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The role of policy in supporting the private rented sector: international comparisons

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Abstract

The size of the private rented housing sector (PRS) varies markedly between countries. The paper explores the role of policy in supporting the PRS with emphasis on the evidence from France, Germany, the UK and the USA. The definition and measurement of the size of the sector in each country is considered. A key issue that is explored is the effect of policies on the demand for private renting and investment in the sector. The roles of subsidies, taxation and regulation are considered in the context of the housing systems of particular countries. The analysis is important in understanding current tenure distribution and is relevant to evaluating policies that seek to increase the size of the sector.

The paper draws on some of the evidence in the authors' research report for the English Department of Communities and Local Government: Promoting Investment in Private Rented Housing Supply: International Policy Comparisons (November 2010). See:

<http://www.communities.gov.uk/publications/housing/investprivaterentedhousing>

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1. Introduction

Differences in the size of private rented sector (PRS) both over time and between countries are doubtless the outcome of many economic, demographic, social, political and institutional factors. It is likely that government policies have played important roles in shaping these factors. It is also clear that governments sometimes attempt to influence the volume of PRS dwellings through a variety of policies. This paper considers such policies in France, Germany, England and the USA. The emphasis is on taxation, subsidies and regulation. Whilst policy may have impacts on quality and well as quantity, the focus is on policies that may influence quantity.

The paper proceeds by defining and quantifying the PRS in the four countries on the basis on recent data. Sections on each country then follow a consistent format in setting out the demand and supply contexts and the policy initiatives towards the sector. A comparative section shows the differences in approach, especially between France, Germany and the USA (which all have a relatively large PRS – more than 20% of the housing stock) on the one hand and England (where the PRS is smaller) on the other. The conclusions stress the difficulty of quantifying the impact of policy in the light of other factors and the possibility of crowding out effects whereby PRS incentives have a negative impact on other sectors. The paper also contributes to the emerging debate in social science on policy success and failure as illustrated in the recent book by McConnell (2010).

2. Definitions and data

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 (e.g. 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% of the PRS stock is overtly traded in the sense of being provided through a market landlord or letting agency. In many countries privately owned housing is an important 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 vary (in most countries it will be deemed to be part of the private sector because it is privately owned). However, in many countries where the private sector is, according to official data large, such housing is an important component of the stock. In other work (Haffner et al 2009) it has been argued that a definition based on allocation has significant merits. This views social rented housing as housing that is allocated according to non-market criteria using administrative processes and private or market rented housing as housing that is allocated according to market criteria. However, the application of this definition is severely constrained by the nature of official data. Consequently, the data in Table 1 is based on the authors' interpretations of official data that classifies according to ownership.

Table 1: Tenure percentage of stock

	Private rented	Social rented	Owner occupied	Other
USA 2004	32	1	67	
France 2006	20	18	58	4
Germany 2006	48	11*	40	1
England 2009	14	17	69	

* co-operatives and government housing agencies

Source: Oxley *et al* 2010 & Pawson & Wilcox 2011

3. Policy and the private rental sector in France

3.1 Demand for private renting in France

In France, the private rental sector typically occupies an intermediate position on the housing market. It 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.

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, 2008 p. 152). Like elsewhere in Europe, also in France the pressure on the housing market is highest in the urbanized regions, in particular the Paris area.

Characteristics of private rental sector tenants

Table 2 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 (1st and 2nd 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 (3rd and 4th 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. 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 residualized.

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.

Looking at the household composition, one can observe that single persons (48%) and one-parent families (8%) are overrepresented in the French private rental sector. By way of comparison: these household types have a share of 6% and 35% among all households.

Table 2: Income distribution in the different tenure sectors in 2001 and 2006

	1 st quartile	2 nd quartile	3 rd quartile	4 th quartile	Total
Owner-occupiers 2001	17.1%	23.6%	27.6%	31.7%	100%
Owner-occupiers 2006	16.1%	23.4%	27.6%	32.9%	100%
Tenants in social rental sector 2001	38.5%	30.4%	21.4%	9.8%	100%
Tenants in social rental sector 2006	42.0%	29.8%	19.4%	8.8%	100%
Tenants in private rental sector 2001	30.1%	24.4%	22.8%	22.7%	100%
Tenants in private rental sector 2006	32.1%	26.0%	23.1%	18.8%	100%
All households	25%	25%	25%	25%	100%

Source: Anah, 2009

3.2 Supply: attractiveness to individual investors in France

The vast majority (about 96 per cent) of French private rental dwellings is owned by private individuals. 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 dwellings, which corresponds to an average of 1.9 private rental dwellings per landlord.

