



An Chomhairle Náisiúnta Eacnamaíoch agus Shóisialta  
National Economic & Social Council

# Ireland's Rental Sector: Pathways to Secure Occupancy and Affordable Supply

No. 141 May 2015

## National Economic and Social Council

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## Abbreviations

### **AHBs**

Approved Housing Bodies

### **BIM**

Building Information Modelling

### **BTL**

Buy-to-Let

### **CALF**

Capital Advance Leasing Facility

### **CGT**

Capital Gains Tax

### **CPI**

Consumer Price Index

### **CSO**

Central Statistics Office

### **DECLG**

Department of the Environment, Community & Local Government

### **HAP**

Housing Assistance Payment

### **HFA**

Housing Finance Agency

### **LPT**

Local Property Tax

### **NAMA**

National Asset Management Agency

### **NESC**

National Economic & Social Council

### **NTMA**

National Treasury Management Agency

### **PRS**

Private Rental Sector

### **PTRB**

Private Residential Tenancies Board

### **RAS**

Rental Accommodation Scheme

### **REITs**

Real Estate Investment Trusts

### **RTA**

Private Rental Tenancies Act, 2004

### **SHS**

Social Housing Strategy

## Acknowledgements

The Council wishes to acknowledge the assistance of several people and organisations in the preparation of this report. We would like to thank the Housing Agency, Private Residential Tenancies Board, Limerick City and County Council, NAMA, ESRI, Irish Council for Social Housing, Irishlandlord.com, Irish Property Owner's Association, DKM Economic Consultants, WK Nolan Property, O'Mahony Pike Architects, Clúid Housing Association, Threshold, Housing Europe—The Federation for Public, Cooperative and Social Housing, Ronan Lyons, Paul Keogh, and Eoin O'Sullivan.

The Council retain all responsibility for the information and views presented in this report.



## The Policy Context

This report is NESC's contribution to Government development of a new national policy for the private rental sector, including issues such as investment, standards and regulation, as indicated in *Construction 2020* and the *Social Housing Strategy*.

The report welcomes and builds on three key recent advances in government housing policy. First, government policy recognises that one-quarter to one-third of the population will find it increasingly difficult to achieve homeownership. Second, Government has made it clear that the goals of housing policy will be affordability, sustainability and inclusion. Third, the Government's social housing strategy represents a significant policy advance.

## Understanding Ireland's Rental Sector

The analysis builds on two NESC reports published in 2014: *Social Housing at the Crossroads: Possibilities for Investment, Provision and Homeownership or Rental: Which Road is Ireland On?* The analysis reflects the recognition in those reports that supply is a key determinant of the availability and affordability of rental housing. An effective overall approach to housing policy requires a mutually supportive combination of finance, direct public influence on supply and a cost and regulatory regime.

Nationally, about 305,000 households (around 19 per cent) are renting from a private landlord, although the percentage of households renting is considerably higher in Galway (40 per cent), Dublin (34 per cent) and Cork (29 per cent).

Ireland's rental sector has some notable characteristics. Census 2011, the most recent year for which we have this data, shows that almost half of all households renting, 129,000, were headed by a foreign national. A high proportion of households in the rental sector, approximately 102,000, are in receipt of rent supplement and other housing payments. Among landlords there is a preponderance of small-scale individual investors and a high share of encumbered buy-to-let mortgages. With growing housing demand and very little new supply in recent years, there are some severe pressures in the rental sector in Dublin and

other cities. This is evident in increasing rents, pressures on government to increase rent supplement rates and, for a small proportion of low-income households who cannot meet rising rents, economic evictions leading to homelessness. The limited supply and high cost of rental housing is now a threat to Ireland's competitiveness and job creation.

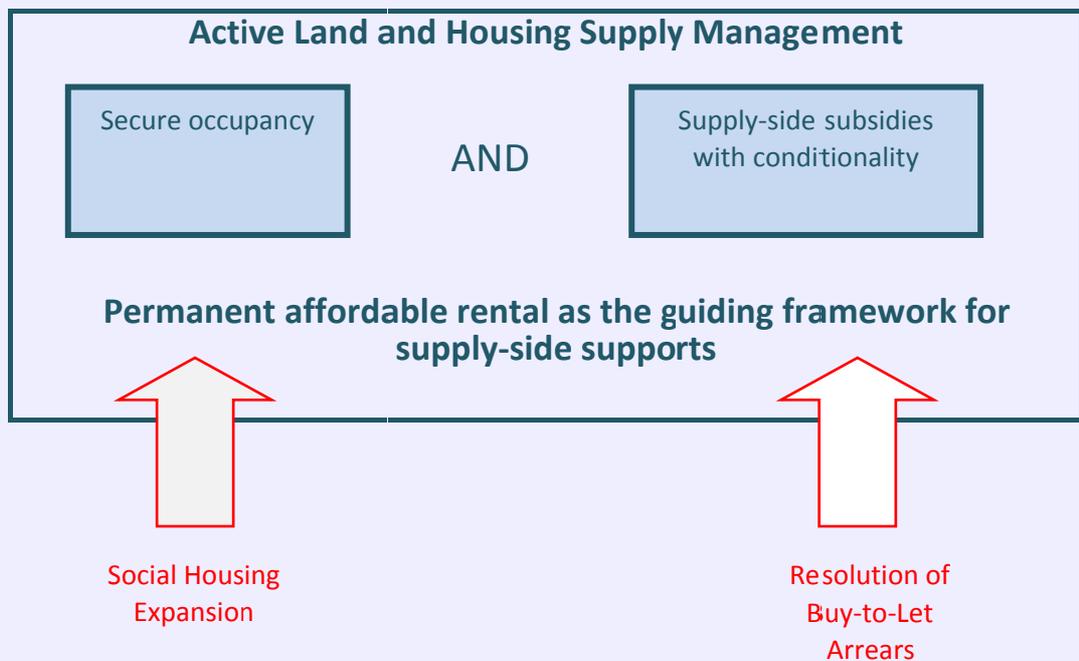
## A Vision and Strategy for Ireland's Rental Sector

The report sets out a vision and strategic reform agenda for the rental sector.

This requires breaking free of the current dualist debate on the private rental sector, in which some argue for rent control and others counter with the need to create better incentives to keep existing landlords in the sector and encourage developers and investors to resume construction and supply. Neither approach, on its own, will be effective. We need policies that *both* provide tenants with more secure occupancy *and* create supply-side supports to increase the availability of affordable rental housing.

But these two policy approaches can only be made consistent when both are placed within a wider strategic and policy frame and supported by other policy approaches, illustrated in the figure below.

### Enhancing the Role of the Rental Sector in Ireland: The Necessary Elements



First, it is necessary to mobilise public authority, assets and capabilities, in NAMA and other bodies, to focus on and lead housing supply, land management, infrastructure and housing affordability—an argument that is set out in more detail in a separate forthcoming NESC report.

Second, we need a coherent programme of conditional supply-side supports to increase the availability of affordable rental housing for intermediate households. As far as possible, these should be integrated with Government’s goals and criteria for investment in social housing. In designing these, Government must strike a balance between desirable conditionality (concerning rents, tenure, allocation, management, quality and energy efficiency), on the one hand, and achieving new investment and delivery, on the other. We propose that the guiding framework should be movement towards a unitary rental system with permanent, affordable, cost-based, mixed-income rental. This suggests that in setting goals and criteria to assess investment and development proposals, a relatively high priority should be given to creating accommodation, and securing assets, that will underpin *permanent* provision of social and affordable housing.

This wider strategic framework needs to be supported by two additional policies. The first is vigorous delivery of the *Social Housing Strategy*. The second is action to address the problem of encumbered buy-to-let properties.

## Pathways to Affordable Secure Rental Housing

This vision and analysis provides the basis for a strategic approach on five interrelated fronts.

### Secure Occupancy

In international housing analysis and policy, the concept of secure occupancy is used, rather than traditional forms of rent control. In a number of the most successful market economies there are well-established, balanced forms of rental sector regulation that create secure occupancy. Drawing on these examples, we identify four elements of a secure occupancy model for Ireland:

- Introduce a system of rent regulation to provide greater certainty for tenants and landlords through a mechanism for disciplined market-sensitive rent adjustment;
- Change the existing system of four-year leases to a regime in which leases are effectively indefinite;
- Remove sale of the property as a reason for vacant possession; and
- Improve the existing dispute resolution procedures.

We emphasise that these provisions are proposed as part of an overall reform package that includes more favourable tax treatment of rental income and measures to enhance the supply of affordable rental accommodation.

### **Measures to Increase the Supply of Permanent Affordable Rental Housing**

The second key policy requirement is supply-side incentives and supports to increase the supply of permanent affordable rental housing available to low-income and intermediate households. Intermediate households are those that struggle in the private rental sector and the market for homeownership, but may not be eligible for social housing or, even if they are eligible, are unlikely to be allocated any, given its scarcity.

Instruments that can be used to encourage the provision of affordable rental accommodation include low-cost loans, access to state land on favourable terms, tax incentives and loan guarantees. If state land is used for affordable housing, land ownership should be retained with a state body or a voluntary organisation with a long-term commitment to providing affordable housing.

Affordable rental accommodation could be provided by both voluntary housing bodies or by the private sector. In either case, the approach would involve the provision of a moderate level of subsidy in exchange for affordable rents.

In the context of secure occupancy, the appropriate tax treatment of rental income is to have full relief of landlords' interest payments. The best strategic approach is to have a simple regime for taxation of rental income, that provides clearer and better incentives for long-term investment in provision of good quality rental homes. More favourable tax treatment should be considered for landlords with tenants in receipt of rent supplement or Housing Assistance Payment (HAP).

### **More Active Housing Supply and Land Management**

To address the imbalance between the demand and supply of rental housing, and of housing in general in Dublin and other cities, there is a need for a more active public role in driving housing supply, leading the revival of development, managing land and the provision of urban infrastructure. This will be the focus of a separate Council report to be published in the near future.

### **Vigorous Delivery of the Social Housing Strategy**

The comprehensive strategic approach to the rental sector set out here depends on vigorous delivery of the *Social Housing Strategy*. A large share of occupancy in the private rental sector consists of unmet social housing need and some of the problems in the sector reflect this. In order to move towards a larger, more stable, private rental sector it is necessary, over the coming decade, to drive back up the share of social housing provision by local authorities and Approved Housing Bodies (AHBs).

### **Managing the Transition of Encumbered Buy-to-Let Mortgages**

A strategic approach to increase the scale, stability and affordability of the rental market must include measures to address the issue of encumbered buy-to-let mortgages, as is noted in the *Social Housing Strategy*. Although not examined in detail in this report, there would seem to be scope for a larger share of these properties to be acquired for social housing, through purchase or lease. In devising a programme to manage the transition of encumbered buy-to-let properties, a relevant factor is the low cost of long-term government debt.

### **Such a Strategy Will be More than the Sum of its Parts**

The elements of this integrated strategy—indefinite tenure, market-sensitive rent regulation, supply-side subsidies, tax reform, active housing supply and land management and resolution of encumbered buy-to-let mortgages—would be mutually supportive. Each helps to create the conditions in which others are feasible and can be most effective.

# Chapter 1

## Introduction and Outline of Policy Recommendations

## 1.1 Introduction

Since early 2014, the Council has given more attention to housing policy than any other issue. In June, NESC published *Social Housing at the Crossroads: Possibilities for Investment, Provision and Cost Rental* (NESC, 2014a). Late in 2014, we published *Homeownership and Rental: What Road is Ireland On?* (NESC, 2014b). A key theme of those reports and our subsequent work is the importance of seeing housing as a system; a range of elements—homeownership, social housing, the rental sector, finance, household incomes, land availability, planning and construction—interact and none can be considered or addressed in isolation. Our work confirms what is evident to most—Ireland’s housing system remains in the shadow of the enormous boom and bust that occurred between 2002 and 2013. This is the context within which current and long-standing issues in the rental sector need to be analysed and addressed.

This report analyses Ireland’s rental sector and makes suggestions on a range of rental sector issues. It does so on the assumption that Irish society and policy wish to create a rental system that can provide high-quality, affordable rental accommodation as lifelong homes to a significant segment of society. It is not the role of NESC to work out in detail the design of policy provisions, but we are confident that the measures proposed here are necessary. Indeed, it needs to be recognised that a larger, high-quality, affordable secure rental sector is necessary not only for social reasons, but also as a key foundation for economic performance and competitiveness. The alternative to the kinds of reforms and initiatives proposed here is a continuation of current tenure and rental provisions, or minor adjustments; that is an option but should be recognised as choosing that the private rental sector will continue to be a residual and transitional form of housing used at a particular stage of life, and by those who have no other option. In the absence of policies to secure delivery of a large supply of affordable homes for purchase, this will have serious social and economic consequences, including damage to Ireland’s competitiveness.

## 1.2 Structure of the Report

**Chapter 2** identifies three key recent advances in Government policy on housing and a number of commitments to further policy development. The first important policy advance is clear recognition of the scale and nature of the housing challenge—that one-quarter to one-third of the population will find it increasingly difficult to achieve homeownership. The second is clarity that the goals of housing policy are affordability, sustainability and equality. A third critical development is the *Social Housing Strategy* itself, published in November 2014. Chapter 2 also notes three significant commitments to further policy development set out in the *Social Housing Strategy*: to develop a cost-rental segment in the Irish housing system; to manage the transition of encumbered buy-to-let properties; and to enhance investment, standards and regulation of private rental. These developments define the context for this NESC report and the Council’s own work underlined the need to examine rental sector issues in a wider context, including land management and its role in shaping housing supply.

**Chapter 3** provides an understanding of Ireland’s private rental sector. It begins by restating the interdependent elements of an effective housing policy: finance, direct public influence on supply and the cost and regulation regime. This reflects the central role of supply in shaping housing outcomes, recognised by most housing analysts, and a focus on supply appears throughout this report and the Council’s recommendations. We explain the increased share of households living in rental housing by reference to key features of Ireland’s housing boom and subsequent bust. The main characteristics of Ireland’s private rental sector are outlined: among tenants, the high proportion of non-Irish nationals and low-income households in receipt of rent supplement and other housing payments; among landlords, the preponderance of small-scale individual investors and the high share of encumbered buy-to-let mortgages. We note the strong recent increases in rent, particularly in the main urban centres. Drawing on a Council report published in 2014, we note the relative advantages of homeownership over rental and the role of rental in the wider housing system (NESC, 2014b). Finally, the chapter sets out a central argument of this report: that there is considerable uncertainty concerning the private rental sector and, indeed, future supply of housing at the right quantity, of the right kind and quality, at an affordable cost and in the right locations. Consequently, a central thrust of the Council’s analysis is the need to find ways to act in such an uncertain world.

**Chapter 4** sets out a new vision and strategy for Ireland’s rental sector. We develop this by showing the limitations of the dualist manner in which rental sector issues tend to be framed at present—as a debate in which some argue for rent control and others counter with the need to increase supply through better incentives for landlords. We suggest that neither approach, on its own, will be effective. We need policies that provide tenants with more secure occupancy *and* measures to increase the supply of affordable rental housing. But these two policy requirements, regulation for secure occupancy and supply-side measures with conditionality, both are necessary, can only be made consistent when placed within a wider strategic and policy frame and supported by other policy approaches. First, it is necessary to mobilise public authority, assets and capabilities, in NAMA and

other bodies, to focus on housing supply, land management, infrastructure and housing affordability—an argument that is set out in more detail in a separate forthcoming NESC report. Second, we need a clear conception of what Ireland is aiming for in designing and using supply-side supports and other measures to enhance provision. We recognise that in designing supply-side subsidies, Government must strike a balance between desirable conditionality (concerning rents, tenure, allocation, management, the layout of housing developments and energy efficiency), on the one hand, and achieving new investment and delivery, on the other. We propose that the guiding framework should be movement towards a unitary rental system with permanent, affordable, cost-based, mixed-income rental. This suggests that in setting goals and criteria to assess investment and development proposals, a relatively high priority should be given to creating accommodation and securing assets that will underpin *permanent* provision of social and affordable housing. A relatively high weighting should be given to projects in which the eventual asset or equity (arising from maturation and amortisation of debt) will be put in the service of further provision of affordable and social housing. We finish the chapter by arguing that these approaches to regulation for secure occupancy and increased supply of affordable rental housing need to be underpinned by two further lines of policy action: delivery of the *Social Housing Strategy* and measures to address the problems of encumbered buy-to-let properties. Taken together, these elements constitute a new vision and strategy for Ireland's rental sector.

**Chapter 5** explains the concept of secure occupancy and discusses the policies required to achieve it. We outline the fundamental relationship between tenure security and regulated uprating of rents. The chapter places Ireland's rental sector in an international context, showing the link between rental and the wider housing system and the role of taxation and other policies. Having examined the existing Irish system, we set out the elements of a secure occupancy model for Ireland. These involve improving rent certainty, making leases indefinite, changes to the conditions of sale of rented property and improvements to dispute-resolution procedures. We emphasise that these measures should be part of a wider reform programme that includes measures to increase supply and reform of the tax treatment of rental income.

**Chapter 6** focuses on ensuring a healthy supply of rental accommodation, particularly affordable homes. It reiterates the fact that Ireland has long had a problem in achieving sufficient supply of housing in or near the main cities and continues to face difficulties in the supply of affordable rental accommodation for low- and middle-income households. Countries with a better record in these regards use a range of supply-side measures, from active land management through to incentives and supports linked to conditionality aimed at provision of new affordable rental accommodation. Consequently, we argue that three kinds of policy are now required. The first is more active management of housing supply and land, to be discussed in the forthcoming report noted above. The second is the design and use of a range of supply-side supports with conditionality focused on creation of permanent, affordable mixed-income housing. The third is a comprehensive and disciplined process to identify and address the factors that make the cost of housing relatively high in Ireland.

**Chapter 7** shows that this strategy will be more than the sum of its parts. The elements of this integrated strategy—indefinite tenure, market-sensitive rent regulation, supply-side subsidies, tax reform, active housing supply and land management and resolution of encumbered buy-to-let mortgages—would be mutually supportive. Each helps to create the conditions in which the others are feasible and can be most effective.



## Chapter 2

# Key Developments in Government Housing Policy

This chapter discusses how policy has advanced, commitments to further policy development and recent NESC work on housing.

## 2.1 Three Major Policy Advances

Before placing rental housing in this wider context, it is important to note that there have been three major policy advances in recent months. These concern:

- a) The scale and nature of the housing policy challenge;
- b) The goals of housing policy; and
- c) The *Social Housing Strategy* and the resumption of social housing provision.

Although the content and direction of housing policy remains unsettled, these three policy steps provide more clarity about the purpose of housing policy than has existed since the 1970s or even earlier. Also of relevance to housing is *Construction 2020*; indeed, as will become clear, the aspects of construction and housing supply it is concerned with are central to the future of the private rental sector and housing more widely.

### 2.1.1 The Scale and Nature of the Housing Policy Challenge

Government has recently clarified its understanding of the nature and scale of the housing policy challenge. ‘Trends in Ireland’s tenure mix, affordability, demography and economy suggest that one-quarter to one-third of the population will find it increasingly difficult to achieve homeownership and that, in the absence of an effective new social housing strategy, there will be increased polarisation in housing options and conditions’ (DECLG, 2014: 17). This places policies for any segment of housing—social provision, owner occupation, social rental and private rental—firmly within the context of the overall housing system; that, in turn, reflects not only the functioning of land and housing markets, but also the income distribution generated by the labour market and the persistence of social disadvantage.

### 2.1.2 The Goals of Housing Policy

Government has made clear that, in this context, the goals of housing policy will be:

- Affordability;
- Sustainability (economic, social and environmental); and
- Inclusion.

It is hard to exaggerate the significance of these clear and reasonable goals; they contrast with past policies, largely implicit, of maximising homeownership by any means and the avowal in 2011 of ‘tenure neutrality’. Government adds that, in setting out to achieve these goals, ‘A precondition for success is an adequate supply of the right kind of housing at a reasonable cost’ (*ibid.*: 17). With this clarity about goals, it becomes possible to ask of any policy idea, resource or entity (public or private): how does it contribute to the achievement of affordability, sustainability and inclusion?

The definition of affordable housing varies internationally. In many countries, affordability is defined as housing costs that consume no more than 30 to 40 per cent of household income (McKinsey Global Institute, 2014). In Ireland, the Planning and Development Act (2000) defines affordable housing as housing or building land provided for those who need accommodation and who otherwise would have to pay over 35 per cent of their net annual income on mortgage payments for the purchase of a suitable dwelling. This Irish legislative definition refers to affordable housing for purchase. This could be extended to a more general definition of affordable housing as that in which housing costs absorb no more than 35 per cent of net household income while also meeting a minimum acceptable standard.

### 2.1.3 The Social Housing Strategy: One Piece of Housing Policy is in Place

The third major policy advance is the *Social Housing Strategy* (SHS) itself. Its three pillars address increased provision of social housing supply, provision of housing supports through the private rental sector, and reform to create a more flexible and responsive set of social housing supports. Indeed, as will become clear, the SHS is even more significant than it might seem at first sight. In a context in which overall housing policy remains profoundly unsettled, and housing supply is inadequate in both scale and composition, the SHS is the one clear stake in the ground, the one coherent strategy around which housing sector actors can mobilise.

We could add that a fourth significant recent policy advance is the Central Bank’s adoption of a new set of rules concerning mortgage lending and borrowing. While opinions might differ about the best technical design of rules on mortgages, it is clear that goals and ideas concerning sustainability/stability and affordability underpin the Central Bank’s approach.

## 2.2 Commitment to Further Policy Development for the Rental Sector

These policy advances are a part of the context within which this report is prepared. Another is the Government's commitment to take innovative measures that will enhance the capacity of the rental sector to contribute sustainably to social housing supports. 'This will help to ensure that Ireland, like many other European countries, has a much more stable and secure source of high-quality accommodation which is affordable and which does not constitute an increasing burden on the state' (DECLG, 2014: 47). Government identifies three kinds of innovative policy development on the private rental sector, we summarise these here.

