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Using the private rented sector as a form of social housing

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Abstract

The paper considers the role of the private rented sector in supplying housing that can be defined as social housing. It will do this by considering policy initiatives in Germany, France, the USA and England that use privately owned housing to meet social needs. The operation of these initiatives will be compared. The allocation and rent conditions attached to dwellings supplied under selected schemes will be examined as will the incentives for landlords to offer housing under these conditions. The functions of the conditions and the time limits attached to them will be compared. It will be shown that such schemes raise questions about the definition and the role of the sector in varying institutional contexts.

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

Keywords: Allocation system, Comparison, Renting, Subsidization
1. Introduction

This paper arises from a project for the English Department of Communities and Local Government that examined the reasons for differences in investment in the private rental sector (PRS) in high income countries. Starting from a global perspective, the project in its final stages focused on four countries: Germany, France and the USA, each with a large PRS, where the policy approaches provided interesting contrasts with England. One aspect of the larger PRS in these countries is the role that the sector has provided in meeting housing needs that elsewhere might be met by social housing which is run by municipalities or non-profit organisations.

These countries are not alone in the connection that is made between the private sector and social housing provision. There are other examples in, for example, Ireland and Flanders (Haffner et al, 2009) where the public sector contracts with private providers for the provision or management of social housing. Nor is the approach unknown in England where, for example, local authorities have in the past used private sector bed and breakfast accommodation to house those in need, in the absence of other options. On a different dimension, in recent years private developers in England have been able to compete with non-profit providers for the receipt of subsidies to provide new social housing.

In this paper we concentrate on the significant schemes in Germany, France and the USA that incentivise private sector involvement in housing provision in return for rental and allocation conditions. We also note the similarities and differences with the new “eighty per cent market rents” scheme in England.

We start by looking at definitions of the private rented sector and data on the size of the sector in the four countries. We then consider each country in turn, noting the specifics of the ways that the private rented sector is used as a form of social housing. The key elements of the schemes in the countries are then compared and some conclusions are drawn about the potential of the private sector to perform a social purpose.

2. Definitions and size of the private rented sector

One benefit of comparative housing research is that it produces ideas about new policy instruments based on experience from other countries. Another is that is introduces a form of ‘shock therapy’ that challenges home grown assumptions about the phenomena under investigation. International comparisons can, for example, challenge how we think about and define the private rented sector.

Table 1 shows four categories of housing that might be included in the PRS. 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 PRS 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 PRS to categories 1 and 2 in Table 1.

In many countries privately owned housing is a significant element of socially allocated provision. This housing benefits from 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)). 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 rented 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.

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

These points of definition are crucial to discussions about the role of the PRS and its potential for achieving social objectives such as those that are attached to social housing. If we define social housing as housing that is socially allocated according to need rather than market forces (Oxley, 2000) then housing that is privately owned but socially allocated is a form of social housing. The same housing defined in terms of ownership would be classed as private rented housing. This is the essence of category 3 housing in Table. It is privately owned but socially allocated. This housing is the focus of this paper.

Social allocation may not be sufficient to pass all tests of whether housing is social. It may be that policy makers also wish social landlords to contribute to wider, social and environmental objectives. It is however, allocation criteria and allocation processes that are the key differentiating elements compared with privately owned market orientated housing.

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

<table>
<thead>
<tr>
<th>Categories</th>
<th>Ownership</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Private ownership by individuals and companies</td>
<td>By market forces. Market rents.</td>
</tr>
<tr>
<td>2</td>
<td>Private ownership by individuals and companies</td>
<td>Not by market forces. Linked to employment or family relationships.</td>
</tr>
<tr>
<td>3</td>
<td>Private ownership by individuals and companies</td>
<td>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.</td>
</tr>
<tr>
<td>4</td>
<td>Non-profit organisations and public bodies</td>
<td>By market forces. Market rents.</td>
</tr>
</tbody>
</table>

Considering the countries in Table 2, the PRS is large either where owner-occupation has been historically relatively small and there is a relatively small social rented sector (Germany) or where there is a large owner-occupied sector and a very low (or almost non-existent) social rented sector (USA). However, in France the PRS co-exists with significant social rented and owner occupied sectors.

