



## Promoting investment in private rented housing supply **International policy comparisons**



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## Executive summary

1. This study investigated the range of policy frameworks currently in place in high income countries to promote investment in private rented housing supply. The research began with a statistical overview of the private rented sector in the 27 high-income OECD member countries (as listed by the World Bank for 2008). From this 12 countries were selected for further investigation: Australia, Belgium (Flanders), Canada, France, Germany, Ireland, Netherlands, New Zealand, Spain, Sweden, Switzerland, and the USA. Four countries were then examined in still more detail to probe the reasons for the varying levels of private rented sector investment, namely, the USA, Australia, France and Germany. The demand for and the supply of private rented housing in these countries was compared with England, although the policy related conclusions from this study apply more broadly to the UK.
2. Despite growth in recent years, the private rented sector in England, which accounts for 13 per cent of the housing stock, is small by international standards. The private rented sector accounts for 20 per cent or more of the stock in all the countries considered in detail and nearly half the stock in Germany (or more depending on the definition adopted).
3. In all countries, private rented sector demand is diverse and comes from households on higher as well as lower incomes. Households that seek mobility and younger households are substantial components of demand. The private rented sector is large in countries where the demand for renting is strong from a range of income groups. In some cases the demand is driven by the lack of options in other sectors. This implies that some households are reluctant private renters who might prefer to own if this was affordable. In Germany, in particular, the tenure is also attractive because of the availability of good quality accommodation with a high degree of tenure security.
4. The tenure choices facing households and the relative costs of those choices, especially the relative costs of owning and renting are, in all countries, crucial determinants of the demand for private rented housing. This in turn has an important impact on the size of the private rented sector.
5. In all the countries examined, including those with a small private rented sector, as well as those with a large private rented sector, most of the stock is owned by individual investors. In all the countries that have a large private rented sector, even those with substantial institutional involvement, more than 60 per cent of the stock is owned by individual investors. Where the private rented sector is large it is attractive as an investment to individuals seeking either a capital gain or a long term stable return.

6. For companies and financial institutions to be interested in the private rented sector, the main requirement from the international evidence is an acceptable risk-adjusted rate of return, and in this trade-off most investors are looking for a more secure rate of return than in other real estate asset classes. Institutional investors are also typically interested in large-scale holdings and thus the structure of the housing stock is fundamental. Scale is relevant from three perspectives: acquisition and disposal costs; management economies; and market information. Institutional investors tend to be more active in larger rental complexes and are typically more geographically concentrated in larger markets. Furthermore, whilst small-scale individual investors may accept negative net rental income, in return for capital gains in either the short or long run, institutional investors are more likely to want a positive income-related return as well.
7. The international evidence shows that a range of contrasting regulatory environments can be compatible with a large private rented sector. Some countries with a large private rented sector have a degree of restriction on rent levels, or at least rent increases, and strong security of tenure for tenants. This is the case, for example, in France and Germany. From the countries considered in less detail, Sweden and Switzerland provide further examples of restrictions on rent increases, strong security of tenure and a large private rented sector.
8. In all countries with a large private rented sector the sector has been in the past, and still is, supported by taxation advantages that promote investment in the private rented sector by boosting the rate of return and sometimes providing a tax shelter. This option for individual investors to use losses from rental income to reduce the tax on other income has been significant in each of the countries considered in detail.
9. The large private rented sector countries considered in detail all offer taxation advantages, especially to individual investors, which are more favourable than those available in England. Taxable net rental income is crucially affected by the deductions that are possible against gross rental income. On this point, the major difference is that in England there is no deduction available for depreciation whereas such deductions do apply in the other countries. In the large private rented sector countries generous depreciation allowances have been very important in encouraging investment in the sector and promoting new building for private renting.
10. A major difference between the taxation of individual landlords in the large private rented sector countries and England is that in all the large private rented sector countries rental income losses can be used to reduce taxable income from other sources. Thus, individuals with income from work or from another business can reduce the tax due on income from these other activities by making, for tax purposes, a loss from net rental income.

11. Capital gains tax is greater in England than in the large private rented sector countries and there are no concessions for holding property for several years. This contrasts with the other countries. In the USA the rate of capital gains tax falls after one year of ownership and in Australia there is a 50 per cent reduction after one year. Deductions begin after five years of ownership in France and liability is zero after 15 years. In Germany no capital gains tax is due after 10 years of ownership.
12. Private sector social supply schemes, which exist in all the large private rented sector countries, encourage private sector organisations to invest in, and in some cases specifically to build, dwellings for rent. They provide support through measures such as grants, tax advantages and sometimes soft loans for the building or acquisition (and sometimes improvement) of real estate intended for rental with conditions attached that limit both rents and the incomes of the eligible households.
13. Whether or not the accommodation that is provided under social supply schemes should be counted as part of the private rented sector or not is a matter of debate. If private ownership of the dwellings is the key criterion then this accommodation is clearly part of the private rented sector. If however the key criterion is whether or not the rent setting and allocation of the dwelling is through market processes then such accommodation might be counted as part of the social rented rather than private rented sector.
14. Germany, France, the USA and Australia all have examples of private sector social supply schemes. They boost the size of privately owned rental sector considerably in Germany, France and the USA. In Germany the scheme is long standing, was much more significant in the past, and is an important explanation for the large private rented sector. In Australia it is new and small-scale. There are additional examples to be found in Belgium, Ireland, Spain and Switzerland. All these countries have schemes that trade incentives, in the form, variously, of long term rental contracts, rental guarantees, financial support and fiscal advantages, for constraints on rents and requirements to house people whose incomes fall within specified thresholds and ceilings. England does not have a comparable scheme.
15. In the USA, Real Estate Investment Trusts (REITs) have been successful in encouraging investment in rented housing. A REIT is effectively a mutual fund for real estate with retail investors obtaining the benefit of a diversified portfolio under professional management. Whilst the potential for residential REITs is limited in the UK, with the boundary between private and social suppliers becoming blurred, the large scale purchase of existing housing association stock by REITs or the conversion of existing large housing associations to REITs has been viewed as a possible source of rental sector growth.
16. Based on evidence from other countries, policies to increase investment in the private rented sector in England might include:

1. Determine the role for the sector. Is there to be a larger 'modern' private rented sector offering high quality accommodation on a flexible basis or is the sector to have another role?
  2. Promote a policy environment that establishes a positive image for the private rented sector as a tenure to meet needs not catered for by other tenures.
  3. Increase the taxation advantages for individual investors.
  4. Promote niche opportunities for institutional investors through improved taxation advantages.
  5. Provide soft loans and/or grants for new investment and improvements.
  6. Promote a favourable regulatory environment – for landlords and tenants.
  7. Provide conditional taxation and subsidy support for affordable rental housing from private landlords possibly using a model similar to Low Income Housing Tax Credits in the USA (depending on the role that the sector is to perform and the definition of the private rented sector that is applied).
  8. Consider encouraging housing associations to supply more market rent properties (depending on the role that the sector is to perform and the definition of the private rented sector that is applied).
17. However the policy mix would need to take account of possible crowding out issues and consider the extent to which additional private rented sector investment displaced investment in other housing sectors.
18. Based on evidence from other countries, policies to increase house building for the private rented sector in England might:
1. Apply a combination of the measures identified above to increase the proportion of the housing stock that is privately rented.
  2. Make the taxation advantages especially favourable for investment in newly constructed buildings, for example, more generous depreciation allowances.
  3. Provide conditional taxation and subsidy support for affordable rental house building by private developers; the housing to be managed by private sector landlords or by housing associations possibly using a model similar to Low Income Housing Tax Credits in the USA (depending on the role that the sector is to perform and the definition of the private rented sector that is applied).
  4. Consider allowing large housing associations to become REITs (depending on the role that the sector is to perform and the definition of the private rented sector that is applied).
19. However, the policy mix would need to take account of possible crowding out issues and consider the extent to which additional private rented sector house building displaced house building for other housing sectors.



20. Based on evidence from other countries, policies to improve the quality of the private rented sector stock in England could:
  1. Continue to regulate for high quality and for quality improvements.
  2. Attach minimum dwelling quality standards to taxation and subsidy incentives.
  3. Provide tax incentives and grants for improvements.

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## Acronyms and abbreviations

<b>AFR</b>	Applicable Federal Rate (USA)
<b>DCLG</b>	Department for Communities and Local Government
<b>GRL</b>	La Garantie universelle des Risques Locatifs ( <i>France</i> )
<b>LIHTC</b>	Low Income Housing Tax Credit (USA)
<b>LPT</b>	Listed Property Trusts (Australia)
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>REIT</b>	Real Estate Investment Trusts
<b>UK</b>	United Kingdom
<b>USA</b>	United States of America

# 1. Introduction

## **Overview**

- 1.1 This is a comparative study of the private rented sector in several high income countries. It examines the reasons for a larger private rental housing sector in some countries compared with England. The policy options for promoting more investment in the private rented sector in England are considered.
- 1.2 The research has been conducted by the Centre for Comparative Housing Research at De Montfort University in Leicester and the OTB Research Institute for the Built Environment at Delft University of Technology. The work has been assisted by the contributions of country experts from the USA, Australia, France and Germany.

## **Objectives of the project**

- 1.3 The Department for Communities and Local Government commissioned this study to investigate the range of policy frameworks currently in place in high income countries to promote investment in private rented housing supply.
- 1.4 The study sought to provide:
  - An overview of existing policy frameworks for the private rented sector across a representative range of high income countries.
  - A detailed, comparative analysis of the policy framework in England with the frameworks in other countries.
  - A critical analysis of how alternative policy frameworks lead to contrasting levels and compositions of investment in the private rented sector housing stock.
  - An analysis of policies to promote investment in new supply in the private rented sector in other countries.
  - An examination of the sources of investment in the private rented sector in other countries (for example, institutional investors and households).
  - An assessment of the private rented sector's relative contribution to total investment in housing supply in the countries considered.
  - An examination of the relevance of comparative analysis of the private rented sector to policy initiatives in England. and
  - Research findings that are of relevance to future investment by both small and large scale investors and landlords in England.

## **Methodology and choice of countries**

- 1.5 To determine the choice of countries and to compare them with the UK, the following research stages and selection criteria were used.

*Stage 1: A statistical overview of the private rented sector in high income countries*

- 1.6 The term 'high income countries' was used in the DCLG brief but was not defined. The World Bank definition of high income countries was used in this research<sup>1</sup>. World-wide this gives a list of 66 countries. The investigation was restricted to high income OECD members as listed by the Work Bank for 2008. This provided a list of 27 countries (this excludes the many very small countries on the world-wide list). Most of these countries (21) are in Europe; the others are Australia, Canada, Republic of Korea, Japan, New Zealand and the United States. We provided a statistical overview of the private rented sector in these 27 OECD countries<sup>2</sup>. This showed indicators of levels of housing investment, the size of the sector relative to other tenures, recent changes in the size of the sector, where this information was available, and relevant demographic and macroeconomic contextual information.

*Stage 2: An overview of policy frameworks in 12 of the countries identified in Stage 1*

- 1.7 From the statistical overview of the 27 countries in the first stage we identified 12 countries for further investigation. This included several with a large private rented sector and some with a smaller private rented sector including some where there are recent policy measures in place that are designed to increase the size of the private rented sector. The selected countries together included those with a range of large (company and institutional) as well as smaller (typically individual) investors in the private rented sector. On this basis the following 12 countries were considered for this policy overview stage of the research: United States (32 per cent), Australia (21 per cent), Belgium (Flanders) (18 per cent), Canada (28 per cent), France (20 per cent), Germany (48 per cent), Ireland (11 per cent), Netherlands (11 per cent), New Zealand (27 per cent), Spain (12 per cent), Sweden (21 per cent), Switzerland (57 per cent), plus England (13 per cent). The figures in brackets show the approximate size of the private rented sector as a proportion of the housing stock based on the latest available data. This overview of policy took the form of a rapid evidence analysis. Using secondary information, the overview summarised for each country: the policies towards the private rented sector, the factors that explain the size and the recent changes in the contribution of the private rented sector to housing investment, the distinction between individual and institutional landlords and the attractiveness of the private rented sector for households and investors in relation to other tenures<sup>3</sup>.

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<sup>1</sup> For a full discussion, and the detailed lists of countries for 2008 by world region see [www.worldbank.org](http://www.worldbank.org).

<sup>2</sup> This is available separately as MS Excel file.

<sup>3</sup> These country reports are available separately.

*Stage 3: The identification of four countries for more detailed investigation*

- 1.8 Four countries were selected for further investigation on the basis of the findings from the previous stage. The selection took account of the size of the private rented sector, its contribution to housing investment, and the range of policies in place to promote increases in the size and quality of the private rented sector stock. Together the countries also provided examples of a range of individual and institutional investors and of the use of fiscal and other incentives to promote investment in the private rented sector. The countries chosen were the USA, Australia, France and Germany.

*Stage 4: Detailed country reports for the USA, Australia, France and Germany and England*

- 1.9 For each country included in the detailed comparison, a country report was prepared according to a common format. The preparation of the country reports in each case included the involvement of a country expert to recommend source material and verify a draft report. The information gathering included accessing the recommended material as well as other material identified by the research team. It included journal articles, official reports, conference papers and statistical information. English language material as well as texts in French and German was accessed. A report for England was prepared following the same approach as that for the four overseas countries that were considered in depth. These country reports are provided as Appendices B to F.

*Stage 5: A comparative analysis of the factors influencing the size of the private rented sector in these countries compared to England*

- 1.10 This analysis considered the key policy levers, the drivers of demand and the sources of supply in each country. In a broader sense it sought to address each of the objectives of the overall project. The outcome is this report.

**Structure of the report**

- 1.11 In the previous sections the objectives of the project, the methodology and the choice of countries have been explained. Alternative definitions for the private rented housing sector are considered in the next section along with a summary of the characteristics of the sector in the various countries. Questions about the size of the private rented sector in the selected countries as a proportion of the housing stock and its contribution to house building are addressed and there is an overview of why the private rented sector is much larger in some countries than in England.
- 1.12 The demand side drivers and the attractiveness of the private rented sector to individual and institutional investors are then considered in

more depth. The relevance of the regulatory environment to both households and landlords is considered. There is then a detailed examination of the taxation of investors in large private rented sector countries compared with England. This considers both the taxation of rental income and capital gains. The availability of soft loans to support rental investment in some countries is examined. There is then a comparative analysis of private sector social supply incentives that are important in boosting the size of the sector in each of the four large private rented sector countries.

- 1.13 The effectiveness of tax incentives and soft loans in promoting more investment in the private rented sector is questioned and the possibility of crowding out effects where private rented sector incentives dampen investment in other sectors is considered. Key differences between England and those countries where the private rented sector is large are summarised and the implications of the evidence from other countries for policies to increase investment in the private rented sector in England are reviewed. Policies for expanding the size of the private rented sector stock, improving the quality of that stock and for more building for the private rented sector in England are assessed on the basis of evidence from other countries. Finally, the overall conclusions from the research are summarised.
- 1.14 The country reports that are provided as appendices (B to F) give more details in the particular national contexts of the issues set out in this main report. The country reports also contain additional references that are a part of the overall evidence base that underpins the research.



## 2. What is the private rented housing sector?

- 2.1 One benefit of comparative research is that it produces ideas about new policy instruments based on experience from other countries. Another is that it introduces a form of 'shock therapy' that challenges home grown assumptions about the phenomena under investigation. In this study there are ideas for new policy instruments but there is also a challenge to how we think about and define the private rented sector.
- 2.2 Table 1 shows four categories of housing that might be included in the private rented sector. The definition of the private rented sector that is used in compiling official statistics varies from country to country. Often it is what is left over after owner-occupation and social renting have been considered. In some countries it is not officially separated as a distinct category (for example, Germany and the USA). It is usually a diverse category bringing together housing supplied by individuals, companies, private sector employers, and even churches and the armed forces. Typically the definition is based on ownership. Rented housing categorised in this way is not necessarily allocated by market forces and supplied at market rents. Estimates for the UK, which broadly adopts such a definition, suggests that only about 80 per cent of the private rented sector stock is overtly traded in the sense of being provided through a market landlord or letting agency (Rhodes, 2006). This ownership-based definition limits the private rented sector to categories 1 and 2 in Table 1.
- 2.3 In many countries privately owned housing is a significant element of socially allocated provision. This housing is subject to tax concessions and sometimes soft loans that are used to encourage investment. The housing is subject to rent and income-related allocation conditions which may be time-limited. Official conventions on classifying such housing, shown as category 3 in Table 1, vary (in most countries it will be deemed to be part of the private sector because it is privately owned but a recent change in legislation in Ireland, for example, means that this will in future be counted as part of the social rented sector (Housing (Miscellaneous Provisions) Act, 2009<sup>4</sup>). However, in many countries where the private sector is, according to official data, large such housing is a substantial component of the stock. Category 3 housing is, for example, a very important element of housing that is privately owned in the USA, Germany and France. In the case of Germany, in particular, the time-limited concessions and allocation conditions applied in previous decades have ended for many properties and they can now be subject to market forces.
- 2.4 In some countries, including England, non-profit organisations, such as housing associations are able to supply some housing at market rents. This is sometimes done through a subsidiary that is specially created for

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<sup>4</sup> See <http://www.irishstatutebook.ie/2009/en/act/pub/0022/index.html> [Accessed 10/09/10].

this purpose. However, such accommodation, which is identified as category 4 in Table 1, will not necessarily be counted as part of the private rented sector.

It may be subject to market forces but if it is owned by a body that is not in the private sector of the economy it will not necessarily be classed as part of the private rented sector.

2.5 These points of definition are crucial to discussions about the expansion of the private rented sector in England. Do we want only categories 1 and 2 to expand or are we also interested in seeing category 3 become bigger? Do we, furthermore, wish to see category 4 expand to increase the volume of market allocated rented housing? Is it ownership or allocation that is the main concern?

2.6 If we switch the argument and say that the main concern is expanding the overall stock of housing, no matter what the ownership or allocation conditions are, then it is essential to consider the extent to which expansion of any of the categories of housing in Table 1 displaces dwellings in another tenure, including home ownership and social rented housing supplied by local authorities and housing associations. This point about possible displacement, or crowding out of other types of housing, is relevant to discussions about increases in the volume of house building for the private rented sector as well as discussions about an increase in the number of dwellings in the stock, and the proportion of the stock, that are part of the private rented sector.

**Table 1: What counts as private rented housing?**

<b>Categories</b>	<b>Ownership</b>	<b>Allocation</b>
<b>1</b>	Private ownership by individuals and companies	By market forces. Market rents.
<b>2</b>	Private ownership by individuals and companies	Not by market forces. Linked to employment or family relationships.
<b>3</b>	Private ownership by individuals and companies	Not by market forces. Social allocation criteria linked to receipt of a tax concession or soft loan. Rents limited. Incomes of occupants limited. Concessions, rent limitations and allocation conditions often time limited.
<b>4</b>	Non-profit organisations and public bodies	By market forces. Market rents.

### **Characteristics of the sector**

2.7 Despite international variations in the composition of the private rented sector, some generalisations across the high income countries examined are possible. Demand is diverse and comes from households on higher as well as lower incomes. Households that seek mobility and younger households are big components of demand. The ownership of dwellings (even where company and institutional involvement is strong) is predominantly by individual households and couples. The average size of holdings is usually small and often around only two or three dwellings.

The belief that property is a sound long-term investment is a fundamental driver for investment and is often encouraged by benign taxation regimes.

### 3. How big is the private rented sector in other countries?

- 3.1 Despite growth in recent years, the private rented sector in England, which accounts for 13 per cent of the housing stock, is small by international standards. Table 2 shows that, as a proportion of the housing stock, the private rented sector in England is significantly smaller than in the four countries examined in detail for this report. It is also smaller than in five out of eight of the countries examined in less detail (Table A1 – Appendix A). The private rented sector accounts for 20 per cent or more of the stock in several countries and nearly half the stock in Germany (or more depending on the definition adopted: see the Appendix E - Germany report). The country reports show that the private rented sector declined in many countries from 1945 until the 1980s (often accompanied by large increases in home ownership) and then either stabilised or grew as a proportion of the stock.
- 3.2 Taking all the countries together (Tables 2 and A1) the private rented sector is large either where owner-occupation has been historically relatively small and there is a relatively small social rented sector (Germany and Switzerland<sup>5</sup>) or where there is a large owner-occupied sector and a very low (or almost non-existent) social rented sector (USA, Canada<sup>6</sup> and Australia). However, in France the private rented sector co-exists with significant social rented and owner occupied sectors.

**Table 2: Tenure % of stock; main countries**

	Private rented	Social rented	Owner occupied	Other
USA 2004	32	1	67	
Australia 2006	21	5	68	6
France 2006	20	18	58	4
Germany 2006	48	11*	40	1
England 2007	13	17	70	

\* cooperatives and government housing agencies

Sources: see country reports, Appendices B to F

<sup>5</sup> For Switzerland see Bourassa *et al* (2009).

<sup>6</sup> For Canada see CMHC (2010).

## 4. How much does the private rented sector contribute to house building in other countries?

- 4.1 In most countries official data on house building does not identify the eventual tenure of the dwellings. There is thus no data in these countries to show how much the private rented sector contributes to house building. The USA and France are exceptions to this rule and Table 3 shows that here around 15 per cent of house building has been intended for the private rented sector in recent years. Such data, even if it was available for all countries, would be of limited value because the actual tenure may change after construction is completed. Many private rented sector dwellings were once in another tenure and dwellings built for the private rented sector can also end up in another tenure. However, there are some incentive schemes in other countries that are designed to increase the level of house building intended for private renting and these incentives may remain in place only as long as specified occupancy conditions are met. These schemes will be discussed later in this report.

**Table 3: Contribution of building for the private rental sector to new housing production %**

	<b>Private rented</b>
USA 2009	17
Australia	Not known
France 2010	Yearly 10% to 25%; average over 20 years 15%
Germany	Not known <sup>1</sup>
England	Not known

<sup>1</sup>. Private housing companies (which own 15 per cent of the rental stock) built 34 per cent of all dwellings in 2008. See Germany report, Appendix E, Table 2-1.

*Sources: see country reports, Appendices B to F*

## 5. Why the private rented sector is large in some countries: An overview

- 5.1 An overview of the main factors that contribute to an explanation of the size of the private rented sector in the four main large private rented sector countries examined is provided in Table 4. The private rented sector is large (20 per cent or more of the stock) in countries where the demand for renting is strong from a range of income groups. In some cases the demand is driven by the lack of options in other sectors and the need for a tenure that allows for a high level of mobility. In Germany, in particular, the tenure is also attractive because of the availability of good quality accommodation with a high degree of tenure security.
- 5.2 In all the countries examined that have a large private rented sector the tenure is attractive as an investment to individuals seeking either a capital gain or a long term stable return. The relative significance of these two aspects of investment varies from country to country. For example, in Australia, the prospects of capital gains is particularly important whereas in Germany an acceptable, secure and long term flow of net income has been more relevant. In Germany and the USA the prospect of an acceptable income-related return has also been essential for companies and institutional investors.
- 5.3 In all countries with a large private rented sector, investment has been in the past, and in most cases still is, supported by taxation advantages that promote investment in the private rented sector by enhancing the rate of return and sometimes provide a tax shelter. This option for individual investors to use losses from rental income to reduce the tax on other income has been relevant in each of the countries considered in detail.
- 5.4 It is also the case that in Germany, France and the USA tax reductions, and in some cases grants and soft loans, have been used over long periods to support privately owned but socially allocated housing. In terms of the categories used in Table 1, there has in each of these countries been an important element of category 3 accommodation that has boosted the size of the private rented sector. This point can be extended to the large private rented sector countries in Table A1; they have large elements of category 3 privately owned rented housing. Switzerland in particular has boosted the size of its private rented sector by using German-style subsidies to support investment in privately owned housing to which rent and allocation conditions are attached (Bourassa & Hoesli, 2010).

**Table 4: Why is the private rented sector large in some countries? Summary**

<b>USA</b>	Very small publicly rented sector. Strong demand including from low income groups. Housing investment is a profitable activity supported by a mainly free market and a benign tax regime. Attractive to individual, company and institutional investors because of reasonable rates of return, taxation advantages and the diverse nature (smaller complexes as well as large apartment blocks) of the stock.
<b>Australia</b>	Very small publicly rented sector. Strong demand from a range of income groups. Significant tax advantages for small scale investors. Acceptable rates of return and long term capital growth prospects.
<b>France</b>	Strong demand at all levels of income. Attractive to individual investors because of acceptable returns that are enhanced by taxation advantages. Significant tax incentives and soft loans for some of the intermediate market. Housing allowances available to all private rented sector tenants.
<b>Germany</b>	Very small publicly rented sector. Strong demand at all levels of income. Attractive tenure for households because of good quality dwellings and strong security of tenure. Home ownership has been relatively expensive. Attractive as an investment since the 1950s because of generous tax advantages, principally degressive depreciation allowances that have helped provide an acceptable rate of return from net income.

## 6. The demand side drivers and the role of the private rented sector

- 6.1 It is clear from the country comparisons set out in Table 5 that there is no one simply identified source of demand for the private rented sector. Everywhere, it is a diverse sector accommodating high as well as low income households. Mobile households are important to demand and turnover in the stock is typically significantly higher than in other sectors. Younger and single households are a significant source of demand in every case. The country reports (Appendices B to F) show that in several cases demand has risen in recent decades as a consequence of affordability problems associated with rising prices for owner-occupied housing.
- 6.2 The information in Table 6 shows that the private rented sector is often a tenure for those who cannot, or do not want to, become home owners or social renters. For some households in all countries it is likely to be a tenure of choice, and this may, in particular, be true for some households in Germany who value the security of tenure that is provided. It has been suggested that in Germany the private rented sector offers the security that is sought in home ownership in other countries (see Germany report, Appendix E, section 2).
- 6.3 This issue of the role of the sector is central to arguments about expanding the sector in England. Is it to be expanded as a tenure for those who aspire to, but cannot obtain, access to other tenures or is to be more a tenure of choice: for households who seek the flexibility offered? It is likely that in England the sector will continue to offer housing in the variety of sub-markets that have been identified (including young professionals, students, high income renters, immigrants and asylum seekers – see England report, Appendix F, section 2) and the relative significance of these sub-markets will vary from one place to another. However there may also be scope for expanding what has been termed the ‘modern private rented sector’ (Rhodes, 2006) that offers flexible and affordable accommodation for younger households and more generally fills a gap in the housing market at one or more points in the life cycle of households rather than being a tenure for life (see England report, Appendix F, sections 3 and 4). The expansion of supply for this market may well require the sorts of fiscal incentives that are available in the large private rented sector countries.
- 6.4 It is important to note that in all the countries examined private rented sector demand from lower income households is significant and in all cases supported by some sort of demand subsidy, typically in the form of a housing allowance that provides income-related and rent-related assistance that varies with household size. In the USA the support comes mainly through vouchers which provide a choice of accommodation from those private sector landlords that accept this demand side but supply-linked form of assistance. The implication is



that low income demand is not sustainable in any country without income-related assistance that makes market rents affordable.

**Table 5: Sources of demand**

<b>USA</b>	Low income households who cannot afford to own. Middle to higher income and mobile households who prefer not to own. High proportions of young and single households.
<b>Australia</b>	New households who cannot afford to own. Middle to higher income and mobile households who prefer not to own. Low income households unable to obtain public housing. Market renter households are about 18% of households in the lowest income quintile and 20 per cent of those in the top quintile. Young mobile households. Young lone person households. One quarter of private renters in top income quartile. <sup>1</sup>
<b>France</b>	Households whose incomes are too high for social renting and too low of home ownership in expensive areas. Mobile households that do not wish to be social renters or home owners. Many young single households. Nearly one fifth of private renters in top income quartile. <sup>2</sup>
<b>Germany</b>	Tenants are spread through the income distribution. Renter households are about three quarters of households in the lowest income quintile and over 40 per cent of those in the top quintile. Average equivalent incomes do not differ greatly on average between renters and owners. A large number of younger households and, in eastern Germany, a large volume of elderly households. <sup>3</sup>
<b>England</b>	Diverse demand including high proportions of young and mobile households. Over half under 35 years old. Average incomes are twice those of social renters. But private rented tenants are spread through the overall income distribution: market renter households are about 12 per cent of households in the lowest income quintile and 10% of those in the top quintile. <sup>4</sup>

Notes:

1. See Australia report, Appendix C, Tables 2 and 3.
2. See France report, Appendix D, Table 3.
3. See Germany report, Appendix E, Table 2-2.
4. See England report, Appendix F.

**Table 6: Role of the sector**

<b>USA</b>	Housing those who cannot afford or do not want to own.
<b>Australia</b>	Housing those who cannot afford or do not want to own.
<b>France</b>	Housing those whose incomes are too high for social renting and too low of home ownership (in expensive areas) and mobile and young employees.
<b>Germany</b>	Secure long term tenure housing those who do not wish or cannot afford to own.
<b>England</b>	Housing diverse groups who cannot afford or do not want to own and those who cannot or do not want to rent from the social sector.

## 7. The attractiveness to investors

### The attractiveness to individual investors

- 7.1 In all the countries examined, including those with a small private rented sector as well as those with a large private rented sector, most of the stock is owned by individual investors. Table 7 shows that nearly all private rented sector dwellings in France are owned by individuals; and in each of the other countries at least 60 per cent of the stock is owned by individual investors. The importance of individual investors is clear even in countries such as the USA and Germany that have sizeable institutional involvement in the private rented sector and many large scale company landlords. The holdings by individual landlords are often very small and may amount to only one or two dwellings. However the average size of individual holdings is higher in Germany and can range from six to 45 dwellings depending on whether the individual is classed as an 'amateur' or 'professional' investor (see Germany report, Appendix E, section 4). These investors are attracted variously by the prospects of capital gain but also by acceptable rental returns. In the large private rented sector countries these returns are enhanced by tax reliefs and the possibility of using private rented sector investment as a tax shelter.
- 7.2 The appeal of the private rented sector to individual investors is summarised in Table 8. Part of the attraction of the private rented sector to small scale investors can lie in self-management but, where the information is available, it is clear that many individual landlords use agents to manage their properties. The use of agents is significant in France, especially when investors purchase properties, through specialised brokers, that are long distances from their place of residence. In Australia 68 per cent of all privately rented dwellings are managed by agents and this must include large numbers of dwellings that are individually owned (Short *et al*, 2008). A German survey suggested that only 27 per cent of individually owned rental dwellings were not self managed (BMVBS/BBR, 2007). In the USA only 20 per cent of individually owned unsubsidised rental units are professionally managed (Apgar & Narasimhan, 2008; see USA report, Appendix B, section 5) but the taxation system perversely discourages professional management (see the information on passive loss deduction rules in the USA report, Appendix B). In England it is estimated that 60 per cent of individual landlords use agents and this proportion has grown in recent years (Rugg & Rhodes, 2008).
- 7.3 As Table 9 shows, individual ownership can potentially present a variety of problems. The actual significance of these problems is, however unclear. For example, whether or not a lack of professional management is a problem for tenants is debatable. Evidence for England (Rugg & Rhodes, 2008; see the England report, Appendix F) shows that tenants are on average more satisfied when individual owners, rather than agents, manage properties. The lack of funding for improvement work, and the problems for tenants when landlords default

on loans, have been identified at some times, and for some landlords, in the USA (Retsinas & Belsky, 2008).

**Table 7: Individual investors**

	<b>% of private rented sector stock</b>
<b>USA</b>	66
<b>Australia</b>	60
<b>France</b>	96
<b>Germany</b>	62
<b>England</b>	73

**Table 8: Individual investors: attracted by**

<b>USA</b>	Small scale often self-managed safe property investment. Significant tax advantages including large costs deductions, transferability of losses to other income and low capital gains taxation. Some small self-managing investors accept low profit margins. <sup>1</sup>
<b>Australia</b>	Small-scale often self-managed safe property investment. Significant tax advantages including large costs deductions, transferability of losses to other income and perception of long term capital gains. Perception of good return relative to costs. Some 'accidental and unintentional' landlords. <sup>2</sup>
<b>France</b>	Small scale often self-managed safe property investment. Low maintenance on new buildings through ten years guarantees from developers. Taxation advantages. Acceptable low rental yields and expectation of capital growth. Availability of 'investment packages' that include management services, New insurance scheme GRL developed covering rent arrears, legal fees and repairs. <sup>3</sup>
<b>Germany</b>	Secure equity building – including for retirement. Taxation advantages. Long term horizon rather than short term capital gains. Secure return. <sup>4</sup>
<b>England</b>	Small scale often self-managed safe property investment. Capital growth and availability of mortgage finance.

**Notes:**

1. See USA report, Appendix B, sections 4 and 5.
2. See Australia report, Appendix C, section 5.
3. See France report, Appendix D, section 5.
4. See Germany report, Appendix E, sections 4 and 5.

**Table 9: Possible problems for individual investment**

<b>USA</b>	For some, low operating margins, debt and foreclose problems. Not all have access to competitively priced funds for maintenance and for quality improvements. High level of self management; potential taxation disadvantages from using a professional management company. <sup>1</sup>
<b>Australia</b>	Taxation system works against holdings of more than one or two properties. High level of self management but 68 per cent of privately rented dwellings professionally managed. <sup>2</sup>
<b>France</b>	Significant quality problems in some of the older private rented sector stock and individual landlords let property on average of a lower quality than the small proportion of other private rented sector landlords. High level of self management. <sup>3</sup>
<b>Germany</b>	Limited market knowledge and problems of effective responses to changing market conditions. Lower returns in recent years. <sup>4</sup>
<b>England</b>	Funding of improvement and maintenance. Lack of professional management. Debt and mortgage default issues.

Notes:

1. See USA report, Appendix B, section 5 and 7.11 and 7.12.
2. See Australia, Appendix C, report section 5 and 7.12 to 7.14.
3. See France, Appendix D, report section 5.
4. See Germany, Appendix E, report sections 4 and 5.

**The attractiveness to institutional investors**

- 7.4 For companies and financial institutions to be interested in the private rented sector, the main requirement from the international evidence is an acceptable and secure rate of return. The key pros and cons for such investors are summarised in Tables 10 and 11. Companies may own and manage properties directly and financial institutions may have such direct holdings or invest indirectly in the private rented sector through a financial vehicle. Of the countries examined in detail, only in the USA and Germany is institutional investment significant and of the countries considered in less detail it is particularly important in Switzerland (where about 28 per cent of the very large private rented sector is owned by pension funds, insurance companies, real estate funds and real estate companies (Montezuma, 2006)) and the Netherlands (where, although the private rented sector is small, around 60 per cent of the sector's dwellings are owned by professional landlords, mainly financial institutions (Elsinga *et al*, 2007)). In Germany, Switzerland and the Netherlands institutional investors are not put off by the strong security of tenure that tenants have. In fact long term tenancies are attractive in keeping down voids and management costs and maintaining a secure long term return. So, long term secure tenancies can benefit landlords and tenants.
- 7.5 Institutional investors are typically interested in large-scale holdings and thus the structure of the housing stock is fundamental. Scale is relevant from three perspectives. One related to acquisition and disposal costs, another to management and the third to market information. Large-scale apartment holdings, as in the USA, allow for transactions costs to be kept down relative to the value of the investment. Large complexes are also conducive to economies of scale in management. Robust market

information is essential to institutional investors who want forecasts of returns and costs. This information is only forthcoming in a satisfactory fashion where there are significant local markets. This is again a question of scale, both for the size of a rental block and the proportion of commercial renting in a local market.

