% | 60,000 | 6% |
| **Child** | 3,500 | 1% | 75,000 | 8% |
| **Nephew** | 107,500 | 22% | 264,000 | 26% |
| **Other** | 129,000 | 26% | 264,000 | 26% |

Source: Own calculations using the inheritance tax calculator on www.focus.de/finanzen/steuern/erbschaftsteuer-rechner/erbschaft-und-schenkung_aid_27819.html (June 28, 2011)

*Subsidies for rented housing construction, purchase and refurbishment*

Since 2006 the German Federal States (Lander) are exclusively responsible for housing subsidy legislation, and most of the 16 states run their own programmes. In many of the programmes subsidized loans from the KfW (Kreditanstalt für Wiederaufbau, a state-owned bank) are combined with additional state specific measures, usually interest rate reductions. These subsidies are available for special purpose investments, for example to supply housing for low income households and those facing particular difficulties to access suitable housing such as released prisoners, homeless people, etc.  Rents on subsidised dwellings are usually capped at a level below the market rent for a period of 12- 20 years. During this period landlords are obliged to let these dwellings only to those target groups. Other subsidies, such as for the refurbishment of the existing housing stock, energy saving measures or disabled access improvements are also available, but these are not exclusively available for rented housing.

While subsidies for rented housing are at a historically low level it should not be overlooked that in the past social housing benefited from considerable support. This policy was initially geared towards the reconstruction of the destroyed housing stock after the 2nd World War, and in the beginning was not really targeted to particular social groups. Later on, the focus was narrowed to low income households and households facing problems on the housing market, particularly after legislation in 2002 (for an overview see Kühne-Bühning 2005 p283-313). Another important fact is that following German reunification in the first half of the 1990s, substantial tax advantages fuelled new rented housing construction, particularly in the former German Democratic Republic but also in west Germany, which led to a massive supply shock in the rental market.

*Individual subsidies to tenants*

Besides these supply side subsidies, the housing costs of low income households are also subsidized. Not only tenants but also owner occupiers are eligible for these subsidies. Low income households receive housing benefit ('Wohngeld'), with the amount depending on their income and their household size. If individuals receive state unemployment benefits or social security, housing costs (for an adequate dwelling) are also covered.

**Policy environment: key milestones, recent initiatives and likely changes**

The German housing market is facing a long term downward trend in construction activity which began long before the recent financial crisis. While this decline in construction was not caused by the crisis, the low interest rates in the aftermath of the crisis did not significantly spur housing investment in the rental sector. For this reason, it is currently hotly debated whether Germany is running into a housing shortage. The first signs of significant rent increases are visible, particularly in densely populated metropolitan areas. Long-term trends for residential investment are nevertheless unclear: while the number of private households is expected to increase until 2025, the population will be shrinking and ageing (Pötzsch 2011).

The demand for new housing may be quantitatively limited in the future, but new kinds of dwellings will be required, such as accessible apartments, housing with services for elderly residents or multi-generational housing, which reduces the need for professional help and allows for assistance by neighbours (Borgloh/Westerheide 2011). Therefore part of the old building stock needs to be refurbished, reconstructed or replaced. This 'quality-based' additional demand is difficult to assess. Mainly for this reason, current forecasts about future housing demand in Germany differ widely. Against this background and with a view to tight fiscal budgets, proposals for new tax incentives for housing investment – particularly higher tax deductions for depreciation – have not been successful until now.

Related to the problem of the qualitatively changing demand for rented housing are regional differences in the way the housing market is developing. It is widely expected that rural regions will be much more affected by population shrinkage than urban areas. This argument is largely uncontroversial, but opinions strongly diverge on the question of whether sub-urbanism – hitherto a major tendency in the mobility patterns of family households – will be replaced by a new urbanism as elderly households seek better public and medical facilities in the cities. This discussion is largely speculative, as existing statistical evidence is scarce and contradictory (BBSR 2011b, BBSR 2010, Schmidt 2010, Brachat-Schwarz 2008, Maretzke 2008) but highly relevant for investment decisions of professional as well as amateur investors in the rental market.

A further major challenge for professional and amateur landlords is energy saving refurbishment of the housing stock. Landlords are obliged to inform new tenants about the energy consumption of the building, and this is increasingly becoming a competitive element in the rented market. As described above, the scope for rent increases after refurbishment is often limited due to a trade-off with normal rent increases.

Another potential problem may be caused by the new banking regulations in the framework of the Basle III Accord. While it is too early to definitely draw conclusions on the impact of this new regulation of the banking sector, many market participants expect increased financing costs for housing investors.

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# 4. The private rented sector in the Netherlands

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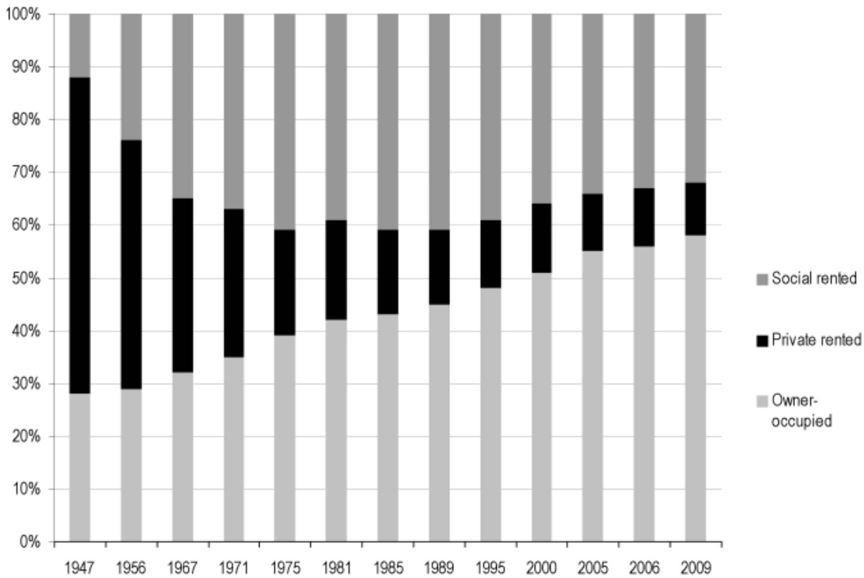
## The current position of private rented housing

The housing stock in the Netherlands was dominated by the rented sector until 2000, when homeownership reached a market share of more than 50% (figure 1). The private rented sector has been squeezed between homeownership and social renting (Boelhouwer & Van der Heijden 1992; Haffner et al 2009). The sector declined from 1.3 million dwellings in 1947 to about 650,000 dwellings in 2010 (see table 1). This decline can largely be explained by the subsidies given for social renting and owner-occupation. Also up until the 1990s, investment by corporations in private rented dwellings received the same subsidies as social landlords following the idea developed during the rebuilding after the 2nd World War that: "what's sauce for the goose is sauce for the gander." The result was that private individual landlords got out of the market. Their 54% share of the housing stock in 1947 had shrunk to 6% by 1993; while the share of corporate investment stayed stable around 6% of stock. The declining reliance on renting out housing to finance old age will also have contributed to the individual landlords leaving this market.

The term private rented sector takes in the following categories of tenancy (according to the WoON 2009 database[1]):

- renting from an organization (pension fund, insurance company, investor, estate agent)
- renting from a private person
- renting from family
- renting from others.

**Figure 1 Tenure distribution in the Netherlands, 1947-2009**




Source: Statistics Netherlands, SYSWOV, adapted by TU Delft/OTB

**Table 1 Housing stock by tenure in the Netherlands since 1981**

| | Owner occupation (%) | Social rented (%) | Private rented (%) | Total (000s) |
|---|---|---|---|---|
| **1981** | 42 | 39 | 19 | 4,957 |
| **1990** | 45 | 39 | 15 | 5,802 |
| **2000** | 53 | 36 | 12 | 6,590 |
| **2010** | 59 | 32 | 9 | 7,172 |

Source: ABF Research - Systeem woningvoorraad (Syswov); 1981: see Figure 1

There are two distinct sectors:

- rental units owned by organisations - generally corporations and
- those owned by private individuals, families or others.

Private rented dwellings are all self contained units that do not share facilities. They are mainly located in the larger municipalities.

*Dwelling characteristics*

In terms of dwelling characteristics, 88% of privately rented homes are rented unfurnished - compared to 99% in the social rented sector. Some 8% are let semi-furnished with curtains and carpets and only 4% are let as fully furnished dwellings. In terms of other dwelling features the private rented sector is more similar to the social rented sector than owner-occupation. The proportion of apartments in the social rented sector is 55%, vs 63% in the private rented sector. In terms of dwelling size privately rented homes tend to be smaller (up to three rooms) rather than larger dwellings. In terms of space, it is the other way around: there is a smaller proportion of privately rented homes with an area below 100 sqm compared to social rented homes. The private rented sector, however, consists of relatively older dwellings: one in three dwellings was built before 1945, while in the social rented sector the proportion is 11%. Nevertheless, the proportion of dwellings in the private rented sector (excluding the 'other' category) with a higher 'deregulated rent' per month (see definition below) is higher than for the social sector – 28% compared to 3.2% (Raden voor de leefomgeving en infrastructuur 2011). Nine per cent of private rented dwellings have a rent of over €878 per month compared to less than one per cent of social rented dwellings.

In general the quality of the housing is ok. The pre-war (1945) stock is in the worst condition - especially in the private rented sector (KWR 2000 calculations in Meijer & Thomsen 2006).

Until the early 1980s, institutional investors built a relatively large number of mainly subsidized rented dwellings - as the same subsidies were available for social and private rented housing. The rate of construction fell sharply, when the bricks-and-mortar subsidies became less attractive and were eventually phased out (table 2; see also below). More recently, there has been an upturn in the construction of private rented dwellings as a result of stagnation in demand from owner-occupiers, especially after 2002 (Haffner et al 2009).

**Table 2 Construction of dwellings by rental sector, 1985-2009**

| | Rental sector (number of dwellings) | Rental sector as % of new construction | Private rented sector (number of dwellings) | Private rented sector as % of construction in rental sector |
|---|---|---|---|---|
| **1985** | 54,795 | 55.8 | 17,642 | 18.0 |
| **1990** | 39,396 | 38.4 | 7,434 | 7.6 |
| **2000** | 15,210 | 21.5 | 5,081 | 7.2 |
| **2001** | 14,095 | 19.3 | 4,630 | 6.3 |
| **2002** | 12,654 | 19.0 | 4,403 | 6.6 |
| **2003** | 12,974 | 21.8 | 4,377 | 7.3 |
| **2004** | 14,140 | 21.6 | 4,982 | 7.6 |
| **2005** | 16,900 | 25.2 | 5,876 | 8.8 |
| **2006** | 20,216 | 27.9 | 7,561 | 10.4 |
| **2007** | 22,764 | 28.4 | 8,735 | 10.9 |
| **2008** | 23,781 | 30.1 | 9,171 | 11.6 |
| **2009** | 25,464 | 30.7 | 10,231 | 12.3 |

Source: ABF Research - Systeem woningvoorraad (Syswov).

## Ownership and financing

The private rented sector is divided into two sectors (Priemus 1998; Haffner et al 2009); private individuals or couples own 44% of private rented dwellings while organizations own 37% of the dwellings (table 3). Of the latter group, the majority of dwellings (133,000) are owned by the 31 members of the IVBN, the Association for Institutional Property Investors in the Netherlands (www.ivbn.nl; end of 2008).

**Table 3 Dwellings by landlord type 2009**

| Renting from: | Percentage of overall stock | Percentage of private rented stock | Number of dwellings |
|---|---|---|---|
| **Private Individuals/couples** | 3.2 | 44 | 225,470 |
| **Organizations (pension fund, insurance company, investor, estate agent)** | 2.7 | 37 | 189,450 |
| **Other (renting from family or others)** | 1.4 | 19 | 101,830 |
| **Total** | 7.3 | 100 | 516,750 |

Source:WoON 2009 calculations by TU Delft/OTB.

The properties that private landlord organizations tend to own were mainly built after 1970 (62%) and are bigger. Their dwellings are thus relatively new and generally of a higher quality -- 54% have four rooms or more. 58% of homes rented by private individuals have up to three rooms. About half of the dwellings owned by small-scale landlords were built before 1945 (49%). These two sectors are also distinguished by differing rent levels. The rents on properties owned by individual landlords tend to be lower; on average they are €539 per month compared to €604 for those owned by organizations. These averages are at least €120 higher than the average monthly rent in the social rented sector, which is €419.

Information on the financial returns from rental dwellings can be found in the ROZ/IPD Netherlands Annual Property Index (IVBN 2010). ROZ/IPD participants achieved a direct return on residential investment of 3.6% in 2008. This figure was relatively stable between 2006-2008. The indirect return (change in capital value), however, fell from 5.7% in 2007 to minus 0.8% for 2008. The decrease in house prices since late 2008 was the result of the global financial crisis affecting the housing and capital markets in the Netherlands (Haffner & De Vries 2010). The overall return from residential investment of 2.8% was the lowest return since 1995.

The average overall return for residential investment for the period 1995-2002 for ROZ/IPD participants reached 16% according to Briene & Hulsker (2002). These returns were much higher than the total returns before income tax that these authors estimated for different types of landlords using different assumptions and data about stock size and location (see below): total returns were estimated between 7% and 9%.

**Tenant demographics**

Table 4 shows the characteristics of the households living in the private rented sector. It illustrates the differences between the two sectors of the private rented market. Tenants renting from an organization had a higher average disposable household income than tenants renting from an individual landlord. Furthermore, tenants renting from an individual landlord tend to be younger - below 30 - and 56% of households are single, indicating that it contains a relatively large student population. The over 65s are more strongly represented in the organization landlord sector. The singles with 51% are also overrepresented in this sector of the private rented market. In terms of ethnicity, 91% of tenants are Dutch in the organization landlord sector, which is almost the average for all Dutch households, while the proportion of Dutch households in the individual landlords sector is slightly lower at 87%.

With its high average period of occupation - 13 years with organization landlords and a little over 11 years with individual landlords - the private rented sector cannot be considered a mobile sector. In the social rented sector, normally considered a sector with relatively low household mobility, the average period of occupation is almost 13 years.

With the history of the private rented market, the organization landlord sector has inevitably tended to be dominated by elderly people. The dwellings generally were built at a time when it was normal for households to rent and not to move into owner-occupation.

**Table 4 Characteristics of households renting from private individuals and organizations**

| | Private Indiviudal landlord | Organization landlord | All households |
|---|---|---|---|
| Average household disposable income (€ per year), corrected for expenses components (like housing allowances) | 25,001 | 27,921 | 35,054 |
| Household structure (%) | | | |
| Single | 56 | 51 | 33 |
| Couple without children | 24 | 29 | 30 |
| Couple with children | 10 | 11 | 29 |
| One parent | 7 | 7 | 7 |
| Other | 3 | 1 | 1 |
| Age groups (%) | | | |
| < 30 years | 26 | 14 | 9 |
| 30-45 years | 32 | 23 | 28 |
| 45-65 years | 23 | 29 | 39 |
| >=65 years | 19 | 35 | 24 |
| Ethnicity (%) | | | |
| Dutch | 87 | 91 | 92 |
| Non-Dutch | 13 | 9 | 8 |
| Housing allowances (%) | 17 | 14 | 35* |

Source: WoON 2009 calculations by TU Delft/OTB.
(*) Of households in the rented sector.

## Legal and regulatory framework, taxes and subsidies

The regulatory framework nowadays can be considered relatively 'neutral', implying no special rules for either rental tenure: the rules for rent-control, security of tenure and housing allowances are the same for private renting and social renting. This is also the case when corporate income tax is considered: social and private organization landlords both pay corporate income tax. For private individual landlords there is also no special personal income tax treatment for rental income in comparison to other commercial enterprise activities or other personal wealth. When other taxes such as transfer tax, value added tax and local property tax, are concerned, there is no different treatment for landlords in private renting than for any other property owner.

*Rent control and security of tenure*

The Netherlands has a strict rent regulation system that covers both social and private renting and is not related to ownership of the dwelling (Haffner et al 2009; Hoekstra 2010). Below a certain rent threshold rent regulations apply. Up until July 1st, 2011, the date when the regulated rents of sitting tenants are increased each year, the so-called 'liberalization rent level' was €652.52 per month. Regardless of who owns the dwelling, a rent up to or equivalent to the 'liberalization' rent level is regulated, and the rent above that level is considered a deregulated or 'liberalized' rent. In the private rented sector, 72% of dwellings have a regulated rent; a higher proportion of private individual landlords' properties (77%) and a lower proportion for organization landlords' (59%).[2]

Dwellings with a regulated rent are subject to a dwelling valuation system; dwellings are given points on the basis of their quality and access to local amenities (access to trains, shops, etc.). It is generally accepted that local amenities are undervalued in this scoring system. Based on the number of points, a maximum rent is determined. This could be the rent that the landlord sets for a new lease, but the landlord does not have to set the maximum rent. Rents in the private rented sector are on average 84% of the maximum rent (Rigo 2010). Central government annually sets a maximum rent increase for dwellings with a regulated rent. Since 2007 the government has increased rents by the rate of inflation (Haffner et al 2009).

Rents on private rented dwellings with more than 143 quality points and a rent above the 'liberalization' rent level (Hoekstra 2010) are not regulated; the initial rent nor the annual rent increase is controlled.

A tenancy agreement in the private rented sector is usually for an indefinite period (Elsinga et al 2007; Haffner et al 2010). That means if the dwelling is sold the tenancy is not affected. The tenant has to give one month's notice to leave. Some leases, however, require the tenant to rent the dwelling for at least one year. A landlord can only terminate a current tenancy agreement under specific circumstances listed in the Dutch civil code, such as the dwelling being needed urgently for his own use.

*Subsidies*

As explained above, until the 1980s, there were similar subsidy arrangements available to both social and private landlords (Elsinga et al 2007; Hoekstra 2010). These subsidies contributed to the running costs of the dwellings and were paid out annually. The Decree on Dwelling-Linked Subsidies in 1992 put an end to these periodic subsidies and replaced them with a one-off contribution. When this programme ended in 2000 (http://www.thesauruszorgenwelzijn.nl/Besluitwoninggebondensubsidies.htm), it put an end to all new supply-side subsidies to renting in the Netherlands. The government does, however, still offer limited subsidies for housing construction in specific urban regions.

All subsidies in the private rented sector come through the demand side, housing allowances which are available across the whole rented sector (Priemus & Elsinga 2007). Housing allowances are available to those in need, contributing towards a monthly rent up to the liberalization level. As the average disposable household income is higher for tenants renting from organization landlords than from private individuals, the proportion of housing allowance recipients is lower in the former than in the latter sector  - 14% compared to 17% (see table 3).  Average disposable household incomes are lower in social housing than in private rented, where the proportion of housing allowance recipients is 40%. This shows that the relationship between income and the share of housing allowances is not one to one. The average income in the social rented sector  of €22,600 is not so much lower that it can explain the total difference in subsidy take-up across the tenures. One of the reasons may be that institutional landlords apparently discriminate in favour of higher income households which do not receive housing allowance. This is reinforced by the formula for affordability calculations used by IVBN members which requires that gross household incomes per month should be at least four times the rent level per month (Raden voor de leefomgeving en infrastructuur 2011).

*Affordability*

In 2006 the average monthly rent before the deduction of rent allowances amounted to €469 in the private rented sector and €397 in the social rented sector (Heylen & Haffner 2009). As a larger proportion of social tenants were in receipt of housing allowances, these allowances amounted to a deduction in rent of €53 in the social rented sector and a €22 deduction in the private rented sector increasing the difference between the average rents paid by households in the two sectors by about €30: social tenants paid on average €344 per month and private tenants paid on €446 per month. Average monthly disposable income per household amounted to €1,720.