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

<table>
<thead>
<tr>
<th></th>
<th>Private rented</th>
<th>Social rented</th>
<th>Owner occupied</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany 2006</td>
<td>48</td>
<td>11*</td>
<td>40</td>
<td>1</td>
</tr>
<tr>
<td>France 2006</td>
<td>20</td>
<td>18</td>
<td>58</td>
<td>4</td>
</tr>
<tr>
<td>USA 2004</td>
<td>32</td>
<td>1</td>
<td>67</td>
<td></td>
</tr>
<tr>
<td>England 2007</td>
<td>13</td>
<td>17</td>
<td>70</td>
<td></td>
</tr>
</tbody>
</table>

* co-operatives and government housing agencies

**Source: Oxley et al 2010**

In the USA, Germany and France there are significant private sector social supply schemes that 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.

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 housing 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. In each case they boost the size of privately owned rental sector as depicted in official statistics. England does not (yet?) have a comparable scheme.

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. 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.

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 discussed in this paper are in addition to such planning related measures.

3. PRS as social housing in Germany

Size and role of the PRS in Germany

Germany is well-known as a country of tenants. The majority of households are tenants. Less well-known is the fact that the rental sector consists of many types of different landlords and that the rental sector is not classified according to social and private renting (Table 3). A PRS exists next to homeownership. In line with our definition of social rental housing based on the allocation of dwellings according to social needs, social rental housing here will be considered the part of the PRS that is temporarily supported by bricks-and-mortar subsidies.

Table 3: Estimated distribution of providers/owners* of dwellings* in Germany, 2006

<table>
<thead>
<tr>
<th>Providers/owners of dwellings</th>
<th>% of stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>100</td>
</tr>
<tr>
<td>Owner-occupied sector</td>
<td>40</td>
</tr>
<tr>
<td>Rented sector</td>
<td>60</td>
</tr>
<tr>
<td>* Small providers</td>
<td>37</td>
</tr>
<tr>
<td>* Professional landlords</td>
<td>23</td>
</tr>
<tr>
<td>Private housing companies</td>
<td>10</td>
</tr>
<tr>
<td>Housing cooperatives</td>
<td>5</td>
</tr>
<tr>
<td>Municipal housing companies</td>
<td>5</td>
</tr>
<tr>
<td>Other government housing agencies</td>
<td>1</td>
</tr>
<tr>
<td>Other landlords with subcontracted management</td>
<td>1</td>
</tr>
<tr>
<td>Other providers, such as churches</td>
<td>1</td>
</tr>
</tbody>
</table>


*) Includes dwellings subsidised with bricks-and-mortar subsidies.
The tax/subsidy and allocation conditions for the PRS generally

The fact that the rental sector is mainly provided by market, private or commercial investors characterises the German housing system. Since World War II West-German housing policy 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). The market-led rent regulation, as well as market-based allocation of dwellings can be considered other examples here.

The fact that housing subsidisation was originally designed as tenure neutral can also be considered a result of applying social market policy in order to prevent distortions in the behavior of actors. Examples are the bricks-and-mortar subsidies and housing allowances that are available in all tenures.

An example from the past is 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 degressive depreciation deduction in income and corporate tax (digressive AfA) 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.

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).

The role and institutional arrangements for the selected social schemes

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).

In the case of bricks-and-mortar subsidised rental dwellings, central government transferred its powers to the federal states in 2006 in order to enable them to make their own legislation as needed. The shift in responsibility was accompanied by a financial compensation paid for annually by the federal government of €518.2 million until 2013.

The system of bricks-and-mortar subsidies means that the dwellings in question are temporarily subsidised in exchange for price and income limits in combination with allocation rules. This way the PRS is able to provide affordable rental housing for special target groups for a limited, but relatively long-lasting period which can be longer and shorter than 15 years. After the subsidy period ends, these dwellings become unsubsidised rental dwellings.

Allocation and rent conditions

Municipalities make the agreements with landlords for the bricks-and-mortar subsidies in exchange for allocation rights in existing or newly-built dwellings (Haffner et al, 2009). In these negotiations, rent levels and rent adjustment will also be negotiated. The bricks-and-mortar subsidy act of 2001 (Wohnraumförderungsgesetz 2001; WoFG, Section 28), which came into force on 1 January 2002 stipulates that the subsidy contract entered into by the subsidising body (the municipality) and the recipient (the landlord) must stipulate the maximum amount of rent that may be imposed on the tenant. Thus the subsidising body and the recipient can negotiate a ‘maximum rent’, taking the local rent level into account.