7.6 In Australia, studies of why institutional investors are not interested in residential property suggest that low rates of return, high management costs, high risks and a lack of robust market information, which are all linked to the small unit size of investment opportunities, dissuade investors who have other more attractive investment options. Added to this, Australian financial institutions are wary about the possible negative public image effects of becoming involved in a sector where evictions may be a necessary part of the efficient management of a property portfolio (Berry *et al*,1998; Berry, 2000; Berry & Hall, 2005). These findings are arguably of significance to England where similar conditions may apply. In England the low yields and the lack of scale economies linked to the structure of the housing stock are important. Another point of particular significance to England is that whilst small-scale individual investors may accept negative net rental income, in return for capital gains in either the short or long run, institutional investors are more likely to want a positive income-related return.

**Table 10: Company and institutional investors: attracted by**

<b>USA</b>	Acceptable rate of return compared with other investments at least for larger multifamily property properties. Relatively low capital costs. Favourable taxation environment. Attractive to institutional capital. Large-scale portfolios are possible. Significant investment through RIETS. <sup>1</sup>
<b>Australia</b>	Low level of attraction. <sup>2</sup>
<b>France</b>	Low level of attraction compared with retail and office investment; poor liquidity compared with other investment <sup>3</sup>
<b>Germany</b>	Stable income returns, attractive financing options and large portfolios of dwellings. <sup>3</sup>
<b>England</b>	Low level of attraction.

Notes:

1. See USA report, Appendix B, section 6.
2. See Australia report, Appendix C, section 5.
3. See Germany report, Appendix E, section 6.

**Table 11: Company and institutional investors: put off by**

<b>USA</b>	Regulatory controls especially land use controls and rent restrictions in some locations. Some periods of tight availability of finance. <sup>1</sup>
<b>Australia</b>	Low rate of return. Land taxation that contributes to a negative yield. High management costs, small unit size of investment opportunities. High risks. Lack of robust market information. Potential negative public image effects of evictions. <sup>2</sup>
<b>France</b>	Low yields and selling regulations that limit liquidity. <sup>3</sup>
<b>Germany</b>	High vacancy rates – especially in the east of Germany.
<b>England</b>	Low yields and scale of investment opportunities.

Notes:

1. See USA report, Appendix B, sections 6, 7 and 8.
2. See Australia, Appendix C, report section 6.
3. See France, Appendix D, report section 6.

## 8. Real estate investment trusts

- 8.1 In the USA, Real Estate Investment Trusts (REITs) have been successful in encouraging investment in rented housing. REITs can manage their own properties, provide related services to their tenants and undertake development and refurbishment. A REIT is effectively a mutual fund for real estate with retail investors obtaining the benefit of a diversified portfolio under professional management. A REIT in the USA does not pay corporate income tax so that there is no double taxation of the income to the shareholder. They are required to pay out 90 per cent of net income. Originally they were designed to attract small investors but they now attract institutional investment.
- 8.2 Whilst important in the USA, the scale of REITs has to be kept in perspective. Less than 1 per cent of multi-family properties are owned by REITs but it has been estimated that REITs account for 8 per cent of apartments (Newell and Fischer, 2009). There are four REITs in the top 10 apartment providers and thirteen publicly traded REITs in the top 50 apartment owners (Jones, 2007).
- 8.3 The Australian equivalent of REITs is Listed Property Trusts (LPTs). However, LPTs do not invest in residential property. One reason is that income returns are deemed too low compared with commercial property and another is related to the nature of the stock especially the lack of large rental complexes in Australia. Whilst REITs can invest in rented housing in France and Germany their involvement is recent and as yet their impact has been small.
- 8.4 It is clear that large landlords are important in the USA and are particularly important in owning large apartment blocks but only some of these large landlords are REITs. Most are not. Jones (2007) argues that a distinctive feature of large scale private sector investment in the USA is that much of it is imbedded in deep urban markets with high proportions of rental housing. He suggests that these deep urban rented markets minimise investment risk and enable purpose-built large-scale developments. The key to the existence of large scale investors, he concludes, is the opportunities provided by large scale local spatial stock concentrations of rented housing. The lack of such deep local markets in the UK (compared with the USA) limits the potential of REITs to buy in bulk and manage as efficiently. Whilst the potential for residential REITs is seen to be limited in the UK, it is argued that this may change as the boundary between private and social suppliers becomes blurred. Jones sees the large scale purchase of existing housing association stock or the conversion of existing large housing associations to REITs as a possible source of growth: *“Enabling the conversion of the large housing associations to REITs in the UK arguably provides the most likely route for the long-term growth of the private rented sector by this means”* (Jones, 2007; p383).

8.5 The potential for REITs in England seems limited on the basis of international evidence about those factors that make REITs work elsewhere. There are two sets of circumstances in which REITs might have a more important role. One is where they respond to niche markets that warrant large scale building and investment and the other is where there is a policy decision to implement the idea of housing association REITs.



## 9. The regulatory environment

- 9.1 From the international evidence it is clear that a range of contrasting regulatory environments can be compatible with a large private rented sector. Tables 12 and 13 set out some key points on rents and security of tenure. Some countries with a large private rented sector have some degree of restriction on rent levels, or at least rent increases, and strong security of tenure for tenants. This is the case, for example, for France and Germany. From the countries considered in less detail, Sweden (Lind, 2001) and Switzerland (Bourassa *et al*, 2009) provide further examples of restrictions on rent increases, strong security of tenure and a large private rented sector. In Australia and the USA a large private rented sector is combined with mainly market rents (with exceptionally a degree of rent controls in some states in the USA) and limited security of tenure. More generally across all the countries considered the pattern for rents is that initial rents are determined by market forces, and increases in rents can be limited, but the limits are usually in line with market circumstances.
- 9.2 It is not possible to make simple statements about the cause and effect relationships between rents and security of tenure regulations on the one hand and investment in the private rented sector on the other. One view would be that free market rents and weak security of tenure for tenants are what landlords want and this will encourage investment. Another is that strong tenant demand is boosted by strong security of tenure and a low risk of dramatic rent increases and this in turn can encourage investment that responds to this demand. Landlords in such circumstances can value the long term secure income that goes with long term tenancies. Another crucial point is that where there is weak security of tenure it does not follow that all tenancies are short and turnover in the stock is driven by moves by unwilling tenants. This is certainly not the case for England as shown by the evidence quoted in the England report.
- 9.3 The experience of other countries shows that a variety of regulations are compatible with a large private rented sector. The fundamental point is that regulations need to result in actions which on balance suit the needs of both tenants and landlords. This means they should not stifle demand or supply and they should not result in hardship for either set of parties. This is more about getting things right in the context of local circumstances than prescribing a common set of regulations that promotes investment.

**Table 12: Market rents?**

<b>USA</b>	Mainly market rents. Some element of control on increases for some properties in some states. Restrictions on rent levels and increases for tax subsidised properties and directly subsidised properties.
<b>Australia</b>	Mainly market rents. Some element of control over rent increases – to keep them in line with market levels and to prevent increase in early months of contract.
<b>France</b>	Rents for new contracts set freely. Limits on increases related to inflation. Rent limits for subsidised properties.
<b>Germany</b>	Rents for new contracts set freely. Limits on increases for sitting tenants – linked to market conditions.
<b>England</b>	Mainly market rents.

**Table 13: Security of tenure**

<b>USA</b>	Limited security of tenure which depends on the contract. Typically six months or one year but can be less or more.
<b>Australia</b>	Limited security of tenure which depends on the contract. Typically six months or one year but can be less or more.
<b>France</b>	Strong security of tenure. Standard contract is three years (individual landlords) or six years (other landlords). Termination of contract only in limited circumstances. Termination of contract only in limited circumstances, for example, rent arrears. Sale of dwelling does not break the lease.
<b>Germany</b>	Strong security of tenure. Length of tenancy in principle indefinite. Notice periods of three to nine months depending on how long the tenancy has run for. Termination of contract only in limited circumstances, for example, rent arrears, landlord needs dwelling for own family. Sale of dwelling does not break the lease.
<b>England</b>	Limited security of tenure which depends on the contract. Typically no more than six months. After an initial six month contract usually two months.

## 10. Taxation

### Overview

10.1 The large private rented sector countries all offer taxation advantages, especially to individual investors, which are more favourable than those available in England. The comparative taxation position for individual investors is summarised in Table 14. Taxable net rental income is crucially affected by the deductions that are possible against gross rental income. A set of cost deductions are possible in all the countries considered, as shown in detail in Table 14. The major difference is that in England there is no deduction available for depreciation. This makes the landlord's tax bill bigger and reduces the net after-tax rental income return in England compared with other countries. Another significant difference is that in the USA, France and Germany capital gains tax is reduced if investments are held for longer, rather than shorter, periods. This encourages long-term holdings of investments. The system in England provides no such incentive for long-term holdings of private rented sector investments.

**Table 14: Taxation of individual investors: summary**

	<b>Cost deductions against rental income</b>	<b>Depreciation allowance</b>	<b>Losses allowable against other income</b>	<b>Capital gains tax system discourages short term holding of the investment</b>
<b>USA</b>	YES	YES	YES	YES
<b>Australia</b>	YES	YES	YES	YES
<b>France</b>	YES	YES	YES	YES
<b>Germany</b>	YES	YES	YES	YES
<b>England</b>	YES	NO	NO	NO

### Cost deductions

**Table 15: Cost deductions against rental income**

<b>USA</b>	All expenses deductible including interest payments, local property taxes and depreciation.
<b>Australia</b>	Wide range of expenses deductible including interest payments, local property taxes and depreciation.
<b>France</b>	If gross annual rental income is less than €15,000, 30 per cent deduction to offset costs; if rental income level is greater than €15,000, a wide range of expenses deductible including interest payments, local property taxes and depreciation.
<b>Germany</b>	Expenses deductible including interest payments, management costs and depreciation.
<b>England</b>	Interest costs and managements expenses deductible. Depreciation costs not deductible.

10.2 Table 15 provides more information on the deductions that are possible against rental income. It also shows that in France there is a simplified procedure for landlords with lower amounts of rental income that allows

for a standard 30 per cent deduction of gross rental income for expenses without the need for detailed specification.

### **Depreciation allowances**

- 10.3 In the large private rented sector countries generous depreciation allowances have been very important in encouraging investment in the sector and promoting new building for private renting. All four large private rented sector countries have such incentives. England does not. The allowances are summarised in Table 16 and more information on the operation of the schemes and their outcomes is given in the country reports (Appendices A to F). In Germany, depreciation allowances have been fundamental to encouraging investment in rented housing since 1945. Earlier schemes, which gave large deductions in the early years of an investment, were more generous than the current taxation regime. They are viewed in Germany as contributing significantly to investment in privately owned rented housing. Now that there is less need for new building, and indeed over-supply in some locations, the deductions, it is argued, can be less generous (Kemp & Kofner 2010; Kofner, 2010).
- 10.4 In France there have been several incentive schemes that have been associated with large numbers of additional dwellings constructed. Currently depreciation allowances can provide for as much as 50 per cent of the cost of a building to be deducted against income over nine years. Some of these schemes, are linked to conditions that limit rents and the incomes of tenants of the dwellings (Taffin, 2008). Depreciation allowances in Germany, the USA and Australia do not have such conditions attached. They simply reduce the rental income tax due in investments, including the construction of new dwellings for rental, and this increases the profitability of such investment.

**Table 16: Depreciation allowances for income tax**

<b>USA</b>	3.636 per cent per annum for 27.5 years. Applies to value of the building, not the land.
<b>Australia</b>	Where construction commences after 18 July, 1985 and before 16 September, 1987 – 4 per cent per annum. After 15 September 1987 - 2.5 per cent per annum. Applies to the cost of construction – not the value of the land. Not allowed for buildings constructed before 1985. Depreciation is also deductible for fixtures and fittings.
<b>France</b>	Special incentive schemes. 20 to 50 per cent over nine years depending on the incentive scheme (with further deductions of 2 per cent per annum up to 16 years in one scheme). Maximum rent levels apply. For current schemes maximum deductible amounts (€60,000 apply). <sup>1,2</sup>
<b>Germany</b>	Currently 2 per cent per annum for 50 years for properties built since 1925 (for older properties 2.5 per cent for 40 years). Earlier (pre-1995) systems allowed much higher rates in earlier years (for example 58 per cent cumulative in first ten years from 1989 to 1996). Deductions apply to value of the building, not the land. <sup>3</sup>
<b>England</b>	No depreciation allowance for properties. Ten per cent of gross income allowable for furniture for furnished properties.

**Notes:**

1. See Tables 9, 10 and 11 in the France report, Appendix D, for more details.
2. If the owner of the property is a company subject to corporate income tax, depreciation is allowed (on a straight-line basis) on the acquisition value of the buildings but not of the land.
3. For details see Germany report (especially Appendix 1), Appendix B. Generous degressive depreciation schemes were significant in promoting investment in previous decades.

**Rental income loss deductions**

- 10.5 A further major difference between the taxation of individual landlords in the large private rented sector countries and England is evident from the information in Table 17. This shows that in all the large private rented sector countries rental income losses can be used to reduce taxable income from other sources. These losses can be big once the generous cost deductions, including depreciation allowances, are applied. Thus individuals with income from work or from another business can reduce the tax due on income from these other activities by making, for tax purposes, a loss from net rental income.
- 10.6 This is a major incentive for small-scale investors in all the large private rented sector countries. No such incentives apply in England. This tax advantage through negative gearing is viewed as a big incentive in Australia where it is particularly advantageous for high income tax payers. In the USA and France there are limits to the allowances but they can still be very important investment incentives. Landlords can, in short, benefit not only by paying no income tax on current rental income (because it is negative) but can pay less tax on, for example, their income from work.

**Table 17: Losses allowable against other income for income tax**

<b>USA</b>	Up to \$25,000 of losses deductible against other income. Reduced amount if individual income is above \$100,000 per annum.
<b>Australia</b>	All negative net rental income can reduce other taxation. Negative gearing important incentive for high income individuals with high marginal tax rates.
<b>France</b>	Negative net rental income up to a maximum of €10,700 per annum can reduce other taxation. Mortgage interest may not be taken into account in the calculation of this deficit. Interest can only be deducted as long as the remaining balance is positive.
<b>Germany</b>	All net negative rental income can reduce other taxation.
<b>England</b>	It is not possible for individuals to use rental income losses to reduce taxation on other income.

### **Capital gains taxation**

10.7 Capital gains tax is greater in England than in the large private rented sector countries and there are no concessions for holding the property for several years. The contrasts with the other countries are summarised in Table 18. In the USA the rate of capital gains tax is higher for short term gains (less than one year) than for long term gains. Short term gains are taxed at the relevant marginal rate of income tax. The maximum long term rate is 15 per cent and for some lower income people it may be zero. If capital losses exceed gains the excess can be used to reduce other income, such as wages, up to an annual limit of \$3,000. In Australia there is a 50 per cent reduction after one year. In Germany and France the tax advantages of owning rental dwellings for longer periods are even more significant. Deductions begin after five years of ownership in France and liability is zero after fifteen years. In Germany no capital gains tax is due after ten years of ownership. In England, not only are rates of capital gains tax higher than in France and Germany but there are no concessions for long term ownership of dwellings.

**Table 18: Capital gains tax**

<b>USA</b>	Maximum of 15 per cent if property owned for more than one year, otherwise marginal rate of income tax which may be as high as 35 per cent. Capital losses can be (within limits) offset against other income. Avoidable if replacement property purchased. Up to \$500,000 deduction for a couple (\$250,000 for individual) if property is used as primary residence for two out of five years before sale.
<b>Australia</b>	Applied at marginal rate of income tax but 50 per cent reduction from the nominal gain if property is owned for at least one year.
<b>France</b>	16 per cent of net gain; ten per cent per annum discount after five years of ownership. Thus no tax liability after 15 years of ownership.
<b>Germany</b>	Applied at marginal rate of income tax but does not apply at all if the property is owned for more than ten years.
<b>England</b>	18 per cent for standard rate tax payers; 28 per cent for others.

## 11. Soft loans

- 11.1 In the USA, France and Germany, in particular, loan finance at favourable rates of interest is available under certain conditions for investment in private rented housing. This is shown in Table 19 and more information is given in the country reports (see Appendices B, D and E).
- 11.2 The two main loan schemes available to private sector landlords in France target the intermediate and the higher rental parts of the market. They are available at sub-market interest rates for up to 30 years (or 50 years for the purchase of land). Maximum rent and tenant income levels apply and these vary with location. Several thousand dwellings are supported each year by these incentives (Haffner *et al*, 2009). Low interest loans have been used for quality improvements such as additional energy efficiency in Germany.

**Table 19: Support through soft loans**

<b>USA</b>	State tax exempt bond financing in limited circumstances. Tax credits apply also to the financed dwellings. Rent and allocation restrictions apply.
<b>Australia</b>	No specific schemes.
<b>France</b>	For some of the private rented sector significant soft loans for individual and institutional landlords. Rent and allocation restrictions apply. In some cases additional tax advantages apply to the financed dwellings. <sup>1</sup>
<b>Germany</b>	Low interest loans for specific purposes such as improving energy efficiency. <sup>2</sup>
<b>England</b>	No specific scheme.

Notes:

1. For details see France report, Appendix D, Table 8.
2. See Germany report (Appendix 3), Appendix E.

## 12. Private sector social supply incentives

- 12.1 Private sector social supply schemes, which exist in all the large private rented sector countries, encourage private sector organisations to invest in, and in some cases specifically to build, dwellings for rent. They all involve what may be called ‘conditional object subsidies’. This means they support the building or acquisition of real estate intended for rental and there are conditions attached that limit both the rents that may be charged and the incomes of the households that may occupy these dwellings. In France such conditional subsidies are also used to promote improvements in the quality of the rental stock. The subsidy may take the form of a grant, tax deduction, a soft loan or a combination of these.
- 12.2 The conditions attached to rents and to occupancy are often time-limited meaning that several years after the dwelling is initially subsidised (or, for example, after the repayment period of a soft loan has ended) it can become part of the open market. Such conditional subsidies have been used not only for supporting rented houses for very low income households (in some cases the schemes do not even target such households) but are used to support housing for those on incomes above the lowest levels. In France, for example, they can support intermediate dwellings such as key-worker housing. Whilst privately owned, the dwellings may (depending on the country and the scheme) be managed by a private company, a non-profit organisation, or a governmental organisation. Germany, France, the USA and Australia all have examples of such schemes. In each case they boost the size of privately owned rental sector. England does not have a comparable scheme.
- 12.3 Whether or not the accommodation that is provided under these schemes should be counted as part of the private rented sector or not is a matter of debate (as the earlier discussion about the definition of the sector makes clear). If private ownership of the dwellings is the key criterion then this accommodation is clearly part of the private rented sector. If however the key criterion is whether or not the rent setting and allocation of the dwelling is through market processes then such accommodation might be counted as part of the social rented rather than private rented sector (Haffner *et al*, 2009). Whilst an allocation based definition is in principle useful in distinguishing social from private rental dwellings, official data inevitably defines the private rental sector on the basis of ownership.
- 12.4 Table 20 provides examples of schemes that incentivise investment in privately owned rental housing that has rent and allocation conditions attached. More information on each case is provided in the country reports in the Appendices. There are additional examples to be found in the countries considered in less detail. In particular, Belgium, (Haffner *et al*, 2009), Ireland, (Haffner *et al*, 2009), Spain (Hoekstra *et al*, 2009) and Switzerland (Bourassa & Hoesli, 2010) all have schemes that trade incentives. These take the form, variously, of long term rental contracts,



rental guarantees, financial support and fiscal advantages, for constraints on rents and requirements to house people whose incomes fall within specified thresholds and ceilings.

**Table 20: Private sector social supply incentives: examples**

<b>USA</b>	Low Income Housing Tax Credits support some privately owned housing with rent restrictions and income related allocation conditions. Also project-based Section 8 assistance (vouchers for low income households) have promoted supply.
<b>Australia</b>	New National Rental Affordability scheme gives tax credits for building of privately owned housing (and housing owned by non-profit organisations) with rent restrictions and income-related allocation conditions. As yet on a small scale to private investors.
<b>France</b>	Tax incentives (principally generous depreciation allowances) and soft loans for some privately owned housing with rent restrictions and income-related allocation conditions.
<b>Germany</b>	Subsidies for housing with rent restrictions and income-related allocation conditions.
<b>England</b>	Since 2004 private firms have been able to bid for funding to support the development of social housing.

12.5 In can be argued that in England there are private sector social supply arrangements through the land use planning system where Section 106 arrangements can require developers to provide a given proportion of social housing as a condition of panning permission. Other countries also have similar arrangements that effectively require private development to cross-subsidise social housing. The schemes identified in Table 20 are in addition to such planning related measures.

## 13. Low income housing tax credits

- 13.1 In the USA building for privately owned rental housing is assisted by Low Income Housing Tax Credits (LIHTC) which in recent years have generated about 120,000 units annually (JCHS, 2009). LIHTC accounts for nearly 90 per cent of all affordable housing created in the USA today. They are essentially construction subsidies that are obtained by developers provided that at least 40 per cent of units go to low income households whose income is less than 60 per cent of the area median. Alternatively qualifying property owners may elect to provide 20 per cent or units for households with incomes below forty per cent of the area median. Normally, however, all or a very large share of units are targeted to households at 60 per cent or less of area medians in order to achieve the maximum allowable tax credits for a property.
- 13.2 The federal LIHTC programme provides quotas of tax credits to each state on a per capita basis. The allocation by the state to individual rental developments is done on a competitive basis. Thus some developers might offer larger proportions of affordable housing or lower rents than the regulations specify in order to have a strong competitive position. Each state is obligated to use a published Qualified Allocation Plan to layout the criteria it will use to pick among competitive applications. Rents must be less than a maximum related to local affordability. The rent ceilings are 30 per cent or 60 per cent of the area median income.
- 13.3 LIHTC provides a 'present value' tax credit of 70 per cent of the cost of new construction or 30 per cent of the cost of acquisition of existing low income housing. The credits are allocated over a ten-year period based on the 'Applicable Federal Rate' (AFR). Nominally the value of the credit is nine per cent annually for the seventy per cent credit and four per cent annually for the thirty per cent credit. In 2008, 9 per cent was established as a floor on the nominal 9 per cent credit. For acquisition of existing rental housing, the applicable credit is also 4 per cent.
- 13.4 The system relies on the sale of tax credit by a general partner that generally retains a one per cent interest in the property, and raises the rest of the equity through sale of the tax credit to third-party investors (Belsky, 2010). The volume of tax credits that can be allocated to a project depends on non-land development costs, the proportion of units set aside for low income households and its credit rate (4 per cent for projects financed from tax-exempt state bonds and 9 per cent for other projects).
- 13.5 Compliance with allocation rules and rent limits was initially (from 1986) required for a minimum period of fifteen years. Beginning in 1990, an additional 15-year 'extended use' requirement was imposed for all properties receiving new tax credit allocations. LIHTC can therefore be seen as a means of providing a temporary subsidy in return for landlords being bound by obligations to house lower income households (Belsky,

2010). LIHTCs have a strong record in terms of housing quality and financial stability and creating new housing in more diverse locations than previous programmes. They enjoy wide bi-partisan support. However, extremely low income households cannot afford the rents unless they have a housing voucher or the developer is able to obtain additional capital and operating subsidies.

- 13.6 The application of a LIHTC type model in England offers a new way of using private investment to boost the rented housing stock. As a tradable instrument that reduces the holders' tax liability they provide an option that may be attractive to a range of investors. From the perspectives of governments and tenants they offer the prospect of efficiency gains from competitive allocation that should result in good value for money. They do not involve direct public expenditure; their exchequer cost is indirect, through tax concessions. They do, furthermore, tie the tax concession to housing that has to conform to specific quality, allocation and rent standards. These specifics can be tied to local decisions that are made about the allocation of a nationally financed policy instrument. The additional housing that results from LIHTC may be privately owned but it might also be owned or managed by other sorts of organisations, including housing associations.

## 14. The effectiveness of tax incentives and soft loans: more investment in the private rented sector or a crowding-out effect?

- 14.1 Incentive schemes that try to increase investment in private rented sector stock may in principle lead to a larger housing stock or the growth of the private rented sector stock may be at the expense of another sector. Similarly more house building for the private rented sector might mean more house building in total or any increased building for the private rented sector may be at the expense of less building for say owner-occupation or social renting. Whether or not there is either a net-addition effect or a crowding-out effect depends on the specifics of the incentives and the housing market context. It is also likely to depend on the period of time over which the effect is measured. In the short run, limits to the growth of total housing demand and housing supply capacity might make crowding-out effects more likely than in the longer run where markets may adjust to larger volumes of aggregate housing demand and supply.
- 14.2 Estimating the existence and scale of crowding-out effects is a complex task and will inevitably require complex estimations. Even then the outcomes will depend crucially on the assumptions adopted. It is therefore not surprising that attempts at such estimates are rare. One study in the USA (Malpezzi & Vandell, 2002) considered whether the LIHTC programme adds to the stock of housing or merely substitutes for units that would have been produced with other sources of finance. Using modelling techniques and data for all 50 states they were unable to reach a definitive conclusion on whether or not LIHTC housing crowds out other unsubsidised units but they were also unable statistically to reject the proposition that crowding out is a possibility.
- 14.3 The difficulty of measurement and the possibility of inclusive results does not mean that the problem should be ignored. Policy makers need to be aware that incentivising more private rented sector housing might be at the expense of less housing in another tenure. This might or might not be a desirable outcome depending on the overall policy objective.

## 15. Key differences between England and those countries where the private rented sector is large

15.1 There are several significant differences between England and countries with a large private rented sector. These are summarised in the 12 points below. Together they show that the history as well as the current context of policies and housing markets is important. One needs to ask questions about the past as well as the present to understand different levels of investment.

1. It is several decades since there was a large private rented sector in England. (It has been less than 20 per cent of the stock in England since 1971 [1961 31%; 1971 20%; 1981 11%; 2007 13%]). In the large private rented sector countries the sector has been at least 20 per cent and as high (in Germany) as over 45 per cent for several decades despite (depending on the country) various periods of growth and decline.
2. In the large private rented sector countries, measures to support the sector have been in place for several decades.
3. Compared with England, there is a broader demand base in other countries: both (depending on the country) from low income households who cannot access social housing – or do not want to – and higher income households who do not want to be owner-occupiers.
4. In England, tenants do not have long-term security of tenure as in Germany and France (although tenure is relatively short in the USA and Australia).
5. In England, rent increases are not subject to legislative limits as in Germany and France (there are limits in some circumstances in the USA and Australia but more generally rent increases depend on market circumstances).
6. In England, individual investors cannot benefit from depreciation allowances as they can in Germany, France, the USA and Australia.
7. In England, individual investors cannot transfer current rental income losses to other income for tax purposes. This can be done in Germany, France (with limits) the USA (with limits) and Australia.
8. In England, there is a high reliance on capital growth rather than a significant return from income (this is very different from Germany where the return is mainly from a stable long term income return, although similar to Australia where capital gains are important).
9. In England, capital gains tax does not encourage long term holdings – that is it does not become proportionately less as the period of ownership increases (as in France where there is no capital gains tax liability if the property is held for 15 years; there is none in Germany if it is held for ten years; in the USA it falls after one year and can be avoided totally if there is reinvestment in another property).
10. In England, the physical structure and location of the rental (and potential rental) stock is not attractive to institutional investors

(compared with the economies of scale and comparable market information offered by deep urban markets and large-scale rental complexes elsewhere, and in the USA in particular).

11. In England, institutional investors perceive that they are not able to obtain a reasonable risk-adjusted rate of return (in comparison with the USA in particular).
12. In England, there are no significant programmes, comparable to those in other countries, to encourage the private sector to invest in and manage affordable housing (despite the recent possibility for private firms to bid for grants to develop social housing). This contrasts markedly with Germany (taking a long term perspective), France and the USA in particular (where LIHTC are important) and in Australia (under the new National Rental Affordability Scheme).

## 16. How to increase the private rented sector as a percentage of the stock in England – based on evidence from other countries

- 16.1 Policies to support the private rented sector should start from a clear view of what the sector is expected to do. Is it to continue to perform a similar role to that which does currently for a variety of households whose needs and demands are not catered for by home ownership or social housing or is it to have a new enhanced role for particular households? This might include some lower income households who choose private renting rather than social renting and some higher income households who choose private renting rather than home ownership.
- 16.2 The details of policy instruments are vital but so are the image of the sector and what government says it wants from the sector and how it sees the future.
1. Determine the role for the sector. Is there to be a larger ‘modern’ private rented sector offering high quality accommodation on a flexible basis or is the sector to have another role?
  2. Promote a policy environment that establishes a positive image for the private rented sector as tenure to meet needs not catered for by other tenures.
  3. Increase the taxation advantages for individual investors.
  4. Consider promoting niche markets for institutional investors where sufficient depth of demand can promote an efficient scale of investment opportunity.
  5. Promote a favourable regulatory environment – for landlords and tenants.
  6. Provide conditional taxation and subsidy support for affordable rental housing from private landlords possibly using a model similar to LIHTC in the USA.
  7. Consider encouraging housing associations to supply more market rent properties.

## 17. How to increase the volume of house building in England intended for private renting - based on evidence from other countries

- 17.1 To increase the volume of house building that is specifically intended for private renting, the international evidence suggests four possible approaches:
1. Apply a combination of the measures identified above to increase the proportion of the housing stock that is privately rented.
  2. Make the taxation advantages especially favourable for investment in newly constructed buildings, for example, more generous depreciation allowances.
  3. Provide conditional taxation and subsidy support for affordable rental house building by private developers; the housing to be managed by private sector landlords or by housing associations.
  4. Consider allowing large housing associations to become REITs.
- 17.2 The measures to promote more investment in private rented sector stock may raise the attractiveness generally of private rented sector investment and lead to improved profitability of building for renting and thus increase supply. Following the lead applied in some countries, the probability of enhanced new production can be increased by targeting the instruments at construction. An example of this is where depreciation allowances are particularly generous for new buildings.
- 17.3 Applying points 3 and 4 above involves widening the concept of the private rented sector. Incentives for the private sector to invest in and build housing with rent and allocation conditions attached are a substantial part of the explanation for a larger private rented sector in some countries. A similar approach in England would require a fresh form of thinking. Similarly, the use of private capital for investment in housing associations with the key incentive being tax concessions would amount to a completely new approach.
- 17.4 The adoption of any of these policy approaches would, as with the measures for increasing the private rented sector as a proportion of the housing stock, have to face up to the issue of crowding out effects. If more private rented sector building is at the expense of less building for home ownership or traditional social housing, there would need to be a clear policy imperative for this approach. The design of a policy package that enhanced building for the private rented sector without negative effects on other forms of house building, and this increased overall output, would need to ensure that there is sufficient aggregate housing demand and sufficient supply side capacity.



## 18. How to address quality issues in England - based on evidence from other countries

- 18.1 Quality is about the physical condition of buildings and the degree of tenant satisfaction with the management of accommodation. Reviewing the approaches adopted elsewhere suggests three possible elements to a quality enhancement strategy:
1. Continue to regulate for high quality and for quality improvements.
  2. Attach minimum dwelling quality standards to taxation and subsidy incentives.
  3. Provide tax incentives and grants for improvements as in France.
- 18.2 Points 1 and 2 relate to evidence from several of the countries whereas point 3 is specific to France which has particular quality problems in part of the private rented sector and has adopted policies that subsidise improvements to dwellings.
- 18.3 Regulations include building and land use planning controls and health and safety standards or their equivalent. Together they are designed to ensure that the construction and occupation of dwellings is of a standard acceptable in the given context. There is no suggestion from the international evidence that changes are required on these matters in England.
- 18.4 Incentives to promote private rented sector investment in other countries typically come with minimum quality standards attached. If such incentives are in the future applied in England, there will be an opportunity for the tax incentive or subsidy to be linked to prescribed standards of management and dwelling quality.
- 18.5 Section 10 of the report on France, Appendix D, sets out a range of measures that are in place in that country to improve the quality of the housing stock, including the private rented sector. The incentives include tax concessions and grants for refurbishment and renovation that are administered by the national home improvement agency. Governments looking for tried and tested measures that have helped to improve many thousands of dwellings could consider the instruments used in France.

## 19. Conclusions

- 19.1 The private rented housing sector in England at 13 per cent of the housing stock, despite growth in recent years, is small by comparison with the large private rented sector in several other high income countries. In those countries where the sector is large (20 per cent or more of the stock) policy measures have been in place for many years that encourage both the demand for private rented housing and incentivise supply. Many of the supply incentives are conditional on the dwellings being allocated to households whose incomes are within specified limits and being supplied at rents that are limited to specified maximum levels.
- 19.2 On the basis of the international evidence, three broad scenarios for promoting additional investment in the private rented sector can be set out. These scenarios are related how broadly the sector is defined and what roles policy makers expect the private rented sector to perform.
- 19.3 In the first scenario the private rented sector is defined to include only privately owned unsubsidised housing that is allocated by market forces. The role of the sector is essentially as it is today in England, serving a variety of households whose needs and demands are not met by home ownership, social housing or any other tenure including shared ownership and cooperative housing. On this basis the international evidence suggests that such housing in England is relatively poorly supported by taxation policies. Incentives in the form of depreciation allowances, the option of using current losses from negative net income to reduce the tax on other activities (including income from employment and other investments) and capital gains tax concessions for the long term holding of private rented sector investments would begin to put the English private rented sector on a par with the large private rented sector countries. These incentives would, as in other countries, incentivise mainly individual investors. These investors are responsible for a clear majority of the private rented sector even in countries where there is significant company and institutional investment. Such advantages could be extended to larger scale investors but the experience of other countries suggests that it will be very difficult to replicate the conditions necessary for a major increase in large scale investment. This is linked to the nature of the housing stock, the lack of scale economies and the relatively low rate of return from rental income. However, there may be niche market opportunities for large scale investment and measures that help identify these opportunities and a policy commitment to the significance of such investment may produce some positive outcomes.
- 19.4 In the second scenario the private rented sector is defined more broadly to include privately owned subsidised housing that is subject to social allocation conditions. The role of the sector is broader than it is currently in England and includes housing those who might otherwise be in conventional social housing, in shared ownership housing or in other forms of low income home ownership. It would include housing those

who currently cannot afford housing of the sort they desire in the owner-occupied and (narrowly defined) private rented sector and who are unable to access social housing. In this scenario conditional investment incentives of the type used for many years in Germany, France and the USA might be applied. The cornerstone of such a policy approach would be tax based incentives tied to conditions about housing quality, allocation and rents.

- 19.5 In the third scenario the private rented sector is defined as housing that is subject to market rents and is allocated by market forces irrespective of the ownership of the housing. In this scenario it should be acknowledged that social housing suppliers in England now build, own and manage some housing that is subject to market rents. This is typically done through a commercial subsidiary. If the policy aim is to increase the supply of this sort of housing then the emphasis could be on encouraging an expansion of the activities of these subsidiaries.
- 19.6 Within any of these three scenarios, any incentives could be targeted especially at newly built housing if the policy aim is to increase the rate of construction of dwelling intended for the private rented sector. For example, depreciation allowances could be more generous for investment in new dwellings compared with investment in the stock.
- 19.7 Whichever scenario is followed, policies need to take account of the possibility, outlined in this report, of crowding-out effects where additional private rented sector investment is at the expense of less investment in another housing sector. Policy makers will need to examine the likely scale of such displacement and take a view on its desirability.