### 2.2.1 Development of a Cost-rental Segment in Ireland's Housing System

The first explores the conditions for development of a cost-rental segment in Ireland's housing system. The *Social Housing Strategy* notes that 'cost rental' and cost-based or affordable rent regimes play an important role in providing housing to low- and middle-income groups in many countries. 'As well as providing the direct benefit of affordable long-term tenancies to such households, this approach plays an important role in moderating the cyclical nature of the overall housing system, rent crises and associated stresses' (*ibid.*: 47, and see Chapter 4 below for definition and discussion of cost rental). It identified a number of reasons why cost rental is particularly relevant in Ireland now. These include the exposure of the Exchequer to increasing market rents, the increasing role of Approved Housing Bodies (AHBs) and off-balance sheet funding, both of which require an ongoing income stream, the need to create more mixed-income, socially integrated, developments and the changing tenure mix.

While Exchequer savings are important, the *Social Housing Strategy* emphasises that some of the greatest advantages of cost rental accrue when the approach has been pursued for a sustained period. 'Then the existence of paid-off, or partly paid-off, rental properties in the not-for-profit sector (housing association or a public housing body) provide the opportunity to pool the rents from older low cost properties and new higher-cost units. A further advantage—achieved when the cost-rental segment reaches a sufficient share of the overall rental sector—is a moderation of market rents' (*ibid.*: 48).

Government notes that the cost-rental approach can be adopted by providers of all kinds—public housing bodies, non-profit housing associations and private investors—though some of the details would vary. Consequently, it notes an important connection between this aspect of the *Strategy* and the proposals for the enhanced provision of social housing through housing associations. The AHBs and the Dublin Social Housing Delivery Taskforce will also be encouraged to create more mixed-income developments in urban areas of high demand. Such developments would include a mixture of units, with a mixture of different types of tenants, paying different forms of rent, including differential rent and cost-based rents.

### 2.2.2 Managing the Transition of Encumbered Buy-to-Let Properties

The second commitment is to further policy development to devise effective means of managing the transition of encumbered buy-to-let Properties. The strategy notes that, while this is firstly a banking and finance issue, the way in which encumbered buy-to-let mortgages are handled can potentially have an important role in reducing the upward pressure on rents and eviction of low-income or rent supplement tenants. An effective strategy in this regard could result in a saving to the state vis-à-vis the cost of building new social housing.

### 2.2.3 National Policy for Investment, Standards and Regulation in the Private Rental Sector

The third commitment, which is reflected in *Construction 2020*, is the promise to develop a national policy towards professionalising the private rental sector, to include issues such as investment, standards and regulation. In doing this, Government intends to draw on the recent studies commissioned for the Private Residential Tenancies Board (PRTB) and on NESC's work on the future development of the private rental sector and its role in providing affordable and secure accommodation.

## 2.3 Recent NESC Reports and Papers on Housing Issues

This report draws on existing Council reports and a number of draft papers on housing discussed by the Council in the past year. In 2004, the Council published a report titled *Housing in Ireland: Performance and Policy*, and a number of individual background papers on demand, supply, social and affordable housing and land management. Following discussion in early 2014, the Council published its report *Social Housing at the Crossroads: Possibilities for Investment, Provision and Cost Rental* in June that year. In September 2014, the Council discussed a paper on housing supply and land, and in November it considered the private rental sector. In December 2014, NESC published a report *Homeownership and Rental: What Road is Ireland On?* and in January 2015 it considered a report entitled *An Analysis of Current Approaches to Sustainable Urban Development in Ireland: Case Studies from Dublin*, which will be published soon.

These papers are relevant for a number of reasons. One is that *Homeownership and Rental: What Road is Ireland On?* analysed the evolution of the private rental sector and outlined the scale and nature of what would be involved in putting rental on an equal footing with homeownership. We draw on this below. A second reason is that analysis of the key challenges concerning the rental sector, particularly the critical need to ensure a healthy and appropriate future supply, brings to the surface the issue of land management and its role in housing supply. This was a central theme in the Council's 2004 report on housing and was discussed by the Council in September 2014. As will be made clear below, to have any

prospect of generating a suitable supply of rental homes—or, indeed, affordable housing of any kind—it is now necessary to achieve more direct public influence on supply through co-ordinated use of public authority, assets and capabilities-focused land management, infrastructure and housing affordability. This is outlined at several points in this paper and is the subject of a forthcoming NESC report on housing supply and land management.

# Chapter 3

## Understanding Ireland's Private Rental Sector

## 3.1 Introduction

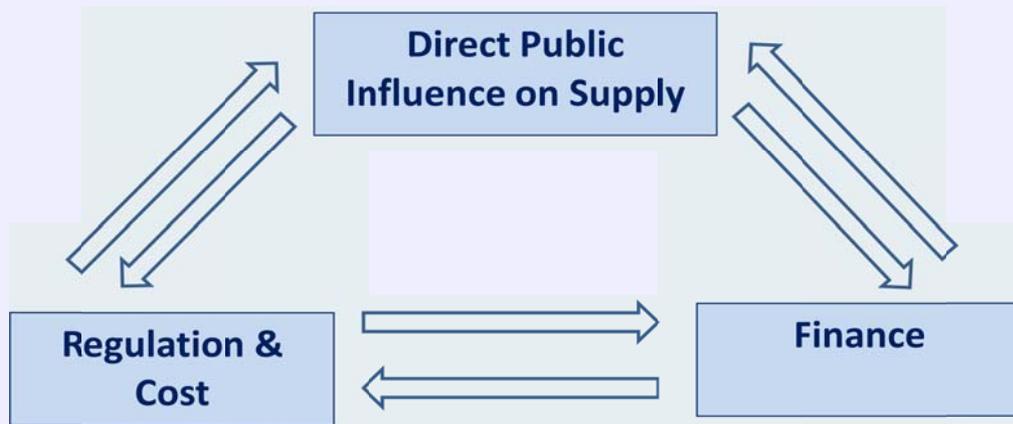
This chapter provides an understanding of Ireland's private rental sector. It highlights the interdependent elements of a sustainable housing policy: finance, direct influence on supply and the regulation and cost regime. It discusses Ireland's changing tenure mix and provides an overview of the current rental sector. The relative advantages of ownership versus rental are discussed. It also notes the degree to which the nature of the rental sector is related to the characteristics of the overall housing system. Finally, it highlights the uncertainty facing all stakeholders and actors—tenants, landlords, investors and public policymakers—and considers how to respond.

## 3.2 Interdependent Elements of a Sustainable Housing Policy

### ***Finance, Direct Influence on Supply, Regulation and Cost***

The Council's 2014 work on social housing identified three interdependent elements necessary for an effective overall approach. These are new financing mechanisms, regulation and cost, and sufficient direct public influence on supply, as illustrated in Figure 3.1.

A key feature of this is the deep interdependencies that exist between these elements. As explained in *Social Housing at the Crossroads*, (NESC 2014a), each of the elements depend on features of the others, and in a functioning system they are mutually supportive; consequently, none will be effective if the others are not also in place and effective. While this perspective was formulated to describe the challenge facing social housing policy, our subsequent work on other aspects—the changing tenure mix and the development of the private rental sector—has underlined its wider relevance.

**Figure 3.1: Interdependent Elements of a Housing Policy**

Indeed, it is notable that almost all of the many ideas now circulating about how to incentivise or drive the supply of affordable rental accommodation involve some suggestion on how to combine finance, a direct influence on supply and the cost and rental regime. For example, among these are suggestions that it is possible to deliver new apartment buildings by combining state provision of land, with private or European Investment Bank off-balance sheet funding, underpinned by a payment and availability agreement in which the State guarantees to pay rent for some proportion of tenants, often with an AHB role in ongoing housing management. Consequently, this framework is a useful way to think about the housing system and to begin comparison of different proposals concerning provision of rental accommodation.

But it has a further value that is relevant in the current logjammed conjuncture. As will become clear, there is a danger that, in desperation to incentivise supply, public policy will get drawn into an overly narrow framing of the problem—as being mainly concerning the profitability of development as determined by the relation between construction/development costs and property prices/rents. The relation between cost and prices remains important but, framed in that way, there is a real danger that public policy will:

- a) devise overly generous incentives; and
- b) buy into a logic that suggests that supply requires a return to peak-level prices, and with it the logic of a cyclical, speculative housing system.

By bringing the conditions of land availability and other influences on supply into the picture, the framework widens the scope of policy action. Put succinctly, some of the blockages to appropriate supply may lie elsewhere and might not be best

addressed by priming the relation between costs and prices and stoking the profitability of the existing actors. Instead, as argued in the Council's 2014 report on social housing, new institutional arrangements are necessary to create an effective and interconnected combination of finance, direct influence on supply, cost and regulation. We explain and discuss this further in the forthcoming NESC report on housing supply and land management.

This framework reflects the central role of housing supply and cost in determining affordability and stability in the housing system. It is important to see that the responsiveness of housing supply shapes not only the price of housing but also the degree of volatility (Cheshire *et al.*, 2014). The less responsive the supply, the more any increase in demand will drive up prices.

It is important to look beyond immediate prices and to focus also on average and long-run housing prices. The price and affordability of housing is not a natural fact: it is determined by policies and institutions and other factors that influence supply and demand. It is sometimes inferred that if houses or apartments are being sold or rented at a given price, then this is the *necessary* or natural price and cost of housing; this thinking is surprisingly widespread and influential. It is not correct, because it ignores what lies behind price and cost. If food were made artificially scarce, then we would observe €20 being paid for a loaf of bread; it would not be seen as sensible or economically correct to infer that this is the necessary price or affordability of survival. Some of the most densely populated places on earth (e.g. the Netherlands) and some with the highest incomes (e.g. Germany) have systems that yield more affordable, high-quality homes, in markets that are more stable, than countries in which land is relatively abundant, like Britain and probably Ireland.

One economic perspective suggests that we pay close attention to both 'supply' and 'demand', and this influences the analysis and arguments in this report. But it is important to see that recognition and understanding of supply and demand as *forces* influencing the quantity, price and affordability of housing is not the same as saying that we can rely on the market to yield good housing outcomes. It is easy to miss this distinction because the term 'supply and demand' is often used as a shorthand for referring to markets and to the complex set of ideas that underpin the proposition that a system of markets will have certain properties.

### 3.3 Understanding Ireland's Changing Tenure Mix

NESC's November 2014 report *Homeownership and Rental: What Road is Ireland On?* analysed in some detail the evolution of the changing tenure mix within Ireland's housing system. It undertook this descriptive and analytical task, rather than advance policy recommendations, because it is important to understand the nature of the private rental sector, and its place in Ireland's overall housing system, before envisioning its future role.

In broad terms, it is important to understand the following. First, in the decades from 1960 to 1990, Ireland experienced a strong increase in the share of homeownership. While a number of economic and social factors drove this increase, the most important was probably a set of public policies that heavily subsidised owner occupation. Second, and related, the share of homeownership peaked at 80 per cent in 1991, reflecting the subsequent withdrawal of many of these supports, within a policy approach that still envisaged homeownership as the dominant and desirable form of tenure. Increased credit availability and a brisk rate of inflation allowed the level of homeownership to continue increasing as policy supports were weakened. Third, the significant increase in the share of the rental sector, specifically the private rental sector, from 11 per cent in 2002 to 19 per cent in 2011, can be attributed to the confluence of a number of factors that characterised Ireland's economic boom and bust. Among these are:

- a) Inward migration and economic growth that greatly increased the demand for rental accommodation;
- b) Rising property prices, which made investment in rental property an attractive option and pushed the price of homeownership beyond the reach of many;
- c) The explosion of credit availability, which encouraged many to seek capital gains through taking mortgages to purchase buy-to-let properties;
- d) Continued limited supply of social housing through either local authorities or AHBs, which pushed low-income families to use housing supports in the private rental sector; and
- e) The economic crisis, housing bust and credit freeze from 2008 to 2013 or so, which strongly favoured rental over home purchase.

Consequently, the growing share of the private rental sector is, to date, in large measure a side effect of three very particular economic conjunctures (the credit and housing boom, strong inward migration and the housing bust) and one major policy conjuncture (the retreat from new social housing provision that characterised most of the period from the late 1980s to the present). Furthermore, as we discuss below, the kind of private rental sector that Ireland has developed is closely related to the main features of the overall housing system and housing market—speculative, unstable and developer-led.

The origins and nature of the expanded private rental sector are relevant, in two distinct ways, in thinking about its possible future nature and its ability to meet the goals of housing policy—affordability, sustainability and inclusion. First, the particular parentage of the existing private rental sector leaves a range of legacy issues that need to be understood and, if possible, addressed—taking short-term measures that have a long-term logic. Among these are the problems of encumbered buy-to-let mortgages and the high share of social tenants in the private rental sector. Second, the mode of investment and provision that characterised the expansion of the private rental sector between 2003 and 2013—

in which individuals used high levels of bank borrowing to buy second homes to become small-scale, individual landlords—cannot (and probably should not) be relied on in future. Not surprisingly, one of the most pressing questions currently being discussed is the prospect for investment in provision of rental accommodation and the terms on which this might be done. As we will see, together these factors create considerable uncertainty about the prospects for a professionalised rental sector that offers households a secure lifelong, or even medium-term, home.

## 3.4 Ireland's Private Rental Sector Now

This section provides an overview of the size of the private rental sector, those living in rental accommodation, some characteristics of landlords, and recent trends in rents. A number of data sources are drawn upon, both here and elsewhere in the report. First, Census 2011 data is used. This is the most accurate source on the number of households living in the private rental sector, and it includes significant socio-demographic data on these households. However, the data is now four years old, and so newer sources of regularly published data are also drawn upon. These include national figures from the Private Residential Tenancies Board (PRTB) on the number of private tenancies registered with them (although they estimate that about 10–15 per cent of tenancies are not registered), rents paid under these tenancies, and data on rental disputes. Quarterly data published by Daft.ie on asking rents and the stock of rental property on the market are also used; as are statistics published by Government bodies on rent supplement, Rental Accommodation Scheme (RAS) and buy-to-let mortgages. Finally, some recent one-off surveys on the private rented sector are referred to.

### 3.4.1 The Size of Ireland's Private Rental Sector

Census 2011 shows that 305,377 households were renting from a private landlord in that year—19 per cent of all permanent private households. Rented accommodation was most likely to be located within the main urban centres. In the city of Galway, 40 per cent of households rented, followed by 34 per cent in Dublin, and 29 per cent in Cork (CSO, 2012b). Apartments were the most popular type of privately rented accommodation (85,000), followed by semi-detached houses (83,000). Three-quarters of apartments were rented, and one-third of both terraced and semi-detached houses.

The number of tenancies registered with the PRTB indicates that private renting has grown in popularity since 2011. Although the PRTB figures for registered tenancies are lower than those in the Census (due to under-registration), they show an

increase of 45,000 households renting privately between 2011 and the end of December 2014<sup>1</sup>.

The amount of stock available to rent (i.e. advertised vacancies) has, however, fallen since 2011. DAFT figures show that at the end of 2011, approximately 15,000 properties were available to rent in Dublin, but by February 2015 this had fallen to 5,200. Outside Dublin there were fewer than 550 properties available to rent in total between the four cities of Galway, Cork, Limerick and Waterford on 1 February 2015—the lowest level since 2007 (Daft.ie, 2015). It has been reported by Sherry Fitzgerald (2015) that there were more sales than purchases of buy-to-let properties by investors in 2014 indicating a decline in the stock of buy-to-let rental properties but official data on the size of the rental sector are only available periodically from the census.

### 3.4.2 Profile of Renters

Census 2011 shows that 128,795 households headed by a foreign national were renting from a private landlord in 2011<sup>2</sup>, making up 42 per cent of all households renting privately.

Social welfare data for 2011 show that 90,026 households were in receipt of rent supplement<sup>3</sup>, while Department of Environment data show a further 16,549 were on RAS with a private landlord. Combined, there were 106,575 households with support from rent supplement or RAS; this amounts to 35 per cent of all households renting privately. In July 2013, the Minister for Housing and Planning announced the introduction of the Housing Assistance Payment (HAP). It is intended that those with a long-term housing need, and eligible for social housing support, will be transferred to this scheme. This is a major policy development. Section 2 of the Background paper for this report provides an overview of HAP, the rationale for its introduction, and the benefits and challenges that are arising. That Section is based on detailed interviews with stakeholders working to implement HAP.

In 2004–5 (the latest year for which there is data), there were also 24,000 individual students renting from a private landlord (Cotter & Murphy, 2009). On average, there are 2.73 persons per household in Ireland, so an approximation of the number

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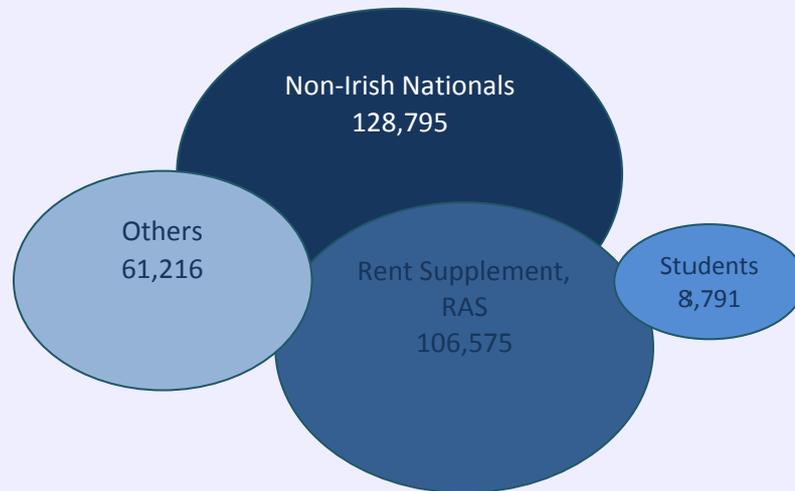
<sup>1</sup> PRTB Annual reports, 2011 to 2013; data for 2014 supplied to NESC.

<sup>2</sup> There may be Irish nationals living in these households headed by non-Irish nationals, as partners, or co-residents in a shared dwelling.

<sup>3</sup> *Statistical Information On Social Welfare Services* (DSP, various years) shows that in 2011 96,803 tenancies received rent supplement. The Department of Social Protection informed NESC that 7 per cent of these tenancies were in shared accommodation, and the remaining 93 per cent were tenancies of individual households (e.g. single people, two-parent families, lone parents and children, generally with sole and exclusive use of the accommodation). Almost all rent supplement is paid to private landlords. The number in receipt of rent supplement has fallen since 2011. At the end of 2013, there were 79,788 recipients (DSP, various years).

of student households renting in the private rented sector is 8,791, or just under 3 per cent of all households renting from a private landlord.

**Figure 3.2: Estimations of the Key Groups of Households Renting Privately**



We illustrate with a Venn diagram rather than a pie chart because there is undoubtedly some overlap between the three main household groups described above. Consequently, numbers cannot simply be added. An example would be non-Irish nationals in receipt of rent supplement, or non-Irish nationals who are students, etc. Nonetheless, the data do give a picture of the key groups renting privately in Ireland: those of other nationalities, those in receipt of state housing supports, and students. There are also 61,216 other households, or 20 per cent of households renting privately, who do not fit into the above groups.

In 2014, the majority of all those renting are young (18–34) and single (63 and 61 per cent respectively). There are also more families renting. In 2006, 22 per cent of families with pre-school children rented, and 18 per cent of families with primary school children; compared to 35 per cent and 29 per cent respectively in 2011 (CSO, 2012a).

Survey evidence suggests that the number of people who see private renting as their preferred option is small: only 17 per cent of private renters see themselves as renting long-term (DKM Economic Consultants *et al.*, 2014c). However, for various reasons—limited ownership prospects, the preferences of migrants, student population and reliance on private rental for social housing—it seems likely that the private rental sector will continue to be a significant tenure for a proportion of the Irish population.

### 3.4.3 Profile of Landlords

Irish landlords are predominantly small-scale: 65 per cent rent one property, and 26 per cent rent 2–3 properties (*ibid.*). Around one third are believed to be ‘accidental landlords’, in that they are renting a property due to inheritance, or are unable (or unwilling) to sell it due to negative equity. Some with mortgage arrears are now renting themselves.

There is also some new institutional investment through Real Estate Investment Trusts (REITs) which are estimated to own 1,500 rental properties, nearly all in Dublin, with projections suggesting that in five years this could grow to 15,000 properties or 2 per cent of the market (*ibid.*). There are also around 3,000 purpose-built student accommodation units. There are also at least 4,000 lodgers renting a room in another person’s owned principal private dwelling (*ibid.*).

In total, at the end of Q3, 2014, 300,543 tenancies were registered with the Private Residential Tenancies Board. The PRTB estimates that approximately 10 per cent of current tenancies are not registered.

In terms of small-scale landlords—which are estimated to provide over 90 per cent of rental properties—it is possible to identify three cohorts<sup>4</sup>:

- **Properties with debt:** There were 141,000 buy-to-let mortgages in Q4 2014 (Central Bank, 2014), or 47 per cent of registered tenancies. However, a survey of landlords in 2014 reported that 70 per cent of landlords have outstanding debt. The higher figure could reflect that a third of landlords own more than one property, and so could have a debt on one property, but not on others. In addition, it may be that debt on some rented houses is based on an owner-occupier mortgage. Almost 20 per cent of landlords reported that they are renting out their original primary residence because they were unwilling or unable to sell it due to negative equity. Assuming these only rent one property, this could mean that there is in the region of another 57,000 (19 per cent of 300,000) rented properties with debt. In total, this suggests that there could be up to approximately 198,000 properties with debt.