The rental dwellings that are subsidised with bricks-and-mortar subsidies are only allocated to house seekers with a right of allocation. That right is based on the fact that the municipality has given the candidate a residence permit. The income limits for the target group are set by the federal government, but can be adjusted according to local circumstances. There is also the possibility to set different income limits based on different amounts of subsidies.

There are three types of allocation rights that municipalities can negotiate with the landlords in question. They run from an effective right of placement by the municipality to freedom of choice by the landlord from the list of candidates with a residence permit.

Financial incentives

There is the general depreciation allowance that has played a large role in the provision of PRS housing. 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. The only general subsidy that allows affordable rental housing to be offered is the bricks-and-mortar subsidies. They are available either as low-cost loans or as interest subsidies.

4. PRS as social housing in France

Size and role of the PRS in France

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; p.107). 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 relatively 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. 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, the relative revival of the private rented sector (see also Figure 1) is mainly due to the various subsidies and 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.

The tax/subsidy and allocation conditions for the PRS generally

There are various policy measures 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;

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

Source: INSEE housing survey, various years
The role and institutional arrangements for the selected schemes

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. About 20 per cent of the PLS loans are taken up by private rental landlords, mainly institutional investors. In 2009, about 8,000 dwellings of private rental landlords were financed with the help of the PLS loan. The PLS loan is provided by banks which submit proposals to a public tender organized by the Ministries of Finance and Housing.

Tax incentives for 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. According to the French government (République Francaise, 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. This is illustrated by the fact that 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.

Allocation and rent conditions

Usually, but this depends on the specific scheme, the support for private rental landlords is combined with certain requirements regarding the rent of the dwelling and the income of the prospective tenants. Consequently, subsidized French private rental sector housing may be considered as a form of social housing. Generally speaking, the rents of the subsidized private rental sector dwellings are higher than those of social rental dwellings (provided by non-profit or limited-profit social rental landlords), but lower than those of non-subsidized private rental sector dwellings. As a result of this, the subsidized private rental sector can be seen as an intermediary sector that bridges the gap between the cheap social rental sector and the expensive non-subsidized private rental sector. Subsidized private rental dwellings can mostly be found in areas with a tight housing market (e.g. the more urbanized regions), in which the need for an intermediary sector is highest.

Financial incentives

PLS loan

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. 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.

Tax treatment of individual private rental landlords

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.

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 (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 itself; A negative balance of a maximum of €10,700 per year may be deducted from the total income of individual private rental landlords (Haffner et al, 2009; p. 133).

Tax incentives for individual private rental landlords

Individual private rental landlords who let dwellings under the standard foncier regime may benefit from tax incentives. These incentives further enhance the possibilities for fiscal deductions. Some schemes work with a

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2 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.
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.

Some tax incentives have regulations with regard to the maximum rent and the income of tenants, whereas others do 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. 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).

5. The private rented sector as social housing in the USA

Size and role of the PRS in the USA

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. The unsubsidised private rented sector is a highly significant part of the housing market – approximately 30 per cent of the total housing stock (see Table 1). In proportional terms, it has gradually declined relative to owner occupation, but in absolute terms it has remained stable or increased in recent decades. Privately owned unsubsidised housing provided for more than 80 per cent (27.4 million) of all renters and nearly two-thirds of the lowest income renters.

There is a very small publicly owned sector (Table 4). 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.

The federal government subsidises around one million publicly owned housing units and two million privately owned units. There are one 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).

There are important senses in which privately produced and owned rented housing is used to support low-income tenants and 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.
Table 4: Key Characteristics on the Rented Sector in the USA

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage of Households in the Rented Sector</th>
<th>Number of Households in the Rented Sector</th>
<th>Commentary</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>45%</td>
<td>19.2m</td>
<td></td>
</tr>
<tr>
<td>1960</td>
<td>38%</td>
<td>20.3m</td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>37%</td>
<td>23.6m</td>
<td>Includes 1.4% public rental and 0.2% subsidised private rental</td>
</tr>
<tr>
<td>1980</td>
<td>34%</td>
<td>27.6m</td>
<td>Includes 1.5% public rental and 2.4% subsidised private rental</td>
</tr>
<tr>
<td>1993</td>
<td>35%</td>
<td>33.5m</td>
<td>Includes 2.4% public rental and 3.0% subsidised private rental</td>
</tr>
<tr>
<td>2000</td>
<td>34% (rented housing units)</td>
<td>35.7m (rented housing units)</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>32.9%</td>
<td>36.0m</td>
<td>27.4m unsubsidised units in 2003*3</td>
</tr>
</tbody>
</table>