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# Appendix A

## Housing tenure in selected countries

**Table A1: Tenure % of stock; other countries**

	Private rented	Social rented	Owner occupied	Other
Belgium (Flanders) 2005	18.4	5.4	74.3	1.5
Canada 2001	28.4	5.6	66.1	
Ireland 2006	11.4	10.7	74.7	3.2
Netherlands 2006	11.0	33.0	56.0	
New Zealand 2006	27.1	6.0	66.9	
Spain 2008	12.0	1.0	85.0	2.0
Sweden 2005	21.0	20.0	59.0	
Switzerland 2000	57.0	3.0	35.0	5.0

*Note: Totals may not add to 100 because of rounding*

Sources:

- Belgium (Flanders): **Haffner, M., Hoekstra, J., Oxley, M., & van der Heijden, H.** (2009) *Bridging the gap between social and market rented housing in six European countries?* (Amsterdam, IOS Press).
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- Sweden: **Whitehead, C. & Scanlon, K.** (2007) *Social Housing in Europe* (London, LSE).
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# Appendix B

## Country report: USA

### 1. Introduction

- 1.1 This report considers the role of the private rented sector in the USA and the key factors influencing the demand and supply of privately owned rented housing. There is some emphasis on policy measures that help to explain why around one-third of the American housing stock is rented. Most housing is in the owner-occupied sector. This has for many decades been supported as the principal tenure of choice for most households. It should be noted that the term 'private rented sector' is not generally used in American policy literature. The usual tenure distinction is simply between home ownership and rental housing. In this report there is an emphasis on federal measures. However, the local variations, especially in the administration of tax credits to support rental production and the use of rent controls, are acknowledged in the relevant sections of the report.
- 1.2 Most rented housing in the USA is private and unsubsidised. There is a very small publicly owned sector. However, significant numbers of privately owned dwellings are subsidised through a variety of programmes. Also there are important demand-side subsidies including housing vouchers that have supported privately rented housing. There is a good deal of variation by state and by city in the financial support and the regulation that the rented sector experiences. The variations in financial support arise from a combination of national funding and local decisions. State and local governments, with a few exceptions, put very little of their own money into housing subsidies. They do, though, play an essential role in the allocation and administration of funding that comes from federal programmes.
- 1.3 There are important senses in which privately produced and owned rented housing is used to support low income tenants and it might be argued that some privately owned rented housing is subject to social allocation criteria and rent limits. This is the case for the major subsidy system for the supply of new private rented housing, the Low Income Housing Tax Credit (LIHTC) programme.
- 1.4 Given the importance of LIHTC, and its relevance as a measure that is very different to approaches in the UK, there will be some emphasis on this topic in this paper. The paper will also give some weight to Real Estate Investment Trusts (REITs) and consider their success in the USA relative to their potential in the UK. There are important differences in the taxation treatment of rental housing in the USA and these will be highlighted. The main issues of interest are the availability of depreciation allowances; the way that the tax system treats losses from rental investment and the related 'passive loss rules'; and the treatment of capital gains. The paper also refers to the application of rental



controls in the USA. The emphasis is on federal measures but the importance of variations throughout the USA is noted.

- 1.5 In a broad context it should be noted that there are a wide range of demand and supply-side supports for rented housing that are designed not only to improve affordability but to promote neighbourhood renewal, labour mobility and support welfare to work (JCHS, 2007).

## 2. The size of the private rented sector and its contribution to housing investment

**Table 1: Key Characteristics on the Rented Sector in the USA**

Year	Percentage of Households in the Rented Sector	Number of Households in the Rented Sector	Commentary
1950	45%	19.2m	
1960	38%	20.3m	
1970	37%	23.6m	Includes 1.4% public rental and 0.2% subsidised private rental
1980	34%	27.6m	Includes 1.5% public rental and 2.4% subsidised private rental
1993	35%	33.5m	Includes 2.4% public rental and 3.0% subsidised private rental
2000	34% (rented housing units)	35.7m (rented housing units)	
2004	32.9%	36.0m	27.4m unsubsidised units in 2003* <sup>7</sup>

Sources: *Malpezzi (1998): 1950, 1960, 1970, 1980, and 1993*  
*U.S. Census Bureau (2001): 2000; Katz & Turner (2008) 2004: \* Apgar & Narasimhan, 2008*

- 2.1 The unsubsidised private rented sector is a highly significant part of the housing market – approximately 30 per cent of the total housing stock. In proportional terms, it has gradually declined relative to owner occupation, but in absolute terms it has remained stable or increased in recent decades. There is considerable geographical variation. For example, the ten largest cities in terms of population each have over 39 per cent of the stock in the rented sector. New York has over 60 per cent and Los Angeles and San Francisco nearly 50 per cent (Jones, 2007).
- 2.2 The federal government subsidises around one million publicly owned housing units and two million privately owned units. There are one

<sup>7</sup> Note that this number is based on self reports from a household survey. The 8.6 million subsidised rentals it implies is higher than the roughly 5.5 million that administrative records data imply. One study by HUD that tried to reconcile the two approaches also found that the specific rent subsidy categories that households reported they fell in did not match administrative records data (Belsky, 2010).

million rentals in properties assisted by tax credits. In addition the federal housing choice voucher programme provides rental subsidies to 2.1 million lower income households (Belsky & Drew, 2008).

- 2.3 Privately owned unsubsidised housing is home to more than 80 per cent (27.4 million) of all renters and nearly two-thirds of the lowest income renters. The vast majority of these unsubsidised units consist of single family residences, two to four family units and dwellings in smaller apartment buildings with five to 49 units (Apgar & Narasimhan, 2008).

### **Definition issues**

- 2.4 There is a difference in America between: (i) housing that is privately owned and is part of the housing market in the sense that it is subject to market forces and has market rents; and (ii) housing that is privately owned but is subject to rent and allocation restrictions. There is an argument that some landlords specialise in accepting housing vouchers that means they accept such restrictions. There are also rent and allocation conditions attached to several subsidy and tax credit programmes. It has been suggested that in total more than 10 per cent of the occupied rental stock is privately owned but subject to such restrictions (Belsky, 2010).
- 2.5 There is a particular issue about how to treat LIHTC housing. The advisor for this report argues that,

*“While privately owned, especially the LIHTC begs the question as to whether it is part of the private market or not. Most would say no – its rents are capped so not really set by the market and there are income eligibility criteria applied. In addition, conditions are placed on its disposition after the 15 year compliance period. As for vouchers, while their rents are also capped, the rent increases are based on a survey of market rents and pegged at whatever the 40<sup>th</sup> percentile rent turns out to be so the cap is sort of set by the market. In both the tax credit and voucher cases, landlords do have to compete for tenants and can do so by lowering rents, and in this sense behave exactly like fully private markets. These nuances are important to helping the reader judge for themselves whether to include older assisted properties, tax credit properties, and/or vouchers as part of the private market or are better thought of as privately owned but with regulated rents” (Belsky, 2010).*

- 2.6 These issues of what to count as part of the private rented sector are germane to the arguments that will be considered in the final report for this project about how to get more investment into the private rented sector in England. They will be considered in a comparative context in that report.

## **3. The demand for private rented housing**

- 3.1 One-third of all households rent their dwelling. Some are renters by choice because they are highly mobile or prefer not to own but most rent out of necessity because of a lack of savings and low incomes (Katz & Turner, 2008). A growing proportion of these households face affordability problems. Even many who report being subsidised report affordability problems, and certainly this is a big issue for those in tax credit properties as well as voucher holders who may end up spending up to about 40 per cent of income by choice (Belsky, 2010). In 2005 45.7 per cent of renter households spent more than 30 per cent of their income on housing.
- 3.2 Large proportions of young people, minorities, foreign born and low income persons rent. This included 47 per cent of unmarried persons living alone, 61 per cent of those under 35, 46 per cent of divorced or separated households and more than 70 per cent of recent movers relocating for financial or employment reasons (Belsky & Drew, 2008).
- 3.3 Single adults with/without children were over-represented in the rental sector in 2000 while married couple families with/without children were significantly under-represented. Younger households (i.e. those with a head of household under 35) were highly over-represented in the rental sector (U.S. Census, 2001).
- 3.4 Lower income and poor households are more likely to rent than own, but there are substantial sections of middle income households that rent. Malpezzi (1998, p377) summarises this state of affairs by commenting that *“most poor people rent, but most renters are not poor”*.
- 3.5 Affordability is however an issue for many tenants. The median income among renter households is just under half that for owner-occupiers. Around half of low income renters (those with household incomes that are 30 per cent or less of the area median) spend 79 per cent or more of their incomes on rent. Overall, renter households are concentrated in central cities whereas owner-occupiers are more prevalent in the suburbs. However, single family rentals are more likely to be in the suburbs and much more likely to be occupied by white middle-aged, married couples with higher incomes than are units in large multi-family structures (JCHS, 2009a).

### **Vouchers**

- 3.6 Since the mid-1970s rental housing vouchers have *“emerged as the most substantial form of subsidised housing in the United States”* (Katz & Turner, 2008, p330). The 2.1 million households currently supported by vouchers in general receive the difference between 30 per cent of the recipient’s income and the rent of a qualifying moderately priced dwelling. They facilitate household choice and are a means of responding quickly to affordability problems. Voucher recipients are much less likely to live in low income neighbourhoods than are public

housing residents. They are judged to have enhanced economic independence and improved the life chances of recipient households (Katz & Turner, 2008).

## 4. The supply of private rented housing

- 4.1 There has been considerable volatility in the amount of new rented housing since data was first collected in the early 1970s<sup>8</sup>. The vast majority of units that are built with the intention of renting them has been 'multi-family units' and output has ranged from just over 100,000 per year in the early 1990s to over 500,000 per year in the mid 1980s (Malpezzi, 1998). Lampert and Pomeroy (2002) note that rented sector completions averaged 314,000 per year in the 1970s but only 165,000 per year in the 1990s. This equates to 16 per cent of total output of new units. In 2007 multi-family completions for rent were 169,000, only one third of the 1986 level (JCHS, 2008, p25). Most recent rental construction is in large apartment buildings. From 1996 to 2005, 1.3 million of the 3.2 million rentals completed were in structures with 20 or more units, and another one million rentals were in buildings with 5 to 19 units (JCHS, 2008; p11). In 2009 16.6 per cent of dwellings started were intended to be multi-family completions for rent<sup>9</sup>.
- 4.2 Around two-thirds of unsubsidised rental units are owned by individuals or couples. The rest are owned by a variety of corporations and other entities including limited partnerships, churches, non-profit organisations and real estate investment trusts. For many individual owners their rental business is a part-time activity. Only one in five rental units owned by individuals and couples is under professional management. Fragmented ownership makes for limited economies of scale (Apgar & Narasimhan, 2008; p288). More details on the ownership of rental dwellings are provided in Appendix 1.
- 4.3 Most unsubsidised rental housing is small scale. Thirty-nine per cent of unsubsidised renters live in single-family housing and 21 per cent in two to four dwelling units. Only 7 per cent is in buildings with 50 units or more (Apgar & Narasimhan, 2008; p280). There is little difference in the average age of rented and owner-occupied properties. In relation to type of property, 45 per cent of the rented sector was in apartments comprising more than five units. The corresponding figure for owner-occupation was less than 3 per cent (U.S. Census, 2003).

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<sup>8</sup> These figures include all privately owned housing starts and completions whether or not they were directly subsidised or assisted with LIHTC. Thus, they include starts that are supported by federal spending or tax expenditures. Also note that multifamily starts over time have been heavily influenced by US tax policy. They were high in the 1970s due to a host of direct subsidy programmes and in the period 1981 to 1986 especially high due to unusually generous depreciation allowances (Belsky, 2010).

<sup>9</sup> Own calculation from US Census Bureau data:  
<http://www.census.gov/const/startsusintenta.pdf>.

## 5. Individual investment in the private rented sector

- 5.1 As stated above around two-thirds of unsubsidised rental units are owned by individuals or couples and only one in five of these units are under professional management (Apgar & Narasimhan, 2008). Eighty-five per cent of small properties (four units or less) are owned by individuals and couples. Many of the owners have low incomes themselves and many report low operating margins.

*“A 1995 survey revealed that more than half of all resident owners, and nearly half of non-resident owners of properties with one to nine units, reported barely breaking even or losing money. As a result, many of these owners lack the resources to maintain, let alone improve, their properties.”* (JCHS, 2009a; p22)

With the twenty-first century housing boom, lending criteria for new purchases by small scale owners were relaxed and the number of households reporting at least some rental income from one to four unit properties jumped from two million in 2001 to 2.9 million in 2007.

- 5.2 There are thus large numbers of small scale landlords self-managing dwellings with low profit margins. In the property boom,

*“Many inexperienced investors made bets they could not cover when declining prices put them underwater on their mortgages. Indeed, tenant evictions from small rental properties in the foreclosure process are now a major concern, and all the more so because some landlords reportedly continued to collect rent even as they fell behind on their mortgages and left tenants unaware of the pending foreclosure.”* (JCHS, 2009a; p23).

## 6. Institutional investment in the private rented sector

### **Profitability**

- 6.1 Malpezzi (1998) reviewed the literature from the 1980s and 1990s on investment in new construction. He concluded that the following four issues were significant:

*Expected profitability of rented property:* He noted that there was a lack of robust research on developer behaviour although a ten to fifteen per cent return before tax was regularly quoted.

*Importance of real estate investment trusts:* These achieved over a thirty year period between the 1960s and 1990s a real rate of return of 5.4 per cent per annum. An estimate of the performance of residential REITS for the period 1994 to 2007 suggested that a total return (income plus capital growth) return of 12.06 per cent compared favourably with a stock

market return of 10.55 per cent over the same period (Newell & Fischer, 2009).

*Availability of finance:* Malpezzi argued that over the thirty year period finance had been available for good quality rental projects at advantageous rates. He, however, commented that there had been “*temporary but significant departures*” (Malpezzi, 1998; p361) when there were credit crunches (for example the early 1980s). Capital is viewed generally available for larger properties in normal times but less so for smaller properties, where costs are higher and competition lower. However since 2008, availability of finance has again been a problem in some sectors of the market (see the comments in section 7 of this paper on funding for LIHTC).

*Land use planning:* Malpezzi argues that land use planning controls have been far more important than rent regulation in influencing rented housing provision. In areas where there are stringent controls, there is a reduction in the supply of low and moderate income rented housing. This has been a particular issue in suburban areas where there is a powerful element of nimbyism. A study by Schuetz (2007) that looked at land use regulation and the rental housing market using case study evidence from Massachusetts suggested that land use regulations were constraining the development of rental housing. Communities with less restrictive zoning were found to build more rental housing, both in absolute numbers, as a share of the housing stock, than those with more restrictive controls.

6.2 Large investors are important for larger investment complexes:

*“The corporations and private partnerships that own the vast majority of large rental properties are more likely to have the resources and economies of scale to provide professional management and to tap a broader set of financing sources. The size of the properties permits careful underwriting, making their loans more attractive to institutional investors and to the secondary mortgage market.”* (JCHS, 2009a; p24)

6.3 In 2006 it was argued that,

*“For the past four years, institutional investors have bid up prices on apartment buildings despite weakness in rent revenues. Investors in rentals are betting that appreciation and lower interest rates will help their leveraged investments outperform stocks and bonds. Indeed, with investor demand still strong, net operating incomes stabilising, and condo conversions rising, values of apartment buildings soared 13.5 percent in 2005—the first double-digit increase since 1984.”* (JCHS, 2006; p20)

6.4 By 2009, the position had changed and it was argued that,

*“While nominal rents rose 3.7 percent last year, real rents fell by 0.2 percent. Rent declines and higher vacancies slowed the growth in 2008 of net operating incomes, which looked to turn negative in 2009. The real price of multifamily properties dropped in 2008 for the first time in years as investors demanded a higher return for taking on greater risk” (JCHS, 2009a; p21).* The data for 2009 shows an industry under greater stress though there are some signs that falling effective rents are stabilising and the speed of reductions in value has slowed (Belsky, 2010).

- 6.5 Mapazzi (1998) suggests that although the largest determinant of investment in new construction and the existing stock is the expected profitability of rental housing, *“Everyone talks about profit, but no one measures it systematically”* (ibid, p360). Quoting some limited data from 1987 to 1992 Malpazzi suggests that the investment performance of rental housing was “strong” compared to other commercial investments.
- 6.6 The data in Table 2 below suggests that in 2009 a ten year assessment of the total return from residential investment (taking account of capital growth and income) shows that it out-performed offices and industrial property but was a little below the aggregated return for all property. The 2009 one year total return is negative, as for all property, reflecting falls in capital values and the income return is a little below that for other types of property. It should be stressed that the data in Table 2 is based on only a small sample of investments but it does provide some indication that rental property has provided a return that compares favourably with some other classes of property over the long term.

**Table 2: IPD US Annual Property Index returns**

	Total return index	Total return %	Income return %	Capital growth %	Total return per year		
	Dec 1998=100	1 yr	1 yr	1 yr	3 yrs	5 yrs	10 yrs
All property	212.0	-17.1	6.6	-22.4	-4.3	3.8	6.6
Retail	247.8	-12.6	6.8	-18.2	-3.5	4.3	8.7
Offices	200.5	-19.5	6.8	-24.7	-4.1	4.1	5.9
Industrial	205.7	-17.9	7.1	-23.5	-4.3	2.8	6.3
Residential	209.9	-16.5	5.8	-21.2	-5.6	3.1	6.4
Other	190.6	-15.1	6.0	-20.0	-4.3	5.1	5.6

Source: IPD US Annual Property Index results for year to 31 December 2009, [www.ipd.com/us](http://www.ipd.com/us)  
 NB: The IPD US Annual Property Index database as at December 2009 covered 3,087 properties of which 482 were residential. The 27 residential funds covered 17% of the \$102,466m capital value of all the property included.

- 6.7 The data in Table 3, based on a larger sample of properties and showing the total rate of return to apartments compared with other properties, also shows that in some time periods rental investment has compared well with both property investment as a whole and with other forms of property investment.

**Table 3: NCREIF Property Index Returns - Total rate of return, first quarter data, selected years**

All property	4.14	2.4	1.51	2.56	3.62	1.6	0.76
Retail	2.92	1.99	1.88	3.0	3.41	1.44	1.13
Offices	5.5	2.66	2.95	2.24	3.91	1.96	0.86
Industrial	3.71	2.46	1.85	2.39	3.34	1.44	0.64
Apartments	3.29	2.37	1.99	3.0	3.52	1.26	0.42

NB: "The NCREIF Property Index is a quarterly time series composite total rate of return measure of investment performance of a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only. All properties in the NPI have been acquired, at least in part, on behalf of tax-exempt institutional investors - the great majority being pension funds. As such, all properties are held in a fiduciary environment - - - In the first quarter of 2010 the Total Market Value (millions): \$233,154.8 and Total Number of Properties: 6,067."

Source National Council for Real Estate Investment Fiduciaries Property Index  
<http://www.ncreif.com/property-index-returns.aspx>

6.8 The argument that rental property represents a good investment in the USA is set out robustly in a research report (Torte Wheaton Research, 2009) that examines investment in apartment properties. It shows that *"The apartment sector now accounts for the second-largest share of institutional investors' real estate holdings, lagging only the office sector"* and states that *"Professionally-managed apartment properties in the United States are a highly liquid asset class that is very attractive to institutional capital due to its stable cash flows, abundant debt financing, and unique diversification benefits"* (ibid, p2). It sets out several factors that explain the attraction of apartments to institutional investors. The key points include the following:

*"1. Apartments have a long track record of having the highest risk-adjusted investment returns compared to other property types. The sector has proven to be most resilient during economic downturns, delivering superior returns during recessionary periods.*

*2. Apartments have the most efficient cash distribution, due to low capital expenditures and technical improvements.*

*3. Apartments have a lower cost of capital and wider availability of debt capital; apartment investments can support more debt with the same level of risk.*

*4. Apartments operate in a favorable, transparent, and market-driven regulatory and taxation environment. In addition, apartments have shorter leases than other property types, allowing them to adjust more quickly to changing market environments.*



*5. Apartment properties vary widely in terms of age, size, quality, and location, creating a broad spectrum of opportunities and possible investment strategies, thereby providing greater liquidity than other sectors.*

*6. Short-term problems from the current economic downturn aside, apartment market fundamentals are expected to remain positive on a cumulative basis over the next five-to-seven year period. Demand is expected to expand and new supply is expected to subside, creating conditions for moderate rent and revenue growth in most locations.” (ibid, p3).*

## **Real Estate Investment Trusts**

- 6.9 Real Estate Investment Trusts (REITs) have been successful in the USA in encouraging both individual and institutional investment in rented housing. REITs can manage their own properties, provide related services to their tenants and undertake development and refurbishment. A REIT is effectively a mutual fund for real estate with retail investors obtaining the benefit of a diversified portfolio under professional management. A REIT in the USA does not pay corporate income tax so that there is no double taxation of the income to the shareholder. They are required to pay out 90 per cent of net income. Originally they were designed to attract small investors but they now attract institutional investment. Residential REITs accounted for 13.5 per cent of the value of all REITs in the USA in 2007 (Newell & Fischer, 2009). There are four REITs in the top 10 apartment providers and 13 publicly traded REITs in the top 50 apartment owners. This is shown in Tables 2 and 5 (Jones, 2007). The ownership pattern of large apartment blocks is quite different than for smaller rental properties. Whilst individuals and couples own 86 per cent of two to four unit rental properties, they own smaller percentages of larger properties (See Appendix 1).
- 6.10 It is clear that large landlords are important in the USA and are particularly important in owning large apartment blocks but only some of these large landlords are REITs. Most are not. It has been estimated that apartment REITs account for eight per cent of apartments in the USA (Newell & Fischer, 2009). Jones (2007) argues that a distinctive feature of large scale private sector investment in the USA is that much of it is imbedded in deep urban markets with high proportions of rental housing. He suggests that these deep urban rented markets minimise investment risk and enable purpose-built large-scale developments. However there is very little information on which investors own what, in which markets (Belsky, 2010).
- 6.11 Nevertheless, the key to the existence of large scale investors, according to Jones (2007), is the opportunities provided by large scale local spatial stock concentrations of rented housing. The lack of such deep local markets in the UK (compared with the USA) limits the potential of British REITs to buy in bulk and manage as efficiently. Whilst the potential for

residential REITs is seen to be limited in the UK, it is argued that this may change as the boundary between private and social suppliers becomes blurred. Jones sees the large scale purchase of existing housing association stock or the conversion of existing large housing associations to REITs as a possible source of growth: *“Enabling the conversion of the large housing associations to REITs in the UK arguably provides the most likely route for the long-term growth of the private rented sector by this means”* (Jones, 2007; p383). The data in Appendix 1 allows the importance of REITS to be put into perspective. Less than one per cent of multi-family properties are owned by REITS and less than three per cent of properties with 50 or more units. Although as stated above REITs are estimated to account for eight per cent of apartments.

**Table 4: Top 10 apartment owner firms, USA**

Rank	Company	No. of apartments with ownership interest
1	Apartment Investment and Management Company*	233,738
2	Equity Residential*	197,404
3	MMA Financial	179,133
4	Boston Capital Corporation	147,000
5	SunAmerica Affordable Housing Partners Inc.	143,702
6	Archstone-Smith*	81,914
7	United Dominion Realty Trust, Inc*	74,875
8	ESIC Realty Partners	74,778
9	Wachovia	70,429
10	The Richmond Affordable Housing Corporation	57,501

\*A REIT. The apartment stock is defined as the total number of apartments in structures with at least five units

Source: Obrinsky 2006, quoted in Jones, 2007

**Table 5: Publicly traded REITS among top 50 apartment owners, USA**

Rank	Company	No. of apartments with ownership interest	Total capitalisation \$m 01.01.06
1	Apartment Investment and Management Company	233,738	11,468
2	Equity Residential	197,404	19,351
6	Archstone-Smith	81,914	15,332
7	United Dominion Realty Trust, Inc.	74,875	6,616
11	Camden Property Trust	65,580	5,821
18	Colonial Properties Trust	45,242	5,460
20	Home Properties	43,432	3,885
22	AvalonBay Communities, Inc.	40,606	9,102
26	Mid-America Apartment Communities, Inc	38,227	2,489
33	AMLI Residential Properties Trust	28,659	1,654
36	Essex Property Trust	26,587	3,696
38	BRE Properties	24,440	4,121
43	Post Properties Inc	21,791	2,755

The apartment stock is defined as the total number of apartments in structures with at least five units.

Source: Obrinsky 2006, quoted in Jones, 2007

## 7. Policy measures that influence investment in the private rented sector

### Rent controls

- 7.1 There are considerable variations within the USA in the nature and form of rent controls. Malpezzi (1998) stated that rent regulation exists in approximately two hundred cities but these cities account for only about ten per cent of the households in this sector. Lind (2001) shows that New York had a system that kept rents permanently below market levels for existing and new tenancies. In contrast, Berkeley (California) and

Washington DC had a system protecting existing tenants from significant increases as well as limiting the increases in new contracts. Los Angeles and New Jersey had a system that protects only existing tenants. He also pointed out that there was evidence of a trend towards a gradual relaxation of controls. Overall, vacancy decontrol and exemptions for new additions to the rental stock is greatly reducing the extent of rent control.

- 7.2 A number of researchers, such as Kutty (1996), have attempted to investigate the impact of rent control. But it is, of course, difficult to generalise for the USA as a whole. For example, Kutty in her study of Western European and North American countries concluded on the basis of 12 types of regulation and rent control that the willingness of landlords to invest in maintenance depended on factors such as the type of rent control and its expected degree of permanence. She highlighted that landlords would be willing to invest if there was a degree of expectation that in the future there would be a shift from tight to relaxed regimes.
- 7.3 Currently, although rents are generally freely negotiated, in four states there are laws that allow cities to limit rent increases. These states are California, Washington DC, New Jersey and New York. Newly built dwellings are often exempt and in many cases vacancy decontrol applies which means that landlords can set rents at market levels when tenants move on. Controls on rents are thus an exception rather than the rule. San Francisco's rent Stabilisation Ordinance exempts all units built after 1979 and in New York State units built after 1974 are exempt. The allowable rent increases are prescribed annually and typically linked to measures of inflation. They may also be adjusted to give the landlord a reasonable return on investment. For example, in San Francisco from March 2010 to February, 2011, the allowable annual increase is 0.1 per cent. This amount is based on 60 per cent of the percentage increase in the Consumer Price Index<sup>10</sup>. This is set by the San Francisco Rent Board which is completely funded through the collection of fees that are imposed on landlords. For the 2009 to 2010 tax year, the fee was \$29.00 per apartment unit but the landlord could recoup 50 per cent of this from tenants. The Rent Board's primary function is to conduct hearings and mediations of tenant and landlord petitions regarding the adjustment of rents under the City's rent control laws. The Rent Board also investigates reports of alleged wrongful eviction. Most residential rental units in buildings that were constructed before 1979 are covered by the San Francisco Rent Ordinance with the exception of those run by non-profit organisations.
- 7.4 The NYC Rent Guidelines Board is mandated to establish rent adjustments for the approximately one million dwelling units subject to the Rent Stabilization Law in New York City. In 1969, the Board's first year of operation, rent stabilisation covered about 400,000 rental units.

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<sup>10</sup> See <http://www.sfrb.org/index.aspx?page=1313> [Accessed 20/05/10].

At the time, the vast majority of apartments were located in older (pre 1947) buildings and fell under the long established *rent control* system. Due to a series of legislative changes, rent control now covers only about 43,000 apartments, while the rent stabilisation system has expanded to over one million apartments which house over two million people – or about one in three City residents (Collins, 2006; p66). It has long been recognised that any “attempt to limit the landlord’s demands” through rent regulation would fail “[I]f the tenant remained subject to the landlord’s power to evict”. Therefore, under rent regulation “the general power to evict is eliminated in favor of a limited power to remove tenants for specifically enumerated causes such as failure to pay rent and disregarding the tenancy conditions (Collins, 2006; p66).” There are regulations that protect tenants from illegal evictions and harassment.

- 7.5 Under the rent control system tenants have permanent tenure and their rights and obligations are fully spelled out in the state Rent and Eviction Regulations. Consequently they are referred to as statutory tenants and they do not face periodic lease renewals. Rent controlled tenancies may only be terminated on grounds set forth in the Rent and Eviction Regulations. Under the rent stabilisation system tenants are also granted permanent tenure, but their rights and obligations are defined by both the Rent Stabilization Code and their individual leases. Rent stabilised tenants have a general right to renew their leases as they expire. Under rent stabilisation there are two means for ending a tenancy: First, there are a number of grounds to evict the tenant such as non-payment of rent, maintaining a nuisance, illegal subletting or use of the apartment for unlawful purposes; Second, there are grounds for refusing to renew the lease such as recovery of the apartment for the owner’s personal use or recovery when the tenant maintains a primary residence elsewhere.
- 7.6 The broad goal of the rent stabilisation system is the establishment of ‘fair’ rent levels for both owners and tenants. Currently the allowable rent increase for rent stabilised apartments in New York City is 2.75 per cent for leases lasting for one year with heating provided by the landlord. Landlords can also apply for Comparative Hardship or Alternative Hardship where they can be allowed to increase rents up to 6 per cent annually. These measures seek to give the landlord fair rents and they recognise that landlords may have limited resources.

### **Security of tenure**

- 7.7 Generally within the USA there are two main tenancy agreements, a lease and a rental agreement. Rental agreements provide for a tenancy of a short period (often 30 days) that is renewed automatically at the end of the period unless the tenant or landlord (sometimes the law states who should give the notice) ends it by giving written notice and the tenant must comply. The written notice is usually one rental period or one month for month-to-month rentals. The landlord can also change the terms of the agreement like the amount of rent (unless local rent

control ordinances prohibit it) with proper written notice (typically one month also).

- 7.8 A written lease, on the other hand, gives a tenant the right to occupy a rental unit for a fixed term - typically six months or one year but can be longer - if the tenant pays the rent and complies with other lease provisions. The landlord cannot adjust the rent or change other terms of the tenancy during the lease, unless the tenant agrees. Unlike a rental agreement, when a lease expires it does not usually automatically renew itself and the tenant must renew the contract, renegotiate another lease, or leave. The contract usually provides a provision for a renewal and the amount of notice required. A tenant who stays on with the landlord's consent after a lease ends becomes a month-to-month tenant, subject to the rental terms that were in the lease.

### **Taxation/subsidy incentives**

- 7.9 Capital Gains Tax on properties held for more than a year is 5 per cent; otherwise the tax is 15 per cent. An individual can exclude up to \$250,000 (\$500,000 for a married couple) of capital gains on the sale of real property if the owner used it as primary residence for two of the five years before the date of sale. The tax can be avoided if on sale the owner buys another replacement property within 189 days.

### **Depreciation allowances**

- 7.10 The tax system applies an approach called the Modified Accelerated Cost Recovery System under which rental property is depreciated on a straight-line basis. Residential rental real estate is considered to have a life of 27.5 years. This means that the cost of the property is depreciated over 27.5 years, which, expressed as a percentage, equals 3.636 per cent of the cost a year. The depreciation allowance applies only to the value of the building, not to the land. In previous periods, more generous depreciation allowances were used to encourage the production and rehabilitation of privately owned rental housing in general and low-income rental housing in particular.

### **Passive loss deductions**

- 7.11 The American tax system treats some investments as 'passive'. Such investments generate income without the investor being physically involved in the activity of producing the return. Thus, for example, investing in a business which others ran would be a passive investment. Before 1986 losses from such investments could be used to reduce tax bills from non-passive activities such as earning a wage or running one's own business. Residential property investments are generally treated as a passive activity. The Passive Activity Loss (PAL) for rental properties allowed individual investors to make losses and have the tax system treat such losses as deductions against other income. In the past rental investment could be treated as tax shelter allowing a reduction of a tax

bill from other income. From 1986 a rule was introduced limiting individual investors from claiming losses from passive investments (including real estate) in excess of income from such activities (JCHS, 2009b). There is an 'Active Rental Exception' that allows up to \$25,000 of rental losses to be deducted each year if the investor is actively involved in the business in the sense of ownership and decision making over such things as selecting tenants and improvements. There are income limits to this allowance and it is reduced once income is above \$100,000 per annum.

- 7.12 Given that all the expenses of investment in a property are deductible for tax purposes, including mortgage interest payments and depreciation, individual property ownership may well result in a loss. The ability to use this loss to obtain a deduction of up to \$25,000 against other income can be a clear incentive for individual investors. However, this does not apply if the investor does not actively participate in the management of dwellings. It does not therefore apply if a management company handles the property *and* the individual taxpayer does not actively participate in management decisions. The definition of active participation in management decisions is not precisely defined but is viewed as going beyond simple ratification of the decisions of the professional management company by exercising independent judgement. Investments by individuals in limited partnerships or individuals with less than ten per cent ownership interest are ineligible for the passive loss allowance.

### **Low income housing tax credits**

- 7.13 Low Income Housing Tax Credits (LIHTC) began in 1986 and by 2009 had provided around 1.7 million units for low income families and in recent years has generated about 120,000 units annually (JCHS, 2009b). The average number of units in LIHTC developments has risen steadily since the start of the programme to around eighty units (JCHS, 2008; p11). LIHTC accounts for nearly 90 per cent of all affordable housing created in the USA today. They are essentially construction subsidies that are obtained by developers provided that at least 40 per cent of units go to low income households whose income is less than 60 per cent of the area median. Alternatively qualifying property owners may elect to provide 20 per cent or units for households with incomes below 40 per cent of the area median. Normally, however, all or a very large share of units are targeted to households at 60 per cent or less of area medians in order to achieve the maximum allowable tax credits for a property.
- 7.14 The federal LIHTC programme provides quotas of tax credits to each state on a per capita basis. In 2006 the credits were worth \$1.95 per capita. The allocation by the state to individual rental developments is done on a competitive basis. Thus some developers might offer larger proportions of affordable housing or lower rents than the regulations specify in order to have a strong competitive position. LIHTC is

administered by state officials who make policy decisions about goals and priorities including the tenant allocation conditions. Each state is obligated to use a publicly released Qualified Allocation Plan to layout the criteria it will use to pick among competitive applications. Rents must be less than a maximum related to local affordability. The rent ceilings are thirty per cent of 60 per cent of the area median income. This means that LIHTC properties can face competition from older conventional rented housing and LIHTC tenants often have choices and may leave a poorly managed and maintained LIHTC property (Kadduri & Wilkins, 2008).

- 7.15 The low-income housing tax credit provides a 'present value' tax credit of 70 per cent of the cost of new construction or 30 per cent of the cost of acquisition of existing low income housing in return for limits on rents charged. The credits are allocated over a 10-year period based on the 'Applicable Federal Rate' (AFR). Nominally the value of the credit is 9 per cent annually for the 70 per cent credit and 4 per cent annually for the 30 per cent credit. In 2008, 9 per cent was established as a floor on the nominal 9 per cent credit. For acquisition of existing rental housing, the applicable credit is also 4 per cent. The developer must decide between two options for the unit. Either 20 per cent of available rental units must be rented to households with income less than 50 per cent of the county median income (adjusted for family size), or 40 per cent of the units must be set aside for households with income less than 60 per cent of the county median income. The rent can be adjusted in future years as median incomes change (Malpezzi & Vandell, 2002).
- 7.16 In principle LIHTC can be used by property owners to offset taxes on other income or can be sold to investors to raise capital funding for a project. However, in practice, seldom if ever do developers use the credits to offset their own incomes. The system relies on the sale of tax credit by a general partner that generally retains a one per cent interest in the property, and raises the rest of the equity through sale of the tax credit to third-party investors (Belsky, 2010). The amount of tax credits that can be allocated to a project depends on non-land development costs, the proportion of units set aside for low income households and its credits rate (4 per cent for projects financed from tax-exempt state bonds and 9 per cent for other projects). The credits are provided annually for 10 years so a dollar of tax credit issued now has a present value of six to eight dollars. If the allocation or rent conditions are not met the credit is not given (Quigley, 2008).
- 7.17 The tax credits are more attractive than tax deductions as they provide an equivalent reduction in a taxpayer's federal income tax, whereas a tax deduction only provides a reduction in taxable income. They are more attractive to corporations, who constitute almost all investors in LIHTC projects, rather than individual investors. This is because investments in tax credits are considered passive, and passive investors are not permitted to deduct losses from their incomes. Only the general partner is considered an active investor and seldom has enough income



to offset using the taxes and benefits by spreading their own limited equity capital across as many new developments as possible to earn developer fees on all properties produced. While the total development cost of an LIHTC property may be \$10 million, the net development cost after selling tax credits varies. It has ranged as low as 50 per cent or less to as high as 100 per cent or more. Over the life of the programme the median share has been in the low to mid 70s (Belsky, 2010).