An important distinguishing characteristic within this cohort is the time when loans were taken out. This has a critical bearing on the yield of these investments.

- **Properties with debt in arrears:** There are 35,600 buy-to-let mortgages in arrears (Q4 2014). In addition, some of the 57,000 mentioned above, may be in arrears. Targets for mortgage restructuring have been set for the six main banks. The most commonly proposed solution is loss of ownership; this applied to almost 18,000 mortgages (69 per cent of proposed solutions) while restructuring

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<sup>4</sup> It may be that some landlords have a mixture of property with debt and no debt.

was the proposed solution for 7,800 mortgages (31 per cent of proposed solutions). Data has also been published on what the Central Bank refers to as 'concluded solutions'. There have been over 15,000 concluded solutions on buy-to-let arrears and 57 per cent of these were loss of ownership (8,600 mortgages) while 43 per cent of the concluded solutions were restructurings (Q3 2014). A concluded solution involving loss of ownership means that action has been taken to initiate court proceedings.

- **Rented properties with no debt:** It is difficult to estimate precisely the number of properties that are debt-free. One way is to subtract those with debt from the total. However, the total is not clear. Based on registrations with the PRTB (though as stated this underestimates the number of tenancies by around 10 per cent or 30,000), the number without debt is somewhere in the region of 130,000 to 190,000.

The composition of tenants in the rental sector and the financial position of landlords explain many of the features of the sector and are relevant in considering its future.

#### 3.4.4 Rents in Ireland

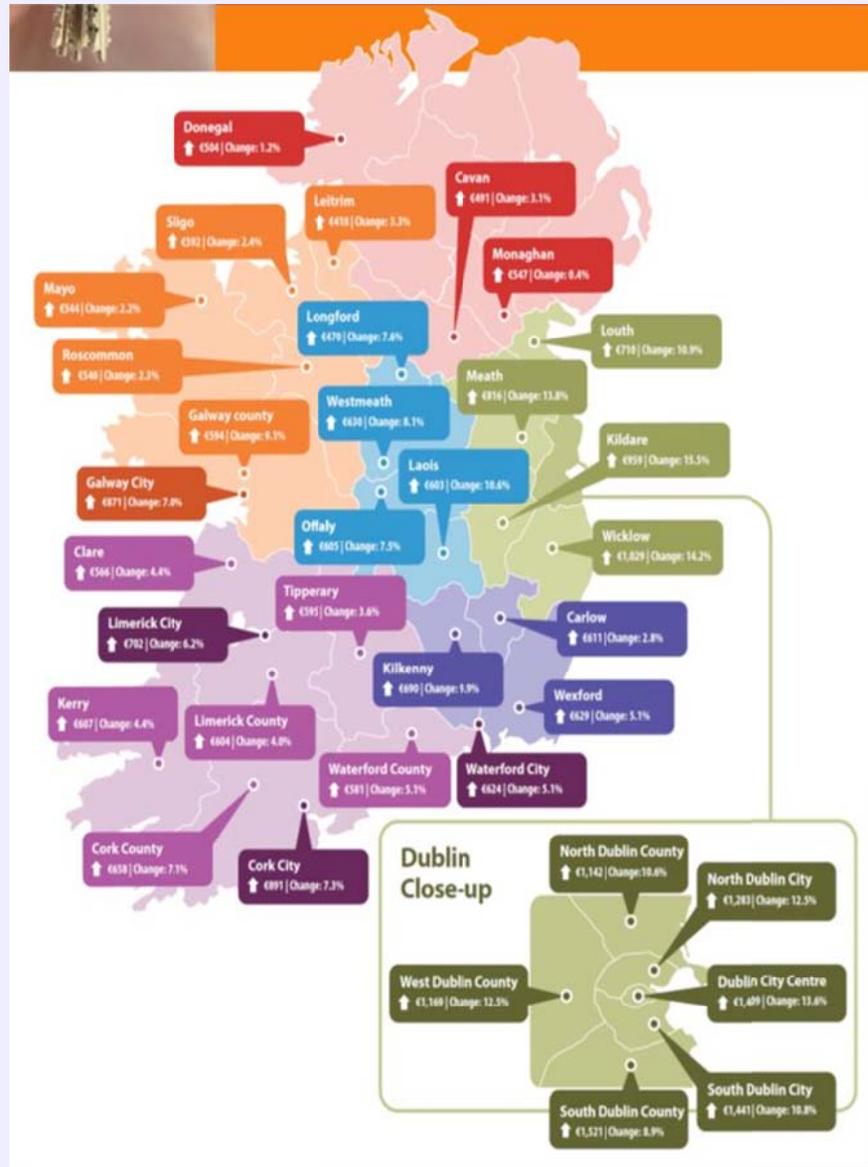
Over the past seven decades, rents in Ireland have typically increased in nominal terms by around 5 per cent annually (Lyons, 2014). The past 15 years or so have been an exception. Rents have been highly volatile over the shorter period and, notwithstanding large increases in rents since 2013, the nominal level of rents in 2013 was roughly the same as a decade earlier. The long-run nominal annual growth in rents of 5 per cent may seem high but is considerably lower than the rate of inflation over this period: from 1947 to 2013, rents fell by around 40 per cent in real terms. Across different decades there was great variation in rental trends. From the late 1940s to the early 1970s, rents increased in real terms by around 30 per cent. In the following decade they fell sharply by around 60 per cent in real terms; nominal rents did not fall but the general level of prices increased at a much higher rate than rents. Subsequently, real rents increased in the 1980s and 1990s.

However, in the three years since the end of 2011 rents have increased in Dublin by 21 per cent, and by 8 per cent nationally (PRTB, 2014). This can be related to the shortage of supply in comparison to demand. Figure 3.3 illustrates the rents being sought in 2014 and year-on-year change across Ireland. In Q4 2014, the average asking rent nationwide was €949, up 10 per cent from one year previously (Daft.ie, 2015). This average hides significant regional variations, with the asking price for rents lowest in Leitrim (€418 per month, up 3 per cent in the last year) and highest in South County Dublin (€1,521 per month, up 9 per cent in the last year).<sup>5</sup>

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<sup>5</sup> PRTB data on average rents paid (not sought) for registered tenancies shows only slightly lower figures—€409 in Leitrim and €1,473 in Stillorgan (data is not available for South County Dublin as a whole). See

Figure 3.3: Rents and Year-on-year Change in Average Monthly Asking Rents, Q4, 2014



Source: Daft.ie, 2015.

### 3.4.5 Rent Supplement and RAS

An important characteristic of the Irish rental market is rent supplement. Rent supplement, together with RAS, currently accounts for 34 per cent of tenancies in the private sector rented market (DSP, 2015). The amounts paid by the State are determined by rent limits set at each review undertaken by the Department of Social Protection. DSP has had a policy of setting rent supplement limits so that approximately 35 per cent of the rental market in any given administrative area is available to those on rent supplement. It uses PRTB data on rents to calculate this level. Tenants on rent supplement are not allowed to rent properties at rents above the rent supplement limits, and are not allowed to pay 'top-ups' to landlords. Strongly rising rents in recent years mean that some rent supplement tenants find that the maximum support available makes it hard for them to acquire or maintain tenancies in some areas. Consequently, the prevailing rent supplement limits have been the subject of considerable debate in recent years.

The most recent official review of the limits, published in February 2015<sup>6</sup>, shows significant variation in rent levels across Dublin postcode areas. Within Fingal, the Fingal county rent supplement limit (for a family with three children) is at or above the 35<sup>th</sup> percentile rent (as estimated from PRTB data) in some parts of the county but not others. The areas where the rent supplement is at or above the estimated 35<sup>th</sup> percentile are Dublin 15, Balbriggan, Kinsealy, Lusk, Rush, Skerries and Swords. In the rest of Dublin, the rent supplement limit for a family with three children is at or above the estimated 35<sup>th</sup> percentile rent in the following postcode areas: Dublin 5, 10, 11, 12, 17, 20 and 24. PRTB data show a total of 13,691 registered tenancies in these seven postcode areas in April 2015, so those would have approximately 4,600 tenancies available at or below 35<sup>th</sup> percentile rents, assuming a normal statistical distribution. In all other postcode areas shown in the review, 35<sup>th</sup> percentile rents are above the rent supplement limits (Dublin 1, 2, 3, 4, 6, 6W, 7, 8, 9, 14, 16 and 18). Although rent supplement and RAS households account for 35 per cent of tenancies nationally, in Dublin these households account for only approximately 26 per cent of all tenancies<sup>7</sup>.

One policy response to the pressures noted above has been the establishment of the National Tenancy Sustainment Framework and the Interim Tenancy Sustainment Protocol<sup>8</sup>. Under these, Department of Social Protection staff have statutory discretionary power to award, on a case-by-case basis, an extra supplement in cases where, for example, applicants are at risk of losing their

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<sup>6</sup> See Department of Social Protection (2015) *Maximum Rent Limit Analysis and Findings Report: February 2015*, downloaded from <http://www.welfare.ie/en/Pages/Maximum-Rent-Limit-Analysis-and-Findings-Report-February-2015.aspx>, 8 April 2015.

<sup>7</sup> The Department's report (*ibid.*) shows 25,453 households on rent supplement in Dublin in December 2014, and the Department of Environment's social housing statistics show a further 6,051 on RAS with a private landlord at that time. PRTB figures show approximately 124,000 households currently renting privately in Dublin, so those on rent supplement and RAS represent approximately 26 per cent.

<sup>8</sup> The latter was introduced in Dublin in 2014 and has recently been extended to Cork. Some stakeholders argue that it needs to be extended to other areas also.

tenancy. There is evidence that it is becoming increasingly necessary for Departmental staff to draw on these discretionary powers in the Dublin area. There are anecdotal reports that illegal top-up payments are made by rent supplement tenants to landlords in order to acquire and maintain tenancies<sup>9</sup>. There are also concerns about how the new HAP scheme will operate in the Dublin area, given that it does not have the same flexibility as the rent supplement scheme to increase payments.

The Department's 2015 report reviewing rent supplement limits suggests that increasing limits would have a number of negative potential impacts. Among these is the suggestion that an increase in rent supplement limits would give an impetus to landlords to renegotiate rents upwards. It also argues that it might drive rent price inflation in the wider market, particularly for low-income households that are competing for similar properties. It argues that the impact on new supply may be marginal at best, given the acute shortage of all rental accommodation. For these reasons, the report does not recommend an increase in rent limits and Government has accepted this advice. However, the report concludes that the existing maximum rent limits and the Department's policy response continue to remain under review. It notes that the Department will ensure flexibility in the scheme through the National Tenancy Sustainment Framework and the Interim Tenancy Sustainment Protocol.<sup>10</sup>

### 3.5 The Relative Advantages of Homeownership and Rental

In its 2014 report *Homeownership and Rental: Which Road is Ireland On?* the Council suggested that it was now necessary to explore Ireland's aspirations, goals and possibilities for homeownership and rental accommodation. It sought to contribute to this by clarifying the advantages and disadvantages of different tenures.

The report concluded that, while the perceived returns on housing investment may be exaggerated, when the alternative is lifetime renting in a profit-rental system, there are real advantages to homeownership (NESC, 2014b). Homeownership

<sup>9</sup> One survey by Threshold found that 44 per cent of its clients were paying illegal top-ups, which was putting them under significant financial strain.

<sup>10</sup> The Government has decided in principle (Decision S180/20/10/1729 dated 08/07/2014) to bring forward an amendment to the Equal Status Acts to prohibit discrimination in relation to residential tenants, or prospective tenants, on the basis that they are helped with their rent through rent supplement/housing assistance payment or other form of social welfare payment. The legislative amendments are currently being prepared in the Department of Justice and Equality in consultation with the Department of Social Protection and the Department of the Environment, Community and Local Government and the Office of the Parliamentary Counsel. They are expected to be ready soon and once approved by Government will be published as amendments to Employment Equality (Amendment) (No 2) Bill which is currently awaiting resumption of Committee Stage in the Seanad.

continues to offer significant attractions. Owners without mortgages enjoy a high level of security and relatively low housing costs. In normal circumstances, those who acquire a house with a mortgage benefit over time from a decline in the real value of the outstanding debt, and eventually acquire a valuable house. One significant disadvantage of homeownership is the possibility of buying before a large downward price adjustment—a contingency that materialised for a share of Ireland's households in the past decade. The eventual acquisition of a valuable asset through mortgage-finance helps with managing finances over a person's lifetime: lower housing expenditure when a mortgage is repaid helps to balance the lower income people have in retirement. If owner-occupation were to become a less common form of tenure, it is not clear how a future older generation would afford to pay for private rental accommodation.

The analysis of the relative advantages of homeownership over rental allowed the Council to consider the view, articulated by some, that achieving greater balance and parity between the two tenures is all about improving the image and perception of renting as a long-term housing option. There are indeed historical and cultural factors that reinforce the widespread aspiration to homeownership in Ireland. But the argument that focuses on history, culture, image and perception glosses over the hard fact that homeownership has concrete advantages—in terms of cost, life-time return and security—over rental. That argument can deflect attention from examination of the reasons why rental is currently a financially inferior option and less secure. It therefore deflects from serious exploration of the kinds of measures necessary to put private rental on a par with homeownership.

The report did emphasise that the advantages and attractions of homeownership are context-dependent and reflect the alternatives available. We discuss this in the next section, where we note that the nature of the rental system in any country is closely related to the characteristics of the overall housing system.

### 3.6 The Rental System and Housing Market are Closely Related

Homeownership is lower in some continental European countries compared to Ireland and other English-speaking countries. International comparisons of the housing systems of Germany, Austria, Sweden, the Netherlands, Spain and the UK suggest that 'in the English speaking countries and the countries of Southern Europe, homeownership is actually essential to acquire a degree of personal security and to offset individual risk' (Elsinga & Hoekstra, 2005: 105). By contrast 'In Germany, Austria and Switzerland there really is no necessity to enter into homeownership for the purpose of acquiring basic security and social acceptance' (*ibid.*: 105). This is explained by tenancy protection laws, fiscal support for landlords and the size, quality and status of the rental sector.

Indeed, international research underlines the degree to which the scale, nature and role of the private rental sector depends critically on the role of the social housing

and homeownership sectors. In particular, in countries with unitary rental markets, policy supports for the supply of cost-rental homes and effective regulation of the private rental sector mean that rental accommodation is a satisfactory long-term option for much of the population. By contrast in dualist rental systems, such as Ireland, long-term tenancy in a profit-rental house or apartment is not an attractive or secure long-term option, so that those who do not qualify for the public rental sector feel they have no option but to strive for owner-occupation. Table 3.1 identifies the broad characteristics of unitary and dualist systems and relates them to features of the overall housing system. For example, in a dualist and speculative system, as in Ireland to date, the very factors that drive households to escape from the private rental sector to get on the 'housing ladder'—rising property prices and insecure occupancy—are the exact factors that landlords feel they require to make the most of their investment.

**Table 3.1: Comparison of Dualist and Unitary Housing and Land Systems**

Dualist & Speculative	Unitary & Land Managed
<ul style="list-style-type: none"> <li>• Unstable prices</li> </ul>	<ul style="list-style-type: none"> <li>• More stable prices</li> </ul>
<ul style="list-style-type: none"> <li>• Rents rise with asset price for regulatory &amp; market reasons</li> </ul>	<ul style="list-style-type: none"> <li>• Predictable rents for regulatory &amp; market reasons</li> </ul>
<ul style="list-style-type: none"> <li>• Tenants are involuntary &amp; temporary</li> </ul>	<ul style="list-style-type: none"> <li>• Tenants are voluntary &amp; long-term</li> </ul>
<ul style="list-style-type: none"> <li>• A 'housing ladder'</li> </ul>	<ul style="list-style-type: none"> <li>• Less 'housing ladder'</li> </ul>
<ul style="list-style-type: none"> <li>• Pressure to borrow, lend &amp; give demand subsidies</li> </ul>	<ul style="list-style-type: none"> <li>• Finance less housing-based, reliance on supply-side policy</li> </ul>
<ul style="list-style-type: none"> <li>• Landlords, motivation is capital gain as much as income stream</li> </ul>	<ul style="list-style-type: none"> <li>• Landlords, motivation is income and long-term asset security</li> </ul>
<ul style="list-style-type: none"> <li>• The need for flexible tenure to achieve capital gains</li> </ul>	<ul style="list-style-type: none"> <li>• Landlords can bear long tenancies &amp; predictable rent uprating</li> </ul>

Source: Kemp & Kofner, 2010.

These observations about the systemic nature of housing, and the close relation between the overall housing market and the kind of rental system that is possible, have important implications. Note that similar pressure and claims are now evident in Ireland's homeownership and rental sectors. In the homeownership sector, many developers now claim that it is not profitable to build at current prices, but we have to fear that the price at which it will be profitable to build may not be affordable for many. Many landlords and potential investors argue that they are

making a loss, or have no incentive to invest, at current rents, but we have to fear that the rents needed to make investment profitable will be widely unaffordable and unattractive. The issue that links and drives these situations is the unstable and land-dependent housing system and its apparent inability to provide affordable housing in a stable and sustainable way. The problems are as much systemic as conjunctural or sector-specific. As noted in NESC's report *Social Housing at the Crossroads*, the impact is most visible on those in lower socio-economic groups (NESC, 2014b). However, it is also increasingly visible across other groups and with research suggests that it is having a significant and detrimental impact on competitiveness.

In its 2014 report on *Homeownership and Rental: Which Road is Ireland On?* the Council noted a further interesting relationship between the advantages and disadvantages of homeownership and rental—one that underlines the case for a more balanced system (NESC, 2014b). Homeownership has distinct advantages in terms of both cost and security, the main potential disadvantage being the possibility of negative equity or capital loss when buying in an unstable market that experiences a house-price bust. The European Commission and others emphasise that a reasonably large rental sector, providing good housing options for young people and those that cannot afford to buy, can play an important role in promoting macroeconomic and housing-market stability (Cuerpo *et al.*, 2014). Putting these two together, it becomes clear that development of a well-functioning and appropriately large rental sector can mitigate the main downside risk of homeownership. Perhaps such stability—provided by the rental sector and those households that have to adhere to stability-oriented rules such as the Central Bank's loan-to-value limits—should be thought of as a public good. Like other public goods, a case could be made that homeowners, who benefit most from the resulting stability, should share in the cost of its provision.

### 3.7 Housing and Competitiveness

The National Competitiveness Council has identified that the recent rapid growth in house prices and rents, particularly in Dublin, is a potentially destabilising development that can have significant adverse knock-on effects on wage expectations, cost competitiveness and inflation (National Competitiveness Council, 2014a, 2014b, 2013). It finds that increases in housing and utility costs accounted for 30 per cent of the increase in inflation between 2003 and 2012. This increase was strongest before 2007, and between 1999 and 2007 average yearly inflation increases of 7.2 per cent were recorded in these costs.

Rising housing costs impact on employees already in Ireland and on those considering migrating here. The impact of rising house prices on the Irish labour market has been modelled and this shows that both high- and low-skill migrants (but particularly the latter) are deterred from moving to Ireland by high housing costs (Duffy *et al.*, 2005). The effects of rising house prices are most keenly felt by immigrants and Irish first-time buyers.

The Society of Chartered Surveyors has also argued that rising rents, and the shortage of housing units could deter investors from establishing or expanding in Dublin because of the difficulties employees encounter in acquiring accommodation (Society of Chartered Surveyors of Ireland, 2015: 11–2).

It has also expressed concern about the impact of higher rents on students, which may be adversely affecting the ability of some third-level institutions to attract students.

## 3.8 Uncertainty

A central argument of this report is that there is considerable uncertainty concerning the private rental sector and, indeed, future supply of housing at the right quantity, of the right kind and quality, at an affordable cost and in the right locations.

### 3.8.1 Uncertainty Facing Tenants, Landlords, Investors and Public Actors

The most acute uncertainties are those faced by households in the private rental sector, particularly those on low incomes. They are uncertain:

- about the future rents they will be asked to pay;
- about whether their landlord will end their tenancy, and, in consequence,
- about whether their current home and neighbourhood will be a long-term one.

But landlords and potential landlords face a range of uncertainties also:

- about the future stream of rents;
- about how soon or how easily they will get vacant possession in certain circumstances, and
- some, with mortgages on buy-to-let properties, face uncertainty about how their bank will seek to restructure non-performing loans and/or interest-only loans.

Potential developers and investors in future rental accommodation can be uncertain about a range of significant factors:

- the availability of a suitable combination of equity and debt finance;
- the costs of development and hence the likely return;

- the extent and costs of regulatory delays;
- the availability and cost of land suitable for development;
- the willingness of the State to make public land available and on what terms this might be done;
- the future demand for different types of accommodation—apartments, houses, etc., and
- the terms on which the State will be willing to enter into new agreements covering the rents of intermediate households.

Public policy actors in departments, agencies and local authorities are uncertain about a range of factors relevant to both unblocking the current logjam and creating the conditions for ongoing supply of rental accommodation and, indeed, housing in general. And they are also uncertain about what regulatory reforms could achieve secure occupancy without damaging future supply of rental accommodation. The policy actors' uncertainties include the following;

- Which of the many factors said to inhibit current supply—development levies, standards, finance, etc.—should they modify and what would the likely response be?—an issue discussed in the Council's forthcoming report on housing supply and land management;
- If development levies are reduced, in an effort to facilitate supply, how should the provision of necessary social infrastructure be funded?
- Whether, despite the apparent return on paper, institutional investors really will come forward to develop and provide rental accommodation that is affordable to a range of households, rather than just to the high-end market;
- What will be the effect of the new planning provisions currently being passed into law;
- What supply-side incentives should be created to encourage supply of rental accommodation that meets the goals of affordability, sustainability and inclusion, while also acknowledging that actors' response to arm's-length incentives can be unpredictable (not because people do not respond to incentives, but because they are complex and not always obvious);
- Whether the future supply will match the pattern of need suggested in the analysis provided by the Housing Agency and others;
- Whether the scale of new provision envisaged in the *Social Housing Strategy* will be achieved; and

- Whether the targets expected to transfer to the HAP will be achieved.