The financial attractiveness of the French private rental sector for individual investors depends on both the rental yields and the potential capital gains (as a result of growth in property prices) that can be realized. 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. It should also 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 because they have inherited the dwelling and/or the dwelling is located in their place of birth. In the last decades, the French government has developed various tax incentives that aim to stimulate individual investment in the private rental sector (see Section 3.4).

3.3 Supply: attractiveness to institutional investors in France

Within the total private rental market, institutional private rental landlords occupy a very minor position; they only own and manage about four per cent of the total private rental dwelling 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). Most institutional private rental landlords own an entire block of private rental housing that they control and manage. The private rental dwelling stock owned by institutional investors is mainly situated in Paris and some other large cities, for example, Lyons and Marseille.

Since the 1990s, 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 2). Nevertheless, some new investment still takes place. These new investments particularly focus on specialized housing, for example, rental homes for the elderly. There are no policies that specifically aim to stimulate institutional investment in the private rental sector, although there are soft loans available to which institutional investors can also apply (see also Section 3.4).

Table 3: The portfolio of institutional investors in France in 1998 and 2008

	Housing	Offices	Retail	Other	Total
1998	36%	46%	11%	7%	100%
2008	16%	51%	21%	12%	100%

Source: IEIF, 2010

3.4 Taxation and subsidies in France

There are various tax incentives and subsidies that influence investment in the French private rental sector, the two most important ones being:

1. Soft loans for private rental landlords (loans with a relatively low interest rate and particular tax advantages);
2. Tax incentives for individual private rental landlords;

Soft loans for private rental landlords

The most important soft loan that is available to private rental landlords is the PLS (*Prêt Locatif Social*), a loan that is available to any kind of investor, including social rental landlords. The PLS loan not only has a favorable interest rate but also gives an entitlement to particular tax advantages: a low VAT-rate and exemption of land and property taxes. About 20 per cent of the PLS loans are taken up by private rental landlords, mainly institutional investors. 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. In 2009, about 8,000 dwellings of private rental landlords were financed with the help of the PLS loan.

Tax incentives for individual private rental landlords

In the last 25 years, various tax measures that aim to stimulate investment in the French private rental sector have been introduced. These are usually named after the Ministers who introduced them: *Méhaignerie, Périssol, Besson, Robien, Borloo*, etc. The tax incentives enhance the possibilities for fiscal deductions. Some schemes work with a fixed reduction of rental income, whereas others offer a yearly deduction of part of the investments costs (accelerated depreciation). Often, both fiscal instruments are combined. The schemes usually run for a period of 9 to 15 years.

3.5 The role of regulation in France

The most important form of regulation that may hamper investment in the private rental sector is rent regulation. In France, the rent regulation in the private rental market is not particularly strict. After all, rent setting is free for new rental contracts and the rental contracts have a limited term. During the term of the rental contract, the annual rent increase may not be higher than the changes in the cost of living index.

However, the rental conditions described above only apply to unsubsidized private rental dwellings. For private rental dwellings that are built with the help of PLS loans, there are additional requirements with regard to the maximum rent that can be asked and the income of the prospective tenants. Some of the tax incentives for individual private rental landlords have similar restrictions.

3.6 France summary: positive and negative impacts of policy

In the last decades, French housing policies have actively sought to increase individual investment in the private rental sector, mainly by developing tax incentives. According to the French government (République Française, 2010; p17), these tax incentives have clearly had a positive effect on the production of private rental housing, thus making the private rental housing market less tight. Since the mid 1980's, the share of the French private rented sector has remained stable at around 20% of the total dwelling stock. This stable share of the private rental sector makes France an exception in a European context (Tutin, 2008).

However, finding the most effective tax incentive is no easy task and requires a lot of fine-tuning. As a rule of thumb, one could say that the take-up of tax incentives with restrictions concerning the rent setting was considerably less than the take-up of incentives without or with few restrictions, even though the first incentives are generally much more generous. At the same time, it is argued that tax incentives without restrictions may push up prices and can result in an oversupply of dwellings in areas where the housing market is less tight (Taffin, 2008).

