More Different Futures Network Topic Review: Rental Housing Market Impacts and Policies

1 Introduction

The network produced strong videos discussing private rental sectors in Australia (Chris Martin), Britain (Ken Gibb) and Canada (Steve Pomeroy) and Hal Pawson’s overview for the Australia/Canada bilateral also touched on key issues. The aim of this paper is to draw on these contributions to briefly outline the impacts and policy implications of COVID-19 on rental housing markets through the emergency, stimulus and longer-term/recovery housing periods.

This raises a complex set of issues. The private rental markets of all the advanced economies, including the ABC countries, comprise a complex mosaic of different consumer groups renting homes across broad ranges of quality provided by a similarly diverse set of providers. Some households rent because they either lack the equity or the incomes to enter home ownership and cannot find tenancies in the non-market provision sectors. Other households, with high incomes and equity (including equity in other properties), rent high quality homes because they have short stay intentions and wish to avoid the transaction costs of owning. In-between low income, long-term residents and the high income mobile, there are not only short-term stay groups such as students, but households aspiring to enter (and more commonly now, re-enter) home-ownership and, especially in the metropolitan cores of the ABC countries, flows of recently arrived immigrants who are orienting and establishing themselves in their new country or region before moving to more permanent long-term tenures in owning and social renting.

With rising housing costs and flat incomes for a wide segment of the income distribution it also has to be recognised that there are increasing numbers of renters that will now never become home-owners nor, at present rates of provision, social renters (and arguably, none of the ABC countries have recognised the implications of the growth in this group and their long-term wealth and old-age provision position).

Ownership of private rental housing (and we note, see TPR 5, that there is now growing ownership of market rental housing by not-for-profit owners) includes large scale commercial owners running rental housing as a real estate business with a focus on long-term returns based on the net incomes raised from the gap between rents and costs, smaller companies with a mix of income and asset value uplifts shaping their notions of returns and individuals owning small portfolios of 1 or 2 properties that they have ‘bought-to-let’ largely to make returns from asset value uplifts and to add to their pension wealth.

This diversity of provision and providers makes the effective design of rental housing systems difficult where governments aim to have a rental sector that is flexible (and especially fostering mobility in local economic change), stable (in the face of cyclical downturns and negative shocks) and fair (does not ‘exploit’ the poor, nor indeed government providers of low income subsidies). Over the last three decades all the demand groups noted above that typically use the private rental sector have increased in all the ABC countries. The lengthening queues of households in ‘need’, and
there is well established evidence that they have increased significantly in the ABC countries in the last decade, are predominantly housed in market rental housing that is often relatively poor quality and, with growing system shortages, is increasingly expensive and raising rent burdens in the bottom half of the income distribution. At the same time, the rising numbers of ‘frustrated’ aspirants to ‘first-home-ownership’ and the growing flow of individuals with disrupted ownership careers returning to renting, has increased the share of middle-income households in the sector (and there is evidence of growing durations of these groups within rental housing paying rents above the 30pc of incomes widely used to define affordable renting). Rental demands from immigrants have risen. Student housing demand numbers have doubled in most major cities over the last two decades (with a lower rate of growth of institutional provision for them). And, of course, there has, with changing demands from mobile executives and workers as well as tourists, been an upward shift in short-term letting and Air BnB.

The main policy responses of governments in the ABC countries, apart from some rental market provision programmes in Canada, to these growing market rental pressures has been to ignore them. Arguably it is the failed government strategies in relation to sustainable home-ownership growth and meeting housing needs with non-market support that has largely shaped the protracted and system wide difficulties of the market rental sector. The essential difficulties of the private rental sector arise because it has, to a large extent, been a flexible market sector in a long period of acute shortages. Inevitably that has raised landlord returns whilst often tenant incomes have stagnated. Nobody should be surprised by that outcome. But nor should the inevitable response be to ‘close-down and control’ all the sector. There are two critical policy questions in all three countries. First, given the rental systems the ABC countries have now, and we note their significant differences below, what roles can they play in emergency and stimulus measures. Secondly, in the longer term, post recovery what roles can a well-organised and financed private rental sector play and how might policy change to achieve that. In this paper we focus on the former rather than the latter question.