- 7.18 Compliance with allocation rules and rent limits was initially (from 1986) required for a minimum period of 15 years. Beginning in 1990, an additional 15-year 'extended use' requirement was imposed for all properties receiving new tax credit allocations. The rules governing this additional 15-year period are complex. Many tax credit projects receive additional subsidies that have compliance periods that extend beyond the initial 15-year period and even the 'extended use' 15 more. In these cases, the other subsidies may lock in affordable use for 30 or more years in total. In cases where only LIHTC rules apply, owners have the right to opt-out subject to an offer to sell the property at a predetermined price to a buyer if one can be found by the allocating agency. If a buyer cannot be found, the owners have a three-year period in which they can transition the property to market rents. LIHTC can therefore be seen as a means of providing a temporary subsidy in return for landlords being bound by obligations to house lower income households (Belsky, 2010).
- 7.19 However, LIHTC housing does not reach the lowest income households. It is possible for such households to receive income related assistance in the form of vouchers that can be used to help pay LIHTC rents and thus create mixed income developments. Whilst rents for LIHTC dwellings can rise over time in line with incomes, the increases may be insufficient to finance operating and capital cost towards the end of the compliance period for dwellings that need capital expenditure to bring them up to an acceptable standard. It has been suggested that capital infusions are needed after 15 years to maintain physical and financial viability (Kadduri & Wilkins, 2008).
- 7.20 LIHTCs have a strong record in terms of housing quality and financial stability and creating new housing in more diverse locations than previous programmes. They enjoy wide bi-partisan support. However, extremely low income households cannot afford the rents unless they have a housing voucher or the developer is able to obtain additional capital and operating subsidies. Because land is not included in the eligible funding costs and is also excluded from the benefit of depreciation allowances, tax credit housing is often built on low cost land in low income neighbourhoods (JCHS, 2007; p5).
- 7.21 Whilst advocates for supply-side programmes generally argue that they increase the supply of housing in general, Malpezzi and Vandell (2002) consider whether the LIHTC programme adds to the stock of housing or merely substitutes for units that would have been produced with other sources of finance. Using modelling techniques and data for all fifty

states they are unable to reach a definitive conclusion on whether or not LIHTC housing crowds out other unsubsidised units but they are unable statistically to reject the proposition that crowding out is a possibility.

- 7.22 The passive loss rules tend to work against individual investors in LIHTC and in favour of corporations: *“The passive loss rules apply to housing credit investments, with an exception that permits investors to take annual credits against income that are equivalent to \$25,000 in deductions - - - While this does not preclude individual taxpayers and closely held corporations from investing in LIHTCs, it does mean they will have less of an appetite for the credits than widely held corporations that can make full use of the credits against their tax liability”* (JCHS, 2009b; p19).
- 7.23 The severe credit market problems disrupted the LIHTC programme in 2008 and 2009 when the corporate investors on which the programme relied moved from profitability to loss and demand for LIHTCs plummeted. As a result *“the price of LIHTCs fell, creating funding gaps in projects that had received tax credit allocations in 2007 and 2008 but had not yet sold them. Thousands of projects and tens of thousands of units that would have otherwise been bought or rehabilitated stalled”* (JCHS, 2009b; p1). In order to address the problem two new federal programmes were introduced in February 2009 as stop-gaps to improve the flow of funding. These initiatives are the Tax Credit Assistance Program (TCAP) and the Tax Credit Exchange Program (Exchange). An early evaluation suggested the relevant additional funding had been beneficial but was not sufficient to plug all the gaps and more was needed to compensate the falls in LIHTC support (JCHS, 2009b).

### **Some additional incentive schemes**

#### *Tax-Exempt Bond Financing*

- 7.24 Under US tax law, state and local governments are authorised to raise capital for various purposes, including housing development by for-profit or not-for-profit corporations, by issuing tax-exempt bonds – generally with terms of ten to thirty years (Lampert & Pomeroy, 2002). When used for private purposes, state tax-exempt bonding authority is subject to a ‘Private Activity Bond’ cap. There are other competing uses for the cap so not all of it goes to produce rental housing. There are restrictions on how these funds can be used. They follow the same requirements as the tax credit programme. By right, any property that receives state tax-exempt bond financing is entitled to 4 per cent tax credits as long as it meets the 40 per cent of units affordable to 60 per cent of area median income requirements of the tax credit programme. These ‘by-right’ allocations do not count towards the per capita cap on allocated tax credits (Belsky, 2010).

#### *The Community Development Block Grant*

- 7.25 Created in 1974, CDBG provides a formula-based federal block grant to localities for a variety of community redevelopment and revitalisation activities – although only a small portion is used to assist new rental development (Lampert & Pomeroy, 2002).

*HOME Investment Partnership Program*

- 7.26 In the late 1980s, community advocates successfully argued for HOME – a specific and separate mechanism outside of CDBG to fund housing (including new construction and rehabilitation of rental, as well as assisted home ownership programmes) with a formula-based allocation to localities similar to CDBG for 60 per cent of the funds and the other 40 per cent going to state governments to administer (Lampert & Pomeroy, 2002).

*HOPE VI (Housing opportunities for people everywhere)*

- 7.27 This has provided federal resources to transform the worst of the old public housing complexes, including demolition and rebuilding.

## 8. Policy measures that influence new building for private renting

### **Positive measures**

- 8.1 Federal production programmes have supported new building for rental since the 1930s. Initially and through to the 1960s the emphasis was on the construction of public housing which was built as a result of the government contracting with local public housing agencies.
- 8.2 From the 1960s to the early 1980s the federal government subsidised the construction of more than 1.3 million privately owned affordable dwellings through cheap loans, generous depreciation allowances and operating support. The government contracted with both profit and non-profit developers and the contracts set out affordability restrictions for a limited period of time.
- 8.3 The current system delegates key decisions to states and local governments who use federal resources to produce affordable housing in low income neighbourhoods. The measures include the LIHTC programme; the Community Development Block Grant (CDBG) programme and the HOME investments partnership programme (see section 7). These programmes have helped deliver large volumes of affordable housing and have fostered a national network of community development corporations that have supported the building,

improvement and management of affordable housing (Katz & Turner, 2008).

**Table 6: Three phases of federal rental housing production support**

Phase	Time	Policy tools	Providers
1	1930s – 1960s	Public housing	Local public housing agencies
2	1960s – 1980s	Subsidised private construction	Profit and non-profit firms
3	1980s – present	LIHTC HOME CBDG	Profit and non-profit firms Community development corporations

Source: text in Katz & Turner, 2008 pp 329-330

### Negative measures

- 8.4 Land use planning controls are seen as providing impediments to an expansion of affordable rental housing in locations where it is needed.

*“Increasingly restrictive local land use and development requirements have contributed to the rise in housing costs over time. This is the result of reducing allowable density, limiting the land supply for development, imposing costly building requirements, and using administrative procedures that add delays and uncertainties.”* (JCHS, 2007; p9)

It is claimed that,

*“In many markets, zoning restrictions, minimum lot sizes, lengthy permitting and approval processes, and voter opposition to specific kinds of developments make the construction of affordable rental housing more difficult and therefore more expensive.”* (JCHS, 2008; p20)

- 8.5 Local property taxes can result in higher taxes on larger rather than smaller properties, disadvantaging larger property developments. This can be a negative in locations where this applies (Belsky, 2010).

## 9. Policy measures that influence the volume of the stock in the private rented sector

- 9.1 Table 7 summarises the policy measures that have a positive impact on the volume of private rented housing in the USA. More information on the policy instruments has been set out in the previous sections.

**Table 7: Principal positive policy measures summary**

Policy category	Main measures	Key outcomes
Demand subsidies	Voucher programme	Raises demand by low

		income households
Production subsidies	LIHTC HOME CBDG	Have produced a significant volume of subsidised affordable housing that is privately owned
Investment tax breaks	Income tax deductions, including depreciation, loss deductions, and Capital Gains Tax concessions	Raises rate of return on investment

## 10. Policy measures that influence the quality of private rented housing

- 10.1 Most of the privately owned, small multifamily rental stock was built at least thirty years ago, and much of this is now in need of substantial repair. Three million private rental units have severe structural deficiencies (JCHS, 2008; p13). Eleven per cent of all renters and twelve per cent of renters in the bottom income quintile live in properties with structural problems (Belsky & Drew, 2008).
- 10.2 Some smaller properties in particular face quality issues.

*“Most smaller properties, especially 1-4 unit buildings, are owned by individuals with very small portfolios (one or two properties), making it difficult for them to realize economies of scale. Small owners also have trouble obtaining funds for capital improvements that could generate operating savings, assuming rents could bear the cost. Given their age, many buildings are energy-inefficient and/or have faulty plumbing and may be in weaker locations.*

*It has been suggested that creating a federally-sponsored small property REIT (S-REIT) could help preserve this stock by bringing in new equity funding and allowing for more professional management. It would also solve the exit tax problem by allowing owners to exchange properties for S-REIT shares while still providing them with cash flow.” (JCHS, 2007; p17-18)*

## 11. Summary 1

- 11.1 There is a longstanding large private rented sector in the USA and currently around a third of households rent. As in all countries, the size of the sector can only be understood in relation to other housing tenures. American households are mostly either home owners or private renters. There is a very small publicly owned rental sector. Home ownership has been encouraged through a variety of fiscal initiatives and a mortgage market in which lending has frequently been relatively easy to obtain for

most households. The publicly owned rental sector has not been subject to significant policy incentives for several decades. Thus demand for private renting is strong amongst those who cannot or do not wish to own. Amongst low income households this demand is supported by housing vouchers that allow households some choice in where they will live and help reduce the rental burden. Nevertheless, many low income American households still face significant housing affordability problems.

- 11.2 Around two-thirds of unsubsidised rental units are owned by individuals and couples and the remainder by a variety of commercial organisations. Individual ownership is typically small scale and in smaller buildings than is the norm for company investment. The larger scale investors include residential REITs that provide a tax efficient way of funding rental housing investment that is professionally managed and provides acceptable rates of return.
- 11.3 Interest, maintenance and local property taxes are all deductible expenses as is depreciation. This is calculated on a straight line basis over 27.5 years. These cost deductions combined with rents that are mainly set at market levels mean that commercially acceptable rates of return are available for most investors. Capital Gains Tax is set at 5 per cent as long as the property is owned for at least one year and can be avoided if the proceeds of sale are re-invested in a similar form of asset. In short, investing in rental housing can be a profitable activity supported by a benign taxation regime.
- 11.4 The supply of new privately owned housing has been supported by the federal LIHTC programme which is administered with a good deal of local discretion through the individual states. This provides a subsidy that is conditional on the newly produced or substantially improved units being available for lower income households at rents that reflect local affordability. The lowest income households may fail to benefit from LIHTC dwellings, even though they can be additionally supported by housing vouchers.
- 11.5 Rents are typically freely determined except in four states where local communities can limit rent increases on older tenancies. Rents in newly produced units are freely determined although there are limits on the maximum rents in LIHTC supported housing.

## 12. Summary 2

1. Around one-third of American households live in rented housing much of which is privately owned and unsubsidised.
2. Many renters cannot afford to own but some can.

3. There are a significant number of low income renting households with affordability problems.
4. Investing in rental housing has proved attractive for both individuals/couples and large scale investors.
5. A large unsubsidised sector has been mostly subject to freely negotiated market rents.
6. Limits on rent increases exist in some locations – these do not affect new dwellings or new tenancies unless the new dwellings are assisted through subsidies or tax credits.
7. Deductibility of expenses, including depreciation, for tax purposes support acceptable rates of return on rental investment.
8. Capital Gains Tax is much lower than in the UK and landlords can avoid the tax by reinvestment in rental property.
9. Low Income Housing Tax Credits, and federal rental production programmes more generally, have been important in supporting the supply of new privately owned affordable rental housing.
10. REITs have facilitated some large scale investment in rental housing.

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### Country expert

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**Appendix 1**  
**Characteristics of Owners of Multifamily Properties by Number of Units in Property, USA<sup>11</sup>**

	Total United States	Less than 5 units	5 to 49 units	50 or more units
<b>Type of owner</b>				
Individual investors, husband/wife	86.3%	89.9%	74.4%	30.6%
Trustee for estate	2.0%	1.9%	2.6%	1.0%
Limited partnership	2.8%	1.7%	5.5%	25.4%
General partnership	2.9%	2.2%	5.2%	12.9%
Real estate investment trust (REIT)	0.7%	0.6%	1.2%	2.6%
Real estate corporation	1.6%	1.0%	3.7%	10.9%
Other corporation	1.3%	0.9%	3.0%	5.7%
Non-profit/church-related institution	0.7%	0.3%	2.0%	6.1%
<b>Age of owner</b>				
Less than 45 years	23.4%	24.0%	19.8%	12.2%
45 to 54 years	25.4%	25.1%	27.3%	28.1%
55 to 64 years	23.5%	23.0%	26.1%	28.5%
65 years or older	27.8%	27.9%	26.9%	31.2%
<b>Race of owner</b>				
White	85.2%	84.6%	88.0%	93.5%
Black or African American	8.4%	9.2%	4.3%	1.5%
Asian or Pacific Islander	3.8%	3.6%	5.1%	3.3%
Spanish/Hispanic origin of owner	5.8%	5.9%	5.6%	1.8%
Owner residence on this property	24.2%	26.8%	10.3%	3.2%
<b>Owner weekly contribution to maintenance/management</b>				
Less than 1 hour a week	34.3%	35.9%	24.0%	46.8%
1 to 8 hours per week	45.2%	46.4%	39.9%	20.5%
More than 8 hours per week	20.5%	17.7%	36.2%	32.7%
Owner would not buy property again	31.9%	32.2%	32.7%	13.3%
<b>Other type of work of owner</b>				
None	23.4%	24.0%	20.6%	13.2%
Other	76.6%	76.0%	79.4%	86.8%
Executive/managerial/admin	15.5%	14.7%	18.3%	35.5%
Owner owns 1 rental property	48.0%	51.6%	29.7%	15.0%
Median percentage income earned from ownership of all rental properties	31.0%	29.0%	43.0%	64.0%

Note: For some items in this table, the percentages are given only for the top categories and may not add to 100%.

*Source: U.S. Census Bureau, Housing and Household Economic Statistics Division Last Revised: December 17, 2004*

<sup>11</sup> **Property Owners & Managers Survey (POMS) (2004)** U.S Census Bureau [WWW] Available from <http://www.census.gov/hhes/www/housing/poms/pomtsum2.html> [Accessed 24/05/10].

## **Appendix 2**

### **Abbreviations and acronyms**

<b>AFR</b>	Applicable Federal Rate
<b>CDBG</b>	The Community Development Block Grant
<b>HOPE</b>	Housing Opportunities for People Everywhere
<b>LIHTC</b>	Low Income Housing Tax Credit
<b>MARCS</b>	Modified Accelerated Cost Recovery System
<b>NYC</b>	New York City
<b>PAL</b>	Passive Activity Loss
<b>REIT</b>	Real Estate Investment Trusts
<b>RGB</b>	Rent Guidelines Board
<b>S-REIT</b>	Small Real Estate Investment Trusts [TBC]
<b>TCAP</b>	Tax Credit Assistance Program
<b>TCEP</b>	Tax Credit Exchange Program
<b>USA</b>	United States of America

# Appendix C

## Country report: Australia

### 1. Introduction

- 1.1 This report examines private rental investment in Australia. It considers the key factors influencing the demand and supply of market rented dwellings. The report shows that strong demand, supported by a favourable taxation regime, has encouraged investment, especially by small scale landlords who own a majority of the stock.
- 1.2 There is very little institutional investment in the sector and this is unlikely to change without policy interventions that improve the risk adjusted rate of return. A new initiative designed to promote private investment in low rent dwellings is considered.
- 1.3 The report is based in secondary evidence including journal articles, census data and especially several reports from the Australian Housing and Urban Research Institute. The production of the report has been greatly assisted by advice from Professor Mike Berry of the Australian Housing and Urban Research Institute at Royal Melbourne Institute of Technology.

### 2. The size of the private rented sector and its contribution to housing investment

**Table 1: Housing Tenure 1991-2006: % dwellings in each sector**

	<b>Outright owner</b>	<b>Purchaser</b>	<b>Private renter</b>	<b>Social renter</b>	<b>Tenure not stated</b>
1991	37.6	31.9	17.2	6.9	6.4
1996	42	26	20	6	7
2001	41	28	20	5	7
2006	34	34	21	5	6

*Sources 1991: Beer, 1999: 1996, 2001, 2006: Wulff et al, 2009.*

- 2.1 Private rental dwellings have comprised around 20 per cent of the Australian housing stock in recent years. The number of dwellings in this sector has increased considerably reflecting overall growth in the numbers of households and dwellings. The data in Table 1 employs the standard Australian Bureau of Statistics definition of private rental accommodation, that is, occupied private dwellings in which the household pays rent to either a real estate agent or a person not living in the same household.
- 2.2 Between 1986 and 1996, the Australian private rental market grew by 34 per cent, but this growth was mainly at the top end of the market with losses at the bottom. There was a further 7.6 per cent growth in the

number of private rental dwellings between 1996 and 2001 and this growth was entirely in the top quintile of the rent distribution. Despite an overall growth in the number of private rental dwellings there were absolute losses in the number of dwellings in the bottom four quintiles of the rent distribution. It is suggested that there was an inadequate supply of low rent units. This is because of a lack of filtering down so that higher rental dwellings have not reduced pressure at the lower end of the market. Thus there was a shortage of affordable private rental housing and this was despite increased incomes for renter households as a whole and increased investment in private rental housing (Yates *et al*, 2004).

- 2.3 Between 2001 and 2006, Australia's private rental sector grew by a further 11 per cent bringing the total number of private renter dwellings to 1.47 million. An analysis of this growth found that the private rental stock again expanded most at the higher end of the rent distribution whilst declining at the lower end. Private renter households increased mainly in the top third of the income distribution with some increase in the lowest income category (comprising 8 per cent of all private renter households). The decline in low rent stock was greater in non-metropolitan than in metropolitan areas. There is an ongoing affordability problem for low income households who rent privately (Wulff *et al*, 2009).

### 3. The demand for private rented housing

- 3.1 Rising demand for renting over the last two decades had been linked to increases in house prices, which have made it more difficult for newly formed households to become owners and to a reduction in the supply of public housing that has made it more difficult for lower income households to find accommodation in this sector (Short *et al*, 2008). Renting is often considered to be a less attractive form of housing tenure than home ownership, as renters have weak security of tenure. On the other hand, renting is also associated with flexibility, and renters may choose to move for lifestyle or employment reasons. Renting is relatively common among young adults and low income households. In addition, some high income households choose to rent for financial, or lifestyle reasons (AST, 2008).
- 3.2 There is a high rate of mobility in the sector. In 2006, renters were three times more likely than owner-occupiers to have changed address within the previous 12 months. At the 2006 Census, 35 per cent of people who were renting had lived at a different address within the last year, compared with only 10 per cent of owner-occupiers. Further, 63 per cent of all renters said that they had lived at a different address five years previously. Census data indicates higher rates of mobility among younger people in renter households. Among renters aged 18 to 24 years, 52 per cent had lived at a different address within the past year and 69 per cent had lived at a different address in the past five years (AST, 2008).

3.3 In 2005-06 the median age for renters (based on the age of the household reference person) was 37 years, which was 15 years younger than the median age for owner-occupier households (52 years). Young lone person households (reference person aged less than 35 years) were the most likely group to be renters (61 per cent). Half of all young couples without children were renters. Lone person households aged 35 to 44 years were more likely to be renters (56 per cent) than owner-occupiers (44 per cent), with the rental rate for this group increasing by nine percentage points between 1995-96 and 2005-06 (AST, 2008)

**Table 2: Distribution of income of households in the private rental sector 2001, 2006**

Household income quartile	2001	2006
	<b>% of private renter households</b>	
1	26	24
2	26	23
3	27	27
4	20	25

Source: adapted from Wulff *et al*, 2009, Table 6, page 17.  
*Totals do not add to 100 because of rounding*

3.4 The data in Table 2 suggests that private rental households are spread fairly evenly with respect to income distribution. It is clear however that the proportion of privately renting households on the highest incomes (in quartile 4) has increased over time and amounted to one quarter of all privately renting households in 2006.

3.5 An alternative representation of the data confirms that there are a considerable number of high income households that rent. The information in Table 3 shows that nearly 20 per cent of high income households in 2005-06 (households in the highest quintile of equivalised disposable household income, i.e. income adjusted to take account of differing household size and composition) rented privately.

3.6 High income renters tended to be younger households than other renters. In 2005-06 half of high income renter households were aged less than 34 years (based on the age of the household reference person) compared with 38 years for all other renter households. High income renter households were also less likely to have children, with just 15 per cent having children aged less than 15 years compared with 36 per cent for all other renter households (AST, 2008).

**Table 3: Housing tenure, by income quintiles, 2005-06**

	Owner without a mortgage	Owner with a mortgage	Renter from state/territory housing authority	Other subsidised renter(a)	Market renter(b)	Occupied rent free	All households(c)
	%	%	%	%	%	%	%
<b>Equivalised disposable household income - quintile</b>							
Lowest	47.6	13.8	13.2	4.0	18.1	2.5	100.0
Second	39.9	27.6	4.5	2.7	22.8	2.1	100.0
Third	28.6	41.9	1.5	2.3	23.8	1.5	100.0
Fourth	24.6	47.3	1.0	2.0	23.5	1.4	100.0
Highest	26.7	50.3	0.4	1.6	19.6	1.3	100.0
All households	34.3	35.0	4.7	2.6	21.3	1.8	100.0

Source: Australian Bureau of Statistics

<http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/7B658062E57862E9CA25743B00162C23?opendocument>

3.7 Table 4 shows the variation in housing costs by tenure in 2003-04. Housing costs accounted for 19 per cent of renters' household income and this was similar to that for home owners with a mortgage. However more than 9 per cent of private renters allocated over half of their income to housing costs, which was a higher proportion than for any other tenure. Extensive work by Australian academics has demonstrated that there are significant affordability problems for low income rental households. The worsening affordability situation for low-income private renter households is compounded by rising housing costs and a shortage of affordable rental housing (Yates *et al*, 2004; Wulff *et al*, 2009). Low income households are also perceived as higher risk renters (greater probability of rent arrears) by property managers and landlords (Short *et al*, 2008).



**Table 4: Housing costs by tenure and landlord type - 2003-04**

	Average weekly housing costs	Average housing costs as a proportion of gross household income	Proportion of households whose housing costs represented		Number of households
			25% or less of gross household income	More than 50% of gross household income(a)	
			\$	%	
Owner without a mortgage	25	3	98.0	1.4	2,702.9
Owner with a mortgage	287	19	67.3	7.0	2,713.8
Renter - state/territory housing authority	84	19	76.1	2.4	376.4
Renter - private landlord	198	19	60.7	9.4	1,638.4
Total renters(b)	174	19	64.3	7.8	2,133.4
All owner and renter households	157	14	77.9	5.1	5,416.7

(a) Includes households with nil or negative total income.  
(b) Includes other landlord types.

Source: Australian Bureau of Statistics

<http://www.abs.gov.au/ausstats/abs@.nsf/0/73CA155695D11034CA25723600026C54?opendocument>

## 4. The supply of private rented housing

- 4.1 Very little new housing is built exclusively for the private rental sector but official data does not allow one to identify the eventual tenure of newly built housing (Seelig, 2001). It thus is not possible to suggest what contribution private renting makes to housing production.
- 4.2 However, there is anecdotal evidence that new rental build is increasing over the last decade, driven by: booming overseas student numbers (studio and one-bed flats built near universities); young higher income professionals wanting to live near the centre of town (encouraged by state and local government planning strategies to increase densities); retired singles and couples looking for lifestyle advantages of central city location (Berry, 2010).
- 4.3 Large land tracts in the inner cities of Melbourne and Sydney are being redeveloped for new residential use on converted light industrial and warehousing land (Docklands type development) and on old high rise public housing estates in Sydney and Melbourne. Due to cost and location factors, the new stock is at the high rental end of the market and much of the stock is pre-sold to investors (Berry, 2010).

- 4.4 Private rental housing is provided by a diverse group of residential property owners such as private householders, non-profit institutions, employers and corporations. The largest group, private householders, provided rental housing for about 60 per cent of households who rented in the private market in 1995-96 (ABS, 1999). The majority of the private rental stock is thus owned by individual households and most of the remaining rental stock is owned by small (especially family-based) partnerships and small companies. There is very little institutional investment in the sector (Berry, 2000).
- 4.5 At a state level there have been arrangements where governments have leased from private owners to increase the supply of 'social housing'. The dwellings are managed by not-for-profit housing associations and tenants get a state rental subsidy.
- 4.6 There have been several initiatives, with varying success rates, to encourage more institutional investment into the private rented sector. There have also been several ideas that have been developed but not implemented. There has also been some consideration of why institutional investment has not been forthcoming in Australia (Berry, 2000; Berry & Hall, 2005; Jones, 2007) and this is considered in section 6.
- 4.7 A significant recent initiative is the National Rental Affordability Scheme. This is discussed in section 8.

## 5. Individual investment in the private rented sector

- 5.1 The vast majority of investors in the private rental market are individuals rather than corporate investors (Yates, 1996). Individuals that invest in the low rent stock have lower incomes on average than rental investors overall. Consequently they receive fewer of the tax advantages that encourage investment in rental property. They also face higher operating costs. They thus receive lower returns on their investment, and are, potentially, the most likely to exit the market. Higher income investors benefit more from tax breaks, but tend to invest in higher valued properties (Yates *et al*, 2004). Overall, private landlords have roughly twice the average incomes of all households (according to a 1997 ABS investor survey quoted by Berry, 2010). It has been suggested that the sector may be split between lower income relatively unsophisticated investors and more rational higher income landlords; many of whom use rental property as tax shelters, directly and by including rental properties in their private tax favoured superannuation funds (Berry, 2010).
- 5.2 Most individual landlords own only one or two properties. Only a small proportion (around 13 per cent according to a 1994 survey) obtains most of their income from their property investment and a majority obtains most of their income from work or a pension (Beer, 1999). Some have

inherited property or they initially rented dwellings as a result of finding it difficult to sell their home when moving. They have been termed 'accidental and unintentional' landlords (Berry, 2000).

- 5.3 Surveys of rental investors have persistently showed that perceptions of a secure long term investment, the advantages of negative gearing and the prospects of capital gains drive decisions to invest in rental property (Beer, 1999, Berry, 2000). An investment is negatively geared when the income derived from the investment is less than the interest cost of borrowing and the other on-going costs of the investment. Rental property investment is frequently negatively geared in Australia. The resulting current losses are claimed by investors as deductions against other assessable income. This contrasts with situation in the UK where the transfer of such losses to other taxable income is not possible.
- 5.4 Two major studies of the motivations of individual investors in rented housing have between them stressed the importance of financial and personal factors in explaining both the decision to invest and the timing of the exit from the market. Wood and Ong (2010) using a quantitative analysis of investors' costs and returns pointed to the importance of financial factors and Seelig *et al* (2009) used interview evidence to examine the attraction of residential property compared with other investments.
- 5.5 The investigation of financial motives concluded that the most important driver of rental investment behaviour is a person's after-tax economic costs (referred to technically as the user cost of capital). A rental investor's user cost of capital is the investor's after-tax economic costs as a percentage of the property value. This takes account of the after-tax interest on debt, the return sacrificed on the investor's equity stake in the rental property investment and capital gains. It also includes the operating costs of providing accommodation such as repairs, property management fees and land taxes, and transaction costs.
- 5.6 On the basis of survey evidence from individual investors in rental housing (Seelig *et al*, 2009, p2) conclude that "The most crucial perception is that it represents a good (long-term) investment, with a sense of 'low risk' and 'guaranteed' return. Most investors have identified 'long-term investment' or 'capital gains' as the most important reason for having invested in property" Most commonly, capital gains over the longer term is what landlords expect, and this is how the success of the investment is judged.
- 5.7 Investors usually accept that costs may well outweigh returns initially, and that positive returns are unlikely for a few years. The tax benefits of negative gearing are not viewed by most landlords as essential to their investment but rather they see this as a 'welcome and generous tool' or 'added bonus' (Seelig *et al*, 2009).

- 5.8 It is shown that “*New and seasoned investors alike report very high rates of satisfaction with various aspects of their property investment, including yield, capital gain, and property and tenancy management. These perceptions provide an ongoing incentive for investors to remain in the property market, to increase their portfolio, to consolidate, or to start realising their assets as part of their investment strategy*” (Seelig *et al*, 2009, p3).
- 5.9 Age and personal circumstances appear to be more important than financial factors and market circumstances in determining when the point of sale was to be. Retirement was a significant factor influencing the decision to exit the market with landlords realising their capital gain at this point in their lifecycle.
- 5.10 Ownership of rental dwellings should be separated from the management of those dwellings. Although many small scale landlords manage properties themselves, estimates suggest that 68 per cent of all privately rented dwellings are managed professionally by real estate agents (Short *et al*, 2008).

## 6. Institutional investment in the private rented sector

- 6.1 Berry *et al* (1998) in an attempt to understand the low level of institutional investment in private rented housing, interviewed senior managers from major Australian superannuation funds and fund managers. They found that the main barriers to rental housing equity investment stressed by these interviewees were high management costs and the small unit size of residential investment opportunities. They also suggested that securitisation would reduce liquidity problems, although the interviewees were comfortable with a degree of illiquidity in return for a premium on the required rate of return. Concern was also expressed about the potential for bad publicity for the institution where, for example, tenants-in-arrears are evicted. Institutional investors cannot furthermore benefit from the tax advantages available to individual investors.
- 6.2 Overall it is clear that professional and institutional investors are absent from this sector, primarily because the expected return on investment is too low given the perceived risks. The risks include: capital risk on the value of the dwellings; interest rate and inflation risks; rental yield risk; operating cost risk; and political risk associated with possible changes to relevant government policies. Large institutions may also be concerned about the lack of complete and robust market information on the performance of this asset, poor tenancy and property management skills in the housing sector and the negative public image effects of tenant evictions. Private investors, especially the major institutions like superannuation (pension) funds, will not invest until the expected returns justify the risks assumed (Berry & Hall, 2005). Institutional investors invest in rental housing only through the secondary mortgage market. In

2008-09 the Australian Government pumped funding into propping up the secondary market in the wake of the Global Financial Crisis (Berry, 2010).

- 6.3 Analysis of the policies that are needed to increase institutional investment suggests that lower risks and higher returns could only be achieved with the help of subsidies: *“A policy package necessary to remove the basic barrier to institutional investment—i.e. an inadequate risk-adjusted rate of return— will entail three components: a form of guaranteed subsidy stream; a mechanism for delivering the necessary subsidy; and, a private financing option.”* (Berry & Hall, 2005; p105).
- 6.4 Jones (2007) argues that Real Estate Investment Trusts have not been successful as a way of promoting institutional investment in private renting. The Australian equivalent is Listed Property Trusts that have existed since 1970. However unlike their American equivalent Australian LPTs do not invest in residential property. One reason is that income returns at 3 to 4 per cent are deemed too low compared with commercial property (offices, retail, industrial) at around 7 to 8 per cent. A lack of large investors is also related to the nature of the stock especially the lack of large rental complexes in Australia.
- 6.5 Another barrier to residential REITs is the lack of adequate professional property managers, by comparison with the commercial property sector. Governments are hoping that the new NRAS (see section 8) will stimulate the growth of housing associations on a scale that encourages them to become professionally competent management organisations who might also attract property managers from the commercial sector (Berry, 2010).

## 7. Policy measures that influence investment in the private rented sector

### Rent controls

- 7.1 The states and territories, rather than the national government, are responsible for residential tenancy legislation. Each jurisdiction has specific legislation concerning the rights and responsibilities of landlords and tenants, and of real estate agents and other property managers acting on behalf of landlords.
- 7.2 Berry (2000, pp662-663) argues that *“Australia has largely been free from the onerous and prescriptive legislative controls constraining landlords in many other advanced capitalist societies during the current century. Rent control, other than during wartime (or as a quickly fading hang-over from war), has been absent. Laws regulating landlord-tenant relations are imposed at the state government level, and therefore vary somewhat between states. However, in general and in relation to similar legislation in other Western countries, the bias in Australia is in favour of*

*landlords rather than tenants reflected above all in the absence of effective security of tenure for the latter.”*

- 7.3 Initial rents are freely negotiated in all Australian states. Increases or decreases in rents may be reviewed by a tribunal (or in Tasmania a magistrate). Reviews take account of market rents for comparable properties, and the state of repair of the premises. The rent cannot be increased before the end of the first year of tenancy and in some states the landlord can only increase rent at intervals of six months. Rent increases may require the service of a notice with a period which varies according to location between 30 and 60 days (Global Property Guide, 2006).

### **Deposits**

- 7.4 At the beginning of a tenancy tenants usually pay rent in advance and pay a rental bond. The maximum advance rent is generally two weeks or a month's rent, depending on the type of tenancy agreement and the state. A rental bond functions as a security deposit in case the tenant fails to pay rent or incurs serious damage to the property. Most states have a Rental Bonds Office that holds these bonds on behalf of landlords and tenants. The amount is typically equal to four weeks rent but in detail the amount depends on the rent level, tenancy agreement and the state (Global Property Guide, 2006).

### **Security of tenure**

- 7.5 There is weak security for tenants. Landlords can obtain vacant possession easily making the investment potentially relatively liquid for investors. There are two types of tenancy: fixed term tenancies, and periodic tenancies, which go either from week to week, or from month to month. In principle landlords and tenants can negotiate a mutually agreeable term for the lease, but *“the general “industry standard” is for an agreement to specify, initially, a six or 12-month tenure period (Fixed-term Agreement) after which it becomes common practice not to specify any further period (Periodic Agreement). This latter agreement provides for the tenant to reside in the property for an indefinite period.”* (Adkins et al, 2002; p12).
- 7.6 The minimum notice that a landlord is required to give ranges from 14 days to 28 days depending on the state. In two states (South Australia and Western Australia) there is no minimum period but landlords and tenants are required to reach an agreement (Global Property Guide, 2006).
- 7.7 The extent to which weak security of tenure is an important problem for tenants and a significant source of ‘involuntary’ mobility is a source of debate in Australia. Data from 1999 shows that almost half of all private tenants had moved at least three times in the last five years whilst in Queensland more than half had moved in the last year. Commenting on

this Adkins *et al* (2002) argue that while some mobility can be explained in terms of preference for flexibility over stability, much of the discussion on movement interprets it as involuntary and as evidence of insecurity of tenure (see also the data on the high rate of mobility in section 3).

## **Taxation**

- 7.8 Several aspects of the Australian taxation system have important influences on the profitability of private renting for individuals and this impact on the level of investment in the sector. The generous cost deductions against rental income and the possibility of benefiting from negative gearing and thus a reduction of tax due on non-property income have positive effects. However the land taxation and stamp duty arrangements effectively incorporate disincentives against individual landlords owning more than one or two properties. Capital gains tax additionally reduces the overall return. Each of these aspects of the taxation system will be considered in turn. There will then be a summary of the findings of a study that has examined the impacts of these measures and recommends a change in favour of American style Low Income Housing Tax Credits (LIHTCs).