Table 5 shows two ways of measuring the affordability of rental housing. One common method is to calculate the proportion of disposable household income spent on rent after housing allowances. If it is more than 30%, the rent is considered unaffordable - in 2006 private renting was less affordable than social renting. Almost 30% of private tenants had a ratio above 30%, while 19% of social tenants exceeded that level.

**Table 5 Proportion of households spending more than 30% of their disposable income on rent after housing allowances by sector and with a residual income for modest living expenses, 2006**

| | **Ratio of rent to disposable household income > 30%** | **RI < RI-norm Modest budget** |
|---|---|---|
| **Rented sector** | 21.2 | 21.2 |
| **Private rented** | 29.4 | 19.6 |
| **Social rented** | 19.0 | 21.6 |

Based on WoON 2006 calculations by TU Delft/OTB (Heylen & Haffner, 2010).

The affordability calculations can also be based on residual income, defined as the disposable income left to a household after housing expenses have been deducted. Table 5 shows the percentage of households that do not have enough residual income to be able to afford a modest but adequate lifestyle (it is also possible to base calculations on the budget for a basic lifestyle). On this calculation private renting was more affordable than social renting, although the difference between the tenures was small. Almost 20% of private sector tenants had less residual income than required for a modest lifestyle compared to 22% among social rented tenants. The dominant development in affordability however is that the average gap in income between tenants and owner-occupiers has been increasing since 1986. In that year, the difference between both tenures was 40%, while in 2009 the average income of homeowners was almost double the average income of tenants (Blijie 2010). This means that the overall rented sector is being marginalized in terms of incomes (Haffner & Boumeester 2010).

### Income taxation

The income tax paid by private landlords differs according to the type of landlord (Haffner et al 2009). There are four main types of taxes on income from private rented dwellings, two for organization landlords and two for private individual landlords with some variations.

Organization landlords in principle pay corporate income tax. These professional landlords (companies) are subject to corporate tax – 20% on profits up to €200,000 and 25% on amounts of profit above that amount (2011; http://www.belastingdienst.nl/zakelijk/vennootschapsbelasting/vennootschapsbelasting-04.html). This tax regime also applies to social landlords since 2008 (Ministerie van Financiën 2007). Revenues (including capital gains) are subject to corporate income tax but costs are tax deductible. Depreciation is however limited. Two kinds of organizations are exempt from corporate income tax: pension funds and institutions, which exclusively invest in real estate (such as insurance companies), provided they pay a dividend to their shareholders (Elsinga et al 2007; Hoekstra 2010). In the Netherlands, these organisations are called Fiscal Investment Institutions (FBI) which are similar investment vehicles to US Real Estate Investment Trusts (REITs).

For private individual landlords there are two main income tax options for their rental activities: they may be taxed as a more or less professional entrepreneur, or as an investor.[3] In practice, the tax inspector decides which applies. In the first situation the landlord is treated as running a business and has to pay personal income tax like any other business which is subject to personal income tax. Actual income (including capital gains) net of costs is taxed at a progressive rate (52% being the highest rate). Those deemed to be ‘real professionals’ who are below 65, when the period starts, and spend at least 1,225 hours a year on the business can profit from an entrepreneur’s deduction. The professional who works fewer hours on the business cannot take advantage of such a deduction. Briene & Hulsker (2002) have calculated that the 'real professional' achieves a total 0.2% higher return than the latter after tax.

Private individual landlords who are deemed to be investors are subject to taxation on the income from their properties in the same way as owners of other personal wealth. Since the tax reform of 2001, the fiscal authorities impute income from investment assets, including rental property (Haffner 2002). The (net[4] total) return is imputed as 4% of the market value of the property corrected for debt. The amount of return that is imputed is then taxed at 30%. This 4% of 30% delivers an effective rate of taxation of 1.2% on net wealth. The tax liability is calculated regardless of the actual income and costs of the landlord in relation to wealth components. This also means that there is no separate capital gains tax. If the dwelling is sold and the equity is put into a savings account, the amount of income tax to be paid will not change. Regardless of the type of personal income taxation, Briene & Hulsker (2002) have estimated that the total rate of return will come down by 1.5 to 2% after income tax. Generally, the return after tax is estimated to be between 5% and 6.3%, depending on assumptions of stock size and location.

**Policy environment**

The Netherlands has perhaps been the country where the private rented sector has been squeezed the most in recent decades, dropping from 60% of the stock in 1987 to 10% or even less (depending on the source) in 2009 (Haffner et al 2009; Hoekstra 2010). The decline was mostly caused by private landlords leaving the sector and selling off their dwellings as part of urban renewal projects to social landlords and probably because the returns were not regarded as attractive enough and the income not regarded as a necessity when a pension system (including a state pension) was being built up after the 2nd World War. Private individual landlords were also not subsidized in comparison to social landlords and owner-occupiers, while rents have been regulated all along.

Organization landlords were also affected by the strict rent regulations, but were compensated until the end of the last century by subsidies available on the same conditions as for social landlords. When the subsidies became less attractive, they benefited from large capital gains as house prices were rising enormously in the 1990s (Haffner & De Vries 2010). The housing policy is now taking effect. The rented sector is being marginalized income wise, as housing allowances – which were last substantially increased in 1997– are available to low-income households, while the generous tax subsidies to homeowners with a mortgage are very attractive to higher income households.

The potentially unfair competition between social landlords and private landlords because of subsidies leaking away to commercial activities by social landlords have been reduced as a result of the agreement between the Dutch government and the European Commission on state aid and competition (December 2009). Social landlords now pay corporate income tax and can only use guaranteed loans with lower capital costs and low-cost land for their social stock (Elsinga et al 2008; European Commission 2009a, b; Tasan-Kok et al forthcoming). Also, 90% of new social housing allocations must go to households earning up to €33,614 'taxable' income per year. The fact remains for the moment that social landlords keep about 750,000 dwellings (2006) under the 'liberalization' rent level, even though their quality points would allow them to be deregulated (Van Blokland 2009). This would explain why the private sector is not able to offer competitive housing in the middle segment of the market.

The attempt between 2004-2007 to increase the liberalized segment of the rented housing market has not been successful (Dekker 2004). Annual rent increases have been limited to inflation since 2007. The present government again aims to allow rent increases, in part because the target group for social renting has been limited only at the point of allocation and there is no means-testing after that point. The aim is to increase rents by more than the average for sitting tenants with an income of €43,000 per year and above and to allow extra rent increases in areas where housing is scarce (VVD-CDA 2010). This is intended to allow the rented housing market to work more efficiently and allow for more supply in the middle segment of the rental market. These plans still need to be further developed and/or passed by the Chambers of Parliament. The future will show whether the private rented sector will be able to pick up the pieces and increase its market share.

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## Notes

[1] Data is from the WoON 2009 database (TU Delft/OTB calculations), unless another reference is given.

[2] The social rented sector has 96% of regulated rents which is not surprisingly much higher than in the private rented sector. These calculations from the WoON 2009 are based on the liberalization rent level as of 1 July 2008 which was 631,73 Euro per month.

[3] For directors and large shareholders, there would be a different personal income tax treatment.

[4] The net rate implies notional cost deductions.

# 5. Private rented housing in the United States

*Stephen Malpezzi*

## Introduction

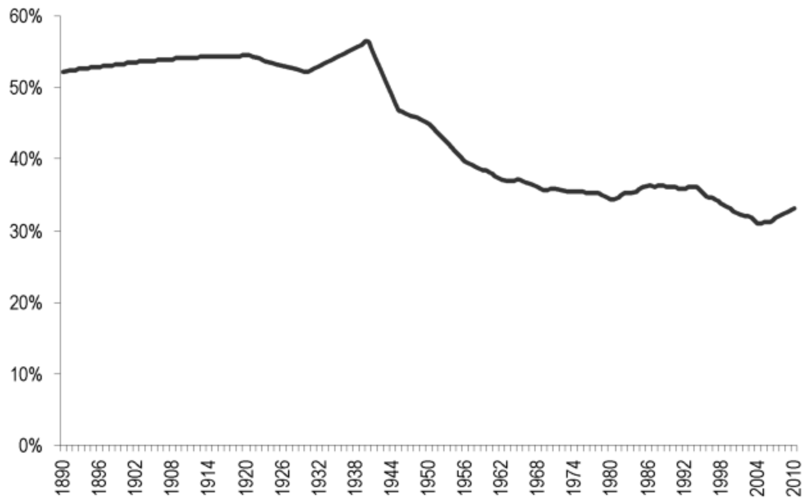
In the U.S., renters are described relative to owners. The official Census-HUD definition is copied here, from the American Housing Survey glossary:

> "Tenure. A housing unit is owner occupied (including a cooperative or condominium unit) if someone whose name is on the deed, mortgage, or contract to purchase lives in the unit. Units where the elderly buy a unit to live in for the remainder of their lives, after which it reverts to the seller, are considered owner occupied. All other occupied housing units are classified as renter occupied units, including units rented for cash, if occupants or others pay some rent, and/or occupied without payment of cash rent, such as a life tenancy or a unit that comes free with a job. Households who do not pay cash rent may still pay utilities."

In the U.S., private renters are also defined as a complementary set: public renters are those who live in units owned by Public Housing Authorities (PHAs) or other government entities. In particular, households who live in subsidized units owned by private entities (e.g. Section 42 units, which can be for-profit, or non-profit) are classified as private; and households who live in private units but who receive housing vouchers are also classified as private renters.

First, some basics. Figure 1 shows the "rentership" rate – the obverse of the much more widely published homeownership rate – from 1890 to the present. Before the Second World War, a little over half of U.S. households rented; but post-war, this ratio fell until it hit about 35% circa 1970; then it took another dip from the mid-90s until it hit a minimum of about 31% in 2004. As the homeownership rate dipped after the subprime crisis, the Great Recession of recent years, the rentership rate has been climbing again; as of writing this, a third of U.S. households are renting. It should also

**Figure 1 Proportion of U.S. households renting (%) 1890-2010**




Source U.S. Census Bureau

be noted that the slowdown of the U.S. economy has been accompanied by a notable slowdown in household formation. From 2000 through 2007, an average of 1.5 million households were formed annually (a 1.4% annual growth rate); from 2008 through 2010, only half a million households were formed per year, a 0.4 percent growth rate, as households doubled up, failed to form, and as immigration slowed.

Rentership rates vary substantially with location. For example, according to the 2009 American Housing Survey, a number of California metropolitan areas have rentership rates near or over 40%; New York is over 60% renters, and Jersey City is over 70 percent rental. At the other extreme, Daytona Beach and Fort Myers (Florida), Nassau (Long Island NY) and Davenport Iowa are examples of metro areas where less than 20% of households rent. Malpezzi (1996) demonstrates that much of the intra-metropolitan variation in homeownership rates can be explained by relative prices of renting and owning; and that these relative prices, in turn, are driven largely by local supply conditions (natural and regulatory constraint).

Most rented housing in the U.S. is private and unsubsidized (table 1). Overall, there are about 39 million renter households in the U.S., with about 79 million home-owning households. About 2.2 million rented units housing, about 2% of households, are

**Table 1 U.S. households by tenure**

| | 1950 | 1960 | 1970 | 1980 | 1990 | 2000 | 2009 |
|---|---|---|---|---|---|---|---|
| **Homeowners** | | | | | | | |
| **(in 000s)** | 23,955 | 32,683 | 40,595 | 53,350 | 59,649 | 70,571 | 78,951 |
| **(%)** | 55.0% | 61.9% | 64.2% | 65.6% | 63.9% | 67.4% | 67.4% |
| **Renters (000s)** | 19,599 | 20,116 | 22,806 | 27,416 | 33,698 | 34,134 | 38,230 |
| **(%)** | 45.0% | 38.1% | 35.8% | 34.4% | 36.1% | 32.6% | 32.6% |
| **Of which public housing** | | | | | | | |
| **(in 000s)** | 170 | 478 | 893 | 1,196 | 1,391 | 1,273 | 1,160 |
| **(%) of rental** | 0.9% | 2.4% | 3.9% | 4.4% | 4.1% | 3.7% | 3.0% |
| **% all households** | 0.4% | 0.9% | 1.4% | 1.5% | 1.5% | 1.2% | 1.0% |
| **Of which Section 42 LIHTC** | | | | | | | |
| **(in 000s)** | Nil | Nil | Nil | Nil | 316 | 1,129 | 1,724 |
| **% of rental** | | | | | 0.9% | 3.3% | 4.5% |
| **% of all households** | | | | | 0.3% | 1.1% | 1.5% |
| **Of which vouchers/certificates** | | | | | | | |
| **(in 000s)** | Nil | Nil | Nil | 625 | 1,213 | 1,510 | 2,282 |
| **% of rental** | | | | 2.3% | 3.6% | 4.4% | 6.0% |
| **% of all households** | | | | 0.8% | 1.3% | 1.4% | 1.9% |
| **Of which other rent subsidized** | | | | | | | |
| **(in 000s)** | | | | | | | 2,107 |
| **% of rental** | | | | | | | 5.5% |
| **% households** | | | | | | | 1.8% |

Note that some units/households can participate in more than one program (e.g. a voucher in a Section 42 unit).
Sources Decennial Censuses, American Housing Surveys, U.S. Department of Housing and Urban Development National Council of State Housing Authorities, Center for Budget and Policy Priorities, Schwartz (2010).

privately owned but with landlords or their tenants receive explicit government subsidies (vouchers or certificates), as shown in table 1. Table 1 also highlights the fact that only about 1% of U.S. households live in public housing, but another 3% live in rented units which have received some on-budget subsidy.[1]

Thus in the United States the private sector provides the great bulk of housing, owner occupied and rental, for high and low income households.[2] Furthermore, only a minority of eligible low-income households live in subsidized units and/or receive rental assistance vouchers. Of about 39 million renters in the U.S., about 15 million (41%) are in theory eligible for some kind of housing assistance because of their low incomes. Even if “layering” is ignored,[3] only about 7 million, or 19% of renters, are actually assisted. Unlike Social Security, Medicare, or homeownership subsidies through the tax code (about which more below), rented housing subsidies are not an “entitlement.”

Table 2 presents basic data on the kinds of structures occupied by renters and owners. Over 70 % of the entire U.S. housing stock is single family owner occupied; very little (about 5%) of owner occupied housing is multifamily. But while most rented housing is multifamily, it surprises many that almost a third of rented housing is single

**Table 2 Occupied housing units by structure and tenure (000s)**

| | Owners | Renters | Occupied without rent | Total |
|---|---|---|---|---|
| **Single family** | 67,246 | 10,556 | 1,179 | 78,981 |
| **Duplex** | 763 | 3,035 | 73 | 3,871 |
| **3 to 4 units** | 575 | 3,733 | 75 | 4,383 |
| **5 to 9 units** | 611 | 4,525 | 51 | 5,187 |
| **10 to 19 units** | 466 | 4,095 | 41 | 4,602 |
| **20 to 49 units** | 504 | 3,089 | 28 | 3,621 |
| **50 + units** | 776 | 3,255 | 50 | 4,081 |
| **Mobile homes** | 5,386 | 1,177 | 244 | 6,807 |
| **Other** | 138 | 160 | 13 | 311 |
| **Total** | 76,465 | 33,625 | 1,754 | 111,844 |

Source 2009 American Housing Survey

family, and another 9% are duplexes. Nationwide, surprisingly little rented housing is in large buildings; only10% of rental units are in buildings with 50 units or more. Of course in large cities the proportion is substantially higher.

*Ownership*

Who owns U.S. rented housing? Using data from the 2001 Residential Finance Survey (the latest available), I have estimated the ownership of private landlords for rented units as:

- 54% Individuals
- 24% Partnerships
- 13% Corporations (including REITs)
- 5% Cooperatives, non-profit organizations
- 4% Other

Thus, more than 75% of the nation's stock of private rented housing is owned by non-corporate individuals or partnerships; the latter tend to be somewhat larger scale than the former. Only a small share of the U.S. private rented stock is owned by larger institutions, whether for-profit or non-profit. Little is known about the characteristics of this large population of rented housing suppliers. I know of no study that provides a direct empirical test of the comparative income distributions of landlords and tenants.

There is some evidence that units owned by larger scale U.S. landlords charge higher rents (Cherry & Ford 1975 and Cronin 1983). These are interpreted by some authors as evidence of market power and the non-competitiveness of the rental market (Ibid. and Gilderbloom & Appelbaum 1988). An alternative explanation is discussed by Downs (1983). He develops the point that small landlords, for whom a single unit is much of their portfolio, can't easily carry even one or two vacant units, so they act as 'turnover minimizers' rather than 'rent maximizers'. Thus small landlords would rationally charge lower rents, implying an observed premium for units controlled by large landlords. In any event, more work on the 'industrial organization' of the sector would be fruitful.

Generally, both households and dwellings can and do move from the private rented sector to owner-occupation (and sometimes back again). The Joint Center for Housing Studies (2008) analyzed tenure switchers during the period 2003-2005 (a period of generally rising homeownership rates. Nevertheless, of 72 million homeowner households in 2003, by 2005 1.9 million — 2.6% — had switched to renting. Naturally, during this period there were more tenure switches in the other direction: of 72 million owner-occupied households in 2003, by 2005 about 7 million, or 9.9%, had switched to owning.

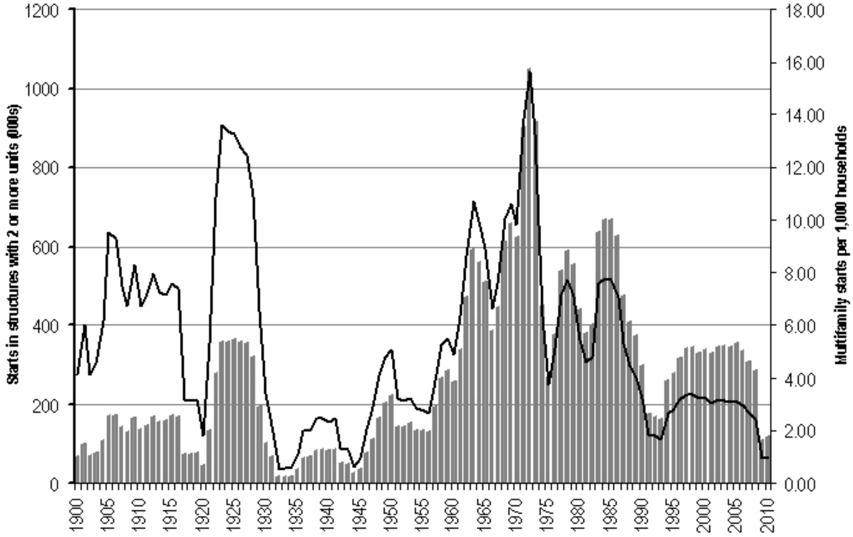
There are few restrictions on converting the tenure status of units at state or national level, though some municipalities have rules adopted to govern conversion from a rental apartment building to a condo. Generally these kinds of rules seem most common in a few states, e.g. California, Oregon, New York, and New Jersey. Most states have few rules, or they are not terribly restrictive.[4]

Landlords are generally responsible for maintenance. Tenants might be responsible for some maintenance in single family properties (e.g. lawn care). Some maintenance will be contracted out but larger scale landlords often do all but the largest tasks in-house. Maintenance quality varies, along with quality of stock and rents, but, since tenants often have choices, units are usually reasonably maintained. Generally the quality of the U.S. housing stock has improved markedly over the past decades, but there are always exceptions that prove the rule. HUD's 'Worst Case Housing Needs' reviews document that the most common problems faced by low income renters are related to cost that are high relative to their incomes; physical problems are much less common.[5]

Figure 2 shows a century of data on housing starts for multifamily units.[6] The bars are multifamily starts (2 or more units in a structure), and the line presents the number of such starts per 1000 households. Note the following points. Multifamily starts ran at a modest 100-200,000 for the first half of the century, except for a brief burst of close to 400,000 units per year during the 1920s. Up until the early 1990s recession, most of the post-war years saw private multifamily starts at around 400,000 to 600,000 per year except for some astoundingly high years just before the 1973 recession. From the mid 90s till the subprime crisis, starts ran at about 350,000. Currently private multifamily starts are at their lowest level since the 1950s.

