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PRIVATE RENTAL HOUSING IN INDUSTRIALIZED COUNTRIES

E. Jay Howenstine  
International Research Coordinator  
Office of Policy Development and Research  
Department of Housing and Urban Development  
Washington, D.C.

January 1981

DEPARTMENT OF HOUSING  
AND URBAN DEVELOPMENT

NOV 19 1982

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## FOREWARD

One of the main functions of the President's Commission on Housing established on June 17, 1981 is to --

"seek to develop housing and mortgage finance options which strengthen the ability of the private sector to maximize opportunities for home ownership and provide adequate shelter for all Americans".

In recent years the future of the private rental housing sector in the U.S. has become a matter of increasing concern. What role it does have to play in national housing policy? And what measures need to be taken to ensure that private rental housing plays its proper role?

These questions have been equally paramount in national housing policy in most other highly industrialized countries. Consequently, an analysis of the policies and strategies, which these countries have adopted in their attempts to promote - in some cases even to salvage - the private rental housing sector, may be of some assistance to the Commission and to policy-makers generally in developing options to strengthen the private rental housing sector in the United States.

## EXECUTIVE SUMMARY

### Is There a Crisis?

In most of the highly industrialized world, there is a long-standing critical condition in the private rental housing market. Within the last five years, rental housing issues have become sufficiently urgent that at least six countries have appointed national commissions to examine the problem.

Quantitatively, in most countries there has been a substantial decline in the percentage of private rental housing not only in the national housing stock but also in annual housing production to the point where it is doubtful that the supply is sufficient to meet either the demand or the need for this type of housing.

Qualitatively, a large part of the existing private rental housing stock is substandard and in urgent need of modernization.

Financially, large numbers of low-income households are bearing excessive housing costs, in spite of housing allowance plans that have been widely adopted to ease financial hardship.

Notwithstanding a greater awareness of the essential role which private rental housing has to play in the national housing market and an array of policies to promote this sector, its future is clouded in most industrialized countries. Preferential treatment for owner-occupancy and for public and non-profit housing on the one hand, and the deterrents of rent regulation on the other hand, place the private rental housing sector at a relative disadvantage. In a majority of cases a realignment of policies will be necessary if vigor is to be restored to private rental housing.

The views expressed are those of the author and do not necessarily reflect those of the Department of Housing and Urban Development. The author acknowledges helpful comments from Dr. Elizabeth A. Roistacher, former Deputy Assistant Secretary, Office of Policy Development and Research, Department of Housing and Urban Development, presently Associate Professor of Economics, Queens College, New York; Professor J. Barry Cullingworth, Centre for Urban and Community Studies, University of Toronto, Canada; Professor Michael Harloe, University of Essex, United Kingdom; Dr. Martti Lujanen, Ministry of Interior, Helsinki, Finland; Robert Hyndman, Canada Mortgage and Housing Corporation; Professor Peter Marcuse, Chairman, Division of Urban Planning, School of Architecture, Columbia University, New York; and Morton Isler, Urban Institute. The paper was presented to the Conference on "Rental Housing Crisis: Implications for Policy and Research" convened by the Department of Housing and Urban Development on November 14, 1980. The Proceedings of the Conference published by the Urban Institute contain an abbreviated version of this paper.

## Overview

Since the early 1900s, and especially since World War II, private rental housing in most countries has been shrinking, in some instances almost catastrophically. The decline came mostly because of the rising success of its competitors, that is, home ownership and the associated prospect of capital gains; social housing (i.e. public rental housing); and housing by non-profit organizations. But a major factor also was discriminatory treatment under rental control systems and consequent neglect.

In many countries the situation changed in the late 1970s. The costs of new housing had risen sharply. Not only did home ownership begin to price itself out of the market, but the financial costs of new social housing programs became increasingly burdensome for governments struggling with inflation. At the same time, the quantitative backlog of housing need had been largely erased. Suddenly preservation of the existing housing stock became an attractive proposition. Likewise, the revival of private rental housing became a means of divesting government of some of its heavy financial and management responsibilities.

It also became increasingly apparent that the private rental housing sector performs functions that the other sectors do not discharge effectively or cannot perform at all. It provides an essential interim arrangement for young persons who cannot yet afford, but want, to buy their own homes. It meets the needs of those who can afford but do not want the responsibilities of home ownership. It caters to the shelter needs of special groups, such as single people, divorced and separated couples, refugees, students and unmarried professionals, particularly in the inner city. And it contributes a flexibility to the housing market that a dynamic economy requires.

Thus within recent years, despite a minority view in some countries that presses for municipalization of land and housing as a social service, there has been a noticeable re-awakening to the gravity of the problem. A fairly general awareness seems to have developed that private rental housing is an essential component in a well balanced national housing policy. And although there is no chance that it will be restored to the prominence it had before World War II, a wide spectrum of legislation has been dedicated to the preservation, revival and promotion of private rental housing.

## Preserving the Existing Private Rental Housing Stock

There is among industrialized nations a wide area of agreement that one of the first priorities is to ensure that the private investor receives a "fair return on capital". To many, this means dismantlement of rent controls.

But at this juncture, this is an almost politically impossible course of action. Despite many bold and imaginative attempts to decontrol, all governments are still caught up with some form of rent regulation and/or control of rental tenure.

The second best solution, then, is to incorporate some concept of "fair" or "reasonable" rate of return on capital into the rent regulation system. In some of its applications, the "fair rent" concept seems to offer a practical way for achieving a genuine reconciliation of the tenant's need for protection against excessive rents which exploit a scarcity situation and the landlord's need for a fair return on capital. Other applications seem to fall short of this realization.

Meanwhile, governments have adopted a wide variety of measures to rehabilitate the private rental housing stock. Grants partially covering the costs of specific structural improvements, such as plumbing, have been widely used, but under rent controls the response was often lethargic. Loans have also been extended for the same purpose, but probably with still less general impact.

Most success appears to have been achieved through the area approach. This method concentrated efforts in areas of high stress; it supplemented housing renovation with improvements in the local environment; it sometimes introduced elements of compulsion, although the reaction to this was clearly mixed; in general it aimed to create a visible, organized momentum in an upward direction.

The area concept has not been free of criticism, however. It discriminated against needy households outside the selected areas. It overlooked the fact that certain types of substandard areas perform an important social function for certain kinds of people, e.g., youth, recent movers and refugees of various sorts. It substantially increased management costs. It has contributed to "gentrification", i.e., the displacement of older, poorer residents by new, more affluent, generally younger households.

One of the most effective devices for increasing private landlords' income and thereby promoting a high level of maintenance and repair work has been the housing allowance. Upward adjustment of rent ceilings is more palatable politically and more equitable socially if consumer subsidies can alleviate hardship on renters living on fixed income and having to pay higher rents, e.g., the elderly.

### Stimulating New Private Rental Housing

The stance of governments generally has been that active support is necessary if the private rental sector is to be revived and play a vital role in the national housing market.

An obvious priority is the exemption of new private unaided rental housing from rent controls. This seems to have been fairly uniformly practiced in most countries, although there have been cases where general rent freezes seem to have been subsequently imposed. Considering rapidly rising housing costs and the high rents that had to be charged, most of such construction was destined for high- and middle-income households. This part of the housing market was of minor concern to governments and on the whole may not have been too adversely affected during the postwar period.

On the other hand, shelter for the mass of workers is of fundamental concern to governments; hence the promotion of private rental housing for them was treated differently. Governments have extended various kinds of direct and indirect financial assistance on two conditions. Construction must not exceed certain space and structural standards. Letting must be within certain income limits on tenants and within specified rent ceilings. While there seems to have been considerable response in the private rental sector to this approach, research is needed to determine the net impact of this mixed set of policies, i.e., combining aid stimuli on the one hand with income-limiting conditions on the other hand. Two other factors have provided additional incentives for landlords: liberation from application of rent ceilings after a given period of time (e.g., in the Federal Republic of Germany 10 years after direct subsidies cease); and the prospect of longterm capital gains.

The fact that governments have supported private rental housing in a variety of ways is testimony to the importance which they attach to the perpetuation and revival of this sector. Some Governments guaranteed loans obtained from the private banking system, while others went further and offered direct long-term loans on a non-subsidized basis. The more usual practice, however, has been some form of direct or indirect subsidy. The favored assistance was below market rates of interest. But aid has also been in the form of capital subsidies, operating subsidies, waivers of interest payments, and tax concessions. Accelerated depreciation allowances have been the most frequently used tax concession.

As in the case of existing housing, the housing allowance has proved to be an effective tool for helping to bridge the gap between high rents of new construction and tenants' ability to pay.



### Non-Profit Housing Organizations

Rental housing provided by non-profit organizations—a rental tenure falling midway between public housing on the one hand and private rental housing on the other—has played a major role in national housing policy in many countries. Generalizations are hazardous. Nevertheless, on the whole non-profit housing probably has shown greater flexibility than traditional public housing on the one hand, and greater social sensitivity than private rental housing on the other. Moreover, it may be fair to say that its management performance has probably been generally superior to public housing but inferior to private rental housing, at least that part owned by corporate bodies.

Governments have—as might be expected—extended more generous assistance to non-profit housing than to private rental housing. They have been solicitous toward capital needs through loan guarantees, direct loans and capital grants. They have also through the provision of interest subsidies, operating subsidies and tax concessions been cognizant of the need to keep operating costs low so as to keep rents low.

Housing allowances have also been an important factor in bolstering the income position of non-profit housing organizations by supplementing the rent payments of low- and moderate-income households.

## Chapter I

### THE DECLINE OF PRIVATE RENTAL HOUSING--THE HISTORICAL PERSPECTIVE<sup>1</sup>

At the turn of the 20th Century, in most industrialized countries the bulk of the housing stock was private rental housing. The upper and middle classes, which could afford the cost of decent housing, dwelt in comfort if not in luxury; but they constituted a relatively small percent of the households. The great mass of workers who had migrated to the city for factory employment lived in housing that was owned by the propertied classes. The grimness of housing conditions and the dependence of workers on privately owned rented housing were graphically described as follows:

"In the crowded slums of the great cities poverty and disease were rampant and infant mortality appalling; sub-tenants and night lodgers lived with the family and thus prevented the development of home life. The planning and extension of towns was left entirely to private initiative. In consequence the working-class quarters in most modern cities were thickly built over; in some countries lofty tenement houses, inhabited by scores of families, were built. Both aesthetic and hygienic considerations appeared to be entirely neglected."<sup>2</sup>

Although housing reform movements looking toward the construction of new social (or public) housing developed during the latter part of the 19th century, practical results were negligible. It is not surprising, therefore, that in the United Kingdom in 1914--and this was probably roughly representative of most industrialized countries at the time--roughly 90% of the housing supply was privately rented. This position, however, was about to change radically.

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<sup>1</sup> The main sources for this study have been national monographs on housing finance prepared for the Seminar on the Financing of Housing convened by the Committee on Housing, Building and Planning of the United Nations Economic Commission for Europe in August 1973 and on the national monographs on current trends in housing, building and planning prepared biennially for the same Committee.

<sup>2</sup> International Labour Office, European Housing Problems Since the War (Geneva, 1924), p. 4.

The coming of the 1920s ushered in an epoch of steady decline in the relative importance of private rental housing in most countries. Many forces were at work. Imbued with a strong social consciousness of the housing needs of the working masses, most European governments embarked on social housing programs to replace slums, particularly after World War II, and often with an accent on industrialized building. The rationale was simple. Since the mass of workers could not afford the economic cost of decent housing, the only recourse was for governments to build housing for letting at rents that workers could afford to pay. This kind of orientation found little place for new private rental housing, which of necessity would have to charge rents that most workers could not afford.

Second, workers increasingly banded together and through their own resources--often supplemented by assistance from trade unions and governments--built low-cost cooperative housing. After World War II, this movement became the nucleus for large-scale programs in many countries promoting non-profit housing organizations.

Third, individual home ownership became an increasingly attractive alternative for better paid workers. Particularly after World War II, the age of affluence associated with high economic growth rates--often supported by government financial incentives such as liberal tax subsidies and more recently by the prospect of capital gains--made it both possible and profitable for more and more of the growing middle class to own their own homes. In the political arena additional strong support for preferential treatment to home owners in many countries came from builders and developers who had an economic interest in the expansion of this sector. In some countries, notably Australia, Canada, Federal Republic of Germany, Finland, Ireland, New Zealand and the United Kingdom, the promotion of home ownership has been given an especially high priority for several reasons. Other things being equal, it appears to be the type of tenure which the majority of people prefer. The more households that take care of their own shelter needs, the less governments will be called upon to do on their behalf. Moreover, placing responsibility for maintenance and repair of housing on homeowners economizes in the use of scarce resources. Not only do owners generally take fonder care of their housing than renters, but they also do much of the actual maintenance themselves. Conversion of private rental housing to owner occupancy (e.g., condominiums) and more recently the sale of public housing to private ownership have been major forces affecting the tenure of the housing stock in many countries.

