Leicester **Business School**

Promoting Investment in Private Rented Housing Supply: International Policy Comparisons

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1. Introduction

1.1 This report summarises recent polices towards the private rented sector in Ireland and comments on the incentives that have been used to promote investment that has been driven largely by small scale investors.

1.2 The report has relied on secondary published material including academic and official sources and has depended heavily on material reported in Haffner *et al* (2009).

2. Data and information

2.1 The size of the private rented sector is shown in Table 1.

Table 1: Housing tenure (in percentages), Ireland, 1961-2006

	1961	1971	1981	1991	2002	2006	Urban areas 2006	Rural areas 2006
Local authority rented	18.4	15.9	12.7	9.7	6.9	7.2	9.7	3.8
Voluntary body rented						3.5	4.7	1.7
Market rented	17.2	10.9	8.1	7.0	11.1	11.4	15.2	6.3
Owner-occupied	53.6	60.7	67.9	80.2	77.4	74.7	70.4	88.2
Other	10.8	12.5	11.2	3.0	4.6			
Not specified						3.2		

Source: Haffner et al 2009, p178 quoting Norris & Redmond (2005) for 1961 to 2002 data; Central Statistics Office (2007) Ireland Census, 2006 see www.ie/census for 2006 data

3. Investment in the PRS

3.1 The private rented sector fell from around 43 per cent of the stock in 1946 to 7 per cent in 1991 and then grew to 11.1 per cent by 2002 and remained fairly constant being estimated at 11.4 per cent in 2006. There has thus been a small increase in the size of the sector over the last twenty years.

3.2 Rent controls, government support for home ownership and a lack of investment incentives contributed to the decline. The recent revival of the sector can be explained by tax incentives and economic and demographic growth that, with a shortage of housing for owner occupation, have helped to boost the demand for market renting. Increases in house prices have both made home ownership more difficult and increased the attractiveness of

market housing as an investment. Data for 2003 suggests that around 27,000 market rented dwellings were owned by 17,500 landlords. Most landlords are individual investors. Many of these landlords have purchased with but-to-let finance. Buy-to-let has been an important component of housing market activity. In 2008 such investors accounted for 18 per cent of all new mortgage borrowing (Ball, 2009). In 2009 27 per cent of all outstanding residential mortgage lending was on buy-to-let properties (Central Bank and Financial Services Authority of Ireland, 2009).

3.3 It is not possible to estimate reliably the contribution of private renting to new production. New house building figures distinguish private sector from public sector production but do not distinguish between private output intended for home ownership and private renting. In the 1990s there was a belief that prospective landlords were crowding out first time buyers and driving up property prices. As a result in 1998 the government sought to discourage new investment in private rented accommodation. The main change was that the deductibility of mortgage interest for tax purpose was removed; this change was short lived and was reversed in 2001. Prior to 1998 it was estimated that 30 per cent of new build was being purchased by private landlords (Galligan, 2005).

3.4 There is no direct investment in the PRS by financial institutions (Crook & Rowley, 2004). More recently the over production of housing in the light of the international credit crisis has promoted measures to encourage privately constructed housing originally intended for home ownership to be used for social rented housing. This is 'The Long Term Lease Scheme' for social housing. It was announced in October 2008. The purpose of the scheme is to remove an over-supply of new dwellings from the market by allowing local authorities to lease the dwellings from developers and use them for social housing. In September 2009 the scheme was extended so that voluntary and co-operative associations could also engage in long term leases to increase the supply of their accommodation. Whether this privately owned housing used for a social purpose should be counted as part of the private rented sector is debatable. Associations will enter into 20 year agreements to lease dwellings from private owners. The associations will provide the management and maintenance of the units. €20m was set aside by the government for the new scheme which had a target of a minimum of 20,000 units leased in 2009.

4. Policies towards the PRS

Rent controls

4.1 Rent controls were in place from World War I until a measure of decontrol began in 1960 when controls on new lettings were removed. Further moves towards decontrol occurred and market rents were introduced in 1982.