Most housing in the U.S. as elsewhere, is from the existing stock. Most rental housing, which is not multifamily, is single family which was built for owner occupation but has been converted to rental. Hence in addition to studying multifamily starts it is important to examine these processes. There is a literature on the effects of tenure on housing maintenance, e.g. Chinloy (1980), Dildine & Massey (1974), and Porrell (1985). There is some evidence that owner occupied housing is better maintained than rental, and that there is some evidence that rental units with resident owners are

**Figure 2 Multi-family housing starts 1900-2010**




Source U.S. Census Bureau

better maintained than other rental units. Mayer (1981) investigated the determinants of rehabilitation of existing rental units, and found that in Berkeley, California public policy was an important determinant of rehab behavior, particularly infrastructure and zoning policies.

Presumably the largest determinant of investment in new construction and the existing stock is the expected profitability of rental housing. A number of studies have analyzed landlord profits using a case study or city specific approach (e.g. Neels 1982, Turner 1990) but the generalizability of these studies is uncertain. Everybody talks about profit, but no one measures it systematically. Anecdotal conversations with developers suggest that ex ante, developers require a 10-15% return on equity before tax, but good systematic data on either ex ante or ex post returns are hard to find. 15% doesn't seem like much of a hurdle rate, given the effort and risks involved. For an alternative view, see Pyhrr et al. (1989 pp. 68-69 and p. 869), who suggest the hurdle internal rate of return is more like 25%, after tax.

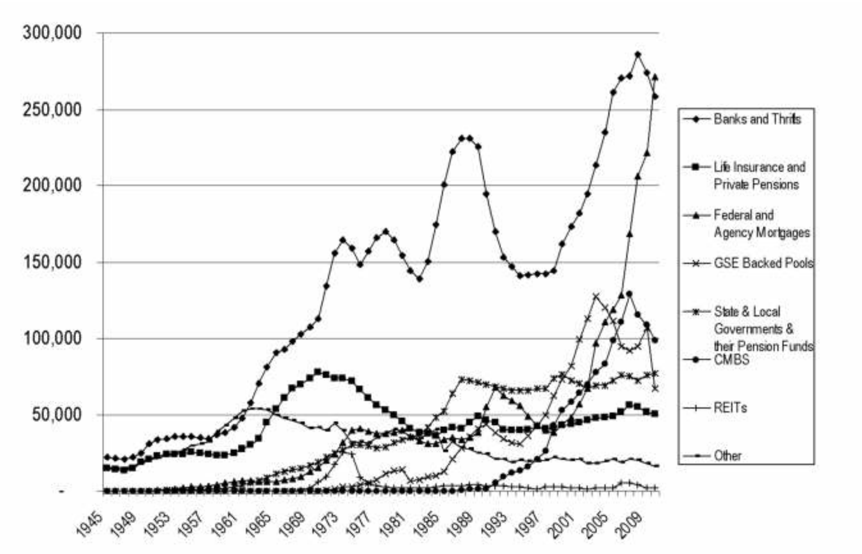
*Financing*

There has long been an active market for mortgages for rented housing in the private sector. At the end of 2010, the Federal Reserve reported $840 billion in outstanding mortgages for multifamily housing (down from a peak of $857 billion in 2009, in constant 2010 dollars). According to tabulations by Harvard's Joint Center for Housing Studies, in 2001 only 45% of small rental properties (1 to 4 units) had mortgages; 58% of 5-9 unit structures, 67% of 10-49 unit structures, and 86% of structures comprising 50 or more units.

Unlike mortgages for single family owner-occupants, it is difficult to find a consistent time series on mortgage rates for rental housing. Terms will vary by scale, type of units, type of landlord/owner, etc.; recent interviews with a local banker in Madison suggest that to get a loan, a small scale landlord with good credit might require an 80% loan-to-value ratio (gearing ratio), paying 1 point (1% of loan balance paid up front) plus other administrative fees; the loan would be an adjustable rate with a term of 3-7 years, and an initial rate of perhaps 5.5 to 5.8%.

Figure 3 shows Federal Reserve data on the capital sources for multifamily housing (as noted above, a reasonable proxy for much of the rental market, albeit one that omits the third or so of rental housing incorporating single family units and manufactured housing) in millions of constant 2010 dollars. Note that despite the rise of some mortgage REITs and CMBS in the 1990s and beyond, the bulk of mortgage financing for multifamily, and hence for rental housing, is provided by depository institutions (banks and thrifts) and by the Federal Government and 'the Agencies' or Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac. The GSEs appear in two places, their holdings of multifamily mortgages, and their issuance of pooled securities carrying their (government) guarantee, which are mainly held in the end by other investors. Note further that after the housing market and economy turned circa 2007, banks retrenched, as did private investors in GSE guaranteed paper. The Federal and GSE direct involvement in the market increased as they became the marginal financier for multifamily (especially 1-4 family properties) as well as housing in general. The Real Estate Investment Trust (REIT) data in the figure are for mortgages held by REITs; REITs more often make equity investments in apartments.The Commercial Mortgage Backed Securities (CMBS) market is by far the bigger player in this mortgage market, going from nowhere in 1990 to the third biggest lender at the peak of the market, with about $140 billion outstanding at that time.

**Figure 3 Real value of multi family mortgages outstanding by lender ($ million 2010)**




Source: Federal Reserve Board

The rental/multifamily markets have not been spared the foreclosure problems that have bedeviled the U.S. housing market and economy.[7] The Mortgage Bankers Association estimates that 20% of foreclosures are small investment properties; analysis of Home Mortgage Disclosure Act (HMDA) data by the Joint Center for Housing Studies finds that a key determinant of whether these small-scale properties go into foreclosure is whether or not the landlord resides on the property.

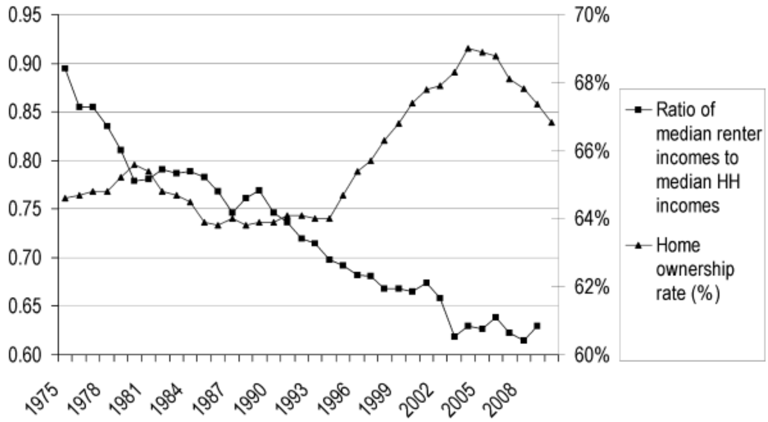
## Tenant characteristics

During the past thirty years, the number of owner households has grown by about 1.5% per annum, and the growth rate of renter households was about 1.2%. Population growth, on the other hand, was a little over 1% per annum. Many new single person households and households comprising unrelated individuals formed, as the average household size dropped from 2.9 in 1980 to 2.6 30 years later.

As the homeownership rate has increased, the ratio between the median income of renters and total median renters household income has fallen, from almost 90% (near-parity) in 1975, to about 63% today, as figure 4 shows. Tabulations by the Joint

Center for Housing Studies and Census data reveal that in 2009, the median household income of all households was $5,105 per month; that for homeowners was slightly higher at $5,172; and that for renters was $2,664. This compares to a median contract rent of $725 per month, or median gross rent of $807 (i.e. with utilities included).

**Figure 4 Ratio of Joint Center median renter incomes to census median household incomes**




Source Joint Center for Housing Studies, State of the Nation's Housing 2011

## Legal and Regulatory Framework

Most rental housing in the U.S. is private and unsubsidized This housing is governed by private contracts, regulated mainly by state and local governments, with the regulations enforced mainly by state and local courts. In the United States, the legal framework of rental housing is defined partly by statutory law, but mainly by common law as interpreted by courts, which has evolved considerably over the past 200 years. Generally, this legal framework varies significantly by state and by locality. For example, as already noted, most U.S. markets have no controls on rents or the duration of tenure, but significant exceptions such as New York, Washington D.C. and Los Angeles differ not only from most of the country in the existence of controls, but also from each other in the design and enforcement mechanisms for their rent regulations.

Most private landlords own their property fee simple absolute, and tenancies are defined by a lease contract. The most common lease duration is for one year; however a substantial number of apartment leases are month to month, and leases of two or three years are not unheard of. It is very common to require a month's rent in advance as a deposit, though this can be raised, sometimes if linked to the potential to more rapid deterioration of the unit, e.g. if the tenant has large pets.

Rental housing is, like other housing, subject to a wide range of land use and development regulations. The primary objective usually stated for U.S. zoning and other land use controls is to correct for externalities arising from "incompatible" land uses. But in the U.S. zoning is commonly used to exclude low income households; many suspect in particular black low income households.

Some observers have noted that jurisdictions can be quite ambivalent (or at least confused) about their objectives. It is not unknown for a jurisdiction to impose regulations to reduce the supply of low and middle income units, only to also require developers of high income properties to build a certain number of low income units at below market cost ('inclusionary zoning').

Zoning and other land use issues in the U.S. are complex and we can only touch on some of the main points here. Fischel (1990) and Pogodzinski & Sass (1990) provide excellent and readable summaries of the empirical literature. Malpezzi (1996) constructs several measures of the restrictiveness of the land use regulatory environment across a number of metropolitan areas, and uses those measures in models explaining rents, asset prices of housing, tenure choice, and several 'externality' outcomes (neighborhood satisfaction, segregation, and congestion). Malpezzi finds that regulations do raise rents; this is, by itself, unsurprising. What is perhaps more interesting in the current context is that asset prices are driven up faster than rents; that home ownership rates decline substantially with more stringent regulatory environments (primarily through indirect effects on prices); and that there is little offsetting environmental benefit to more stringent regulations, at least as yet measured.

### Taxes and Subsidies

For most rental housing, across-the-board tax preferences are now modest. Green & Malpezzi (2003) explain why economists measure tax expenditures against a benchmark of taxing recurrent income and the real portion of capital gains at the same rates as other income, net of the costs of producing this income. They show that against this benchmark, income from rental housing is not too far off the benchmark, as a first approximation; while owner-occupied housing is highly favored, at least for upper income taxpayers (largely due to permitting the deduction of mortgage interest and property taxes, while not taxing any of the income from the asset). Income from a corporation facing stylized tax treatment is overtaxed, as income is taxed at both the corporate level and again when distributed as dividends; though in practice effective tax rates for corporations vary enormously depending on their particular tax situation.

More specifically, for a prototypical, unsubsidized rental housing unit, net operating income is taxed as ordinary income, at the taxpayer's marginal rate. Mortgage interest is deductible from rental income, as are most operating costs, including property taxes. Furthermore, an additional deduction is permitted as a depreciation allowance for the structure (not including the land), as a straight-line deduction assuming a 27.5 year useful life of the structure. This depreciation allowance is subject to recapture on sale if unit has appreciated.

Losses on rental property may be used to offset taxes on other types of income, but there are restrictions, the so-called 'passive loss rules', that limit the ability to offset incomes from wage and salary, and "active portfolio" income (stocks and bonds).[8]

At sale, rental housing capital gains, like all capital gains, are taxed at preferential rates, currently 15%. (For comparison, the top marginal federal tax rate on recurrent income is 35%. In practice capital gains taxes are often avoided by selling one property and buying another within a specified time frame, using a so-called 1031 exchange.[9]

Most states also tax rental income, both recurrent and capital gains. Rates vary but are generally much lower than the federal rates. Most states piggyback on the federal calculation of the tax liability, though some do make modifications to the liability.

At the federal level there are some special tax credits for developers of low income housing. The Low Income Housing Tax Credit was originated in conjunction with the Tax Reform Act of 1986 (TRA 86) to provide incentives for private sector production of low income housing. The credits provide a mechanism for funding a wide range of projects including new construction, substantial rehabilitation, moderate rehabilitation, acquisition, and repair by existing owners.

The Low Income Housing Tax Credit provides a 'present value' tax credit of 70% of the cost of new construction or 30% of the cost of acquisition of existing low income housing in return for limits on rents charged. The credits are allocated over a ten year period based on the 'Applicable Federal Rate' (AFR). Nominally the value of the credit is 9% annually for the 70% credit and 4% annually for the 30% credit. For acquisition of existing rental housing, the applicable credit is also 4%.

The developer must decide between two options for the unit. Either 20% of available rental units must be rented to households with income less than 50% of the county median income (adjusted for family size), or 40% of the units must be set aside for households with income less than 60% of the county median income. (The rent can be adjusted in future years as median incomes change). The maximum gross rent, including utilities, paid by households in qualifying units may not exceed 30% of maximum qualifying income. The federal program mandates a 15 year period for maintaining the unit as a low income unit; in practice the lock-in periods are often longer. If the rent restrictions are not followed, there are provisions for recapturing the tax credits used. For more on the mechanics of this program, see Guggenheim (1989).

Housing Choice Vouchers are the primary demand side subsidy; they are a revised version of the older Section 8 existing housing allowance program. The government pays the difference between 30% of tenant income and the so-called ‘fair market rent’ (FMR) for the unit. The FMR is calculated annually for each county by the U.S. Department of Housing and Urban Development, and is usually somewhat less than the county's median rent. Generally households are eligible if their incomes are less than half the Area Median Income (AMI), though, as we discuss elsewhere, only about a third of eligible households actually receive vouchers.

In addition to vouchers and subsidies through the tax code, most notably the Section 42 LIHTC just discussed, in the introduction we briefly alluded to other housing subsidy programs, notably public housing, housing vouchers, the aforementioned Section 42, and “other.” According to the latest data, about 1.2 million households live in public housing, 1.7 million in Section 42 units, and 2.3 million receive vouchers. The “other” category comprises 2.1 million households and includes a grab-bag of programs, mostly legacy programs, like Section 8 New Construction and Section 202, which provided subsidies to private landlords. These programs have not been adding units in quite some time (and the same is true for public housing); in fact these programs are shrinking, but significant numbers of units still exist. In the past two decades most new subsidies have been provided through tax credits (on the supply side) or vouchers (on the demand side). Many – not all – U.S. housing economists have argued that the shift to demand- side subsidies is a positive development, from the perspective of both efficiency and equity. Galster (1997) and Yates & Whitehead (1998) provide a good review of these issues; see Mayo (1987) for a brief review of the best U.S. evidence on relative efficiency of supply side and demand side programs.

Table 1, initially discussed above, focused on rental programs and therefore omits the largest U.S. housing subsidy, the favorable tax treatment of owner-occupied housing (deductible interest on up to a $1 million mortgage, deductible property taxes, and no taxation of homeowner capital gains under $250,000). HUD's current budgetary outlays for housing subsidies to low income households stands at $59 billion, and the LIHTC program currently costs about $6 billion per year, and these accrue, or at least are initially targeted towards, low income households. The Office of Management and Budget estimates the cost of homeowner tax breaks at $118 billion, and these mostly accrue to upper-income households, who have the largest mortgages and the highest marginal tax rates (which maximizes the value of the deduction).

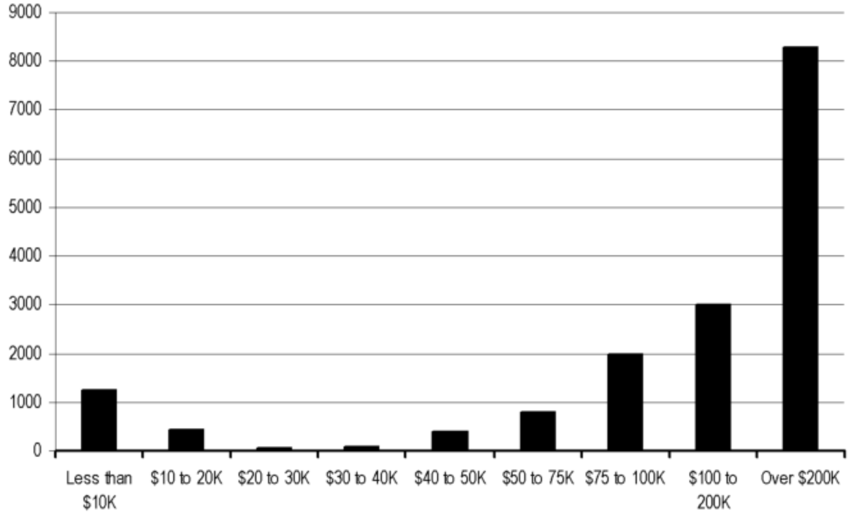
Figure 5 presents estimates of the average housing benefit from these low income housing programs and from the homeownership tax subsidies. The average household with annual income under $10,000 receives about $1,100 in housing subsidies; while the average household with income over $200,000 receives about $9,000 on average. Of course these averages mask substantial variation with categories; only about a third of eligible low-income households actually receive subsidies. For reference, the median household income in 2005 was about $46,000, and the poverty threshold for a family of four was $19,350.

*Rents*

Much has been written about U.S. house price volatility, especially the boom during the decade prior to 2006, and the subsequent bust, and their interactions with the aggregate economy. While rents exhibit some interesting patterns of their own, the first point to note is that they are much less volatile than housing's asset price. Figure 6 shows the most widely used index of real rents, based on the CPI, over the past four decades. Over four decades there's hardly any discernable overall trend, although real rents fell by about 20% during the first decade of the chart; during three decades from the minimum index value (1981) to date real rents rose by about a quarter. More recently, during the period of real house price increases of 5-7% per year (1996 to 2006), rents were only growing by 1% over background inflation. During the 2006-9 house price bust, when real house prices were falling by 10-15 % per year, real rents were still increasing slightly.

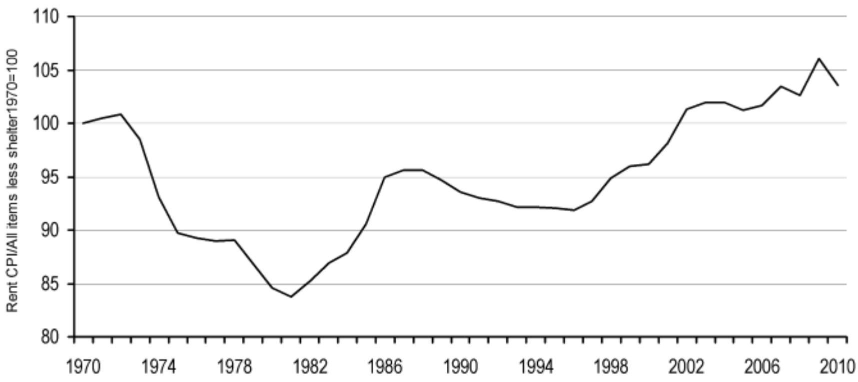
Of course these national averages mask variation across markets, and across households. While there is CPI rental data for 27 large metropolitan areas, and occasional place-to-place rent indexes for one or a few years, most locations were not covered until the recent work of Carrillo, Early & Olsen (2010) who have constructed annual

**Figure 5 Average annual federal housing benefits including subsidy and tax expenditure ($) by total household income**




Source Carasso, Steuerle & Bell (2005)

**Figure 6 Real Rental Index 1970-2010**




Source Bureau of Labor Statistics

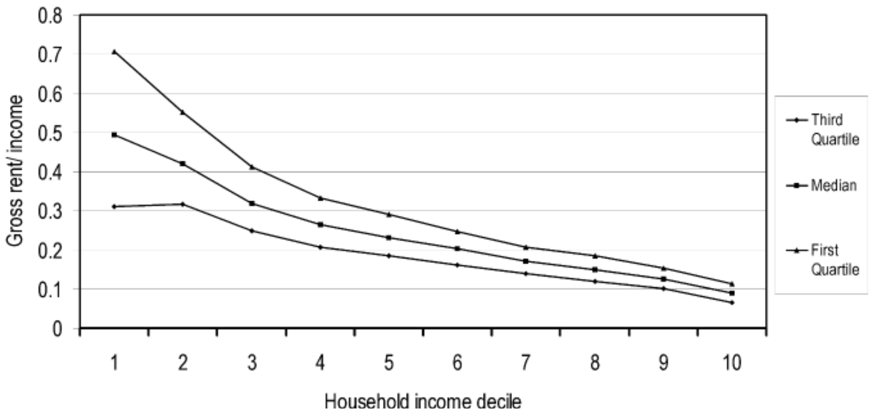
rental price indexes for every metropolitan area, and for the non-metropolitan areas of every state, from 1982.

