

PRIVATE RENTAL POLICIES AND PROGRAMS: REVIEW OF THE INTERNATIONAL EXPERIENCE

Introduction

The private rental sector is a critical part of Canada's housing system, providing accommodation to almost one third of Canadian households. Over the past two decades investment in maintaining or expanding the private rental sector has steadily declined from historical levels, raising concern about the future of the rental sector and the health of the overall housing system

Objectives and Methodology

Canada Mortgage and Housing Corporation (CMHC) commissioned this research report to examine how different countries have developed policies and programs aimed at improving the quality, increasing the supply, and prolonging the life of the private rental housing stock. The review examined recent trends and the policies and programs in place since 1990 in 10 countries from Europe, Scandinavia, the Pacific Rim and North America.

A typology of policy approaches was developed as a framework for the analysis based on three categories of policy response, or measures:

- tax measures (including depreciation, tax exemptions, tax credits and tax-based investment funds);
- subsidy measures (including preferred rate loans as well as grants); and
- facilitative measures (including deregulation, and mortgage insurance).

The review focused on major programs and policy initiatives primarily at the national level – it did not examine smaller scale municipal and planning policies, typically developed and implemented at the local level.

An assessment framework generated answers to five questions for each of the countries reviewed:

1. What stimulated the introduction of the measure and are the conditions that underpinned the initiative relevant to those that prevail in Canada in the late 1990s.
2. What was the intended (explicit) objective of the measure? To what extent did it meet its objective?
3. Did the approach generate any unintended or auxiliary impacts and what does this suggest in the way of lessons for Canada?
4. What was the duration and level of funding allocated to the program? Has this been revised over the duration of the initiative?
5. Does the measure remain in place today? Has it undergone modification and, if so, in what way? If no longer in place, why was the measure terminated?

Detailed country profiles outline these answers.



Findings

The role and size of the private rental sector ranges widely across the countries examined. The UK and Finland have the smallest private sectors, roughly 10% of the total stock, while Germany has the largest private rental sector, at 47%. In the remaining countries the private rental sector accounts for one-quarter to one third of the stock.

In most countries, the private rental stock accounted for more than half of each country's stock in the prewar period. From 1945-1970, housing policy focused on major construction initiatives emphasizing public or social housing and homeownership - with the result that the private rented sector declined in relative size and importance.

Since the 1970s, the private rental stock has continued to contract, as a proportion of the total stock in all countries except Germany and Japan.

Initially, this relative decline in size was due to high levels of production in the social and homeownership sectors; private rental production continued but was dwarfed in volume by these two other housing sectors.

Since the 1980s, the contraction of the private rental sector has reflected a new phenomenon - weakened demand for rental housing due to both demographics and historically low mortgage rates that enhance ownership affordability and a consumer shift to this tenure.

Associated with weak effective demand, the fundamental cause of limited private rental investment across almost all countries is the lack of a competitive rate of return, especially in light of the risks inherent in rental investment.

While the relative size of the private rented sector has contracted in most countries reviewed, and the economic viability of private rental development has weakened, there has been only a very limited policy response.

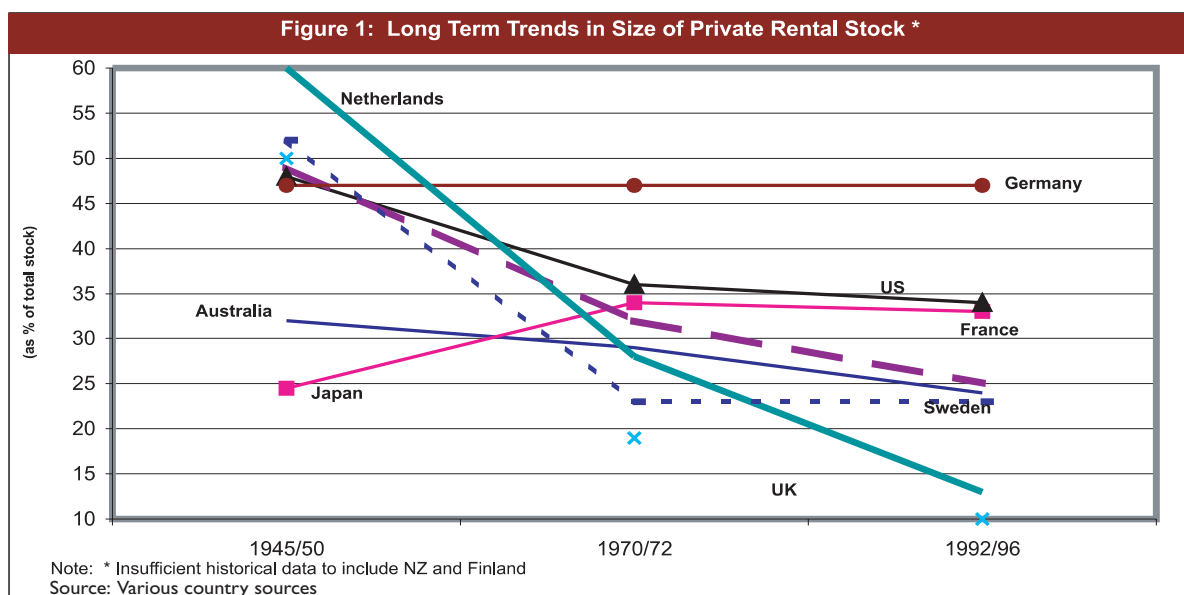
The overall finding from the search for policies and programs in other countries is that the health of the private rental sector has not generally been identified as a serious policy issue. Rather, government responses have been laissez faire - market forces and the underlying attractiveness of investment have been left to determine the level and type of private rental new production and rehabilitation.