4. Policy and the PRS Germany

4.1 *Demand for private renting in Germany*

Germany is well-known as a country of tenants. One of the explanations for this may be provided by the policy of the social market economy that has been influencing West-German housing policy since World War II. The idea behind a social market economy is that social welfare is best served by bringing about economic progress via market forces; government intervention is designed to support these (Busch-Geertsema, 2004). Market-led (rent regulation and allocation of dwellings) and tenure neutral subsidisation can be considered elements of it.

This influence most likely has contributed to an explanation for the size of the PRS. Households were not forced to make the move from renting to owning. Another explanation can be found in the system of social welfare which according to Behring and Helbrecht (2002) has covered the risks for households well. There is no perceived need to become a homeowner; the household can find the same security in the rented sector (see also Tegeder and Helbrecht, 2007 and Toussaint et al 2007) Tenants are inclined to trust the tenancy agreement and rent regulations and thus do not feel socially disadvantaged.

The result of not pushing tenants into homeownership is a large rental sector where demand is strong from a range of income groups. Tenants are spread through the income distribution. Renters are about three quarters of households in the lowest income quintile and over 40 percent of those in the top quintile (Bundeszentrale für politische Bildung, 2008). In particular, the tenure is also attractive because of the availability of good quality accommodation with a high degree of tenure security.

Another reason for the size of the PRS will be found in the use of the sector to subsidise temporarily rental dwellings with bricks-and-mortar subsidies in combination with rent and allocation requirements. In other countries these dwellings may have been designated as social sector, while in Germany these schemes provide private sector social supply incentives. The subsidised dwellings become unsubsidised rental dwellings after the subsidy period ends.

4.2 *Supply: attractiveness to individual investors (37% of the total housing stock) in Germany*

Private person landlords indicate in the BMVBS/BBR (2007) survey that they move into renting because of the secure equity building, also in old age. Furthermore, the tax advantages are considered relevant (see below). Reasons of family property or inheritance are also mentioned. Generally, it is about a long term horizon (secure return) rather than short term capital gains (Kemp and Kofner, 2010).

4.3 *Supply: attractiveness to institutional investors (23% of the total housing stock) in Germany*

The prospect of an acceptable income-related return which is secure and long term has also been essential for companies and other institutional investors. Generally these types of investors have a larger scale than the private person landlords, striving for profit maximization, portfolio improvement, maintaining market shares and expansion. Resale to tenants (privatisation) has also been mentioned as investment motive (BMVBS/BBR, 2007). The cooperative owners mention cost-effectiveness and up-to-date stock for members as well as adherence to the articles of the cooperatives as investment motives.

4.4 *Taxation and subsidies in Germany*

An important tax instrument to have been crucial in maintaining the attractiveness of PRS investment was the depreciation deduction in income and corporate tax which used to be available for investors in all tenures (Haffner et al 2009). Since 1950 the digressive depreciation deduction in income and corporate tax has been ascribed a large part of the success of the free-financed PRS. This instrument allowed for larger shares of fiscal depreciation in the beginning of the ownership period. This allowance could be regarded as compensation to landlords for their social conscience in not striving for maximum returns (Kemp and Kofner, 2010). At the end of 2005 the digressive depreciation deduction was abolished in favour of the linear one which is available for investors in rental housing (Bundesministerium der Finanzen, 2009; BMVBS/BBR, 2007). Now that there is less need for new building, and indeed over-supply of dwellings in some locations, the deductions, it is argued, can be less generous (Kemp and Kofner 2010; Kofner, 2010).

The fact that negative income from housing investment (depreciation and debt interest) could be deducted from other income was also perceived as attractive, especially by private person landlords.

Another tax instrument is the taxation of capital gains: No capital gains tax is due after ten years of ownership. Before the end of the period, it is applied at marginal rate of income.

The only general subsidy (if we exclude different energy saving instruments) that allows affordable rental housing to be offered is the bricks-and-mortar subsidies (see above). They are available either as low-cost loans or as interest subsidies and helped investors realise their desired returns. More recently, as Germany is facing a shrinking population in many regions, it has changed the focus of its housing policy away from general subsidization to more targeted and regionally-diversified subsidization (Bundesregierung, 2001).

4.5 *The role of regulation in Germany*

Rent control is strict, but market-led, while tenant security can be considered strong.