And, like others, NESCC cannot claim to be certain about what precise policy measures will be effective in resolving the current logjam and in driving the supply of affordable housing.

### 3.8.2 Strategic Uncertainties

Taking all of these points together, there is considerable strategic uncertainty about the future shape of the Irish housing system. It is very hard to know which of the following scenarios will or can characterise a future housing system that meets the goals of affordability, sustainability and inclusion.

- A growing private rental sector that is affordable and stable, combined with somewhat increased social housing and continued fall in the share of homeownership—a German-type model.
- Strong and sustained increase in the share of housing provided by AHBs and local authorities, combined with homeownership and a relatively small private rental sector—a Dutch-type model.
- The creation of a large amount of affordable and sustainable housing for purchase (or shared ownership), with somewhat increased social housing and a private rental sector that remains residual and transitory—a more affordable version of the British or Australian-type model.

Consequently, a central thrust of the Council's analysis is the need to find ways of acting in such an uncertain world.

## 3.9 Responding to Uncertainty

There are three general kinds of response to uncertainty:

- Wait—until more certain information, and/or more favourable conditions, are provided by events or analysis.
- Insure against uncertainty, price it in some way or create incentives that will resolve or reduce it.
- Establish framework goals and institutional arrangements for experimentation by the range of relevant actors, and a system of monitoring, feedback and adjustment.

To some degree, Ireland's response to housing issues since the onset of the crisis has involved waiting—although not so much on the issue of mortgage resolution or, more recently, social housing.

A version of the second response would be an attempt to design a set of arm's-length incentives that will be so smartly designed that they address exactly the truly binding constraint on private development by existing industry actors, without creating any unintended consequences. In the face of the pervasive uncertainty described above, this seems fairly futile; no actor has sufficient panoramic knowledge to identify the truly binding constraint and what change in incentives would relax it. Nor have all actors an interest in disclosing all the relevant information. In that context, it is not surprising that the search for measures to unlock the current logjam in Irish construction and housing supply has not converged on a clear, actionable answer.

We believe that the third response to uncertainty is the most promising. Two core policy ideas and developments are critical in informing and building an institutional response that tackles this combination of strategic uncertainties and long list of specific uncertainties:

- Mobilising public authority, assets and capabilities to focus on housing supply, land management, infrastructure and housing affordability; and
- Movement towards a unitary rental system with permanent, affordable, cost-based, mixed-income rental as the guiding framework for conditional supply-side subsidies.

Instead of being paralysed by the many uncertainties, this involves taking these uncertainties inside an institutional system whose operation is informed by principles of the following kind:

- The Government's goals of housing policy—affordability, sustainability and inclusion.
- Active land management.
- Secure occupancy and permanent, affordable, cost-based rental as a guiding framework.
- Step-by-step identification of the constraints on development and housing provision in specific contexts.
- New financing models, including those offered by public bodies.
- Sustained analysis and action on the factors that make provision of housing so costly in Ireland.
- Innovation and new business models in construction, and

- Exploration of shared ownership and community land trust possibilities.

### 3.9.1 Evolving Responses to Uncertainty

In the policy areas that bear on Irish housing—including banking policy, mortgage arrears policy, planning policy and housing policy proper—elements of all three responses to uncertainty can be observed since the onset of the crisis. A central argument of this report, and the forthcoming report on housing supply and land management, is that the more the focus is on housing, the more the third, institutional response to uncertainty becomes essential. Indeed, this is already evident in some of the key steps taken in the past year—the Housing Agency's holding of land from the Land Aggregation Scheme, the increasing focus on the housing role of NAMA, the creation of the Dublin Housing Supply Task Force and the Dublin Social Housing Delivery Task Force and wider work under *Construction 2020*. But the more we consider the current conjuncture and take into account the long-term pathologies in housing supply, the stronger becomes the conviction that these developments still fall short of what is required. Further consolidation and exercise of public authority is needed to achieve the common good.

A central argument of NESC's 2014 report *Homeownership and Rental* was that the trends in Ireland's tenure mix and the relative advantages of homeownership and rental, noted above, pose challenging questions to Ireland's overall approach to housing policy that must now be addressed.



# Chapter 4

## A Vision and Strategy for the Rental Sector in Ireland

## 4.1 Introduction

At present, the discussion of Ireland's rental housing sector is framed in narrow terms. While some advocate rent control, others dismiss this, arguing instead for incentives to encourage developers to increase supply. The Council believes that this dualist framing of the issues is misleading. It prevents a realistic but ambitious discussion of what is required to support the development of a sustainable, affordable and attractive rental sector.

To put the discussion on a better track, this chapter advances a series of arguments and sets out a vision and strategy for the rental sector in Ireland. This is done in four steps:

- Breaking free of the current dualist framing of the issues: rent control versus incentives for developers/investors;
- Putting policy for the rental sector in a wider strategic context: active housing supply and land management and the creation of permanent, affordable rental housing as a guiding framework for supply-side supports with conditionality;
- Underpinning this wider approach with active policy on two fronts: delivering the *Social Housing Strategy* and addressing the problem of encumbered buy-to-let properties; and
- Pulling the strands together to set out a new vision and strategic approach to the rental sector.

The Council believes that only with this vision will it be possible to develop the rental sector within an effective response to Ireland's overall housing challenge. It is vital not only for achieving social progress and cohesion, but also to underpin further development of a competitive economy.

## 4.2 Breaking Free of the Dualist Framing: Rent Control versus Incentives for Developers

The current housing situation starkly highlights the vulnerability of tenants in the private rental sector (and the related exposure of the State to rising rents) and the limited supply of affordable and suitable rental accommodation. In current policy discussion, there is a tendency to adopt a dualist framing of these issues in which the case for greater rent control, or rent certainty and security of tenure, is counterposed to arguments for incentives to encourage developers and investors to resume construction and supply. This dualist framing is illustrated in Figure 4.1.

**Figure 4.1: The Current Framing of the Debate on the Rental Sector**



There are a number of drawbacks to this.

First, with the dualist framing, debate tends to polarise and there is a risk that these two positions will cancel each other out, yielding limited policy progress.

Second, if one or other of these policy positions were to prevail, there is a real risk of limited success and some unintended consequences. Without greater rent certainty, the acute pressures facing those on lower incomes, amounting to economic eviction and homelessness for some, will continue. Without more supply, upward pressure on rents and all the associated problems will continue.

Consequently, there is a need for effective policy action on both fronts—greater rent certainty and increased supply of rental accommodation. The back-and-forward debate between these two needs to stop now.

However, it is not just a matter of progressing from either/or (rent control or incentives to developers and investors) to a focus on both/and. Even that way of framing the problem—and progressing to policy design on both fronts—contains significant risks.

First, there is a risk that an overly blunt system of rent control would damage future supply and could encourage some existing landlords to leave the rental sector.

Second, there is a risk that in its desperation to incentivise development and supply, policy will offer excessively generous provisions and insist on insufficient conditionality. Such incentivising provisions might apply either to new investments or to existing landlords.

As well as accepting the need for policy on both fronts—rent regulation and incentives for supply—the kind of action required on each needs to be re-thought in line with the best international thinking and practice in order to;

- focus not on rent control of a traditional kind but on what is required to give tenants secure occupancy; and
- focus not on ad hoc incentives for developers but on a coherent set of supply-supporting measures with appropriate conditionality.

We summarise these ideas here, but they are discussed and developed in greater detail throughout the report.

In international policy and analysis of rental housing, the focus has shifted from legal security of tenure and rigid rent control to ‘secure occupancy’ (Hulse & Milligan, 2014). This does, indeed, depend on appropriate legal provisions concerning tenure and rent-setting, but also on other factors including actual practice and tenant’s perception of security. What Ireland needs now are provisions that support secure occupancy, and we propose such measures in Chapter 5. Without these it is impossible to envisage a larger, high-quality rental sector that provides affordable accommodation as a lifelong, or even medium-term, option for households. The absence of secure affordable rental accommodation is now undermining Ireland’s competitiveness and the damage to overall economic performance is likely to increase.

On the side of supply, more is needed than ad hoc measures, such as reducing development levies or VAT on construction, in the hope that they will incentivise developers and builders to restart construction. As we explain later and in a forthcoming report, the focus on individual cost problems and possible ad hoc responses neglects wider barriers to supply and gives insufficient attention to the kinds of conditionality that should accompany state action to reduce costs or taxes. Instead, we need a range of supply-oriented supports to generate a healthy supply of permanent affordable accommodation that matches demographic patterns, located in and near the centres of population and employment. Without this there will be continued scarcity, pressure for increases in rents and housing supports, and a race for each household to ‘get on the housing ladder’, with consequent competition between homeownership and rental.

Combining the need for action on both fronts with this rethinking of the approach needed in each case we can move beyond the dualist framing, shown in Figure 4.1, to a more integrated statement of the policy challenge concerning Ireland’s rental sector, shown in Figure 4.2. Exploration of this integrated policy agenda is the core focus of this report while Chapter 5 examines secure occupancy and Chapter 6 outlines measures to support supply.

**Figure 4.2: A More Integrated Perspective on Policies for the Rental Sector**

But as we now explain, policy on both of these fronts will not be sufficient. Unless wider land and housing supply problems are addressed, these policies will pull against and undermine each other. It is not just a matter of moving from either/or to both/and.

### 4.3 Putting Rental Sector Policy in a Wider Strategic Context: Active Supply Management and Cost Rental

The two policy requirements, regulation for secure occupancy and supports to promote supply, can only be made consistent when both are placed in a wider frame and supported by other policies. The wider frame and necessary additional policies are:

- Mobilising public authority, assets and capabilities to focus on housing supply, land management, infrastructure and housing affordability; and
- Moving towards a unitary rental system with permanent, affordable, cost-based, mixed-income rental as the guiding framework for conditional supply-side subsidies.

The Secretariat discussion's with a wide range of industry and policy actors in recent months clarifies why this is the case. Those discussions focused, among other issues, on the prospects of private investment in the provision of affordable rental housing, or projects that would provide for a mix of social tenants, intermediate households and market rents. Indeed, such discussions have been recently convened by government departments in the context of the *Social Housing Strategy and Construction 2020*.

Those discussions help identify three elements or levels, two of which are often run together and the third of which is usually not recognised:

- a) The terms that a private investor and the State agree on for the provision of rental accommodation (concerning the provision of state land, the composition of units and rent levels and P&A agreements; supports or not for intermediate households);
- b) A set of ‘cost of regulation’ issues that have become significantly more complex in recent years—often referred to, somewhat misleadingly, as ‘planning’ issues; and
- c) The higher-level land availability and land management problems that seem acute now, but that existed over many decades, underpinning the speculative and unstable pattern of housing supply and prices.

The distinction is important for a number of reasons. Most of the focus is on (a)—the terms on which it might be possible to coax developers and investors to bring forward new rental housing supply. This sometimes extends to (b)—ways in which the application of regulatory compliance/planning provisions or processes might be relaxed to encourage construction and supply in either. But if land availability and higher-order housing supply problems are not in view, three consequences are likely.

First, measures under (a) and (b) are likely to be less effective than expected and hoped for. Second, public policy is likely to over-incentivise private actors and under-do conditionality, as it desperately seeks to stimulate activity; it is likely to pile on the incentives in an effort to overcome the unacknowledged hurdles implicit in (c). Third, policy is more likely to focus on the relation of prevailing cost to prices/rents and on incentives (relying too much on what we later term an instrumental and incentive-based approach), rather than focusing on the varied and complex set of issues—organisational, financial, regulatory and planning—that are commonly involved in delivering housing of the right kind in the right place at an affordable price (what we call the coordinative approach, see Section 4.3.1). The incentive-based approach focuses on using public policy incentives to bring costs of development in line with selling prices and rents. But the underlying housing policy task is not that: it is, rather, to bring cost and prices in line with affordability. Only a vigorous coordinative approach, in which the State uses its authority and resources for active management of land and housing supply, within which appropriate incentives are set, can achieve this.

Without this wider framing there is a risk that—accepting the traditional business models, practices and industry logic—policy will inadvertently re-establish the traditional pattern in which an unstable housing market with a strong price cycle is seen as the unavoidable price that has to be paid to achieve adequate housing supply of the right kind in the right place (or even of the wrong kind in the wrong place).

There is also a risk that in thinking about how to offer key resources, such as state-owned land, policy will find itself conflicted about how to balance two important housing policy goals: increasing the provision of social housing by local authorities and AHBs, on the one hand, and creating a system of affordable housing provision

for intermediate households, on the other. The wider framing we propose offers a way of managing this tension.

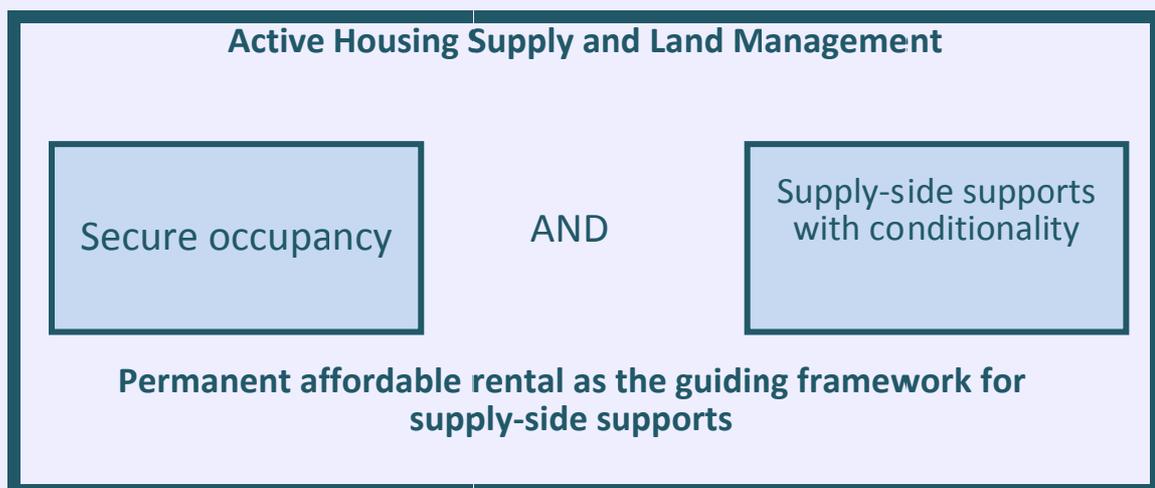
A further risk is that in its anxiety to incentivise supply, policy will accept under-provision of social infrastructure, or burden the State with the full cost.

What we hear in much of the current discussion, operating within the traditional frame, illustrates these tensions and risks: ‘the only way to get supply is to let the cost-price cycle unfold and limit planning restrictions that increase costs’; ‘the only way to secure rental provision is to have flexible rents and tenancies, with vacant possession on sale’. While such statements can be seen as promoting the interests of certain actors, they also describe fairly accurately the traditional reality of Ireland’s housing and rental system. Only by changing that reality can the goals of affordability, sustainability and inclusion be pursued.

Our central argument is that the necessary policy requirements, regulation for secure occupancy and supply measures with conditionality, can only be made consistent when both are placed within a wider strategic and policy frame and supported by other policy approaches.

Figure 4.3 illustrates the elements of this reframing. It highlights the need to focus on both secure occupancy and supply-side subsidies with conditionality, but as elements within a wider framing in which the State plays a more active role in housing supply, public infrastructure and land management. In addition, it shows that measures to enhance supply need to be informed by a sustained focus on growing a permanent, affordable rental segment in the Irish housing system that is moving towards a more unitary system.

**Figure 4.3: The Wider Framing of Rental Sector Issues**



We now discuss the two elements that make up the wider policy context within which action on secure occupancy and supply-side subsidies must be set: active supply and land management, and a guiding framework for supply-side supports.

#### **4.3.1 Mobilising Public Authority, Assets and Capabilities for Active Housing Supply and Land Management**

As emphasised above, the private rental sector issues (such as rent certainty and security of tenure) cannot be resolved without also addressing the supply challenge. But the supply challenge cannot be addressed without more direct state influence on housing supply and more active land management.

NESC's forthcoming report on housing supply and land management will be published shortly. This describes the current conjuncture and the complex set of bottlenecks that are inhibiting construction activity and housing supply. It distinguishes between two approaches evident in current government attempts to address the many factors restricting activity: an *instrumental approach, based on cost calculation and altering the incentives facing developers*, and a *coordinative approach, based on information gathering and alignment of actors*. It also questions the adequacy of the former approach, taken on its own, given that the current lack of construction activity and housing supply is 'over-determined'—there are more than enough sufficient causes to explain the lack of activity. Only by latching onto one or two of these explanations, and ignoring most of the others, can some analysts and actors be able to confidently assert that reduction of specific cost-creating factors (such as development levies, Part V, standards or VAT) would be sufficient to unleash development and supply. Finally, it suggests that the coordinative approach, already well underway, needs to be taken further and given greater institutional coherence and thrust.

Based on that analysis, the forthcoming report argues that it is now necessary to go further in mobilising public authority, assets and capabilities to take a more active approach to housing supply, land management, infrastructure and affordable housing. The resources, capabilities and assets accumulated in NAMA need to be even more actively combined with those in government departments, the Housing Agency, local authorities and other public bodies. These assets and capabilities need to be used as soon as possible to lead large-scale housing development that meets the need for affordable rental housing of the right type. It may also be necessary to create new institutional arrangements to facilitate the financing and delivery of social housing on a larger scale. Overcoming the current institutional fracture will allow decomposition of the existing supply and construction problem, initiation of action and innovation, and monitoring and adaptation. This approach should then proceed to a sustained, comprehensive and inclusive programme of inquiry, exploration and action to improve the costs, technology and innovative capacity of house building in Ireland. The crisis has revealed the need for the system to take an authoritative overview of the land and housing situation to manage land and housing supply, recursively combining land supply, finance and regulation. In returning to a more activist approach, Ireland can learn from other countries that use active land management and other policies to create more

affordable, stable and inclusive housing systems, which, in turn, underpin national competitiveness.

Although we see this as the critical context within which policies for the rental sector should be set, we do not discuss it further in this report. This context does, of course, inform the analysis of supply-side measures and conditionality below and in more detail in Chapter 6.

### **4.3.2 Permanent Affordable Rental as the Guiding Framework for Conditional Supply-side Subsidies**

The second element of the wider context is a clear conception of what Ireland is aiming for in using supply-side subsidies to support social and affordable rental housing. We suggest that the guiding framework should be movement towards a unitary rental system with permanent, affordable, cost-based, mixed-income rental. This involves creating policies that will ensure provision of affordable housing for intermediate households. These are households that struggle in the private rental sector and the market for homeownership, but may not be eligible for social housing or, even if they are eligible, are unlikely to be allocated it, given its scarcity. Before elaborating on the implications of this, we underline the degree to which such a focus on intermediate households is virtually implicit within existing policy.

Several aspects of existing policy on social housing embrace, or overlap with, the need to ensure provision of permanent affordable housing for intermediate households. As noted in Chapter 1, the goals of housing policy have been greatly clarified in recent months. These are more affordability, sustainability and inclusion. Furthermore, Government is clear about the nature and scale of the housing policy challenge, stating that enduring features of Ireland's demographic and economic context mean that 'one-quarter to one-third of the population will find it increasingly difficult to achieve homeownership' (DECLG, 2014: 17). A number of the key elements of the *Social Housing Strategy* touch on affordability within the rental sector and shortage of suitable accommodation for intermediate households. These include the commitment to increased delivery by AHBs, the creation of new off-balance sheet financing models and the focus on development of a cost-rental segment in the Irish housing system. The *Social Housing Strategy* sets out the broad logic of cost rental and of a larger affordable rental sector in a more stable and inclusive housing system. The introduction of HAP is a definite move in the direction of supporting the affordability of housing for intermediate households, since it is designed to be supportive of employment and involves income-related rent. Indeed, the income limits for access to the social housing list mean that measured housing need includes many intermediate households. The Government's strong policy leaning against segregated, stigmatised social housing, with high concentrations of social disadvantage, and its wish to create integrated, mixed-income housing and communities, also implies simultaneous provision of social housing, social housing supports and affordable housing for intermediate households. In summary, given the income limits on social housing, the challenge of delivering the targeted output of social housing by local authorities and AHBs, and

the difficulty in creating HAP tenancies, thought must be given about how to meet the need for affordable housing for intermediate households.

Our analysis confirms what is implicit in existing government strategy: policy must create a framework for a continuum of housing, from social through affordable housing for intermediate households. But the analysis, and implicitly government policy as summarised above, also strongly suggest that these tasks are best addressed in an integrated way. In other words, in designing and delivering its *Social Housing Strategy*, Government should recognise that this overlaps, and needs to be integrated, with its emerging policy to enhance the rental sector. Such an integrated approach would be more conducive to meeting several goals—social housing output, increased investment in rental housing provision, off-balance sheet funding, social integration and other goals—than an imposition of a rigid separation between actions and investments that provide social housing and developments with the potential to increase the availability of affordable rental.

In supporting and engaging with potential investors for provision of social or affordable housing, the State should seek a number of outcomes and reflect these in its criteria. These goals and related criteria, as they apply to social housing, are currently being developed within Government's work on the *Social Housing Strategy*. In designing supply-side subsidies, Government must strike a balance between desirable conditionality (concerning rents, tenure, allocation, management and the layout of housing developments), on the one hand, and achieving new investment and delivery, on the other. There are, of course, several goals and criteria. They are likely to include the nature, experience and reputation of potential investors (whether AHBs or private), the speed of delivery and quality of the proposed development, the cost of finance, conditions on the spectrum of tenants and rent levels, and the commitments the State makes to paying or guaranteeing rental income.