Finally, the adoption of rent controls first in World War I and then again in World War II created an institutional framework that increasingly tended to undermine the profitability of rental housing as a private investment. Originally conceived as an emergency measure for avoiding or at least mitigating the undesirable effects of a sudden and drastic disequilibrium in the supply and demand for housing, with the passage of time the rent control system became

more and more an instrument of long-term social housing policy substituting for insufficient housing subsidies to meet national housing needs of low- and moderate-income households. It thus became enshrined as a pillar of social justice for workers.

By the early 1960s, most European governments were convinced that on balance the disadvantages of rent controls outweighed their benefits.<sup>1</sup> Accordingly, programs were adopted for relaxing rent controls and harmonizing rent levels between the older and newer housing stock, generally including provision for some form of housing allowances to ease individual hardships arising from the rent increases. But the programs did not bear the expected fruit. Building costs and thus the rents on new housing, along with prices in general, were rising faster than the scheduled rate of increase in controlled rents, so that decontrol and equalization of rents became a never, never proposition. Moreover, in certain cases where rents were actually freed from controls, e.g., in the Federal Republic of Germany and Switzerland, the public outcry about the large, and sometimes exorbitant, rent increases was so intense that controls were quickly restored in large urban areas. Throughout this turmoil, while raising rents had some effect in increasing the profitability of rental property, or at least in preventing it from worsening as a consequence of general inflation, private rental housing tended to remain a secondary issue—to some extent perhaps almost an orphan child. In short, it seemed well nigh impossible to extricate private rental housing from rent control systems.

Unfortunately statistical data on this sector are fragmentary. Most national censuses do not collect data on the private and public components of the rental housing stock. Among fourteen of the nineteen countries for which rental housing data are available, the dominant trend during the postwar period has been an expansion in owner-occupied housing and a decline in the rental housing sector ranging from under 1 percentage point in Norway and the Federal Republic of Germany to over 23 percentage points in Spain (Table 1). On the other hand, in five countries—Canada, Japan, Netherlands, Switzerland and Yugoslavia—the percentage of rental housing has been rising. But this table, it should be emphasized, is only a measure of total rental housing and does not give a breakdown among the three types of rental housing—public, non-profit and private.

<sup>1</sup> Cf. United Nations Economic Commission for Europe, European Housing Trends and Policies in 1959 (Geneva, 1960), ST/ECE/HOU/1, p. 56.

Table 1. Changes in the Rental Housing Sector as a Percentage of Total Occupied Conventional Dwellings in Selected Countries, 1940s - 1970s.<sup>1</sup>

(In percentages)

A. Countries with a Decline

| Country                        | 1940s                 | 1950s    | 1960s    | 1970s    | Total Change<br>in Percentage<br>Points |
|--------------------------------|-----------------------|----------|----------|----------|---|
| Norway                         |                       |          | 43.1(60) | 42.4(70) | .7                                      |
| Federal Republic<br>of Germany |                       |          | 64.9(61) | 64.1(68) | .8                                      |
| Denmark                        |                       |          | 48.1(60) | 46.8(70) | 1.3                                     |
| France                         |                       |          | 45.0(62) | 43.1(68) | 1.9                                     |
| Luxembourg                     |                       |          | 45.3(60) | 43.1(70) | 2.2                                     |
| United Kingdom                 |                       |          | 53.0(61) | 50.5(71) | 2.5                                     |
| Sweden                         |                       |          | 54.4(60) | 51.6(70) | 2.8                                     |
| Finland                        |                       | 42.7(50) | 39.0(60) | 38.5(70) | 4.2                                     |
| Italy                          |                       | 48.7(51) | 46.6(61) | 44.2(71) | 4.5                                     |
| Ireland <sup>2</sup>           | 42.7(46)              |          | 35.6(61) | 28.9(71) | 13.8                                    |
| Austria                        |                       | 62.0(51) | 53.0(61) | 47.0(71) | 15.0                                    |
| Belgium                        | 61.1(47)              |          |          |          |   |
| United States                  | 56.0(40) <sup>3</sup> | 45.0(50) | 38.1(60) | 37.1(70) | 18.9                                    |
| Spain                          |                       | 51.2(50) | 42.5(50) | 27.5(70) | 23.7                                    |

B. Countries with an Increase

|                    |  |          |          |          |      |
|--------------------|--|----------|----------|----------|------|
| Netherlands        |  | 68.8(56) |          | 69.6(71) | .8   |
| Yugoslavia         |  |          | 22.5(61) | 24.5(71) | 2.0  |
| Canada             |  | 34.4(51) | 34.0(61) | 40.0(71) | 5.6  |
| Switzerland        |  |          | 62.5(60) | 68.8(70) | 6.3  |
| Japan <sup>4</sup> |  | 28.8(58) | 35.7(63) | 40.8(73) | 12.0 |

<sup>1</sup> United Nations, Statistical Survey of the Housing Situation in the ECE Countries Around 1970 (New York, 1978) pp. 80-87.

<sup>2</sup> Households.

<sup>3</sup> Bureau of the Census, United States, Historical Statistics of the United States: Colonial Times to 1957 (Washington, D.C., 1960), p. N-139-146.

<sup>4</sup> Housing Bureau, Ministry of Construction, Japan, Housing in Japan (Tokyo, 1980), p. 10.

The piecemeal data that are available on the private rental housing sector as a percentage of the national housing stock have been assembled in Table 2. This gives a more accurate picture of the low state to which this sector has fallen.

The most dramatic fall was registered in the United Kingdom—from 90% in 1914 to 16% in 1975. A similar decline took place in Ireland, where by 1979 the private rental sector had fallen to 12% of the total housing stock. There are no data on the Irish situation in the early 1900s. But since home ownership has traditionally been higher in Ireland than in the United Kingdom, the private rental sector there was probably not as large as in the U.K. Nevertheless, one study concluded that "Since the turn of the century, the private rental sector has declined continuously."<sup>1</sup>

The other highly industrialized continental European countries probably had private rental sectors roughly equivalent in size to that of the United Kingdom in the early 1900s. But the decline has not been nearly as great. In 1968, 41% of the French housing stock was still in the private rental sector, and in 1972 an estimated 34 to 50% of the German urban housing stock was privately rented. Professor Hallett has in fact maintained that private rental housing in the Federal Republic of Germany has relatively prospered since World War II, quite the opposite of the British experience.<sup>2</sup>

In other parts of the developed world conflicting trends were in evidence. The private rental housing stock in both Australia and New Zealand declined from the upper 40% range in earlier years to the 20% or lower range in later years, only to increase slightly in the most recent years. On the other hand, in Canada the private rental housing sector rose from 34% in 1961 to 40% in 1971, only to fall off to 38% in 1976. Similarly, there has been a fairly steady rise in the privately rented sector of Japan through the years, 1958-1973, reaching a peak of 27.4% of the national housing stock. Since then, however, it declined slightly to 26.1% in 1978.

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<sup>1</sup> J. McKeon and R. Jennings, Public Subventions to Housing In Ireland (Dublin, National Institute for Physical Planning and Construction Research, 1978), p. 45.

<sup>2</sup> Graham Hallett, Housing and Land Policies in West Germany & Britain (London, MacMillan, 1977), pp. 1-2.

Table 2. Private Rental Housing as a Percentage of Total National Housing Stock in Selected Industrialized Countries in Selected Years.

|                              | Pre-1940s   | 1940s               | 1950s               | 1960s               | 1970s               |                     |
|------------------------------|---|---------------------|---------------------|---------------------|---------------------|---------------------|
| Australia                    |   | 45(47) <sup>1</sup> | 35(54) <sup>1</sup> | 21(66) <sup>2</sup> | 22(71) <sup>2</sup> |                     |
| Canada <sup>3</sup>          |   |                     |                     | 33(61)              | 37(71)              | 34(76)              |
| Denmark                      |   |                     | 35(55) <sup>4</sup> | 29(65) <sup>4</sup> | 30(70) <sup>4</sup> | 24(79) <sup>5</sup> |
| Finland <sup>6</sup>         | Average recent annual rate of decline—10,000 units (1.8% of total rental stock) |                     |                     |                     |                     |                     |
| France <sup>7</sup>          |   |                     |                     | 41(68)              |                     |                     |
| Federal Republic of Germany  |   | 68(48) <sup>8</sup> |                     |                     | 34(72) <sup>8</sup> | 50(72) <sup>9</sup> |
| Ireland <sup>10</sup>        |   |                     |                     | 17(61)              | 15(71)              | 12(79)              |
| Japan <sup>11</sup>          |   |                     | 19(58)              | 24(63)              | 27(68)              | 27(73)              |
| Netherlands <sup>12</sup>    |   |                     | 46(56)              |                     |                     | 23(75)              |
| New Zealand <sup>13</sup>    | 47(16)  |                     | 21(51)              |                     |                     | 17(71)              |
| United Kingdom <sup>14</sup> | 90(14)  |                     | 52(51)              |                     | 19(71)              | 15(76)              |
| United States <sup>15</sup>  | 53(00)  | 56(40)              | 44.7(50)            | 37.3(60)            | 35.8(70)            | 31(78)              |

Footnotes to Table 2.

- 1 Department of National Development, Australia, The Housing Situation (Canberra, 1956), p. 17.
- 2 Simon Whiteley, Private Rented Housing in Australia (London, Department of the Environment, 1979), p. 10.
- 3 Statistics Canada, Census of Canada and Canada Mortgage and Housing Corporation, Canadian Housing Statistics, various years.
- 4 Lars Ostergaard, The Privately Rented Sector in Denmark (Copenhagen, Ministry of Housing, 1978), pp. 8-9.
- 5 Ministry of Housing, Denmark, Current Trends and Policies in the Field of Housing, Building and Planning (Copenhagen, 1979), p. 4.
- 6 Supplied by Martti Lujanen, Ministry of Interior, Finland, November 6, 1980.
- 7 J. Robert Dumouchel, European Housing Rehabilitation Experience: A Summary and Analysis (Washington, D.C., National Association of Housing and Redevelopment Officials, 1978), p. 39.
- 8 Michael Harloe, "Decline and Fall of Private Renting", Centre for Environmental Studies Review, May 1980, p. 31. Harloe adopts a more narrow definition than Hallett.
- 9 Graham Hallett, Housing and Land Policies in West Germany and Britain (London, MacMillan Prss, 1977), p. 18.
- 10 1961 figure—J. McKeon and R. Jennings, Public Subventions to Housing in Ireland (Dublin, National Institute for Physical Planning and Construction Research, 1978), p. 46; 1971 figure—Department of Environment, Current Trends and Policies in the Field of Housing, Building and Planning (Dublin, 1979), p. 3; 1979 figure—Ibid., (Dublin, 1980), p. 3.
- 11 Ministry of Construction, Japan, Housing in Japan (Tokyo, 1980), p. 10.
- 12 M. Harloe, op. cit., p. 31. Derived from Table 1 and Harloe's estimate of ratios within rental sector.
- 13 Simon Whiteley, Private Rented Housing in New Zealand (Wellington, National Commission, 1979), p. 12.
- 14 Department of Environment, United Kingdom, Housing Policy: Technical Volume (London, HMSO, 1977), Part III, p. 62—for 1914; Ibid., Housing Policy: A Consultative Document (London, HMSO, 1977), p. 14—for years 1951, 1971 and 1976.
- 15 Bureau of Census, United States, Historical Statistics of the United States: Colonial Times to 1957 (Washington, D.C., Department of Commerce, 1960), Table Series N-139-149—for 1900 and 1940; data for years, 1950, 1960, 1970 and 1978 derived by subtracting total public housing stock receiving federal subsidy (Department of Housing and Urban Development, Justification for 1981 Estimates, 1980 p. D-26) from total rental housing stock (Cf. Table 1, and Bureau of Census, Annual Housing Survey: 1978, Washington, D.C., Department of Commerce, 1980, p. 1).



Further corroboration of the generally declining state of the private rental housing sector is to be found in the available annual housing production data (Table 3). Broadly, there appear to be three categories of countries.

