

EDITORIAL

Private renting: are institutions the answer?

Throughout much of Europe the private rented sector is the same size or smaller than it was 30 years ago. This is largely due to the growth of owner-occupation. But the global financial crisis has stopped or even reversed the increase in owner-occupation in many places, and it is clear that households that would formerly have expected to move into home ownership will now have to remain for a longer period—or even permanently—in private rented housing. What needs to be done to ensure a suitable supply?

As always in questions of housing, the answer varies by country. But there is one prescription that seems to be universally attractive: to get more pension funds, insurance companies, etc. to invest in rented housing. These institutional investors are often contrasted favourably with ‘mom and pop’ individual landlords. Institutions, it is claimed, would be more professional: they would have longer time horizons, manage their properties more efficiently, and have more money for improvements and maintenance. In the UK in recent decades, government has tried various policy initiatives to bring more institutions into the sector—but without notable success.

Although the USA is often held up as a model of institutional investment, individuals own most of the stock there. In fact, a recent comparative survey* of private rented housing carried out at LSE London found no country in which institutional investors own most of the private rented housing. Even in Switzerland, where institutions are required by law to invest in property, over 60% of private rented dwellings are owned by individuals or couples—and in France the figure is more than 95%.

One factor seems to be key: institutions are more likely to invest if rented blocks are owned in their entirety by a single landlord (as in the USA or Sweden) than if apartments are separately owned (as in the UK or Ireland). In the USA, for example, individual investors own 83% of single-unit properties, but only 13% of properties with 50 units or more. Institutional investors (Real Estate Investment Trusts and other corporations) own 24% of these large properties. In Sweden and Austria, countries where relatively few landlords are private individuals, corporations tend to own mostly multi-story rental buildings, while single units in individual ownership make up only a minor part of the private rented stock. In the UK, major financial institutions generally look for investments in amounts of £200 million (Euros 232 million) or more, and purchasing entire blocks is more practical than assembling portfolios of hundreds of individual apartments.

There are other reasons that institutions may shy away from investing in private rented property. The management costs are greater than for commercial property and there are limited opportunities for achieving economies of scale, especially where properties are individual units rather than entire blocks. There is reputational risk—institutions don’t want their names associated with problem tenants, evictions, etc. And even in sophisticated markets like London’s, the data on residential rents and yields are poor. But perhaps the main reason that institutions avoid the private rented sector is that they expect to make higher yields elsewhere.

Small individual landlords predominate in most countries. They often have very small portfolios—1-5 units—and many are not motivated purely by financial considerations. Often these landlords do their own management and maintenance, and accept lower rates of return than institutions would demand. Were institutions to displace them, it seems probable that rents would go up—or, to put it another way, only if rents rose would institutions be willing to invest. It would therefore make more sense for governments to focus on improving the professionalism of existing landlords than on attracting new ones.

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* *"Towards a sustainable private rented sector: Lessons from other countries". Copy on request from lse.london@lse.ac.uk (Read more in the new books section.)*