2 Rental Market Context

Although the underpinning characteristics of rental market systems differ from country to country, over the last 10-15 years there has been an expansion in rental sector in the ABC countries, including growth in student housing and long-term demand for affordable rental housing for low income households. In the UK, where the share of private rental provision had fallen from 90pc in 1914 to 10pc by 2000, the sector has doubled in tenure share from 10 to 20 percent between 2000 and 2020 and was projected to reach 25 pc by 2025. That growth, in broad policy terms, has been unmanaged and is as much due to policy neglect, for other sectors, as policy intent. In 2018, the Curtin Bank Centre reported that 25 pc of Australians rent privately, some 30 pc of households are aged 25-34, two-thirds are households with no children, 30 pc have rented for more than a decade and a similar share for 5-10 years, and that there is a growing flow of elderly households into the sector. The Canadian sector is similar in scale to Australia and has, historically, played a similar role.

Several key aspects of supply differ across the countries and reflect their different regulation arrangements. Strict rent controls contributed to the long-decline of most of the UK’s PRs from 1914 to 1989 but have had little role since then. In Canada ‘second-generation’, that is return related, rent controls apply in all the major provinces and, usually, market rents are set when properties are re-let and then controlled until the next re-letting). Control, tax and other rental policy settings in Canada have led around 20-25 percent of rental sector by large scale professional, commercial landlords. Arguably, until the last decade Canada had developed a relatively large, stable, well managed system that comprised a set of regulations that provided a balance between landlords and tenants. Neither the UK nor Australia could make similar claims.

Two other factors have driven rental sector supply. Rental housing comprises, in Canada, 27 pc of the housing stock but less than 15pc of new construction. This means that a constant rental share
requires a significant flow of former home-owner units into private rental ownership. However, the flow of formerly owner-occupied properties into rental tenures has greatly diminished. In market housing systems rising incomes will, over long periods of time, lead to home owners moving to larger and better homes leaving older properties to lower income households, and especially renters.

Some commentators call this ‘naturally occurring rental housing, NOAH’ but this term is not used here because in most countries the processes that produced such housing have not functioned since the 1980’s and are in no sense ‘natural. The growth in the number of lower-income, younger home owners (now slowed) and neighbourhood renewal have absorbed such properties. There are clear estimates for Australia and Canada that over the last decade alternative destinations for these properties have reduced the stock of affordable middle and low-income rental housing substantially (by 200,000 in Australia and 350,000 in Canada). Steve Pomeroy calculates that, for Canada, that for every new affordable rental unit produced with government subsidy in recent decades some 15 units have been lost from the traditional flow of older owned units into rental housing. Rents have increased steadily above inflation rates in all three of the ABC countries since 2000 but this has induced little new supply as the gross returns in home ownership, with even higher house price increases have eroded flow of stock into renting.

The second major shift has been the extension of the ‘rentier’ growth of older, upper and middle income home owners into providing ‘mum and dad’, ‘investor’ and ‘buy-to-let’ rental provision. This represents the failure of tax, monetary and other policies to produce more stable housing market conditions. There is also evidence that once particular places, and particularly the globally visible major metropolitan areas, become identified as ‘hot markets’ they have attracted similar investor attention from other regions of their own countries and overseas. For the last decade the majority of additional market rental units provided in all three ABC countries have been provided by these investor owners with a primary interest in capital uplift. As rental housing has become less affordable it has also become potentially less stable in relation to negative demand and price shocks: and that is the reality that CV-19 has brought to most rental housing markets in the ABC countries.

Tax subsidies for rental ownership remain significant in Canada, and especially Australia (with negative gearing). Since 2016 the UK government has reduced the attractiveness of BTL investment (raising stamp duties on BTL purchases and increasing capital gains tax obligations). However, in none of the three countries is there a coherent long term view of what housing policy goals are to be delivered by the PRS and what a purposive post-COVID-19 policy looks like. We do not pursue that issue further here but will return to it in later discussions.