The high group consists of Australia, Canada, Federal Republic of Germany and Japan—countries in which private rental housing has been fairly stable within a range of 20 to 50% of total housing production through most of the postwar period. This is the group in which the U.S. falls. Both the Federal Republic and Japan averaged close to 40% during most of the period, though in recent years their levels have fallen considerably. In the Federal Republic the level was 20% in 1978 and in Japan it was 25.3% in 1974.

At the lower end of the scale are Denmark, France and the Netherlands. Here although private rental housing was fairly consistently maintained at a level of 10 to 20% during much of the postwar period, in more recent years it has nearly collapsed. In France and the Netherlands it has fallen to 3% and in Denmark to 5%.

Norway is the one country in a possible middle category, where the level has been reasonably stable in the 10 to 20% range.

\*\*\*\*

The conclusion emerges clearly: in most industrialized countries the private rental housing sector is considerably smaller today than in 1945 and substantially smaller than in the early 1900s.

Table 3. Private Rental Housing as a Percentage of Annual Housing Production in Selected Countries.

|                                | 1950s   | 1960s                  | 1970s               |                            |
|--------------------------------|---|------------------------|---------------------|----------------------------|
| Australia <sup>1</sup>         | 13(59-60)   | 30(64-5)               | 35(69-70)           | 32(73) <del>19(78-9)</del> |
| Canada <sup>2</sup>            | Average rental starts as proportion of all starts 1970-79 - 40% |                        |                     |                            |
| Denmark                        | 15(40-70)   | 18(67) <sup>4</sup>    | 14(70) <sup>4</sup> | 5(76) <sup>3</sup>         |
| France <sup>3</sup>            |   | 20(60)                 | 7(71)               | 3(76)                      |
| Federal Republic<br>Of Germany | 40(45-70) <sup>3</sup>  | 47(50-74) <sup>5</sup> | 42(75) <sup>3</sup> | 20(78) <sup>3</sup>        |
| Japan <sup>6</sup>             |   | 48(65)                 | 40(70)              | 25(74)                     |
| Netherlands <sup>3</sup>       | 16(50-56)   | 18(65)                 |                     | 16(75) 3(77)               |
| United States <sup>7</sup>     |   |                        |                     | 24(74) 23(79)              |

1. Indicative Planning Council for the Housing Industry, Report on Multi-Unit Dwelling Development in Australia (Canberra, Australian Government Public Service, 1980), p. 12. The series is for multi-unit dwellings as percentage of private housing starts.

2. Supplied by Philip Brown, Canada Mortgage and Housing Corporation, December 12, 1980.

3. Michael Harloe, "Decline and Fall of Private Renting," Centre for Environmental Studies Review, May 1980, p. 31.

4. Ministry of Housing, Denmark, Financing of Housing in Denmark (Copenhagen, 1972), p. 10.

5. Graham Hallett, Housing and Land Policies in West Germany and Britain (London, MacMillan, 1977), p. 14.

6. Ministry of Construction, Japan, Housing in Japan: '75 (Tokyo, 1975), p. 46.

7. Bureau of Census, United States, New Private Housing Units Started (Washington, D.C., Department of Commerce, 1980), pp. 3, 11.

Chapter II

THE PLACE OF PRIVATE RENTAL HOUSING IN NATIONAL HOUSING POLICY

A. The Negative View

Among some European socialist parties, there is a strong view that there is no legitimate place for private rental housing in the housing market. This ideological position has been aptly summed up by Ex-Prime Minister Harold Wilson in the United Kingdom:

"The plain fact is rented housing is not a proper field for private profit."<sup>1</sup>

The idea that a landlord should take profit on a basic service such as shelter, when the worker even in the best of circumstances is barely able to obtain minimum standards of health and decency, is considered immoral. The worker should be able to obtain shelter at a better price, at least no more than, and perhaps significantly lower than, cost. That means almost inevitably public ownership and management of land and dwellings.

In this view there is no sadness about the shrinkage of the private rental sector. In fact, municipalization of the private housing sector to the point of extinction should be pursued with vigor. It may be noted, however, that although the British Labour Party has been in office several times during the postwar period, formidable financial problems were encountered and implementation of the municipalization policy did not proceed far.

There is another totally different kind of negative view concerning the future of private rental housing. It is based not on a moral judgment (for the adherents probably accord the sector a thriving role), but on a dispassionate assessment of the forces operating in some of the countries today.

For Lars Ostergaard of the Danish Ministry of Housing, the eclipse of the private rental housing sector is a more or less inevitable product of the preference of people for home ownership, buttressed on the one hand by the deliberate acts of government with its tax subsidies for owner occupancy and on the other hand by the fortuitious workings of the (inflationary) free market which yields handsome capital gains. Ostergaard concludes:

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<sup>1</sup> Quoted in J. B. Cullingworth, Essays on Housing Policy: The British Scene (London, George Allen and Unwin, 1979), p. 61.

"It seems likely that the greatest part of the privately rented sector will be converted into owner-occupied dwellings. Left in the privately rented sector will be only two groups of dwellings: (1) the oldest, the poorest and most obsolete dwellings, not allowed to be converted into freehold flats and difficult to sell to housing co-operatives and (2) rented dwellings owned by insurance companies or pension funds, who might still wish to place their funds in this form of investment."<sup>1</sup>

In a similar vein, Professor Harloe, after reviewing the experience of five countries comes to the conclusion that:

"The outlook for (private rental housing) is now bleak. the basic reason for this is the economic weakness of the sector and not the policies which are now being adopted towards it. In fact, the less restrictive policies of the 1970s have been accompanied by the serious decline of the sector and the cessation of most new investment in it; whereas the more restrictive policies of the 1950s and early 1960s did not prevent the maintenance of a large private rental stock and substantial new investment taking place."<sup>2</sup>

## B. The Positive View

### 1. General Objectives of National Policy

There appears to be a more or less general concensus in Western Europe that at least in principle governments should ensure that all citizens have a choice in regard to shelter. This concept is formulated in different ways.

The Federal Republic of Germany believes that the purpose of housing policy is "to intensely promote the construction of dwellings so as to enable every family and citizen to freely select a convenient and reasonable priced home."<sup>3</sup>

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<sup>1</sup> Lars Ostergaard, The Privately Rented Sector in Denmark (Copenhagen, Ministry of Housing, 1978), p. 86 (underscore in original).

<sup>2</sup> Michael Harloe, "Decline and Fall of Private Renting", Centre for Environmental Studies Review, May 1980, pp. 33-34 (italics inserted).

<sup>3</sup> Ministry for City Planning and Housing, Federal Republic of Germany, The Financing of Housing in the German Federal Republic (Bonn, 1970), p. 62.

To Ireland, "The basic aim...(is) to ensure that, as far as the resources of the economy permit, every family can obtain a house of good standard, located in an acceptable environment, at a price or rent they can afford."<sup>1</sup>

In the Netherlands, "The government endeavors to create a situation in which the citizens have a free choice between rental and ownership housing without an unjustified difference of treatment."<sup>2</sup>

Japan states that "the ideal of the housing policy is to enable all of the people to secure houses above a certain standard in a good and healthy environment in conformity with family size, dwelling area, etc."<sup>3</sup>

Norway believes that the "principal aim of housing policy ... is that every family or single person household should have at their disposal a suitable dwelling at a cost which is reasonable in relation to their income."<sup>4</sup>

As a strategy to achieve the above objectives, governments generally have realized the importance of maintaining the major components of the housing market-- owner occupancy; public housing; private rental housing; and non-profit housing-- in a good state of health. This is essential to facilitate economic and social mobility within the society and to keep viable options open for all citizens in choosing their place of residence.

## 2. Reassessment of the Private Rental Housing Sector

The question of whether housing policy should be specifically concerned with preserving or promoting the private rental housing sector does not seem to have been addressed as a major national issue in most countries during the first two postwar decades. Rather its fate seems to have been submerged in action and controversy about other more politically vital issues, such as slum clearance, public housing, home ownership and rent control. Ironically, however, one of the

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<sup>1</sup> Department of the Environment, Ireland, Current Trends and Policies in the Field of Housing Building and Planning: Ireland 1980 (Dublin, 1980), p. 3.

<sup>2</sup> Ministry of Housing and Physical Planning, Netherlands, Current Trends and Policies in Housing and Building in 1977, (Hague, 1978), p. 5.

<sup>3</sup> Ministry of Construction, Japan, Housing in Japan: '75 (Tokyo, 1975), p. 20.

<sup>4</sup> Ministry of Local Government and Labour, Norway, Current Trends and Policies in the Field of Housing, Building and Planning (Oslo, 1978), p. 3.

outcomes of this process was to focus attention on the private rental housing sector as it had not been before, and to revive interest in its future well-being. Many factors converged to bring about this resurgence of interest.

First of all there appears to have been a new appreciation of the fact that this sector performs a number of functions which the other sectors do not discharge effectively or cannot perform at all.<sup>1</sup> It provides an essential interim arrangement for young persons who cannot yet afford, but want, to buy their homes. On the other hand, there is an ever large number of persons in affluent societies who can afford the cost of decent housing but who do not want the responsibilities of home ownership, particularly among the elderly. Nor will either public housing or non-profit association housing solve their housing needs. They expect the housing market to offer them suitable choices. Furthermore, private rental housing has demonstrated a capacity for catering to the needs of special groups, such as single people, students, divorced and separated couples, refugees and unmarried professionals, particularly in the inner city.<sup>2</sup> By contrast public housing is better designed to meet more traditional general housing needs, such as those of large families, low-income families and the homeless.

Moreover, private rental housing contributes an important degree of flexibility to the housing market. A dynamic economy requires, inter alia, a type of housing that provides easy and immediate access for members of the labor force who are attracted to growth centers or growth industries, or who are upwardly mobile in their occupations. There is a need, too, for transitional accommodation for those who may not be eligible for public housing, or if eligible, for whom there may not be a public housing vacancy. The high mobility of private renters was indicated in a New Zealand Housing Preferences Survey, which showed that 67% of private renters expected to move within the next two years as compared to 12% of home owners, and 24% of public sector tenants.<sup>3</sup> Whiteley concludes that rental housing is "the provider of flexibility; ... (even though, for example) ... only 1 in 5 households occupy privately rented accommodation at any one time (in Australia), in terms of households moves the sector plays a far more significant role."<sup>3</sup>

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<sup>1</sup> Cullingworth, op. cit., pp. 37-8.

<sup>2</sup> David C. Thorns, Rental Housing - Choices and Constraints (Wellington, New Zealand, National Housing Commission, 1979), Research Paper 80/3, p. 54.

<sup>3</sup> Simon Whiteley, Private Rented Housing in New Zealand (Wellington, National Housing Commission, 1979), p. 16.

<sup>4</sup> Simon Whiteley, Private Rented Housing in Australia (London, Department of Environment, 1979), p. 21 (*italics supplied*).

Second, experience demonstrated that large-scale slum clearance and urban redevelopment often impaired, and in cases, even destroyed the social fabric of vibrant communities.<sup>1</sup> While European governments seldom bulldozed central city areas on the scale that the U.S. did for urban renewal purposes, there was nevertheless a tendency to denigrate old housing as inferior and expendable and often to proceed without an appreciation of the values of existing community life. Governments increasingly recognized that respect for people demanded a more sensitive and flexible policy in preserving the social structure while rehabilitating the physical environment—a realization that redounded considerably to the benefit of the private rental housing sector.<sup>2</sup>

A third factor has been the new patterns of household formation at both ends of the age scale. Young people are forming independent households earlier in their life cycle than formerly. There has also been a significant increase in single person households, particularly of women. These trends have substantially increased the demand for short-term rental accommodation, particularly in the inner city which is especially attractive to mobile youth. At the same time the rising income levels of retired persons attributable to more generous social security programs and to increased savings resulting from economic affluence have enabled increasing numbers of them to set up their own households as compared to an earlier era.

Fourth, the rapid rise in costs of new construction has placed greater fiscal burdens on governments struggling to curb public expenditures in their attack on inflation. Not only does the revival of new private rental housing make it possible for governments to disengage from some of their heavy financial and management responsibilities for public rental housing, but directing more attention to rehabilitation of the existing housing stock, much of which is private rental housing, is also much less expensive than new construction. On the average rehabilitation is less than half the cost of new construction. Consequently, urban rehabilitation suddenly became a very attractive proposition.<sup>3</sup>

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<sup>1</sup> Cf. United Nations Economic Commission for Europe, Seminar on Citizen Participation in the Planning, Implementation and Management of Human Settlements (Geneva, 1980), HPB/SEM.26/1.