4.2 The Residential Tenancies Act of 2004 allows all market sector rents to be determined freely by landlords and tenants. It states that the rent may not be greater than the open market rent and may be reviewed (upward or downward) only once a year unless there has been a substantial change in the nature of the accommodation. Tenants have to be given 28 days' notice of new rents. Disputes about rents are referred to the independent Private Rental Tenancies Board.

Security of tenure

4.3 Market rented tenants have in the main had minimal security of tenure in Ireland, although the Residential Tenancies Act 2004 introduced some fundamental reforms. Galligan argues that "Historically, lack of security of tenure was the greatest single reason preventing many households from viewing the market rented sector as a desirable form of housing tenure" (ibid., 2005; p109). Until 2004 there was a distinction, however, between the formerly rent-controlled sector where existing tenants continued to have security under the 1982 Housing Act and tenants in the remaining uncontrolled sector. The position has been modified by the 2004 legislation that bases security of tenure on four-year cycles from when the new law took effect (September 2004). Tenancies in existence on 1 September 2004 became 'Part 4 tenancies' on 1 March 2005 unless a valid Notice of Termination was served before that date. Part 4 tenancies can only be terminated by the landlord on specified grounds (in accordance with the Act) and by either party by Notice of Termination under the Act. Unless terminated, they last for four years from their commencement date or from 1 September 2004, whichever is later. The notice period required to terminate a tenancy depends on the length of the tenancy and varies, if the landlord gives notice, from 35 days for tenancies of less than a year to 112 days for tenancies of more than four years. If the tenant gives notice, the notice period varies from 35 to 56 days. If a fixed-term tenancy is due to expire during the existence of a Part 4 tenancy and the tenant intends to remain in occupation, the tenant must, during the 2nd last or 3rd last month of the fixed term, notify the landlord of that intention to continue the tenancy[1]. The landlord can terminate the tenancy without specifying grounds during the first six months but once a tenancy has run for six months the tenancy can only be terminated by the landlord in limited circumstances (Haffner *et al*, 2009).

Taxation/subsidy incentives

4.4 There were no fiscal incentives (and arguably some disincentives because of the adverse tax treatment of landlords compared with other businesses) for market renting until 1981, when tax relief schemes for construction, conversion and refurbishment were introduced. From 1998 to 2001, the government actually discouraged investment in market renting, because of a

[1] See Citizens Information Ireland www.citizensinformation.ie.

perception that it was crowding out home ownership, by removing the deductibility of interest on borrowing by landlords for tax purposes.

4.5 There has been little direct government support for market rented provision: "Apart from the mortgage tax relief available to all house purchasers (owner occupiers as well as landlords), no financial measures were taken to increase the supply of private rented housing for most of the twentieth century." (Galligan, 2005; p106).

Incentives/disincentives for more overall investment in the sector

4.6 Tax incentives for new build and refurbishment introduced in 1981 had very little effect until they were combined with urban renewal schemes in 1986. After 1986, the incentives became more generous and more geographically focussed. The tax relief took the form of a deduction of part of the cost of capital expenditures from rental income. The allowance, which reduced landlords' tax bills, was conditional on the property being rented for ten years from the first letting. A generic reduction in the rate of capital gains tax from 40 per cent to 20 per cen in 1997 indirectly made market renting a more attractive investment. Output increased following these incentives. Their effect may have been large, but their impact is debatable. It has been suggested that high rates of house-price inflation and low interest rates were more important, in combination with the buoyant demand from a growing economy, in boosting investment in recent years than fiscal incentives (Galligan, 2005; p108). However, it has also been claimed that the reinstatement of interest tax relief in the 2002 Finance Act together with the tax deductibility of expenditures on fixtures and fittings and other costs "makes this form of investment very attractive for potential investors" (MacLaran & Williams, 2005; p159). Equally, it does seem that although it can be argued that in the twenty-first century the fiscal system has been changed in the landlords' favour, in reversing some previous anomalies the changes amount to little more than putting market renting on a level playing field with other forms of investment.

Incentives/disincentives for more new house building for PRS

4.7 The Urban Renewal Scheme, which was established in 1985 and subsequently extended to towns, villages and rural areas, incentivised housing development in declining areas but the assistance available to landlords was much more generous than that available to homeowners. The output of market rented housing thus rose significantly and the overall quality of the private rented stock improved markedly.

