

How to Develop a Sustainable Formal Rental Housing Market

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Contents

1 / Why rental housing is needed

2 / Tenants and Investors

3 / Legal framework

4 / Profitability and risk

5 / Finance and Subsidies

Need for Rental Housing?

- Most countries encourage homeownership for good reasons:
 - assistance can be directly provided to the end user
 - ⇒ more efficient, better targeted,
 - the occupants are responsible for maintenance,
 - no rent to pay at old age (no or low pensions).
- It is also the most popular tenure:
 - = social promotion + security + capital gains (often)
 - ⇒ Cultural bias in favor of home-ownership
- However:
 - Access to formal homeownership is (very) limited ,
 - Homeownership reduces mobility,
 - Homeownership produces lower densities and larger sprawl.

A Wide Range of Potential Tenants

Not everyone can buy their home...

- Even if interest rates are low (or subsidized), households with low or irregular income cannot afford it or do not even have access to credit.
 - Other potential obstacles to HO: absence of clear property rights or of an efficient registration system.
- ⇒ Rental is needed for:
- house starters,
 - households with low or irregular income.

...Nor should buy it too early

- Too much mobility is bad for community stability, but not enough mobility is worse
 - Link between unemployment and HO? (Oswald – controversial issue: USA vs Germany)
 - Mobility is easier for tenants: homeowners face higher transaction costs & lack of transparency of the market;
- ⇒ Rental is needed for (young) workers.
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- ▶ Plus students, those experiencing transitional events in their life, and those who simply do not want to own or prefer to own one unit and live elsewhere.

The Supply of Affordable Rental Housing

- The market easily provides rental housing:
 - For the richer,
 - For the poorer: renting slums is high profitable (& risky).⇒ Social housing was created in Europe in the 19th century to house urban workers in decent conditions.

- Rental housing for middle-income requires to:
 - Create or restore balanced rights of tenants & landlords;
 - Make rental investments profitable and lower rental risk;
 - Provide appropriate lending (“buy-to-let”);
 - Professionalize rental property management.

- Rental housing for low-income:
 - A low rent with minimum quality standards requires subsidies
 - Tenants need more protection⇒ Two reasons why investors should be kept under control.

Potential Investors

Are diverse

- Small private landlords renting one or a few units or rooms in their home;
- Medium scale owners owning between 10 and 50–100 units;
- Institutional investors in housing (pension funds, insurance companies);
- Other professionals: developers, property management companies;
- Employer housing;
- Non-profit housing associations, foundations and cooperatives;
- Public entities (governments) and PPPs.

Have different needs

- Individuals:
 - Need security (payment default can be a disaster for small savers);
 - Limited time horizon is limited (need quick – and fair– procedures to solve conflicts);
 - Must be able to recover the property (for themselves or relatives).
- Institutional investors (when they exist) are preferable:
 - Long-term equity investors, professional management, economies of scale,
 - Prefer financial assets (easier to manage) or commercial property (higher profit).

Legal and Administrative Needs

- ▶ Ensure that the rights of landlords and tenants are balanced:
 - Duration & termination of the contract
 - Rent setting & rent increase
 - Solving conflicts: Fair dispute resolution
- ▶ Main items to be in the law:
 - A definition of the type of housing unit the rental of which is covered by the law (*main residence / unfurnished / ...*)
 - Duration & termination of the contract (*fixed term / renewal / termination*)
 - Initial rent setting and rent increase
 - Required written documents (*contract/inventory/notice to pay, to quit*)
 - Processes for solving conflicts (*mediation, conciliation, arbitration*)
- ▶ A good law is not enough: must be enforced.

Profitability and Risk

- ▶ Increasing the gross rate of return:
 - Housing for low-income: rent constrained by affordability
 - Higher rent or lower investment cost requires demand or supply-side subsidies.
- ▶ Reducing the expenses:
 - Professional management and maintenance,
 - Low-interest loans to investors to produce leverage effect.
- ▶ Reducing the tax burden:
 - Rental income & capital gains need a fair tax treatment,
 - Often the contrary: no level playing field between rental and ownership
 - A good tax model should include main expenses deductible, economic depreciation, and losses offsetting taxes on other income and/or carried forward for a few years.
- ▶ Risk mitigation:
 - Insurance products covering the risks of default and damages to the property;
 - Public guarantees for social housing finance.

Finance

- Different financing needs for different owners/investments (individual, small, corporate).
- Small owners: capital or micro-finance for renovation, improvement or expansion.
- Medium to long term capital, both debt (loans or bonds) and equity (investment funds, including REITs when tax structure makes them feasible).
- Long-term debt for rental housing not available in most developing countries:
 - Prevents to leverage equity and boost rental return (if interest rates are low enough)
 - Reduces capacity of individuals and small companies to invest in formal rental housing.
- When available, underwriting closer to commercial/project finance than mortgage: need to, evaluate the borrower, the market, the legal framework (ex: England).

Subsidies

- Direct subsidies to tenants most effective (better targeted & more flexible), but:
 - Entail heavy fiscal commitments (applicable rents to be capped)
 - Require the collection and update of information on beneficiaries.
 - Limited impact on quantity and quality.
- Subsidies to investors more efficient to increase the supply of housing and can be a counter-cyclical instrument to boost economy, but:
 - Less transparent
 - Targeting issues
 - Compliance with commitments to be monitored.
- Investors subsidies may be given in several forms, including tax rebates, grants, soft loans, free or discounted land, and guarantees
 - Soft loans most efficient (leverage effect)
 - Long-term non-capped commitments to be avoided
 - Cross-subsidies (with free rental or non-residential) to be considered.

Public Housing?

- Many examples of Governments building and managing social housing:
 - Because of emergency (reconstruction after war, natural disaster)
 - To control tenant choice (military and civil servants)
 - Rarely successful:
 - Costly to build;
 - Poor rent collection and lack of maintenance made it turn into ghettos.
 - Global trend towards reducing its role in Europe from East (mass privatization) to West (sales to sitting tenants in UK).
- ⇒ Last resort solution if others do not work; at least management should be outsourced to private companies.

Conclusion

- Most difficult (technical & political) but top priority
= **create or improve the legal framework:**
 - must be clear and stable,
 - must allow (some) rent increase, accelerated procedure for conflict resolution (arbitration committee), property recovery,
 - must be enforced.

- Next come financial issues:
 - compare (risk, return) couple with other investments (real estate and financial products),
 - make the necessary adjustments through taxation and guarantees;
 - provide finance (long-term credit).

- For low-income:
 - look for reliable non-profit investors,
 - provide subsidies (soft loans and guarantees, etc.),
 - make sure they comply with agreed commitments,
 - public housing: only in case of emergency (better local than central).

Thank you for your attention!

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