<sup>2</sup> Cf. United Nations Economic Commission for Europe, Symposium on Urban Renewal and the Quality of Life (Geneva, 1978), HBP/SEM.19/R.1.

<sup>3</sup> Cf. United Nations Economic Commission for Europe, The Improvement of Housing and Its Immediate Surroundings (Geneva, 1977), ECE/HBP/21.

Fifth, the sharp rise in housing costs also increasingly put home ownership beyond the reach of large numbers of potential owners. A longer period of waiting for home ownership has, therefore, become more common, in fact there may be a growing group of "enforced renters" who will never be able to afford to buy their own homes. This factor has assumed great importance in many countries, such as Australia, Federal Republic of Germany, New Zealand and Switzerland.

Sixth, by the middle of the 1970s most countries had succeeded in overcoming the quantitative backlog of housing need inherited from the past. This fact contributed to major national policy shifts in the late 1970s toward qualitative improvements in housing services, the rehabilitation of the existing housing stock, and the reduction of excessive shelter-to-income ratios of low income households<sup>1</sup>—shifts which also tended to elevate the importance of the existing private rental housing sector.

Finally, the historical preservation movement played a minor, though strategically important, role in enhancing the value of the private rental housing stock. The cities of Europe go back centuries, many well over a thousand years. Built mainly in masonry and designed with high architectural quality, the "old town" has long been an object of pride and loving care. But because of postponements of maintenance and repair during the Great Depression of the Thirties and during World War II and the early postwar period, a big backlog of work had accumulated, particularly in central cities. It is not surprising, therefore, that governments at all levels took an increasingly keen interest in preserving the architectural heritage, which of necessity involved to a very large extent inner city private rental housing.

In this reassessment that has been going on for the last five years, private rental housing has taken on new value and new appreciation in probably most of the industrialized countries of the world.

The maintenance of this sector has two major aspects: preservation of the existing private rental housing stock; and construction of new private rental housing. The next two chapters will examine policies which governments have adopted to cope with these two aspects. Another chapter will review programs which governments have undertaken on a significant type of rental tenure falling midway between public housing on the one hand and private rental housing on the other, i.e., rental housing owned by non-profit organizations. And a final chapter will review the evidence on the central issue: Is there a rental housing crisis among the industrialized countries of the world?

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<sup>1</sup> Cf. United Nations Economic Commission for Europe, Seminar on Housing Policy (Geneva, 1977), ECE/SEM 15.



Chapter III

PRESERVING THE EXISTING PRIVATE RENTAL HOUSING STOCK

A. The Struggle for a Fair Return on Invested Capital: The Nemesis of Rent Control

As a general proposition it is probably fair to say that people invest money in rental housing with the intent to earn a fair return on capital. The issue of what rate is a fair rate will differ from country to country and admits of no single, definitive reply. But put very simply, if there is no assurance, or at least a prospect, of a fair return in the long-term, then investors will, other things being equal, place their money elsewhere.

Invariably rent controls have come into being in a disequilibrium situation, i.e., where a sudden and drastic restriction in the supply of, or an expansion in the demand for, housing would enable landlords to charge exorbitant rents and thus obtain an excessive rate of return on capital. Rent controls, therefore, are a necessary and legitimate protection for workers in the short-run against the traumatic effects of events such as war. But experience after the First and Second World Wars reveals clearly the way inequities creep into rent control systems in the long-term.

1. Deficiencies of Rent Controls

Rent controls in European countries generated several sorts of distortions over the long-run.<sup>1</sup> First, they created serious inequities among renters. With building costs, interest rates and land costs rising rapidly, as tended to happen most everywhere under postwar conditions, the result was excessively low rents for long-standing tenants, i.e. the "haves", and excessively high rents for recent entrants into the housing market, i.e., the "have nots", such as young couples, war veterans and workers moving to growth areas and industries.

Second, rent controls led to inequities between renters and landlords. For example in 1947, average rents in Italy and France fell to 0.5 and 1.3%, respectively, of average family income. Rents often did not cover the landlord's operating costs, much less yield a fair return on capital invested. Moreover, stereotyped thinking about landlords tended to obscure the fact that many had acquired property for retirement income. For example, in the United Kingdom in 1975 over half of the rental housing stock was owned by individuals, with apparently a majority of them being holdings of one property each.<sup>2</sup>

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<sup>1</sup> E. Jay Howenstine, "European Experience with Rent Controls," Monthly Labor Review, June 1977, pp. 21-28.

<sup>2</sup> Department of Environment, United Kingdom, Housing Policy, Technical Volume (London, HMSO, 1977), Part III, pp. 72-4.

Third, rent controls led to widespread physical deterioration in existing housing. With the costs of operation and living generally rising, fixed rents were increasingly a deterrent to proper maintenance and repair. The most important single justification for rent increases in most countries was to promote better maintenance and repair of the existing housing stock.

Fourth, rent controls were a negative influence on the supply of housing. If income to private rental housing is squeezed excessively and the prospect for reasonable relief is bleak, then there is a great incentive to sell the investment for owner-occupation, to convert the space to more profitable commercial use, or in an extreme circumstance to demolish the building and sell the land. In the last two cases, the national housing stock is depleted, while in all three cases, there is shrinkage in the private rental sector. And as far as new private rental housing is concerned, there is little or no prospect for new construction if there is no exemption from rent controls.

## 2. "Fair Rent" and a "Fair Return on Capital"

When it became apparent that it was not politically feasible in the calculable future to abolish rent controls, a new concept of "fair rent" emerged. The concept took many forms. The idea seems to have been first introduced by the United Kingdom in the Housing Act of 1965. Fair rent should take into account all the circumstances of the dwelling unit, in particular its age, character, locality and state of repair. It was not, however, to include any provision for scarcity value; rather it was to be a price which the market would determine in a situation in which demand and supply were in balance. The machinery for determining fair rents was simple. It was assumed that agreement between landlords and tenants would become "normal practice." If the two parties could not agree, they could call on the rent officer, who would help them settle on the "proper rent" in accordance with the Act. Finally, if the rent officer's view was not acceptable to either party, the rent would be determined by a rent assessment committee. In short, a fair rent was set by negotiation and arbitration among landlord, tenant and rent officer. Rents could be re-negotiated once every three years, but no specific provision was made that the rent should yield a fair return on capital.

Other governments adopted different approaches. Australia and New Zealand coming from a different historical and institutional situation have adopted "fair rent" principles that more or less coincide with market rents. In New Zealand the concept of an "equitable rent" was established in the Rent Appeal Act of 1973. Such a rent is what a reasonable landlord might expect to receive and a reasonable tenant expect to pay, having regard to the locality, the standard of accommodation, the State of repair, the prevailing level of rents, and a proper return to the

landlord. On application from the tenant, the valuer from the Government's Valuation Department establishes an "equitable rent" based on his analysis of the factors. If his recommendation is rejected, it goes to the Rent Appeals Board for final determination. The Board calculates 10% of the market value of the property and adds an allowance for taxes, insurance and maintenance and then compares the figure with market rentals of comparable properties. Rents fixed under the Appeal procedure are close to market rentals. There has been little incentive for tenants to use the procedure. In the State of South Australia, the "fair rent" principle is not intended to hold rents below the prevailing market level; rather it is to protect tenants from excessive rents. The onus is placed on the tenant to claim protection from the Residential Tenancies Tribunal, which decides whether the rent is excessive or not depending on comparable rents, current capital values, maintenance costs, services provided by the landlord, standard of accommodation and state of repair.

In 1974, Denmark developed the concept of an "economic rent", which must cover operating costs and actual capital costs, i.e., interest plus amortization of capital on the outstanding mortgage. Or alternatively, particularly in the case of old properties with low or zero capital costs (i.e., with little or no mortgage), economic rents might cover operating costs plus 7% of the 1975 assessed value of the property. Spain has also established 7% as a reasonable rate of return. By contrast, the Netherlands adopted 5% as a fair rate of return on invested capital.

Another variant was the "cost rent" concept applied by the Federal Republic of Germany to private rental housing that had received public grants and loans. As long as subsidies were paid, landlords were prohibited from charging a rent that covered more than costs incurred. As regards non-subsidized private rental housing, according to the Act of 1974 rents could not be increased more than once a year and could not exceed the local norm, that is, the rent paid in the district or in comparable districts for accommodation of comparable type, size, amenities, character and situation. The landlord was, however, permitted to pass on in higher rents any cost increases, such as increased interest rates or increased operating costs.

The Italian Law on Fair Rent in 1978 established the principle that the yearly rent must be 3.85% of the "conventional value" of the dwelling, but at the same time placed on the tenant responsibility for current upkeep. Heating, administration of the building, small repairs and the interest cost on major improvements were also borne by the tenant. The "conventional value" was based on standard building costs updated each year, and was corrected according to the following factors: cadastral category of the dwelling; city population; urban location; floor level; age of building; and state of conservation of the building.

In 1979, Austria adopted legislation stipulating that the calculation of rents should be in accordance with the principle of covering costs. Detailed guidelines for the determination of rents were to be issued by the Ministry of Construction and Technology in 1980.

In Sweden, beginning in 1978 rents in multi-family housing have been determined through a collective negotiation procedure, rent controls having been completely abolished in 1975. Landlords and tenants are encouraged to work through representative organizations. The Act specifies the forms and conditions for negotiations, which are normally expected to result in a written agreement. If agreement cannot be reached, the rent tribunal may resolve the issues. In certain cases, the tenant can request that the rent be appraised by the court. The court must then set a rent which is reasonable in relation to other dwellings of the same size and standard, using rents charged by municipal housing enterprises as a guide. A "reasonable rent", therefore, emerges as the objective of national policy.

Summarizing, in some of its applications, the "fair rent" concept seems to offer a practical way for achieving a genuine reconciliation of the tenant's need for protection against excessive rents which exploit a scarcity situation and the landlord's need for a fair return on capital. Other applications seem to fall short of this realization. In the United Kingdom, for example, the Francis Committee which was set up to review the rental market situation in 1971 concluded that, nationally, fair rents were on the average about 20% below free market rents.<sup>1</sup> The subject is worthy of further research.

## B. Rehabilitating the Existing Private Rental Housing Stock

To cope with the worsening private rental housing situation, governments felt compelled to adopt a wide variety of measures to rehabilitate the existing housing stock.<sup>2</sup> Two major phases can be distinguished in the formulation of policy: first, the repair of individual housing structures; and second, the development of the area approach.

### 1. Improving Individual Structures

The simplest remedial effort has been the payment of subsidies to improve the basic services of the dwelling unit, particularly plumbing facilities: bath or shower with hot and cold water supply; a wash hand basin with hot and cold water;

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<sup>1</sup> United Kingdom, Report of the Committee on the Rent Acts (London, HMSO, 1971), Cmnd. 4609, p. 62.

<sup>2</sup> Cf. Harold L. Wolman, Housing and Housing Policy in the U.S. and the U.K. (Lexington, Mass., Heath, 1975), Chap. 4.

kitchen sink with hot and cold water; and inside flush toilet. The general objective was to upgrade the quality of the housing stock so that households could enjoy minimum housing standards.

Early in the postwar period, in the Housing Act of 1949, the United Kingdom established access to fixed standard grants to install the above basic amenities as a basic right. This investment was expected to provide satisfactory accommodation for at least thirty years. The size of the grant, which covered about half of the cost of installation, was increased at intervals as building costs climbed. For landlords, the inducement was never sufficiently high to achieve the hoped-for results. Even with a liberalization of subsidy terms in 1971, only 16% of 454,000 improved dwellings in 1973--the peak of the program--were privately rented. Other governments adopted similar programs, generally applicable to both owner-occupied and rental housing.

As concern for the aging housing stock heightened in the 1970s, most governments adopted more comprehensive financial rehabilitation programs. In France, the National Fund for the Improvement of Housing started making direct subsidies for rehabilitation of existing housing in 1971 covering 30 to 40% of costs. In 1973, subsidies were placed on a fixed price basis for specific improvements, and in 1975 the amount of the grant was increased up to 50% of cost, depending on the magnitude of the improvement. The minimum qualifying grant was Fr. 2,500 (approximately \$535).

In 1973 Sweden offered special grants of 20% of the approved conversion cost with a maximum of SKr 6,000 (approximately \$1,200) to stimulate the building industry's activity in rehabilitation.

Since 1974, Denmark has given direct grants to cover 25% of maintenance, improvement and insulation costs for all types of housing. In 1980 the Government adopted a new Urban Renewal and Housing Renovation Act which sets up an interest-guarantee system to help finance urban rehabilitation. The guarantee subsidizes for a period of four years interest costs exceeding 6%, after which time the subsidy is phased out in accordance with price and wage adjustments. The program will be completed in fifteen to twenty years. A recent study showed that about 500,000 houses are substandard, two-thirds of which are in the private rental sector.

