

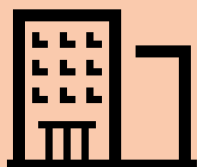
QDD.

Rent-to-buy: What potential does it offer for improving access to affordable housing?

Feedback from three continents

In a context marked by strong urbanization, the development of affordable housing can considerably improve the living conditions of low-income households in the countries of the global South. The study of 15 rent-to-buy schemes in 11 countries on three continents (Europe, Africa, and Latin America) gives insights into the contribution this type of mechanism can make.

Key figure from Brazil



260,000

In Brazil, the Programa de arrendamento residencial (PAR) financed the purchase of 260,000 rent-to-buy housing units from 1999 to 2009, with public aid covering 70% of the cost of the housing.

I. Affordable housing: A challenge for tomorrow

Significant needs, but policies that still have a limited impact

By 2050, the world will have 2.25 billion new urban dwellers, while 1.2 billion people already live in precarious conditions. In this context, access to decent housing for low-income households, which are traditionally excluded from the formal housing market, is a major challenge for social inclusiveness in the countries of the global South, which will be home to the majority of these new urban dwellers. Faced with this rapid growth in demand, many countries have implemented policies to support demand, centered on individual home ownership through purchase, made possible itself by bank loans. However, this model has shown its limits, and it is still inaccessible to low-income households, which are rarely eligible for a mortgage.

The alternative to social or affordable rental housing has only been developed to a very modest extent in the countries of the global South. The lack of incentives in public policies and the scarcity of long-term financial resources may explain the low interest that institutional investors have shown in this sector. However, the rental market, whether formal or informal, is in fact a housing solution for a significant proportion of the population: 20% in Latin America, and up to 40% in the continent's largest cities. This sector is often expensive and of poor quality in the absence of aid and an incentive-based regulatory framework.

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Focus: from 6 to 40% of tenants

Among the inhabitants of the Caribbean and Latin America 20% are tenants, compared to over 30% in Europe and the United States, but only 17% in Africa. On each side of this average, however, the percentage of tenants varies greatly: from 6% in Nicaragua to 38% in Colombia, and more than 40% in some cities such as Bogota and Buenos Aires.

Overcoming the traditional divide between renting and buying?

Between these two approaches, rent-to-buy aims to overcome the opposition between the status of a tenant and an owner by allowing a gradual transition between them. Can this scheme be a transitional method for households with modest or irregular incomes and no verifiable payment history to access loans? Under what conditions might it promote access to formal, decent, and affordable housing for low-income households? The comparative study^[1] carried out for the Agence française de développement (AFD) (the French Development Agency) at the request of the Government of Ecuador covered 15 schemes that are, or have been, operating in 11 countries (see Table 1). It gives an overview of the diversity of international experiences in rent-to-buy, and helps identify the challenges facing the system and the conditions for its success.

Table 1 – List of schemes studied

Country	Scheme
Algeria	Programme national de location-vente
Kenya	Tenant Purchase Scheme
Brazil	Programa de Arrendamento Residencial (PAR)
Chile	Arrendamiento con promesa de compraventa
Colombia 1	Residential leasing
Colombia 2	Semillero de propietarios
Mexico 1	Arrendavit
Mexico 2	Alternativa Urbi
Belgium 1	Location-vente
Belgium 2	Bail Ecureuil
Spain	Propiedad compartida
France	Prêt social location-accession (PSLA)
Ireland	Tenant purchase scheme
United Kingdom 1	Rent and buy
United Kingdom 2	Shared ownership

II. An attractive concept, diversified approaches, and multiple challenges

Firstly, we need to distinguish between a rent-to-buy scheme and a leasing contract, which is a common formula in the commercial and industrial sectors aiming to increase the liquidity of companies by limiting their fixed assets. That is not the objective in mind for members of a low-income household who are in search of a home. Rent-to-buy is a particular kind of home ownership whereby a household that initially rents a dwelling buys it at the end of

a probationary period at a price that is reduced by some of the rent that has already been paid, and which is regarded as up-front savings (see Diagram 1). This system can be found, with variations, in Europe and Latin America and, less commonly, in Africa.