**The tax/subsidy and allocation conditions for the PRS generally**

Rental housing investment in the USA is encouraged by several tax advantages. Up to $25,000 of rental losses can 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.

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. The tax system applies an approach 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 and is thus depreciated over this period. 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.

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.

In the unsubsidised sector, market allocation applies but for the subsidised sector there are income based allocation conditions and rent limits.

**The role and institutional arrangements for the selected social schemes**

The main form of privately owned social housing in the USA is the Low Income Housing Tax Credits (LIHTC) programme which in recent years has generated about 120,000 additional rental units annually (JCHS, 2009). LIHTC accounts for nearly ninety per cent of all affordable housing created in the USA today. The credits are essentially construction subsidies that are obtained by developers whose properties comply with specified rent and allocation conditions.

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3 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).
LIHTC is a federal programme that 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.

**Allocation and rent conditions**

The receipt of LIHTC requires that at least forty per cent of units go to households whose income is less than sixty per cent of the area median. Alternatively, qualifying property owners may elect to provide twenty per cent of 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. Rents must be less than a maximum related to local affordability. The rent ceilings are thirty per cent of sixty per cent of the area median income. Compliance with allocation rules and rent limits was initially (from 1986) required for a minimum period of fifteen years. Beginning in 1990, an additional fifteen-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).

**Financial incentives**

LIHTC provides a ‘present value’ tax credit of seventy per cent of the cost of new construction or thirty 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, nine per cent was established as a floor on the nominal nine per cent credit. For acquisition of existing rental housing, the applicable credit is also four per cent.

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 (four per cent for projects financed from tax-exempt state bonds and nine per cent for other projects).

### 6. The private rented sector as social housing in england

**Introduction**

The assertion by Kemeny (1995) that the rented market in England can be classified as a dualist rather than a unitary system usefully summarises the overall situation. The social rented and private rented sectors operate, for example, in terms of legislation and regulation as separate entities. There have, however, been initiatives where there has been collaboration (e.g. housing associations as managing agents schemes in the 1990s). More recently, there have been policies proposed (such as the Coalition Government’s affordable rents scheme) that suggests a future blurring at the edges of these two sectors.

**Size and role of the private rented sector**

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

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Table 5: Key Characteristics on the Private Rented Sector in England
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 13 per cent of households living in the sector. Approximately 1 million additional households were renting in 2008 compared with the late 1980s. The overall quality of accommodation, however, remains poor. Over 45 per cent of properties did not meet the national decent homes standard in 2007. 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.

A number of factors have contributed to the recent revival of the private rented sector. These include initiatives such as ‘buy-to-let’. Equally important, however, are the supply and demand trends in the 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. Labour market factors have included 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 1.4m in 1995/96 to nearly 2m in 2006/07 and an increase in migrant workers from Eastern European countries (often referred to as A8 countries).

**Taxation, subsidies and the private rented sector**

There is an acknowledgement that the national fiscal regime favours owner occupation rather than private renting. This has been evident for many decades since the abolition of Schedule A taxation for home owners in the early 1960s. However, 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) and Jones (2007). Nevertheless, there continues to be a debate on the extent to which the sector might be revived and transformed into a ‘modern rental system’ through institutional investment.

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4 Decent homes standard definition was changed in 2006. It became a higher standard.
5 The data for 1971 includes housing association stock as part of the private rented sector.
6 In comparison, 70 per cent of households were home owners and 17 per cent were social renters.
7 The largest institutional investment landlord is the Grainger Trust with over 13,000 properties in ownership in the UK.
8 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.
**Private renting and social housing**

As well as policy discussions on reviving and reforming the private rented sector, there are a number of small-scale initiatives that bridge the gap between social renting and the private rental market. Historically, for example, there were a number of projects encouraged by the Government in the 1990s including HAMA (housing associations as managing agents), private sector leasing (PSL) and HALS (housing association leasing schemes). Common features of these schemes involved high quality services provided by the managing agents, a guaranteed income for private landlords and vacant possession at the end of the period. Cope (1999 p 253) in a brief overview concluded that the benefits centered on encouraging new landlords to let property so creating ‘socially managed private sector housing’. Although government grants were available in the 1990s to cover, for example, set up costs for housing associations and capital funding to get properties up to a reasonable condition, these no longer exist. Even so, there continue to be small scale examples of this type of initiative.