Our analysis leads us to two suggestions:

- i. In setting the goals and criteria for investments in social housing, the State should, as far as possible, integrate these with provisions and criteria for investments in affordable rental housing for intermediate households; and
- ii. The guiding framework for designing conditional supply-side subsidies should be movement towards a unitary rental system with permanent, affordable mixed-income rental accommodation.

These suggestions reflect the unitary rental and cost-rental approach that—as noted by the Council in earlier work and by the Government in the *Social Housing Strategy*—provides the basis for stable, affordable, rental housing systems in a number of European countries. We do not intend to restate the basic cost-rental analysis here.

It is, however, useful to draw attention to the reasons why—in seeking to build a strong sector of permanent affordable rental housing—the model of unitary cost rental provides a guiding framework for the design and implementation of supply-side supports with conditionality. Cost rental has the potential to provide secure

affordable housing to both intermediate and low-income households (if the latter receive additional supports). It achieves this in a number of ways, but primarily by:

- Insulating households from the increases in market rents that occur as property values rise.
- Ensuring that the equity in the housing stock that accrues over time is put to the service of continued affordable housing provision.

Further advantages can include limiting the residualisation and stigmatisation of publicly provided social housing, levelling the playing field between rental and homeownership, disciplining the profit rental sector through competition, insulating households from the full investment returns required by profit rental landlords and mobilising off-balance sheet finance for the supply of affordable housing. The Austrian experience illustrates that with efficiency in provision it is possible, with a cost-rental approach, to achieve an initial reduction relative to market rents that is greater than the level of subsidy provided (CECODHAS, 2013). Box 4.1 summarises some key features of cost rental.

One of its suggestions is that in setting goals and criteria to assess investment and development proposals, a relatively high priority should be given to creating accommodation and securing assets that will underpin *permanent* provision of social and affordable housing. Reflecting this, in Government's criteria for assessing investment possibilities, a relatively high weighting should be given to projects in which the eventual asset or equity (arising from maturation and amortisation of debt) will be put in the service of further provision of affordable and social housing. There are, naturally, several ways in which this could be achieved.

In addition to providing affordable homes in the coming years, building a segment of permanent affordable rental housing can act as a disruptive reform, in the sense in which this was used within the *Action Plan for Jobs*. The Irish private rental sector is dominated by the for-profit sector, with mostly small-scale individual landlords. Greater diversity and competition are required. With a sustained government focus on building the share of permanent affordable rental housing, it will be possible to transform the overall rental sector and with it the Irish housing system.

### Box 4.1: Affordable Cost Rental

#### Profit and Cost Renting Defined

Profit renting refers to a situation in which a landlord charges the maximum obtainable rent for a dwelling, regardless of the historic cost. Cost renting refers to a situation in which rents cover only the actual incurred costs of providing the dwelling (Kemeny, 1995). Initially, cost rents are not necessarily lower than profit rents. Subsidies have been widely used to enable a cost-rental sector to compete with profit rental in the early stages. Rents charged in countries with substantial cost-rental sectors, such as Austria and the Netherlands, are generally affordable rents in that they are less than market rents but would typically be higher than those paid by social housing tenants in Ireland.

#### Subsidies and Maturation Allow Rents to be Lower

Lower rents in cost rental does not depend solely on subsidies but are also affected by maturation. Maturation works as follows. The rising cost of providing new accommodation means that, over time, the costs of older accommodation declines relative to the cost of new accommodation. With cost rental, the benefits of the falling relative costs of older accommodation are passed onto tenants. The cost savings may be spread over both new and old accommodation: a process known as rent pooling. If cost-rental organisations are efficient, they may be able to achieve initial rent reductions that exceed the level of subsidies provided, even before maturation benefits arise. In the case of Austria, rents are not pooled but rents from the start are substantially below market rents. In an example of a cost-rental development in Vienna presented by CECODHAS (2013), combined subsidies are estimated to have a net present value of 13 per cent but the initial rents were 50 to 60 per cent of market rents. Some of the initial capital cost was met by the association's own equity on which they are allowed charge a limited return; this return is included in the rental figure quoted.

#### Affordable Rental

The definition of affordable housing varies internationally. In many countries, affordability is defined as housing costs that consume no more than 30 to 40 per cent of household income (McKinsey Global Institute, 2014). In Ireland, the Planning and Development Act (2000) defines affordable housing as housing or building land provided for those who need accommodation and who otherwise would have to pay over 35 per cent of their net annual income on mortgage payments for the purchase of a suitable dwelling. This Irish legislative definition refers to affordable housing for purchase. If this were extended to rental it would imply that affordable rental could be defined as rental housing provided for those who would otherwise have to spend more than 35 per cent of their net income on housing. This would cover existing social housing. However, affordable rental can be distinguished from existing social rental housing in that it would receive limited subsidies in comparison to social housing in which most of the costs are covered by subsidies. For higher income social tenants paying higher differential rents, social and affordable rental merge into each other. Affordable rental subsidies could be made available to both profit rental and non-profit rental organisations. The provision of incentives to both could maximise the response. However, the long-term impact on rents is potentially greater if provided by non-profit organisations adopting a broadly cost-rental approach. It may be feasible to achieve lower initial rents with non-profit landlords, and there is also the potential for non-profit landlords to use the benefits of maturation to sustain low rents or to cross-subsidise additional affordable rental accommodation.

### 4.3.3 Underpinning the Wider Policy Framework: Delivering the *Social Housing Strategy* and Addressing the Problem of Encumbered Buy-to-Lets

Furthermore, it is necessary to include in this policy discussion two additional policies that underpin this wider framing.

One is the *Social Housing Strategy*, which was noted in Chapter 1. As already observed, three aspects of that strategy are of particular significance: the commitment to increased delivery by both AHBs and local authorities, the creation of new financing models, and the development of a cost-rental segment in the Irish housing system. A critical characteristic of the *Social Housing Strategy*, as was emphasised by the Council in June 2014, is ensuring that the resumption of housing supply and construction is not decoupled from the increase in social housing provision.

The second critical support to this strategy for the rental sector is addressing the problem of encumbered buy-to-let properties. These pose significant problems for landlords and tenants. The impact of new insolvency arrangements to date has been modest. There would also seem to be scope to increase the proportion of these properties that are acquired (purchased or leased) for social housing. With the current low level of long term government bond yields, the ongoing costs associated with buying such properties is relatively low.

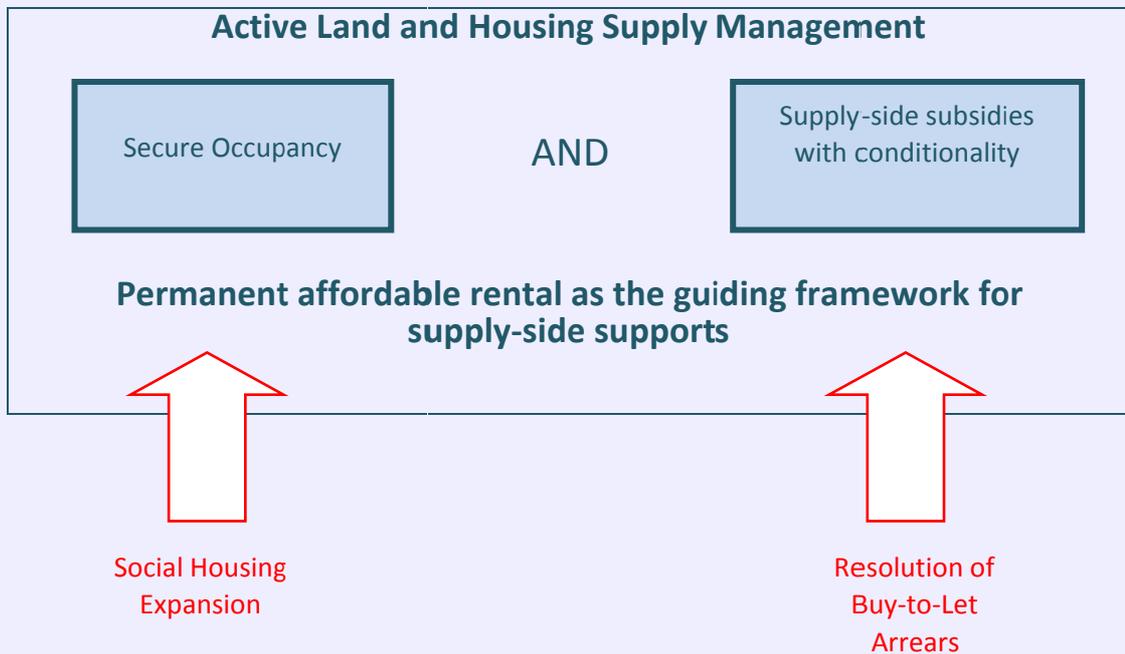
## 4.4 Pulling the Strands Together: A New Framework for a Larger, More Affordable Rental Sector

Figure 4.4 illustrates the strands of work we see as necessary in a new vision and strategy for Ireland's rental sector.

It highlights the need to focus on both secure occupancy and supply-side subsidies with conditionality, but as elements within a wider framing in which the State plays a more active role in housing supply, public infrastructure and land management. In addition, it shows that measures to enhance supply would be informed by a sustained focus on growing a permanent, affordable rental segment in the Irish housing system, moving towards a more unitary system.

Finally, we also believe that policy measures to enhance the private rental sector's role should include two additional elements: expansion of social housing and resolution of buy-to-let mortgages.

Figure 4.4: Enhancing the Role of Private Rental In Ireland: The Necessary Strands



The only way to transcend the current dualist debate about how to improve the private rental sector, in which rent control is counterposed to new incentives for developers, is to recognise the wider frame within which both sit—a dysfunctional land system that limits appropriate supply and underpins our unstable, unaffordable and unsustainable housing system. To address this we need coordinated use of public authority, assets and capabilities focused on land management, infrastructure and housing affordability. Within that context, it will be possible to combine regulation for secure occupancy with supply-side supports linked to conditionality on affordability.

# Chapter 5

## Secure Occupancy

## 5.1 Introduction

A rented dwelling is a home, so, for the tenant, secure occupancy of the dwelling is a key issue. Security is important to many aspects of human well-being, including family functioning, childhood development, economic and social participation, and physical and mental health (Van Gelder, 2010). Secure occupancy is of particular importance to lower-income groups and those with families.

A rented dwelling also provides an income stream for an investor. To be attractive, this income stream needs to be sufficient to cover costs and provide an appropriate return. For landlords, an important element of security is the ability to end a tenancy in cases where the tenant does not fulfil the obligations of the rental contract. With any investment there is a trade-off between the rate of return and the degree of risk. Housing is seen as a fairly low-risk investment in the long term, and international investors in residential property usually invest based on returns in the region of 4–6 per cent.

This chapter argues that secure occupancy is necessary for both renters and investors. Drawing on international experience, it shows that there is real danger to dualist thinking whereby renters and investors are simply seen as having opposing needs. Without secure occupancy, rental will remain a residual and transitory tenure, confined to those in the early stages of life or those with no other option. Households will feel insecure entering retirement and old age in a rental home in which both rent and tenancy are uncertain. We argue that a focus on a common goal of secure occupancy, analogous to the focus on long-term relationships in other business and social spheres, can serve renters, investors and the wider housing system more effectively.

By contrast, a focus on rent control, pure and simple, will be divisive. Arguments against it will surface quickly and will concentrate on its possible negative effects (usually the negative effects of traditional forms of rent control, which crudely capped rents at a point in time). Among the unintended effects of old-style rent control were reductions in the quantity and quality of rental accommodation, tenants staying longer in unsuitable properties that are rent-controlled, and the emergence of black markets in accessing rent-controlled accommodation.

This chapter argues for a focus on secure occupancy rather than rent control. In a number of the most successful market economies, there are well-established,

balanced forms of rental sector regulation that create secure occupancy. Drawing on these examples, we focus on what is required to enhance the development of a sustainable rental sector that can, in turn, help to stabilise and enhance the working of the wider housing system, and indeed the wider economy.

This chapter begins by outlining the idea of secure occupancy, underlining the fundamental relationship between tenure security and regulated rent updating. It places Ireland in an international context, among a group of countries with relatively weak security of tenure and rent regulation. We also show how approaches to rent regulation have evolved over the past century, as has economic analysis of its role in the housing system.

Section 5.3 identifies Ireland's strategic options by drawing on international comparative research on the relationship between regulation and the size and other characteristics of the rental sector. This shows that the effects of regulation are shaped by other factors, including the relative tax and subsidy position of rental as compared to other tenures. It also highlights the role that security of tenure plays in sustaining the long-term demand for rental housing and the risks of rent regulation that is either too weak or too strong. We outline the German system, which is described in international research as relatively well balanced.

In Section 5.4, we outline the current regulation of the rental sector in Ireland. Finally, Section 5.5 outlines the elements of a secure occupancy model for Ireland. This has four elements—rent certainty; indefinite leases; changes to conditions of sale; and improved dispute resolution supports. Once again, we emphasise that the move towards secure occupancy should be seen in the context of complementary policy actions on a number of other fronts:

- Active policy measures to promote supply (as outlined in Chapter 4 and discussed further in Chapter 6);
- Measures to deal with legacy issues, particularly the encumbered buy-to-let mortgages and vigorous delivery of additional social housing under the *Social Housing Strategy*; and
- Co-ordinated use of public authority, assets and capabilities to drive housing supply, land management, infrastructure provision and housing affordability.

## 5.2 Secure Occupancy

In this section, we outline the concept of secure occupancy and discuss some of its dimensions.

### 5.2.1 The Concept of Secure Occupancy

In international research and housing policy, the concept of secure occupancy is increasingly used as a new framework for analysing security of rental housing (Hulse & Milligan, 2014). While the security of owner-occupied housing was long recognised as having multiple dimensions, the security of rental housing has traditionally been reduced to the issue of legal security of tenure and property rights. Secure occupancy is defined as the extent to which households that occupy rental dwellings can make a home and stay there, to the extent that they wish to do so, subject to meeting their obligations as tenants. It is a multi-dimensional concept that involves being able to participate effectively in rental markets, to rent housing with protection of rights as tenants, consumers and citizens, to receive support and assistance from governments if required and to exercise a degree of control over housing circumstances and make a home (*ibid.*: 643). This concept has legal, practical and perceptual dimensions and determinants.

For reasons elaborated later in this chapter, we see this as a useful way to think about the position of both tenants and landlords and a good starting point for consideration of the policy and regulatory possibilities. The question is: what is required to achieve secure occupancy of rental housing in Ireland now?

### 5.2.2 The Fundamental Relationship Between Tenure Security and Rent Regulation

It is also important to bear in mind that there is a fundamental relationship between tenure security and regulated rent updating. Hubert underlines the obvious but easily overlooked point that these two features are intimately related:

In the absence of some binding rule for the updating of rents for sitting tenants, a landlord could easily circumvent tenure security by a sufficiently drastic raise in rent (economic eviction). And whenever the contractual rent for a sitting tenant falls below the initial rent for new contracts, protection against eviction is necessary to prevent the landlord from giving notice to quit (Hubert, 2003: 69).

In other words, if making the private rental sector an attractive long-term housing choice requires security of tenure, it would also seem to require some form of rent control of equivalent length. But, as we discuss below, the nature of rent control has evolved considerably over the past century and the stringency and duration of rent control can lessen the more there are effective policies driving the overall supply and availability of cost-rental accommodation.

### 5.2.3 Secure Occupancy: Ireland in International Context

Cuerpo *et al.* note that rental market regulation in Europe has a number of dimensions:

- **Rent Setting:** This refers to setting rent at the beginning of a new rental contract, and changes to rent during an existing one;
- **Landlord–Tenant Relationship:** This refers to the issues that define the tenant and landlord relationship such as length of tenure, reasons for eviction, notice periods and deposits; and
- **Judicial Procedures:** This includes the procedures used to deal with problems related to rent or relationships (Cuerpo *et al.*, 2014).

Across Europe and the EU, they find a number of combinations of these regulations and identify a number of countries with higher tenancy protection. These include Denmark, Austria and Germany, which rely more on rent controls; and Lithuania, Belgium, Spain, Portugal and the Netherlands, which support it through a pro-tenant bias in contract regulation. German tenants also have strong security of tenure, with contracts typically of indefinite duration. Landlords can only terminate contracts in very limited circumstances and the tenant can object to the termination of a contract on the grounds that it could cause unjustified hardship—which includes being pregnant or ill, doing exams, having difficulty with school or kindergarten changes, and being elderly. A key safeguard for tenants is that the sale of the property does not end the lease. An exception is that the landlord can end the lease prior to a sale if the landlord would lose out by at least 20 per cent due to the lease. Sweden has the highest degree of tenancy protection, both through rent controls and pro-tenant contract regulation. Indefinite leases are typical in the Netherlands and Sweden. France and the Netherlands also have some rent regulation (DKM Economic Consultants *et al.*, 2014c). The UK and Finland have deregulated rental markets, though, as noted below, Finnish rental contracts tend to be indefinite and to specify the formula for rent increases. Meanwhile Ireland, Italy, Latvia, Greece and Poland have both lower rent control and contract regulation, which is more favourable to landlords than to tenants.

### 5.2.4 The Evolution from First-, Second- and Third-Generation Rent Regulation

In considering rent control it is important to take account of the diversity of possible regulations. Housing analysts distinguish between first, second and third generation rent control (Arnott, 1998: 859).

First-generation rent control was typically introduced in wartime emergencies. This was the case with the rent control introduced during the First World War in Ireland, which persisted until 1982. This type of rent control usually involved rent freezes and attempted to force a transfer from landlords to tenants. This ‘transfer model’ usually had partial coverage, being limited to existing stock, certain regions, certain

types of dwellings, or old leases. Although such controls lasted for many decades, outside of an emergency context they were often considered to have negative effects on the quantity and quality of rental accommodation. However, it has been argued that it was not just strict rent control that led to a decline in the private rental sector, but also the fact that better-off households left the sector to become homeowners or social housing tenants, leaving the private rented sector housing those on lowest incomes. Private landlords also received none of the subsidies enjoyed by homeowners and social landlords, which supported the growth of other tenures. Inflation in property values and maintenance costs and landlords' loss of political influence in many countries were other factors argued to have led to the decline of the sector<sup>11</sup>.

These first-generation controls were removed in many countries from the 1970s onwards. Second-generation rent controls are more flexible. They allow rents to be increased by a defined annual amount, usually related to the general cost of living. The permitted increases also aimed to cover the costs of maintenance and repair. Since the 1990s, a third generation of rent control is also evident. It regulates rents within an individual tenancy, but not between tenancies<sup>12</sup>.

### 5.2.5 Rent Regulation in the Evolution of an Affordable Rental System

International experience suggests that regulation, including both rent regulation and security of tenure, plays a role in building an affordable rental sector and the evolution to a unitary rental system (NESC, 2014a). In the early development of a permanent affordable rental sector, when the cost-rental segment is small and has achieved limited maturation and equity both public subsidy and general rent regulation each play an important part. Indeed, most integrated rental markets continue to be characterised by a degree of tenant protection, both in terms of some kind of market-sensitive rent regulation and security of tenure.

But it has been observed that as the cost-rental sector grows, and integration proceeds, rent control tends to be phased out in favour of a looser regime of rent regulation. Kemeny suggests that, broadly, more rigid rent control is replaced with regulation that allows full market rents to come into play when rental housing is vacated but that still provides protection from full market rents to sitting tenants (Kemeny, 2005). A common feature of the unitary rental markets in Switzerland, Sweden, the Netherlands and other countries is continuing rent regulation, even though there is a tendency towards relaxing it (Hoekstra, 2010: 84).

This has two important implications. First, there is no static right or wrong position on rent regulation: its value and effects depend on the state of the overall housing system, as well as on detailed design of the regulatory system and factors shaping

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<sup>11</sup> See Harloe, 198) cited in Crook & Kemp, 2015.

<sup>12</sup> The introduction of housing allowances for those on low incomes supported the introduction of second and third-generation rent controls as they helped provide housing for those with affordability challenges, without jeopardising investment in rental property overall.

housing supply. Second, we should not necessarily read the partial relaxation of rent control in certain European countries as a move to a deregulated, private housing system; it can also be a reflection of the scale and success of the non-profit cost-rental sector in influencing, and even dominating, the profit rental sector.

### 5.2.6 Economic Revisionism on Rent Regulation

Rent control was traditionally seen by economists as a textbook example of regulatory folly. But a significant ‘revisionism on rent control’ is evident in the past two decades (Arnott, 1995, 1998). Within academic economics, this was fostered by progress in the theoretical analysis of imperfect markets, particularly search-cost, information problems and mobility cost. There is no doubt that these features play a major role in the housing market.

Hubert argues that some of the more realistic models of the housing market were developed in an attempt to improve understanding of rent controls (Hubert, 2003). As it turned out, when accounting for the particularities of the housing market, the analysis came up with some rigorous arguments in favour of the intervention. Hubert outlines three lines of such reasoning, each addressing one of the important features of rent control: the rent ceiling of the transfer type, tenure security, and regulation of rent reviews (*ibid.*: 71). Consequently, he suggests that there is little doubt that the revisionism on rent control is built on arguments firmly based in established economic theory.

One important aspect of this revised view is that real-world rent controls are more complex than assumed, with their impact depending to a large extent on the details of the regulation (Arnott, 1998). In addition, empirical evidence is fragmented and far from conclusive. It is increasingly accepted that housing markets suffer from imperfections, which create scope for well-designed rent regulation to improve efficiency (Hubert, 2003: 63). Nevertheless, a majority of economists remain sceptical of rent regulation (Jenkins, 2009).