### **Cost deductions and negative gearing**

- 7.9 All expenses can be deducted against the landlord's total income for income taxation purposes. The expenses that can be claimed include advertising costs, interest on loans, bank charges, council rates, insurance, land tax, property agent fees or commissions, repairs and maintenance (stationery, telephone, water charges, gardening and mowing, pest control), and travel undertaken to inspect the property or to collect the rent (Global Property Guide, nd).
- 7.10 For new buildings the depreciation deduction takes the form of the Australian Government Building Write-Off (BWO) allowance, which enables a landlord to deduct from their annual taxable income an amount equal to 2.5 per cent of the construction cost of a newly built dwelling or an extension.
- 7.11 In addition to the building allowance for capital and operating expenses, investor landlords can also deduct a whole range of book depreciation items on dwelling fixtures – curtains, carpets, stoves, dishwashers and other plumbing, etc. Thus book losses for negative gearing can be very large (Berry, 2010).
- 7.12 With individuals who have other sources of income able to transfer annual losses from rental property to reduce their overall tax bill, the prospect of negatively gearing property investments is a particularly

attractive proposition for high income earners on the maximum marginal tax rate. In the mid-1980s the Federal Government ended negative gearing, replacing it with a 4 per cent depreciation or building allowance for new rental dwellings. It was however reintroduced in 1987 and the building allowance was reduced to 2.5 per cent. It is seen as an important incentive for investors who rely on capital gains for the return from their investment (Berry, 2000).

### **Land taxation and stamp duty**

- 7.13 Land tax is an annual tax, levied on all real estate properties. Exemptions to land tax are extended in most states, to a person's primary place of residence, and to farms. The tax base is the assessed value of the property. All jurisdictions, except the Northern Territory, impose land tax on the value of land (excluding the value of the dwelling). It is payable on dwellings that are not a primary place of residence (rental properties, second homes). Stamp duty is levied by all jurisdictions on the change of ownership of land and dwellings. Typically, the higher the value of the transaction, the higher is the rate of stamp duty (Global Property Guide, nd; Wood *et al*, 2003b).
- 7.14 Land Tax is payable only above certain specified land value thresholds, but is then payable on the combined land value of all property holdings. The multiple property landlord is thus far more likely to be liable to pay land tax. It has therefore been argued that land tax arrangements act as a barrier to landlords increasing their portfolios above one or two properties: *"State Government land tax is levied beyond a minimum value threshold, which varies between states and over time. In larger metropolitan housing markets the threshold is normally surpassed after one or, at most, two dwellings, encouraging the maintenance of a highly dispersed pattern of rental ownership."* (Berry, 2000; p663).
- 7.15 This is confirmed by Wood *et al* (2003b) who demonstrate that State and Territory Land Tax and Stamp Duty create disincentives for single property landlords who wish to add to their investments in rental housing, and thereby potentially limit the supply of dwellings in the private rental market. They show, by way of an example, that for the typical single property landlord in Sydney the effective tax burden increases by nine percentage points when they invest in one additional rental dwelling.

### **Capital Gains Tax**

- 7.16 Capital gains tax was introduced in 1983. Before this capital gains on all assets were untaxed. Capital gains tax is applied at the investor's marginal rate of income tax. The capital gain is computed by deducting the 'cost base' from the gross selling price or fair market value of the property. The 'cost base' of the property is the sum of the following amounts:
- acquisition cost of the property
  - incidental expenses of buying and selling the property



- improvement costs and
- non-capital costs of ownership of an asset acquired on or after 21 August 1991 (for example, interest on borrowing to purchase the asset, rates and land taxes, repair and maintenance expenditure) to the extent that these are not otherwise deductible

7.17 The cost base of the property sold within one year of acquisition cannot be indexed. Otherwise, the non-capital costs of ownership of an asset can be indexed. The indexation method that can be applied depends on the date the property was acquired. For assets acquired before 1999 indexation is related to the consumer prices index. For properties purchased since then there is simply a 50 per cent discount from the unindexed gain as long as the property is owned for at least one year (Global Property Guide, nd). This is a huge incentive to higher income investors (Berry, 2010).

### **The impact of the taxation system**

7.18 An evaluation of the financial viability of rental property investment and the tax system suggests that a range of factors influences financial viability including mortgage interest rates, property prices, income tax rates, income tax deductions and, negative gearing. Tax deductions help to make investing in the private rental market more financially viable and increase the supply of rental property (Wood *et al*, 2003b).

7.19 However, the combined effect of negative gearing, capital gains and BWO tax arrangements on financial returns is greatest at the high rent end of the market. The effect is small at the low-rent end of the market and so the pattern of rental housing financial returns is distorted, disadvantaging investments at the low-rent end of the market.

7.20 Woods (2001) found that tax and other incentives encourage high income investors to acquire high rent dwellings and low income investors acquire low rent dwellings (often managing one expensive property rather than two cheaper ones). This adds to a bias in favour of high rent segments and reinforces the structural shortage in the low rent segment. Rents relative to dwelling quality were found to be higher in the low rent segment because a higher proportion of investor return comes from rental yield than in the high rent segment (Woods, 2001). Gross rental yields are higher for lower income investors (Berry, 2010).

7.21 It argued that on its own the BWO allowance has little effect on tax burdens, reducing the average effective tax rate by only one percentage point. The negligible impact arises because BWO allowances are recaptured on sale of the rental property, through capital gains tax. An alternative means of reducing the tax burden of landlords and of directing investment to the low-rent end of the market is the Low Income Housing Tax Credit as used in the United States. This allows a landlord to deduct from their taxable income an amount equivalent to 70 per cent of the present value of a newly constructed or substantially renovated

dwelling. It is seen as a better option than the BWO (Wood *et al*, 2003b).

## **Assistance for rental households**

### *Setting up a tenancy*

- 7.22 There are a range of services instigated at state level that are designed to help low income tenants set up their tenancy and thereby encourage landlords to let their properties to low income renters. Collectively these have been termed Private Rental Support Programs. The services provided include help with the bonds that are required at the start of a tenancy. This takes the form of grants, loans or guarantees. The assistance can also include help in making advance rent payments and clearing rent arrears (in the form of loans or grants); assistance with moving and utility costs and information and advocacy services. An evaluation of these programmes shows that perceptions of private rented sectorP are generally positive amongst both tenants and the practitioners responsible for administering the programmes. They believe, in particular, that bond loans and grants are important in helping low income households enter the private rental market and maintain their tenancies (Jacobs *et al*, 2005 and 2007).

### *Housing allowance*

- 7.23 Demand for private renting has been supported by Commonwealth Rent Assistance (CRA). It is a direct housing subsidy available to eligible private tenants and is the major form of housing assistance to low income households. It is argued however that it fails to target the poorest tenants and those living in high cost housing markets (Wood *et al*, 2003a). CRA to private tenants is channelled to those in receipt of benefits and/or pensions. Apart from some family households, low paid working households do not receive CRA. The amount paid varies by rental level up to a threshold. As it is capped its value is eroded in areas where housing costs are high. It is not therefore sufficiently generous to alleviate affordability problems for lower income households in high rent locations (Randolph & Holloway, 2007).

## **8. Policy measures that influence new building for private renting**

### **General measures**

- 8.1 Investment in newly constructed dwellings is stimulated by the interaction of depreciation allowances and capital gains taxes and by the ability to reduce (state based) stamp duties by purchasing dwellings 'off the plan' (Yates & Wulff, 2005; p8). More generally the tax advantages of investing in rented housing are likely to support the purchase of new dwellings for renting as well as acquisitions from the existing stock.

## National Rental Affordability Scheme

- 8.2 In 2008, the Australian government introduced a new scheme, the National Rental Affordability Scheme (NRAS), which has potential to directly contribute to the supply of private rental housing let at submarket rents. It aims to increase the supply of affordable rental housing through the production of 50,000 additional dwellings by 2012. The dwellings will be owned by the bodies financing their development, for example, privately-owned property developers, financial institutions, or non profit housing/welfare organisations. The property and tenancy management of the new dwellings to be undertaken by, among others, private businesses (for example, real estate agents) (Lawson *et al*, 2010; Johnston, 2009).
- 8.3 The scheme provides a subsidy on the condition that the dwellings are rented for at least ten years at a rent that is no more than 80 per cent of the local median market rent. There are allocation conditions that require the dwellings to be rented to households whose income falls within given limits. These income thresholds are modelled on eligibility criteria for Commonwealth Rent Assistance (Johnston, 2009). A modelling exercise of a sample of NRAS properties and households found that 40 per cent of households with affordability problems would be moved from paying more than 30 per cent of their income on housing to paying less than 30 per cent. It also finds that the NRAS is likely to create savings in CRA expenditure of 5 per cent (Ong & Wood, 2009).
- 8.4 The subsidy takes the form of a tax credit for private sector participants and a grant for charity participants. For private investors, the NRAS initially provided a \$6,000 tax credit per new dwelling constructed, each year, for ten years, from the Australian government, plus \$2,000 cash or in-kind contribution from the state or territory government. The in-kind element can be in the form of stamp duty or land tax concessions. The cost of NRAS to the Australian Government through to 2012 is projected to be \$625 million (Ong & Wood, 2009). NRAS is inflation indexed and is now worth over A\$9,000 in nominal terms (Berry, 2010).
- 8.5 NRAS has not yet appealed to institutional investors. In the first two rounds, only housing associations and other non-profit community organisations have taken up the subsidies. Round 3 is currently underway and is aimed at the institutions – bids have to have a minimum of 1,000 dwellings. *“It is very doubtful that much will eventuate here – because of the barriers that exist (as per 6.1 and 6.2)”* (Berry, 2010).
- 8.6 NRAS was introduced to build up a housing association sector as an equity investor and manager of an affordable rental stock; private investors would provide debt funding. This to date has meant normal bank mortgage finance. The bigger housing associations are borrowing up to 100 per cent on NRAS dwellings supplementing NRAS subsidies with cash flows from other dwellings in their balance sheets. Rents

charged have to be no greater than 80 per cent of the market level but mostly are 75 per cent to meet the regulatory requirements for charity tax status. To date there have been few private for-profit equity rental investors taking up NRAS subsidies (Berry, 2010).

- 8.7 NRAS has been introduced alongside a large 'Nation Building and Jobs Plan' (A\$5.6 billion for affordable housing) as part of the Australian Government's fiscal stimulus package to fight the global financial crisis (GFC). This is in the form of a capital grant for 75 per cent of the cost of a new dwelling, the remaining 25 per cent has to attract private funding (mortgage debt). Early in 2010, the government agreed that housing associations could couple NRAS subsidies with Nation Building grants. There are other boosting schemes around homelessness and Indigenous Housing and a one-off growth fund for housing associations under 'National Partnership Agreements' between the Commonwealth and the states. But these are short term as is National Building. The long term is governed by a 2009 introduced National Affordable Housing Agreement (NAHA) that requires state public housing authorities and housing associations to leverage future Commonwealth grants by 25 per cent. The NAHA replaced the Commonwealth State Housing Agreement that ran from 1945 to 2008 and funded public and community housing (Berry, 2010).

## 9. Policy measures that influence the volume of the stock in the private rented sector

- 9.1 Over the long run demographic change (principally smaller households) has boosted demand for the sector (Beer, 1999). Housing market and taxation arrangements have been favourable to small scale investment in private renting. Capital growth (increasing house prices) has made the sector an attractive investment, together with provisions that allow negative net income streams to offset tax on other activities. Demand has been encouraged by the lack of a significant social sector.
- 9.2 There is a well-established tradition of investing in residential property. Such investment has been encouraged by taxation arrangements such as negative gearing, which enables investors to defer tax liabilities until capital gains are realised. Financial innovation has increased access to finance for investment. These changes have contributed to a growth in investment since 1996 (Yates & Wulff, 2005; p8). Rental housing investment is also encouraged by low volatility of returns by comparison with equities and other asset classes (Berry, 2010).
- 9.3 Negative net-rental income can be offset against other income for tax purposes. A major incentive for investment is long term capital growth. Negative gearing is important for high income individuals with high marginal tax rates.

- 9.4 The attraction of private renting as an investment is combination of financial incentives and the availability of an investment that ordinary households can understand and perceive as giving a long term safe return. It has been summarised in this way:

*“Rental investment leaves the landlord in control of a highly visible asset, bricks and mortar, with psychological benefits for risk averse investors with limited knowledge of the broader investment environment --- rental housing --- has been one of the few effective avenues, along with savings banks, home ownership and life insurance, for personal savings. In this sense it has functioned as a ‘sink’ for trapped savings.”(Berry, 2000; p663)*

- 9.5 Despite the high level of investment in the private rented sector there is concern that there is a shortage of low rent stock. A wide ranging evaluation of this shortage (Yates *et al*, 2004) suggests that there are two main approaches to addressing this issue. One involves replacing the private rental market and the other supplementing the market.
- 9.6 Replacement might occur through creating a secondary rental market, such as happens with head leasing by a social landlord. This solution has been implemented on a small scale in different states through head leasing low rent properties as they become available. This involves creation of a secondary market for low income tenants and ensures that the low rent stock is allocated to those households most in need of it. The need for control over the allocation process is reinforced by the argument that shortages are magnified because existing low rent stock is occupied by higher income households. It is suggested that the declining numbers of low rent properties mean that an approach that is restricted to better targeting of the existing low rent stock will be limited.
- 9.7 Market supplementation could be accomplished by the development of a social housing sector. If the private sector helps to provide this social housing it is argued that new tax breaks, guarantees or other forms of direct subsidy will be require together with demand side rental assistance (Yates *et al*, 2004). The National Rental Affordability Scheme provides another model that potentially adds to the stock of privately owned rented housing that is subject to rent limitations and allocation criteria designed to target households on lower incomes.

## 10. Policy measures that influence the quality of private rented housing

- 10.1 The Australian censuses do not include data on the quality of houses and thus are not usually used in housing analyses in Australia. There appear to be no specific initiatives that are designed to improve the quality of the housing stock. However given that maintenance expenditure is deductible for income tax proposes and capital expenditure on improvements is deductible for the purposes of capital

gains tax, there are arguably fiscal incentives to maintain and improve properties. The policy literature does not identify poor quality rented housing quality as an issue.

- 10.2 The quality focus is now on environmental standards. National building regulations now specify 5-star energy standards on all new houses. A 6-star requirement is widely tipped to become mandatory industry wide. This is low by European standards, partly reflecting the Australian climate and customs (Berry, 2010).

## 11. Summary 1

- 11.1 The private rented sector represents around one fifth of the housing stock in Australia. As a proportion of the stock this has changed little for two decades but the absolute numbers have increased considerably. This growth has principally been at the top end of the market with the availability of lower rent accommodation declining. This has contributed to significant affordability problems for low income households.
- 11.2 There is a high rate of mobility in the sector and large numbers of young households. There are large numbers of single people who rent privately but so do half of all young couples without children. The proportion of higher income renters is growing, probably reflecting rising house prices.
- 11.3 Landlord and tenant legislation is in detail principally a matter for individual states but the overall position is one of free market rents and very limited security of tenure for tenants. There are some limits on rent increases, especially in the short term but landlords can obtain vacant possession easily and at short notice.
- 11.4 Most private rental housing is owned by individuals who typically own only one or two properties. Land and stamp duty thresholds work against larger holdings. Investment in the private rented sector is influenced by a favourable demographic, economic and fiscal environment. Taxation advantages support investment, as does long term capital growth. These factors encourage individual but not institutional investment. This is virtually non-existent. Institutional investors invest in rental housing only through the secondary mortgage market.
- 11.5 The deductibility of a wide range of expenses from rental income for tax purposes, including financing costs and depreciation helps to increase the rate of return to investment. Investors who engage in negative gearing, accepting ongoing losses, against the prospect of long term capital gain, are assisted by a tax system that allows these losses to be offset against other income. The tax system has encouraged investment at the top rather than lower end of the market.

- 11.6 Assistance with rental deposits and housing allowances help low income households enter the sector and make renting more affordable. There are however doubts about whether the national housing allowance system provides sufficient support for the lowest income tenants.
- 11.7 Professional and institutional investors are absent from this sector, primarily because the expected return on investment is too low given the perceived risks. Evaluations in Australia suggest that some new form of subsidy is required in order to improve this rate of return and encourage institutional investment.
- 11.8 A new National Rental Affordability Scheme is promoting the building of new private rental dwellings. Investors receive tax credits on the condition that the properties are let at sub-market rents to households within specified income limits. The scheme is however open to non-profit organisations as well as private investors and the take up by the private sector has been very low.
- 11.9 In the short term as part of a reaction to the GFC a new 'Nation Building and Jobs Plan' and other financial packages are providing capital grants to support rental house building.

## 12. Summary 2

1. The private rental stock is growing in Australia. Over one-fifth of all households rent privately.
2. There are large numbers of young mobile households in the sector and a growing proportion of higher income households.
3. There is a significant affordability problem for low income tenants despite assistance from housing allowances and rental deposits.
4. Free market rents are accompanied by weak security of tenure for tenants.
5. Most rental housing is owned by individual landlords who typically own one or two dwellings.
6. The deductibility of a wide range of expenses from rental income for tax purposes, including financing costs and depreciation helps to promote individual investment in the sector.
7. The advantages of negative gearing, for tax purpose, accompanied by the prospects of long term capital growth provide an important stimulus for individual investment in the sector.
8. Professional and institutional investors are absent from this sector, primarily because the expected return on investment is too low given the perceived risks.

9. Policy measures that include subsidies to increase the rate of return are a necessary condition for more institutional investment.
10. A new system that gives tax breaks to private investors in low rent dwellings is expected to increase the supply of privately owned affordable accommodation.
11. A 'Nation Building and Jobs Plan' and 'National Partnership Agreements' are in the short term providing additional assistance for rental house building.

## 13. References and acknowledgements

### Country expert

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## **Appendix 1**

### **Abbreviations and acronyms**

<b>ABS</b>	Australian Bureau of Statistics
<b>BWO</b>	Building Write-Off
<b>CRA</b>	Commonwealth Rent Assistance
<b>GFC</b>	Global Financial Crisis
<b>LIHTC</b>	Low Income Housing Tax Credits
<b>LPT</b>	Listed Property Trusts
<b>NAHA</b>	National Affordable Housing Agreement
<b>NRAS</b>	National Rental Affordability Scheme
<b>private rented sector</b>	Private Rental Support Programs
<b>REIT</b>	Real Estate Investment Trusts

# Appendix D

## Country report: France

### 1. Introduction

- 1.1 This report gives an overview of the policies relating to the private rental sector in France, with specific attention being paid to policy measures that aim to promote investment in this sector. The paper is based on an analysis of the literature, of relevant policy documents and of statistical data sources. Two French housing experts (Jean-Pierre Schaefer and Claude Taffin) have provided information and advice.

### 2. The size of the private rented sector and its contribution to housing investment

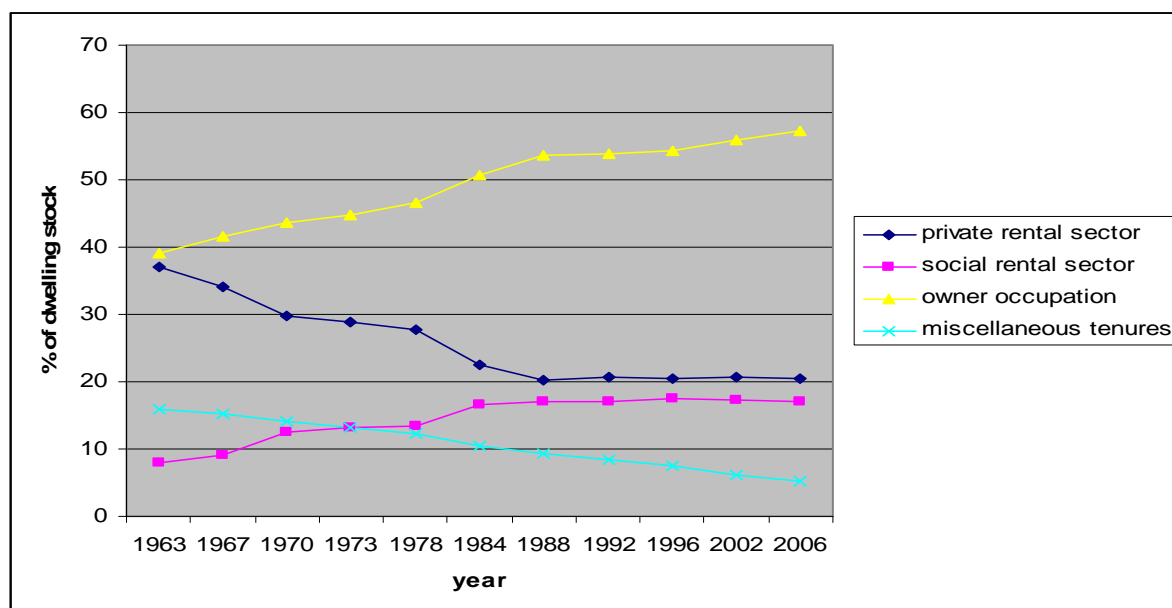
#### **Introduction**

- 2.1 This section presents some basic characteristics of the French private rental sector; its importance compared to the other tenure sectors, the importance of the different types of private rental landlords, and the contribution of the private rental sector to the production of new dwellings.

#### **The size of the private rented sector in historical perspective**

- 2.2 As in many other European countries, the private rental sector had a dominant position on the French housing market in the period before World-War II (Haffner *et al*, 2009; p107). In the decades after World-War II, the share of the sector decreased considerably. This was partly due to the fact that the rents of private rental dwellings that were occupied before 1948 were strictly regulated. This rent regulation, combined with heavy taxes for private rental landlords, led to low returns and prompted many private landlords to sell their property. In addition to this, urban renewal operations in inner city areas also resulted in a decline of the private rental dwelling stock.
- 2.3 In the 1980s, the decline of the private rented sector came to an end (see also Figure 1). Since then, the proportion of private rental sector dwellings has been stable; the private rental dwelling stock having a share that corresponds to about 20 per cent of the total dwelling stock. According to most French housing experts, this relative revival of the private rented sector is mainly due to the various tax incentives to private investors that have been developed by the French government (Taffin, 2008). Tutin (2008) notes that the stable share of the private rental sector makes France an exception in a European context.

**Figure 1: Tenure distribution in France (main residences), 1963-2006**



Source: INSEE housing survey, various years

### Types of landlords

- 2.4 The vast majority (about 96 per cent) of French private rental dwellings is owned by private individuals. Only a very limited part of the private rental stock (about 4 per cent, which equates to 230,000 housing units) is owned by institutional private rental landlords.

### Housing production

- 2.5 In the 1980s the share of the private rental sector in total housing production was relatively limited (5 to 10 per cent of this production, between 10,000 and 20,000 new private rental sector dwellings each year). In the 1990s, the share of the private rental sector in housing production increased to about 15 per cent (with a yearly output fluctuating between 35,000 and 45,000 private rental dwellings). After the turn of the century, the production of private rental dwellings further increased, reaching a peak of more than 85,000 dwellings in 2006 (see Table 2). In the last few years, the production figures have dropped again, mainly as a result of the global economic crisis.

**Table 2: Housing starts in France in the period 2004-2010 (\*1,000 dwellings)**

	2004	2005	2006	2007	2008	2009	2010 <sup>12</sup>
<b>Social housing (HLM)</b>	44.0	54.0	57.0	64.0	68.0	80.0	100.0
<b>Intermediate rental housing</b>	2.4	1.3	1.1	1.1	1.7	1.6	3
<b>Private rental sector</b>	57.9	73.3	85.5	79.7	58.4	44.3	57
<b>Owner occupation</b>	272.3	293.7	292.8	294.9	254.6	194.3	195.7
<b>Secondary homes</b>	21.2	21.8	23.8	23.2	17.4	12.2	15.3
<b>Total</b>	<b>397</b>	<b>441</b>	<b>460</b>	<b>465</b>	<b>400</b>	<b>334</b>	<b>371.5</b>
<b>% private rental sector</b>	<b>15</b>	<b>17</b>	<b>19</b>	<b>17</b>	<b>15</b>	<b>13</b>	<b>15</b>

Source: based on information provided by Schaefer, 2010

### 3. The demand for private rented housing

#### Introduction

- 3.1 This section analyses the private rental sector from the demand-side and focuses on the characteristics of private rental sector tenants. Furthermore, the main characteristics of the private rental dwelling stock are presented.
- 3.2 The data that is used in this section comes from the French national housing survey (*L'Enquête logement*) which is conducted every four to six years by the French national statistical institute (INSEE). The most recent of these was carried out in 2006 and had a sample size of about 43,000 cases. Some results of the survey were published in ANAH (2009a).

#### Characteristics of tenants in the private rented sector

##### *Income distribution*

- 3.3 Table 3 shows that, as far as the income distribution of households is concerned, the private rental sector has an intermediate position between the owner-occupancy sector and the social rental sector. The lower income groups (first and second quartile) are more strongly presented than in the owner-occupancy sector, but less strongly than in the social rented sector. With regard to higher income groups (third and fourth quartile), the tenants in the private rental sector occupy the middle ground as well. There are relatively more higher income groups than in the social rental sector but less than in the owner-occupancy sector.
- 3.4 Between 2001 and 2006, the share of lower income groups in the private rental sector has increased. This trend is also visible in the social rental sector. Thus, as a whole, the French rental sector is becoming more residualised.

<sup>12</sup> This is an estimation.

**Table 3: Income distribution in the different tenure sectors in 2001 and 2006**

<b>Owner-occupiers 2001</b>	17.1%	23.6%	27.6%	31.7%
<b>Owner-occupiers 2006</b>	16.1%	23.4%	27.6%	32.9%
<b>Tenants in social rental sector 2001</b>	38.5%	30.4%	21.4%	9.8%
<b>Tenants in social rental sector 2006</b>	42.0%	29.8%	19.4%	8.8%
<b>Tenants in private rental sector 2001</b>	30.1%	24.4%	22.8%	22.7%
<b>Tenants in private rental sector 2006</b>	32.1%	26.0%	23.1%	18.8%
<b>All households</b>	25%	25%	25%	25%

Source: ANAH, 2009a

### *Demographic characteristics of the tenants*

- 3.5 The average age of the tenants in the private rental sector is 42 years, which is 10 years less than the average age of all households. The households in the French social rental sector are on average 49 years old. The relatively low average age of private rental sector tenants is related to the fact that the private rental sector houses many (young) single working people and students.
- 3.6 Looking at the household composition, one can observe that single persons (48 per cent) and one-parent families (8 per cent) are overrepresented in the French private rental sector. By way of comparison: these household types have a share of 6 per cent and 35 per cent among all households.

### *Housing benefits*

- 3.7 About three million tenants in the French private rental sector receive a housing benefit. On average, these tenants receive an allowance of €200 per month.

### *The demand for private rental dwellings*

- 3.8 Just as in many other European countries, the French private rental sector is the domain of households who cannot or do not want to move to the social rental sector, for example, because of the long waiting times or because their income is too high. For many tenants in the French private rental sector, the owner-occupancy sector is not a good alternative either, for example, because house prices are too high or because owning a home makes it more difficult to move.
- 3.9 Ball (2010) notes that many private rental sector tenants live in the inner city areas of the large cities, with the greatest number in Paris. Such tenants are highly mobile; two-thirds occupy their dwelling for less than four years (Ball, 2010; p29).

### *Pressure on the private rental market*

- 3.10 In a Western European context, the tension on the French private rental market can be described as moderate. The pressure on this market is stronger than in Germany and the Netherlands, but less than in the United Kingdom, Spain and Italy (Massot, 2009; p152). Like everywhere, also in France the pressure on the housing market is highest in the urbanised regions, in particular the Paris area.

### **Characteristics of the private rental dwellings<sup>13</sup>**

- 3.11 Private rental dwellings in France are relatively old; about 44 per cent of the private rental dwelling stock was constructed before 1948. For the total French housing stock this is only 30 per cent; relatively more social rental and owner-occupancy dwellings have been developed since 1948. The average size of a private rental dwelling is 65 square metres, compared to 69 square metres in the social rental sector.
- 3.12 In 2.2 per cent of the private rental dwellings, there is no indoor toilet and sometimes even no running water (ANAH, 2009a; p22). This mainly concerns dwellings that were built before World War II. In recent decades, the volume of such low quality dwellings has steadily declined.
- 3.13 According to Donner (2000, p283) dwellings let by institutional market rental landlords are generally of higher quality than those let by individual market rental landlords.

## **4. The supply of private rented housing**

### **Introduction**

- 4.1 This section discusses the characteristics of both individual and institutional private rental landlords.

### **Individual private rental landlords**

- 4.2 As indicated in Section 2, the large majority of French private rental landlords are individual households. According to the national housing survey 2006, there are 2.48 million individual private rental landlords in France, which corresponds to 9.4 per cent of all households. These individual private rental landlords let approximately 4.66 million<sup>14</sup> dwellings (including vacant dwellings) which corresponds to an average of 1.9 private rental dwelling per household. Table 4 highlights the age

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<sup>13</sup> All figures presented in this paragraph refer to the year 2006.

<sup>14</sup> According to ANAH (2009a), the housing survey 2006 underestimates the number of private rental dwellings owned by individual landlords. According to the *Compte de logement* 2010, there are about 5.6 million rental dwellings in France that are owned by private individuals (including furnished flats and rent-free dwellings).



distribution of the individual private rental landlords; indicating that the households are relatively old.

**Table 4: Age distribution of individual private rental landlords, 2006 (column percentages)**

Age	Individual private rental landlords	All households
< 40 years	12	28.4
40 -59 years	45.6	37.5
60-74 years	27.8	20.2
> 74 years	14.7	13.9
<b>Total</b>	<b>100</b>	<b>100</b>
<b>Average age</b>	<b>57</b>	<b>52</b>

Source: ANAH, 2009a

4.3 Table 5 shows the income distribution of the individual private rental landlords, divided up according to the number of rental dwellings that these landlords possess. The table shows that more than 50 per cent of the individual private rental landlords belong to the highest income quartile. Furthermore, there is a positive correlation between the household income and the number of private rental dwellings owned.

**Table 5: Income distribution of individual private rental landlords, 2006 (column percentages)**

	All individual private rental landlords	Owning 1 dwelling	Owning 2 dwellings	Owning 3 or more dwellings	All households
<b>1<sup>st</sup> quartile</b>	8.9	9.6	7.9	6.8	25.0
<b>2<sup>nd</sup> quartile</b>	16.7	19.1	10.6	12.9	25.0
<b>3<sup>rd</sup> quartile</b>	23.8	24.2	26.9	19.4	25.0
<b>4<sup>th</sup> quartile</b>	50.6	47.1	54.6	61.0	25.0
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: ANAH, 2009a

### **Institutional private rental landlords**

4.4 Within the total private rental market, institutional private rental landlords only occupy a relatively minor position (they own and manage about four per cent of the total private rental stock). The group of institutional private rental landlords is rather diverse. It consists of banks, insurance companies, investment funds and Real Estate Investment Trusts (SCPI in French). We have not been able to find statistics on the importance of each of these investors. Most institutional private rental landlords own an entire block of private rental housing that they control and manage.

This private rental dwelling stock owned by institutional investors is mainly situated in Paris and some main cities, for example, Lyons and Marseille.

- 4.5 Since the 1990's, institutional private rental landlords have sold a substantial share of their housing stock (this stock declined from about 500,000 dwellings to less than 250,000 dwellings). This development is due to the fact that institutional investors are increasingly focusing on investing in offices and retail, where they can enjoy higher returns than in housing (see Table 6).
- 4.6 Nevertheless, some new investment still takes place. These new investments particularly focus on specialised housing, for example, rental homes for the elderly (Schaefer, 2010).

**Table 6: The portfolio of institutional investors in France in 1998 and 2008**

	<b>Housing</b>	<b>Offices</b>	<b>Retail</b>	<b>Other</b>
<b>1998</b>	36%	46%	11%	7%
<b>2008</b>	16%	51%	21%	12%

Source: IEIF, 2010

## 5. Individual investment in the private rented sector

### Introduction

- 5.1 We have not been able to find statistics on the total individual investment in the French private rental sector. Nevertheless, based on the available statistics, it is possible to make some rough and indicative calculations:
- Table 2 shows that in 2005, about 73,000 new private rental dwellings were produced. In that year, a private rental dwelling had an average price of €141,000 (Ministère du logement et de la Ville, 2008; p39). Thus, as a rough estimation, the total sum of individual investment in the private rental sector in France in 2005 was around €10.3 billion (73,000 x 141,000).
  - In addition to this, there is also investment by individuals in the existing housing stock (individuals buying existing dwellings in order to let them). Official data on this are not available either, although it is estimated that this concerned about 50,000 dwellings per year in the 2005 to 2007 period (Schaefer, 2010).
- 5.2 In 2005, 71 per cent of the new dwellings acquired by individual investors were apartments. Most of them (67 per cent) were bought from developers, whereas the rest (33 per cent) was constructed under the commission of individual persons. About 40 per cent of the dwellings concerned were located in an agglomeration with more than 100,000 inhabitants (Ministère du logement et de la Ville, 2008; p36).

## **Financial aspects of individual investment in the private rented sector**

- 5.3 In the past individual investors in the French private rental sector obtained a rental yield of around 5 per cent per year. Recently, however, rental yields of 3.5 to 4 per cent are cited in developer's advertisements which try to encourage individuals to invest in the private rental sector.
- 5.4 It should be noted that rental yields are not the only reason for individuals to invest in the private rental sector. Potential capital gains (as a result of growth in property prices) may also be a strong incentive.
- 5.5 Last but not least, it should be noted that not all individual private rental landlords are letting dwellings for purely economic reasons. Some of these landlords are in the business for family-related and/or nostalgic reasons, for example of because they have inherited the dwelling and/or the dwelling is located in their place of birth.

## **Organisational aspects of individual investment in the private rented sector**

- 5.6 Some new developments, especially those associated with fiscal incentives, in the private rental sector are developed through specialised companies. In the last ten years, a network of companies has emerged that sells dwellings (mainly apartments) that are meant to be let by individual private landlords. Some of the companies in this network are tied to developers.
- 5.7 A substantial share of new private rental sector dwellings is sold as a package that includes the management of the flat and insurances for covering damage or rent arrears. The usual fee for such services is about 8 per cent of the yearly rent, but fees may range between the 4.5 and 12 per cent, depending on the kind of services that are included in the package. Management fees can be deducted from the rental income for taxation purposes.
- 5.8 A government backed insurance scheme, Garantie des risques locatifs (GRL), provides cover for rent arrears and damages by tenants. This form of insurance reduces the risks of private renting (Shaefer, 2010)<sup>15</sup>.
- 5.9 It is difficult to estimate what percentage of the private rental dwelling stock owned by individual landlords is managed by professionals. It is clear, however, that this phenomenon is especially visible in the larger cities where it could reach up to one third of the market (Schaefer, 2010).

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<sup>15</sup> See also <http://www.french-property.com/guides/france/working-in-france/letting-property/protection-non-payment-of-rent/insurance/> [Accessed 25/08/10].

