NERI Research inBrief

May 2018 (no55)

Cost Rental Housing – A Model for Ireland?

Paul Goldrick-Kelly

ISSN 2009-5848

SUMMARY

In the context of significant shortages in accommodation and substantial increases in housing costs in the Republic of Ireland, there has been renewed focus on social housing in Ireland. This conversation has, increasingly, turned towards the construction of social units along lines observed elsewhere in Europe.

This Research inBrief briefly introduces cost rent as a concept. It then goes on to outline the various models of cost rental provision in a number of comparable European jurisdictions. The inBrief concludes with a brief discussion of possible lessons to be drawn from experience – primarily centred on the desirability of unitary markets where cost rental social provison competes with other tenure types. Moving to this system should improve stability within the housing system in the Republic of Ireland as a whole and dampen the negative macroeconomic effects of fluctuations within housing markets.

KEY POINTS

- Cost rental housing is defined as provision where charged rents are directly related to the actual costs of provision (Kemeney, 1995). This includes current and capital costs.
- Rent models associated with social housing are varied, but many incorporate cost rental features. Depending on the system, rents can cover costs at the level of a development or across developments. The Republic of Ireland is unusual in the degree to which charged social rents are determined by income. Despite the widespread presence of cost rents, governments in Europe still support tenants unable to pay rents through income supports and subsidies.
- Historic experience indicates that, given adequate initial support, cost rental systems can be crucial elements within *unitary markets* - where social rents are widely accessible and compete with private tenures. Evidence suggests that these markets are associated with the relative absence of instability, preventing large swings in price.

Nevin Economic Research Institute (NERI)

31/32 Parnell Square
Dublin 1
+ 353 (1) 8897722

45-47 Donegall Street
Belfast BT1 2FG
+ 44 28 90246214

e-mail: *info@ NERInstitute.net*
Web: *www.NERInstitute.net*

Research for new economic policies

Introduction

In the context of significant shortages in accommodation and substantial increases in housing costs in the Republic of Ireland, there has been renewed focus on social housing in Ireland. This conversation has, increasingly, turned towards the construction of social units along lines observed elsewhere in Europe.

This Research inBrief briefly introduces cost rent as a concept. It then goes on to outline the various models of cost rental provision in a number of comparable European jurisdictions. The inBrief concludes with a brief discussion of possible lessons to be drawn from experience – primarily centred on the desirability of *unitary markets* where cost rental social provison competes with other tenure types. Moving to this system should improve stability within the housing system as a whole and dampen the negative macroeconomic effects of fluctuations within housing markets.

What is Cost Rental Housing?

Cost Rental Housing refers to a model of provision where charged rents reflect the actually incurred costs of provision (Kemeney, 1995). Rents are tied to the costs associated with maintaining properties alongside delivery expenses associated with financing or construction of units.

In contrast, rent setting within for profit systems is largely determined by the maximum rent level that can be borne by the market, regardless of provision costs. In most cases, cost rental provision delivers accommodation at lower rent levels than the for profit sector though this is dependent on current delivery costs.

Cost Rental Models of Social Housing in Europe

Cost rental housing plays a predominant role in a number of social housing systems in Europe. In Austria, Denmark, France and Finland rents are derived from the costs of provision. Cost rental also applies to social housing provided by independent housing associations within Northern Ireland (Young et al., 2013). Rent covers credit costs, management fees, taxes as well as costs associated with the maintenance and continued viability of projects (Young et al., 2013), (Tsenkova and Vestergaard, 2011), (CECODHAS, 2013).

In the Austrian and Danish cases, housing providers are legally obliged to ensure rents cover costs of provision at the level of individual projects. Finnish municipal and Limited Profit Housing Companies as well as French HLMs[1] are allowed balance costs over projects so that aggregates rents cover aggregate costs. This gives HLMs some flexibility with rents, as certain developments can be subsidised by higher rental income elsewhere (CECODHAS, 2013). Housing associations in Northern Ireland must apply rents and charges that cover expenses, though this can entail cross subsidisation between projects or other market activities (Young et al., 2013).

In all of these cases, rents are also subject to legislation. In Denmark, rents are based on historic costs. Housing agencies are allowed; however, to maintain these rental costs when debts are repaid. This allows organisations to supplement their equity. In Austria, subsidies are linked to rent limits over the subsidisation period and fixed rents are applied after loans have been repaid. The French state also applies rent regulations for financing schemes and subsidies. Net construction costs – which include reductions from state subsidies – also affects rental costs. (CECODHAS, 2013).

[1] HLM refers to *Habitation à Loyer Modéré* or rent controlled housing that is both public and private.

In Finland, cost rental provisions are mandated for a fixed period (usually 45 years) after which the rents can be determined by prevailing market conditions or the property sold. Rents can also vary according to the distribution of developments across "expensiveness zones" (CECODHAS, 2013).

Social rents in housing administered by the *Northern Ireland Housing Executive* (NIHE) are similarly set according to a points based system subject to annual regulated inflation rate or uplift – primarily based on the number of rooms in a given dwelling - although this does not include location or demand conditions. The NIHE calculates rent uplift based on an identification of the total rental income required to cover costs. Housing stock administered by Housing associations built or procured before 1992 have rents set in accordance with the NIHE points system (Young et al., 2013).