Rent control has been and still is concerned with protecting sitting 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. Rent control for sitting tenants in the free-financed rented sector can occur by several legal means, but is always market-led implying a comparison with rents of rented dwellings with a similar quality in a similar location. There is the general rule that rents may not be increased by more than 20% within a three-year period. Apart from 'normal' rent increases, landlords are allowed to increase rents after modernisation with 11% of price.

Security of tenure has also been and still is quite strong in Germany. This implies that the length of tenancy in principle is indefinite (Wurmnest, nd). The notice period for tenants is always three months. Contrary to the landlord, the tenant does not need a reason for handing in the notice. The tenant is allowed to transfer the contract to a new tenant accepted by the landlord.

Notice periods for landlords run from three months to nine months depending on length of stay. 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.

4.6 *Germany summary: positive and negative impacts of policy*

Policy has played an important role in maintaining a healthy PRS by way of regulation and subsidization of the rental housing. Kemp 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 has created a competitive tenure that caters for broad layers of the population in the long-term.

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. 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.

A conclusion must be that in Germany strong tenant demand has been boosted by strong security of tenure and a low risk of dramatic rent increases. This in turn encouraged investment responding to this demand. Landlords in such circumstances apparently value the long term secure income that goes with long term tenancies keeping down voids and management costs

5. Policy and the Private Rented Sector in England

5.1 Demand for private renting in England

The Government commissioned a study of the private rented sector in England in 2007 (Rugg and Rhodes, 2008), which was sub-titled as the ‘contribution and potential’ of the sector. It together with other reports (e.g. Bill et al, 2008), commentaries (e.g. Ball, 2010) and recent developments (e.g. HM Treasury, 2010) have highlighted the relative importance of a number of interrelated national policy areas including demand and supply, fiscal policy, and stock quality and property management.

The evidence for this section of the paper is drawn from published secondary sources with extensive use has been made of Rugg and Rhodes (2008). The primary focus of this paper is on England. 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, 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.

The following table provides data on the private rented sector in England between 1971 and 2009.

Table 4: The Private Rented Sector in England

Year	Number of Dwellings	Percentage of Housing Stock
1971 ¹	3.1m	19.3%
1976	2.3m	13.6%
1981	2.0m	11.3%
1986	2.0m	10.3%
1991	1.8m	9.0%
1996	2.1m	10.1%
2001	2.1m	10.1%
2006	2.7m	12.2%
2009	3.1m	13.9%

Source: Pawson, H and Wilcox, S. (eds) (2011), UK Housing Review 2010/2011, Coventry, Chartered Institute of Housing, Tables 17 a and b.

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 2009, this had increased to nearly 14 per cent of all households living in the sector². Over one million additional households were renting in 2008 compared with the late 1980s. The private rented sector is diverse and fragmented. Rugg and Rhodes (2008, p xiv) identify ten distinct sub-markets including young professionals, students, housing benefit market, tied housing and temporary accommodation. 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.

Changes in demand have been fuelled by housing and labour market factors. In relation to the latter, they include, firstly, greater mobility requirements in some occupational sectors, especially in the early stages of working careers e.g. financial services. Secondly there has been a growth in the higher and further education sectors with the number of full-time students increasing from 1.4m in 1995/96 to nearly 2m in 2006/07. Thirdly there has been a growth of migrant workers from Eastern European countries (often referred to as A8 countries). In relation to the former, the crisis in mortgage availability for first time home buyers has been a crucial factor as aspirations for owner occupation have been hit. At the same time, waiting lists for social housing increased nationally from 1 million in 2000/1 to 1.8 million in 2009. Households have had little alternative but to look for accommodation in the private rented sector.

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, some councils have increasingly made use of the private rented sector for accommodation for homeless households. Declining sub-sectors have included tied accommodation (particularly in rural areas) and long established tenants with regulated tenancies.

From a policy perspective, the growth of demand has been fuelled by policy changes outside of the housing sector (such as higher education and the economy). In addition, an unwillingness to provide increased investment in social housing together with only limited intervention to support the aspirations of owner occupation (through, for example, shared equity schemes) has by default contributed to growing demand.

¹ The data for 1971 includes housing association stock as part of the private rented sector.

² In comparison, 68 per cent of households were home owners and 17 per cent were social renters.