Figure 7, from Green & Malpezzi (2003), demonstrates that, as in many other countries, richer American renters pay lower fractions of their income on rent. That is, rents rise with incomes, but less than proportionately (Whitehead 1999). Extensive multivariate analysis has confirmed this (see for example Mayo 1981). Implications for affordability and its measurement are discussed in Quigley & Raphael (2004).

### Current and prospective policy environment

It can be argued that the the relative stability of rents, and the general sense that the U.S. rental market works reasonably well, can mask some important policy channels

**Figure 7 Housing expenditure: rent to income ratios by income decile (renters)**




Source 1993 American Housing Survey

in both the near and long term. As of writing, the recovery from the 2007-2009 recession remains disappointingly slow, with GDP growth well below typical performance in the recovery period and unemployment at 9% well into the nominal recovery, high levels of debt and continued overhang of mortgages in default and foreclosure.

In this environment, the private rented sector is not an especially hot political topic per se – the owner-occupied market, employment, and fiscal and monetary policies are much more at the forefront. To some extent this misses the fact that the boom and bust in asset prices and the high level of foreclosures affect the rental market as well as owner-occupied, but most debate is focused on the owner-occupied sector.

As Congress and the administration battle over deficit reduction, there is a real likelihood that on-budget spending on housing vouchers will be cut back as part of the required fiscal tightening.

In general, despite the pride of place given to home ownership as part of 'the American Dream, in the U.S. the private rental market continues to play an important role, housing roughly a third of the population. The U.S. private rented sector has not been seen as a residual sector per se. Most poor people rent, but most renters are not poor.

Overall, the U.S. private rental market performs fairly well. But the U.S. can do better. Exclusionary zoning, restrictions on conversion of houses to apartments, and other impediments to low cost rental are particular areas of concern.

It is worth pointing out the limits of policy. In market economies like the U.S., government policies have important effects, but the market itself is the major determinant of how well people are housed. With a proper regulatory environment in place, ensuring elastic supply, housing conditions will improve pari passu with incomes and the state of the economy generally. Economic development is the most effective way of improving housing conditions in all countries (Malpezzi 1990). To a considerable degree, what is good for the economy is better for housing.

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## Notes

*In preparing this draft I benefited from comments by Jeff Mack and Mark Obrinsky, but they are not responsible for the opinions expressed herein.*

1 These include the Section 42 Low Income Housing Tax Credit program, Section 8 New Construction and Substantial Rehabilitation, and other programs described in Green & Malpezzi (2003) and Schwartz (2010).

2 Local governments regulate rents for part or all of the market in about 200 cities in the U.S. These cities contain about 10% of the U.S. renter population, and about 4-5% of the total rental stock is controlled. Details of the effects of these controls can be found in Turner & Malpezzi (2003).

3 In some cases it is possible to combine subsidies from more than one program. Probably the most common combination is for a poor household in a Section 42 LIHTC unit to also receive a housing voucher.

4 For an example of one of the more restrictive sets of rules, see

http://www.andysirkin.com/HTMLArticle.cfm?Article=182&Hit=1

[5] See: http://www.huduser.org/portal/publications/affhsg/wc_HsgNeeds09.html

[6] In a typical year fewer than 2% of single family units are built for the rental market; most single family rentals have changed tenure since construction.

[7] See the discussion of the Wisconsin Foreclosure and Unemployment Relief website for a broader introduction to the foreclosure problem in the U.S. http://www.bus.wisc.edu/realestate/wi-fur/

[8] These passive loss rules are somewhat complicated. See http://www.irs.gov/pub/irs-pdf/p925.pdf for details.

[9] See http://www.irs.gov/businesses/small/industries/article/0,,id=98491,00.html

# 6. The private rented sector in Denmark

*Kathleen Scanlon*

### The current position of private rented housing: definition, scale, property types, location

As in many European countries the relative size of the Danish private rented sector has been falling for decades. At 16% of the housing stock, it is now less than half the size it was in percentage terms in 1960. Private renting is more common in urban areas than elsewhere, and is most common in Copenhagen, where 29% of dwellings are rented privately. There are about 450,000 units in the private rented sector in Denmark today, compared to just over 600,000 in 1970. Over the same period the number of social rented units has more than doubled from about 230,000 to more than 500,000 (Christoffersen 2010, p. 21), reflecting strong Danish support for a universalist social housing sector. Table 1 gives tenure changes since 1960.

**Table 1 Tenure since 1960 (%)**

| | 1960 | 1970 | 1980 | 1990 | 2000 | 2004 | 2010 |
|---|---|---|---|---|---|---|---|
| **Private rental** | 39.8 | 34.7 | 22.1 | 18.4 | 18.0 | 17.4 | 16 |
| **Owner-occupied** | 45.7 | 48.6 | 52.1 | 51.7 | 51.3 | 50.5 | 48 |
| **Co-operative*** | | | 2.1 | 4.5 | 6.3 | 6.7 | 16 |
| **Social rental** | 9.8 | 14.5 | 14.4 | 16.8 | 19.1 | 19.0 | 20 |
| **Official housing** | 4.7 | 2.2 | 3.1 | 2.6 | 1.4 | 1.4 | |
| **Not in use** | | | 6.2 | 6.1 | 3.9 | 5.0 | |
| **Total number of dwellings (000s)** | 1,463 | 1,743 | 2,109 | 2,353 | 2,489 | 2,561 | |

*The co-operative tenure was created in the 1970s in order to allow tenants in private rented housing to buy their property (OECD 1999).
Source 1960-2004 Lunde 2010; Andrews et al 2011

The private rented sector in Denmark is dominated by flats (table 2), and private rented dwellings tend to be older and smaller than the rest of the housing stock. Some 57% of private rented dwellings were built before 1940, as opposed to only 35% of owner-occupied dwellings and 5% of social rented dwellings (Det Økonomiske Råd 2001 / The Danish Economic Council 2001). In Danish law, different regulations apply to various physical types of buildings, so it is meaningful to subdivide the private rented sector into dwelling types. Danish experts consider the 'real' private rented sector comprises only dwellings in buildings with three or more units, and these are the dwellings that have historically been affected by both rent-control regulations and restrictions on division of ownership (which de facto means that it is not possible to change the tenure of many private rented dwellings).

**Table 2 Dwelling types in the Danish private rented housing stock, 2010**

| Dwelling type | % of housing stock |
|---|---|
| Farm houses | 0.3 |
| Detached houses | 13.5 |
| Semi-detached or terraced houses | 9.5 |
| Dwellings in multi-storey buildings | 70.0 |
| Colleges | 4.1 |
| Residential institutions | 0.6 |
| Other year-around dwellings | 1.9 |

Source: Ejendomsforeningen Danmark and Danmarks Statistik

New construction of private rented dwellings basically ceased in the 1970s but started again in the 1980s, mostly funded by institutional investors. Rules for construction of new social housing imposed a maximum sq m cost, which meant it couldn't be built in the best locations or the best quality, especially in the Copenhagen area (Christoffersen 2010). This left a gap in the market for high-quality rental units. From a low level, new private rented construction continued to increase until the mid-2000s. From 2003-2007 there was an annual tax-incentive programme for institutional investors in the private rented sector as well as a subsidy to private developers to build dedicated student accommodation. Since 2002, the profits of pension funds and insurance companies from investments in the private rented sector have been taxed at 15% rather than the normal corporate rate of 30%.

After 2007 there was an influx to the sector of newly constructed flats that were originally destined for owner occupation; when the decline in the housing market made them impossible to sell, they were changed to private rental. As these units were originally built for owner occupation, they can in the future be sold as such.

## 2. Ownership, rents and financing

Recent surveys show that about 40% of private landlords are individuals with other jobs; they tend to have small portfolios and therefore own only 8% of private rented dwellings. Professional landlords — either individuals or businesses — make up 35% of landlords but own more than half of private rented dwellings. The remaining landlords are companies whose main business is not renting, builders and institutional investors. They represent 7% of landlords and have 10% of dwellings and tend to have been involved in the private rented sector for decades; on average their first property was purchased in 1930 (Andersen 2010).

There are no current official statistics on rents in the private rented sector, since Danmarks Statistiks last collected data on this in 1999. IPD Dansk Ejendomsindeks collects data for the big professional landlords; their figures show that the Copenhagen area has rents about 20% higher than in the provinces, and that rents are higher in buildings owned by professional investors (Christoffersen 2010 p.199).

Rents for regulated dwellings are certainly below market levels. IPD figures indicate that in Copenhagen, rents based on value-of-the-tenancy regulations are about 80% of market levels (Table LEJ01). However they have been increasing in real terms since 1980 (see OECD 1999, Figure 19). This is largely because of changes in the formulae governing cost rents, in particular increases in the allowances for maintenance and capital charges. In 2001, Ball estimated that “for modern dwellings, rents are now similar to those in an open market, although such market rents in general still lie below levels where investments in building private rental properties are profitable.” Recent IPD figures underline this; they calculated the operating return on residential rented property at just 2.5% in 2010 (IPD Table AFK01 from Ejendomsforeningen website); total return including increase in capital value was 3.3%. The ten-year average total return was, however, much higher at 10.2% (Table AFK03). The Danish

Economic Council said in its 2001 report on housing that rents would have to rise by 43% to reach market levels.

Purchases of existing multi-unit rental dwellings can be funded with a mortgage (normally maximum LTV of 80% and 30-year term) or a commercial loan.

## 3. Tenant demographics

Households in private renting are more likely to be young, single and in receipt of housing benefit. Except for a small minority of wealthy renters, they generally have lower incomes than owner-occupiers and residents of co-operatives — the average household in the private rented sector had an income 30% below the Danish average in 2000 (Det Økonomiske Råd 2001 / The Danish Economic Council 2001). They are also more likely to be out of work and less likely to own their own businesses. The young tend to live for relatively short periods in private rental (as little as 1.2 years for young couples under the age of 30), while those over 60 live on average for 19 years in the tenure (Skifter-Andersen 2010, Table 11.4). In 1999, ethnic minorities were about three times more likely to live in social housing than in private rental (Det Økonomiske Råd 2001 / The Danish Economic Council, Table III.7).

In 1999, some 10% of tenants in the private rented sector received regular housing benefit and 15% received housing benefit for pensioners. These figures were much lower than for social-housing tenants (16% and 25% respectively) (Det Økonomiske Råd 2001 / The Danish Economic Council 2001, Table III.7).

The private rented sector is generally not a tenure of choice. There is a strong cultural preference for owner-occupation in Denmark (indeed, the ratio of mortgage debt to GDP is among the highest in the world). Those who cannot afford owner-occupation would generally prefer to live in the social rented sector, which is generally in good condition, non-stigmatised and accommodates a wide range of households.

## 4. Legal and regulatory framework, taxes and subsidies

In Denmark, the tenure of buildings is generally fixed and can only be altered with difficulty. According to Christoffersen, “when a house is originally established in a given tenure, there are important restrictions and barriers with regard to later change of tenure” (p. 29). In particular, ‘real’ rented buildings cannot generally be sold as individual units to owner-occupiers. This has been a matter of political contention, and there have been periods when such ‘breaking up’ was permitted as part of urban regeneration programmes or to encourage owner-occupation or the formation of cooperatives (a form of owner-occupation). The current position is that some rented buildings — listed buildings or those built since 1999 — can be broken up and sold as owner-occupied flats. In addition, any rented building with more than six units can be sold at market price to tenants if they create a co-operative housing society (Christoffersen p.197) — the tenants only have right of first refusal and cannot force a sale (i.e. there is no 'right to buy'). According to Ball (2001), "Such rental buildings can be bought cheaply and come with significant tax breaks. A large number of conversions to co-operatives have arisen as a result." It is generally prohibited to demolish private rented housing, unless the owner of a two family house for instance wishes to use all of the dwelling himself. In that case the municipality normally allows the owner to eliminate the rented dwelling.

*Current rent regulation*

Much of the Danish private rented stock is subject to some form of rent control. New buildings are exempt, but the amount of new private rented sector construction is low. Calculation of rents is complex. Edlund (2003) states that "currently, at least five different rent control systems exist simultaneously." This has come about because the various changes in regulation sometimes applied only to housing constructed subsequently, while existing housing remained subject to the previous regulatory regime. In general there is a break in 1974. Private rented housing built before that time is subject to more stringent regulation than housing built later, while private rented housing built after 1991 is exempt from rent control entirely (OECD 1999). 88% of buildings with between 11 and 20 units have regulated rents.

In all, just under a half of private rented dwellings are rent-regulated. Individual local governments (communes) can decide whether to apply rent regulations in their areas. In Copenhagen and the surrounding area rent regulation is more common than in small towns and rural areas.

The most important systems now are the running-cost system or 'omkostningsbestemt husleje', which applies in most major cities, and the value-of-the-tenancy (sometimes translated as the 'value of the rented dwelling') system. The permitted rent in the first case is based on the landlord's running costs plus a fixed owner's yield and a fixed amount for exterior maintenance. Calculations for the second are somewhat different but actual rent levels are similar. Rents can be raised if the running costs exceed the existing rent, or if the landlord has made improvements (Edlund 2003).

Landlords can bring their units out of the purview of rent regulation by carrying out a 'thorough renovation'; this is known as a 'paragraph 5 clause 2' renovation. After this, rents can be set according to 'the value of the tenancy'—a legal concept that implies a rent somewhat below the market level. This renovation and rent rise is on a unit-by-unit basis, so there are buildings where some units are renovated and have near-market rents, while others are unrenovated and have regulated rents. In 18% of private rented buildings, over half of the units are renovated; professional landlords are the most likely to carry out these renovations (Andersen 2010, p. 205).

There is a system of rent tribunals that deals with disputes between landlords and tenants (Edlund 2003). According to Edlund, "there is considerable uncertainty with regard to tenancy laws, particularly as a result of the many differing and complicated sets of rent regimes in force. Moreover, it is not possible for lay people to properly calculate the maximum rent applicable to a particular tenancy."

The effect of rent regulation is strengthened by the fact that the standard lease takes the form of an open-ended contract, which the landlord can interrupt only if he wants to use the property personally, if the building is to be demolished or renovated, if the dwelling belongs to an employer where the tenant no longer works, or if the tenant has engaged in serious misbehaviour. The tenants may sub-let and trade tenancies (OECD 2006). It is however possible to engage in a closed-ended contract if the lease period is less than 2 years, and if the contract clearly states that the lease ends after 2 years without further notice.

*Taxes and subsidies*

According to Ball (2002), "landlords' yields are taxed more than the returns of property owners in other sectors." Landlords (private individuals or companies) pay income tax on their rental income, and can offset interest charges and operating costs. Individuals can choose for their rental income to be taxed as part of their personal income, or to be taxed as business or investment income. There is no depreciation allowed for residential rented property—although it is permitted for other types of property. Losses on rented property can be offset against other types of income.

In the past, pension funds and life insurance companies that owned private rented housing have received tax incentives during certain periods. These institutions were the main investors in new private rented housing in the period 1985-1999 (OECD 1999). In the early 2000s there was again a move to stimulate investment in the private rented sector, and pension funds and private investors were given tax credits and grants to invest in the construction of new rented housing directed at average income groups (OECD 2000; Ball 2004). Since 2002, the profits of pension funds and insurance companies from investments in private rented property have been taxed at 15% rather than the normal corporate tax rate of 30% (OECD 2006). Landlords who are private individuals cannot access these subsidies.

All other housing tenures in Denmark receive some sort of subsidy. The construction of social housing and new co-operatives is subsidised by the state, and neither social housing providers nor co-operatives are subject to income tax (and conversely have to bear the full burden of mortgage interest). Table 3 summarises regulation of and subsidies to housing in Denmark.

## 5. Policy environment: Five key milestones and why important; recent initiatives and likely changes.

The first regulation of rents in Denmark was a rent freeze in 1916, imposed in response to big rent increases in the first year of the First World War. Rent committees were set up by municipalities to ensure that the freeze was adhered to and tenants' rights protected. After 1918, the freeze was gradually relaxed and was removed in 1931. Rent regulation was then imposed 'temporarily' in March 1939, "for fear of strong rent rises during the coming world war, and of shortages of material for new construction" (Lunde 2010 p.263). This went alongside the creation of redistributive welfare state structures through the 1930s. The state in effect compelled landlords to subsidise rents, and the result was virtually to shut down private investment in rented dwellings — ending the prolific construction of new rented buildings in the 1930s. In addition to the rent freeze, there were bans on evictions and demolitions, a ban on owning more than one house, and forced auctions of empty homes.

Over the decades after the Second World War the stock of Danish housing grew, due to massive state subsidies for new construction of social housing, and the post-war housing shortages disappeared. Rent control, however, remained and became a tool for redistribution. Rather than eliminate the rent regulations (which were still categorised as 'temporary'), politicians added to them. The oft-amended law governing rent control during the post war period was the rent control act (Lejeloven), under which rents are determined by 'the value of the rented dwelling'. This did not imply market rents, but in practice meant rents were based on the rents of similar units in terms of their location, type, size, quality and standard (OECD 2006). There were various changes to the system in the 1950s, including permitting smaller communes to do away with regulation, but no change in principle.

**Table 3 Regulation and housing subsidies**

| Instrument | Housing tenures | | | |
|---|---|---|---|---|
| | **Owner occupied** | **Private rental** | **Social housing** | **Co-operatives** |
| **Income tax** | No | Profits taxed at 28% | Exempt | Exempt |
| **Real estate tax** | Yes | Exempt | Exempt | Exempt |
| **Land tax** | Yes | Yes | Yes | Yes |
| **Rent regulation** | n/a | Yes for older dwellings | Yes | Yes |
| **Character of housing support** | Low real estate tax; subsidies from urban renewal scheme (as loans); exemption from capital gains tax | Insider advantage accruing from rent regulation; subsidies from urban renewal scheme | Exemption from real estate tax; insider advantages accruing from rent regulation; subsidised construction | Exemption from real estate and capital gains taxes; price cap on shares implies low second-hand prices in some cases; loans to finance new co-op dwellings guaranteed by municipality |
| **Housing allowances for low income non-pensioners** | No | Yes | Yes | No |
| **Housing supplement in state pension** | Yes, as a loan | Yes | Yes | Yes<br>40% grant<br>60% loan |

Source: OECD 2006, Table 4.2

In 1966, however, there was political agreement about the desirability in principle of removing rent regulation and allowing rents to move with the market. It was felt that a one-off change would be too drastic, so a scheme was devised that was intended to gradually bring rents in both private and social rented housing up to market levels by 1974. But the scheme, which was based on fixed annual percentage increases in rent, did not anticipate the high inflation of the early 1970s and was not adjusted to take it into account. In 1974, then, rents in the private rented sector were at more or less the same level in real terms as they had been in 1967 (Christoffersen 2010; OECD 1999).