In the English case, rents are determined with a rent formula which incorporates property values and local earnings. This is further adjusted to account for the number of bedrooms and extant rental caps. Some properties are also rented at "affordable rent" levels at rates set up to 80% of prevailing market rents. Both rental schemes are adjusted according to retail or general inflation (Wilson, 2016). This is somewhat similar to prevailing "differential rents" in the Irish system calculated, primarily, with reference to tenant income (National Economic and Social Council, 2014).[2]

In all cases, general allowances and benefits can be availed of by qualifying tenants. While this is not restricted to social housing as such, this is an important supplement to rental incomes for providers (National Economic and Social Council, 2014).

Some Lessons from theory and history

While institutional and funding arrangements vary the principle of significant cost recovery[3] is a feature of most cases we have reviewed. Rents are not directly tied to income, as occurs in the Irish case.

Cost rental funding in these cases allows independent housing bodies elsewhere to avail of diverse sources of capital funds, as rents can, themselves, cover interest and amortisation costs on advanced credit. In contrast, funding for social housing in the Republic of Ireland comes from central government (NESC, 2014). This has resulted in severely restricted supply in practice (Norris and Byrne, 2016).

As Kemeney (1995) points out, modern construction costs are much higher than those observed for previously built accommodation. This leads to a gradual fall in the real value of debt associated with a property, known as Maturation. Cost rents tend to decline in real terms over time because of this process (NESC, 2014)

Where this process advances, maturation allows cost rental housing to compete with other forms of provision. This occurs in the rental market or against outright home ownership in what are termed *unitary markets, which* accommodate broader swathes of the population and facilitate further sector stability (Kemeny, Kersloot and Thalmann, 2005). Where this process has succeeded, governments have provided initial support and subsidisation to the nascent cost rental sector (NESC, 2014).

In contrast, within *Dualist* rental systems public and private provision systems are distinct and subject to differing provision and tenure conditions (NESC, 2014). Within these systems, governments tend to support home-ownership through favourable legislative treatment and subsidy. The private rental sector does not face competition because social rents are restricted to disadvantaged groups. The sector is also limited by constraints on government spending and subsidisation.

[2] While income is factored into English social rental calculations, Irish social rent is effectively solely determined by income level.

[3] Albeit with varying levels of public subsidy and loan guarantee.

This model predominates in a number of states, including Ireland (Norris, 2014)

The advance of a *dualist* model in Ireland has been tied to changes in social provision in Ireland which were, in turn related to changes in financing arrangements. The turn to central government grants from local government loan financing led to pro-cyclical social housing provision (Norris, 2014). Rather than acting as a counterweight to the tendencies within housing markets, as they did from the 1930s to 1960s, social housing provision acted to exacerbate them (Norris and Byrne, 2016). This has substantial effects on broader macroeconomic stability (Norris and Byrne, 2016).

In contrast, Austria's *unitary market*, of which its cost rental social housing sector is an important part, saw modest fluctuations in house prices and promoted macroeconomic stability (Norris and Byrne, 2017).

Thus, diversified funding models underpinned by an approach to rent setting that takes account of costs appear well established in a European context with a number of advantages for domestic housing markets and macroeconomic stability more broadly. There is considerable scope for an approach in the Republic of Ireland informed by these models.

References

Aedes, 2013. Dutch social housing in a nutshell. Dutch Association of Social Housing Organisation

CECODHAS, 2013. Study on Financing of Social Housing in 6 European countries. CECODHAS

Healy and Goldrick-Kelly, 2017. Ireland's Housing Emergency- Time for a Game Changer. NERI Working Paper, No. 41. Dublin: NERI

Kemeny, J., 1995. From Public Housing to the Social Market: Rental Policy Strategies in Comparative Perspective, London: Routledge

Kemeny, J., Kersloot, J. and Thalmann, P., 2005. Non-profit housing influencing, leading and dominating the unitary rental market: Three case studies. *Housing Studies*, *20*(6), pp.855-872.

National Economic and Social Council, 2014. Social Housing at the Crossroads: Possibilities for Investment, Provision and Cost Rental. Report number 138 June, 2014. Dublin: NESC

Norris, M., 2014. Path dependence and critical junctures in Irish rental policy: From dualist to unitary rental markets? *Housing Studies*, *29*(5), pp.616-637.

Norris, M. and Byrne, M., 2016. Social housing's role in the Irish property boom and bust. *UCD Geary Institute for Public Policy Discussion Paper Series. WP2016/15*.

Norris, M. and Byrne, M., 2017. Housing market volatility, stability and social rented housing: comparing Austria and Ireland during the global financial crisis. *UCD Geary Institute for Public Policy Discussion Series. WP 2017/05*

Tsenkova, S. and Vestergaard, H., 2011. Social Housing Provision in Copenhagen. In *ENHR International Conference Sustainable Urban Areas*.

Young, G., Orr, A., Gibb, K., Wilcox, S. and Redmond, D., 2013. Review of Social Rent Setting in Northern Ireland.