A social product?

So that this product can fulfill a social purpose, the challenge is to allow deferred ownership for households in groups excluded from mortgage credit, because of either their low income or their lack of banking history.

Colombia has a scheme for households with modest and stable incomes (from two to four times the minimum wage) that has been extended to informal workers since 2017, thanks to the involvement of the Fondo Nacional del Ahorro (FNA) (National Savings Fund), a powerful public institution. Since 2019, the program has been focused on helping those with considerably lower incomes (one to two times the minimum wage). In Brazil, the program targeted low-income households, and applied income ceilings.

In Mexico, it was, perhaps surprisingly, a private developer that designed a package for households in the informal sector. But the 2008 financial crisis suddenly meant that it could not be set up, thereby blocking long-term funds. The study shows that, without the commitment of public bodies or any specific aid, rent-to-buy can be developed by private operators but in such a way that it is aimed at middle-class or even upper-middle-class households, as in Chile or Great Britain (see Diagram 2).

Managing the transitional tenant-to-owner regime: a legal and social challenge

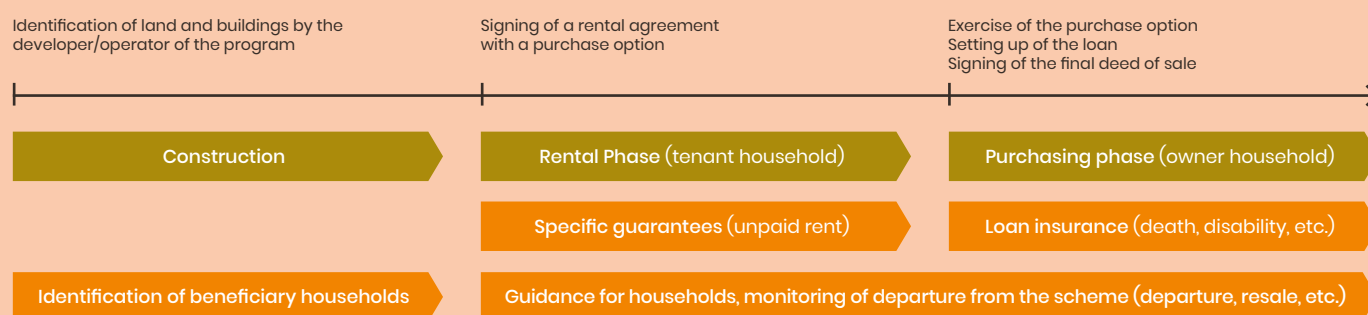
By law, occupants are tenants and do not become the owner until they exercise their purchase option. This means that maintenance of the building shell and the property taxes remain the responsibility of the entity that owns the building, even if they are included in the calculation of the rental fee. The lack of experienced operators who can take on this rental management phase, as well as the novelty of this status for the beneficiary households, can lead to delicate situations, particularly in collective housing. As a result, in Brazil, the collection of charges seems to have been difficult, although the rate of rent arrears was very low. Social support for the beneficiaries, as well as local rental management, seems essential to avoid any issues arising from co-ownership.

Adapting the duration of the rental phase

A very short rental period is favorable to operators of the program, who consequently limit the term of their commitment, but for the household it is not much different to a traditional purchase. A long rental period, on the other hand—of 15 years or even more, as in Kenya or Brazil—dilutes the portion saved within a long consumption phase. The choice made in Brazil was therefore to offer households the opportunity to exercise the purchase option earlier than planned. In most cases, however, it is difficult to distinguish between the consumption and savings portions of the household's payments before the purchase option is exercised. Ultimately, a rental phase of 5 to 10 years, which allows the household to prove its ability to pay, seems to be the most appropriate for the product.

[1] This issue of QDD brings together the main findings of the study conducted by J.-P. Schaefer, C. Tutin, and M. Defay: "Panorama des dispositifs internationaux de location accession" (2020). It was produced with information kindly provided by A. Campoy Diaz and H. Leite Jr (Brazil), J. Riquelme Bravo (Chilean Ministry of Housing), N. Cuervo and A. Guerrero (Colombia), A. Morales (Mexico), J. de Juan Mateo (Procvivis France) and C. Gueffier-Pertin (USH France).