Figure 2 overviews the type of approaches used in each country. Most of the subsidy and tax mechanisms are a legacy of earlier policy eras – few of them have been implemented in the past decade.

A number of countries have maintained or modified programs that already existed prior to the 1980s but, outside of the U.K. tax incentives (and to a much lesser extent Real Estate Funds in Finland), none have introduced significant new programs directed at the private rental sector.

The major policies that have been implemented were primarily in the form of facilitative measures, notably deregulation of rent controls, with the expectation that this would create greater opportunity for profitability and thus encourage investment.

Some countries have revised general tax policies and this has impacted the private rental sector - some positively and some in a less favourable way.



**Figure 2:
Summary of Policy Responses ***

	Tax	Subsidy	Facilitative /Regulatory
U.K.	✓		✓
Sweden		✓	✓
Finland	✓		✓
France	✓	✓	✓
Germany	✓	✓	✓
Netherlands	✓	✓	✓
U.S.	✓		✓
Australia	✓		
New Zealand	✓		✓
Japan		✓	
* Reflects policies used since 1980. These may not remain in place in 1998.			

Deregulation

Deregulation of the rental sector has been pervasive. However, the review found that deregulation (e.g. reducing or phasing out rent controls), in and of itself, was a necessary but not a sufficient condition to stimulate private investment in rental rehabilitation or production. At the same time, tax incentives acting alone were also found to be less than effective in cases where some level of rent regulation persisted.

Tax Measures

Almost all countries have also used tax measures at some point, typically in efforts to improve investment through more attractive after-tax rates of return on rental investment.

During the 1990s, Australia, NZ, France and Germany have all implemented tax reforms to make new private rental investment more attractive. All four countries have employed depreciation as the instrument of policy, and all permit losses on rental properties to be deducted against other sources of income.

The depreciation rates and periods in Australia and New Zealand are more modest than those in France and Germany. However, the two South Pacific countries have no rent controls so depreciation allowances are not required to first overcome what might be perceived

by investors as negative influences of controlled markets. In the two European examples the depreciation rate may have had to be higher in order to overcome the (perceived) negative influences of rent controls.

The trend in the U.S. has vacillated between tax measures that directly stimulated new rental production in 1981-86 (notably accelerated depreciation) to reform that removed these benefits and made rental investment much less attractive in 1986. There was an offset for this in relation to targeted affordable housing development in the form of the Low Income Housing Tax Credit. However, these provisions are not available to developers that are not targeting low-income households.

Direct Subsidies

Only three countries have used direct subsidies - small capital grants in The Netherlands (replacing a previous system of longer-term subsidies), but even the new program was eliminated in 1995; and interest rate subsidies in Japan and Sweden). In both of these latter countries, these subsidies are a legacy from previous decades - they were not implemented as a policy response to more recent declining investment. Moreover, they were not unique to the private rental sector - they were concurrently used to support homeownership production. The interest rate subsidies are now being phased out in Sweden.

France and Germany also provide subsidized loans, for which private landlords are eligible. However these are linked to provision of accommodation for low-income households, so rents are regulated and held well below market.

Summary of International Experience

This review reveals that it is extremely difficult, and perhaps misleading, to isolate the impact of a single policy initiative. The specific context in which a policy or program was implemented, and the dynamic interaction with other policies have a critical bearing on the outcomes generated by the specific initiative under review.

The only countries that appear to have maintained a healthy investment environment without direct subsidies are New Zealand and Australia. Notably, neither have rent controls and both permit depreciation and deductibility of rental losses (including non-cash book losses caused by depreciation) against other sources of income.

Germany, and to a lesser degree France, have maintained some levels of rehabilitation and new production but the investment incentives in these two countries are somewhat more generous than those in the South Pacific countries reviewed. It is concluded that in the European nations, a residual system of rent control has increased the need for compensating incentive measures. For investment to be attractive, it must first overcome the impacts of the regulatory framework, which imposes some degree of risk - actual or perceived, and may suppress rent levels.

This suggests that the pre-condition to private investment is not a single policy, but a critical balance across the range of measures - subsidy, taxation, regulatory and facilitative.

Lessons for Canada

The most striking finding is that variants of almost all the identified policies used in other countries have, at some time in the past two decades, been employed and evaluated in Canada.

Evidently, other countries have not discovered a panacea to encourage the production or rehabilitation of the private rental stock.

Canada at various times has used: low interest loans, operating subsidies in the form of interest free loans or grants to enhance the rate of return on investment, favourable tax provisions including accelerated depreciation and tax induced investment funds (to the extent that tax provisions facilitated syndication).

In terms of rent controls, many provinces have already deregulated or softened their policies - or are in the process of doing so.

The only mechanism used in the other ten countries that has not been attempted to date in Canada, is tax-exempt bonds (as used in the U.S.) to encourage expenditures on upgrading and adding to the stock.

CMHC Project Manager: David Metzak

Research Report: Private Rental Policies and Programs: Review of the International Experience

Research Consultants: Steve Pomeroy, Focus Consulting, Ottawa, Greg Lampert, Economic Consultant, Toronto, Kathleen Mancer, Kathleen Mancer Consulting, Vancouver

A full report on this project is available from the Canadian Housing Information Centre at the address below.

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The Canadian Housing Information Centre
Canada Mortgage and Housing Corporation
700 Montreal Road
Ottawa, ON K1A 0P7

Telephone: 1 800 668-2642
FAX: 1 800 245-9274

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