3 Emergency policy responses affecting mortgage market

The COVID-19 emergency measures in the ABC countries have radically reduced the potential adverse effects in the PRS. Wage replacement programmes and rental assistance subsidies (though significant ‘group’ omissions were identified in the sessions) have avoided significant increases in rent arrears and that non-payment or reduced payment of rent is not yet a major problem. A moratorium on evictions was put in place in all 3 countries for those accumulating arrears as a result of lack of income and this has meant that arrears and evictions have not yet added significantly to homelessness issues. Indeed, Gavin Wood identified that emergency income payments may have increased the net incomes of the poorest fifth of households in Australia. The great policy concern is what happens next, when emergency arrangements are removed? And we also need to recognise what opportunities have been created by shifting demands for property, at least in the short term, induced by Covid-19.

What is happening in rental markets? The evidence from markets is that, although less ‘stopped’ that the home-ownership sector, tenant moves, and entries have been greatly reduced. The reduction in travel and tourism activities has had a particular impact in the Airbnb sector and the

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switch of universities to online teaching until, roughly, the start of 2021 has also created an excess supply of both student specific accommodation and rental properties shared by students. The switch away from Air BnB and student lettings has been into broader short-term letting markets where advertised vacancies have increased (in all three countries) and there has also been an exit flow of landlords from these sectors seeking to sell flats. This is more pronounced in cities that have been contemplating regulatory or tax measures to restrict some or all forms of Air BnB.

Digital Finance Analytics report that In Melbourne and Sydney there are signs of ‘investor’ sector exits and sales, in a fifth of cases with capital losses, involving highly leveraged ‘mum’ and ‘dad’ investors. There is an expectation that further reductions in property values and the potentially rising difficulties of managing tenant arrears and vacancies may further discourage more ‘amateur’ landlords. Other than that rental sector trends are somewhat unclear. Long-term commercial investors are unlikely to dispose of their assets. Unlike 2008-2009 the current downturn is not a financial crisis and capital market funds could be available to large scale investors who buy properties at reduced capital values. A major concern may be the long term commitment and customer care of such investors and whether regulatory regimes can nudge such changes towards well managed and permanently affordable rental housing. Several proposals are being made in the ABC countries for non-profits, and landlords with good track records for customer care and property maintenance, to be the lead purchasers of rental properties now being shed from the BTL sector. Reduced immigration may create some slack in lower end metropolitan rental markets. As for new construction, there was much scepticism that ‘build-to-rent’ would flourish at scale and pace to reduce wider affordable rental pressures in the UK and Australia and that the yield gaps were sufficiently large that subsidies or tax concessions to drive construction would have to be at a scale with non-profit investors and the different long-term possibilities for these different rental construction options would come into play.

So, whilst there may be relative stability in the very short term within the sector, and some positive possibilities to use previously short-term lets differently, there is a pronounced concern about the ‘cliff edge’ for the sector if income supports are reduced, and eviction moratoria ended. None of the governments appear to have a clear strategy for the scale and roles of the private rental sector and, with a quarter of all households, and the majority of the poor, in each nation now housed within market rental housing that not so benign neglect needs to change. Present overall sector outcomes contribute neither to fairness/inclusion and stability goals.

5 Conclusions

The rental market is a difficult sector to encapsulate and there is no single silver bullet policy solution given the diverse roles of the sector. The overall view of the network is that the COVID pandemic may have, on balance, some positive effects in the short term (as long as emergency income and eviction provisions remain in play). However, it has exposed some vulnerabilities particularly in relation housing and care services for older people in the sector and highlighted the adverse qualities of homes that many poorer households live in and that expose them to negative overcrowding risks and spillovers. The suggestion of a potential for a healthy market correction, with new landlords capable of making returns (that previously could not be achieved in recent decades in existing as well as new properties) at affordable rents is not yet backed by investor behaviours and needs to be closely monitored. Unless such investment is rapidly forthcoming then housing market recovery after 2021/2 may see property values rise and yield gaps for long-term investors widen. In thinking about the long term-strategy for provision into the rental market governments now also need to look at provision possibilities from the non-profit sector and these alternatives are discussed in TPR 5.

Duncan Maclennan / Linda Christie