Diagram 1- Principle of, and procedure and support for, the rent-to-buy scheme



Ensuring balance in the model

The challenge is to ensure the long-term financial viability of projects while offering a product that is competitive with private rental housing, informal or otherwise. During the rental phase, the rental fee can be adapted to the income of the households, but a gap can arise between the means of the households and the cost of the housing. The reduction in costs is achieved through budgetary support, through tax incentives or indirectly through the provision of land and the involvement of local authorities.

In Brazil, as in Algeria, the quantitative importance of rent-to-buy programs was linked to significant public aid, which made it possible to offer very low rents (two to three times lower than the free market in the case of Brazil). Algeria's own rent-to-buy scheme, set up by l'Agence nationale d'amélioration et de développement du logement (AADL) (National Agency for Housing Improvement and Development), involves the payment of a personal deposit, after which the dwelling is sold for about a third of the market price, thus entailing substantial direct budgetary support. In these two countries, the cost of the scheme has led to its abandonment in favor of more traditional publicly funded ownership programs (such as in Brazil) or rental programs (such as in Algeria).

In Europe, there is no budgetary support for these schemes, although there are tax incentives. Similarly, in Colombia, households benefit upon acquisition from the general "Mi casa ya" home ownership assistance program (involving mortgage loans at interest rates agreed by the state). The scheme therefore requires a careful mix of different types of aid to ensure both its attractiveness and its long-term viability.

Sparking the interest of public and private economic players

Beyond the financial model, the challenge is also to convince manufacturers, on the one hand, and private or public financial institutions (pension funds or unemployment benefits) on the other, to commit to this product.

The question of how long the funds are committed for remains crucial. This explains why private arrangements are rare, and why institutions that start up are generally partially or wholly public in nature. In the case of the Brazilian PAR program, the long lock-in period results in negative or very low internal rates of return. Shortening the rental phase may be an incentive for private players, but it reduces the household's probationary phase and thus the period in which the household's ability to manage a monthly fee can be monitored. Finally, during the rental phase, the entity that owns the property must manage it in its entirety while also engaging in social monitoring, which requires skills that

are generally not found in financial institutions. While these skills were sometimes to be found in some of the entities that developed the product in Europe and Kenya, financial institutions such as Brazil's Caixa Econômica Federal (CEF) (Federal Savings Bank) or Colombia's Fondo Nacional del Ahorro (FNA) (National Savings Fund) had to bring them in on this occasion. In offering a guarantee of sustainability, the involvement of public or partially public institutions—such as the HLM (low-income housing) cooperatives in France, Caixa in Brazil, or the FNA in Colombia—has played a decisive role. By contrast, the low-key involvement of public bodies in Mexico, Belgium, and Spain has led to a rather limited take-up of the product.

Assessing and managing associated risks

The study also shows that the introduction of guarantees and insurance is useful to operators—who must protect themselves against both vacancies and non-payment—and to beneficiaries—who can thus avoid going into insolvency. In the case of Brazil, the program was accompanied by the creation of a specific guarantee fund, financed in part by the beneficiaries (with a contribution of 1.5% of each rental payment). Various schemes in Brazil, Colombia, and Mexico incorporate an insurance obligation for the tenant-recipient, covering the risks of death and unemployment, and housing-related risks.

If the planned purchase does not take place, households can find themselves in a range of diverse situations. In some countries, such as Colombia and Kenya, beneficiaries do not have the right to stay in their homes, or they only get back a fraction of the accumulated savings (in those cases where this vested portion has been clearly identified). The issues of household mobility, and particularly of the resale of the property, is sometimes dealt with by anti-speculation clauses that provide for the reimbursement of aid or advances that have been received by the household.

Integrating the real-estate and urban dimensions

Just as with any real-estate project, the operation has a proprietary dimension for both the owner and the beneficiary. They must both pay attention to the architectural and urban character of the properties to ensure their long-term value as assets. The rollout of large programs in peripheral areas, notably in Algeria and Mexico, raises the question of how sustainable they are. The argument around economies of scale does not seem to be acceptable in the face of the risk that there will be a decline in the asset value of poorly served properties. In Brazil, the PAR program involves medium-sized projects of around 150 units within collective housing projects, on land that has been specifically selected and acquired based on accessibility criteria. This appears

to have made it possible to develop programs that are well integrated into the urban fabric and offer a degree of social diversity.