The 1966 agreement also for the first time allowed for the division of ownership in former rented buildings, to permit creation of owner-occupied apartments. There were minimum requirements regarding the physical condition and facilities, and new multi-unit buildings could be owner-occupied from the beginning. This led to the exodus of the best quality parts of the private rented sector from the tenure. After 1975 this type of change increased greatly, as tenant co-operatives were given the right of first refusal. The calculation of sale prices was regulated in such a way as to deny the original owners any possibility of capital gains. This avenue of tenure change was closed in 1979 for most properties.

In 1975 a supplementary rent control act (Boligreguleringsloven) was passed; this act introduced a system of cost-based rents. Municipalities could choose whether to apply the earlier Lejeloven or the new regime, and as of 2003 about 369,000 units were subject to the cost rent regime with only about 55,000 under the earlier law (OECD 2006). The new system implied a real increase in rents in 1976 of about 30% in real terms (OECD 1999).

The lack of maintenance in the private rented sector that resulted from rent control was addressed by a series of urban renewal programmes in the 1970s. These did not explicitly target this sector but as these buildings were in worst repair they benefitted most.

In 1991 rent control was lifted, for new buildings only, on negotiation of a new lease. Subsequent rent rises are limited to the cost of living or trappeleje (step change), where the rent increases annually by a set amount that is stipulated in the lease. In 2004, landlords were allowed to charge market rents for new rooftop ('penthouse') apartments built on top of otherwise rent-controlled buildings.

*Policy discussions*

Experts both internal and external have been proposing reform of Danish rent regulation for decades. The Danish Economic Council said in 1970 that there was no longer a shortgage of housing in Denmark and advocated the elimination of rent regulation, but to no avail. In 1987 the Ølgaard Commission was appointed to look at housing policy, and published its report the following year. It focused mainly on social housing, and said that lifting rent control on the private sector would be a political gesture without real effect as long as the subsidies given to other tenures were unchanged (Christoffersen 2010, p. 123).

In 1994 a rent law commission (Lejelovskommissionen) was set up to look specifically at rent regulation. Its 1997 report (Lejelovskommissionnen 1997) recommended only marginal changes and did not address the issue of differing subsidies to different tenures.

The OECD devoted chapters to housing in its 1999 and 2006 economic surveys of Denmark; both made the case strongly for a relaxation leading to eventual elimination of rent regulation. The Danish Economic Council made similar points in a widely cited 2001 report on the country's housing market.

The criticisms are based on the effect of the regulations on the utilisation and maintenance of the stock, and the disincentive they represent for new construction. Rents paid do not necessarily relate to the unit's desirability in terms of location, size and general attractiveness, leading to overconsumption of housing, lock-in effects and an insider/outsider split, where desirable homes are acquired on the basis of insider knowledge. In addition, the limited availability of private rented housing brought about by rent control leads to a 'pushing out' of households into other tenures. This has a price effect on housing in those other tenures, particularly owner-occupied housing.

In terms of maintenance, until the late 1990s the formulae used for the various rent-control regimes applied a standard amount for maintenance which did not reflect differences in buildings' physical condition or location, and landlords were limited in their ability to pass these costs on to tenants. This has led to an underinvestment in maintenance. The OECD in 1999 identified "a back-log of maintenance work of about DKr12 billion (1989 prices) for the pre-1950 stock" (p.115).

The maintenance charges were increased in the late 1990s, which improved maintenance somewhat. Of greater importance though were the effects of a widespread urban renewal programme in the early 1990s. Most of the housing improved was private rented housing. "Most of the urban renewal projects (were) carried out with the landlord as contractor, for whom the urban renewal project typically replaces and finances maintenance investment that the landlord otherwise would have had to undertake at a later stage to keep up the value of his housing capital" (OECD 1999, p.117). The OECD points out that "one of the main lessons to be drawn from the experiences of Denmark and many other European countries is that rent controls, most often without proper regard for incentives to maintenance, have serious long-term effects on the quality of the relevant housing stock, in the end necessitating heavy government outlays to offset the deterioration of the capital stock"(OECD 1999, p.116).

*Lessons for the UK*

In terms of lessons for the UK, the Danish case presents more errors to avoid than of positive examples to follow—as evidenced by the steep and continuing fall in the percentage of private rented dwellings in the overall building stock. This mirrors the UK experience up to the late 1980s, but while the UK sector began to grow after deregulation the Danish sector has continued to shrink. It has yet to reach the low of 8% seen in the UK in 1990s, but that is almost certainly due to the legal framework, which does not allow the ownership of multi-unit blocks to be split up—and thus de facto preserves them as private rental. If the dwellings could have been sold individually, as is the case in the UK, then landlords would have sold them to owner-occupiers, particularly in the long Danish house-price boom that lasted until 2008—but landlords can sell only to other landlords or in some cases co-ops formed of existing residents.

The Danish system has not been able to reverse the fall in numbers of private rented dwellings. Existing landlords have incentives to sell, and there has been relatively little new construction, even though rents on newly constructed dwellings can be freely set.

One area in which the Danish market appears to perform better than the UK market is in meeting the housing needs of the elderly. They make up only a minority of tenants, but the over-60s spend on average almost 20 years in the private rented sector. Clearly the strong Danish security of tenure is a factor—elderly people can be sure that they have a permanent home, even if it is rented. And pensioners can be confident that their housing payments will not rise sharply, as even for non-rent-regulated units periodic increases must be stipulated in the lease, or will reflect inflation.

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# 7. The private rented sector in Ireland

*Michelle Norris*

## Introduction

In common with most other European countries, in the early 1900s the private rented sector in Ireland accommodated the vast majority of the population, but as the century progressed, this tenure contracted more radically than has been the norm elsewhere. In 1961 17.2% of Irish households lived in private rented accommodation but this declined to 7% by 1991 (Central Statistics Office various years). This development is linked to the concurrent growth of the social rented and owner occupied sectors due, at least in part, to the greater generosity of government subsidies to these tenures compared to private renting and also to the widespread control of private rent from the First World War until these controls were removed for all new tenancies in the1960s and finally abolished entirely in the 1980s (Galligan, Y. 2005). By the 1980s, O'Brien & Dillon (O'Brien, L. & Dillon, B. 1982), characterised private renting as a 'forgotten tenure' concentrated chiefly on providing poor quality housing for low income households and short term accommodation for young people making the transition to home ownership or third level education.

Since the early 1990s however the private rented sector in Ireland has staged a recovery as the proportion of households accommodated in this sector increased to 10.3 % in 2006 (Central Statistics Office various years). This development is related to the emergence of barriers to access to the social rented and the owner occupied sectors (due respectively to a lack of output and galloping price inflation during the late 1990s and early 2000s) and also to the introduction by the government of more generous subsidies for private residential landlords. With the expansion of the tenure, both tenant demographics and dwelling quality have changed.

This chapter describes the current characteristics of the private rented sector in Ireland in terms of definition, size and location, ownership, financing and tenant demographics. It then examines changes in the legal, regulatory, taxation and subsidy framework for this sector since the early 1990s.  The conclusions identify five key policy milestones, which have had the greatest impact on the private rented sector.

*Current size, structure and location*

The private rented sector is not defined in Irish law, however the term is commonly used in government policy statements and in popular usage to refer to furnished and unfurnished dwellings rented by private, for-profit landlords.

The most recent data on the characteristics of the private rented stock is from the 2006 census  It indicates that at that time the sector accommodated 145,317 households, accounting for 10.3 % of all households in the country (Central Statistics Office various years). The vast majority of these private rented dwellings were furnished by landlords and the tenants supplied their own furniture in only 11.4% of cases.

Table 1 compares the characteristics and location of private rented dwellings to that of the remainder of the housing stock.  It reveals a number of significant differences between the two sectors:

- The private rented sector contains more apartments and bedsits/studios (41.6% of dwellings in this tenure) and fewer houses (57.3%) than the remainder of the housing stock (91% of which consists of houses)
- Private rented dwellings contain fewer rooms than the rest of the housing stock. 40.5 % of private rented dwellings contain three rooms or less compared to 11.2% of other dwellings.
- Private rented dwellings are newer than the remainder of the housing stock. 39.3% of private rented dwellings were built since 1995 compared to only 26.4% of other dwellings.
- Despite this, private rented dwellings are significantly less likely to have central heating – 18.3 %  of dwellings in this tenure do not have central heating compared to only 3.0 % of other dwellings. This reflects the higher number of dwellings built pre 1919 and conversions, as opposed to purpose built apartments in the private rented stock. Few dwellings currently lack sewage facilities or piped water and the absence of these facilities does not vary significantly between tenures.
- Private rented dwellings are unevenly spatially distributed - 39.9% of dwellings in this sector are located in Dublin compared to 27.5%  of dwellings in other tenures.

**Table 1 Characteristics of private rented dwellings compared to dwellings in other tenures, 2006**

| | | Private rented dwellings % | Other dwellings % |
|---|---|---|---|
| Furnished or unfurnished | Furnished | 88.6 | N/a |
| | Unfurnished | 11.4 | N/a |
| Type of dwelling | detached house | 15.7 | 45.8 |
| | Semi-detached house | 25.2 | 27.5 |
| | Terraced house | 16.4 | 17.7 |
| | Purpose built apartment | 27.1 | 5.3 |
| | Converted apartment | 11.3 | 1.0 |
| | Bed sit/ studio | 3.2 | 0.3 |
| Size of dwelling | 1 room | 5.8 | 0.9 |
| | 2 rooms | 14.1 | 3.1 |
| | 3 rooms | 19.7 | 7.2 |
| | 4 rooms | 17.4 | 10.3 |
| | 5 rooms | 21.3 | 24.5 |
| | 6 rooms | 11.8 | 20.1 |
| | 7 rooms | 5.3 | 14.7 |
| | 8 rooms | 2.0 | 9.0 |
| | 9 rooms | 0.6 | 3.9 |
| | 10 rooms + | 0.3 | 3.0 |
| Dwelling quality indicators | No central heating | 18.3 | 8.3 |
| | No piped water | 0.1 | 0.2 |
| | No sewage facility | 0.2 | 0.3 |

| | | Private rented dwellings % | Other dwellings % |
|---|---|---|---|
| Year of construction | Before 1919 | 12.1 | 10.4 |
| | 1919 to 1940 | 5.6 | 7.6 |
| | 1941 to 1960 | 5.3 | 10.2 |
| | 1961 to 1970 | 4.0 | 8.1 |
| | 1971 to 1980 | 6.4 | 15.4 |
| | 1981 to 1990 | 7.7 | 11.8 |
| | 1991 to 1995 | 7.9 | 6.2 |
| | 1996 to 2000 | 14.1 | 10.2 |
| | 2001 or later | 25.2 | 16.2 |
| Regional distribution | Border | 7.8 | 11.3 |
| | Dublin | 39.9 | 27.5 |
| | Mid-East | 7.9 | 11.0 |
| | Midland | 4.2 | 6.0 |
| | Mid-West | 7.6 | 8.6 |
| | South-East | 8.5 | 11.2 |
| | South-West | 14.2 | 14.7 |
| | West | 10.0 | 9.7 |

Source: Central Statistics Office (Various Years)

Note: data does not total 100% because non responses (the ‘unstated’ category) are not included in this table

*Tenant Demographics*

The only comprehensive data on the demographic characteristics of private renting tenants, available from Census 2006 relates to their nationality. It indicates that non Irish nationals are more heavily concentrated in the private rented sector – they head 40.7 % of households in this tenure but only 6.6 % of households in other tenures (Central Statistics Office various years).

Table 2 sets out further relevant information on the demographics of renting households generated from the 5% anonymised sample of census returns. Due to the small size of this sample private tenants could not be disaggregated and so this data compares all tenants both those in the social and private rented sectors to home owners.

This shows that the age profile of households in the rented sector is younger than homeowners. Renting households contain marginally more children under 15 and significantly more individuals aged between 15 and 29 years. In contrast the owner occupied sector contains significantly more individuals aged 45 years and older.

**Table 2 Socio-economic profile of households by tenure, 2006**

| Household socio-economic profile | | Rented % | Owner occupied % |
|---|---|---|---|
| Age group (individuals) | < 15 years | 22.2 | 20.6 |
| | 15-29 years | 36.7 | 19.9 |
| | 30- 44 years | 24.1 | 22.9 |
| | 45-59 years | 10.5 | 19.7 |
| | 60-75 years | 4.4 | 12.0 |
| | 75 years + | 2.2 | 5.0 |
| Employment status | Employed | 57.0 | 58.4 |
| | Unemployed/ seeking first job | 11.3 | 3.6 |
| | Unable to work due to illness | 4.6 | 3.6 |
| Ethnicity | Irish/Irish Traveller | 67.6 | 95.2 |
| | Other | 32.4 | 4.8 |
| Highest level of education | No formal education/primary level | 31.7 | 35.5 |
| | Third level degree or higher | 45.5 | 36.1 |
| Socio economic group | Employer/manager | 10.2 | 20.6 |
| | Higher professional | 4.3 | 6.4 |
| | Unskilled manual | 8.9 | 3.5 |

Source: generated by the author from the 5% anonymised sample of census returns.
Note: rented includes dwellings occupied free of rent, private rented and social rented dwellings. Data excludes not stated.

Although both tenures contain similar proportions of employed people, the rented sector contains a much larger proportion of households headed by an unemployed person, and lower proportions of higher professionals and managers and more unskilled people than the owner occupied sectors. Despite this, levels of educational attainment in both sectors are similar.

The census doesn't include any data on the incomes of private renting tenants or the affordability of this tenure, however information on this issue is available from the Household Budget Survey (Central Statistics Office 2007). This information is outlined in table 3 below.

**Table 3 Household income and housing costs by tenure, 2004/05**

| Tenure | Average gross weekly household income € | Source of income | | % of net household income devoted to rent or mortgage payments |
|---|---|---|---|---|
| | | Non statutory sources (%) | State transfer payments (%) | |
| **Owned outright** | 801.81 | 82.2 | 17.8 | 0.3 |
| **Owned with mortgage** | 1,413.51 | 94.5 | 5.5 | 9.36 |
| **Rented from a local authority (social rented)** | 453.57 | 48.9 | 51.1 | 9.08 |
| **Private rented** | 908.48 | 86.5 | 13.5 | 22.91 |
| **Occupied free of rent** | 634.14 | 81.1 | 18.9 | |
| **State** | 987.96 | 87.3 | 12.7 | 7.07 |

Source: Central Statistics Office, 2007.
Note: mortgages payments have been adjusted to take account of the value of Mortgage Interest Tax Relief

This indicates that the gross weekly incomes of private renting households is just below the national average. The average incomes of households in this tenure are lower than those of home owners with a mortgage but marginally higher than outright home owners and more than twice the average incomes of social renting households. Private tenants also derive the vast majority (86.5 %) of their incomes from non-statutory earned income, investments, private pensions etc whereas their counterparts in the social rented sector derive just over half their incomes from state transfer payments (mainly benefit payments).

Despite their relatively high incomes, table 3 indicates that affordability is a significant problem for private tenants. In 2004/05 occupants of this tenure devoted on average three times more of their income to rent costs than the national average. Longitudinal research by Fahey et al (Fahey, T., Nolan, B. & Maître, B. 2004) indicates that, since the mid 1990s, housing costs have risen most dramatically in this sector, whereas the proportion of income devoted to servicing mortgages and paying local authority rents has remained almost static concurrently.

*Ownership and Financing*

No comprehensive data on the ownership of private rented dwellings in Ireland exists, but the available information suggests that the vast majority of private landlords are small investors who own one or two properties, and institutional investors are very rare.

Research conducted by the private renting tenants rights organisation, Threshold in 2001 (Threshold, 2001), found that the vast majority (90%) of private landlords in Dublin owned two properties or fewer. More recent research by the same organisation highlighted a number of significant barriers to entry to institutional private residential landlords in the Irish context (Threshold, 2004). The key barriers to entry identified in this research are as follows:

- inadequate revenue income due to the greater service obligations associated with managing residential compared to renting commercial property;
- few opportunities for reducing management costs because residential purchase opportunities are generally modest in size (individual apartments rather than apartment blocks);

- buy-to-let mortgages are available which enable individuals to invest in the private rented sector but no financhial products have been devised to support investment by institutions;
- inadequate data on rent yields and
- a poor legislative framework for the governance of the private rented residential sector (although as discussed below this has been addressed in recent years).

Comprehensive data on the financing of private rented housing is also not available. The only data available relates to mortgage lending to residential landlords since 2005. This suggests that the proportion of mortgages drawn down by this sector grew from 13.1% (5,172 loans) in Quarter 1 2005 to 14.1% (6,647 loans) in Quarter 1 2006. Since then lending to this sector has contracted, reflecting a sharp drop in mortgage lending more generally, and in Quarter 1 2009, only 966 residential investor mortgages were granted, accounting for 8.8% of mortgages drawn down (Irish Banking Federation/ PriceWaterhouseCoopers various years). No information on the number of landlords who have inherited their rental properties in recent years is available. However the general view among commentators is that in recent years most landlords have borrowed and or drawn on their own resources to enter this market.

**Legal and regulatory framework**

Since the abolition of rent controls in1982 the private rented sector has remained largely unregulated. This situation has been addressed since the early 1990s and a comprehensive body of regulation has been incrementally assembled, albeit not always effectively implemented. This section presents a chronological summary of the development of this regulatory framework and outlines the available evidence on its effectiveness. All of the measures discussed here are national in scope, but many are implemented by local authorities in Ireland rather than national government.

Progress in establishing a modern regulatory structure for the private rented sector started in the early 1990s with the introduction of regulations setting out minimum standards for private rented accommodation in 1993. The standards specified by these regulations were extremely basic and have recently been raised significantly by the Housing (Standards for Rented Houses) Regulations 2008. The 2008 regulations specify that all social and private rented accommodation must comply with the following minimum standards.

They must

- be structurally sound, with roof, floors, ceiling, walls and stairs in good repair and not subject to serious dampness or liable to collapse because they are rotted or otherwise defective
- contain a toilet, with a wash hand basin adjacent and fixed bath or shower, supplied with hot and cold water. Bathroom facilities shared between dwellings are not permitted
- provide a fixed heating system in each habitable room, which can be controlled by the tenant
- contain a kitchen which includes a cooker with a 4 ring hob with oven and grill, extractor fan, fridge and freezer, microwave oven, sink with a draining area, adequate storage, a washing machine and dryer (which can be shared between units)
- be adequately ventilated and have adequate natural and artificial lighting. Communal areas in multi-unit buildings must contain adequate emergency lighting
- contain adequate fire safety measures - a mains-wired smoke alarm, a fire blanket, emergency lighting in common areas and an emergency evacuation plan, in the case of multi-unit dwellings; a fire blanket and either a mains-wired smoke alarm or at least two 10-year self-contained battery-operated smoke alarms in the case of a single dwelling
- proper, pest and vermin-proof refuse storage facilities, and
- an adequately maintained electricity and gas supply (see: Department of the Environment, Heritage and Local Government, 2008).

Local authorities are responsible for inspecting private rented dwellings to ensure compliance with the minimum standards regulations. However until recently inspection activity was very low. Norris and Winston (Norris, M. & Winton. N. 2004), report that only 2.2% (5,059) of the private rented dwellings identified in the 2002 census were inspected that year. They attribute this poor performance to the following factors:

- private landlords are required by the law to register their dwellings with local authorities, but compliance is very poor which creates difficulties for identifying rented properties

- landlords' registration fees fund inspection activity so low levels of registration lead to low levels of inspection
- many local authorities do not prioritise this activity – the vast majority of inspections are carried out by a handful of local authorities, all responsible for cities.