Under the Housing Modernization Act of 1977, the Federal Republic of Germany subsidized a wide range of improvements in existing housing, i.e., shape of dwelling;

lighting and air conditioning; thermal insulation; sound insulation; energy and water supply; drainage; sanitary installations; heating and cooking facilities; and protection against theft and violence. The assistance was granted only on the following four conditions: that the dwelling was considerably improved; that the cost was justified in relation to the expected life of the dwelling; that financial arrangements were guaranteed; and that the dwelling would provide appropriate accommodation for diverse groups of people. These improvements were designed to meet five objectives: to remedy unsound housing conditions; to conserve buildings having historical or architectural significance; to remove social hardship; to avoid unbearable increases in rent; and to contribute to the community's urban development. According to an agreement between the Federal and state governments, annual subsidies not to exceed 7.2% of cost were extended for modernization work. Every three years the amount of the subsidy was reduced by a third.

Austria has a program which, as amended in 1978, extends a 40% subsidy to rental housing for the repayment of principal and interest on housing improvement loans made on the capital market. There are two main requirements. First, the dwelling after modernization must correspond to a publicly assisted new dwelling as regards its size and facilities. Second, the modernization costs per square meter ( $M^2$ ) must amount to at least 25% of the entire building costs per  $M^2$  for publicly-assisted new housing.

Switzerland has extended its home owner financial assistance program to include renovation of existing rental dwellings; approximately 20% of the nation's apartments are in need of renovation. In a special program to renovate 11,000 apartments in 1977-78, annual Federal subsidies extending for a period of six years amounted to 2% of total renovation costs.

With conservation of old residential areas and dwellings being one of the central problems of national housing policy in the latter half of the 1970s, the Finnish National Housing Bank extended its loan facilities to private rental housing. Loans were made for 25 years up to 60% of the cost of the renovation work when low-income households were involved.

To assist with the repair and improvement of family units, Canada extends loans to landlords of rent-controlled properties, with a forgiveness clause of up to \$3700 over a 5 year period. Belgium and Norway provide similar rehabilitation loans for rental housing.

A closely related type of subsidy has been financial assistance for the preservation of buildings having historic value. France has a legislative policy on historical preservation dating from 1913, which was reinforced in 1930 providing for the protection of historically significant structures and their immediate surroundings.

In 1973 Sweden adopted special provisions for the modernization of buildings with historic value. The Federal Republic of Germany and the Netherlands have similar programs. This type of rehabilitation—generally available to both owner-occupied and rental property—tends to be much more costly than standard improvements in non-historical dwellings and frequently involves a high degree of expertise to restore original facades and interiors.

## 2. The Area Approach

Experience with programs concentrating on the rehabilitation of individual structures rather quickly demonstrated two truths. Investment in improving isolated individual structures may be lost, if meanwhile the neighborhood is deteriorating badly and the whole area is later cleared and developed. Conversely, the impact of rehabilitation efforts may be maximized only if there is simultaneous improvement in the whole community. Accordingly, most governments have tended to move toward an area approach in their rehabilitation programs.<sup>1</sup>

The area approaches have been many. The first British area approach in 1969 concentrated on voluntary action through informal and flexible procedures, higher grants for house improvements and a new grant for environmental improvements. Local authorities were given power to declare "general improvement areas". The response was dramatic; requests for dwelling improvements practically doubled from 1969 to 1971, but the private rental sector was the least responsive. The second phase of United Kingdom policy came in 1974 with the concept of "Housing Action Areas". This approach provided greater powers to enforce action, e.g., through the power of acquisition of properties, and telescoped the time frame to five years. Normal grants were raised from 50 to 75% and even to 90% in exceptionally needy cases; discretionary repair grants were introduced; and larger environmental grants were made available for such works as street repair, stone cleaning and planting.

France has developed a so-called "grouped operations" approach—originally introduced under the Malraux law to promote historical preservation in 1967—that was applied to conservation programs generally in 1972. Working through Local Centers for Housing Improvement, it has a special economic rationale. By grouping a number of applications for rehabilitation work into a single job, it is possible to achieve economies of scale by letting contracts to the lowest bidder. At the same time there is from the urban planning standpoint the potential of restoring an entire neighborhood on an upward trend. Within the area, property owners are required to upgrade to established standards. They have three options: conduct the work themselves; delegate the work to the Local Centers; or cede the building at a fixed price to the Center, retaining the first right to acquire it after

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<sup>1</sup> Cf. J. Robert Dumouchel, European Housing Rehabilitation Experience (Washington D.C., National Association of Housing and Redevelopment Officials, 1978), pp. 84-5.

rehabilitation. The approach was revised in 1976 under the title "programmed operations". Larger districts were set up; environmental improvements were integrated with housing rehabilitation; compulsory powers were dropped; and only 60 to 75% of the dwellings were targets for upgrading.

The Netherlands followed generally the British model. They sought to improve individual dwellings, while carrying out improvements in the immediate neighborhood by facilitating traffic movement, providing more play areas and redesigning where necessary the layout of streets, squares and public gardens. The investment was considered justified, if rehabilitation made the neighborhood viable for another 25 years.

One half of rehabilitation subsidies in the Federal Republic of Germany has been directed to "modernization zones" designated by local governments for a period of five years. To qualify, 50% of the housing stock within such zone must need modernization. The law prevents landlords from displacing tenants to carry out modifications, and from carrying out works against the tenants' wishes. Modernization costs can also be written off against income tax at an accelerated rate. Canada, Denmark and Finland have adopted similar neighborhood approaches, and Switzerland envisages it in the future. In 1979, Norway decided to give priority to simultaneous, area-wide renovation.

The area approach is not without certain deficiencies, however.<sup>1</sup> First, it has led in some cases to what has now become labeled as "gentrification", that is, the forcing out of older, poor residents by new, more affluent persons as a result of increased rents and housing costs accompanying urban rehabilitation.

Second, the profits to be made from marked increases in housing prices as a consequence of urban rehabilitation have given uncaring landlords incentives to evict or harass tenants to get occupancy of potentially valuable improvable houses.

Third, concentrated area programs have greatly increased management costs (while no doubt also increasing the quality of the delivery of public programs). A U.K. study estimated that the Housing Action Area (HAA) programs in Birmingham required 13 times as many professional staff per 1,000 houses as did the General Improvement Areas (GIA), and that the 1975 annual cost of estimated time per HAA house was about £472 (approximately \$950) as compared to £35 (approximately \$75) for a GIA house.<sup>2</sup>

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<sup>1</sup> Cullingworth, op. cit., pp. 88-97.

<sup>2</sup> Tim Mason, "Politics and Planning of Urban Renewal in the Private Housing Sector", in Urban Deprivation and the Inner City, edited by Colin Jones (London, Croom Helm, 1979), p. 155.



Fourth, studies in the U.K. have shown that housing need is widely distributed. Concentrating public subsidies solely or mostly on designated areas discriminated against needy households outside these areas. Fifth, certain types of substandard areas perform an important social function for certain types of people, e.g., youth, recent movers, refugees of various sorts. If, therefore, the rehabilitation program changes the physical character and economic cost of a neighborhood, the social function may also be terminated.

Finally, urban deterioration is due to housing dynamics of a broader nature than the neighborhood focus. Too much decentralization of power to local authorities may diminish the effectiveness of a concerted national effort on this front. Moreover, correction of housing stress in selected areas may merely push out the forces of urban deprivation into other areas.

### 3. Hardship Subsidies to Private Renters

Consumer subsidies have played an increasingly important role in helping to rehabilitate the private rental housing sector. In most countries it seems to be the general rule that wages and salaries for those in the active labor force and consumer prices increase at a more rapid rate than rents.<sup>1</sup> Consequently, no basic problem of social equity is raised for the great mass of people when rents are increased to keep pace with rising costs generally, although of course vehement outcries may be registered. But poor persons on fixed incomes do encounter real hardship when rents are increased to relieve the financial squeeze on landlords. It is, therefore, a simple and equitable solution to provide a housing allowance or rent rebate to relieve the financial squeeze on the hard-pressed renter. As a matter of fact, the introduction of or an increase in consumer housing subsidies may almost be a political condition to obtaining relaxation of rent controls. This was particularly true in the movement toward rent equalization on which many governments embarked in the 1960s.

In 1955, the Federal Republic of Germany appears to have been the first country to link consumer housing subsidies with relaxation of rent controls as a major instrument of national policy. The amount of the housing allowance was based on the principle that housing expenditures should be kept below 10% for families with very low incomes, rising to 20% for those with incomes just under the eligibility limits.

Denmark and the Netherlands adopted a similar approach in 1967. Denmark envisaged the progressive phasing out of rent control over an eight year period; Netherlands over a ten year period. The assumption was that during the previous

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<sup>1</sup> E. Jay Howenstine, Housing Costs in the United States and Other Industrialized Countries, 1970-1977 (Washington, D.C., Department of Housing and Urban Development, 1979), pp. 14, 19.

decade the incomes of most persons had increased sufficiently that they could afford to pay higher rents without exceeding a fair shelter-to-income ratio--in the case of Denmark 20%; in the case of the Netherlands between 10 and 19% for families.

Ireland also followed the principle in 1967 with a differential rent policy that adjusted rents to the tenant's income and family circumstances as rents generally were moved upward toward a free market level.

In the early 1970s both France and Austria introduced housing allowances to relieve the hardship which increased rents imposed. The French legislation limited the application to the elderly and the handicapped, while the Austrian law applied to low income families generally. The 1976 housing reform in France, inter alia, extended to rental housing companies the right to housing allowances on the part of the renters on the condition that banks would charge less than the going market interest on private sector loans.

When landlords agree to rent to low income families at rentals based on income, the Canadian housing allowance covers the difference between the subsidized rent paid by the tenant and the full market rent normally charged. The Federal Government and the Provincial Government split the cost 50-50. In Finland the housing allowance which goes mainly to tenants in rental dwellings has reduced the average shelter-to-income ratio from 31% to 15%. In 1973, the Norwegian Government increased its housing allowance substantially to overcome individual hardships, particularly for the elderly, resulting from the raising of rents following relaxation of rent controls and the raising of interest rates on existing mortgages on older housing.

#### 4. Tying Rent Increases to Improved Maintenance and Repair of Existing Rental Housing

The argument that landlords need "fair rents" in order to pay for the maintenance and repairs that are required to provide the tenant with decent housing services is cogent. But there is no assurance--particularly after a long period of rent restrictions--that the landlord will use the income from rent increases for such purposes. It may be in his short-term interest to spend the income for other purposes and further neglect the condition of his property.

Consequently, governments have often accompanied rent increases with a specific injunction that a proportion of the increase be earmarked for expenditures on repairs and improvements. For example, the U.K. made an increase in rents conditional on the use of some of the rent income to improve the state of repair of the housing unit. If the landlord failed to execute his part of the arrangement, then the rent increment could be disallowed or the tenant could obtain repayment of the increment. In Denmark the 1974 Act specified that 15% of the increased rent income on pre-1949 housing should be set aside for maintenance.

France has a somewhat related policy. To induce landlords owning pre-1948 rental dwellings to modernize, a 3.5% surtax was levied on their leases, the proceeds of which were used to subsidize improvement works on rental housing.

Denmark adopted still another ingenious way of recapturing some of the "windfall gain" from increased rents on pre-World War II housing that was built at comparatively low cost levels. In embarking on its comprehensive rent equalization program in 1967, the government specified that 50% of the rent increase on privately owned housing during the forthcoming eight years should be paid into a special Landowners Investment Fund controlled by a Board made up of landlords, tenants and government officials. These funds then became available for loans at low interest rates to landlords to carry out improvements to their property. The Fund's effectiveness has been limited, however, by rapidly rising building costs.

## Chapter IV

### STIMULATING NEW PRIVATE RENTAL HOUSING

The traditional source of financing for private rental housing in most European countries appears to have been the propertied classes. Considering the density of occupancy, investments in land and buildings were respectable, secure and reasonably profitable.