More recent organisational illustrations of this blurring of social renting and private renting include, firstly, large housing associations 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 subsidiaries of housing associations as well as private sector providers. The latter are exemplified by Unite that owns over 125 properties in 24 cities and provide 38,300 bedspaces.

There are also a number of council-led initiatives. Regeneration and Renewal reported that Birmingham City Council had 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.

However the most significant development is the Coalition Government’s affordable rent scheme, which is due to come into operation in April 2011 (Communities and Local Government, 2010). The key features are that homes will be let at 80% of market rents and landlords will have greater flexibility in the use of tenancies. It appears that there will be average government grant of £29,000 per property and the scheme is intended to make a significant contribution to the target of providing up to 150,000 new affordable homes between 2011/12 and 2014/15. The most recent guidance in February 2011 indicates that housebuilders and developers will be encouraged to provide homes through this new scheme (Communities and Local Government 2011).

**Allocations and rents**

Details of the affordable rent scheme are still emerging. Nevertheless, it is anticipated that allocations of properties will primarily be based on need. However, changes to the welfare system, including housing benefits, imply that the scheme is most likely to be relevant to households where there is at least one member in full time work.

In relation to rents, there is an on-going debate on the operationalisation of the 80% figure. From a geographical perspective, it has been pointed out by a number of commentators that the scheme is unlikely to be viable in low price housing market areas. In parts of the Midlands and Northern England, private rents are equivalent to or lower than social rents. In these circumstances, housing associations would not be able to operate the affordable rent scheme, unless additional finance was available perhaps through cross-subsidisation from projects in high price areas.

At the same time, there has been other research suggesting that while the proposed new model may provide a development solution in a period of fiscal austerity in high price / rent areas, it could have serious repercussions for low income households. Family Mosaic (2011, p3), which is a large housing association operating in London and the South East, conclude that ‘setting rents at 80% of market rents would increase tenants’ requirements for housing benefit by over 150%’. It would thus also have major implications for the government’s strategy to reduce the cost of the welfare bill.

**Overview**

England is an example of a country with a dualist rental system. There have, however, always been small scale schemes involving collaboration between private landlords and housing associations and local authorities. However, over this decade, there could be significant changes leading to the blurring of the distinction be-
tween the two rental sectors with the development of the affordable rent scheme. Nevertheless, there are major challenges for many stakeholders in implementing this new model.

7. Comparing and contrasting the private rented sector and social housing

Each of the four countries has schemes that encourage private landlords to supply housing that is to be allocated socially. A major difference is that in England the scheme considered in this paper is new and some of the operational details have still to be clarified. Also, in England the attempt to promote the involvement of the private sector in social provision is set in an historically less policy-friendly approach to private sector housing investment. In Germany, France and the USA there have been for several decades policies which, through various combinations of tax concessions and direct subsidies, have encouraged private sector investment. In these countries, the social rental schemes can be seen as in keeping with a generally supportive fiscal environment for private rental landlords. In England the context is different. Rates of return on investment are not as generously enhanced through taxation as in the other countries.

The basic principles driving the schemes are the same in each country. They each involve incentives to supply accommodation that is not to be allocated in the open market. These incentives amount to conditional subsidies. The conditions relate in all cases to rent levels and allocation criteria and processes. As the information in Table 6 shows, the details of the incentives and conditions vary from country to country. In France and the USA, where an important aspect of the incentives are tax concessions, the direct exchequer costs are low or even close to zero (other than administrative costs). In England where the incentives take the form of cash grants the direct public sector costs are more significant. The rent conditions all seek to set rents at sub-market levels with some sensitivity to local market circumstances. In the French and the English cases the levels are between those found in the traditional or “pure” social sector and open market levels. The rents in these cases are in keeping with the concept of intermediate housing that is intended for those who can afford more than the lowest social sector rents but not full market rents. In Germany there is an element of negotiation between the public sector subsidy provider and landlords. This negotiation allows for higher levels of subsidy to be explicitly linked to lower rents on a scheme-specific basis.