## 5.3 Identifying Ireland’s Strategic Options: International Patterns, Path Dependence and Critical Junctures

### 5.3.1 Rental Systems and the Importance of Context

The case for strategic thinking and strategic choice gains support from the outcome of a large-scale comparative research project, led by the University of Cambridge and the LSE—*The Private Rented Sector in the New Century—A Comparative Approach* (CCHPR, 2012). It reinforces the view that Ireland needs to make strategic choices about the future of its private rental sector in the overall housing system.

The research project arose from strong and opposing views about the role of regulation in the private rented sector. At one extreme, all regulation was seen as constraining the sector, while at the other it was argued that only with strong regulation could there be a well-operating private rental system.

The study, like other studies, for example Crook & Kemp (2015), found that:

- There is no simple or consistent relationship between regulation and the size of the rented sector. In some countries where regulation has been stable or increased, the sector has declined rapidly, while in others there has been little change in scale. The relationship between the levels and changes in the size of the sector and changes in regulatory frameworks is not consistent across countries (*ibid.*: 84).
- Lower regulation is not generally associated with a larger private rented sector. Changes do not follow deregulation immediately and where they do it often reflects other factors, such as the introduction of buy-to-let mortgages or changes to tax treatment, or more social housing provision through the private rental sector.
- A number of other factors may be equally or more important than regulation in different contexts. The most important factors include the relative taxation and subsidy positions, the scale of social housing provision and, in general, the cost, availability and suitability of housing in other tenures, as well as the non-housing investment opportunities available.

These findings led the authors of the study to highlight both an element of path-dependence and the fact that housing systems do change. In particular, changes in the wider economic and housing context drive change and determine how changes in regulation will impact on the growth of the rental sector. To give an example, Box 5.1 provides an overview of how English and German Private Rental Systems have evolved.

The CCHPR study also noted that a number of European countries have begun to modify the regulation of their housing systems, partly to help meet the needs of those excluded from owner-occupation, and partly to reduce the public sector cost of housing poorer households. To do this, some countries have deregulated further, while others have increased regulation, mainly in relation to security of tenure. Ireland, for example, increased its regulation of the private rented sector, both in terms of security of tenure and of rent, with the 2004 Residential Tenancies Act (see Section 5.6). Reflecting on the Irish position, Norris (2014: 634) has noted that support for the dualist housing system, which was predominant during most of the twentieth century, is being withdrawn by Government as subsidies for homeowners become unaffordable. Meanwhile, an increasing number of households are forced into the relatively unregulated private rental sector and face unaffordable mortgages. Using ideas of path dependence, ‘critical junctures’ and ‘contingent break point’, she argues that these pressures have opened up a period of opportunity for fundamental change in the direction of Irish housing policy. The Council shares this view and, as outlined in Chapter 4, proposes a new vision and

strategy for Ireland’s rental sector. Drawing on the lessons of the international comparative study discussed above, we see that new strategic direction as requiring not only regulation for secure occupancy but also reform in the wider incentive and tax regime that shapes the decisions of investors and households.

### **Box.5.1: The Context of Rental Systems—Example of England and Germany**

**England:** Private renting declined in the UK in the post-Second World War period, reflecting a combination of first and second-generation rent controls; unfavourable tax treatment of private landlords; and favourable supports for owner-occupation and for housing bodies to build good-quality and affordable rental accommodation. Rents were deregulated in the late 1980s.

The sector is now relatively small and transitory, and has seen a decline in the number of elderly tenants and an increase in migrants, students, divorcees and young professionals. Landlords are mainly individuals and couples, usually with another full-time occupation, with three-quarters of tenants renting from this type of landlord. By 2006, 78 per cent of privately rented dwellings had been bought, and just 12 per cent inherited. Favorable yield prospects and resale intentions are important investment motives for these landlords.

In England, property prices between 1995 and 2007 rose in real terms, and inflation has been much higher than in Germany. Mortgage finance has also been more readily available. Coupled with the insecure rental tenancies available, this has led to homeownership rates in England being high. In 2012, they were at 57 per cent (down from 64 per cent in 2003), while 41 per cent rented, half from social landlords, and half from private landlords.

**Germany:** Large numbers of dwellings were destroyed or damaged in the Second World War and there were many refugees. Much of the housing sector remained state-controlled until the late 1960s. Rents were controlled, tenants were protected from eviction, and allocation of housing was handled by local housing offices. New private and social construction was heavily subsidised. By the late 1960s, the housing shortage had been addressed and State control was replaced with focus on incentives to stimulate private construction, often for rental. Landlords also benefited from accelerated depreciation of rental buildings from 1949 to 2005, and no capital gains tax is paid on the sale of residential rental buildings held for a minimum of 10 years. Refurbishment costs can be deducted from rental income, and landlords are also allowed to fully offset losses on rental property against other sources of income.

Eighty-four per cent of German landlords are private individuals, with the majority self-employed or pensioners. However, a sizeable number of this group are specialist landlords, with one in eight owning more than 30 dwellings. Twenty-six per cent of let dwellings are houses where the owner lives in one part and the tenant in another part. A very high proportion of rental properties have been inherited—46 per cent, with 50 per cent purchased. The motivation for investment is usually old-age provision, security of investment, and accumulation of capital. A 2007 survey found that 41 per cent of German landlords were making a profit from their rented property, and a further 41 per cent covering their costs. Nine per cent were making a loss (usually in the East).

With controls on rent increases, and indefinite tenancy lengths, renting is attractive to many groups, and tenants are made up of all sectors of society, rather than niche markets. The size of the private rented sector (over 40 per cent of households) makes them a politically important group.

In addition, inflation in Germany has been low, so property ownership yields little capital appreciation. In fact, average property prices there have been falling relative to the consumer price index since 1995. It is also difficult to access mortgages, with large deposits needed (Kemp & Kofner, 2010).

The relatively large size of the German rental sector is also attributed by some to the favourable tax regime (Haffner *et al.*, 2009: 145).

### 5.3.2 Lessons on the Revival of the Private Rental Sector

A recent OECD Working Paper, *A Revival of the Private Rental Sector of the Housing Market? Lessons from Germany, Finland, the Czech Republic and the Netherlands*, throws interesting light on ways in which regulation shapes both the size and functioning of the private rental sector (de Boer & Bitetti, 2014).

First, tenancy security is of critical importance in shaping the long-term role of the rental sector: 'Germany and the Netherlands show that strong tenancy protection is a pre-condition for long-term demand for rental dwellings ... Landlords in the Netherlands and Germany also have an interest in strong tenancy security, because it creates the long-term demand for rental housing, and there are no calls for weakening tenancy security' (*ibid.*: 22). From an Irish perspective, it is of interest to note that the grounds on which landlords may terminate a tenancy are considered relevant in this regard. In Finland, reforms that allowed the sale of the dwelling as a valid reason for contract termination may have contributed to the conversion of private rental dwellings to owner-occupied housing (*ibid.*). Another important lesson, emphasised by de Boer and Bitetti, is that (strong) tenancy security must be coupled with effective eviction procedures, as landlords have to be sure that they can evict tenants that do not fulfil their contractual obligations. The German and Dutch cases show the benefits of this approach.

Rent-setting regulation also influences the functioning of the rental market. While there is a broad international trend from first to second and third-generation rent regulation, there are now wide differences between national regimes. 'As with tenancy security, rent price protection can be too strong, but weak or no rent price protection affects the structure of the rental market as it can reduce demand for rental housing' (*ibid.*: 23). The authors endorse the economic analysis of an earlier OECD review of housing markets:

In the presence of fixed costs of moving and lack of available insurance against a sharp, unanticipated rent increase, well-designed rent control can be welfare-improving [...] On the one hand, absence of rent regulations can lead landlords to hold up tenants by unexpectedly raising rents, since moving costs make renters less mobile. On the other hand, excessively strict rental regulations (such as cumbersome eviction rules) can lead tenants to hold up landlords' property. Thus, rental regulations should strike a balance between landlords' and tenants' interests, create security of tenure and avoid market segmentation between sitting and new tenants (Andrews *et al.*, 2001: 52).

Between the extremes of too much and too little rent regulation, German rent-setting regulations are described as 'well-balanced'. Lux and Sunega reach a similar conclusion in their comparison of the private rental sector across Europe: 'In countries with the extreme liberal system of second-generation rent regulation

(Finland, and since 2001 the UK) the share of private rental housing grew. However, the long-term stabilisation of the PRS is not observed in countries with the most liberal system of rent regulation [...] but rather in a country with a moderate system of second-generation rent regulation and stronger protection of the duration of a lease (Germany)' (Lux & Sunega, 2010: 357).

From an Irish perspective, it is also interesting to note the approach to rent-setting in Finland, a country seen as a leading example of radical deregulation of both tenancy security and rent regulation. The deregulation was in response to the severe banking and housing market crisis of the 1990s and was intended to bring more rental apartments into the market. In the case of long-term rental agreements, the rent is typically reviewed annually. But, note de Boer and Bitetti, 'the size of rent increases must be specified in the lease agreement, and in most cases, the rent increases are based on the cost of living index' (de Boer & Bitetti, 2014: 26). Thus, even in the deregulated Finnish market 'maximum rent increases are put in almost all contracts, despite the fact that the government does not regulate these maximum increases' (*ibid.*: 29). So, on international experience, a deregulated rental market is one in which landlords and tenants enter long-term contracts that specify the basis on which rents will increase in future years.

### **5.3.3 Germany: A Modern System of Rent Regulation in a Stable Housing System**

What are the characteristics of the German system of rent regulation that is regarded, in an international context, as well balanced? It is a strong example of the third-generation rent regulation referred to above. Put simply, on formation of a tenancy rents are largely determined by prevailing market rates, but it creates a mechanism for managing rent adjustments within a tenancy (see below for further details). It should be said at the outset that the system of rent regulation has, over the decades, worked in the context of a housing system that has a sufficient supply to meet the needs of Germany's gradually declining population. The overall balance between housing demand and supply is relevant in understanding the relatively effective functioning of the third-generation, market-sensitive system of rent regulation, as noted in the OECD working paper cited above and other research. Indeed, as we note below, in recent years the dynamic growth of certain German cities has created some imbalance between demand and supply in these areas and has thrown up problems—concerning the functioning of the rent regulation system and the need to generate new supply.

Since the Council takes very seriously the imbalance between demand and supply in Dublin and other Irish cities, and the supply concerns that can arise in discussion of rent regulation, we believe that any learning from the German system of rent regulation must be combined with a strong focus and vigorous action on increasing the supply of affordable housing in Ireland. It is for this reason that the vision and strategy set out in Chapter 4 link reforms to create secure occupancy with a range of enhanced actions of supply. The latter are discussed in Chapter 6.

In its general operation, the German system contains recognition of the importance of supply, especially of homes that are affordable to middle and low-income

households. Thus, there is a close connection between the system of rent regulation, on the one hand, and supply-side supports designed to encourage supply of rental accommodation, on the other. Such subsidies are available to both public and private providers (including for-profit providers), and this is linked to the regulation of rents for a specified period. For newly built dwellings this is 20 years and for renovated dwellings 12 years. Loss of social housing stock after the lock-in period is a significant problem.

Non-subsidised housing is also subject to a looser type of rent regulation. For new rental contracts there is considerable freedom to negotiate rents. In general, new rents cannot be more than 20 per cent above the maximum of a comparable dwelling in the area (Fitzsimons, 2014: 30). Rent increases in existing contracts are controlled. There are a number of methods through which it is possible to legally implement rent increases. One option is to state the actual amount of rent to be paid in future years. A second option is for the contract to state that rent increases will be linked to an official cost of living index. Neither of these methods is widely used. If these are not used, rents can be increased in line with locally comparable rents. This can be done in three ways. First, rent increases can be based on the official rent guide for the areas (the *Mietspiegel*, literally 'mirror rent'). Second, the landlord can engage a housing expert to independently assess the local rent market. Third, the landlord can identify three examples of comparable dwellings at higher rent. The most widely used approach is to base rent increases on the *Mietspiegel*.

In a rising rent market, there will be rent increases for existing tenants. However, there are a number of factors that moderate the rise in rents in this scenario. First, the Economic Offences Act places a general ceiling on excessive rent increases. Second, the *Mietspiegel* covers rents for the past four years rather than just the immediate past; this implies that there is a lag in the effect of rent increases on reference rents as measured by the *Mietspiegel*. Third, if the two-yearly update of the *Mietspiegel* is based on inflation, this may be less than the increase in rents in a rising market. Fourth, there is a limit of a 20-per-cent increase in rents over three years.

As we emphasise throughout, all approaches to the regulation of rent work best in a market with adequate supply, and stable housing prices. There are concerns about both of these in certain parts of Germany and strong rent increases have been noted. However, this may reflect that after decades of slightly falling populations, there are not enough new dwellings being built to meet demand in the dynamic cities that have growing populations. It may also be due to reduced tax subsidies for landlords since 2005 (Kemp & Kofner, 2010). Others argue that low interest rates and the comparatively poor value of stock market investments have led to much greater investment in property in certain areas such as Berlin, leading to rising property prices, and a desire by landlords to recoup their outlay through increasing rents as much as legally permissible (Kofner, 2014).

## 5.4 The Existing Irish Situation

As discussed in Chapter 3, the Irish private rental sector is dominated by two large groups— migrants and those in receipt of rent supports—and it contains a relatively small group of others and students. Landlords are predominately small-scale with 65 per cent owning just one property.

As noted in NESCC’s report, *Homeownership and Rental*, growth in the private rented sector in Ireland has been underpinned by tax incentives (Section 23 for urban renewal and Section 50 for student accommodation), a decline in local authority-owned social housing, the rising cost of buying a home, liberalisation of mortgage markets, and high capital appreciation in property during the 1990s and early 2000s.

The Irish rental sector to date is more similar to England’s than Germany’s, although as Norris (2014) argues, the sector is currently in a period that is opening up opportunities for fundamental change. Irish property prices have been volatile, and before 2007 had increased almost constantly since the mid-1990s. Almost 4 out of 10 landlords bought their rental property as an investment, and a further 2 out of 10 are landlords because their home is in negative equity and they could not, or did not wish, to sell it (DKM Economic Consultants *et al.*, 2014c). This points to a large group that would want to sell their property if the price was right.

In Ireland, the private rental sector is regulated by the provisions of the Private Rental Tenancies Act, 2004 (RTA). This provides for ‘Part 4’ tenancies of four years, which allow the tenancy to be ended at any time by either tenant or landlord within the first six months. For the remaining three and a half years it can be ended only in two ways. First, the tenant can end the tenancy for any reason by giving a specified period of notice, and secondly the landlord can give the tenant notice for a variety of reasons, including if they intend to sell the dwelling in the next three months, refurbish it, change its business use, or require it for their own or family member occupation<sup>1314</sup>. After four years, if the landlord does not give the tenant notice, the tenancy can continue for another four-year tenancy (‘continuing Part 4 tenancy’), although during the first six months of the new tenancy the landlord can again give notice for any reason. The landlord may also give the tenant notice to leave at the end of the first four years, rather than allowing them to proceed to a continuing Part-4 tenancy.

Although the Act increased renters’ security of tenure compared to the previous position, it still leaves the renter in an insecure position due to these provisions. A

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<sup>13</sup> There are also other reasons for a landlord to end a tenancy, such as the tenant not complying with the legal requirements of the tenancy. For further information, see Threshold’s guide to the Act: [http://www.threshold.ie/download/pdf/residential\\_tenancies\\_act\\_2004\\_a\\_quick\\_guide.pdf](http://www.threshold.ie/download/pdf/residential_tenancies_act_2004_a_quick_guide.pdf), downloaded 4 April 2014.

<sup>14</sup> It is likely that institutional landlords make less use of some of these provisions (e.g. requiring the property for family use) and as the sector matures, the experience of tenants will become more diverse.

recent survey showed that 12 per cent of Irish renters had had to move within the previous 12 months due to the dwelling being sold (I-Reach, 2014).

The Residential Tenancies Act also specifies that rent may not be greater than the market rate. This is defined as ‘a rent that a willing tenant not already in occupation would give and a willing landlord would take for the dwelling, having regard to other terms of the tenancy and the letting values of dwellings of a similar size, type and character to the dwelling and situated in a comparable area’. The rent may be reviewed (upward or downward) once a year only (unless there has been a substantial change in the nature of the accommodation that warrants a review). Tenants are to be given 28 days notice of new rents. This provision can benefit the tenant (and be problematic for the landlord) during a time of falling market rents, and the reverse is the case when rents are rising. The sharp increase in rents in large urban areas over the past two years has led to a number of cases of ‘economic eviction’, whereby the tenant has to leave the property as they cannot afford to pay the higher market rent. The I-Reach research cited above showed that 15 per cent of tenants had moved out of their previous rental accommodation as the rent was too high, with this figure at 18 per cent for tenants in Dublin. The security of tenure provided by the four-year lease cycle clearly can be undermined by the fact that rents can legally be increased in line with the market. Average market rents have increased by 21 per cent over three years in Dublin<sup>15</sup>, so, depending on the characteristics of the property, a landlord can increase rents by at least that much, and more for accommodation where the rents have not increased for a number of years previously.

For the landlord, the RTA provides security in a number of ways. It outlines the behaviour required of tenants, which includes paying the rent and any other specified charges, avoiding causing damage beyond normal wear and tear, and not engaging in or allowing anti-social behaviour. Disputes arising between landlords and tenants can be heard by the Private Residential Tenancies Board (PRTB), a statutory body established by the Residential Tenancies Act, to replace the courts in relation to the majority of landlord and tenant disputes. Landlords must register with the PRTB to be able to use the dispute resolution function (€90 per tenancy). A further fee of €25 is paid to use the dispute resolution services.

## 5.5 Elements of a Secure Occupancy Model for Ireland

As noted above, the evolution of the Irish private rental sector more closely mirrors the English than the German system, although the Irish system is more regulated than that in the UK, with longer leases and rents that must comply with market

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<sup>15</sup> See the *PRTB Rent Index Quarter 4 2014*, which shows that rents in Dublin increased from 78.0 on their index in Q4 2011, to 94.0 in Q4, 2014.

rates. However, the impact of the financial crisis and the role of volatile, speculative housing systems creates momentum, and a need, for further reform in Ireland. Rent regulation and secure occupancy are issues that arise in consideration of the challenges facing Irish housing policy. Rent regulation arises most urgently because of the crisis generated by strongly increasing rents in Dublin and, to a degree, other cities, with existing security of tenure further weakened by high increases in market rent. It is increasingly recognised that a well-developed and efficient rental market providing a viable alternative to ownership plays a balancing role by alleviating house price pressures and smoothing housing market dynamics. This is especially the case when it proves to be an affordable platform for young and low-income households, providing them with a viable alternative to a hasty first step onto the property ladder (Cuerpo *et al.*, 2014). The issue of rent regulation also arises more strategically when we consider the relative long-term characteristics of unitary versus dualist rental systems.

In the context of the overall strategy illustrated in Figure 4.4, we outline four elements of a secure occupancy model for Ireland:

- Improving rent certainty;
- Making leases indefinite;
- Changes to the conditions of sale of rented property; and
- Improvements to dispute resolution procedures.

The Council suggests that Irish policy should now develop a balanced reform to combine these elements. As outlined in Chapter 4, it emphasises that this approach should be accompanied by a number of other reforms and lines of public policy action aimed at securing and strengthening the supply of rental accommodation. These actions, also discussed in Chapter 6, include more active public management of housing supply and land management, supply-side supports linked to conditionality and reform of the tax treatment of rental income to improve the returns to landlords.

### **5.5.1 Improving Rent Certainty**

A recent review of the regulation of the private rental housing market in Europe concludes that ‘most countries now allow for various forms of rent indexation linked to consumer price inflation and rent adjustment clauses’ (O’Sullivan & de Decker, 2007). It is interesting that the form of rent regulation in place in most European countries after several decades of gradual de-regulation is still stronger than that in place in Ireland after a decade of gradually increasing regulation of the private rental sector.

This section looks at one way of improving the certainty around rents, based on a flexible market-conforming approach. It should be noted that in other countries,

policy to ensure more rent certainty is often accompanied by incentives for new construction and favourable tax treatment for landlords.

As discussed in Section 3.4.2, both landlords and tenants have been exposed to significant variation in rents. This has heightened in recent times. For example, in the last three years rents paid rose by 21 per cent in Dublin, and leases can be ended with a maximum of 112 days' notice (after 4 years), for a landlord to sell or occupy a rented property. In a time of short supply this is causing great difficulties for tenants—particularly low-income and family renters—wishing to stay in one place, and to find suitable alternative accommodation if necessary, leading to stress as well as disruption.

Since 2007, most Irish landlords have been experiencing decreasing returns—reflecting a combination of falling rents, increasing costs and changes to tax treatment. As noted, concessions on rent certainty internationally are sometimes offset by more favourable tax treatment. It is critical that rent certainty and tax treatment are also considered together in an Irish context.

There are, indeed, strong arguments for reconsidering the tax treatment of landlords. These include that private rental is treated differently than other businesses—interest costs are not all deductible, and there is no 'negative gearing', which means losses cannot be offset for tax purposes. The tax treatment may also have negative impacts on tenants insofar as refurbishment costs are not all deductible. There is a strong case for looking at tax treatment as a means of both improving rent certainty and supporting the wider development of the sector as a business. However, reform of the tax treatment of landlords should be part of a wider package of reforms and policy development in which tenants are given greater secure occupancy, and other factors influencing the supply of affordable rental homes are addressed.

A recent comparative review of rental systems argues that to develop an efficient private rental sector 'requires a *balanced* combination of tenant protection and tax incentives to stimulate both demand for and supply of private rental housing (Kofner, 2014: 268) but the research also notes that this takes time and demands courage from policymakers.