## **Umbrella organisation**

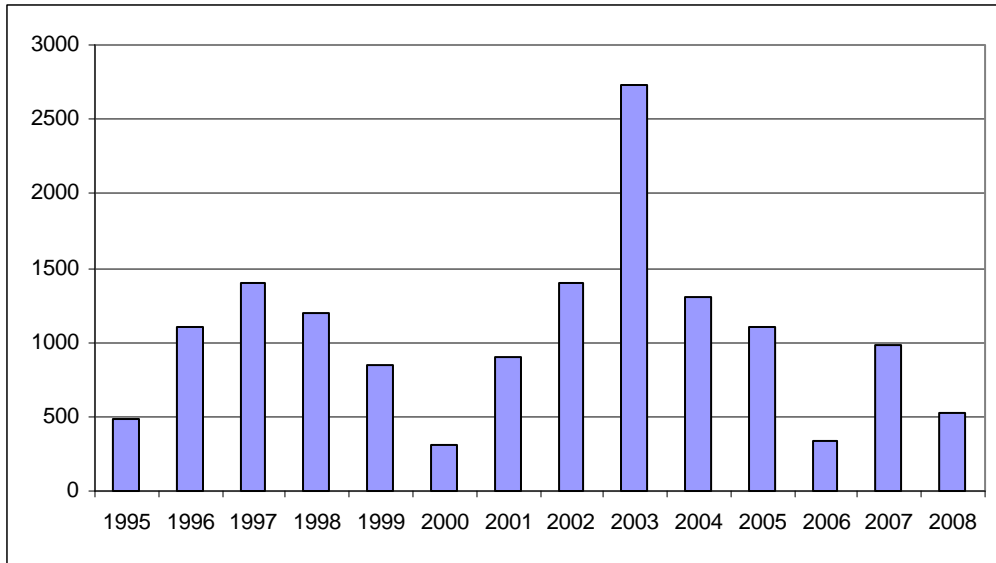
- 5.10 The umbrella organisation for French individual private rental landlords is called UNPI (*Union Nationale de la Propriété Immobilière*). This organisation lobbies government on behalf private landlords. They regularly ask for the dismantling of the social housing sector and less taxation of the revenues provided by private rented property.

## **6. Institutional investment in the private rented sector**

### **Introduction**

- 6.1 The amount of money that institutional investors in France invest in the private rental sector varies per year, but generally ranges between €500 million and €1 billion (see Figure 2), although there was a sudden surge in investment in 2003. Every year institutional investors add 3,000 to 6,000 new private rental dwellings to the French housing stock.
- 6.2 According to a panel of institutional private rental landlords (Ad Valorem, 2010), the main impediments to residential investment in the private rental sector are the strict regulations with regard to letting (36 per cent) and the relatively low yields (34 per cent). An additional factor impeding investment is the limitation on liquidity imposed by selling regulations that oblige landlords to offer a sale to sitting tenants before an offer to another investor (Schaefer, 2010).
- 6.3 The importance of institutional private rental landlords has significantly decreased in recent decades. Their share within the total private rented sector dropped from about 12 per cent in 1984 to currently about 4 per cent. The insurance companies, who used to be important private rental landlords, have disinvested considerably. This is due to the fact that they could realise higher yields outside the residential sector (Businessimmo, 2007; see also Table 7).

**Figure 2: Amount of money (in million Euros) invested in the French private rental sector by institutional investors, 1995-2008**



Source: IEIF, 2010

### Financial aspects of institutional investment in the private rented sector

6.4 The returns that institutional investors in the private rental sector can make are dependent on both the returns from renting and the returns from capital growth (increase in property prices). According to the IPD France Annual Property Index, the returns from letting were 3.7 per cent in 2009. However, as a result of the global economic and housing market crisis, the capital growth was negative, resulting in a total return that was close to zero.

6.5 Over a longer time period, the total returns show a more positive picture; they were 9.2 per cent over the last ten years (see Table 7). However, this is still lower than the returns on investments in other types of property, which explains the withdrawal of institutional private landlords from the rental sector. The rental yield is much lower in the residential sector than in the other property sectors.

**Table 7: Returns on investments in property according to the IPD France Annual Property Index (results for December 31, 2009)**

	Total yield	Total yield in %	Rental yield in %	Capital yield in %	Total yield per year		
	1997=100	1 yr	1 yr	1 yr	3 yrs	5 yrs	10 yrs
<b>All property</b>	312.4	-1.4	6.1	-7.1	4.8	10.1	10.1
<b>Retail</b>	524.9	-1.1	6.1	-6.8	7.3	14.2	13.8
<b>Offices</b>	317.6	-1.9	6.5	-8.0	4.2	9.3	9.9
<b>Industrial</b>	302.7	-3.5	7.7	-10.5	2.0	8.2	9.7
<b>Residential</b>	261.7	0.1	3.7	-3.4	5.0	9.8	9.2
<b>Other</b>	300.8	1.1	6.3	-4.9	6.6	10.9	10.0

Source: [www.ipd.fr](http://www.ipd.fr)

## **Organisational aspects of institutional investment in the private rental sector**

- 6.6 Regarding professional management of real estate, including real estate in the private rental sector, a group called APOGEE (*Institut Français du Management Immobilier*) includes most managers of real estate and provides advice and analyses of the sector, although for its members only.

## **7. Policy measures that influence investment in the private rented sector**

### **Introduction**

- 7.1 There are various policy measures that influence investment in the French private rental sector. The most important ones are summarised below:
1. Rent regulation and security of tenure.
  2. Soft loans for private rental landlords (loans with a relatively low interest rate and particular tax advantages).
  3. Tax incentives for private rental landlords.
  4. Incentives for improving the quality of the private rental stock.

### **Influence of the various policy measures**

- 7.2 There are four sets of policy measures to consider:
- Rent regulation and security of tenure are generally seen as a disincentive for investments in the private rental sector. They are described in the remainder of this section.
  - The soft loans and tax incentives primarily stimulate investment in new private rental dwellings. These policy measures are discussed in Section 8.
  - There are also two tax incentives that stimulate investment in the existing housing stock. These incentives are described in Section 9.
  - The policy measures that focus on the quality of the existing private rental dwelling stock. These are covered in Section 10.

### **Rent regulation and tenant security**

#### *Rent regulation*

- 7.3 In France, rents for new contracts in the private rental sector may in principle be set freely. However, for private rental dwellings that are built with the help of PLS and PLI loans, particular tax incentives or ANAH grants (see Sections 8 to 10), there are conditions with regard to the maximum rent that can be asked and the income of the prospective

tenants. During the term of the rental contract, the annual rent increase may not be higher than changes in the cost of living index.

### *Rental contracts*

- 7.4 In the private rental sector, the standard length of a rental contract is three years for individual private rental landlords and six years for institutional private rental landlords.
- 7.5 Six months before the term of the contract expires the landlord may offer a new contract. In the new contract, the landlord may only ask a higher rent if it can be demonstrated that the old rent is substantially below the current market rent. In which case, a new rent may be set on the basis of reference dwellings. The landlord then has to prove that the rents of six (in urban areas of over one million inhabitants) or three comparable dwellings are significantly higher than the current rent<sup>16</sup>. In order to simplify this process, some French cities have set up an observatory of market rental sector rents. In the Paris urban area, the rent increase at the renewal of contracts in the unregulated market rental sector is sometimes limited by central government decree (Haffner *et al*, 2009; p121).
- 7.6 If the landlord does not offer a new contract with a new rent when the old one expires, the old contract is automatically renewed for three years under the existing terms (Boccardo & Chamboredon, 2004; p17).
- 7.7 The landlord can only terminate the tenancy agreement in the following cases:
- The landlord wishes to use the home for his or her own occupation or to house a close relative.
  - The landlord wishes to sell the property. In this case the tenant must be given first right of refusal (*droit de préemption*).
  - The landlord wishes to carry out a major refurbishment of the property.
  - The tenant has not met his obligations in the past (for example, by falling into arrears with the rent).
- 7.8 Notice to terminate a contract during the tenancy period may only be given if the contract contains a special clause (*clause résolutoire*) and the tenant has several months of rent arrears. In practice, this is a relatively time-consuming and complex legal process (Boccardo & Chamboredon, 2004; p21). French private landlords can insure themselves against non-payment by tenants through a government-backed insurance scheme: *La Garantie universelle des Risques Locatifs: GRL*.

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<sup>16</sup> See [www.logement.gouv.fr](http://www.logement.gouv.fr)

## 8. Policy measures that influence new building for private renting

### Introduction

- 8.1 In France, there are two main policy measures that influence the production of new private rental dwellings: soft loans and tax incentives. The main features of these policy measures are described in this section.

### Soft loans for private rental landlords

- 8.2 The French housing system is characterised by different soft loans that can be used for the construction or acquisition and renovation of rental dwellings. Although the most important loan (PLUS) is only available for social rental landlords, there are also two loans that are available to private rental landlords: the PLS and the PLI. Table 8 shows the main features of these loans.

#### *PLS loan*

- 8.3 The PLS loan is available to any investor that wishes to provide dwellings in the intermediate rental sector: the rental segment just above the traditional social rental sector (in terms of rental prices). The loan is particularly aimed at regions with tight housing markets in which there is a relatively large gap between the 'cheap' social rental sector and the 'expensive' market rental sector.
- 8.4 Tied to the PLS loan are certain tax advantages: a low VAT-rate and exemption of land and property taxes. During the term of the loan, private rental landlords have to comply with certain regulations concerning the rent level and the income of the tenants. About 20 per cent of the PLS loans are taken up by private rental landlords, mainly institutional investors.

#### *PLI loan*

- 8.5 The PLI loan is comparable to the PLS but focuses at a more up-market rental segment. There are no tax advantages tied to the PLI and the interest rate of the loan is slightly higher than for the PLS. At the same time the maximum rent that may be asked for PLI dwellings is higher as well, and the conditions with regard to the incomes of the tenants are less strict. Each year, about 1,000 to 3,000 rental dwellings are financed with the help of the PLI.
- 8.6 The PLS and PLI loans for private rental landlords are provided by banks which submit proposals to a public tender organised by the Ministries of Finance and Housing.



**Table 8: Main characteristics of the PLS and PLI loans for rental landlords**

	<b>PLS</b>	<b>PLI</b>
Target group	all investors	all investors
Interest rate	depends on credit provider and type of landlord, usually around 1.2% higher than the interest on the Livret A saving accounts	depends on credit provider and type of landlord, usually around 1,5% higher than the interest on the Livret A saving accounts
VAT-rate	Low (5.5%)	Normal <sup>17</sup> (19.6%)
Exemption from land and property taxes	Yes (25 years)	No
Term of the loan	30 years (50 years for the value of the land)	30 years (50 years for the value of the land)
Amount of the loan	> 50% of investment costs	variable
Duration of contract with state: during this contract the maximum rent levels and income requirements for tenants apply	term of the loan, minimum 15 years (	term of the loan, minimum 9 years
Maximum rent level (in € per square metre) in 2010	Ranging between €7.30 and €12.38, depending on the region	Ranging between €7.20 and €17.38, depending on the region
Maximum income level	depending on region and household size	depending on region and household size, higher income limits than in the PLS
Geographical coverage	All regions but above all cities with a market rent > €9 per square metre	Only the more urbanized regions
Number of dwellings financed in 2005-2009 period	177,000	7,500
Number of dwellings financed in 2009	40,000	About 1,500
Number of dwellings financed by institutional private rental landlords in 2009	5,200 (13%)	Data not available
Number of dwellings financed by individual private rental landlords in 2009	2,800 (7%)	Data not available

Source: [www.logement.gouv.fr](http://www.logement.gouv.fr), information provided by Schaefer, 2010

## **Tax incentives for private rental landlords**

### *General tax treatment*

- 8.7 Individual private rental landlords have to pay income tax on the rental income they receive from their property. If the annual gross rental income is under €15,000, the *micro-foncier* regime applies. Under this regime, a fixed percentage of 30 per cent may be deducted from the rental income to offset the costs incurred by the landlord. The *micro-foncier* regime cannot be combined with tax incentives that aim to encourage investment in the rental sector.

<sup>17</sup> However, for renovation work, the low Value Added Tax applies.

- 8.8 For individual private rental landlords who receive over €15,000 in annual gross rental income, the standard *foncier* regime applies. Under this regime, the expenditure that the landlord incurs in connection with letting his property (and not only maintenance costs, but also the cost of refurbishment and improvement and property taxes, as well as interest on mortgages and management fees) may be deducted from the rental income. These expenses may in fact be higher than the rental income. A negative balance of a maximum of €10,700 per year<sup>18</sup> may be deducted from the total income of individual private rental landlords (Haffner *et al*, 2009; p133).

#### *Tax incentives for individual private rental landlords*

- 8.9 Individual private rental landlords who let dwellings under the standard *foncier* regime may benefit from tax incentives. Various tax measures have been brought in over the past 25 years. These are usually named after the Ministers who introduced them: *Méhaignerie*, *Périssol*, *Besson*, *Robien*, *Borloo*, etc. The incentives generally entail a yearly deduction of a percentage of the rental income, as well as a yearly deduction of a percentage of the investment costs (depreciation).
- 8.10 Some of the tax incentives (for example *Borloo neuf*, see Table 9) for private rental sector investment can be interpreted as an attempt to provide more and better affordable rental housing for middle-class households, whose incomes are too high to access the social rented sector. As far as this is concerned, they can be seen as the French answer to the housing problems that are experienced by key-workers, especially in the big cities. Tax incentives that seek to increase the supply of private rental housing for middle-class households typically use criteria with regard to the income of the tenants and the maximum rent that may be asked.
- 8.11 However, there have also been tax incentives without any income restrictions for tenants and no or very high maximum rents (for example *Robien recentré*, see Table 9). These incentives primarily aimed to stimulate the (private rental) housing production (Taffin, 2008).

#### *Current tax incentives*

- 8.12 In 2006, the law *Engagement national pour le logement (loi ENL)* has resulted in a reform of the various tax incentives. Since then, only the *Dispositif Robien recentré*, the *Dispositif Borloo neuf ou populaire* and the *Dispositif Borloo ancien* were in use. Individual private rental landlords could apply for the first two tax incentives until 31 December 2009, whereas the *Borloo Ancien* tax measure is still accessible nowadays. In order to replace the *Dispositif Robien recentré* and the *Dispositif Borloo neuf ou populaire*, a new tax incentive called *Scellier*

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<sup>18</sup> The interest on mortgages may not be taken into account when calculating this deficit. This interest may only be deducted as long as the remaining balance is positive.

was introduced on 1 January 2009. This tax incentive is supposed to be simpler than its predecessors (Bouteille, 2010). The main characteristics of all the aforementioned tax incentives are shown in Tables 9 and 10.

**Table 9: Main characteristics of the Robien recentré and the Borloo neuf tax incentives for investment in the market rental sector**

Period	1-09-2006 till 31-12-2009	01-01-2006 till 31-12-2009
Objective	Stimulate general supply in the private rental sector	Stimulate supply of private rental housing for middle-income groups
Income limits	No	Yes, depending on household type
Maximum rent level (2009)	Depending on the region, ranging between €9.02 and €21.65 per square metre	Depending on the region, ranging between €7.22 and €17,32 per square metre
Yearly tax deduction as % of the investment cost	6% of the investment can be deducted in the first 7 years, 4% in the years 8 and 9	6% of the investment can be deducted in the first 7 years, 4% in the years 8 and 9, after that 2.5% for two periods of three years (optional)
Fixed reduction (as % of the rental income)	0%	30%
Term of the arrangement	9 years	9 years with the possibility of an extension of 2 times 3 years
Geographical coverage	All regions	All regions

Source: [www.logement.gouv.fr](http://www.logement.gouv.fr)

**Table 10: The main characteristics of the Scellier tax incentives**

	<b>Scellier</b>	<b>Scellier intermédiaire</b>
Period	01-01-2009 till 31-12-2012	01-01-2009 till 31-12-2012
Objective	Stimulate supply in the private rental sector	Stimulate the supply of private rental dwellings for middle income groups
Income limits for tenants	No	Yes (same limits as in <i>Borloo Neuf</i> )
Maximum rent levels in 2009	Depending on the region, ranging between €9.02 and €21.65 per square metre (comparable to <i>Robien recentré</i> )	Depending on the region, ranging between €7.22 and €17.32 per square metre (comparable to <i>Borloo Neuf</i> )
Yearly tax deduction as % of the investment cost	If the dwelling is bought in 2009 or 2010, a total of 25% of the investment costs may be deducted from the income tax over a period of 9 years (with a maximum deductible amount of €60,000). This corresponds to a yearly tax deduction of 2.78%	If the dwelling is bought in 2009 or 2010, a total of 25% of the investment costs may be deducted from the income tax over a period of 9 years (with a maximum deductible amount of €60,000). This corresponds to a yearly tax deduction of 2.78%

	of the value of the investment.  If the dwelling is bought in 2011 or 2012, a total of 20% of the investment costs may be deducted from the income tax over a period of 9 years (with a maximum deductible amount of €60,000). This corresponds to a yearly tax deduction of 2.22% of the value of the investment.	of the value of the investment.  If the dwelling is bought in 2011 or 2012, a total of 20% of the investment costs may be deducted from the income tax over a period of 9 years (with a maximum deductible amount of €60,000). This corresponds to a yearly tax deduction of 2.22% of the value of the investment.  In the years 10 to 16, 2% of the investment cost may be deducted from the income tax (in two 3-year periods)
Fixed reduction (as % of the rental income)	0%	30%
Term of the arrangement	9 years	9, 12 or 15 years
Geographical coverage	Only available in the more urbanised areas	Only available in the more urbanised areas

Source: [www.logement.gouv.fr](http://www.logement.gouv.fr)

### *Capital gains tax*

- 8.13 Capital gains tax is levied at 6 per cent on the net gain in the value of the property. After five years of ownership a 10 per cent per annum discount applies. There is thus no liability for capital gains tax after 15 years of ownership (Global Property Guide, 2010).

### *Effects and output of the tax incentives*

- 8.14 According to the French government (République Française, 2010; p17), the tax incentives have clearly had a positive effect on the production of private rental housing, thus making the private rental housing market less tight. Between 2003 and 2007, the number of dwellings that was sold by developers to individual private rental landlords increased from 30,000 to 60,000. According to the French government (République Française, 2010; p17/18), this surge in housing production was mainly due to the *Robien* tax incentive that was introduced in 2003 and revised in 2006. In 2008, almost 230,000 individual private rental landlords were taking advantage of this incentive.
- 8.15 In 2008, the total expenses on tax benefits were about €600 million. However, it should be realised that the extra construction in which the tax incentives result, also lead to extra income for the government, for example, through Value Added Tax and other taxes (Bouteille, 2010; Taffin, 2008). The average fiscal expense per financed dwelling is €16,000 (République Française, 2010; p18).

### *Evaluation of the tax incentives*

- 8.16 The tax incentives for French individual private rental landlords have been in existence for over 25 years. Some schemes worked with a fixed reduction of rental income, whereas others offered a yearly deduction of part of the investments costs (accelerated depreciation). Often, both fiscal instruments were combined.
- 8.17 The way in which a tax incentive is designed has an influence on its outcomes. For example, the mechanism of accelerated depreciation may result in larger and more expensive dwellings than the mechanism of a fixed deduction (Schaefer, 2010).
- 8.18 Some tax incentives had regulations with regard to the maximum rent and the income of tenants, whereas others did not have such restrictions. In general, one could say that the take-up of incentives with serious restrictions was considerably less than the take-up of incentives without or with few restrictions, even though the first incentives are generally much more generous (Schaefer, 2010).
- 8.19 At the same time, it is argued that tax incentives without restrictions may push up prices. Moreover, they could lead to an oversupply of dwellings in areas where the housing market is less tight (Taffin, 2008).

## Incentives for institutional private rental landlords

- 8.20 The French policies towards the private rental sector mainly focus on individual investors. This is due to the fact that they own the large majority of the private rental stock. Moreover, they are also most likely to invest because the French institutional investors have been reducing the share of residential real estate in their portfolios for many years and are not likely to change their policy (Taffin, 2008; p3).
- 8.21 The French government has not introduced specific policy measures that aim to reverse the disinvestment by institutional private rental landlords. Nevertheless, it should be noted that institutional investors can use the soft loans that are available for investment in the rental sector (PLS, PLI, see Table 8).
- 8.22 Furthermore, France has recently developed specific fiscal regulations for Real Estate Investment Trusts (REIT's). However, until now, the impact of such REITS is limited.

## 9. Policy measures that influence the volume of the stock in the private rented sector

- 9.1 The volume of the private rented housing stock can increase in two ways: by the construction of new private rental dwellings and by the conversion of existing dwellings into private rental dwellings. The incentives that were described in Section 8 (PLS, PLI, *Robien recentré*, *Borloo neuf*) mainly focus on the first aspect. Nevertheless, depending on the conditions of the policy measure concerned, they may also be used in cases in which existing dwellings are bought, renovated and refurbished and subsequently let to tenants.
- 9.2 Individual investors that buy and subsequently let an existing dwelling without renovating or refurbishing it, may apply for the *Borloo ancien* tax incentive of which there are two variants (see Table 11). In 2008, 8,350 private rental dwellings (without renovation works) were added to the private rental dwelling stock that is subject to this tax incentive (ANAH, 2009a).

**Table 11: Main characteristics of the Borloo tax incentives**

	<b><i>Borloo ancien intermédiaire</i></b>	<b><i>Borloo ancien social</i></b>
Period	01-10-2006 till present	01-10-2006 till present
Objective	Make a larger part of the existing dwelling stock available for renting	
Income limits	Yes, depending on household type	Yes, depending on household type
Maximum rent level in 2009	Ranging between €8.19 and €17.31 per square metre, depending on the region	Ranging between €5.10 and €6.24 per square metre, depending on the region.
Yearly tax deduction as % of the investment cost	Not applicable	Not applicable
Fixed reduction (as % of the rental income)	30%	60%
Term of the arrangement	6 years (without subsidised renovation) or 9 years (with subsidized renovation)	6 years (without subsidised renovation) or 9 years (with subsidized renovation)
Geographical coverage	All regions	All regions

Source: [www.logement.gouv.fr](http://www.logement.gouv.fr), ANAH, 2009b

## 10. Policy measures that influence the volume and the quality of private rented housing

### General policies with regard to housing quality

- 10.1 French regulation determines what a ‘decent home’ is; each dwelling should meet minimum quality standards in order to be suitable for letting. The quality regulations specify that a dwelling with a surface area below 9 square metres, a height below 1.80 metres or a volume lower than 22 cubic metres is not authorised for rental uses (but it can be sold). Local authorities are entitled to oblige landlords to ensure safety and prevent health hazards for the tenants. This is particularly the case in the big cities, where *marchands de sommeil* (sellers of accommodation for the night) rent rooms to immigrants, the aforementioned quality standards are sometimes not met. As far as new construction is concerned, the quality standards for the private rental sector are similar to those in the other tenures (Schaefer, 2010).

### Policy incentives that aim to improve the quality of private rented housing

- 10.2 The *Agence Nationale de l’Habitat* (ANAH) is a national body that provides grants for home refurbishment and improvement. ANAH also manages the *Borloo* tax incentive (see Section 9). Private rental landlords who choose to carry out renovation works are not only entitled to this fiscal incentive but also to a specific subsidy. In order to qualify for such a subsidy the following conditions must be met:

- After the renovation, the dwelling must be let by the home-owner for at least nine years.

- The renovation work should cost at least €1,500 and it must be approved by ANAH.
  - The renovation work may not cost more than a certain amount of money per square metre. This ceiling differs between the different French regions.
- 10.3 The amount of subsidy that an individual private rental landlord can receive depends on the maximum rent that is allowed (the lower this maximum rent, the higher the subsidy) as well as on the particular region. The amount of the renovation costs that is subsidised may range between 15 and 80 per cent (ANAH, 2009b).
- 10.4 In 2008, about 26,000 dwellings were renovated with the help of the above subsidy scheme, often within the framework of urban renewal programmes. This involved a total subsidy of €317 million, which corresponds with an average subsidy of about €12,000 per dwelling.
- 10.5 As part of the above subsidy arrangement, ANAH also provides complementary premiums to individual private rental landlords who bring a vacant dwelling (vacant for at least 12 months) to the rental market (premium of €3,000) or who substantially improve the energy rating of their dwelling (premium of €2,000).

## 11. Summary 1: transferability of fiscal incentives?

- 11.1 This report has shown that France has developed several policy instruments that aim to stimulate investment in the private rental sector; the fiscal incentives for individual private rental landlords have in particular turned out to be successful. The question therefore is whether such incentives could be transferred to other countries, for example the United Kingdom.
- 11.2 Some lessons of 25 years of fiscal incentives for the private rented sector in France:
- The specific features of the fiscal incentives have a strong impact on quantity of the housing production, as well as on the size and the location of the new private rental dwellings that are built. Therefore, it is very important that the parameters within such incentives (zones, maximum rents, income restrictions, kind of fiscal deduction) are designed in a sensible and careful way, preferably based on a sound housing market analysis.
  - In designing the fiscal incentive, one has to strike a balance between simplicity on the one hand, and a custom-made approach on the other hand. This especially applies to regionalisation that is applied.
  - The efficiency of the fiscal incentives depends on the economic situation. In a period of low economic growth and little construction,



the effect of the incentives will probably be strong. In 2009, about 66 per cent of new dwellings built by developers in France were sold to individual private rental landlords that make use of the tax incentives (Bouteille, 2010; p7). This illustrates the importance of such incentives as countercyclical measures. However, in a period of high economic growth and a high construction rate, investment will probably also be made without fiscal support. In which case, the incentives may result in an inefficient use of government money and possible windfall profits for investors.

## 12. Summary 2: main findings of country report

1. Until the 1980's, the share of the French private rental sector had been declining as a result of strict rent regulation and tenant protection and limited yields for private rental landlords.
2. Since the 1980s, the share of the French private rental sector has remained stable at around twenty per cent. This stabilisation seems to be mainly due to the various tax incentives that have become available for individual private rental landlords.
3. The share of the private rental sector within the total housing production is about 15 per cent.
4. More than 95 per cent of the French private rental dwelling stock is owned by private individuals. These individual private rental landlords own on average two dwellings.
5. Tenants in the French private rental sector are relatively young and mobile and often live in a single-person household.
6. Compared to the other tenure sectors, French private rental dwellings are relatively old and small.
7. French developers and/or brokers often develop housing complexes that specifically aim at individual investors.
8. For several decades, French institutional private rental landlords have been disinvesting in residential property because they could realise higher yields in other property sectors.
9. Investors that want to invest in the private rental sector can apply for low-interest loans. Moreover, for individual private rental landlords, there are tax incentives available.
10. Private rental landlords that want to renovate their dwelling can apply for special renovation grants.

## 13. References and acknowledgements

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[www.insee.fr](http://www.insee.fr) (French national statistical institute)

[www.ipd.fr](http://www.ipd.fr) (French branch of the Investment Property Databank)

[www.logement.gouv.fr](http://www.logement.gouv.fr) (French ministry of housing)

[www.performance-publique.gouv.fr](http://www.performance-publique.gouv.fr) (various budgetary aspects of French government policies)

## Appendix 1

### Abbreviations and acronyms

<b>ANAH</b>	<i>Agence Nationale de l'Habitat</i>
<b>APOGEE</b>	<i>Institut Français du Management Immobilier</i>
<b>ENL</b>	<i>Engagement national pour le logement</i>
<b>GRL</b>	<i>La Garantie universelle des Risques Locatifs</i>
<b>IEIF</b>	<i>L'Institut de l'Épargne Immobilière et Foncière</i>
<b>INSEE</b>	<i>L'Institut National de la Statistique et des Etudes Economique</i>
<b>IPD</b>	Investment Property Databank
<b>PLI</b>	<i>Prêt Locatif Intermédiaire</i>
<b>PLS</b>	<i>Prêt Locatif Social</i>
<b>PLUS</b>	<i>Prêt Locatif à Usage Social</i>
<b>REIT</b>	Real Estate Investment Trusts
<b>SCPI</b>	<i>Société Civile de Placement Immobilier</i>
<b>UNPI</b>	<i>Union Nationale de la Propriété Immobilière</i>
<b>VAT</b>	Value Added Tax

# Appendix E

## Country report: Germany

### 1. Introduction

1.1 For the purposes of this report the following, as shown in Table 1, are the main types of providers in the private rental sector in Germany: small providers, private housing companies and housing cooperatives<sup>19</sup>.

**Table 1: Estimated distribution of providers/owners\* of dwellings\*\* in Germany, 2006**

Providers/owners of dwellings			% of stock	Number of dwellings (x1,000)
Total	100			39,617
Owner-occupied sector	40			15,960
Rented sector	60			23,657
<b>* Small providers</b>		<b>37</b>		<b>14,507</b>
* Professional landlords		23		9,150
<b>Private housing companies</b>			<b>10</b>	<b>4,059</b>
<b>Housing cooperatives</b>			<b>5</b>	<b>2,079</b>
Municipal housing companies			5	2,120
Other government housing agencies			1	206
<b>Other landlords with subcontracted management</b>			<b>1</b>	<b>453</b>
Other providers, such as churches			1	233

Source: BBR (2007, p198)

\*) *Bold indicates the actors of private rented sector as the term is defined in this text.*

\*\*) *Includes dwellings subsidised with bricks-and-mortar subsidies.*

1.2 The fact that the rental sector, including the part that is subsidised with bricks-and-mortar subsidies is mainly provided by market, private or commercial investors characterises the German housing system (Droste & Knorr-Siedow, 2007). It is rooted in West-German housing policy that since World War II has been based on a policy of the social market economy: social welfare is best served by bringing about economic progress via market forces; government intervention is designed to support these (Busch-Geertsema, 2004).

1.3 Market forces nowadays indicate that Germany is a country that is being, and will further be, confronted with growing and shrinking cities and regions at the same time. As a response, Germany has more or less integrated housing policy into other policy areas, especially the development of cities and spatial planning (Bundesregierung, 2009). The new law on spatial planning (2008) aims to find a balance between standard rules for all federal states and freedom to react to local circumstances. In the case of bricks-and-mortar subsidised rental

<sup>19</sup> This is based on the advice of the German housing experts who are listed in Section 13. In this definition the private rented sector would not include public providers (municipal and other government providers). While they are often governed by private law, as are the private suppliers, they usually behave in a more social way than their commercial counterparts.

dwellings, central government transferred its powers to the federal states in 2006 in order to enable them to make their own legislation as needed (see 9.2).

## 2. The size of the private rented sector and its contribution to housing investment

### Size and development of sector

- 2.1 The private rented sector consists of an estimated 53 per cent of the dwellings provided and of an estimated 48 per cent if the tenant cooperatives are excluded (Table 1). The rental sector in total comprises 60 per cent of stock provided, while homeownership makes up the remainder. The private rented sector consists of dwellings both subsidised and not subsidised with bricks-and-mortar subsidies. The dwellings not financed by bricks-and-mortar subsidies are termed 'free-financed'. The subsidisation scheme is time-limited, even though it can run several decades, and thus delivers in due course non-subsidised rental dwellings to the private rented sector.
- 2.2 The (private) rented sector has developed in a relatively stable fashion in recent decades considering that it totalled 60 per cent of stock in 1982 in former West Germany and 69 per cent in former East Germany (Haffner *et al*, 2009)<sup>20</sup>. It received a boost following the reunification of East and West Germany in 1990, especially in the East. The housing experts indicate that this was the result of the return of private property to private owners and of tax facilities that were available for new construction and renovation.
- 2.3 Since 1950 the degressive depreciation deduction<sup>21</sup> in income and corporate tax has been ascribed a large part of the success of the free-financed private rented sector (see Appendix 1). This instrument allows for larger shares of fiscal depreciation in the beginning of the ownership period. At the end of 2005 the degressive depreciation deduction was abolished in favour of a linear one (Bundesministerium der Finanzen, 2009; BMVBS/BBR, 2007). There were both fiscal and policy reasons (information from experts). Policy wise, a general degressive depreciation allowance<sup>22</sup> is thought to no longer fulfil a role in a country that is confronted simultaneously with growing and shrinking regions.

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<sup>20</sup> This is a description in average terms. Regional differences occur. High rental shares can be found in former East Germany, in the north of North-Rhine Westphalia and in metropolitan areas (Kofner, 2010; p123).

<sup>21</sup> Degressive depreciation means that the value of the depreciation allowance for tax purposes is generous in the early years of ownership and goes down over time.

<sup>22</sup> HM Treasury (2010) reports that the provision of private rental housing with degressive tax facilities have recently been challenged as incompatible with EU law (European Court of Justice, Case C-244/09, OJ C233/4, 26 September 2009). According to the experts the ruling of the European Court of Justice did not declare the instrument as such as incompatible with EU law, but its restriction that it was only available for property located in Germany.

- 2.4 Other reasons for the relatively large size of the private rented sector can be found in the attraction of tenants to the good quality of the dwellings and the strong security of tenure in the rented sector, while homeownership was relatively expensive because of high house and land prices and relatively difficult to finance because of the need to save before a dwelling could be acquired. Last but not least, the explanation that is put forward for a big private rented sector is the fact that the rented sector apparently serves the same function in Germany – providing security of tenure – as the owner-occupied sector does in other countries (Behring & Helbrecht, 2002; Tegeder & Helbrecht, 2007; Toussaint *et al*, 2007). Thus Kofner (2010) argues that there is no unreasonable cultural emphasis on homeownership (see also Kemp & Kofner, 2010).
- 2.5 The combination of these factors has made the (private) rental sector attractive as an investment since the 1950s. The share has remained relatively large in the past century because of a competitive position in relation to homeownership in terms of subsidies and dwelling characteristics. Sufficient demand has also helped to increase rents more than inflation up until the mid-1990s (BMVBS/BBR, 2007).
- 2.6 Between 1999 and 2009 the private rented sector has increased in size (by more than 600,000 dwellings<sup>23</sup>) because of the sale of public dwellings to mostly UK, US Canadian and Australian investors on the one hand and continental non-German European investors on the other (BMVBS/BBR, 2007; Claßen & Zander, forthcoming; Vesper *et al*, 2007).

### **Contribution of private rented sector to new house building**

- 2.7 The exact contribution of private providers of rental housing cannot be determined, as the producers of new-built dwellings distinguished in Table 2-1 (Appendix 2) are not uniform groups. See 5.3 and 6.3 for further information.
- 2.8 Because of an oversupply of dwellings nationally total dwelling production has decreased to the lowest point since World War II (BBSR/BBR, 2010; Bundesregierung, 2009). This also applies to the rental sector, as the relative importance of new building of multi-family dwellings (of which the rental sector mainly consists; about 80 per cent) is decreasing in favour of one-family dwellings and 'two-family dwellings' (see also BBR, 2007). Also the building of rental dwellings which are subsidised with bricks-and-mortar subsidies is at a low at the moment because of the shifting policy focus away from new construction (see 1.3).
- 2.9 Generally, stimulating new construction is thus no longer a public policy objective. Renovation of the existing stock has become more important

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<sup>23</sup> In terms of the estimated number of dwellings of private housing companies (Table 1), it would be an addition of about 15%.

than construction (BMVBS/BBR, 2007; Bundesregierung, 2009). Aims include the adaptation of the stock to aging occupiers, shrinking population and environmental requirements; especially in the less metropolitan areas.

### 3. The demand for rented housing<sup>24</sup>

#### **Rented housing according to age, household type and income**

- 3.1 Even though the size of the private rented sector is exceptional, the structure of its demand is not (Table 2-2, Appendix 2).
- The bigger the household, the larger the chance of it being a homeowner.
  - There is a large volume of younger households, and in East Germany there is also a large volume of elderly households in rented housing.
  - The market share of the tenants is higher among lower income households and the unemployed (Table 2-2).
- 3.2 However, the differences between rental and owner-occupied households in average equivalent income per household do not seem to be large in 2006 with €400 per month (2000 prices) and €250 per month in West and East Germany respectively (Bundeszentrale für politische Bildung, 2008).

#### **Sub-markets**

- 3.3 These relatively small differences confirm that the private rented sector caters for all types of households (Kofner, 2010). This results from the many types of providers that are competing with each other and that are mostly behaving in a profit-oriented fashion. This implies that all types of suppliers provide many types of comparable quality levels in rental housing (also between free-financed and bricks-and-mortar subsidised housing; Hubert, 1998; Busch-Geertsema, 2000) to many types of different households – including low-income households.
- 3.4 The markets for one-family and two-family dwellings are considered a sub-market in comparison to the market for multi-family dwellings and both sub-markets have been and are forecasted to develop differently. A move in new construction is taking place towards one- and two-family dwellings (see 2.8) and up until 2020 this trend is forecast to continue (BBSR/BBR, 2010). The opposite development is forecast for the market of multi-family dwellings. These shifts imply that new building in the rental sector will remain curbed.