In three of the countries (but not in England) household income levels are an explicit allocation criterion. The qualifying income levels vary within countries according to local circumstances and the particular scheme that is applied. In the USA there are detailed federal and local rules that link eligibility for tax credit housing to household income relative to the local median level. In England allocation criteria follow the tradition of the less prescriptive requirement that a household should be “in need” defined with a degree of flexibility, but taking account of current housing circumstances and households’ resources. Another important factor distinguishing the English case from the other three in Table 6 is the lack of any time constraint to the rental and allocation conditions. This means that the housing supplied can be regarded “permanent” social housing in contrast to the “temporary” social housing in the other countries.
<table>
<thead>
<tr>
<th></th>
<th>Rent conditions</th>
<th>Allocation conditions</th>
<th>Incentives</th>
<th>Time limits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Germany</strong></td>
<td>Negotiated maximum levels and increases</td>
<td>Income limits; residence permit required</td>
<td>Soft loans and interest concessions</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>France</strong></td>
<td>Scheme specific maximum at intermediate (between “pure social” and market) level</td>
<td>Income limits; scheme specific</td>
<td>Soft loans and tax incentives (low VAT and property tax concessions)</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>USA</strong></td>
<td>Location specific ceiling = 30-60% of area median</td>
<td>Income limits related to area median</td>
<td>Tax credits (Present value= 70% construction cost or 30% acquisition cost)</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>England</strong></td>
<td>80% market level</td>
<td>No specific income limits but needs related</td>
<td>Grants (average £29,000 per dwelling)</td>
<td>No</td>
</tr>
</tbody>
</table>

In both Germany and the USA the use of private providers to supply social housing is an aspect of the prevailing model of social housing provision. It is in fact in both countries, a model that does not identify “social housing” as a separate category. In Germany the approach is in line with the overall post-war approach to bricks-and-mortar subsidies which were designed as a concession model, temporarily ring-fencing subsidised rented dwellings from the rest of the housing market under a special regime. The dwellings move to the unsubsidized rental sector when the subsidy period finishes. As the periods of subsidisation expire, given that few allocation rights are newly subsidised, the Bundesamt für Bauwesen und Raumordnung (2007) expected that no more than almost 1.8 million subsidized dwellings were to be left at the end of 2010. In terms of stock, it concerns less than five percent and in terms of rental stock less than eight percent.

In the USA LIHTCs have a strong record in terms of housing quality and financial stability and 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. The LIHTC model provides a way of using private investment to boost the rented housing stock. As a tradable instrument that reduces the holders’ tax liability credits 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 non-profit providers.

8. Conclusions

In Table 1 we indentified four categories of rental housing, defined in terms of differences in ownership status and allocation criteria. Which of the four categories is defined as private rental housing and which as social rented housing depends on whether it is ownership or allocation that is emphasised. We have pointed out the difference between what official data counts as private rental housing and what ideally might be classed as market rental housing on the basis of allocation criteria.
The examples of Germany, France and the USA show that privately owned and socially allocated housing (category 3 in Table 1) can be an important element of a housing systems. The new eighty percent market rent scheme may become an important part of the English system if it proves to be sufficiently attractive to private landlords. The English example in particular provides an example of another issue in applying the taxonomy of Table 1: how to define “private ownership”? Some of the “private” organizations that will be attracted to the 80 per cent market rent scheme will be subsidiaries sheltering under the umbrella of non-profit social housing groups. In the German, French and American cases, the “private” providers of social housing can be in competition for the receipt of the tax or other incentives with non-profit organizations that are not in private ownership. The schemes may thus be available to, but not exclusive to, private landlords.

With appropriately structured and administered systems that depend on conditional subsidies, privately owned rental housing has the potential to perform some social housing functions. Private landlords will clearly not necessarily provide the wider social functions, such as the promotion of environmental goals, social inclusion and social participation that might also be expected of social housing. However, this may be different if the conditions for the receipt of concessions stretch beyond rent and allocation criteria. Private renting and social renting are not the watertight boxes that they once were in some countries.

9. References


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