5.2 *Supply of private rented property in England*

The sector can be characterised as having a few large private institutional and many small landlords³. Rugg and Rhodes (2008, pp 128-130) note that individuals and couples accounted for 73% of all landlords in 2006 compared to 61% in 1993/94. Private and public companies account for 15% of all landlords in 2006 compared to 20% in 1993/94. Nearly 60% of landlords own less than 5 properties in 2006 compared to 43% in 2003/04. In 1993/94, 12% of landlords owned more than 250 properties but this had declined to 3% by 2006. 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 provides 38,300 units of accommodation.

According to Rugg and Rhodes (2008, pp 3-4), four interrelated factors account for the revival of the sector over the last two decades. These are, firstly, the Housing Act, 1988, which introduced shorthold tenancies and lifted rent restrictions on new tenancies. Secondly, there was the recession in the early 1990s that led to owner occupiers renting out properties because of an inability to sell. Thirdly, there was a response by providers to the expansion of higher education. Lastly, there was the availability of buy-to-let mortgages, which encouraged individuals to purchase properties to rent. There has been, for example, considerable media coverage on buy-to-let. But as Rugg and Rhodes (2008, p 11) point out, although there have been 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.

5.3 *Taxation and subsidies in England*

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 taxation⁴ 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).

The Treasury recently consulted on the issue of encouraging more investment in the sector. But there is little indication of any major shift in thinking. This is despite responses to the consultation paper that highlighted a wide range of potential fiscal measures to benefit the sector 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.

5.4 *The role of regulation in England*

The poor overall quality of private rented sector is evidenced on the basis that over 45% of properties did not meet the national decent homes standard in 2007. Policy has prioritised improvements to social housing over the private rented sector. Regulatory measures such as landlord accreditation schemes are aimed at tackling this issue of poor quality housing.

There has, thus, 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. However, the new coalition government has 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. Instead the emphasis will be on councils making use of their existing powers – many of which are discretionary.

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

³ The largest institutional investment landlord is the Grainger Trust with over 13,000 properties in ownership in the UK.

⁴ 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.

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. The trade off between security of tenancy, stock condition and a more favourable investment climate presents an interesting policy agenda.

5.5 *England summary: positive and negative impacts of policy in England*

There is a growing consensus that there is and should be a ‘modern private rented sector’ that provides good quality affordable accommodation for a range of types of households. Ball (2010), however, cautions against adopting an exaggerated optimism for the future as, for instance, the vast majority of households aspire to owner occupation and most experience private renting only at some stage in their housing life cycle with it providing homes for life for very few people.

The private rented sector has in part grown because of government decisions on the economy and on other tenures. Although the three main political parties appears to favour a greater role for private renting, there has been no long term coherent and comprehensive policy for the sector.

6. Policy and the PRS in the USA

6.1 *Demand for private renting in the USA*

One third of all American 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). Large proportions of young people, minorities, foreign born and low income persons rent. Affordability is an issue for many tenants. The median income among renter households is just under half that for owner-occupiers. Low income demand is supported by vouchers. 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 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).

6.2 *Supply: attractiveness to individual investors in the USA*

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. 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. There are thus large numbers of small scale landlords self-managing dwellings with low profit margins.

6.3 *Supply: attractiveness to institutional investors in the USA*

The data in Table 5 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 5 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 5: Investment returns in the USA

	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
 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.

Real Estate Investment Trusts, or 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). 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.

6.4 Taxation and subsidies in the USA

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.

The American tax system applies an approach to depreciation allowances called the Modified Accelerated Cost Recovery System (MACRS) 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.

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 (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 ninety 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 forty per cent of units go to low income households whose income is less than sixty per cent of the area median. Alternatively qualifying property owners may elect to provide twenty 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 sixty per cent or less of area medians in order to achieve the maximum allowable tax credits for a property.

6.5 *The role of regulation in the USA*

Rent controls

There are considerable variations within the USA in the nature and form of rent controls. 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.

Security of tenure

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 thirty 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). 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.

Malpezzi (1998) 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.

6.6 *USA summary: positive and negative impacts of policy*

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. Tax deductions have a strong influence on the rate of return on property investment and provide an important means of support for private renting.

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.

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. Some studies suggest that land use regulations are a significant constraint on the size of the PRS.