From 2006, additional funding was given to local authorities for this function and they were encouraged to increase their inspection activity by the housing ministry as part of an action programme on standards in the private rented sector. As a result, between 2006 and 2009 the numbers of standards inspections increased from 9,835 to 17,200 (Department of the Environment, Heritage and Local Government 2006).

The provision of all services related to all tenancies in the rented residential sector is regulated by the Equal Status Act, 2000 which prohibits discrimination on the ground of gender, age, ethnicity, sexual orientation, disability, family status, marital status, religion and membership of the Irish Traveller community (an indigenous nomadic ethnic minority group). The only aspects of rental accommodation provision to which the provisions of this Act do not apply are:

- cases where the landlord wishes to let the dwelling to a close relative
- cases where occupants' privacy would be infringed by the provision of accommodation to member of another gender.

Tenants or applicants for housing who feel they have been discriminated against on grounds covered by the Equal Status Act have the right to take a case to a quasi-judicial body called the Equality Tribunal which can award them monetary compensation or insist that the relevant service is supplied to them, if their case is proven.

The Residential Tenancies Act, 2004, is the principal piece of legislation regulating private rented housing in Ireland (social housing is excluded from its provisions). It is national in scope and sets out the rights and responsibilities of landlords and tenants. The 2004 Act significantly increased the security of tenure for private residential tenants. Prior to its enactment the vast majority of tenancies could be terminated with one month's notice from either the landlord or tenant.

The 2004 Act enables landlords to terminate a tenancy without specifying grounds during the first 6 months. Once a tenancy has lasted 6 months, the landlord can only terminate it during the following 3.5 years if:

- the tenant does not comply with the obligations of the tenancy

- the dwelling is no longer suited to the occupants' accommodation needs (e.g. because of overcrowding)
- the landlord intends to sell the dwelling in the following 3 months
- the landlord requires the dwelling for own or family member occupation
- the landlord intends to refurbish the dwelling
- the landlord intends to change the business use of the dwelling.

At the end of 4 years, a new tenancy will commence and the cycle begins again on the same basis as outlined above. The Act also provided for notice periods of tenancy termination on the part of both landlords and tenants, which increase in line with the duration of the tenancy (Department of the Environment, Heritage and Local Government, 2004).

The Private Residential Tenancies Board (PRTB) is the government agency responsible for the implementation of the 2004 Act. All tenancies (not dwellings) subject to this legislation must be registered with the PRTB which has quasi-judicial status and is empowered to mediate (i.e. facilitate agreed settlements) or adjudicate (make a legally binding judgement) in order to resolve disputes between landlords and tenants. Tenants and landlords can opt to have their case dealt with by mediation and then opt for arbitration if mediation fails to achieve a satisfactory outcome or they can opt to proceed straight to arbitration in the first instance. The results of this mediation/ adjudication process are legally binding although an appeal can be taken to a mainstream court but only on judicial review grounds (i.e. only on a point of law not in relation to the substantive issue at hand).

According to the Private Rented Tenancies Board (Private Residential Tenancies Board, 2008) in 2005 and 2006, 90% of cases referred to it opted to proceed straight to adjudication and two thirds of cases were brought by tenants with the vast majority of the remainder being brought by landlords – local authorities and neighbours can also take cases. In the majority of cases relating to breaches of tenant obligations, the Board found against the tenant, in half of cases relating to breaches of landlord obligations the Board found against the landlord.

## Taxes and subsidies

As mentioned in the introduction to this chapter, the limited public subsidies for private renting was one of the key reasons for the historic decline of this sector. In recent decades its resurgence has been driven by the introduction of new public subsidies. However some of these have been withdrawn with the sharp downturn in the Irish economy and associated fiscal crisis following the international ‘credit crunch’ in 2008. Others have been significantly reformed in recent years as has the taxation regime for private rented dwellings.

The tax treatment of the private residential sector remained unchanged for many years. Up until recently private landlords could write off the full costs of their mortgage interest, ongoing maintenance and upgrading of dwellings and major refurbishment against tax on their rental income. In addition, private tenants could write off a proportion of their rent against income tax, although the value of this relief is very modest compared to the Mortgage Interest Tax Relief available to home owners. However since 2008 these allowances have been rolled back by government. Tax relief on the costs of refurbishing private rented dwellings was withdrawn and in 2009 the proportion of mortgage interest which was tax deductable was reduced to 75%. Also in the same year, a flat tax of €200 per annum on residential investment property and second homes (the Non Principal Private Residence Charge) was introduced. In the 2011 national budget the government announced that private tenants’ rent relief tax credit will be withdrawn incrementally over the next seven years.

In terms of subsidies to the private rented sector the most significant development of recent decades is the introduction of fiscal incentives for purchasers of new or refurbished office and residential developments in run-down neighbourhoods. These measures (commonly known as Section 23 incentives) were applied to a number of inner city areas in 1985. These were subsequently extended to city suburbs, towns and rural areas and were abolished in 2006. The subsidies available to private residential landlords were more generous than those offered to owner occupiers and particularly in cities, they drove a radical expansion in private rented accommodation (particularly of new built apartments) and an improvement in the quality of the stock (Norris. M. & Gkartzios, M. 2011).

Dedicated support for the housing costs of private tenants was introduced in 1975 by the Social Welfare (Supplementary Welfare Allowances Act). This income-related housing allowance is called rent supplement and is available only to private tenants dependant on state benefits or participating on state return to work training schemes.

Claimants can retain their rent supplement for a period after their return to employment, but at the end of this period and/or once their earnings reach a certain level or they work more than 30 hours a week, the supplement is withdrawn. The level of rent supplement claimants receive is determined using the following formula: rent supplement = (ai - mr) - (i - d), where

- ai is assessable income, which includes all household income with the exception of that received from a limited number of secondary benefits (for instance child benefit)
- mr is the maximum rent for which rent supplement is available. This is calculated with reference to actual rent together with the cap on the rent which the benefit will cover. The latter varies regionally and also according to household size and type of accommodation
- i is actual income, and
- d is prescribed deductions from actual income, which are the secondary benefits mentioned above.

In June 2005 the rent supplement payments based on this formula contributed an average of 85.7% of claimants' rent. At this time 54,123 households were in receipt of this support, which is 38.3% of the households resident estimated to be in private rented accommodation (Norris M. et al 2008). The latest available data indicates that the number of claimant households increased to 97,260 by 2010 (Department of Social Protection, (2010). The number of claimants has expanded significantly since the sharp downturn in Ireland's economy with an associated increase in unemployment post 2007.

This benefit has been significantly reformed in recent years (Norris, M & Coates M. 2010) as a result of concerns about the spiralling costs of rent supplement (which have risen faster than the number of claimants since the 1990s) and the 'unemployment trap' associated with arrangements for the withdrawal of the benefit when claimants enter employment. Traditionally, rent supplement claimants have had to find their own accommodation (subject to the limits on the rents which the benefit will subsidise). However, since 2006 local authorities have gained responsibility for finding accommodation for claimants in receipt of rent supplement for 18 months or longer. Under the Rental Accommodation Scheme (RAS) local authorities lease long term accommodation from private landlords and sublet it to households in this category.

The available evidence indicates that this scheme had had mixed success (Norris, M. & Coates M. 2010). Transfer of eligible rent supplement claimants to the RAS programme has been slower than expected due to less than expected interest from landlords and the fact that many of the properties occupied by the rent supplement claimants were not suitable for transfer to RAS because they breach the minimum standards for rented property. In addition it was envisaged that RAS would be cheaper than the rent supplement system because RAS landlords are offered below market rents in return for a guaranteed long term lease, however in practice the local authorities responsible for implementing RAS have failed to secure the savings envisaged. On the positive side, the RAS scheme has increased the security of tenure of rent supplement claimants and also helped to improve housing standards in this section of the private rental market as many rent supplement claimants have been moved to better standard accommodation on their transfer into the RAS system.

Notably the Housing (Miscellaneous Provisions), Act, 2009, defines RAS accommodation as legally equivalent to social housing and in the same year the housing minister announced a radical cut in funding for new social house building and that in future, long term leasing arrangements, similar to RAS would be used to source most new social housing under the Social Housing Leasing Initiative. These developments will reduce the security of tenure of social tenants as in theory their tenancy will only last for the duration of the lease. Furthermore, unlike mainstream social housing tenants, most of whom rent their dwellings from local authorities, tenants of dwellings procured under RAS and the long term leasing scheme will not enjoy the right to buy their dwelling. More generally, these developments will also blur the traditional sharp division between the social and private rented sectors in Ireland, in terms of the legal rights of tenants and the public subsidies available.

**Key milestones**

After half a century of sustained residualisation in terms of number of dwellings, quality of accommodation and the socio-economic characteristics of tenants, the private rented sector has been revitalised since the 1990s. Furthermore, since the early 2000s the traditional sharp divisions between the legal rights and public subsidies available to tenants in the social and private rented sectors in Ireland have diminished. The key milestones in this resurgence of this sector were:

- the introduction of income related housing allowances for benefit dependent private renting tenants in 1975. Due to this development the social rented sector's role as the dominant provider of housing for low income households was eroded and by the mid 2000s the number of rent supplement supported private rented tenancies almost equalled the number of mainstream social housing tenancies provided by local authorities and housing associations.

- the introduction of 'Section 23' tax incentives for purchasers of new or refurbished office and residential developments in run-down neighbourhoods between 1985 and 2006. Particularly in cities, these measures led to a radical expansion in the number and quality of private rented dwellings.
- the introduction of regulations setting out minimum standards for private rented accommodation in 1993 and of more ambitious minimum standards regulations in 2008. The 2008 regulations in particular marked the start of strong efforts to address the residue of very poor quality housing in the private rented sector.
- the introduction of the 2004 Residential Tenancies Act and the establishment of the Private Residential Tenancies Board to implement this legislation. The 2004 Act significantly increased the security of tenure of private tenants and made the tenure more attractive for long term occupation.
- the establishment of the Rental Accommodation Scheme in 2006, which enables local authorities to take long leases on accommodation for re-letting to rent supplement claimants and the recent extension of this measure to provide for the leasing of privately owned dwellings for use as social housing. This development has blurred the traditionally sharp distinction between the private and social rented sectors in Ireland.

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# 8. The private rented sector in France

*Jean Bosvieux and Bernard Vorms*

## The current position of private rented housing: definition, scale, property types, location

In France, the term 'private rented housing' is defined as rented units – furnished or unfirnished – that are not subject to the specific regulations of social housing but excludes dedicated accommodation for student or old people.

*The private rented sector as part of the wider housing stock*

The private rented sector accounts for 22% of the total stock of primary residences, which is about 6 million units. Private rented homes are mostly owned (95%) by individuals. The proportion owned by private institutional investors has dropped significantly since 1980 and is now only 3% - the remaining 2% are rent-free residences owned by public bodies.

The withdrawal of institutional investors was for strategic reasons: since the second half of the 1970s, they have chosen to focus on other forms of investment. Residential real estate is seen as wasteful in terms of the management costs. This resulted in a contraction in the private rented sector (see table 1), which lost 900,000 dwellings between 1978 and 1988. This decline has been halted with the introduction of tax incentives for investment in rented housing in 1984. Institutional landlords, have however continued to disengage, but this has been more than offset by investments by individuals (Bosvieux, J. 2011).

**Table 1 The French housing stock by tenure (000s units)**

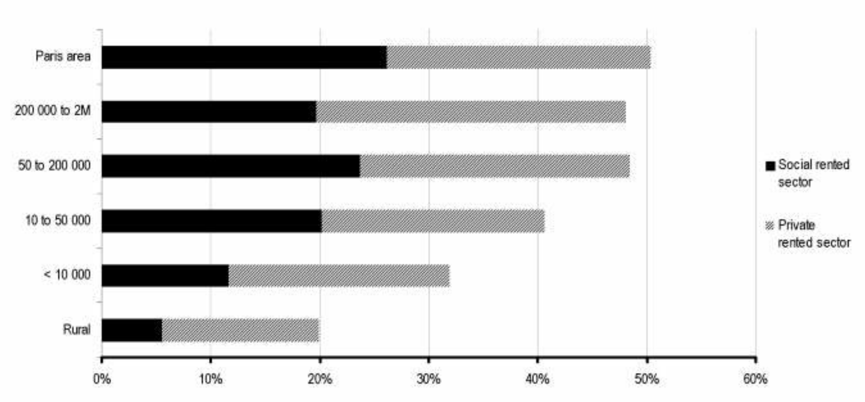
| | 1970 | 1978 | 1988 | 1996 | 2006 |
|---|---|---|---|---|---|
| **Owner occupiers** | 7,350 | 8,695 | 11,386 | 12,645 | 15,385 |
| **Private rented sector** | 5,019 | 5,171 | 4,292 | 4,776 | 5,955 |
| **Social rented sector** | 1,565 | 2,481 | 3,622 | 4,101 | 4,621 |
| **Others** | 2,473 | 2,294 | 1,957 | 1,764 | 1,034 |
| **All** | 16,407 | 18,641 | 21,257 | 23,286 | 26,995 |

Source: enquête logement

*Location and level of rents*

Figure 1 shows how private rented housing is mainly located in heavily urbanized areas. Nearly half is in cities with over 200,000 inhabitants. 25% are homes in apartment buildings owned by a single landlord, 45% are in condominiums, 30% are detached houses.

**Figure 1 Distribution of rented sectors by size of settlement (population)**




Source: enquête logement 2006

**Table 2 Rents by size of settlement (population)**

| €/square metre | Rural | < 10,000 | 10,000 - 50,000 | 50,000 - 200,000 | 200,000 - 2m | Paris area |
|---|---|---|---|---|---|---|
| **Social rented sector** | 4.3 | 4.7 | 4.3 | 4.6 | 4.8 | 6.0 |
| **Private rented sector (unfurnished)** | 5.3 | 6.4 | 7.1 | 7.5 | 8.6 | 14.1 |
| **Private rented sector (furnished)** | 4.9 | 7.7 | 9.6 | 10.5 | 12.2 | 21.9 |

Source: enquête logement 2006

In condominiums, rented units coexist with owner-occupied housing. Nothing prevents the owner of a home in a condominium disposing of it as he pleases, to occupy or to rent it out, or even to use it as a second home.

Table 2 shows how rent levels vary greatly depending on location - with higher rents in the bigger towns. The gap between private and social housing rents varies similarly. It is substantial in the Paris area and there is little or no difference in smaller cities and rural areas where there may be competition between private and social housing.

The vast majority of households aspire to home ownership. When asked about the main reason that motivated their decision to buy their homes, recent owners primarily cite the desire to own their home. This aspiration is not unique to France, it is found in almost all developed countries, such as the U.S. where home ownership is part of the “American Dream”. Usually, it is not based on an economic rationale.

If the aspiration for home ownership is so strong and widely shared, why do so many households still rent?

The first reason is economic. Many households are excluded from home-ownership because their income is insufficient, they have precarious jobs, or they lack capital, or a combination of those reasons. They are tenants by default, and if given the opportunity, would prefer to be in the social sector. Home-buyers in France benefit from excellent security and interest rates amongst the lowest in Europe. The rate of default is low and repossessions are rare. The downside of this very favourable state of affairs is that a number of potential borrowers cannot take advantage of the opportunities. They have to rent in the private sector because they do not have sufficient income to give lenders adequate repayment certainty or because of the nature or the irregularity of their income, their age, or for health reasons.

For other households, being a tenant is the result of a choice that may be related to the fact that their lives are not settled. This is especially true of young adults whose employment or marital status is likely to change. The first home of students away from their families, and of people at the start of their professional careers is almost always rented. Many young adults experience periods when they have a succession of fixed-term jobs before securing stable employment. Some have periods of unemployment when they return to live with their parents. It is therefore essential for them to be able to move home quite quickly, which being a tenant allows. Entering into a long-term relationship often prompts a change of accommodation.

**Table 3 Mobility rates per year by tenure between 2002 and 2006**

| | **Annual moves as a proportion of the sector (%)** |
|---|---|
| **Owner-occupiers** | 4.7 |
| **Social rented sector** | 10.1 |
| **Private rented sector** | 19.4 |
| **Other tenures** | 15.9 |
| **All** | 8.8 |

Source: enquête logement

In expensive areas, the wide gap between private and social rents puts heavy pressure on the social rented sector. Demand for social housing exceeds supply by a lot making the chances of getting a unit quite remote and waiting lists are often very long. For many households, the private rented sector is the only possible option, especially for households who are not settled and cannot afford the luxury of a long wait, especially if they expect to move within a short time. In addition, small apartments for young households with one or two rooms are scarce in the social rented sector.

That explains why households who expect to move within a short time, most often choose to be tenants in the private sector. If they need to move or lose their jobs, the notice period is quite short and the moving costs are much lower than for homeowners. On average, a tenant in the private sector moves every five years, a tenant in the social sector every ten years, and an owner-occupier every 20 years.

**Ownership and financing**

As mentioned previously, almost all private landlords are individuals. The individual landlord is generally rather old, 57 on average. In Ile-de-France, about a third of privately rented homes belong to owners over 65 and only 14% of them are under 40.

Private landlords also tend to have very small portfolios: almost two-thirds of landlords own one dwelling and 90% own less than four units. The average is close to two dwellings, except in the Ile-de-France where it is 3.8 units. Often private landlords are retired executives or independent professionals who have quite a high income. They have a strong preference to manage their properties themselves. Less than 40% of homes are looked after by a property manager.

Of the nearly 3 million owners, those who bought their properties for investment are the minority. The majority are ‘involuntary’ landlords, who did not acquire their homes to rent them out: half are inherited and the other half are rented out after a move, often because of changing jobs.

Despite its risks, including the risk of unpaid rent, real estate is perceived as a safe investment, which offers protection against inflation. This view is not groundless; between 1965 and 2000, house prices kept up with household incomes and since then they have prices have risen much faster. However, the overall performance of real estate investment is highly dependent on price trends. The price increase between 1997 and 2008 generated significant gains, but the rental yield decreased correspondingly. Structurally, the net rental yield is low, partly because rental income is heavily taxed.

In France, condominiums cannot be solely for rental purpose. The mortgage conditions for buying a rental investment are not significantly different than if you buy the home for personal occupation. There is a requirement for higher down payments, because of a higher default rate. Individual investors rely heavily on loans. This is encouraged by tax conditions, which allow them to deduct interest from their rental income and, in recent years by low interest rates. Loans are generally at fixed rates with also fixed monthly repayments, however, very few of them are endowment loans.

As they tend to be highly leveraged, individual investors rely on the rent for their repayments. 10 to 15% of them seek to hedge against the risk of voids and unpaid rent through ad hoc insurance offered by real estate brokers. The premium cost is between 2 and 3% of the rent. The disappointment of some unwise investors, encouraged by tax incentives, who bought homes in areas where rental demand was low, has demonstrated that the risk of voids is real.

When asked in 1996 about their intentions in managing their properties, the vast majority (80 %) of individual investors expected not to make any changes in the near future, 5% expected to expand their holdings and 15% expected to reduce them. This did not anticipate subsequent changes - new investors more than offsetting the withdrawals. Table 4 explains some of the main reasons why landlords rent out properties.