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<sup>24</sup> Private renting as such is not separated out in the statistics.



## **Motivations of private renters**

- 3.5 In addition to the reasons described in 2.4, even though households may wish to become homeowners (Prognos, 2010), homeownership is becoming more unaffordable (for some households) and the labour market requires a flexible workforce (BBSR/BBR, 2010). Nevertheless, up to 2025 a slight increase of homeownership by about five percentage points is forecast.

## **Key changes in demand in recent years**

- 3.6 The uneven development of population, households and economic activity across Germany poses large risks in the regions that are losing out. Risks of vacancies will be especially high for multi-family rental dwellings, and especially in East Germany and the old industrial areas in West Germany (BBSR/BBR, 2010). Only in one-fifth of the regions will the risks of vacancies be medium to low.
- 3.7 A high vacancy rate will tend to increase the attraction of the rental sector to low-income households. This will reinforce the ongoing trend that low-income households already can increasingly be found in the private rented sector (Busch-Geertsema, 2000). The fact that municipalities are paying the housing costs for the unemployed will allow the private rented sector to cater increasingly for low-income households (information from experts). The development came about because the share of the bricks-and-mortar subsidised rental sector, which can mostly be found in multi-family buildings in the outskirts of cities, has shrunk to about 5 per cent of housing (from a high close to 20 per cent; BBR, 2007; p195). The number of subsidised rental dwellings for which the subsidy period is ending is larger than the number of new-subsidised rental dwellings.

## **4. The supply of private rented housing**

- 4.1 The main types of private rented sector suppliers according to Table 1 are:
- small providers (estimated to be 37 per cent of stock) which include:
    - 'amateur' or non-professional individual landlords
    - professional individual landlords
  - professional landlords which include:
    - private housing companies (estimated to be 10 per cent of stock)
    - cooperatives (estimated to be 5 per cent of stock).

### **Small providers**

- 4.2 The supply structure of the German private rented sector is comparatively 'normal' (Kofner, 2010). Individuals, couples and partnerships dominate (almost an estimated 62 per cent of rental stock;

BMVBS/BBR<sup>25</sup>, 2007). Table 2 shows further characteristics, which clearly distinguish between professional landlords with more active market behaviour and supra-regional investments and the non-professional landlords<sup>26</sup>.

- 4.3 If housing cooperatives are excluded from the private rented sector, small providers own 76 per cent of the private rented sector stock (14,507 out of 19,019 dwellings). Within this, small non-professional landlords own 28 per cent of the private rented sector stock (5,357 out of 19,119 dwellings).

### **Private housing companies**

- 4.4 Private housing companies are the largest group of the professional landlords (Table 1). These are in principle companies that rent out their own dwellings. They are the profit maximisers, though originally, before non-German firms entered the market on a large scale (see 2.6), with a significant social conscience and a long-term investment focus (Kemp & Kofner, 2010). These new owners are not expected to display the 'social conscience' of German enterprises (Barry, 1993; p17/21). Table 3 shows some facts about private housing companies (BMVBS/BBR, 2007).

### **Cooperatives**

- 4.5 Tenant cooperatives aim to provide accommodation at cost prices. Any profits will be returned to the members who at the same time usually are the tenants (BMVBS/BBR, 2007; Haffner *et al*, 2009). Cooperatives let dwellings to people who buy a share in the housing cooperative. This share usually amounts to about 1 per cent of the cost of building the dwelling and makes the tenant part-owner of the dwelling, ruling out any conflict of interest between the occupant and the owner.

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<sup>25</sup> Part of this study from which is regularly quoted in this text is a (not-completely representative, but biggest) survey of private individual landlords which own multi-family buildings that were constructed before 1991 (BMVBS/BBR, 2007). Conclusions are applicable for former East and West Germany. This distinction remains relevant even fifteen years after reunification of both parts of Germany because of structural differences between both housing markets.

<sup>26</sup> Amateur landlords own 23% of stock, a share which is equal to the share of stock of professional landlords (Table 1; information from experts).

**Table 2: Types and characteristics of individual, couple and partnership landlords with multi-family dwellings\*, 2005/2006**

Type of landlord	Amateur landlord (up to 15 dwellings)	Professional individual landlord (16 dwellings and more)
Most frequent form	- individual - couple - partnership	- individual - couple - partnership
Characteristics**	- relatively high household income on average - relatively more often retired - few dwellings (6-7 on average) - often personal connection to dwelling or lives close by - aims for a good relation with the tenant - prefers security in equity building in real estate to a high return - partly cannot cope with the necessary information for the management of the dwelling	- relatively higher household income on average - relatively more self-employed - more than 45 dwellings on average - seldom lives in the property
Management***	Mostly self, but also outsourced	Mostly self, but also outsourced
Investment motives****	- security in old age - secure equity building - tax savings - sometimes personal reason (e.g. family property) - inheritance building	- security in old age - secure equity building - tax savings - combination of return and security in equity building - demand stimuli
Return/vacancies*****	- 30% earned a profit - vacancy share is higher	- 43% earned a profit - vacancy share is lower

Source: BMVBS/BBR (2007); own interpretation; Survey in the notes refers to survey of natural person landlords with ownership of dwellings built before 1991 (see footnote 7).

- \*) Multi-family dwellings comprise about 80% of rental stock (see text). The multi-family dwellings of households comprise about 42% of stock.
- \*\*\*) The survey shows the relatively high household income and that two thirds of landlords are self-employed or retired; 24% is employed.
- \*\*\*\*) The survey shows that 73% is self-managed, while 21% is managed by private housing company.
- \*\*\*\*\*) The first three motives are the most important motives according to the survey. Combination of return and security motive is stronger for professional individual.
- \*\*\*\*\*) The survey shows that 41% achieved a profit, defined as a surplus of revenues over costs in the last five years; 19% was making a loss. The survey shows a total share of vacancies of seven percent; 13% in East and six percent in West. 2.5% are considered needed.

4.6 Cooperatives encourage the accumulation of housing equity in line with central government objectives. Since 1996 it has been possible to accumulate equity in ownership cooperatives as well. The majority of cooperatives are tenant cooperatives though. They represent a hybrid form between renting and owning with strong security of tenure because the tenant also owns some share in the overall property. As they embody a way of building equity, national government has designated cooperatives as the third pillar of housing (Bundesregierung, 2009).

**Table 3: Types and characteristics of cooperative and company landlords, 2005/2006**

Type of landlord	Cooperative	Private housing company
Most frequent form	registered cooperative (e.G.)	- limited company (GmbH) - company (AG)
Characteristics	- aim of providing affordable and long-term housing for members - non-profit* status in corporate tax, if mostly renting-oriented - 97% of cooperatives are members of umbrella organisation GdW** - average number of dwellings of GdW** members is 1,200 - majority is post-WWII stock	- mostly not public stockholders - sale and purchase of dwellings - offensive marketing
Management	member participation, efficient management	efficient management
Investment motives	- usage of funds according to articles of cooperative - cost effective (break-even) - up-to-date stock for members	- profit maximisation - portfolio improvement - maintaining market share - expansion - resale to tenants (privatisation)

Source: BMVBS/BBR (2007); own interpretation

\*) See for non-profit status 3-7, Appendix 3.

\*\*) The GdW Bundesverband deutscher Wohnungsunternehmen (translates as GdW federal union of German housing companies) is the national umbrella organization of the former non-profit landlords ([www.gdw.de](http://www.gdw.de); [Accessed 08/11/06]; from Haffner et al, 2009). Some of the private housing companies will also be GdW-members.

## Discussions about increasing the supply of the private rented sector

- 4.7 There are no policy discussions taking place about increasing the size of the private rented sector as the share of private renting is relatively high and the risks of rental vacancies are increasing (see 3.6 and 3.7).
- 4.8 However, there is a public discussion taking place about increasing subsidisation in particular for private providers of rental dwellings to help alleviate the shortages of dwellings that are expected in growth areas (information from experts).

## 5. Individual investment in the private rented sector

### Total investment in housing

- 5.1 The number of dwellings completed (Appendix 2) is not a number of total investment in housing because it excludes investment in the existing stock. Estimates about total investment in housing show that since 2000 annual investment in the stock has been surpassing the amount of investment in new dwellings (BBR, 2007; p147). In 2006 the total amount comprised almost €130 billion. The total amount of investment in 2006 amounts to a decrease since 1995 (€160 billion) as a result of the decrease in the construction of new dwellings. In terms of GDP the

total decreased from eight per cent in 1995 to 5.3 per cent in 2004. In 2008 total investment in housing amounted to €141 billion (GdW, 2009).

### **Contribution of individuals to investment in the private rented sector**

- 5.2 There are only estimates of the differentiation of total investment over groups of dwelling owners. In 2004 a total amount of €73 billion is estimated (extrapolation) to have been invested in the existing multi-family rental stock which has been built up since 1990. The small providers are estimated to have invested in this stock almost €14 billion (almost 19 per cent of total); owner-occupiers and other landlords, €52 billion (almost 72 per cent; BMVBS/BBR, 2007). The remainder was invested by GdW-members (see Section 6).
- 5.3 Private persons were responsible for 58 per cent of new dwellings in 2008 (Appendix 2), but this share includes new owner-occupied dwellings. According to the survey of BMVBS/BBR (2007) only 7 per cent of investment by individual/couple/partnership landlords resulted in an increase in the number of dwellings; the remainder of investment was in existing dwellings. This implies that individual landlords have a big impact on the quality of housing.

### **Main motives for landlords**

- 5.4 Tables 2 and 3 show the main motives for investment in rental housing when acquisition is the focus. The amateur landlords and the cooperatives are the least profit focused, while the professional individual/couple/partnership landlords and the housing companies are more market oriented. In all cases, investment is about a long horizon and security (see also Kemp & Kofner, 2010; Kofner, 2010). Because the housing market has not provided for short-term capital gains, especially in recent decades, a long-term horizon is a necessary condition for investment in rental housing.
- 5.5 Individual landlords mainly invest in the existing stock according to the survey results of BMVBS/BBR (2007) because of the relatively poor quality and the high energy costs of the dwellings which reduce their market competitiveness. The third motive is the improvement of return/rent income, while the availability of support was considered unimportant.

### **Main factors influencing investment in the private rented sector by individuals**

- 5.6 In the five years up to 2005/2006 41 per cent of multi-family rental dwellings built before 1991 in East-German cities did not cover costs (Table 2; survey of BMVBS/BBR, 2007). These losses will impact negatively on new investment decisions. Further barriers to investment in the existing stock were reported as low rent levels and the missing

equity (2005/2006). In West Germany, barriers to investment were much lower. In total more than 40 per cent of German rental dwellings were reported to need no investment due to good quality.

- 5.7 Kofner (2010) argues that amateur landlords, because of their more limited market knowledge and knowledge about subsidies, are more likely to have problems coping with changes such as decreasing demand (and vacancies), increasing numbers of elderly, the increasing share of migrants, the high government aims for energy saving, and the limited financial public aid available. As amateur landlords on average are 58 years of age according to the survey of BMVBS/BBR (2007), they will also have more problems in financing their investment. This may not be the only reason though why investments in existing stock are equity intensive.
- 5.8 BMVBS/BBR (2007) signals rising housing expenses being confronted with decreasing numbers of bricks-and-mortar subsidised rental housing. On the one hand fewer dwellings are entering the subsidy system, while on the other the period of subsidisation of existing dwellings is ending. An increase in the demand for cheaper rental housing can already be observed (BMVBS/BBR, 2007).
- 5.9 As a result for the dwellings for which the revenues did not cover costs the landlords did not have investment plans in East Germany for the period 2005/2006 (survey of BMVBS/BBR, 2007). Disinvestment tendencies are suspected contrary to West Germany where these landlords developed investment plans, reflecting the more attractive markets than in the East.
- 5.10 Return options on housing investment have become worse in the past five years and no significant improvement is expected for the next five years, the survey of BMVBS/BBR (2007) shows. It is no longer automatic, as it was 20 years ago, that investing in a multi-family dwelling will deliver satisfactory returns.

## 6. Institutional investment in the (private) rental sector

- 6.1 Institutional investment is defined as investment by GdW-members (see Table 3), even though they are not all part of the private rented sector. The 3,000 GdW-members (approximately) own about six million dwellings and represent about two-thirds of the dwellings of the professional landlords (Table 1). The GdW-members are divided up as follows across owners of dwellings:
- Municipal housing companies (42 per cent).
  - Cooperatives (37 per cent).
  - Private housing companies (15 per cent).
  - Public housing companies (3 per cent).
  - Church housing companies (2 per cent).

- Other housing companies (1 per cent).

The private rented sector-actors in this list, the cooperatives and private housing companies, are estimated to own more than half of the dwelling stock of GdW-members (weighted according to the housing stock). Thus information about them can be taken as indicative for the private rented sector. Table 3 gives an impression of their characteristics and investment motives.

- 6.2 There are different vehicles for indirect investment (Bundesregierung, 2009; information from experts). German Real Estate Investment Trusts (REITs) are allowed to invest in housing stock built as of 2007. There are two REITs and 12 organisations that are striving to become a REIT. While open-ended property funds seem to ignore housing as an investment, closed-end funds<sup>27</sup>, which are relatively unknown in other countries, seem to focus on special segments. The stock in the former funds is highly fungible, contrary to the stock in the latter funds. The most important investment vehicles are said to be German stock companies which can attract funds from the capital market and foreign legal structures which are used by foreign financial investors to structure their investments. But these companies with a focus on housing seem to be more the exception than the rule in Germany. As information about the indirect investment options is scarce, they are excluded from the following descriptions.

### **Contribution of institutions to investment in the (private) rented sector**

- 6.3 There are incomplete estimates on the differentiation of total investment over groups of dwelling owners. New-built private housing companies are estimated to have contributed 34 per cent in 2008 (Appendix 2), but the companies include public ones.
- 6.4 GdW (2009) reports that in total about €141 billion was invested in housing in Germany in 2008 (+0.8 per cent in real numbers; see 5.1). GdW housing companies invested almost €9 billion in 2008 which amounts to a nominal decrease of one per cent in comparison to 2007. Investments in new stock decreased more than investments in existing stock. Seventy-eight per cent of investment came from investments in the existing stock which is the same as the national average. GdW (2009) argues that the decrease in new construction is the result of the abolition of the degressive depreciation deduction in combination with the increasing complexity around renovations that aim for energy saving.

### **Returns on investment**

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<sup>27</sup> According to the umbrella organisation VGF (<http://www.vgf-online.de/ueber-uns.html> [Accessed 19/05/10]) the 48 members managed an investment volume of €134 billion which amounts to about 80 per cent of the market of closed-end funds. With more than six billion new investments in 2009, the members' share comprised about 70 per cent of the new investment.

6.5 Investment in the housing stock has not been rewarded by very high returns compared to other investment categories, but the returns have been stable between 1995 and 2005 (BMVBS/BBR, 2007). Returns generally come from income and not from capital growth, as house prices on average have not been rising in the last two decades. For 2009 the total residential return comparative to other properties, according to the IPD Annual Property Index, was high however, as Table 4 shows.

**Table 4: Returns on investments in property according to the IPD Germany Annual Property Index, 2009**

	Total return index	Total return %	Income return %	Capital growth %	Total return per year		
	Dec 1995=100	1 yr	1 yr	1 yr	3 yrs	5 yrs	10 yrs
All property	160.6	2.5	5.2	-2.6	3.4	2.5	3.1
Retail	187.5	2.6	5.6	-2.8	4.4	4.6	4.3
Offices	151.8	2.0	5.1	-2.9	2.8	1.4	2.6
Industrial*	187.3	-2.9	7.9	-10.1	1.5	3.4	4.4
Residential*	178.2	5.3	4.2	1.0	5.1	4.8	4.4
Other	160.9	3.8	5.0	-1.2	3.8	2.8	3.1

Source: [www.ipd.com](http://www.ipd.com).

\*) Index based in December 1996.

\*\*) The capital value of residential property is a little more than 12 per cent of the total value of all the properties included in the index. This small share plus the fact that only 50 per cent of all institutional investors are included, may make the index unrepresentative of the real estate market (information from experts).

6.6 As with the individual/couple/partnership landlords, the averages mask the problems that the vacancies cause. For GdW-members the vacancies in 2008 fell slightly in comparison to the previous year (GdW, 2009). The shares differ regionally from 1 per cent in Hamburg to 14 per cent in Sachsen-Anhalt; almost 11 per cent in the East and 3 per cent in the West.

6.7 These differences influence the returns of GdW-landlords. On average the return on total capital invested amounted to 3.1 per cent in 2007 compared to 2.9 per cent and 3.0 per cent in 2005 and 2006, respectively. The return is slightly higher on average in West Germany (3.2 per cent) than in East Germany (2.9 per cent). The return on investment averages one per cent in 2007, compared to 0.7 per cent and 1.0 per cent in 2005 and 2006 respectively. These returns seem to be lower than the IPD returns, but they are for different years.



## **Policy and other measures to promote institutional investment**

- 6.8 There are no special measures to promote institutional investment as such. Any measures that are available (Section 7) do not differentiate between different types of investors.

## **Debates about increasing institutional investment**

- 6.9 There are no debates about increasing institutional investment as such.
- 6.10 But there are worries about the ‘social face’ of the non-German institutional investors that have been coming into the private rented sector since 1999. The foreign investors (see 2.6 and 4.3) apparently expect sufficient returns as they have been buying rental stock. According to BMVBS/BBR (2007, p35; see also Veser *et al*, 2007) international analysts regarded Germany as one of the most attractive markets in 2005 and 2006. Reasons included a stagnating price development at the lower range, attractive financing conditions, more than average income returns, a low rate of homeownership and large portfolios of dwellings available. Also in the period of falling interest rates, new investment options were sought allowing for high leverage (information from experts; Claßen & Zander, forthcoming). The former non-profit private and public housing companies (GdW-members) were also regarded as not efficiently managed and not valued according to the market offering potential value gains. The capital gain was meant to be realised in due course by sale to preferably the tenants (BMVBS/BBR, 2007). The new owners also aim for a high income return before the point of sale is achieved.

## **7. Policy measures that influence investment in the private rented sector**

- 7.1 Soon after World War II the system of regulation and subsidisation of rental housing that more or less still is in place (Table 5) was established. It developed in the 1950s through to the 1970s (Appendix 3). In principle, even though there was an emphasis on quickly replacing lost stock via bricks-and-mortar subsidised rental housing, the private actors were not forgotten, and regulation of landlord and tenant rights which was perceived to be in favour of tenants was compensated by a fiscal degressive depreciation deduction for the landlords (Kofner, 2010; Appendix 1).
- 7.2 With the abolition of the degressive depreciation deduction, the ‘normal’ treatment that applies to any investor – inter alia a normal depreciation deduction – remains. The exception is the capital gains tax exemption when the property is owned for more than ten years. This is to prevent speculation. A second one is the deduction of the costs of investment in the existing stock in the year of investment (renovation, modernisation).

- 7.3 Kemp & Kofner (2010) and Kofner (2010) argue that relatively strong tenant protection allows for relatively stable returns on housing investment in the long-run. These stable, but relatively lower returns are compensated by some subsidisation, although this is less nowadays than in the past. The combination of restrictions and subsidies (including bricks-and-mortar subsidies for social renting) has created a competitive tenure that caters for broad layers of the population in the long-term.
- 7.4 Even though technically there may no longer exist much of a tax advantage to investment in housing in comparison to other investments, the tax treatment of the investment in housing used to make rental dwellings good investment and this may still be perceived to be the case, especially for individuals (see also 5.10). It should be noted that any negative income from housing can be deducted from other income for income tax purposes. This is a facility that since very recently is no longer available for income from stock and savings accounts (information from experts; see also Kemp & Kofner, 2010).

**Table 5: Policy measures that influence private rented sector-investment by owners in Germany, 2010**

Measure	Aim of stimulating new investment or acquisition of rental housing	Aim of stimulating investment in existing stock	Other aim	Comments
Rent control	not applicable	not applicable	to protect sitting tenants	- market-led - will indirectly hamper investments*
Security of tenure	not applicable	not applicable	to protect sitting tenants	- indefinite contracts, long periods of notice - will indirectly hamper investments*
Housing allowances	not applicable	not applicable	to provide affordable housing	will indirectly stimulate investments*
Income taxation and corporation tax***	no - but capital gains exemption	no - but capital gains exemption - but deduction of investment in year of investment	not applicable	- investor in rental housing is treated like investor in other rental property/investments** - but loss deduction perceived as attractive by private persons
Bricks-and-mortar subsidies	yes	yes	to create affordable, good quality housing	shift from stimulating new production to stimulating investments in existing stock, but decreasing importance
KfW****- programme for energy-efficient building	no (only for owner-occupiers)	yes	to improve energy efficiency and to reduce the	energy-efficient building may increase costs which potentially hampers investments

			costs for energy usage	
EnEV energy savings regulation (since 2002)	yes, requires investment	yes, requires investment, but not obligatory	to improve energy saving of dwellings	requirements will increase costs which potentially hampers investments

Source: Own compilation (with help of experts); see Appendix 3 for more information

\*) These instruments do not aim to stimulate investment, but will influence decisions.

\*\*) There is no tenure neutral treatment with owner-occupation.

\*\*\*) Some cooperatives have a fiscal non-profit status, not paying corporate tax. They mainly focus on their 'renting business' and not on new investment.

\*\*\*\*) KfW Bankengruppe is a special circuit financial institute that the Federal Republic of Germany and the federal states own ([http://www.kfw.de/EN\\_Home/KfW\\_Bankengruppe/index.jsp](http://www.kfw.de/EN_Home/KfW_Bankengruppe/index.jsp); [Accessed 15/05/10]). It offers support to encourage sustainable improvement in economic, social, ecological living and business conditions, among others in the areas of small and medium-sized enterprises, entrepreneurialism, environmental protection, housing, infrastructure, education, project and export finance, and development cooperation.

## 8. Policy measures that influence new building for private renting

8.1 See Section 7.

8.2 Because of the policy shift from new-build to stock (see 2.9), general subsidies to housing construction have been decreasing, while support for stock investment has been increasing (BMVBS/BBR, 2007).

## 9. Policy measures that influence the volume of the stock in the private rented sector

9.1 See Section 7.

9.2 Since the shift in housing bricks-and-mortar subsidisation away from central government in 2006 (see 1.3 and 2.8) federal states are able to design their own housing investment policies. The shift in responsibility was accompanied by a financial compensation paid for annually by the federal government of €518.2 million until 2013 (information from experts).

## 10. Federal policy measures and programmes that influence the quality of private rented housing

10.1 There are different tax deductions possible for buildings in redevelopment areas and also for historic buildings (Bundesregierung, 2009; pp92/93). Also the measures mentioned in Section 7 and 9 influence the quality of dwellings.

- 10.2 Investment in housing quality is also stimulated via urban renewal. The programme on the social city (Soziale Stadt) since its inception in 1999, has subsidised declining neighbourhoods (Bundesregierung, 2009).
- 10.3 Then there are programmes that indirectly stimulate the improvement of housing quality, if the worst-quality dwellings are demolished or improved. These programmes stimulate some disinvestment in housing but also improvements in quality (*Stadtumbau Ost* since 2002, *Stadtumbau West* since 2004) by subsidising demolition and redevelopment<sup>28</sup>.
- 10.4 KfW Bankengruppe has a programme for subsidising dwelling reconstruction and modernisation that adapts dwellings to the needs of the elderly (Appendix 3).
- 10.5 Last but not least, the federal states and municipalities have developed their own programmes and measures, for example, subsidies for investments in solar energy (information from experts).

## 11. Summary 1

- 11.1 The key factor for explaining the large size of the German private rented sector (estimated at 53 per cent of all dwellings provided; or 48 per cent when cooperatives are excluded) is for investors an attractive mix of regulation and subsidisation that has been in force in the post-World War II period.
- 11.2 A special feature was (and still is) that private landlords could receive bricks-and-mortar subsidies to build affordable rental housing for special target groups for a limited, but relatively long-lasting period. After the subsidy period ended, these dwellings would become unsubsidised rental dwellings that could be let according to the private rented sector rules. At its peak close to 20 per cent of stock was subsidised in this way; nowadays it is around five per cent.
- 11.3 A special feature was the degressive depreciation allowance in income and corporate tax for any new-built rental dwelling. This allowance could be regarded as compensation to landlords for their social conscience in not striving for maximum returns. The fact that negative income from housing investment (depreciation and debt interest) could be deducted from other income was perceived as attractive, especially by private person landlords.
- 11.4 A special feature is the rent regulation that prescribes that rent adjustments for sitting tenants are market-led and not regulated by norms.

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<sup>28</sup> See <http://www.stadtumbau-ost.info/>; <http://www.stadtumbauwest.de/> [Accessed 28/01/10].

- 11.5 Private renting was also stimulated because households were not pushed into homeownership. Renting provides security of tenure, while homeownership used to be relatively expensive.
- 11.6 Even though the private rented sector is extremely large, the structure of demand is comparatively normal: the lower the income, the younger and the smaller the household, the more likely they are to be a tenant. The structure of supply is also comparatively normal: individuals dominate (estimated 62 per cent of rental stock).
- 11.7 As Germany is facing a shrinking population in many regions, it has changed the focus of its policy. Bricks-and-mortar subsidies are now the responsibility of the federal states, but have been decreasing in importance. In contrast the focus on investments in the existing stock via energy savings, urban restructuring and, adaptations to the stock for elderly persons has increased in importance. Tax measures are mainly focused on investment in stock as well, except the capital gains exemption after an ownership period of ten years. Landlords in income and corporate tax generally are treated as any investor.

## 12. Summary 2

1. The German private rented sector is very large with an estimated size of 53 per cent of the dwellings provided (or 48 per cent when tenant cooperatives are excluded).
2. The structure of demand is comparatively normal: the lower the income, the younger and the smaller the household, the more likely they are to be a tenant.
3. The structure of supply is comparatively normal: individuals dominate (estimated 62 per cent of rental stock).
4. The size of the sector is the result of past policies motivating private individuals and companies to invest in the rental sector. It appears that a good mix between regulation and subsidisation was found.
5. Subsidisation included a degressive depreciation allowance and bricks-and-mortar subsidies for temporary social renting.
6. Nowadays Germany is being threatened by a reduction in the population in many regions.
7. The central government's policy is shifting from the central level to the federal states (local responsibility).

8. The central government's policy is shifting from new construction to investment in existing stock.
9. Present day policies thus no longer include stimulation of general investment in the private rented sector. Energy savings, modernisation and measures to adapt older person's accommodation are particularly being promoted.

## 13. References and acknowledgements

### Country experts

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## Appendix 1 Degressive depreciation allowance until 2005

- 1-1 There is a difference between corporation tax and personal income tax, as far as the tax rates are concerned, but no difference between the two taxes in the way of deducting depreciation. This scheme was set up in 1953 (Leutner, 1990) and has continued, with a few variations, until it was abolished in 2005 being replaced by the regular system of linear depreciation.
- 1-2 Linear depreciation applies to all rented properties, also to properties subsidised by bricks-and-mortar subsidies, and not to the cost of land (Braun & Pfeiffer, 2004, p9). For properties built before 1925, the depreciation rate is 2.5 per cent for 40 years, while for properties built after 1925, it is 2 per cent for 50 years.
- 1-3 Until its abolition, in the last version of the depreciation allowance, owners were allowed to choose between the linear and degressive depreciation systems in the case of new-built dwellings. The degressive system meant in 2005 that annual fiscal depreciation was 4 per cent in the first ten years, 2.5 per cent up until year 18 and 1.25 per cent from year 19 until year 50. Table 1-1 also shows earlier systems.
- 1-4 Fiscal depreciation has been regarded a powerful subsidy tool, as each buyer-landlord of the property can take advantage of the deduction on the basis of the historical purchase price. House price inflation alone gave landlords a strong incentive to sell off in order to build new properties.
- 1-5 Braun & Pfeiffer (2004) calculated that landlords could have reduced rents substantially, 20 per cent of the market rent, if they were to pass on the tax benefits to their tenants in full (instead of regarding them as additional profit). This would have made renting more attractive than buying for housing consumers.

**Table 1-1 Development of degressive depreciation deduction on new-built rented dwellings**

<b>Before 1989</b>				
Years	1-8		9-14	15-50
Annual depreciation	5%		2.5%	1.25%
Cumulative depreciation	40%		55%	100%
<b>From 1989</b>				
Years	1-4	5-10	11-16	17-40
Annual depreciation	7%	5%	2%	1.25%
Cumulative depreciation	28%	58%	70%	100%
<b>From 1996</b>				
Years	1-8	9-14	15-50	
Annual depreciation	5%	2.5%	1.25%	
Cumulative depreciation	40%	55%	100%	
<b>2005</b>				
Years	1-10	11-18	19-50	
Annual depreciation	4%	2.5%	1.25%	
Cumulative depreciation	40%	60%	100%	

Sources: *Braun & Pfeiffer (2004), Hubert (1998), Kirchner (2006)*

## Appendix 2

### Tables on new construction and tenant characteristics

**Table 2-1 New house building in buildings (units and %\* of total number of dwellings), Germany, 1995-2008**

Year	Total number of dwellings	Dwellings in buildings				
		Public builders (1)	Private builders (2)	Of which private housing companies	Private households (3)	Non-profit organisation (4)
1995	539,936	3,614	223,551	192,012	293,176	4,265
%		<b>0.7</b>	<b>41.4</b>	<b>35.6</b>	<b>54.3</b>	<b>0.8</b>
1996	498,844	3,004	221,046	184,648	258,186	3,013
%		<b>0.6</b>	<b>44.3</b>	<b>37.0</b>	<b>51.8</b>	<b>0.6</b>
1997	515,566	2,915	231,286	185,613	262,805	4,114
%		<b>0.6</b>	<b>44.9</b>	<b>36.0</b>	<b>51.0</b>	<b>0.8</b>
1998	443,748	2,877	180,511	148,054	245,387	3,462
%		<b>0.6</b>	<b>40.7</b>	<b>33.4</b>	<b>55.3</b>	<b>0.8</b>
1999	416,547	2,588	163,522	136,631	237,266	3,191
%		<b>0.6</b>	<b>39.3</b>	<b>32.8</b>	<b>57.0</b>	<b>0.8</b>
2000	377,325	3,375	142,968	120,082	219,917	2,271
%		<b>0.9</b>	<b>37.9</b>	<b>31.8</b>	<b>58.3</b>	<b>0.6</b>
2001	292,328	1,699	110,012	94,318	172,053	2,161
%		<b>0.6</b>	<b>37.6</b>	<b>32.3</b>	<b>58.9</b>	<b>0.7</b>
2002	259,875	1,778	90,251	77,422	159,656	2,015
%		<b>0.7</b>	<b>34.7</b>	<b>29.8</b>	<b>61.4</b>	<b>0.8</b>
2003	240,938	1,389	80,098	68,863	152,645	1,956
%		<b>0.6</b>	<b>33.2</b>	<b>28.6</b>	<b>63.4</b>	<b>0.8</b>
2004	252,163	1,196	80,675	70,229	164,325	1,599
%		<b>0.5</b>	<b>32.0</b>	<b>27.9</b>	<b>65.2</b>	<b>0.6</b>
2005	217,124	852	69,537	60,016	141,801	1,576
%		<b>0.4</b>	<b>32.0</b>	<b>27.6</b>	<b>65.3</b>	<b>0.7</b>
2006	224,575	1,397	78,589	69,343	139,161	1,490
%		<b>0.6</b>	<b>35.0</b>	<b>30.9</b>	<b>62.0</b>	<b>0.7</b>
2007	188,856	1,011	66,248	57,580	116,781	1,275
%		<b>0.5</b>	<b>35.1</b>	<b>30.5</b>	<b>61.8</b>	<b>0.7</b>
2008	155,820	898	60,087	52,489	89,676	1,576
%	<b>100</b>	<b>0.6</b>	<b>38.6</b>	<b>33.7</b>	<b>57.6</b>	<b>1.0</b>

Source: Statistisches Bundesamt (2009) Fachserie 5, Reihe 1, Jahrgang 1995-2008.  
 \*) Because of a category other the percentages of columns (1)-(4) do not add up to 100.

**Table 2-2 Tenants\* as percentage of households by household type, age, income quintile and unemployment in Germany, 1991, 1996, 2001, 2006**

	West Germany				East Germany			
	1991	1996	2001	2006	1991	1996	2001	2006
<b>Household type</b>								
Single, man	84.3	78.8	77.9	73.7	87.0	89.9	81.7	82.2
Single, woman aged up to 64	78.9	81.5	80.4	77.7	91.3	92.8	85.5	86.9
Single women 65+	69.5	67.0	61.4	58.8	85.7	88.6	80.6	82.3
Couple without children	55.0	53.6	48.7	46.1	69.0	69.6	61.3	57.9
Couple with children up to age 16	54.7	50.9	49.3	47.4	74.9	65.7	57.4	52.9
Couple with children aged 17+	30.1	37.5	32.2	31.3	57.6	58.3	41.2	37.4
Single parent	61.2	69.9	73.5	74.1	87.5	83.7	81.8	85.1
Average	60.1	60.0	57.5	55.3	75.2	74.0	67.2	66.6
<b>Age</b>								
Aged up to 40 years	76.2	74.7	77.2	76.5	79.2	78.4	77.3	78.5
41-65 years	49.7	51.6	48.0	46.9	70.9	67.4	60.3	57.5
66+	57.7	54.9	48.7	44.3	76.6	80.2	67.6	67.6
Average	60.1	60.0	57.5	55.3	75.2	74.0	67.2	66.6
<b>Quintiles of net household income</b>								
First quintile	71.8	74.5	73.8	74.8	75.3	80.5	76.1	79.0
Second quintile	65.2	66.2	62.9	60.9	75.3	71.8	63.3	70.2
Third quintile	65.2	61.7	56.8	58.6	77.5	71.6	67.3	58.1
Fourth quintile	58.4	56.4	54.7	47.6	71.3	70.9	62.8	61.1
Fifth quintile	49.8	47.3	45.2	41.7	71.5	72.1	57.8	51.2
Households with unemployed persons	80.0	69.5	71.6	78.5	74.1	69.1	69.1	71.6
Average	60.1	60.0	57.5	55.3	75.2	74.0	67.2	66.6

Source: Bundeszentrale für politische Bildung (2008, p227)

\*) The difference between these percentages and 100% is the share of homeowners in each group.

## Appendix 3

### Policy measures that influence investment in the private rented sector

#### Rent control

- 3-1 Since the 1970s (Kofner, 2010) rent control in Germany has been concerned with protecting sitting tenants, not new tenants (Haffner *et al*, 2009). Rents for new leases in the market rented sector can be negotiated freely, as long as they are not considered exorbitant rents under economic criminal law.
- 3-2 Rent control for sitting tenants in the free-financed rented sector can occur by several legal means, but is always market-led. Rent changes for sitting tenants can be based on the rents of three similar rented dwellings. Alternatively, rent changes can be based on a so-called *Mietspiegel* (translated as rent mirror), a database with local reference rents of non-subsidised market rents. Reference rents are based on comparable quality characteristics for buildings and dwellings and their locations. There is the general rule that rents may not be increased by more than 20 per cent within a three-year period. Apart from 'normal' rent increases, landlords are allowed to increase rents after modernisation with 11 per cent of price.