7. *Comparison: Differences and similarities in policy support for the PRS*

In the three countries with a large PRS (USA, Germany, France) the sector has been in the past, and still is, supported by taxation advantages that promote investment in the PRS by boosting the rate of return and sometimes providing a tax shelter (Table 6). This option for individual investors, the vast majority of landlords in these countries, to use losses from rental income to reduce the tax on other income has been significant in three of the four countries considered. The large PRS countries 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 PRS countries generous depreciation allowances have been very important in encouraging investment in the sector and promoting new building for private renting.

A major difference between the taxation of individual landlords in the large PRS countries and England is that in all the large PRS 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.

Capital gains tax is greater in England than in the large PRS 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. 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.

Private sector social supply schemes, which exist in all the large PRS 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.

Table 6: Taxation of individual investors: summary

	Cost deductions against rental income	Depreciation allowance	Losses allowable against other income	Capital Gains Tax system discourages short term holding of the investment
USA	YES	YES	YES	YES
France	YES	YES	YES	YES
Germany	YES	YES	YES	YES
England	YES	No	No	NO

Source: Oxley et al 2010

In the USA, France and Germany loan finance at favourable rates of interest is available under certain conditions for investment in private rented housing (Table 7). 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 7: Support through soft loans

USA	State tax exempt bond financing in limited circumstances. Tax credits apply also to the financed dwellings. Rent and allocation restrictions apply.
France	Significant soft loans for individual and institutional landlords. Rent and allocation restrictions apply. In some cases additional tax advantages apply to the financed dwellings.
Germany	Subsidies for housing with rent restrictions and income-related allocation conditions.
England	No specific scheme.

Source: Oxley et al 2010

It is clear that a range of contrasting regulatory environments can be compatible with a large PRS. Tables 8 and 9 set out some key points on rents and security of tenure. Some countries with a large PRS 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. 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 PRS 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.

Table 8: Market rents?

USA	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 subsidized properties.
France	Rents for new contracts set freely. Limits on increases related to inflation. Rent limits for subsidised properties.
Germany	Rents for new contracts set freely. Limits on increases for sitting tenants – linked to market conditions.
England	Mainly market rents.

Source: Oxley et al 2010

Table 9: Security of tenure

USA	Limited security of tenure which depends on the contract. Typically six months or one year but can be less or more.
France	Strong security of tenure. Standard contract is 3 years (individual landlords) or 6 years (other landlords). Termination of contract only in limited circumstances.
Germany	Strong security of tenure. Length of tenancy in principle indefinite. Notice periods of 3 to 9 months depending on how long the tenancy has run for. Termination of contract only in limited circumstances e.g. rent arrears, landlord needs dwelling for own family). Sale of dwelling does not break the lease.
England	Limited security of tenure which depends on the contract. Typically no more than six months. In many cases 2 months.

Source: Oxley et al 2010

From a public policy perspective, there are explicit proactive policies in the USA, France and Germany compared to England. In the latter, there is a broad political consensus in favour of further promoting the sector, but policies are fragmented and small scale. Measuring policy success and failure between different countries is therefore challenging. On the one hand, in three countries it can be argued that there is a significant degree of success in relation to the ideas of McConnell (2010) on process, programme and political dimensions. In England, however, although there is evidence of a significant growth in the private rented sector over the last two decades, it is suggested that this is despite policy rather than because of it. There is a political success, but a lack of coherent processes and programmes.

8. Conclusions

Policy can attempt to influence the size of the PRS. The material presented shows that both the demand for the PRS and the attractiveness of investing in the PRS have been affected by policies in each country considered. However, the impact of policy is difficult to quantify as the fortunes of the sector depend in each country on many factors that impact on demand and supply both now and in the past, as well as the attractiveness of other investment opportunities. It is unlikely that policy alone can provide a simple explanation for the size of the PRS. In any case, in as much as policy does have an influence, it is likely to be the impacts relative to those on other sectors that are important. Thus a more complete analysis would also consider the impacts of policy on home ownership, social renting and other tenure forms.

Governments can clearly incentivise investment in the PRS through taxation and subsidy advantages and the promotion of soft loans. Incentive schemes that try to increase investment in PRS stock may in principle lead to a larger housing stock or the growth of the PRS stock may be at the expense of another sector. Similarly more house building for the PRS might mean more house building in total or any increased building for the PRS 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.

Estimating the existence and scale of crowding-out effects is a challenging 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 fifty 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. The difficulty of measurement and the possibility of inconclusive results do not mean that the problem should be ignored. Policy makers need to be aware that incentivising more PRS 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.

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