After World War I, the situation changed. Many fortunes, particularly those based on land ownership, were broken up, rent controls tended to undermine the profitability of investment in housing, and new forms of housing tenure developed. During the interwar period and after World War II, a new type of enterprise, the building company, emerged. On the financial side it assembled credit from the private capital market, and on the construction side it acquired and developed land and proceeded to build flats (i.e., apartment houses). From information available it also appears that a large part of investment in rental housing came from individuals who owned no more than one or several dwelling units. This is certainly the case in Australia, Denmark, the Federal Republic of Germany, New Zealand and the United Kingdom and appears to be true of Japan. In Japan 55% of the funds invested in rental housing in 1973 came from personal savings and only 36% from commercial financial sources.<sup>1</sup>

Sensing the useful contribution of the private investor-builder to the solution of the national housing problem, it was not long before governments were taking steps to encourage private rental housing.

#### A. Freedom From Rent Control

As observed in Section III A (1), under the rent control system in most European countries in the early postwar period existing private rental housing was not able to earn a fair return on capital invested. And in spite of good intentions in some quarters to remedy the situation, fundamental obstacles remained. Clearly owners of rental property had little alternative but to accept the situation, limited as they were by the security of tenure that tenants had acquired by law.

With regard to the construction of new rental housing, however, the situation was quite different. If investors were to have sufficient incentive to build new rental housing, it was rather obvious that they should be free from the application of rent controls. It appears that governments generally adopted this principle. But still more positive support was needed on the part of governments if the private rental market was to prosper.

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<sup>1</sup> Ministry of Construction, Japan, Housing in Japan: '75 (Tokyo, 1975), p. 48.

## B. Capital Support—Alternative Mortgage Terms

The last fifteen years have seen far-reaching changes in systems of financing private rental housing in industrialized countries.<sup>1</sup> Traditionally, both owner-occupied and rental housing were financed on the basis of fixed annuity mortgages. This system worked passably well in an era of stable interest rates and building costs, but it nevertheless had a basic flaw: it took no account of the time profile of the borrower's expected life income. To overcome this objection to home ownership financing, a number of governments adopted the principle of scheduling the rate of mortgage payments to accord with the rising life-cycle curve of family income. As family income rose on account of advancement and rising productivity of the wage-earner(s), the annual cost of housing was also increased.

The inflationary surge of recent years has posed additional acute problems for both home ownership and rental housing. Sharp rises in interest rates and building costs raised housing costs and rents beyond the reach of the mass of low- and moderate-income families. Moreover, they led to distortions in the housing market, with rents on new housing far out of line with rents of equivalent accommodation in the existing housing stock. To cope with this problem, governments applied the similar principle of scheduling the rate of mortgage payments to take account of rising interest rates and building costs as well as rising income. As household income and building costs rose from general inflation, rents were increased accordingly.

In creating a new flexible mortgage instrument, governments had three factors with which to work. First, they could reschedule rates of amortization of the capital loan itself different from the conventional flat rate system. Second, they could reschedule rates of interest payment different from the traditional fixed rate system. Third, they could institute a flexible interest subsidy system to facilitate a rescheduling of mortgage payments of principal and interest aiming to bring rents within reach of low- and moderate-income families.

Norway was the first country to revise its national housing policy in 1966. The first mortgage normally obtained from the Norwegian State Housing Bank required no payment of principal during the first five years, a 0.5% rate of payment the

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<sup>1</sup> Cf. E. Jay Howenstine, Foreign Housing Subsidy Systems (Washington, D.C., Department of Housing and Urban Development, 1973), National Technical Information Service, No. PB 233 891, Chapter III; Organisation for Economic Co-operation and Development, Housing Finance: Present Problems (Paris, 1974), Report No. 2, "Time-Path Problems of Debt Service and Their Implications for Financial Institutions and Financial Markets".

second five years, a 1% rate the next five years, and a much higher rate to be determined after the initial 15 year period during which the second mortgage covering 30% of the cost was to have been paid off. The second mortgage was paid off at the rate of 5% for the first five years, 6.5% for the second five years, and 8.5% for the third five years.

In practice, it was found that, while desirable, the rescheduling did not go far enough to reach the needs of young married couples. Consequently, a new "levelling loan" system was introduced in 1973 to include rescheduling of interest payments as well. The system was based on the assumptions that the average annual increase in wages was 6%, that three-quarters of the wage increase should be applied to higher housing costs, and that 20% of the wage-earner's income should be devoted to housing expenditures. The government decided that an initial interest rate of 4.6% (later reduced to 4%) was reasonable, and that the difference between the 4.6% collected and the 5.5% charged should be added to the principal. When the interest rate on payments rose to 5.5%, the loan principal reached its highest level; thereafter the process was reversed and repayment proceeded at a progressively higher rate. The system applied to private rental housing as well as owner-occupied and cooperative housing.

In 1968 Sweden adopted a "parity loan" program, in abolishing its production subsidy system providing interest subsidies for social housing. Traditionally, borrowers obtained 70% of cost on first and second mortgages from private banks, and a state housing loan for the balance on a third mortgage, all on a flat annuity basis. The new system assumed that in the long-run building costs would increase at an annual rate of 3%, and that increases in the interest rate, starting at 5.1%, would not rise above 6%. From the interest payments made, the first and second mortgages were serviced first, with the remainder going to the state housing loan. During the first eight years interest payments did not cover the full carrying costs of the third mortgage; hence the amount of the loan rose accordingly. After eight years, amortization on the third mortgage started on a progressive schedule with the expectation that the total loan would be repaid in 25 to 30 years.

Unhappily, with interest rates rising higher than 6% while building costs were increasing less than 3%, the "parity number" resulted in excessive rent increases. As a consequence, the "parity loan" program was superseded by a new system in 1975 that restored interest subsidies. This system established 3.4% as a reasonable rate of interest (a guaranteed rate), with the proviso that it is increased 0.25% annually. The government then granted interest allowances to cover the difference between the rising guaranteed interest and the general loan market rate, which in 1980 was 11%. When the guaranteed interest rate equalled the general level of interest in the credit market the subsidy ceased.

In the early 1970s, Finland adopted a plan to lower housing costs during the early mortgage years and to increase them in later years so that the cost ratio of new to old dwellings would on the whole remain in line with the use values of the houses. Amortization rates were rescheduled with no repayment of principal in the first years and higher rates in later years. Likewise, interest rates were low at first (zero on the second state housing mortgage) and then increased in the course of the loan period. The plan developed several weaknesses. The system was relatively rigid and administratively hard to change. Moreover, housing cost increases came with jumps and not in an even progression.

The Netherlands adopted a sophisticated "dynamic cost-price rent" system in 1975 to implement the same general objectives. The basic concept was that the effective initial rate of interest on housing loans could be lower than the high market rate, because the latter included a premium for the expected loss of purchasing power on account of an anticipated inflationary trend. The theory was that, rather than compensate for this loss of purchasing power by charging higher interest rates in the present, the compensation should be in the future in the form of additional loan value and higher rent income which would tend to follow rising costs of new construction.<sup>1</sup> Under the system, the investor received a yield guaranteed by the government. The "basic rent" was equivalent to 5% of the capital invested, which the government believed was a fair return on housing intended for average income groups. The gap between the basic rent and the rent calculated according to the dynamic cost-price rent formula was then covered by a direct subsidy to the investor. For example, when the dynamic cost-price rent was 5.7% (1978), the subsidy was 0.7% of the capital investment. Under the formula, repayments of principal to the state by the borrower kept pace with the yearly rent increases which were approved by the government.

France undertook a major reform of its housing finance in 1977, which now provides one standard form of loans for all rental housing—both private and non-profit sponsored. The Credit Foncier, the national loan bank, extends loans ranging from 55 to 95% of cost for a period of 34 years with a 2 year period of deferred amortization; there may also be an interest waiver of 2 years and 3 months. Interest rates are as follows: 5.5% for the first 6 years; 6% for 4 years; 7.5% for 7 years; and 9.85% for the balance of 17 years. The loan carries a 20% subsidy.

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<sup>1</sup> J.W.G. Floor, Rents, Subsidies and Dynamic Cost (Hague, Ministry of Housing and Physical Planning, 1972).

The Federal Republic of Germany has a complex subsidy system which extends (among other types of tenure) to private rental housing and is administered through the Lander (the states). The terms vary among the states. The rate of interest is around 4%, but can be lower and even zero on public loans that may range as high as 65 to 70% of cost. Amortization is 1% for the first 35 years, and thereafter is normally increased. Operating subsidies, varying from DM 0.60 (approximately \$.25) to DM 1.10 (approximately \$.45) monthly per M<sup>2</sup> of living space are generally granted for a period of five years. In addition annual subsidies for 7 to 10 years are available to lower interest and amortization on loans obtained on the capital market. To qualify for financial assistance construction must not exceed certain standards, and the income of occupants must not exceed certain limits. Rents must exceed neither ceilings established by different states nor 30% of family income.

Belgium has created a National Housing Society to promote rental housing by private companies and non-profit organizations. The society extends loans at 1-1/2% interest to approved construction companies for a period of 66 years on certain conditions. Construction must comply with specific standards, and dwellings must be let at limited rents to tenants with incomes below specified ceilings taking into account the size of the family and the location of the residence.

The Swiss system for subsidizing private rental housing contains an interesting built-in, long-term compensatory mechanism that takes advantage of probable continued rises in the price structure. If a developer is unable to obtain financial backing in his own region, the Federal Government negotiates a loan through banks in other regions up to 90% of cost on the basis of a government loan guarantee. A government interest-bearing loan is extended to the developer to enable him to reduce rents approximately 23% below costs, by fixing an annual rent increase of 3% for a period of 25 years. After 10 years it is assumed that the rent increases to a level necessary to cover costs, and in the succeeding 15 years steadily rising rents yield sufficient income to repay the loan. To lower rents for low income households the Federal Government provides a constant non-repayable subsidy for 10 years which permits an additional rent reduction of 7%. Thus rents paid during the first years of occupancy cover 70% of costs. To provide still lower rents for the elderly and handicapped, a second non-repayable subsidy for a period of 25 years is available to rental companies. This subsidy reduces the rent another 19% or a total reduction of 40% of the economic cost. These subsidies are available only when there is a proven shortage of certain categories of apartments in the applicant's district and only when certain minimum construction requirements are met.

In Japan the National Housing Loan Corporation established in 1950 has extended loans at below-market interest rates to landlords who construct rental housing above a fixed scale, provided the land is mortgaged along with the building.



Dating back to 1938, Canada has used an interesting device--the limited dividend corporation--to promote the construction of private rental housing. Up to the late 1960s the Central Mortgage and Housing Corporation provided a mortgage covering 95% of cost for a 50 year period at market rates of interest. As interest rates rose, it became more and more difficult to produce competitive rentals for low- and moderate-income families.

In addition to the limited dividend corporation program, in 1975 the Canadian Government adopted a new Assisted Rental Program (ARP) program which contained two options. It will either guarantee the mortgage with a private bank at market rates of interest for a minimum period of 5 years. Or it will provide the mortgage directly at a low interest rate for up to a maximum of 35 years, with the provision for possible readjustment of interest rates every 5 years. In either case, the Corporation also extends an interest-free second mortgage up to a maximum of \$1,200 per dwelling unit, the principal of which is decreased one-tenth annually. In 1979 the interest-free second mortgage was changed to a "payment reduction loan", i.e., a second mortgage not exceeding for the first year an amount equal to \$2.25 per month for each \$1,000 of the first mortgage.

### C. Tax Concessions

Tax concessions have been widely used--and very effectively--by foreign governments to stimulate home ownership,<sup>1</sup> but they have been less frequently used to promote private rental housing.

Accelerated depreciation allowances for investment in private rental housing are used in at least two countries. In the Federal Republic of Germany owner-occupiers who build two dwelling units, one for their own occupancy and one for rental (a rather common European pattern), can deduct 5% of the cost for eight years and 2.5% thereafter. Landlords may also deduct debt charges, maintenance and other expenses from income taxes up to the imputed rent of the property<sup>2</sup>. Japan provides accelerated rates of depreciation to improve the attractiveness of investment in private rental housing.

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<sup>1</sup> Cf. E. Jay Howenstine, "Innovations in European Home Ownership Policy", Construction Review, April 1975, pp. 4-10.

<sup>2</sup> Michael Harloe, Private Rented Housing in West Germany (University of Essex, Colchester, United Kingdom, 1979, unpublished manuscript), p. 50.

Australia--contrary to the practice in many industrialized countries--does not make mortgage interest payments tax deductible for home owners, but it does extend this privilege to landlords. By heavily mortgaging rental properties, the Australian investor can reduce his taxable income to zero and some even make losses which can be offset against earnings from other sources. The opportunity to use the tax system in this way has been a major reason why landlords have been willing to accept relatively low initial rates of return in the early years on their investment.<sup>1</sup>

Canada offers a tax shelter inducement to investment in rental housing through relaxation of the capital cost allowance provisions of the Income Tax Act. The owner may deduct from other income the amount by which expenses of a new rental project (which under the Multiple Unit Residential Building Program may include a capital cost allowance even if it creates a loss) exceed revenue. France has approached the issue in a different way. Real estate companies which build social housing subject to rent limitations are exempt from corporate income taxation, and the dividends they distribute are only partially taxable.