**Table 4 Main reasons for owning rental properties**

| | |
|---|---|
| **To have a regular rental income** | 49% |
| **To have an asset to hand on to family** | 33% |
| **To have a secure investment** | 28% |
| **The high rental income** | 18% |
| **Personal attachment to the property** | 16% |
| **Plans to have a child – expand the household** | 5% |

Source: enquête logement 1996

In 2009 the total amount of investment in the private rented sector was €24.2 billion

- €10.5 billion in newly built dwellings,
- €8.5 billion in existing dwelling purchases
- €5.2 billion in maintenance and improvement. (source: Housing Accounts)

Newly built dwelling purchases (with tax incentives) accounted for 2/3 of the developers' sales in 2010.

*Tenant characteristics*

Tenants in the private rented sector have tended to be younger and more mobile in recent years

Compared to tenants in the social sector and home-owners, tenants in the private rented sector are young: 30% are under 30 and an equal proportion are over 50 (respectively 12% and 46% in the social sector). The proportion of young people in the private sector is increasing, while the population in the social sector is ageing. In the private sector, the head of household is on average 42, against 49 in the social sector and 57 for homeowners.

The number of young tenants in the private rented sector is primarily explained by the fact that young people are setting up home together and starting families later and later. The social housing stock mainly comprises apartments for families that are not suitable for single persons; they also lack savings for home purchase, so the only choice is to be a tenant in the private sector. Moreover, young people are often gaining professional skills and have not yet settled down. 48% of private rented units are leased to individuals, against 39% in the social sector. Family instability tends to increase the proportion of single persons housed in the private sector. Couples separating creates a need for small, cheap dwellings. Most of the supply of small dwellings is provided by the private sector.

Private sector tenants are characterized by high mobility. On average, they stay in their homes five years, while social sector tenants stay 10 years and owner-occupiers 20 years; 60% of them occupy their homes for less than four years, against 35% of tenants in the social sector and 17% of homeowners. More than a quarter have moved within the last year. In the Paris region they remain tenants for longer.

This feature is reflected in the average age of tenants; at the same age, the private sector tenants are more mobile than those in the social sector because the benefits of social tenure are lost on moving (Massot, A. 2005).

*Tenants with a range of different profiles*

The breakdown by socio-professional category of private sector tenants is similar to that for all households: 56% are workers or employees and 16% managers. It is different from the social sector, in which workers and employees are over-represented and independent managers significantly under-represented. The private rented sector also houses more than three-quarters of students and 26% of immigrant households.

Between the three main sectors, income disparities are important: households with incomes less than the median account for 29% of homeowners, 60% of private sector tenants and 72% of social sector tenants. The poor population resides mainly in rented dwellings, mostly in the social sector but also in the private sector. The sharp increase in the number of young low-income households during the last 20 years has resulted in a shift from home ownership to renting.  The social sector houses a large number of poor households, but a period renting in the private sector is often unavoidable when they are initially looking for housing.

**Legal and regulatory framework, taxes and subsidies**

Strong regulatory constraints govern relations between tenants and landlords.The Act of 6 July 1989 regulates precisely the relationship between landlord and tenants in unfurnished rented dwellings, which account for 93% of homes in the sector. It tries to strike a balance between the rights and obligations of landlords and tenants.

The landlord is free to choose his tenant, provided he does not engage in illegal discriminatory practices. He is entitled to require information from applicants  about their identity and their financial situation. He may require a personal guarantee if their resources seem insufficient and a deposit equivalent to one month's rent excluding charges (ANIL, Habitat actualité 2004). The tenant must take out insurance against risks - fire, water damage, etc.

The law describes precisely the contents of leases, - the rent, terms of payment and possible revision of its conditions and the maximum amount of the deposit. It established the principle of a 3-year written lease between the parties - 6 years if the tenant is an institution. An individual landlord cannot enter into a lease for a period of less than 3 years unless there are specific grounds justifying that, eg for professional or family reasons, which might mean that he has to take the home back.

It also controls precisely the grounds, on which a landlord can give notice to the tenant. At the end of the lease, the landlord can give notice for three reasons: for him or a member of his family to live in the dwelling, to sell it or to take it back because of a 'serious and legitimate' reason (non-payment of the rent, degradation, nuisance to neighbors etc). Notice must be given six months before the lease expires. If he wants to sell the property, the notice must indicate the price and conditions of the proposed sale to the tenant, who has first refusal. A clause allowing a landlord to terminate the contract can be included in the lease for a number of grounds: non-payment of rent or charges, non-payment of the deposit, a failure to take out insurance covering the rental risks. The tenant may, in turn, terminate the lease at any time without giving any reasons, provided a number of formalities are followed. Notification must be sent by registered post giving three months' notice, which may be reduced to one month in certain situations. These provisions aim to protect the tenant but affect the liquidity of the asset and reduce the ability of the landlord to dispose of his property and make investing in private rented properties less attractive.

As for responsibilities for maintaining the housing, the same balance between landlord and tenant prevails. The principle is that the tenant is responsible for the maintenance of the dwelling and minor repairs. The landlord in turn must give the tenant decent housing. He must also keep the dwelling in a fit state and to make all repairs, other than normal maintenance, for which the tenant is responsible.

*Fixing the rent*

There are no restrictions on the rent for a newly-let property or for a new tenant on an existing property. During the tenancy and for renewed leases, the rent increases cannot exceed the increase in the 'reference rent index'. However, when a lease is renewed, the landlord has the right to increase the rent if it is far below the levels for comparable units in the area. This option is rarely used, partly because it is often difficult to obtain neighborhood rent references. These rules are binding on the landlord who is not free to determine the rent during the life of a lease and in case of renewal. They also limit mobility by encouraging tenants to stay in their homes.

The 1989 Act resulted in a relative balance in the relationship between landlords and tenants. However, two major difficulties compromise the balance of these relationships: the share of expenses and the management of non-payment when a tenant acts in bad faith. In this respect, the regulatory framework favours tenants.

*The share of rental expenses*

Rental expenses, which account for approximately 30% of the rent, are divided between the landlord and the tenant. A decree of 26 August 1987 includes an exhaustive list of the expenses which the landlord is entitled to charge to the tenant. This approach has been criticized because of its rigidity. The list fails to take into account changes in technology and new services to the tenant. Over the last 15 years, expenses have grown faster than rents, and it is landlords, who have covered the majority of these additional costs, which does not encourage them to invest in modernizing their properties. Although necessary, changes in the regulations are unlikely because of the near impossibility of reaching an agreement between landlords and tenants. The 1987 decree was the result of a consultation launched in 1972! Some minor progress has however been made recently.

*Eviction process*

The eviction process is long and inefficient. To protect households unable to pay their rent the legislature has increased the barriers to eviction. The landlord must follow the procedures for seeking eviction. Grounds for evicting a tenant are generally for unpaid rent or rental expenses. The details are not described here but it suffices to say that it rarely takes less than 18 months to evict a tenant after the landlord has started to take action. This length of time is exceptional in Europe. It can discourage people from becoming landlords. In an attempt to remedy this, various measures to change the relationship between landlord and tenant have been introduced without tangible results. The latest, the 'guarantee of rental risks' (GRL), allows the landlord to insure against the risk of default by tenants with a rent to income ratio up to 50%, while that usually accepted by insurance companies is 30%. The additional premium for the increased risk is paid by a kind of provident fund financed by mandatory contributions of all employers, called the '1% logement'. The GRL has up to now been used by a small number of landlords, so that it is not yet covering its costs.

*Furnished accommodation: a more flexible regulation*

Controls on the renting of furnished accommodation were introduced in 2006. The minimum lease is one year - nine months if the tenant is a student. At the end of the lease, the landlord can give notice without a precise reason. Notice must be given three months before the lease expires. The tenant can leave at any time with one month's notice. There are no restrictions on the rent for a newly-let property or for a new tenant of an existing property. During the tenancy and for renewed leases, the rent increases cannot exceed the increase in the 'reference rent index'. The deposit required and the sharing of costs between the landlord and the tenant – maintenance etc - are not regulated.

*A heavily taxed sector*

Taxation weighs heavily on the returns from investing in private rented housing in terms of the taxes on the increase in the value of the property and the rental income. It is therefore an important factor in the decision to invest. Investing in real estate is disadvantaged compared to securities because of the tax liabilities. It is taxed from the first euro, while many financial investments, such as life insurance, benefit from total or partial exemption.

Construction costs are subject to VAT at 19.6%, which cannot be recovered, as rents are not subject to it. Home owners are required to pay a property tax. In addition, owners of significant wealth (exceeding € 800,000 until 2010, € 1,300,000 in 2011) are subject to the 'solidarity' wealth tax.

The transfer of goods is also taxed: when homes are sold, a registration fee of about 5% of the value of the property is paid by the buyer; when transferred to heirs, there is inheritance tax. The level of inheritance tax depends on the relationship between the deceased and the heir, and also on the share of the amount being inherited. Tax is due on the amount of the share exceeding € 160,000. For the children who inherit from their parents, the rate is about 20% for a share of € 500,000 to €1,300,000.

Capital gains tax is generally levied at 16% - this is increased by 12% for social levies; the total tax liability is reduced by 10% per year, once the property has been owned for 5 years; the seller's principal residence is exempt from this tax but rental units are subject to it; and there may be inheritance tax on top of that.

Finally, the rental income is subject to income tax - while the imputed rent of owner occupiers is not: it is added to the landlord's other income. In 2002 the tax paid for rental income accounted for 15% of the total income tax paid by landlords, excluding social levies (12% of net rental income). The taxable rental income is calculated by taking away various expenses from the rent received, including mortgage interest and the expenses for major repairs. Landlords who receive less than €15,000 in rent can opt for a simplified system in which costs are assessed at a flat rate of 40% of the amount of rent. Almost half of them have chosen this plan, reflecting the attractiveness of the simplified measures, although according to the tax administration, the percentage of those who actually gain from it is much lower.

### Policy environment: Five key milestones and why important; recent initiatives and likely changes

Despite the rhetoric of 'a France of homeowners', governments, whatever their political orientation, have always recognized the need to provide choice. Housing policy in France addresses the three main sectors: owner-occupation, the social and private rented sectors. Like most developed countries, France has, since the mid-20th century, encouraged home ownership, which is the aspiration of most French people. But unlike other European countries it has never favoured it at the expense of the rental sector. A private rented sector of sufficient size is considered necessary, particularly to accommodate new households and promote residential mobility.

Housing policy is not developed separately from economic issues. It aims, especially in times of crisis, to support economic activity and employment. This happened in 2008-2009, when, among other measures, the government strengthened the fiscal incentives for investment in private rented housing to try to limit the decline in construction activity. Even outside this crisis, building lobbies are pressing for policies, which assist the private rented sector. In 2010, purchases by investors accounted for more than 60% of the developers' sales.

*Tax incentives to attract investment in the private rented sector*

In an attempt to stem the decline in the private rented sector, the government in 1984 sought to encourage investment in the private rented housing through tax incentives. These measures have borne fruit since the early 1990s and since then support for rental investment has never wavered. Whatever the arrangements, tax incentives are intended to promote an increase in the supply of rented housing and encourage housing construction: they are therefore targeted primarily or exclusively at investments in new housing. Encouraging investment in new building reflects the state's objective to maintain a significant private rented sector in order to offer alongside the social rented sector, a real alternative to homeownership.

Since 1984, there have been different tax incentives. The current programme, 'Scellier', is a tax reduction of between 22% and 32% on the cost of the investment, depending on the constraints the investor accepts in terms of a cap on the rent on the property, and a commitment to house tenants on incomes below an agreed level. The rent caps are mostly higher or equivalent to the market rents, except in the most expensive areas (Paris, the French Riviera and the border region of Geneva). Since 2009, these incentives no longer apply in rural areas or small towns.

Despite some excesses that have sometimes led to housing in places where it is not needed, the incentive schemes to promote rental investment have been effective. But their very success is a problem: the fact that maintaining an adequate supply of rented properties depends so greatly on support from the state makes it difficult to envisage their removal and de facto condemn future governments to perpetuate them.

*How to develop an offer of intermediary rent housing?*

In the most expensive areas, the wide gap in rents between the social sector and the private sector has raised the possibility of developing an intermediate rented sector. Various attempts have been made to promote the sector, the most important being a policy of private social renting ('conventionnement privé'), which gives tax benefits to a landlord in return for a commitment to set a below market rent and to let the dwelling to tenants under an income ceiling. This policy, which also aims to promote social mix, was a failure partly because of the reluctance of private landlords to accept such constraints. Setting a rent ceiling presupposes a precise knowledge of market rents, which does not exist in France.

The state is now turning to social housing agencies to try to generate a supply of intermediate rented housing. This new approach has attracted criticism however on the grounds that it would take funding away from social rented housing.

*Rent regulation*

The focus of the media on the Paris housing market leads periodically to examples of 'excessive' rents, some of which actually seem exorbitant in relation to the quality of housing involved. These practices, often attributed to 'sleep merchants', landlords who let dwellings in very poor condition exploiting poor people, often immigrants, are however not the norm.  They do attract the attention of politicians who have to show that they are being addressed.

Proposals have been put forward to try to stop it. Thus, while the rent is currently freely determined with a new tenant, it has been suggested that it should be determined by reference to the rent of the previous tenant, which was the rule from 1981 to 1986. In its manifesto, the Socialist Party proposes to regulate the rent on a newly rented dwelling according to the current market rent which is more or less the German system. Rent regulation in the private rented sector will probably be an issue for the 2012 presidential election.

*Towards tax reform?*

Rented housing is heavily taxed, which makes it economically marginal for many investors. The tax system causes a distortion between the owner-occupier and the private rented sector, to the detriment of the latter. Imputed rents are, since 1965, no longer taxed. The property tax base has not been updated for 30 years, which is also a source of inequity. More generally, the taxation of sales is considered excessive, which tends to hinder residential mobility and the buying and selling of properties, and thus undermine market efficiency.

Several recent studies (Centre d'Analyse Stratégique 2010; Trannoy, A. 2011; Boulhol, H. 2011) recommend tax reforms that would reduce, or even remove registration fees and would tax capital gains more heavily and holding real estate assets, restoring the equity among homeowners and landlords. Many believe that the property tax system should be reformed on the same principle, as the current system encourages retention and therefore high prices. Such a reform is difficult to achieve for a number of reasons, especially because it would affect the resources of local authorities. Besides, if many policy makers agree on the necessity of reform, there is no consensus among them on what the new tax system should be like.

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# 9. Conclusions: Implications for the UK

*Kathleen Scanlon and Christine Whitehead*

## The Important questions for the UK

Demand for private renting in the UK is growing, spurred by the interaction of demographic pressures, migration, inadequate access to social housing and the increased difficulties facing households who want to enter owner-occupation, particularly in the wake of the global financial crisis.

These are mainly 'push' factors and they do not suggest that private renting is a tenure of choice – rather it often continues to be perceived as a second or even third best option; where many tenants and landlords find themselves by default and neither side feel they are getting value for money. This is hardly the environment for ensuring the development of a sustainable sector answering the wide ranging demands and needs of a growing population.

Yet there are 'pull' factors which are much more obvious in other countries. These relate particularly to flexibility which includes easy access, low transaction costs and a wider range of housing options, such as sharing smaller units or large mansion flats; the avoidance of debt and exposure to falling capital values and in terms of management, the potential for economies of scale as well as greater professionalism.

One reason why private renting has been relatively unimportant in the UK has been the availability of a large social sector for lower income and vulnerable households at the bottom end of the market. Another has been the ease of access and low transactions costs as well as the relative fiscal benefits associated with owner-occupation, especially when house prices are rising. This leaves private renting as the residual tenure for the 'squeezed middle' and those further down the system who cannot get into social renting - but one where the size of that residue is increasing rapidly.

It is not only in the context of increasing constraints on access to other tenures but also in relation to more positive factors such as the value of private renting in improving labour mobility and choice among more mobile households that greater emphasis has been put on making the private rented sector work more effectively. The areas of particular policy concern include:

- the scale of the sector – private renting has grown rapidly but rents are still rising in many areas where housing opportunities are limited. Underlying this issue is the overall shortage of housing and the very low levels of investment in new building, especially since 2007;

- the insecurity of that growth – the sector has grown rapidly in part because owner-occupiers have been unable to sell and therefore let instead; and purchasers have not been able to obtain a mortgage and therefore remain as renters. This trend could in time be reversed, although that reversal is moving further into the future day by day. Equally, there are signs of relative growth in the types of households likely to want to continue to rent; and at the same time rates of return on renting alone remain below that necessary to ensure continued investment;

- the uneven quality and professionalism of management in such a fragmented sector mean that those with choice as to tenure cannot find the standards they require while those without choice face worsening problems in enforcing tenancy contracts;

- uncertainty as to how the housebuilding industry might fill the gap in output left by the decline in new investment in the Buy to Let market and the lack of mortgage finance for first time buyers. In particular, can they be encouraged to restructure supply to provide dwellings that meet the needs of longer term and institutional investors;

- linked to this, issues around the fragmentation of ownership in multi family apartment blocks and new build developments where in some other countries, notably the USA and Denmark, these would be in single ownership with associated economies of scale and consistency of provision;

- whether the sector would be more sustainable if there were a larger proportion of institutional investors who would provide housing on the basis of rental returns rather than expected capital gains – and more generally whether a sector with a predominance of small landlords can meet long term demands;

- whether there are options around integrating the private and social rented sectors more closely which would better meet the needs of lower income and vulnerable households in an environment where policy is moving towards using the private sector even to provide for homeless households; and, most fundamentally,
- whether the sector can meet the full range of demands and needs in an increasingly complex market place where government support is declining both for investment and lower income households.

This is a surprisingly large agenda in a world where it could be argued that the sector is doing a good job. On the supply side, it seems that the UK might have more to teach other countries than vice versa, as the tenure has been growing faster than almost anywhere else. In this context, one commentator suggested that the UK private rented market is actually operating effectively – that it was expanding to meet demand, providing generally reasonable quality housing, to people who could obviously afford the rents. As a result she questioned whether any large scale public intervention should be considered.

Others disagreed, arguing that the fragmented and small-scale nature of UK landlords, and the tenure flexibility of individual dwellings, means that the gains could leak away just as quickly were circumstances to change. These new higher levels of provision cannot be maintained without some significant restructuring of ownership and funding. Moreover, some parts of the market are dysfunctional and require government intervention if they are to provide adequately for all types of private tenant. It is in this context that we turn to look at lessons from countries with different histories and experiences.

**What we can learn from other countries?**

As with any empirical evidence, we can learn much more readily what is not true from comparative analysis rather than what is true. When it comes to positive lessons these can only be indicative, pointing towards areas where policy development might be concentrated. It will be extremely rare that policy can be readily transferred because of the very different histories, legal, administrative and fiscal environments.

**Findings – correcting some negative assumptions**

The evidence presented at the seminars, in the questionnaires and the country studies highlighted at least five areas where some widely held assumptions are incorrect – or at least inadequately nuanced:

- institutional finance does **not** dominate private rented sectors in other countries. Even in the USA or Germany, where it is usually assumed to be the most important source of finance, it is clearly untrue. Only in Switzerland, where it is significantly a function of regulatory requirements, is it the most important source of funding;
- regulation is **not** inherently associated with smaller, poorly operating private rented sectors. Some of the larger private rented sectors, notably in Germany but also in other European countries, have strong regulation in place with respect to rent rises and security of tenure, while some of the smaller sectors are seen to work badly;
- private renting is **not** only for young, mobile and transient households. There are countries where large numbers of middle and higher income family households live comfortably and by choice in the private rented sector;
- private renting is **not** inherently unsuitable for more vulnerable households - but there tends to be considerable government support and regulation in place where it works reasonably well;
- most fundamentally, scale is **not** to be equated with a well or badly operating market. Rather the size of a sustainable private rental market relates to the relative desirability and accessibility of different tenures in each country's particular environment. So for instance if a large well functioning social sector is in place the optimal size of the private sector will be smaller; if transactions costs in the owner-occupied sector are high it will be larger; and, perhaps most importantly, if other sectors are favoured through fiscal and subsidy measures, the sustainable scale will be smaller than in countries where taxation policy favours landlords. The objective should therefore be an overall housing system which meets the fundamental requirements of different groups of households across the range of tenures.