#### Security of tenure

- 3-3 Security of tenure has been quite strong in Germany since the 1970s (Kofner, 2010). Nowadays this implies that the length of tenancy in principle is indefinite (Wurmnest, nd; information from experts). 'Fixed-term lease contracts' were only permitted under special circumstances. Tenants thus are fairly well protected. The notice period for tenants is always three months. Contrary to the landlord, the tenant does not need a reason for handing in their notice. The tenant is allowed to transfer the contract to a new tenant accepted by the landlord.
- 3-4 Notice periods for landlords run from three months to nine months. The three months period is applicable in the first five years; the nine months is applicable from the ninth year on. Special circumstances that can end a contract are if the tenant has at least three months of rent arrears or is causing a nuisance. If the landlord or his family needed the home themselves, there may also be grounds for terminating the contract, provided this would not cause unacceptable inconvenience to the tenant. Also, the rule is that the sale of a dwelling will not break the lease.

#### Taxation/subsidy incentives

- 3-5 Since the 1950s German landlords have been treated as investors: revenues are taxed, costs are tax deductible (Kemp & Kofner, 2010). Nowadays this means that interest costs for debt are deductible. Also normal maintenance investments are tax deductible in the year of investment (Bundesregierung, 2009), while value increasing investments

as well as new investments are subject to linear depreciation (RWI, 2009; see Appendix 1). These aspects are considered normal investor tax treatment. This also applies to the possibility to offset losses from renting from taxable income (Kemp & Kofner, 2010; information from experts).

- 3-6 Capital gains from the sale of residential real estate is tax-free unless the building has not been held for more than ten years or the seller is a commercial real estate dealer (regular trader; Kemp & Kofner, 2010).
- 3-7 Cooperatives whose rent revenues comprise more than 90% of revenues have fiscal non-profit status (BMVBS/BBR, 2007). This implies that they are not paying corporate tax. This fiscal non-profit status was available more broadly until 1990 (Haffner *et al*, 2009).
- 3-8 Since its inception, the system of bricks-and-mortar subsidies has been designed as a concession model providing subsidies for any landlord for the temporary provision of subsidised rental housing to specified target groups. Loans with a lower-than-market (subsidised) interest rate are often available from a special financial institution owned by the federal states (the KfW Bankengruppe; Haffner & Oxley, 2009). After the subsidy period ends, the dwelling becomes a non-subsidised dwelling subject to the normal private rented sector-rules.

#### **Other incentives/disincentives for more overall investment in the sector**

- 3-9 Other ways the German government stimulates housing investment are:
  1. KfW Bankengruppe offers several programmes, under which there is one for energy-efficient building and one for the adaptation of dwellings for the use by elderly (BMVBS, 2010; information from experts). In principle they offer either a loan with lower-than-market interest or a grant.
  2. The EnEV energy savings regulation has been applicable since 2002 (BMVBS/BBR, 2007; information from experts). It is obligatory since 2007 for new buildings and for certain measures for existing dwellings. It has been enforced since 2009. It should increase investments in dwellings, as it requires owners to make new investments to fulfil the requirements of the regulation on the one hand, as soon as the owner takes measures to modernise the housing stock or to replace the technical installations. On the other hand it could give rise to hesitation as long as investment costs are not covered by market rents.
  3. By subsidising demand via housing allowances, supply may indirectly be triggered.

## **Appendix 4**

### **Abbreviations and acronyms**

<b>AG</b>	Aktiengesellschaft
<b>BBR</b>	Bundesamt für Bauwesen und Raumordnung
<b>BBSR</b>	Bundesinstitut für Bau-, Stadt- und Raumforschung
<b>BMVBS</b>	Bundesministerium für Verkehr, Bau und Stadtentwicklung
<b>e.G.</b>	Eingetragene Genossenschaft
<b>EnEV</b>	Energieeinsparverordnung
<b>EU</b>	European Union
<b>GDP</b>	Gross Domestic Product
<b>GdW</b>	GdW Bundesverband deutscher Wohnungsunternehmen
<b>GmbH</b>	Gemeinschaft mit beschränkter Haftung
<b>IPD</b>	Investment Property Databank
<b>KfW</b>	Used to be called: Kreditanstalt für Wiederaufbau
<b>Bankengruppe</b>	
<b>REIT</b>	Real Estate Investment Trusts
<b>RWI</b>	Rheinisch-Westfälisches Institut für Wirtschaftsforschung
<b>VGf</b>	Verband Geschlossene Fonds e.V.



# Appendix F

## Country report: England

### 1. Introduction

- 1.1 This report builds on the report produced in March 2010 on an overview of the private rented sector in England. This formed a baseline study to the same format as the other 'Stage Three' countries. It primarily focused on a commentary on data and information on the trends in the sector together with a brief policy analysis.
- 1.2 The overall aim of this report is to set the scene for an informed discussion on promoting investment in private rented housing supply through a comparative perspective. The more specific objectives are fourfold and these are to:
- Provide a succinct account of the private rented sector to a similar format adopted for the other 'Stage Three' countries i.e. Australia, France, Germany and the USA.
  - Highlight current policy initiatives at the national and local levels.
  - Set out the prospects for and issues facing the sector.
  - Begin to consider the lessons that can be learnt from other countries, which is taken forward further in the final overall report.
- 1.3 The next section provides an overview of the private rented sector. This is followed by a focus on the trends in the size, demand and supply aspects. Section four outlines the policy framework and this is followed by a description of new initiatives. Section six briefly investigates the investment framework over the last two decades, while section seven summarises the immediate prospects. The final section begins to consider the relevance of the experiences from other countries. There are also two summaries provided.
- 1.4 The evidence is drawn from published secondary sources and there is an extensive bibliography at the end of this report. No primary research has been undertaken. Extensive use has been made of the Government-commissioned study of the private rented sector by Rugg and Rhodes (2008a and 2008b)<sup>29</sup>.
- 1.5 The primary focus of this report is on England and not on Great Britain or the United Kingdom. The policy rationale for this is that housing is a 'devolved task' i.e. it is the responsibility of the national governments in England, Northern Ireland, Scotland and Wales. It is, nevertheless,

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<sup>29</sup> It is worth noting that a similar review has been undertaken in Scotland – see Scottish Executive (2009), *Review of the Private Rented Sector*, Edinburgh, Scottish Executive.

recognised that for the purposes of the overall project many aspects of institutional investment (such as taxation and fiscal strategies) are not devolved functions. Therefore, where appropriate, a wider framework is provided.

## 2. Overview

2.1 The following table provides data on the private rented sector in England between 1971 and 2007.

**Table 1: Key Characteristics on the Private Rented Sector in England**

Year	Number of Dwellings	Percentage of Housing Stock	Condition of Stock : Proportion of private rented properties not meeting decent homes standard <sup>30</sup>
1971 <sup>31</sup>	3.1m	19.3%	NA
1976	2.3m	13.6%	NA
1981	2.0m	11.3%	NA
1986	2.0m	10.3%	NA
1991	1.8m	9.0%	NA
1996	2.1m	10.1%	62.4%
2001	2.1m	10.1%	50.7%
2006	2.7m	12.2%	46.8%
2007	2.9m	12.9%	45.4%

Source: Wilcox, S. (ed) (2009), *UK Housing Review 2009/2010*, Coventry & London, Chartered Institute of Housing and the Building Societies Association, Tables 17 a and 23a.

*Points to note: There is no reliable information on the contribution of the private rented sector to new house building.*

2.2 The major overall features of the sector are:

- A century of decline followed by a recent revival: Approximately 75 per cent of households were in the private rented sector after the First World War, but this declined to less than 10 per cent by 1991. By the end of 2007, this had increased to approximately 13 per cent of households living in the sector. Seventy per cent of households were home owners and 17 per cent were social renters.
- Approximately one million additional households were renting in 2008 compared with the late 1980s.
- The overall quality of accommodation is poor: Over 45 per cent of properties did not meet the national decent homes standard in 2007.
- According to Rugg & Rhodes (2008b, pp3-4), four interrelated factors account for the revival of the sector over the last two decades:

<sup>30</sup> Decent homes standard definition was changed in 2006. It became a higher standard.

<sup>31</sup> The data for 1971 includes housing association stock as part of the private rented sector.

- Housing Act, 1988: This introduced shorthold tenancies and lifted rent restrictions on new tenancies.
  - Recession in the early 1990s leading to owner occupiers renting out properties because of an inability to sell.
  - Expansion of demand, for example, students as a result of the growth in the higher education sector.
  - Availability of buy-to-let mortgages which encouraged individuals to purchase properties to rent.
- Detailed information on the relative importance of each of these factors is not readily available. There has been, for example, considerable media coverage on buy-to-let. But as Rugg & Rhodes (2008b, p11) point out, although there are over one million buy-to-let mortgages, many landlords were using this financial product to refinance their existing stock portfolio rather than purchase newly built apartments and flats in city centres.
  - The private rented sector is diverse and fragmented. Rugg & Rhodes (2008b, pxiv) identify ten distinct sub-markets:
    - young professionals
    - students
    - housing benefit market
    - slum rentals
    - tied housing
    - high income renters
    - immigrants
    - asylum-seekers
    - temporary accommodation and
    - regulated tenancies
  - Overall, the average age of heads of housing in the private sector are much younger than other tenures – over 50 per cent of private renters are under 35 compared to approximately 20 per cent of owner occupiers and 20 per cent of social renters.
  - Mobility is a key characteristic of the sector with over 80 per cent of households in the same property for less than five years and 40 per cent having moved at least once in the previous 12 months.
  - Equally diverse are the types and characteristics of landlords. The sector can be characterised as having a few large private institutional and many small landlords<sup>32</sup>. Rugg & Rhodes (2008b, pp128-130) note:
    - Nearly 50 per cent of private landlords are individuals and 25 per cent are couples.
    - Individuals and couples accounted for 73 per cent of all landlords in 2006 compared to 61 per cent in 1993/94.

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<sup>32</sup> The largest institutional investment landlord is the Grainger Trust with over 13,000 properties in ownership in the UK. It is worth noting that it also owns 7,000 properties in Germany.

- Private and public companies account for 15 per cent of all landlords in 2006 compared to 20 per cent in 1993/94.
  - Nearly 60 per cent of landlords own less than 5 properties in 2006 compared to 43 per cent in 2003/04.
  - In 1993/94, 12 per cent of landlords owned more than 250 properties but this had declined to 3 per cent by 2006.
- It is estimated that in 2006 60 per cent of private sector landlords in England used agents to manage their properties. This was up from 37 per cent in 1993/4 (Rugg & Rhodes, 2008b).
  - Estimates for the UK, **suggest** that only about 80 per cent of the private rented sector stock is overtly traded in the sense of being provided through a market landlord or letting agency (Rhodes, 2006).

### 3. Trends in the private rented sector

3.1 A useful starting point is to classify trends in the dynamics of the private rented sector over the last two to three decades. As a wide range of authors note, the long term decline of the sector ended in the late 1980s (see, for example, Crook and Kemp, 2002, Kemp, 2004, and Rugg & Rhodes, 2008b). A number of stages can be identified:

- A growth period from the late 1980s to the mid 1990s: A number of factors contributed to this situation including the liberalisation associated with the introduction of shorthold and assured shorthold tenancies and the lifting of rent restrictions on new tenancies. In addition, the owner-occupied housing crash was significant with households renting out properties that they were unable to sell. The number of private rented dwellings increased from 1.8m to 2.1m between 1991 and 1996.
- A period of stability from the mid 1990s and early 2000s: The number of private rented dwellings did not change between 1996 and 2001, even though buy-to-rent mortgages became readily available from 1998.
- A second growth period from the early 2000s onwards: The number of private rented dwellings increased from 2.1m in 2001 to 2.9m in 2007. This is popularly referred to in magazines such as 'Landlord & Buy-to-Let'<sup>33</sup>, as the 'buy to let boom'.

3.2 A number of commentators (such as Rugg & Rhodes, 2008b) have argued that the role of buy-to-rent has been overstated. For example, many buy-to-let mortgages were used for re-mortgaging purposes. A more plausible analysis is that the growth of the private rented sector over the last decade reflects broader supply and demand trends in the

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<sup>33</sup> See <http://www.landlordnet.co.uk/>.

housing and labour markets. Access to owner occupation, especially for first time buyers, became less affordable, while the opportunities to become a social housing tenant were reduced because of the increase in the size of housing registers. Existing and potential landlords responded to these demand drivers.

- 3.3 Similarly, the changes in demand have been fuelled by labour market factors. These include:
- Greater mobility requirements in some occupational sectors especially in the early stages of working careers, for example, financial services.
  - Growth in the higher and further education sectors with the number of individuals in full time education increasing from 1.4 million in 1995/96 to nearly 2 million in 2006/07.
  - Migrant workers from Eastern European countries (often referred to as A8 countries).
- 3.4 These trends have altered the demand side of the sector. As was pointed out in the previous section, there are a number of sub-sectors/niche markets. The growth over the last two decades has been in especially the young professional sector, students and immigrants. In addition, councils have increasingly made use of the private rented sector for accommodation for homeless households (see below). Declining sub-sectors have included tied accommodation (particularly in rural areas) and long established tenants with regulated tenancies.
- 3.5 From a supply perspective, the key trend has been the relative growth of small scale landlordism at the expense of companies. In 2006, approximately 75 per cent of landlords were private individuals or couples and 10 per cent were property companies. The respective figures for the early/mid 1990s were 60 per cent and over 15 per cent. Nevertheless, these overall trends do hide a number of developments over the last decade. Firstly, larger housing associations have been setting up subsidiaries that provide market rented accommodation. Places for People, for instance, through its Blueroom subsidiary, own over 5,000 properties. Secondly, the student market has seen the rise of new niche providers. These include Unite that owns over 125 properties in 24 cities and provide 38,300 bedspaces with a further 1,200 new spaces to be available during 2010.
- 3.6 The geography of private renting is also diverse and changing. At a regional level in 2001, over 16 per cent of households in Greater London were in the private rented sector compared to 8 per cent in the North East. At a local authority level, there were a number of inner London Boroughs with substantial private rented sectors including the London Borough of Westminster with over 35 per cent. There is also a substantial private rented sector in some parts of rural England. Rugg &

Rhodes (2008b, p36) highlight that in the North East in 2001, over 20 per cent of households in wards classified as rural villages were in the private rented sector. However, as has already been pointed out in this report, a major but declining contributory factor in rural areas is tied accommodation.

3.7 These complex trends are leading to a growing consensus that there is a 'modern private rented sector' emerging that provides flexible and affordable accommodation for younger households (see, for instance, Rhodes, 2006). Nevertheless, care is required in not over-stating this trajectory or implicitly suggesting an exaggerated optimism for the future. Factors to bear in mind include:

- The vast majority of households aspire to owner-occupation.
- Most households experience private renting at some stage in their housing life cycle, but it provides homes for life for very few people.
- The private rented sector fulfils an important but specialist role in the housing market and this varies considerably by area.
- The structure of the supply side suggests a decline in interest among traditional property companies but potentially the rise of new corporate players.
- The majority of landlords are individuals and couples holding less than five properties. This is sometimes referred to as 'small-scale landlordism' and a 'cottage industry' i.e. private renting is not regarded as the prime source of income<sup>34</sup>. But this is not to suggest that small landlords necessarily offer a poor service or product compared with corporate organisations.

## 4. Policy framework

4.1 As has already been pointed out, the Government commissioned a study of the private rented sector in 2007. Rugg & Rhodes (2008a and 2008b) sub-titled their study as the 'contribution and potential' of the sector. It together with other reports (for example, Bill *et al*, 2008), commentaries (for example, Wilcox, 2008) and recent developments (for example, HM Treasury, 2010) have highlighted a number of interrelated national policy areas including demand and supply, fiscal policy, and stock quality and property management. The key issues affecting each of these areas are outlined below. This is followed by a brief discussion of the neglected issue of a local policy framework (see Davies, 2007).

### **Demand and supply**

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<sup>34</sup> Personal correspondence with Professor Michael Ball, University of Reading.

- 4.2 The previous sections highlighted a degree of uncertainty over the future trends. But the consensus is that there is likely to be a continuing rise in demand because of the difficulties of households in meeting their aspirations for owner occupation and the shortage of social rented property. The role of the ‘modern private rented sector’, thus, appears to fill a gap in the housing market that meets the demand at one or more points in housing life cycle of households. It is not a ‘sector for life’.
- 4.3 Changes in supply have been a response to demand pressures. The impact of buy-to-let has been to increase supply with a minimum impact on overall house price inflation (NHPAU, 2008). Nevertheless, a number of cities are reported to have faced the prospects of dealing with a glut of city centre apartments that have been difficult to let. There has also been an entry into the market of new players such as large housing associations and specialist student housing providers (for example, Unite).
- 4.4 A linked theme in the debate on supply has been the frequent assertion that the private rented sector could make a much more significant contribution to increasing new housing output (see, for instance, Bill *et al*, 2006 and 2008, and the Property Industry Alliance *et al*, 2010). This, however, raises a number of challenging issues and questions. To what extent, for example, would this be a substitute for social housing or owner-occupied properties? What would be the organisational and fiscal models needed to achieve higher outputs? Does this type of supply necessitate a more radical perspective on the role of private renting – does it become a ‘home for life’?
- 4.5 The Chartered Institute of Housing in a recent briefing paper suggest that there is a role for a ‘more dynamic, affordable rented sector’ than one currently based on two independent tenures – social renting and private renting (Davies and Lupton, 2010)<sup>35</sup>. It is also worth noting that a study by Hometrack reported in Inside Housing revealed that 15,000 households allocated general needs homes in 2009 would have had enough income to afford intermediate renting (Brown, 2010).
- 4.6 The crucial point is, however, that there is a political and social consensus in favour of meeting the aspirations of households to become owner occupiers. The new Minister for Housing in the coalition government highlighted this in his first policy speech on the ‘age of aspiration’<sup>36</sup>.
- 4.7 The fundamental policy options on the future role of the private rented sector are:
- Maintaining the ‘modern private rented sector’ in its role of meeting household requirements at certain points in the life cycle.

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<sup>35</sup> The potential parallels with Sweden and its integrated rental sector are interesting in this respect – see also final section of this report.

<sup>36</sup> See <http://www.communities.gov.uk/newsstories/housing/16050061>.

- Transforming private renting into a tenure of choice and aspiration.
  - Creating an integrated dynamic affordable rented sector.
- 4.8 The first option requires relatively minor changes, while the latter two explicitly push towards radical changes in housing policy across all tenures as well as in fiscal policy.

#### **Fiscal policy (see also section six)**

- 4.9 There is an acknowledgement that the national fiscal regime favours owner occupation. This has been evident for many decades since the abolition of Schedule A taxation<sup>37</sup> for home owners in the early 1960s. There appears, however, to be little political appetite to review this situation. Instead there have been and continue to be a series of measures to encourage institutional investment through, for example, Residential Business Expansion schemes in the early 1990s, Housing Investment Trusts and, more recently, Real Estate Investment Trusts. These generally have not been successful – see Bill *et al* (2008), Cook and Kemp (2002), Jones (2007) and the Property Industry Alliance *et al* (2010).
- 4.10 The Treasury are currently consulting on the issue of encouraging more investment in the sector. It will be interesting over the next few months to analyse the responses and suggestions especially in the light of earlier contributions by the Smith Institute (see Bill *et al*, 2006 and 2008). These highlighted that a wide range of fiscal measures were necessary such as changes to Stamp Duty Land Tax (SDLT), the encouragement of tax efficient investment vehicles and changes to VAT. They also emphasised that fiscal measures had to be seen as part of a broader package of creating a level playing field on taxation and changes to the planning system for landlords and investors.
- 4.11 Nevertheless, the debate on investment, taxation and planning has to be located within the policy arena of the future role of the sector (see above).

#### **Stock quality and property management**

- 4.12 The poor overall quality of private rented sector has already been highlighted. Although improvements have taken place in the last decade, national policy has prioritised social rented properties and the decent homes standard over the private rented sector. Regulatory measures such as landlord accreditation schemes are aimed at tackling this issue.

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<sup>37</sup> Schedule A taxation relates to income from land and property. Landlords pay tax on their rent receipts while owner occupiers have not done so since 1963. There is a recent review article on this issue – see **Welham, P.** (2007) The Tax Treatment of Owner-Occupier Housing in the UK, *Scottish Journal of Political Economy* Vol 29, No 2, pp139-155.



- 4.13 There has been a strong emphasis in the debates on the private rented sector on the need to ‘professionalise’ private rented sector management. It is argued that this would contribute to improved stock quality and better relations between tenants and landlords. There are a number of policy aspects including regulatory regimes based on, for instance, accreditation and licensing schemes for private landlords. Local authorities are responsible for implementing these types of measures. One of the themes emerging from the debate on the Rugg Review was the appropriateness of tighter regulations and tougher sanctions (see Stubbings, 2010). However, the new coalition government has recently announced that it is not intending to proceed with plans to introduce new regulations covering, for instance, a national register of landlords, regulation of letting and managing agents, and compulsory written tenancy agreements<sup>38</sup>. Instead the emphasis will be on councils making use of their existing powers – many of which are discretionary.
- 4.14 There are also debates on security of tenure. As has already been noted, the introduction in 1988 of shorthold tenures and later assured shorthold tenancies (along with lifting rent restrictions on new tenancies) contributed to the growth in the sector. Nevertheless, it is argued that assured shorthold tenancies provide only limited security for tenants. Wilcox (2008) argues that there is a case for making modest changes in the legislation to give a greater degree of security in exchange for tax incentives to improve the quality of the stock.
- 4.15 The trade off between security of tenancy, stock condition and a more favourable investment climate presents an interesting policy agenda. Again, however, its relevance depends on the future role of the sector.

### **The local policy dimension**

- 4.16 Councils through their regulatory role play an important part in the private rented sector at the local level. As Davies (2007) has pointed out, this has been a neglected area of housing strategy – ‘a cinderella service’. There are a number of factors that have contributed to this situation. Firstly, local housing strategies tend to focus on issues such as stock condition in the private sector (i.e. owner occupation and private renting – with the latter being marginalised) and empty homes. Secondly the emphasis is on individual regulation of private landlords.
- 4.17 Davies (2007) suggests, however, that there is potential for a strategic enabling role for councils, which could involve:
- A focus on geographical concentration on neighbourhoods with high levels of private rented sector in poor condition (as has been happening in most of the housing market renewal pathfinders).

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<sup>38</sup> See <http://www.communities.gov.uk/news/corporate/16111381>.

- An emphasis on the opportunities and challenges of the student housing market.
- The potential of private rented property to meet the needs of homeless households.
- Integrating private rented property into choice-based lettings schemes.

4.18 There are clearly opportunities for councils and the Homes and Communities Agency to think strategically about the role of the private rented sector through the single conversation process and the local investment plans and agreements.

4.19 Nevertheless, this type of facilitating role presupposes that the current role of the private rented sector is maintained.

## 5. New initiatives

5.1 There have been two significant national developments over the last twelve months linked to institutional investment in the private rented sector as well as a number of local initiatives. The two national developments are as follows:

- The Treasury announced as part of its Pre-Budget Statement in December 2009 that it intended to issue a consultation paper on investment in the sector. This was published in February 2010 (HM Treasury, 2010). It argues that the sector could contribute to tackling the under-supply of new housing in the UK. A number of issues are raised including encouraging both individual and institutional investment with the emphasis on the latter. The consultation on these proposals closed at the end of April 2010.
- The Homes and Communities Agency, which is the housing and regeneration agency for England, initiated work in 2009 on securing institutional investment for private rented housing<sup>39</sup>. In February 2010, it announced it was seeking expressions of interest for six sites in London that will be led by a consortia headed either by a private rental fund investor or a major contractor/builder<sup>40</sup>. It is understood that over 60 expressions of interest were received from a diverse range of stakeholders including developers, housing associations and land owners. In April 2010, Regeneration and Renewal reported that two out of four potential investors (Aviva and Aegon) had announced their willingness to participate in this initiative (Carpenter, 2010).

<sup>39</sup> For more details, see <http://www.homesandcommunities.co.uk/Private-Rental-Sector-Initiative>.

<sup>40</sup> See *Inside Housing* (2010) HCA Picks Private Sector Sites *Inside Housing* 26 Feb.

- 5.2 The key driver for both of these initiatives has been to attract investment into the private rented sector so as to increase overall output of new housing. It is less clear as to the intended role of the new development in the private rented sector funded through these schemes (see above).
- 5.3 At the local level, there have also been a series of interesting developments. Regeneration and Renewal reported that Birmingham City Council has accepted a planning agreement for a scheme that involves 26 per cent of provision in the form of intermediate rent of 80 per cent of market value for 21 years (Marrs, 2010). This is instead of the normal policy of 35 per cent affordable homes. The city council has also been reported as agreeing the business case for a joint venture with an institutional investor to provide up to 1,500 family homes for private renting.
- 5.4 The example of the planning agreement illustrates the challenge of balancing long term need with a pragmatic response to the recession. On the one hand it is important to ensure that housing development is not constrained in the current financial situation by existing requirements for affordable housing provision. But on the other hand, there is growing pressure faced by councils and housing associations to tackle the increase in the number of households on housing registers.

## 6. Policies for investment in the private rented sector

- 6.1 There have been a number of studies of specific measures to attract institutional investment into the private rented sector (for example, Crook and Kemp, 2002, on housing investment trusts, and Jones, 2007, on real estate investment trusts). Bill *et al* (2008, p5) comment,

*“Real estate investment trusts have failed to encourage the building of homes for rent, nor have they helped professionalise the rented sector. Both these aims were central to the policy introduced after years of debate in January 2007. So what now?”*

- 6.2 The conclusions over the lack of success of these initiatives are similar. Firstly, the rules governing these instruments do not reflect the standard operating procedures of property companies and are not attractive to institutional investors. The Property Industry Alliance (2010) and Bill *et al* (2006 and 2006) further confirm this comment. Secondly, the existing structure of the private rented sector comprising small landlords and a pepper potting of units is a disincentive. Economies of scale in property management are required and can only be achieved primarily from geographical proximity. Large scale sustained investment by companies would require a new policy direction for the sector in terms of role and function.

6.3 As has already been pointed out, new specialist niche markets are emerging, for example, student provision. But as Bill *et al* (2006 and 2008) note there are a number of bigger conditions (as well as fiscal instruments) that would need to be met to attract large scale institutional investment to achieve 40 to 50,000 new properties per year. Yet there is considerable potential. The Property Industry Alliance (2010) notes that the top ten investment managers have approximately £62 billion of property under investment, but only 1 per cent is invested in residential property. The bigger conditions include:

- Need for a long term perspective and consensus on the role of the sector and the financial, planning and taxation policies. It is argued that there have been far too much short-termism and pragmatic approaches.
- Maintaining a healthy property investment market as housing is a subset of the 'property asset class'. But, as pointed out above, housing is effectively a new asset class and investors will only be attracted if, firstly, they can make substantial investments and, secondly, that it is attractive in terms of risks and returns relative to other major asset classes.
- Reforming the planning system so that private rented property is not encouraged at the expense of social renting. This could be achieved by creating a new use class or licensing system. The latter might involve a requirement that a proportion of new homes would have to be rented out for a fixed period of time.
- Rethinking the regulatory framework by, for example, simplifying the complex framework covering stock condition and landlord-tenant relations through a single comprehensive piece of legislation. Nevertheless as Bill *et al* (2008) point out, unfortunately much of the debate centres on a rather sterile argument over deregulation. Instead it is argued that a simplified comprehensive approach would create consistency and clarity for all parties.

6.4 In relation to fiscal instruments, a wide range of suggestions has been put forward in recent years (and have been usefully summarised by the Property Industry Alliance, 2010):

- Reform of Stamp Duty Land Tax to create a level playing field for institutional purchasers.
- Changes to VAT including lowering the rate for refurbishment.
- 100 per cent capital allowances to offset the refurbishment of homes for rent.
- Reforming the rules on real estate investment trusts to allow for ones to be established that are not listed on the stock exchange.

## 7. Immediate prospects

- 7.1 There continues to be considerable debate on the future role and nature of the private rented sector (see, for example, Rugg & Rhodes, 2008a and 2008b, Wilcox, 2008). The recent Treasury consultation paper on investment in the sector is likely to generate a further period of debate.
- 7.2 An important strand to this debate is the impact of the economic recession. There are a number of elements that point to possible retrenchment but also alternatively to growth. They relate to the factors highlighted by Rugg & Rhodes (2008b) that have resulted in a revival of the sector over the last two decades including:
- The lack of availability since 2008 of buy-to-let mortgages and its consequences for investment in the sector (but see above on the debate on the significance of buy-to-let).
  - A plateau-ing out effect of the rise in the number of full-time higher education students from 2010 because of a cut-back in government funding and short term targets.
  - The impact of the recession on owner-occupation and the likelihood that households that are unable to sell may resort to letting their property.
- 7.3 At the same time, the focus has to take note of changes in the other tenures. There is increasing demand for social housing that is unlikely to be met through a new affordable housebuilding programme. Furthermore, the lack of suitable mortgage products for first time-buyers is increasingly making it difficult for households to get on to the bottom rung of the owner occupation ladder. Both of these drivers suggest a growing demand for private rented property. However, as Wilcox (2008) notes, landlord behaviour is affected by declining returns and lower house price expectations. Nevertheless, he points out that surveys of smaller landlords often emphasis their conservative-nature and a status quo position with a desire to retain 'good tenants'.

## 8. Learning the lessons from elsewhere

- 8.1 A comparative perspective can be useful for contributing to a more informed debate about the role of the private rented sector. Two justifications are usually put forward to justify such an approach. These are 'shock therapy' (i.e. challenging existing opinions and thinking) and policy transfer. Both are, however, subject to health warnings! It is imperative that there is an appreciation of the different economic, political and social environments in different countries. Therefore, a focus on overall quantitative data provides only a superficial picture. The 'Stage Two' and especially the 'Stage Three' countries in this project

provide an appropriate balance between quantitative and qualitative information and, as such, useful comparisons can be drawn.

8.2 A comparative perspective on private renting can challenge conventional thinking i.e. dispel a number of myths that have emerged from this case study of England:

- Deregulation and a large private rented sector: Much of the thinking in this country is based on the misleading proposition that a large private rented sector requires a high degree of deregulation. The case studies of France, Germany and the USA highlight that large private rented sectors exist with straightforward comprehensive regulations. The key issue is one of better regulation rather than little or much regulation.
- Over-emphasis on large scale institutional investment: Although there is a greater level of institutional investment in private renting in countries such as the USA, the sector is still dominated by small scale landlords. In the debate on attracting institutional investment, there is a danger of neglecting the needs of existing landlords.
- Institutional investment: This form of investment is well-established in countries such as Germany and the USA and is a result of long term consensus policies on the roles of all tenures as well as on the principles of fiscal incentives. Changes in fiscal incentives (as well as, for example, planning policies) will not be effective unless there is an agreement over the future role of the private rented sector.
- National and local policies: The examples of Germany and the USA illustrate that federal policies need to be considered along with regional and local strategies. There has been relatively little debate in this country on the role of councils as strategic enablers of the private rented sector.

## 9. Summary 1

9.1 The private rented sector is diverse in terms of types of landlords, tenants and geographical patterns. The function and role of the sector is varied with a number of niche markets. Nevertheless, a key characteristic of the sector is a predominance of small scale landlords.

9.2 There are continuing issues of poor housing conditions, tenants who are unclear over their rights and responsibilities, unsatisfactory management arrangements and a few unscrupulous landlords. The scale and detailed nature of some of these issues are far from clear. There have been on-going attempts at national level to tackle some of these issues over the last decade mainly through regulatory requirements and standards.

- 9.3 There have been significant changes in the private rented sector over the last two to three decades. The long term decline has been reversed in relative and absolute terms. There is a consensus that the sector is gradually being transformed into a 'modern private rented sector', which provides flexible and easy access accommodation for a young mobile population.
- 9.4 There has been no explicit Government policy statement that clearly indicates the specific future role of the private rented sector in the housing market. There have, however, been frequent acknowledgements that it performs an important function. Clarity on this point is essential if a productive debate is to take place on additional investment.
- 9.5 The existing and future role of the sector is inextricably linked with owner occupation and social renting. For example, the difficulties faced by potential first time buyers may propel them to live in the private rented sector. Similarly, households that are on housing registers but not in high or urgent need are unlikely to be housed in the social rented sector and may seek accommodation in the private rented sector. Nevertheless, it must be appreciated that the majority of households aspire to owner occupation.
- 9.6 Investment in the private rented sector is a complex issue. Buy-to-rent mortgages in the early/mid part of the last decade were significant but their importance is often overstated as a significant proportion were used for re-mortgaging purposes. Attempts to establish large scale institutional investment through, for example, Residential Business Expansion Schemes, Housing Investment Trusts and Real Estate Investment Trusts have not been successful.
- 9.7 It is often unclear as to the objective of additional investment. It might be to provide new accommodation, improve existing properties or to enable landlords to build up portfolios by purchasing stock from other tenures. The impact of additional investment on owner occupation and the social rented sector may be both positive and negative. For example, policy instruments that encourage landlords to buy up relatively low priced owner-occupied property might result in improved stock condition but could reduce the opportunities for first time buyers.
- 9.8 Learning lessons from other countries is the standard justification for a comparative approach. The experiences in other countries suggest that a number of myths and uncontested statements frequently made about the private rented sector in England can be challenged. For example, it is possible to have a large viable sector with high degrees of regulation and security of tenure.
- 9.9 In relation to additional investment, a key finding from other countries is the importance of long term consensus strategic principles on the role of the sector as well as consistent policy instruments.

## 10. Summary 2

1. Approximately 13 per cent of households live in the private rented sector in England compared to 10 per cent a decade ago.
2. There is considerable diversity in the sector in terms of landlords, tenants and geographical patterns.
3. There continues to be challenges in tackling issues such as poor stock condition.
4. Although there are significant niche sub-markets, there is a growing consensus that the sector is gradually being transformed into a 'modern private rented sector' that provides flexible and affordable accommodation primarily for young mobile households.
5. The future of the sector is inextricably linked to the owner-occupied and social rented sectors. Most households aspire to become owner-occupiers.
6. There has been no explicit statement by the Government on the detailed role of the private rented sector as part of the housing market.
7. Attempts to attract investment into the sector have not been very successful.
8. There can be unintended consequences for other tenures if policies for attracting additional investment are not specific and straightforward.
9. There are a number of myths on promoting private renting that can be dispelled by investigating the sector in other countries. It is possible to have a large viable private rented sector with high degrees of regulation and security of tenure.
10. Significant additional investment in the sector is only likely if there is a long term consensus on its role with consistent and well-established policy instruments.

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- Tables 17a-d on dwellings by tenure
- Tables 23a-b on housing conditions in England
- Tables 30a-b on property characteristics by tenure and age in Great Britain
- Tables 31a-c on tenure profile in Great Britain
- Table 32a on race by tenure in Great Britain
- Table 33 on tenure and consumer durables
- Table 34 on tenure and employment status of head of household in England
- Table 35 on tenure and employment status of recently moving head of household in England
- Table 36 on incomes of heads of households by tenure in Great Britain
- Table 37 on tenure and source of income in England
- Table 38 on tenure and gross weekly household income in Great Britain
- Table 54a-b on types of lettings in the private rented sector in England
- Table 72 on rents and earnings in England

This data is available online at <http://www.ukhousingreview.org.uk/>. It is in part drawn from Communities and Local Government Live Tables.

Communities and Local Government Live Tables on Housing (mainly MS Excel spreadsheets) – see

<http://www.communities.gov.uk/housing/housingresearch/housingstatistics/livatables/>

- Tables 101-110 on tenure for UK, Great Britain and England
- Tables 731 and 734 on private rents and tenancies in England
- Table 740 on private sector rent index for England
- Tables 801-813 on household characteristics by tenure in England
- Table 901 on household expenditure by tenure in England

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