In its work for the PRTB, DKM (2014a) provided a very timely review of six options that might be used to support rent certainty. Box 5.2 provides a summary. With the exception of the first option in which rents are frozen at their 2000 level in nominal terms, DKM estimate that all of the other options would have permitted larger increases in rents over the period 2000 to 2014 than the actual increases in Dublin over this period.

It is important to note that actual rents would not always follow the pattern of the maximum permitted rent. In fact, DKM note that 'given the macroeconomic circumstances post 2007 [to 2014], rents under all options may well have been closer to what actually transpired in the free market, when rents [in Ireland] declined by 22.7 per cent' (DKM Economic Consultants, 2014a: 81).

For example, in a variant of the German model, option 5, the calculated maximum permitted rent increase was an average of 4.7 per cent annually. The dominant influence on this calculation is the assumed cap on rents of 5 per cent<sup>16</sup>. This is applied in such a way that the maximum permitted rent increase was close to 5 per cent even if market rents were falling.

### Box 5.2: Rent Certainty–DKM Analysis<sup>17</sup>

DKM looked at six options that could be used to moderate rents:

- **Option 1: Fix rents at 2000 level.**
- **Option 2: Index rents to the Consumer Price Index (CPI).**
- **Option 3: Index rents within a tenancy. Market rent then links to CPI, with 10-per-cent increase after four years.**
- **Option 4: Index rents within a tenancy, initial rent increase of 10 per cent, then link to CPI.**
- **Option 5: Index within tenancy, initial rent 5 per cent above market and change in line with market average (variant of the German system).**
- **Option 6: Rents linked to operating cost index.**

The annual increase in private rents for Dublin as estimated over the period from 2000 to 2013 was 0.8 per cent in nominal terms (DKM Economic Consultants, 2014a).

This was less than the increase in the CPI; hence if rents in the period had been indexed to the CPI (option 2) rents in 2014 would have been higher.

In options 3, 4 and 5, to compensate for indexation it is assumed that the rent increases at the start of the contract or start of the next contract (for example, year 5). Since the CPI increased by more than rents, adding additional rent increases naturally leads over time to an even larger increase in projected rent.

The operating cost index, option 6, increased by more than market rents, largely because of large increases in mortgage interest rates and also in 2005 to 2008 due to increases in house prices.

<sup>16</sup> DKM assume that in the first year (2000) 75 per cent of tenants are covered by new contracts so that their rent increase is capped at 5 per cent. It is assumed that there is no rent increase for the other 25 per cent on the basis that they are within 12 months of a rent increase. This leads to an increase in rents of 3.8 per cent (i.e. 75 per cent of 5 per cent). In the following year, rents increase by 5 per cent for the remaining tenants (who are getting new rental contracts) and by 3.8 per cent for the remaining 75 per cent (the average market increase for the previous year), giving an overall increase of 4.1 per cent. The result is that rent increases in most years are close to 5 per cent.

<sup>17</sup> DKM were commissioned by the Housing Agency on behalf of the PRTB to look at the issue of greater rent certainty in Ireland, and they published their report in October 2014.

It should be pointed out that in Germany there is considerable freedom to negotiate rents for new rental contracts. In general, new rents are not supposed to be more than 20 per cent above the maximum of a comparable dwelling in the area although it is possible for rents to be above this limit provided the landlord is not asserting ‘clearly disproportionate power’ (Fitzsimons, 2014: 30). New legislative proposals in Germany are planning to cap the maximum permitted increase in rent to 10 per cent over average local rents in areas of strong rental demand.

For existing rental contracts, rents in Germany are regulated. In a rising rent market, there will be rent increases for existing tenants. However, there are a number of factors that moderate the rise in rents in this scenario. First, the fact that the rents are set relative *to* the past four years rather than just the immediate past implies that there is a lag or dragging anchor effect on the rent increases. Second, reference rents are updated every two years based on inflation and this may be less than the increase in rents in a rising market. Third, there is a limit of a 20-per-cent increase in rents over three years; since 2013 cities have been allowed to introduce a cap of 15 per cent over three years (Haffner *et al.*, 2009; Fitzsimons, 2014). There is also provision to increase rents following modernisation of dwellings, including energy retrofitting.

There is a strong case now for designing and implementing a flexible market-sensitive model of rent regulation in an Irish context, particularly in large urban areas where demand outstrips supply. In such a model, controls on rent are not divorced from the dynamics of the market. Instead, rents can be set relative to the market but with a dragging anchor that helps to moderate and smooth changes, and to prevent excessive annual increases. This would allow rent increases to be moderated, which would not only help the housing system but also help to maintain costs and competitiveness in an economy. A flexible market-related model of rent regulation can also allow the situation of existing tenants and new contracts to be differentiated, and so the needs of both potential new investors and existing landlords can be responded to. For tenants, greater certainty on rent can improve security of occupancy. If such a model were adopted, the existing PRTB average rent figures<sup>18</sup> could provide a basis to develop a market-related reference point for rents in many larger areas of Ireland. These figures, hosted by the CSO in an interactive databank, show the average monthly rents paid in 446 local areas across Ireland, by property type and number of bedrooms, each year from 2008 to 2013. It may be possible for the CSO to add a function that calculates the average rent over the last four years, for each type of property in each area; a figure that could be used as a basis for the maximum rent that could be set. However, the precise

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<sup>18</sup> See <http://www.cso.ie/px/pxeirestat/Statire/SelectVarVal/Define.asp?Maintable=RIA02&Planguage=0>, accessed 11 March 2015

approach of any such model should be developed based on inputs from stakeholders in the sector.

As well as having a clear role within a larger rental sector in which there is secure occupancy, a system of rent regulation has a strong logic within the Government's approach to housing supports. We saw in Chapter 3 that a high proportion of tenancies in the private rental sector are funded by rent supplement and Rental Accommodation Scheme (RAS) and Government intends to greatly increase the number in the HAP scheme. A feature of using the private rental sector to meet social housing need, emphasised in the Council's 2014 report *Social Housing at the Crossroads*, is that it exposes the Exchequer to rising market rents. In addition, when rents are rising strongly and public resources are scarce, as in the current period, the ceiling on rent supplement levels can be lower than market rents, making it hard for certain low-income tenants to meet the rents demanded by landlords. It is this that can give rise to some of the economic evictions that have been observed in the past year or more, leading, in some cases, to homelessness. Housing organisations and others have argued that the rent supplement ceiling should be increased to match the rising market rents. Government has decided against, this arguing that, given the share of supported tenancies, such an increase may lead market rent upward. Whatever view one takes on this issue, the logical corollary of the Government's position would seem to be the need for a system of rent regulation that dampens the increases in market rents. If such a system had been in place in recent years it would have helped to moderate Exchequer spending on housing supports for tenants in the private rental sector.

We noted above that a modern form of market-sensitive rent regulation plays a role in building a unitary affordable rental sector, especially in the early phase of that long-term project. We now see that it can also play a role as part of a social housing policy that uses supports for tenants in the private rental sector, pending increased supply by local authorities and Approved Housing Bodies (AHBs).

### 5.5.2 Making Leases Indefinite

A second element of a secure occupancy regime is making leases indefinite. It should be noted that at the time of the Residential Tenancies Act in 2004 the introduction of regulation on tenure length (and other provisions) was strongly opposed on the grounds that it would damage and shrink the private rental sector. No such outcome materialised. In fact, the number of households renting from a private landlord rose by 110 per cent, from 145,317 to 305,377, in the 2006–2011 inter-censal period<sup>19</sup>.

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<sup>19</sup> CSO interactive tables of Census data – see [http://www.cso.ie/px/pxeirestat/Database/eirestat/Profile%20The%20Roof%20Over%20Our%20Heads%20-%20Housing%20in%20Ireland/Profile%20The%20Roof%20Over%20Our%20Heads%20-%20Housing%20in%20Ireland\\_statbank.asp?SP=Profile 4 The Roof Over Our Heads - Housing in Ireland&Planguage=0](http://www.cso.ie/px/pxeirestat/Database/eirestat/Profile%20The%20Roof%20Over%20Our%20Heads%20-%20Housing%20in%20Ireland/Profile%20The%20Roof%20Over%20Our%20Heads%20-%20Housing%20in%20Ireland_statbank.asp?SP=Profile%20The%20Roof%20Over%20Our%20Heads%20-%20Housing%20in%20Ireland&Planguage=0), accessed 29 April 2015.

The current Part 4 tenancy means that after four years the tenancy can be ended for any reason within the subsequent six months. The ‘continuing Part 4’ provision should be modified so that all tenancies would be continuous and based on indefinite contracts. This increase in security of tenure would move Ireland more in line with most Western European countries. It should be seen in the context of the other reforms outlined in this report, including increased rent certainty, enhanced dispute resolution procedures (discussed below) and changes in the tax treatment of rental income designed to improve the yield of rental housing and build a larger, more stable, rental sector.

### 5.5.3 Changes to Conditions of Sale

As noted above, in some countries where rental is characterised by secure occupancy, sale of the property is not a reason for ending a tenancy and property is commonly sold with tenants in situ (e.g. Germany and Sweden). Removing sale as a reason for ending a lease would significantly improve secure occupancy and the Council recommends that this be adopted for Ireland<sup>20</sup>.

One view is that this could reduce the price that those selling rental properties could achieve, compared to the price with vacant possession. On the other hand, the more the Irish rental system is driven by long-term yield, rather than changing asset prices, the higher the value purchasers will put on properties with an existing, secure rental stream. In addition, it should not be forgotten that the overall reform package proposed here includes improvement of the tax treatment of landlords. We also emphasise that changes in the conditions of sale of this kind should be part of a wider package that includes measures to manage the transition of encumbered buy-to-let properties, as indicated in the Government’s *Social Housing Strategy*.

### 5.5.4 Dispute Resolution Procedures

The final element of our package is further improvements in dispute resolution procedures. In Ireland, only a small proportion of all registered tenancies end in disputes heard by PRTB. In 2013, there were 903 disputes in relation to deposit retention, and 999 in relation to rent arrears. There were 320 in relation to overholding (the tenant not leaving the property after a legal eviction notice has been served).

However, in 2013, it took seven months on average for a dispute to be heard. Approximately 1 per cent of cases were then appealed, with 24 per cent of those related to rent arrears and overholding (PRTB, 2013). These took a further five

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<sup>20</sup> Countries in which this applies include Germany and Sweden. In addition, there are a number of countries in which landlords may be required to mitigate the effects of ending a tenancy on tenants. For example, in the Netherlands in some situations the landlord is required to make a minimum payment to a tenant’s moving and refurbishing expenses. In France, if a tenant is over 70 and on a low income the landlord may be required to automatically renew the tenancy or offer an alternative residence (see DKM Economic Consultants, 2014b).

months on average to be heard. This can create very significant problems for tenants and for landlords, with anecdotal reports of the latter sometimes resorting to paying disputing tenants to leave. By contrast, it is reported that dispute resolution takes two months in France, and three in Sweden (DKM Economic Consultants, 2014b). It seems likely that the time taken to process disputes may increase as the PRTB takes on responsibility for tenancies of approved housing bodies.

There is a need to appoint PRTB adjudicators more quickly, to make the processes less cumbersome and less costly, and to consider scope for online processing of disputes. Ways to moderate rent arrears arising from disputes, such as paying rents into an escrow account until the disputes are resolved, could also be considered. It would appear that the system is not working in a way that either best supports tenants or landlords. In part, this reflects reductions in staff and inability to replace staff and/ or recruit staff for new roles. The PRTB's staff numbers reduced from 70 in 2010 to 35 in 2012 (PRTB, 2012). The PRTB is subject to the Employment Control Framework of public sector bodies. However, the PRTB is self-funded through the registration fees paid by landlords. It has built up resources that could now be deployed to ensure that the service it offers is supportive of the long-term development of the sector.



# Chapter 6

## Ensuring a Healthy Supply

## 6.1 Introduction

Shortages of supply are central to the current pressures evident in the private rental market. The limited new provision of housing for sale and social housing has greatly increased the demand for private rental accommodation. Increased provision of new private rental accommodation and other forms of housing is now a pressing requirement. Without new supply to meet existing and future demand, the pressures now evident in the rental market and reflected most acutely in the level of homelessness will continue to grow.

In outlining a vision and strategy for the rental sector in Chapter 4, we argued that reforms to move towards secure occupancy must be accompanied by vigorous measures to enhance supply. Drawing on both international evidence and analysis of Ireland, we suggest that there is a strong case for incentives to encourage the supply of rental accommodation. However, as discussed in Chapter 3, the first step must be to use public authority, assets and capabilities to lead the resumption of affordable housing supply.

Section 6.2 considers the general housing supply challenge and the obstacles to the supply of institutional rental accommodation. Section 6.3 identifies the main ways in which the supply challenge can be addressed. This considers three dimensions: more active public management of housing and land supply generally, incentives for rental accommodation, and using innovation to reduce the costs of construction.

## 6.2 The Housing Supply Challenge

Problems can arise in any country with regard to several dimensions of housing supply:

- Inadequate overall supply;
- Supply in the wrong location;
- Supply of the wrong kinds of housing units;

- A strong volatile cycle in housing output and supply; and
- Reflecting the above, problems of affordability.

There is no need to discuss the origin of these problems here. They are widely acknowledged in housing research and the Council has discussed them in a number of reports (NESC, 2004 and a series of background papers; NESC 2014a, 2014b). Broadly speaking they have three sources:

- Planning and development control, in its effort to shape the pattern of housing development, can tend to limit total supply and, in particular, can constrain supply in growing urban areas—although, in some contexts, planning can lead the transition of land from agricultural use to urban development.
- The economics of land, construction, housing and finance contain a range of factors that can generate overall supply problems, high levels of volatility and insufficient levels of affordable supply for those on low incomes.
- The particular characteristics of Ireland’s property development and construction sector have tended to generate supply problems over the decades, acutely in the subsequent period of virtually no output.

At international level, limits of housing supply and its role in exacerbating housing affordability problems is now widely discussed (McKinsey Global Institute, 2014).

Several of these supply problems are evident in Ireland now and others have been a recurring feature of our unstable housing system.

The current lack of new rental accommodation provision is part of the general problem of a slow housing supply response in the face of a strong increased demand. Housing output remains at a very low level. There were only 8,300 housing completions nationally in 2013, 57 per cent of which were individual houses. In 2014, this increased moderately to just over 11,000 completions. The composition changed somewhat with fewer individual houses (47 per cent) and more apartments (20 per cent from 11 per cent in 2013). The percentage of housing schemes or estates remains the same (33 per cent). The proportion of completions occurring in Dublin has increased. In 2013, Dublin had 1,360 completions or around 16 per cent of national output; in 2014, completions had increased to 3,304 or 30 per cent of housing output.

Rental accommodation is in particularly short supply in Dublin and some other urban centres. The current challenge is to combine a supply response with keeping housing affordable. One current warning signal is the strong recent growth in land prices, which seems to reflect expectations of continued housing price growth.

There is also the danger that housing supply, when it resumes, will not provide the type of housing that Ireland needs in the coming decades. Demographic patterns suggest that almost 60 per cent of projected new households in the Dublin area are estimated to consist of one or two persons in the period to 2018 (Future Analytics

Consulting, 2014). This implies a large need for smaller homes, including apartments. Yet the market demand for new housing is perceived to be primarily for family houses. This raises the question as to why there seems to be a discrepancy between the realities of the demographically based projections, on the one hand, and the market reality as seen by developers, on the other. Insofar as supply is recovering, the primary industry emphasis at present appears to be on new housing suited to owner-occupation that may in some cases be purchased by individual buy-to-let investors.

There are also particular obstacles to new institutional investment in supply of rental housing. Ireland does not have a tradition of developing new housing designed for institutional rental supply. Nowlan (2014) has identified obstacles to the development of new institutional rental accommodation as follows:

- i. **‘Shovel ready’ land:** Availability of land for new apartments/houses at prices that produce an acceptable rent to occupiers and an acceptable investment return to investors.
- ii. **Shortage of development industry specialists:** Institutional property investors want a reliable supply of built and let units coming from the development industry. However, the number of development industry specialists in this sector who can supply ready-developed ‘product’ to institutional investors is limited.
- iii. **Planning:** Real, or perceived, planning, infrastructure and administration blockages including Part V. All of these involve time, money and increased risk for developers.
- iv. **Coordination of social housing procurement:** There are multiple state agencies involved in procuring such social housing units. There is also a problem associated with the unavailability of firm commitments to fund units in advance at viable rents, and delays in processing the application by social tenants for rent support, directly or through AHBs (*ibid.*).

To ensure that an appropriate proportion of the new supply is for dedicated rental accommodation, there is a need to devote attention to the specific requirements of this type of new supply.

A key influence on the supply of new rental property is the return available to investors. Net rental yields for both individual and institutional buyers of rental property now appear attractive in Dublin (see Section 1 of the Background paper for this report). Initial rental yields would not cover all of the capital repayments for those using a mortgage to buy property but there is the attraction of acquiring an asset over time.

Returns would be lower for existing investors who have paid higher prices for their properties. These investors have also been adversely affected by a series of tax changes since 2007 as described in Section 1 of the Background paper for this report.

The viability of the construction of new apartments for rental in Dublin has been examined by Nowlan (*ibid.*). Nowlan finds that such construction is potentially viable at current rental levels, ‘but only if efficient procurement practices are adopted, land is available at reasonably priced levels and there are no significant planning-related delays’ (*ibid.*: 4).

In consequence of the current low level of new housing supply, Ireland’s long-term problems in generating appropriate supply and the underdeveloped nature of the rental sector, active and effective policy approaches to promote housing supply are needed. It is not a matter of ‘intervening’ in an unfettered and functioning market. It is important to see that policies promoting housing demand and supply have existed, in one form or another, in Ireland for most of the past century. Indeed, across the world—including all the advanced economies of Europe and North America—there are a range of policies that promote housing supply, particularly supply that will be affordable to both intermediate and low-income households.

### 6.3 Addressing the Supply Challenge

This section considers the following responses to the complex supply challenge:

- i. More active public management of housing supply and land.
- ii. Supply-side supports to promote rental housing provision:
  - a. Affordable accommodation for intermediate households;
  - b. Students and older people;
  - c. Tax reform; and
  - d. Vacant commercial space.
- iii. Reducing the cost of construction.

The first and third of these are the subject of a separate report to be published soon by NESC. Consequently, they are only briefly discussed here with the main focus on supply-side supports to promote the provision of affordable rental homes.

#### 6.3.1 More Active Public Management of Housing and Land Supply

To address the challenge of rental supply it is necessary to resolve the wider issues affecting housing supply generally. As shown by the Council in 2004, Ireland has long struggled to facilitate a sufficient and suitable supply of housing in and near the main cities (NESC, 2004).

This report on the rental sector will be accompanied by the forthcoming report on housing supply and land management. That report shows that new construction is

currently affected by a range of bottlenecks and it is difficult to determine the relative significance of each in any general way. It argues that it is now necessary to mobilise public authority, assets and capabilities to take a more active approach to housing supply, land management, infrastructure and affordable housing. The resources, capabilities and assets accumulated in NAMA need to be actively combined with those in government departments, the Housing Agency, local authorities and other public bodies. Overcoming the current institutional fracture will allow decomposition of the existing supply and construction problem, initiation of action and innovation, and monitoring and adaptation. This approach should include a sustained, comprehensive and inclusive programme of inquiry, exploration and action to improve the costs, technology and innovative capacity of house building in Ireland. The crisis has revealed the need for the system to take an authoritative overview of the land and housing situation, to manage land and housing supply, recursively combining land supply, finance and regulation. In retuning to a more activist approach, Ireland can learn from other countries that use active land management and other policies to create more affordable, stable and inclusive housing systems, which, in turn, underpin national competitiveness.

### **6.3.2 Incentives to Support Supply of Rental Accommodation**

International experience and analysis of Ireland's situation confirm that there is a strong case for incentives to encourage rental supply linked to conditionality on affordability. This case is strongest for those on lower incomes seeking to find accommodation in the rental sector. Other groups in need of affordable rental accommodation include students and older people. The experiences of a number of countries in providing incentives to encourage the promotion of rental accommodation, mostly conditional on the rents being affordable, are described in Section 3 of the Background paper for this report. In addition, in seeking to develop a larger and more stable rental sector there are good reasons to reform the general tax treatment of rental income, in the context of reforms to give tenants secure occupancy. In current circumstances, a particular opportunity for increasing the supply of rental accommodation in Dublin and other cities arises from the presence of much vacant space over commercial premises. Here we identify the main measures that can encourage such supply.

#### ***Incentivising Provision of Affordable Rental for Intermediate Households***

Those in private rental accommodation spend a considerably higher share of their income on housing compared to those in either owner-occupied housing or in social housing. Within the private rental sector the most acute housing affordability pressures are for those on low incomes not receiving state rental support payments. Those receiving such payments have relatively low housing expenditure but often have difficulty in either securing or retaining housing due to the shortage of affordable rental accommodation. This is particularly the case in large urban areas.

Back in 2004, the Council advanced the case for supply-side supports to increase the provision of affordable rental accommodation for 'intermediate households'. In its 2014 report *Social Housing at the Crossroads* the Council reiterated the potential of

cost-rental housing to meet the housing needs of intermediate households: these are households that struggle in the private rental sector and the market for homeownership, but may not be eligible for social housing or, even if they are eligible, are unlikely to be allocated it, given its scarcity (NESC, 2014a). The recent DKM report for the Private Residential Tenancies Board (PRTB) recommended the provision of low-cost loans to investors to build rental housing for low-income tenants not in receipt of income support schemes, in return for which a lower rent would be charged for the period of the loan (DKM Economic Consultants, 2014b).

As we noted in Chapter 4, the Council recognises that in designing supply-side subsidies, Government must strike a balance between desirable conditionality (concerning rents, tenure, allocation, management and the layout of housing developments), and achieving new investment and delivery. We suggest that the guiding framework should be movement towards a unitary rental system with permanent, affordable, cost-based, mixed-income rental accommodation. This involves creating policies that will ensure provision of affordable housing for intermediate households. Indeed, we believe that such a focus on intermediate households is virtually implicit within existing social housing policy.