Finally, although most of the examples studied concern new construction projects, the scheme can also be applied to the purchase of existing housing, as was the case in Chile, where the intention was to revitalize neighborhoods.

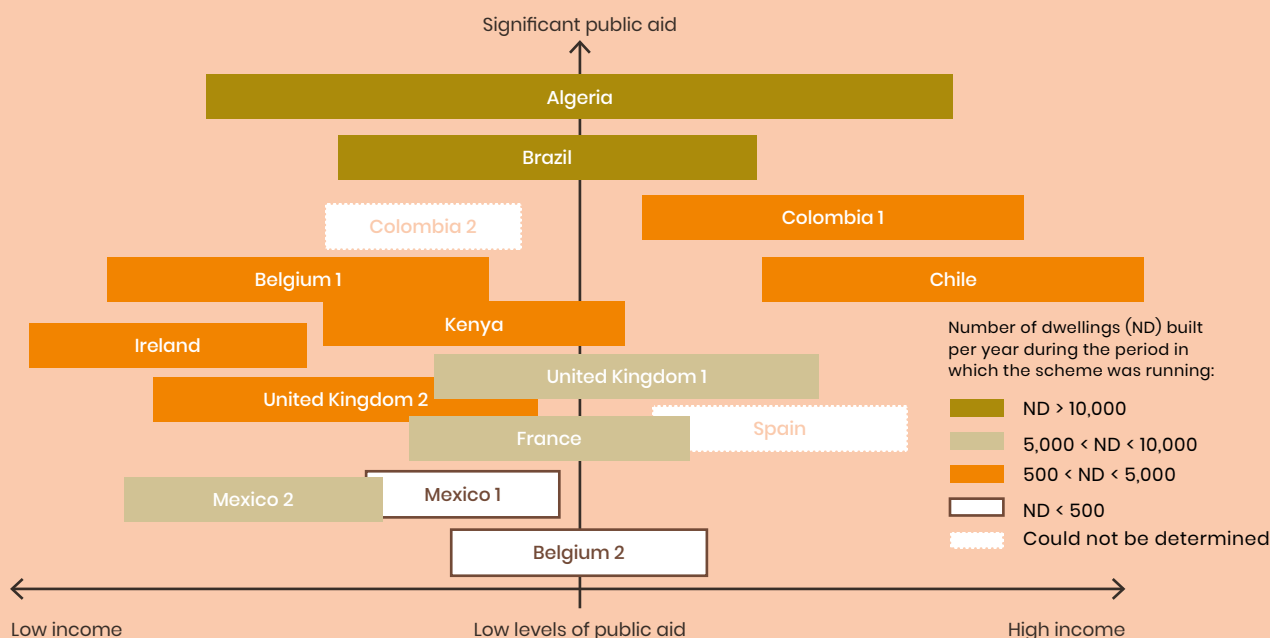
III. A useful auxiliary product in housing policies, but with certain conditions

Beyond the differences in economic and social contexts, the study suggests that rent-to-buy is an interesting avenue to explore to better ensure the solvency of households that are drawn to the idea of home ownership but that would otherwise be excluded from the ordinary channels

of mortgage credit, and to give them access to a formal offer of decent housing. The use of public aid and the support of local authorities appear to be conditions for success in meeting this social goal. Otherwise, rent-to-buy may be viable only for middle- or even upper-middle-class households.

Rent-to-buy should also be supported by robust financing and protection mechanisms, and by public or partially public financiers or operators who are capable of encouraging private players to become involved. When these conditions are met, rent-to-buy is a useful auxiliary product within an overall housing policy, and it can also contribute to the emergence of an affordable rental sector, particularly by strengthening the sector's regulatory frameworks and institutional players.

Diagram 2 - Classification of schemes according to their importance (number of dwellings created per year), the income of beneficiary households, and the amount of public aid that has been provided



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