Exemption from land taxes--a widely used instrument in regional development policy--has been extended to include rental housing. In the Federal Republic of Germany land tax relief for a period of 10 years is offered to private rental housing ventures; exemption has also been extended to land transfer duties amounting to 7% of the price of the land. France has also provided exemption from local community taxes.

Still another tax concession that was applied by Norway until 1967 was exemption from the general turn-over tax, which at that time was 20%. In 1968 the Government substituted a capital grant based on the size of the dwelling.

A Committee appointed by the Finnish Government in 1980 to examine the causes of a disturbing decline in the private rental housing stock (i.e. an annual loss of 10,000 dwellings or 1.8% of the total rental stock) has an interesting recommendation to increase the supply of private rental housing. It would exempt the first \$650. of annual rental income from (a) income taxation, and (b) the deductions made against social security pensions. This would increase the willingness of the small landlord to rent his property.

#### D. Subsidies to Renters

Section III B (3) above described the widespread use of consumer subsidies to ease hardship on tenants with fixed incomes arising from an increase of rents on existing housing.

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<sup>1</sup> Simon Whiteley, Private Rented Housing in Australia, op. cit., pp. 57-8.

Chapter V

RENTAL HOUSING PROVIDED BY NON-PROFIT HOUSING ORGANIZATIONS

A. European Tradition and Practice

There is a long European tradition of what might loosely be called organized self-help that is rather different from U.S. experience. While the U.S. had an almost inexhaustible frontier to absorb the energies and satisfy the ambitions of every person so moved, Europe had no internal safety valve; it was the U.S. itself that to a large extent provided the haven for the oppressed, but free, spirits. While the U.S. had an open society with a fairly responsive governmental structure, European countries were confronted with a more closed, less responsive type of society rooted in ancient traditions of autocratic monarchical power and in varying degrees of class structure inherited from a land-owning aristocracy and perpetuated by the rising bourgeoisie.

One of the few ways the leadership of the masses had to deal with this situation, pending the day when Social Democratic parties were voted into national office, was to create their own sources of power by organizing. The trade union was the single most important instrument. The consumer cooperative was another, in fact the two often went together. A third structure was the philanthropic enterprise designed to improve the lot of the poor. These not-for-profit organizations--well established in the life of the people--were, therefore, ready to take on a new function of providing housing for workers when in the interwar and postwar periods the concept of social housing came to fruition. To the above three types should be added a fourth--the so-called public utility company, which became popular in a number of countries after World War II. The public utility company was a quasi-public body--the creature of the state in authority and financial resources--but in its management and operation outside the trappings of government and in many cases involving a considerable degree of tenant participation.

From modest and straggly beginnings, today the non-profit housing organization has emerged as one of the principal providers of rental housing in many countries.

Since 1949 in the Federal Republic of Germany non-profit housing associations have constructed about one-third of new housing and one-half of all rental dwellings. HLM housing (Habitations a Loyer Modere) in France has constituted over one-half of new postwar housing. In the Netherlands, roughly one-third of new housing has been constructed by non-profit organizations, and high levels have been reached in Denmark and Sweden. One of the best known and largest single organizations is the Swedish HSB (Tenants' Savings and Building Association) founded in 1923. With the support of special legislation, cooperative housing in Norway constitutes over one-half of new urban housing. In Ireland a 1969 White Paper announced a new policy of developing a strong non-profit housing movement. In Canada 1973 amendments to the National Housing Act included provisions to promote non-profit housing.

The escalating cost of new housing attributable to rising building costs, interest rates and land prices, has created a problem with which most governments have been struggling to cope, that is, the gap between the cost levels of the older and the newer housing stock.<sup>1</sup> The rising costs have resulted in big disparities between the rents of old and new dwellings, which cannot be explained by differences in use value, since they provide roughly the same level of housing services. Over the period 1970-77, in one-third of 16 countries (for which data are available) the rate of increase in costs of new housing exceeded the rate of increase in per capita income, and in all but two countries—Japan and Switzerland—the rate of increase in housing costs exceeded the rate of increase in the Consumer Price Index.<sup>2</sup> The question was: should the high rents of new housing be brought down to the low levels of the old housing? Or should the rents of the old housing be brought up to the level of the new housing?

In the early stages of dealing with this issue, governments were disposed to the former course of action. There was a feeling that to a considerable extent these cost increases might be temporary and that over the long-term the level would be stabilized more nearly in line with the cost structure of existing housing. It was also the cheapest alternative. To bring the rents of a small percent of the private rental housing stock down to those of the bulk of the stock was much more manageable financially than to attempt to raise the rents of the whole stock up to those of the most recent additions.

But in the light of persistent inflation in housing costs, governments gravitated to the concept of raising the rents of the old housing and lowering the rents of the new slightly so as to reach some happy medium. On the one hand this was promoted by the recognition that as a result of increased economic affluence wage earners were able to pay higher rents. And on the other hand it provided greater income to the landlords which could be used for better maintenance and repair and provide a fair return on capital. By adopting this policy a smaller (?) consumer type of subsidy for special hardship cases could be substituted for the original more general production subsidy for the building.

The rent harmonization programs on which many governments embarked in the late 1960s and early 1970s, however, did not resolve the question, since housing costs were increasing at a more rapid rate than rent adjustments. The issue remains.

It may well be that there is a still greater long-term problem of the income of renters lagging behind general rent levels geared to rapidly rising costs of new housing. If so, subsidies to ease the excessive cost burden on renters may become more and more a generalized need rather than a specialized need for hardship types of cases.

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<sup>1</sup> A. Andrzejewski and M. Lujanen, Major Trends in Housing Policy in ECE Countries (Geneva, United Nations Economic Commission for Europe, 1980), p. 22.

<sup>2</sup> E. Jay Howenstine, Housing Costs in the United States and Other Industrialized Countries, 1970-77, op. cit., pp. 14-7.

In the celebrated 1975 Housing Pact among the major political parties in Denmark, non-profit housing emerged as one of the major national objectives. A special concept of the housing association was developed in the United Kingdom during the 1970s which provides a form of tenure midway between the county council house of local authorities and private rental housing. Non-profit sponsored housing has been the most important form of publicly assisted housing in Austria, which adopted a special Act on the subject in 1979.

Trade union housing efforts have been particularly outstanding in the Federal Republic of Germany and Sweden. Neue Heimat, organized by the German building trade unions, owned over 400,000 dwelling units in 1977, while Svenska Riksbyggen, founded by the Swedish building trade unions, has accounted for one-tenth of new housing during many postwar years.

The remainder of the chapter reviews the principal ways that governments have promoted non-profit housing.

## B. Techniques for Promoting Non-Profit Housing

### 1. Loan Support

Without state support, it would have been difficult for non-profit organizations to reach a high level of housing activity. Consequently, most governments have been solicitous toward their capital needs.

Denmark, France, Spain and Switzerland have extended loans covering 95% of cost, with the French credit being available for a period of 34 years. Belgium and Canada have given 100% loans for non-profit housing projects. Austria loans up to 90% of capital cost. Loans for land acquisition in the Netherlands are for a period of 75 years, while building loans are for 50 years.

In Sweden and the Federal Republic of Germany, where the resources of the capital market are considerable, the public loan has been mainly in the form of a third mortgage, in Sweden 30% and in Germany up to 40%. In Denmark where the resources of the capital market are less extensive, the public loan in the form of second and third mortgages has usually represented 60% of capital cost.

### 2. Loan Guarantees

Some governments have provided loan guarantees in addition to or in lieu of direct loan support. In the Netherlands, municipalities offer guarantees to mortgage institutions of up to 90%, with the central government being responsible for half the loss in case of foreclosure. The Swiss Federal Government not only arranges for mortgage credit up to 90% of cost for a non-profit housing organization which cannot find loan capital in its own region, but it also guarantees the loan.

Denmark provides a special kind of guarantee to non-profit organizations which protects them from short-term instability in interest rates. In the traditional system, mortgage credit institutes issue long-term bonds which are sold on behalf of the non-profit organization in the private capital market in competition with corporate and government bond issues. If the market rate of interest rises above normal (i.e., 6%), the government protects the non-profit organization in carrying out its building program by covering that portion of interest costs exceeding 6%. The guarantee system is maintained for four years, when it is phased out in accordance with price and wage adjustments.

### 3. Capital Grants

Considering the special contribution which the mobilization of the energies and resources of non-profit organizations can make in increasing the supply of rental housing, many governments have opted for the simplest form of subsidy: the capital grant. This type of subsidy has the advantage of keeping the capital cost of new housing more nearly at the level of the existing housing stock, and it avoids the continuing burden on the financial budget that is involved in interest and operating subsidies.

The Danish Government extends a non-repayable capital grant to non-profit organizations amounting to 23% of cost. In France 20% of the government loan amounting to 95% of cost is written off as a capital grant. The Canadian system provides a capital grant equal to 10% of cost, plus a start-up grant of \$10,000 for sponsor groups.

The Netherlands lowers initial capital costs by two special subsidy systems. A location subsidy enables sponsors to write off a portion of high land costs, which would otherwise inflate rent levels. Second, subsidies are available to adapt dwellings to the needs of handicapped persons.

### 4. Interest Subsidies

Probably the most usual form of financial assistance has been production subsidies in the form of below-market rates of interest. In some countries, loans carry a zero rate of interest. For example, in Denmark one of the planks in the 1975 Housing Pact was the provision of interest-free loans on 23% of the capital cost, the principal of the loan to be repaid when the housing development was "economically on its feet"—or within a maximum of 50 years. On the other 73% of the cost, the government loan carried a 6% interest rate for a period of 5 years, after which it was adjusted to the going market rate. The interest rate in Finland has varied from zero to 3%.

The Belgian National Housing Institute has charged 1-1/2% on its loans. Canada, France and the Netherlands have extended loans with varying degrees of interest subsidy.

The Swedish form of interest subsidy is rather unique. The Government guaranteed a starting interest rate of 3.9% on its loans to non-profit organizations, which was raised each year by a predetermined amount, i.e., by 0.15% each year for the first five years and 0.2% thereafter. The government then covered the difference between the guaranteed rate and the market rate until such time as the two rates coincided, which was estimated to be 23 years.

##### 5. Operating Subsidies

Subsidies toward operating costs have a special appeal to many governments. They perform a function on the production side analogous to that which housing allowances perform on the consumer side. By covering part of the annual operating costs (including perhaps charges on capital), they make it possible to charge lower rents. Then as rents rise, pari passu, with increases in consumer incomes, the subsidies can be tapered off unceremoniously.

The introduction of operating cost subsidies in the Federal Republic of Germany came as a part of the general policy to restrict the public share of housing finance from 44% in the early 1950s to around 6% in 1972. This form of subsidy was substituted for subsidies on direct loans.

Ireland and the Netherlands have offered operating subsidies for a fixed initial period as an incentive for non-profit organizations. In Ireland, the government subsidy covered one-third of the annual loan charges for the first 7 to 10 years. The Dutch subsidy was for a period of 10 years to help cover interest charges, capital repayments, management and maintenance costs. It was reduced each year as compulsory rent increases raised the operating income of the non-profit organization. The Netherlands also has three other types of special operating subsidies. One, called the "good and inexpensive" subsidy, is an extra annual grant toward operating costs when outstanding design has added greatly to the quality of the housing. Another is paid in cases where experimental design has involved higher capital outlays. A third provides an annual subsidy of FL.400 (approximately \$110) to dwellings intended to accommodate the elderly.

If, in Denmark, a non-profit organization has acute difficulty in finding tenants for new housing (because of high rent levels), then a special subsidy is made available to help cover operating costs.

In Switzerland, the operating subsidy takes two different forms. The first provides constant non-repayable subsidies over a period of 10 years, which enables the sponsor to lower rents by approximately 7% for low-income groups. The second, applying to the elderly, the handicapped, people in need of care and people undergoing vocational training, provides constant, non-repayable subsidies for a maximum of 25 years, which permits a reduction in rent equivalent to approximately 17%.

6. Tax Concessions

Although detailed information is not available, it appears that in most countries non-profit organizations are tax-exempt enterprises.