This perspective suggests that in setting goals and criteria to assess investment and development proposals, a relatively high priority should be given to creating accommodation and securing assets that will underpin *permanent* provision of social and affordable housing. Reflecting this, in Government's criteria for assessing investment possibilities, a relatively high weighting should be given to projects in which the eventual asset or equity (arising from maturation and amortisation of debt) will be put in the service of further provision of affordable and social housing. There are, of course, several ways in which this could be achieved.

The provision of low-cost loans is one of a number of instruments that could be used to encourage the provision of affordable rental accommodation. Other instruments include access to state land on favourable terms, tax incentives and loan guarantees. Such incentives should be focused on large urban areas where demand does not meet supply. If state land is used for affordable housing, land ownership should be retained with a state body or a voluntary organisation with a long-term commitment to providing affordable housing.

Affordable rental accommodation could be provided by voluntary housing bodies or by the private sector. In case of either, the approach would involve the provision of a moderate level of subsidy in exchange for affordable rents. Permanent provision of affordable rental is most securely achieved when housing is provided and managed by a non-profit or limited-profit landlord who has a long-term commitment to providing affordable accommodation; such an entity needs to cover its costs but does not rely on achieving the full market return on its capital. With this approach, where surpluses are made, they would be recycled into investment in further social or affordable housing. In countries with large cost-rental sectors such as the Netherlands and Austria, voluntary housing bodies provide accommodation at affordable rents to a substantial share of the population.

The capacity constraints on Ireland's AHBs imply the need to also consider other means of providing affordable (and social) housing. There is evidence that private

equity firms are interested in investing in affordable and social housing. This offers the prospect of greater scale than can be achieved through reliance on debt-funded AHBs, but with this trade-off, the retaining affordability depends on remunerating the equity employed at an adequate rate. Another possible channel would be to create a local authority-linked housing body or housing trust that would be outside the general government sector and provide a combination of affordable and social housing.

Nowlan (2014) identifies the supply of ‘shovel-ready land’ at a price that ensures affordable rents as the most obvious blockage to new institutional rental accommodation. He argues that land could be made available by NAMA at a reasonable price and that this could be linked to conditions on the rent. There is clear willingness to accept conditionality but the precise terms need examination by reference to the overarching goals and criteria mentioned above.

One institutional arrangement that has been used elsewhere, particularly the US, to ensure long-term affordability is a community land trust. A community land trust is a non-profit legal entity that holds land in perpetuity in stewardship for the common good. In terms of housing, the community land trust model has mostly been used to promote a model of affordable homeownership (in which the homeowner leases the land) but has also been used for affordable rental (Angotti, 2007).

### ***Illustration of Supply-side Subsidies with Conditionality***

The current low cost of long-term funds affords an opportunity that facilitates the provision of cost-rental accommodation at attractive rents. The National Treasury Management Agency (NTMA) sold 30-year bonds at an interest rate of below 1.5 per cent in March 2015.

Consider an example of how a cost rent approach could work in Ireland. Suppose long-term funds could be made available at an interest rate of 2.5 per cent. If a unit of rental housing could be provided at €200,000, then the initial interest finance cost with a repayable mortgage would be €9482. Suppose other management and maintenance costs, including sinking fund contributions and allowance for vacancies, came to €2,500. In this scenario, an initial cost rent of €1,000 per month would be sufficient to cover costs. Possible ways of reducing this cost rent include enhanced construction efficiency to reduce the initial capital cost and management efficiency to reduce running costs. A lower initial cost rent would also be facilitated by the provision of low-interest public loans on which repayments could be deferred, which is how the capital advanced leasing facility (CALF) loans work. Initial costs could also be reduced if the loan were on an interest-only basis: at 2.5 per cent, the initial finance cost would be €5,000. When other costs are included, this would make it possible to have an initial cost rent of €625. If one allowed rents to increase, it would become possible at a later stage to initiate capital repayments.

The question arises as to how low-cost funds could be provided for the provision of such housing. The Housing Finance Agency (HFA) is at present the most obvious means of providing low-cost funding. The HFA is a state entity; if it were to lend

money at a cost close to the State cost of funds, this could make low-cost funding available for affordable housing.

A disadvantage of HFA lending is that the money raised to undertake such lending is part of the national debt. However, this is not necessarily an overriding constraint at present. Ireland has EU targets to meet regarding the deficit, debt and public expenditure. The debt rule does not apply to Ireland until 2019. If the deficit and public expenditure rules are met, and there is moderate economic growth, then the debt ratio will fall substantially, leaving some scope for lending by the HFA. Work is progressing on the development of a new financial vehicle whose activities would not add to the national debt. In the interim, the HFA can be used. The cost of raising long-term finance for the State and the HFA as a state organisation is exceptionally low at the moment and this provides an opportunity to provide low-cost finance for social and affordable housing.

### ***Affordable Rental Accommodation for Students and Older People***

Many students face great difficulties in finding suitable accommodation, adding to the pressure in the private rental market. There is a marked shortage of dedicated student accommodation in Irish cities compared to university towns in the UK and other EU countries. Some third-level institutions offer student rental accommodation. Where education institutions have space available, an obvious solution is for the institutions to develop more student accommodation. This can be profitable while offering a valuable service to students; accommodation can be let to visitors in holiday periods. It offers a relatively easy opportunity to combine land, finance and rent conditionality—a combination that, as noted throughout this and other reports, is harder to achieve in general. In addition, providing more customised supply can not only meet specific needs, but also free up general rental accommodation for other groups that seek it. The DKM report recommends that the development plan standards for the provision of student accommodation be reviewed (DKM, 2014b). Whatever the binding constraints on the provision of more dedicated student housing, the Council believes that indentifying and addressing these is of great importance.

There are also arguments for developing rental accommodation specifically for older people, who benefit particularly from secure occupancy. Currently, the Department of Environment, Community & Local Government provides funding through the Capital Assistance Scheme to develop such accommodation. Increased provision of independent and supported housing, in which AHBs play a key role, will become more important as the population ages and rates of homeownership decline.

### ***Tax Treatment of Rental Income***

Reform of the tax treatment of rental income is a definite element of a new vision and strategy for Ireland's rental sector. We discuss this here. As noted in Chapter 4, tax reform should be part of a wider reform and investment package that includes regulation to provide tenants with secure occupancy, along the lines outlined in Chapter 5.

The current tax treatment of rental income in Ireland is unusual in that not all mortgage interest is deductible in the computation of rental income. Neither is the local property tax treated as an expense for tax purposes. The ability to deduct interest is the norm elsewhere in calculating taxable rental income, and this approach applies in Ireland in relation to commercial property. The Council considers that, in the context of secure occupancy, the appropriate tax treatment of rental income is to have full relief of interest payments where the landlord has borrowed to provide the rental property. This is also proposed by DKM as a long-term option. As in the case of corporation and other taxes, there are advantages to having as simple, clear and uniform a tax regime as possible, with limited use of special tax allowances.

Although the DKM report agrees that full relief of interest is the right long-term goal, it suggests that Government might move to this over a number of years rather than immediately (*ibid.*). One reason is the possible impact on revenue, although current buoyancy may make this less pressing. A second reason is to leave policymakers with the ability to use selective provision of full interest relief as an incentive to target particular objectives. These include encouraging landlords to accept tenants on rent supplement or HAP and to promote ‘rent certainty’ leases<sup>21</sup>. The focus on use of tax incentives to promote ‘rent certainty’ leases reflects DKM’s view that the existing system of rent regulation and four-year tenancies should be largely retained. In that context, thought turns to devising tax provision that might promote ‘rent certainty’ or longer-duration leases. With secure occupancy, no such provisions are necessary.

In the Council’s view, the best strategic approach is to have a simple regime for taxation of rental income, which provides clearer and better incentives for long-term investment in provision of good-quality rental homes, and to address issues of affordability and secure occupancy through the kind of regulatory reforms set out in Chapter 5. In the comprehensive and balanced reform package proposed by the Council, it would not be necessary to use special tax incentives to encourage longer leases and greater rent certainty. As well as creating a clearer overall regime, this approach allows policy to focus on the design of supply-side subsidies and other measures to meet the most important and challenging long-term objective: increasing the supply of permanent, affordable rental housing for low-income and intermediate households.

In the context of moving to a new tax and regulatory regime, consideration could be given to whether it is possible to use favourable tax treatment to redress the

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<sup>21</sup> DKM propose that landlords who accept rent supplement/HAP tenants for a minimum of five years should receive 100-per-cent interest relief on borrowings. In addition, they propose that landlords accepting rent supplement or HAP should also receive relief from capital gains tax. DKM also propose that there would be 100-per-cent interest relief on borrowings when a rent certainty lease is in place. The lease would have a minimum period of five years during which it could be terminated by the tenant but not the landlord. Another option proposed by DKM in relation to rent certainty leases is that some proportion of the rental income be disregarded for tax purposes.

disadvantage that rent supplement and HAP tenants face when acquiring and maintaining suitable tenancies.

The DKM report recommended a tax incentive for rental accommodation by extending the Living City Initiative to include rental properties (*ibid.*).<sup>22</sup> There was an earlier Countrywide Refurbishment Scheme designed to improve the standard of existing rental residential accommodation, but this ended in 2008. There was limited awareness and uptake of this scheme. However, if promoted more effectively, such a scheme could be of value in upgrading property and facilitating investment to meet current regulations, including those that banned bedsits. Consideration should be given to the provision of tax relief for expenditure on refurbishment in rental accommodation (beyond the existing Home Renovation Incentive).

### ***Vacant Space over Commercial Premises***

Casual observation suggests that there is an abundance of vacant space above commercial premises that has potential to be used for residential rental accommodation. The DKM report recommended that consideration be given to restructuring commercial rates to encourage this; it would mean reducing commercial rates if the space were habitable and increasing rates if the space were not habitable (DKM Economic Consultants, 2014b).<sup>23</sup> DKM's recommendation follows on from a commitment in *Construction 2020* to consider removing incentives in existing commercial rates that allow a property to deteriorate. At present, vacant but inhabitable commercial property is entitled to a refund<sup>24</sup> of commercial rates subject to a number of conditions, while uninhabitable space is exempt from rates. No doubt there are some complex issues in designing a more appropriate rates system. But the Council's view is that, given the need to increase housing supply in our cities, commercial rates should be restructured to encourage better use of vacant space.

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<sup>22</sup> This initiative is to provide tax relief for investment in the refurbishment of old (pre-1914) residential and retail property in areas to be designated in the centres of Dublin, Cork, Limerick, Waterford, Galway and Kilkenny. It is designed to bring families into city centres and to transform pre-1914 buildings into modern homes. Those availing of the scheme can claim tax relief on refurbishment expenditure; the tax relief on any one project is capped at €200,000 for commercial investors. The residential component of this initiative is specifically for owner-occupiers. It may encourage the switch of some older rental property to family homes. The initiative has not yet commenced, it was first proposed in 2012 but required EU state aid approval. This has recently (February 2015) been obtained. The DKM report proposes extending this scheme to rental property in the same cities as the owner-occupier initiative. It would apply to the upgrading of existing rental property as well as to the conversion of buildings from other use to rental accommodation. Its application could include conversion of vacant space over older commercial premises into rental accommodation. It could also be an incentive for the upgrading of some of the pre-1963 rental properties. If the initiative were to be extended in this way, it would require another state aid application, which would take some time.

<sup>23</sup> At present, if a property is used for both commercial and residential use, the commercial part is subject to commercial rates while the residential part is liable for the Local Property Tax (LPT).

<sup>24</sup> In Dublin, Cork, Limerick, Galway and Waterford, a refund of 50 per cent may be claimed, while elsewhere a refund of 100 per cent is available.

### **Earlier Tax Incentives**

In earlier decades, tax incentives were a strong motivation for investment in new residential accommodation, both rental and owner-occupied. This approach was ultimately very problematic in that it encouraged building activity in areas with limited underlying need for new housing. In earlier years, it had some success in encouraging redevelopment of core city areas. The lessons of past decades as well as the tight limits on the public finances mean that any such incentives would have to be very focused on the most pressing priorities. In particular, any incentives would need to be focused on large urban areas where demand exceeds supply, and be time-bound and subject to regular review to ensure that they are addressing the challenges identified.

### **6.3.3 Reducing the Cost of Construction: Innovation and Building Information Modelling**

In terms of supply-side measures, it is also important to consider how the development and construction sector might reduce its overall cost base. *Construction 2020* here envisages the development of a more competitive construction industry based on best practice (Government of Ireland, 2014). It names a number of the actions needed to help the sector to transform. These include work by Enterprise Ireland with the sector, such as the Management4Growth programme, Business Accelerator programme and Lean Start programme. *Construction 2020* also notes that Building Information Modelling (BIM) has become a powerful tool in driving efficiencies and increased productivity in construction (*ibid.*).

#### **Box 6.1: Impact of Building Information Modelling**

**In the UK, the adoption of Building Information Modelling (BIM) is having a dramatic impact on the UK construction industry. In 2011, the Government Construction Strategy mandated the use of BIM on all public sector projects by 2016. This led to Government and the construction industry working together to develop the industry's skills and reduce the cost of infrastructure. BIM has been identified as a significant contributor to the savings of £804m in construction costs in 2013/14 recently announced by the Cabinet Office. At a project level, for example, the Ministry of Justice has identified BIM as having enabled £800,000 of savings in the development of the Cookham Wood Young Offenders Institution.**

Source: Digital Built Britain, 2015.

Enterprise Ireland has recently commenced a BIM Start Programme, which is the first stage of a three-part programme that will support companies in developing a strategic roadmap with the aim of successfully integrating their products and services into the information needs of designers and contractors. Improvements in innovation and efficiency also include the optimisation of the use of e-planning

systems. Adoption of new technologies, modern methods of construction and delivery processes will be crucial for sustainable competitive construction enterprises but also in underpinning supply of more affordable housing. Increased productivity through improved training and skills and through the adoption of technology can make significant cost, building-performance and project-delivery differences.

The Council strongly supports any action that promotes deployment of modern construction practices in Ireland and the attraction and eventual emergence of enterprises and sectoral institutions that are capable of working in the new technical, financial and regulatory environment. It sees this as a central part of the more active approach to housing supply and land management discussed in its forthcoming report. It emphasises that housing and other policies must ensure that any improvement in efficiency should be reflected in the price of housing both for purchase and rental.

## 6.4 Conclusion

Increasing supply is central to addressing the problems in the rental sector. The lack of new rental accommodation is part of the general problem of limited new housing supply. There is a pressing need to address the obstacles to new housing supply. In its forthcoming report, the Council argues that it is now necessary to mobilise public authority, assets and capabilities to take a more active approach to housing supply, land management, infrastructure and affordable housing.

There is a limited recovery under way in new housing development in Ireland at present. The primary emphasis is on new housing suited to owner-occupation, which may in some cases be purchased by individual buy-to-let investors. Ireland does not have a tradition of developing new housing supply designed for institutional rental supply. If some proportion of the new supply will be for dedicated rental accommodation, attention must be devoted to the specific requirements of this type of new supply.

International experience in countries with larger stable and affordable rental sectors shows the role of targeted incentives and supports in boosting the supply of new rental accommodation. New incentives should, as far as possible, be targeted at the provision of permanently affordable rental accommodation. A number of instruments can be used to achieve this, including low-interest loans, provision of land and loan guarantees on private borrowing. Another possibility to consider is the use of Part V to require that a share of new accommodation be allocated to affordable rental in addition to the requirement for social housing. Such accommodation could be provided by either voluntary housing bodies, the private sector or possibly new local-authority linked institutions. If arrangements could be made so that the overall cost of finance was low and other costs are efficiently managed, then it would be possible to provide affordable rental accommodation on a cost-rental basis at below current market rents.

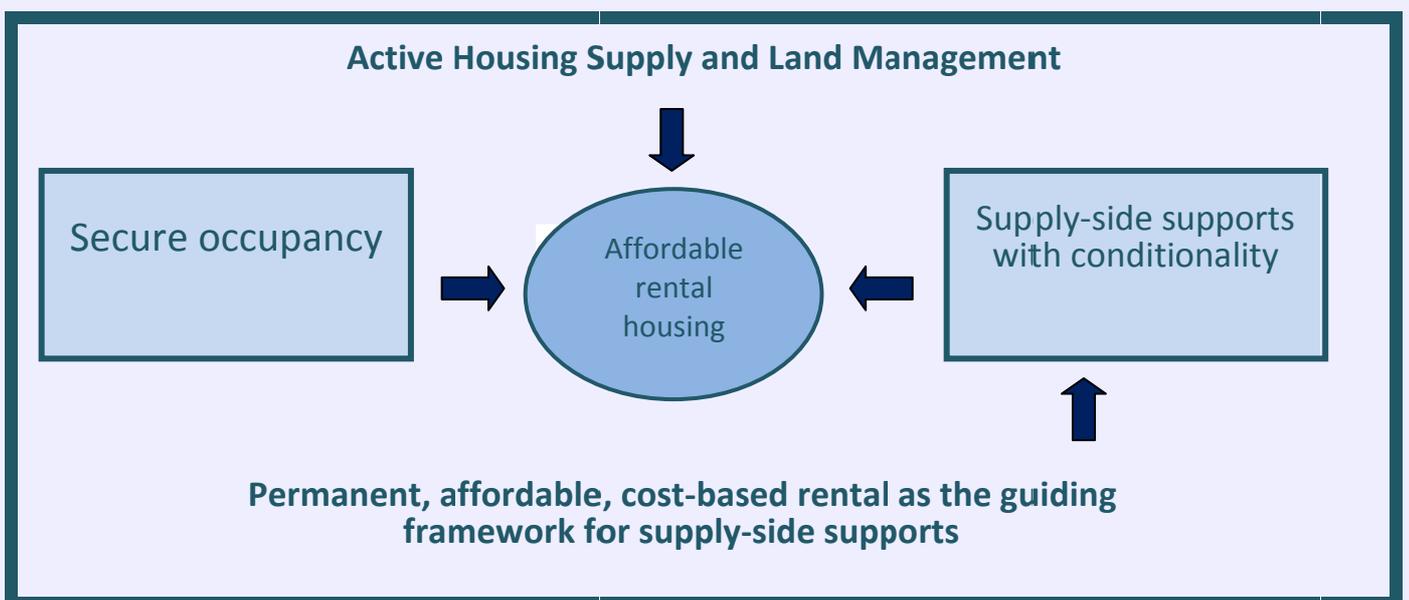


Chapter 7  
Pathways to Affordable Rental  
Housing: A Strategy that is More than  
the Sum of its Parts

This report has outlined a new vision for Ireland’s rental sector and strategic approach to reform. This broad approach is necessary for a number of reasons. First, housing is a system, and it is not sensible to analyse and act on its various parts—owner-occupation, private rental, social housing, planning, construction, finance or land supply—in isolation. Second, there are complex issues and interests involved in the provision of rental accommodation; these can easily cancel each other out, leading to limited policy development. Or they can give rise to an incoherent overall policy approach. Third, the Government’s clearly stated goals for housing policy—affordability, sustainability and inclusion—inherently transcend the various sectors and parts of the housing system. The clear statement that the first goal of housing policy is affordability, though simple, is potentially transformative. In the case of any aspect of housing—from owner-occupation, through rental to finance, planning and construction—a powerful starting point is to pose the question: what is required to achieve affordability?

In this short final chapter, we emphasise that the strategic approach we propose contains several pathways, all of which contribute to increasing the availability of affordable rental housing. This is illustrated in Figure 7.1.

**Figure 7.1: Pathways to Permanent Affordable Rental Housing**



Consideration of this shows how heavy reliance on any one policy approach or instrument is unlikely to be effective, but together these approaches can be more than the sum of their parts.

For example, despite the problems created by rapidly rising rents, sole reliance on stronger rent regulation is unlikely to be effective; imbalances between demand and supply would make themselves felt and landlords could end tenancies relatively easily. Increasing security of tenure is necessary to make rent certainty effective and vice versa. But it is also important to see that longer tenancies reduce the need for highly restrictive rent control, supporting adoption of a flexible market-sensitive approach. In other words, much of the work of affordability is done by having indefinite leases, not by restriction on the setting of rent in new tenancies.

Provision for secure occupancy also creates a context in which it is possible to move strongly to improve the tax treatment of landlords' rental income through allowing full deductibility of interest payments. In the absence of secure occupancy, there would be a strong temptation to undertake limited tax reform; full interest allowance, or other preferential tax provisions, would then be available to incentivise landlords to offer longer or rent certainty leases.

But, of course, a stronger regulatory framework for secure occupancy can only do some of the work and could, on its own, have a damaging effect on the supply of rental housing—either through encouraging existing landlords or discouraging new investment. Consequently, the strategic approach outlined here combines improved regulation with several lines of policy action to enhance supply. This is central to the vision and strategy and is a condition for the effectiveness of the other elements.

A further synergy is that provisions creating secure occupancy reduce the pressure on Government to increase rent supplement and HAP outlays and the risk to low-income tenants threatened with economic eviction. Likewise, a strong increase in the provision of social housing, through vigorous delivery of the Social Housing Strategy, would weaken the need for stringent rent regulation and pressures for increases in rent supplement. Addressing the problem of encumbered buy-to-let properties will be supportive of secure occupancy, more stable operation of rent supplement and HAP, and of retaining existing supply.

In summary, the elements of this integrated strategy—indefinite tenure, market-sensitive rent regulation, supply-side subsidies, tax reform, active housing supply and land management, and resolution of encumbered buy-to-let mortgages—would be mutually supportive. Each helps to create the conditions in which the others are feasible and can be most effective. Such a strategy will be more than the sum of its parts.





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