4.8 A report on institutional investment in the sector has suggested that many significant changes are required before financial institutions will be interested in investing in the sector (Crook & Rowley, 2004). These changes include the

availability of sufficient and reliable data on rents and yields and the establishment of an intermediary vehicle such as a Real Estate Investment Trust. Such a tax transparent vehicle would, it is argued, allow financial institutions to invest in residential property without direct contact between institutions and tenants. Research (Crook & Rowley, 2004) suggests that institutions perceive management costs to be high and economies of scale to be limited.

Incentives/disincentives for improving the quality of the housing stock

4.9 Poor quality in the PRS has been a significant problem in Ireland. In recent years the issue has been addressed by increased application of minimum standards requirements. There is evidence that minimum standards need to be raised and enforcement needs to be more effective (Coates & Feeley, 2007).

4.10 The implementation of reforms in the private rented sector under the Residential Tenancies Act 2004 is underway. The Private Residential Tenancies Board (PRTB) is a statutory independent body supported by central government. There are links between tax relief on private rented accommodation and registration, introduced in the Finance Act 2006, which has contributed to the increase in registration numbers. The PRTB also provides a comprehensive dispute resolution service as an alternative to the Courts, which involves mediation or adjudication and tenancy tribunal appeal hearings.

4.11 The proceeds of tenancy registration fees, received by the PRTB have been provided in recent years to assist local authorities in their functions relating to the private rented sector. Over €4 million was allocated in respect of 2008, linked largely to enforcement of higher standards. In general, local authorities have significantly expanded their inspection activity in recent years with the number of inspections more than doubling – from 6,815 to 14,008 - in the period 2005 to 2007. A further significant increase in inspections - up 23 per cent to almost 17,200 was recorded in 2008 (EHLG, 2009).

Additional comments on policy: support for owner-occupation

4.12 Policy has put much emphasis on encouraging both the demand and the supply of owner-occupied housing. The growth of owner occupation has been boosted by tax reliefs and incentives for social renters to buy their dwellings. Until the recent credit crunch, home ownership was also boosted by the easy availability of mortgage finance. These measures have limited the potential growth of private renting.

Additional comments on policy: Increased use of the private rented sector to supply social housing

4.13 Under the Residential Accommodation scheme (RAS) local authorities set up contracts with market landlords who agree to provide accommodation that meets minimum standards. The RAS is expected to expand the amount of market rented accommodation available on a long-term basis to low-income tenants who are unable to access local authority housing. The RAS was introduced in 2005 and is gradually being used to move long term welfare recipients into private housing where they pay income related rents but landlords receive higher rents under contracts with local authorities (Haffner *et al*, 2009). RAS represents an important element of the Government's housing policy and one that it is according to the Government, along with the new long term leasing initiative, set to assume an increasingly prominent role in meeting housing needs in the future.

5. Summary: What are the key factors that influence investment in the PRS?

5.1 Investment is influenced by demand from several categories of tenants: low income households who cannot obtain alternative accommodation, those using the tenure as an interim solution before becoming home owners, students and working households seeking flexibility (Galligan, 2005). Demand for private renting has been boosted by house price inflation, centralised wage controls that have made home ownership less affordable, increases in newly forming households and high levels of net inward migration. These factors are seen to have boosted demand from middle income households priced out of the owner-occupied market (Galligan, 2005). Until recently capital growth expectations have been significant.

6. Reasons for selecting or not selecting Ireland in the next stage of the research

6.1 Reasons for selecting Ireland:

- There has in recent years been a considerable amount of research into the private rented sector in Ireland and the government has taken several measures that are intended to promote investment in the sector and to improve quality.
- There has also been an important study of why there is little institutional investment in the sector and what changes would be needed to increase institutional investment.
- The evidence from all of this could be informative from the perspective of promoting investment in England.

6.2 Reasons for not selecting Ireland:

- Several of the measures to promote the sector are recent and evidence of impact is limited.
- At eleven per cent of the stock the sector remains small – smaller than in England.

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