## Positive Lessons

Each of these negative findings has clear implications for UK policy which are reinforced by the evidence presented by the international experts:

*Funding*

First, it is not enough to concentrate on introducing institutional finance into the sector. The fundamental attributes of private renting point to the need for a range of investors, including a high proportion of small companies and individual landlords. Many of these may come and go but there is evidence that some types of small landlords may stay for decades or even generations, if the circumstances are right (see panel 1). This requires more transparent and more focused regulation with respect to contractual relationships and enforcement.

*Regulation*

Second, most countries with similar experience to the UK that had heavy and inflexible regulation with respect to rents and security are fearful of any re-introduction. Indeed they argue it will stop investment in its tracks. But the evidence from other countries with large scale, stable private rented sectors and well defined regulatory frameworks such as Germany suggests that greater certainty with respect to rents and longer term tenancies help smaller investors to obtain the returns they require (see panel 2).

Important in this context is who the sector aims to house. There are obvious benefits, whatever the tenure structure, for a country to have a flexible tenure that can accommodate those who want to move quickly or frequently — particularly given the relatively high transactions costs for owner-occupied housing. This role requires much less of a regulatory framework than one where the sector is expected to accommodate lower income and vulnerable households with little negotiating power.

There are countries where private renting is seen as a suitable and practical tenure choice even for middle-income families. There seem to be two main factors behind this. The first is security of tenure: households are unlikely to prefer a private rented dwelling as a long-term family home, or a place to live in retirement, if they are on a short lease or at least are aware that they can be asked to leave with fairly short notice at any time. The second may be 'cultural'. Since the 1970s, with easier access to mortgage funding, the UK has a tradition of climbing the 'housing ladder'. Households start in private rental before moving into the owner occupied sector buying more spa-

**Panel 1 The small investor – the key to expanding the UK private rented sector**
*John Heron*
The need for a larger private rented sector has rarely been clearer. Much of the recent debate about how to do this has emphasised the need for corporate and institutional investment. Yet, analysis of the private rented sector in modern economies around the world reveals a consistent story – private individual landlords dominate the supply of property with larger institutions rarely playing a meaningful role. Future UK housing policy must focus on private landlords, who essentially operate as small-to-medium sized businesses, and recognise that these landlords require incentives to expand supply. Institutional investment is generally not suited to the fragmented, dispersed nature of the rental market and is unable to react quickly to the specifics of local demand. Most critically, corporate landlords cannot compete with the cost efficiencies that private landlords achieve because private landlords do not charge for their own entrepreneurial effort.

We face the challenge of increasing the motivation of private landlords to invest in property to rent at a time when house prices are flat or showing only modest growth, and landlords are asked to increase the quality of the housing stock through a number of measures, including the "Green Deal", and more aggressive local authority enforcement. This could require the UK to come into line with successful private rented sectors around the world, which offer significant tax incentives.

Germany and the US, two of the largest and most developed private rented sectors, offer landlords an array of tax incentives, such as the ability to offset rental losses against other types of income and depreciation allowances. Countries as diverse in culture as France, Australia, Finland, Belgium, Norway, Spain and Switzerland all offer more significant tax incentives to private landlords. Such an approach in the UK would raise the appeal of investment in rented property, making investment less cyclical and more long-term, to the benefit of landlords, tenants and ultimately the UK plc.
*John Heron is director, Paragon Group*

cious and expensive accommodation until they acquire a long-term family home in mid-life.This is not the pattern elsewhere; nor is it likely to be the case in the UK at least for the next few years.

Greater security of tenure at market rents is already possible in the UK through assured tenancies. In practice, they are little used, partly because of lender requirements and uncertainties related to market volatility, but also because of the lack of

**Panel 2 The benefits of long term rental arrangements**

*Peter Westerheide*

If rental markets are to provide a good alternative to owner occupied housing, they must be able to offer a stable, long term option. There are many reasons why households may prefer private renting in addition to the flexibility it offers. The risk of high mortgage debt, particularly for low and medium income earners without substantial financial wealth in volatile housing markets, is one good reason for remaining in the private rented sector. Another, especially for elderly and handicapped people is better access to support and assistance from managers, neighbours and the community.

For these groups, security of tenure is of the utmost importance. From a tenants' point of view, unlimited tenancies combined with strong regulation against eviction and prohibitive rent increases are necessary to give that guarantee. In Germany these conditions exist: contracts for residential leases are usually unlimited; the notice period increases with the length of residency; tenants may only be evicted if they have not fulfilled their contractual obligation – even if the landlord wants to use the property himself unless there is an urgent need; rent increases are limited and it is simply not possible to evict a tenant in order to get another one who pays a higher rent.

This level of regulation at first glance may seem unattractive to investors and there are some tenants who exploit their protected position to the disadvantage of landlords. But it offers a large number of benefits. The security of tenure attracts long term tenants who pay their rents reliably, treat the landlord's property responsibly and care about their neighbourhood. It is the role of legislation and its implementation to maintain a balance between necessary regulation and tenant protection on the one hand and security for investors on the other.

*Peter Westerheide is senior researcher, Centre for European Economic Research, Mannheim*

tenant demand. Understanding how a different regulatory framework might interest investors, reduce risk and provide a product for which there is widespread demand is a major challenge for policy makers.

*A wider range of tenants*

Third, as we have already noted, private renting can suit families and even older households if good quality, well managed accommodation on a long lease is available. Whether there will be a demand in the UK depends as much or more on access and conditions in the other tenures as it does on the nature of the private renting product. This partly reflects continuing aspirations to own (which have been maintained since the financial crisis) but also the existence of submarket rents and better access to housing benefit in the social sector.

*Vulnerable households*

Fourth, there is nothing inherently impossible about private landlords providing for lower income and vulnerable households. There are many countries where they play

**Panel 3 Private renting and lower income tenants**

*Robbie de Santos*

Low-income households have increasingly had to look to private rented housing as access to both social housing and home-ownership has become even more limited. But with increasing demand also higher up the income scale, many local rental markets are short of supply, contributing to rent increases far above inflation. This has constrained choices for many low income tenants, giving them little leverage to challenge poor conditions and avoid rogue landlords. Tenants are aware that competition for cheap properties at the lower end of the market makes them highly dispensable to landlords.

The experience of tenants in the private rented sector is a major concern for Shelter. Private tenants now make up 36% of our advice caseload, despite accounting for just 16% of all households. In the past year, the number of private tenants coming to us for advice increased by 38%. Problems with their landlord include disrepair, illegal eviction, rent increases and withheld deposits.

Statistics suggest that nearly a quarter of private renters now find themselves constantly struggling to keep up with their rents – an increase of 85% between 2009 and 2010. Many low income households do receive Local Housing Allowance (LHA) to cover some or all of their rent, although a significant number of those eligible fail to claim it. But the recent policy change which limits LHA to paying only the lowest third of local rents is likely to make many areas, particularly in London, unaffordable.

Significant increases in the supply of private rented housing are necessary to help empower lower income tenants in the market and relieve affordability problems. In the meantime, especially in the light of the Localism Bill which gives new powers to allow local authorities to place homeless households into the private rented sector, the government must focus on enforcing decent standards for low income renters.

*Robbie de Santos is policy officer at Shelter* an important role, and in some cases are the only providers. Most successful examples depend on generous income related support and often on well defined government licenses which determine the quality of service and sometimes allowable rent increases. But most countries also have sub-sectors of the private rented market where vulnerable households have to accept expensive, insecurity and low quality housing – a problem which seems again to be increasing in the UK (see panel 3).

There were important examples in the evidence presented at the seminars and in the questionnaires about different ways government can intervene to support more stable and even relationships between landlord and tenant. But there are still fundamental problems relating to conflicting objectives between profit seeking landlords and tenants with few other opportunities, which cause particular difficulties when market power rests more with the landlord.

*New supply*

Fifth, is the issue of how to ensure an adequate new supply. This in part depends on attracting a range of investors prepared to demand more housing for rent and here there is evidence of a preference for new homes. But it also depends on the housebuilding industry and particularly on built form and ownership. A number of examples, including the USA, Australia and Denmark, pointed to the issue of single ownership of apartment blocks. The UK system, particularly the leasehold arrangements, and indeed the mixed communities agenda, make it easy for households to own within such blocks and almost impossible to ensure single ownership. But there are clear benefits particularly in management terms to single ownership, particularly with respect to maintenance of the common parts and replacement of capital equipment – so it is worth asking how these benefits could be realized within the UK system. This is an area where company and institutional investment is likely to be most relevant if only because Buy to Let mortgage companies are concerned by concentrations of ownership in particular schemes as a source of additional risk (see panel 4). Of interest in this context is the role of government support for the provision of new affordable homes by the private sector. The current system in England does allow private developers to bid for grant and there are many examples in the new round of allocations. But grant in its current form is likely to end or be much reduced after 2015 presenting both challenges and opportunities to government, local authorities and developers alike. The Australian programme for supporting affordable housebuilding which comes from a culture of private provision could provide a useful example – as can the USA with its continued provision of tax benefits for low cost housing (see panel 5).

**Panel 4 Private rented housing in the USA: single landlord, multifamily dwellings**

*Alex Schwartz*

When it comes to private rental housing, what is ordinary in the United States is extraordinary in the United Kingdom. In the US privately owned housing comprises 90% of the rental housing stock, while in the UK it accounts for only 40%. In the US, it is standard practice for a single investor to own an entire multifamily rental building or complex. Private investors routinely acquire multifamily rental properties, and hundreds of new multifamily rental buildings are built every year, mostly under single ownership. These properties are almost always under common ownership – it is rare for rental units within the same property to be owned by more than one entity. In the UK, multifamily buildings are seldom owned by a single entity; instead, each dwelling unit is owned separately.

The larger multifamily properties are usually owned by limited partnerships, Real Estate Investment Trusts or other corporations; small rental properties tend to be owned by individual investors. The largest real estate investors own hundreds of rental properties, with tens of thousands of rental units.

To build new rental housing, developers obtain a construction loan from a bank or other financial institution – which is priced to reflect the risks of development. Developers are also usually expected to provide some of their own funds. After the property is completed, the developer replaces the construction loan with a permanent mortgage, usually from a different lender at a much lower interest rate.

The private rental sector in the US is certainly not without problems. Construction levels since 1990 are about half of what they were previously, when more generous tax incentives were available and financing was easier to obtain. Most new rental housing is targeted to affluent households, and rental housing affordable to low-income households is increasingly scarce. Yet the US example shows that ownership of rental housing need not be fragmented; multifamily rental properties can thrive under a single owner.

*Alex Schwartz is an associate professor at The New School, New York*

**Table 5 A tax-incentive scheme for affordable housing: The Australian experience**

*Terry Burke*

In short-term rental markets such as in the UK and Australia, landlords and tenants face a lot of uncertainties about their plans and relationship and tend not to share information effectively. Most investors have limited knowledge of past and potential returns: investment is as much an act of market faith as rational decision making. Private landlords may well know their intentions with respect to the length of use of the property, but potential tenants do not. Some tenants may have to leave after six months, while others may be able to stay for years.

The National Rental Affordability Scheme (NRAS) introduced in Australia in 2008 was designed to increase the supply of rental housing for families on low to moderate incomes by levering in private investment and stabilising that supply. It offers a ten year refundable tax offset or payment (worth around £5,700 in mid-2011) to private investors who invest in new housing or renew previously uninhabitable housing and offer it to eligible households at rents at 80% of full market rents or lower.

The scheme aims to provide investors with greater certainty and financial incentive as the potential returns are transparent, with the amount of future tax credits and rental returns known; and to provide tenants with longer term, more affordable, secure housing consistent with the ten year time horizon. In addition, not-for-profit housing providers were expected to manage most properties in partnership with mainly institutional owner/investors, guaranteeing greater security as compared to housing managed by individual landlords. The government's target of creating 50,000 homes by 2014 implied an 18% increase in the total private rented stock. In its initial years, take-up has been disappointingly slow particularly by institutional investors. The target has now been cut to 35,000 as part of the cuts package to pay for the Queensland floods clear-up costs. There have been a series of the usual bureaucratic hurdles that confront new and complex policy reform, and expectations were probably anyway too high, given the planning and infrastructure delays that inevitably accompany larger residential developments. The model is a good one, but underlines the need for close attention to implementation.

*Terry Burke is a professor, at the Institute for Social Research, Swinburne University of Technology, Melbourne*

**Panel 6 Getting institutional investment into private renting – the Holy Grail?**

*Tony Crook*

Governments in Britain over the last three decades have searched for the Holy Grail of company ownership and institutional investment in the private rented sector. All the initiatives so far have failed. Indeed, the latest one, Real Estate Investment Trusts, while working for commercial property have not produced even one residential REIT. Some new companies have been established but most are limited partnerships or property unit trusts with limited shareholder liquidity. These serve niche markets and are often registered offshore for tax purposes.

What are the continuing barriers to nurturing such companies? Once it was a lack of tax transparency, which is important to getting pension and life funds into the sector because of their desire for indirect investment. With the introduction of REITs this is no longer the impediment it was, although the detailed REIT rules still remain problematic. Finding the right stock remains a barrier as institutions will want to make large investments. Bulk purchases have also incurred Stamp Duty Land Tax (SDLT) at its highest rate because of the sheer value of large transactions. Getting good management in place remains a challenge, and the VAT charges on the cost of the more intensive management that residential property needs as compared to commercial is another tax 'hit' on gross rents. Most importantly, net rents have not so far produced the income yield that pension funds need, while (until recently) capital gains have given good returns to small scale individual landlords.

There are now encouraging signs. Recent changes in tax rules mean that Stamp Duty Land Tax will only be levied on the average price of a dwelling in large-scale portfolio transactions. Recent proposals to amend the detailed rules applying to REITs should give them adequate time to establish themselves before the full rules apply. The current state of the property market may at last help emerging REITs to find the stock they need – because a combination of building to let privately and the REIT structure gives house-builders a new market. Although 'build-to-let' is never likely to replace or even overtake supply by private individuals, it can provide an important new ingredient to supply. This could prove a propitious time than any in the last three decades to secure the Holy Grail.
*Tony Crook is emeritus professor of town & regional planning, at the University of Sheffield*

*Subsidies and fiscal arrangements*

What is clear from all the international evidence is that the relative tax and subsidy position of the different tenures is fundamental to the nature and successful operation of the private rented sector. If, as in the UK, owner-occupation is favoured, and transactions costs are low, then owner occupation will remain the aspiration of most reasonably well off households. At the present time this choice is constrained by access to mortgage funding – but the fact that there may be some return to 'normality' in the medium term reduces the incentive to investors to make long term commitments, where they cannot realize capital gains. Equally, a large well managed social sector means poorer more vulnerable households are housed often at a lower cost to the tenants. Again this position is changing in the UK – and in other European countries – with greater emphasis on private provision giving greater opportunities to private landlords prepared to provide in this submarket.

The evidence is anyway that more private renting will be necessary at least into the medium term and that the tax incentives, as compared to other countries, are probably inadequate. There is some optimism that REITS could bring greater institutional investment but they would almost certainly remain a relatively small part of the market (see panel 6). Thus incentives need to be concentrated on smaller company and individual landlords who are prepared to provide good quality rented housing. There are many such examples of incentives across the world – but any package must be tailored to the UK fiscal environment – but must also provide some comfort that benefits will be available into the longer term. If we are to focus on the small landlord sector, then there are some clear questions which need to be answered about how the sector should operate (see panel 7).

*The scale of a sustainable sector*

Sustainability is about an appropriate scale for the overall system not inherently about increasing the size of the sector. Appropriate scale is a matter of the fundamentals of demand and cost. On the demand side these include demographic change – especially migration and increasingly fragmented families; income distribution and the incentives to save and invest; the mix of dwelling types and their location – more urban, more flats – equals more private renting and the nature of the labour market. The objective must be to match supply to these diverse and growing demands – which requires the capacity to make a reasonable and predictable rate of return on investment as compared to other areas of the economy. But scale is also as much about policy decisions particularly with respect to the fiscal and subsidy environment in

**Panel 7 Is small landlordism innately problematic?**

*Julie Rugg*

Evidence from across Europe shows that small landlords own a large proportion of the sector. Even Germany, traditionally held up as the model for institutional investment, has a substantial proportion of properties owned by individual landlords. Given that this situation is likely to continue, it is essential to consider in more detail the economics of small landlordism, and – perhaps less tangibly – the cultures of letting across Europe. If we allow the contention that small landlordism might not be innately problematic in the UK, we need to ask what successful small landlordism looks like.

This is not an easy question to answer, since desiderata for the sector are often laden with broader policy agendas that seek to mitigate failings elsewhere. Furthermore, the sector in the UK is so diverse that effective policy intervention is difficult to frame: what might appear to be desirable for one renting group might be quite disadvantageous to another.

Answers might rest on new research in three areas: first, what are the typical routes into small landlordism? Is owning and letting property incidental to movement within the owner occupied market, as is often the case in the UK? Do families often own property which is passed through generations? Is the potential for letting out part of a property commonly built into its structure? These differences may be superficial, and it could be the case that countries share some common cultures of small landlordism.

Second, what are the roles that small landlordism plays in housing markets across Europe? Do small landlords meet demand across a range of types of renter, or do they tend to be focussed on a particular part of the market, resulting in under-supply elsewhere? Indeed are there submarkets in rental sectors across Europe?

Third, a successful PRS is one in which a good fit is usually achieved between the needs of both tenant and landlord. What are the legal, financial and economic circumstances, which help to achieve this? Where mismatches are common and the sector is considered to be 'failing', is that something which reflects the innate attributes of small landlordism?

*Julie Rugg is senior research fellow, Centre for Housing Policy, University of York* which the sector, and housing more generally operates as well as about history and cultural norms.

The objective must be to balance these different pressures to provide adequate incentives and constraints to help ensure that the full range of demands are met; that there is efficiency in production and provision across all sectors (private renting is concentrated where there are economies as compared to other sectors); and the necessary regulatory structure meets the challenges of ensuring effective contractual relationships.

One conclusion from the evidence from the fifteen countries examined here was not surprisingly that no country has it all right. Moreover, those countries with large scale, well operating private rented sectors tended to be prosperous, to have generous income related support and to have a balance between demand and supply, or in some cases even declining demand, for housing overall. Other countries with large private rented sectors, notably the USA and Australia where housing markets are more volatile and there are relatively small social sectors show much greater signs of stress. The UK lies somewhere in between and can take lessons from the whole range of international experience.

*The potential for policy transfer*

It cannot be reiterated often enough that policy can seldom be transplanted directly from one country to another. The outcomes of policies depend not only on the policies or regulations themselves but crucially on each individual country's legal, institutional, cultural and historical background. For example, the USA's Low-Income Housing Tax Credits could not be implemented here without changes because the UK tax system does not allow for tradable tax credits. The acceptability of private renting as a long-term tenure choice in Germany reflects not only the system of long-term leases and rent control, but also the fact that households remain in private renting until they are able to buy with the intention of staying in the dwelling for much of their life.

This is not to say that cultures and systems cannot change — they can and do. But adopting policies from elsewhere without understanding why they work in their own countries means they will almost certainly fail here.

Finally, it is imperative to stress that the private rented sector does not exist in isolation. Any policy intervention seeking to attract greater investment into the private rented sector needs also to ensure that the overall housing supply is increased offering the double benefit of relieving pressure on the overall housing market and meeting the need for rented housing.

# The Contributors

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