7. Renter Subsidies

On the whole, renters of non-profit housing participate equally with other renters in housing allowance systems, as described in Section III B (3).



Chapter VI

IS THERE A CRISIS?

In the United States there is lively debate as to whether there is a crisis in the private rental housing market. The United States General Accounting Office says YES.<sup>1</sup> The Pollyana Institute says NO.<sup>2</sup> Ira Lowry examines the evidence and concludes that U.S. "rental housing markets are approaching crisis conditions."<sup>3</sup>

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<sup>1</sup> U.S. General Accounting Office, Rental Housing: A National Problem That Needs Immediate Attention (Washington, D.C., 1979), p. 1.

The GAO concludes:

"Millions of Americans cannot afford home ownership and cannot find affordable rental housing. Immediate national attention is necessary if an adequate supply of affordable rental housing is to be available. The Department of Housing and Urban Development is the principal Federal Agency responsible for providing assistance for rental housing. The Congress and the Administration should take steps to mitigate this nation-wide crisis."

See also Uriel Manheim, Rental Housing in the 1980s (Washington, D.C., National Association of Home Builders, 1979), pp. 1-13.

<sup>2</sup> The Pollyana Institute, Rental Housing: Two Decades of Progress (Washington, D.C., 1980). Cited in Ira S. Lowry, "Rental Housing in the 1970s: Searching for the Crisis", paper prepared for the HUD Conference, "The Rental Housing Crisis: Implications for Policy and Research", November 14, 1980, to be published by the Urban Institute, p. 3.

The Institute concludes:

"The past two decades have seen steady improvement in the housing circumstances of renters, especially those with low incomes. Rents in constant dollars have dropped, per capita housing consumption by renters has increased, and the incidence of both overcrowding and major housing defects has diminished sharply. Millions of single adults, formerly constrained to live with relatives, have been able to afford separate homes--either living alone or with friends. The supply of suburban rental dwellings has increased, widening the locational options of those who prefer renting to owning. And for renters who prefer owning, the opportunities have seldom been better."

<sup>3</sup> Ira S. Lowry, "Rental Housing in the 1970s: Searching for the Crisis", Ibid., p. 18.

What is the position in other industrialized countries? A crisis is defined as "an unstable or crucial time or state of affairs". There are at least three major criteria for determining whether the industrialized world generally is confronted with a crisis in the private rental housing market. Is the quantity of the private rental housing stock adequate to meet the market demand (and/or need) for this kind of housing? Does its quality meet minimum housing standards? Can households afford the rents of private rental housing?

A. The Quantitative Criterion

It is safe to say that, probably in 1939 and certainly in 1945, the U.S. did not confront the magnitude of general housing need that faced most of the other industrialized nations. After World War II, many countries faced an unprecedented housing crisis. Three decades of intensive national effort were required to overcome the continuing national problem in an elemental quantitative sense.

As already observed, the attack on the crisis was three pronged: publicly owned rental housing; non-profit organization rental housing; and home ownership. Despite numerous complaints, the private rental housing sector was to a large extent a passive factor in the overall national housing strategy of most governments. The central overriding social, economic and political consideration was that the mass of workers could not afford rents freely determined in the open market, particularly of new rental housing. In fact in most countries, the private rental housing sector continued to shrink.

By the mid 1970s, most governments could and did say that, grosso modo, the national quantitative housing backlog had been eliminated. But meanwhile three decades of high rates of national economic growth had brought affluence to an increasingly larger number of workers, and rates of household formation had considerably increased the quantitative housing needs of the population. For the first time large numbers of person had acquired an income position that entitled them to express their preferences for housing in a way that they had never been able to before. Consequently, it is not at all certain that in the new situation the shrinking supply of private rental housing--taking into appropriate account the supply of other forms of rental housing--is in fact sufficient to meet the market demand for this type of housing.

The answer to this question would require, first of all, an analysis of vacancy ratio data (which in some countries do exist, but are not available for the present report). With lower rates of mobility generally in the West European labor market, a vacancy rate of around 3% appears to be the normal equilibrium rate as compared, say, to 5% in the U.S. But for a proper assessment, vacancy

rates would be needed for the private housing sector as well as the housing stock as a whole. As the U.K. Department of Environment points out,

"The market for private rented accommodation has for many years been a seller's market both nationally and locally, in which demand at the going rents exceeds the supply. The basic reasons have been the shortfall of available dwellings relative to households, and the concentration of much of the effect of that shortfall into the private rented sector... The consequence is that the effect of any shortfall in the supply of housing which is not absorbed by families living as concealed households appears in the private rented sector. A margin of households over available dwellings that is small when expressed as a proportion of the national housing stock is very much larger as a proportion of the stock in the private rented sector, and larger still in relation to the 'accessible' private rented sector."<sup>1</sup>

Information would also be needed on the sharing of dwellings by independent households and by persons living as part of someone else's household before a firm conclusion could be reached on whether the private rental housing stock was quantitatively adequate. But adequate for what? --for effective demand in the market? or for basic shelter needs of the people? European governments have a highly developed consciousness of the social service needs of the people in respect to shelter.

The weak quantitative data base does not provide a firm basis for drawing conclusions. Nevertheless, judging on the basis of descriptions of housing markets, most industrialized countries appear to have a considerable, if not severe, quantitative deficiency of private rental housing.

#### B. The Qualitative Criterion

How adequate is the stock of private rental housing when measured by minimum housing standards? All the available evidence suggests that much of the private rental housing sector of the industrialized world is in serious--perhaps in many metropolitan areas in critical--need of rehabilitation and modernization, particularly in the inner city. This is a product of many factors.

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<sup>1</sup> Department of the Environment, Housing Policy: Technical Volume, op. cit., p. 82.

The first consideration is age. Harloe found that in four European countries, Denmark, France, Federal Republic of Germany and the Netherlands, the proportion of the private rental housing stock that was built before World War II was twice as high as in the U.S.<sup>1</sup> Although the European housing stock (which tends to be predominantly masonry as compared to the U.S. stock which tends to be mainly wood) is of a more durable character, this does not lessen the lower quality that tends to be generally associated with space, layout and size of older dwelling units.

Second, inadequate household equipment, such as lack of piped water, lavatory, and bath or shower, tends to accompany older dwelling units. For example, according to the 1960 censuses, Sweden, Switzerland and the United Kingdom were the only countries in which more than 50% of the dwellings had a bathroom with a fixed bath or shower; in France the rate was 28% and in the Netherlands 26% (1955).<sup>2</sup> Ten years later the situation was much improved as a result of modernization programs (Table 4). But there were still only six countries in which over 75% of the dwellings were equipped with laboratories. Further substantial progress will certainly be recorded in the 1980 Census. But the fact remains that there is a considerable portion of the housing stock that still lacks some of the basic household amenities. Moreover, this physically deficient housing tends to be concentrated in the private rental housing sector. In Japan, 28% of the rental housing stock was substandard in 1978 compared to only 6% of owner-occupied housing.<sup>3</sup>

Third, the persistence of rent controls and regulations after World War II has been a major deterrent to private landlords maintaining their dwelling units in a good state of repair. Fourth, the outmigration of industries and jobs from central urban areas has led to an overall environmental deterioration in a number of European cities.

In short, the combination of forces impinging on the private rental housing sector has, from a qualitative point of view, produced a critical situation. Harloe summarizes as follows: "The profile of the private rental sector which emerges is one characterized by economic weakness. Most of the stock is old and

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<sup>1</sup> Michael Harloe, "Decline and Fall of Private Renting", op. cit., p. 32; see also United Nations Economic Commission for Europe, The Housing Situation and Perspectives for Long-Term Housing Requirements in European Countries (Geneva, 1968), p. 54.

<sup>2</sup> A. Andrzejewski and M. Lujanen, Major Trends in Housing Policy in ECE Countries, op. cit., p. 15.

<sup>3</sup> Housing Bureau, Ministry of Construction, Japan, Housing in Japan (Tokyo, 1980), p. 11.

Table 4. Percentage of Dwellings Equipped with Basic Facilities in European Countries, 1970-1971

|   | <u>Percentage of dwellings equipped with:</u> |                 |                             |
|---|---|-----------------|-----------------------------|
|   | <u>Piped water</u>                            | <u>Lavatory</u> | <u>Fixed bath or shower</u> |
| Austria                                   | 84.2  | 69.8            | 52.9                        |
| Belgium                                   | 88.0  | 50.4            | 47.8                        |
| Bulgaria <sup>f</sup>                     | 66.1  | 28.0            | 34.0                        |
| Czechoslovakia                            | 75.3  | 49.0            | 58.6                        |
| Denmark                                   | 98.7  | 90.3            | 76.5                        |
| Finland                                   | 72.0  | 61.4            | 39.0 <sup>d</sup>           |
| France <sup>c</sup>                       | 90.8  | 51.8            | 50.2                        |
| German Democratic Republic                | 82.1  | 40.9            | 38.7                        |
| Germany, Federal Republic of <sup>b</sup> | 99.2  | 84.0            | 81.8                        |
| Greece                                    | 64.9  | 41.2            | 35.6                        |
| Hungary                                   | 36.1  | 27.2            | 31.7                        |
| Ireland                                   | 78.2  | 69.2            | 55.4                        |
| Italy                                     | 86.1  | 79.0            | 64.5                        |
| Netherlands                               | -   | 80.8            | 81.4                        |
| Norway                                    | 97.5  | 69.0            | 66.1                        |
| Poland <sup>e</sup>                       | 55.1  | 40.7            | 38.2                        |
| Portugal                                  | 47.8  | 33.7            | 32.6                        |
| Spain                                     | 70.9  | 70.9            | 46.4                        |
| Sweden                                    | 97.4  | 90.1            | 78.3                        |
| Switzerland                               | -   | 93.3            | 80.9                        |
| United Kingdom                            | 98.3 <sup>a</sup>                             | 86.3            | 90.7                        |
| Yugoslavia                                | 33.6  | 26.2            | 24.6                        |

a 1961. b 1972. c 1968. d Excluding saunas. e 1974. f 1975.

Source: A. Andrzejewski and M. Lujanen, Major Trends in Housing Policy in ECE Countries (Geneva, United Nations Economic Commission for Europe, 1980), ECE/HBP/29, p. 16. Drawn from United Nations Economic Commission for Europe, A Statistical Survey of the Housing Situation in the ECE Countries Around 1970 (New York, 1978), E/F/R.78.II.E.5.

728.1  
1333.63  
H68p

deteriorating, much of it is owned by landlords with limited resources, and is housing low income tenants.... The private rental sector has become increasingly restricted to those who cannot afford the cost of decent housing without heavy subsidies.<sup>1</sup>

C. The Affordability Criterion

Even if housing in a country or region is adequate on both quantitative and qualitative grounds, a crisis situation may still be said to exist if excessively large numbers of households cannot afford the costs of shelter by paying a reasonable percentage of their income. A forthcoming report under the U.S.-Canadian Bilateral Program shows that in Canada and the U.S. 24% and 28%, respectively, of metropolitan households were spending over 25% of their income for shelter in 1974.<sup>2</sup> There is no recent comprehensive analysis of comparative shelter cost-to-income ratios among European countries, but from available evidence it is clear that large segments of the working population are forced to carry excessive housing cost burdens.<sup>3</sup> It should be pointed out, however, that among European countries a fair ratio of income for housing costs tends to be more in the range of 15 to 20% rather than 25% as in North America. Even so, most governments have provided more generalized and more generous consumer housing subsidies than has the U.S.

One symptom of the affordability problem was the sudden appearance in a number of countries, including Denmark, France, Federal Republic of Germany, Netherlands, Sweden and Switzerland, in the early 1970s of a considerable number of unoccupied new dwelling units that could not be sold or rented within a reasonable period of time. For example, in the Federal Republic of Germany there were over 300,000 new dwelling units unoccupied in 1973 and 1974.<sup>4</sup>

1 Harloe, op. cit., p. 32.

2 Paul Burke, Connie Casey, Gerd Doepner with assistance of Jay Howenstine, Philip Brown and Patricia Streich, Housing Affordability Problems and Housing Need in Canada and the United States: A Comparative Study. This report develops a so-called "core need" approach which finds that the shelter-to-income ratio approach considerably overstates the amount of need because it fails to take account of certain types of underconsumption and overconsumption of housing services. The more true measure, i.e., the "core need" approach, shows 17% and 22% of households in housing need in Canada and the United States, respectively.

3 Cf. E. Jay Howenstine, Foreign Housing Subsidy Systems, op. cit., Chap. VII.

4 Andrzejewski and Lujanen, op. cit., p. 22.