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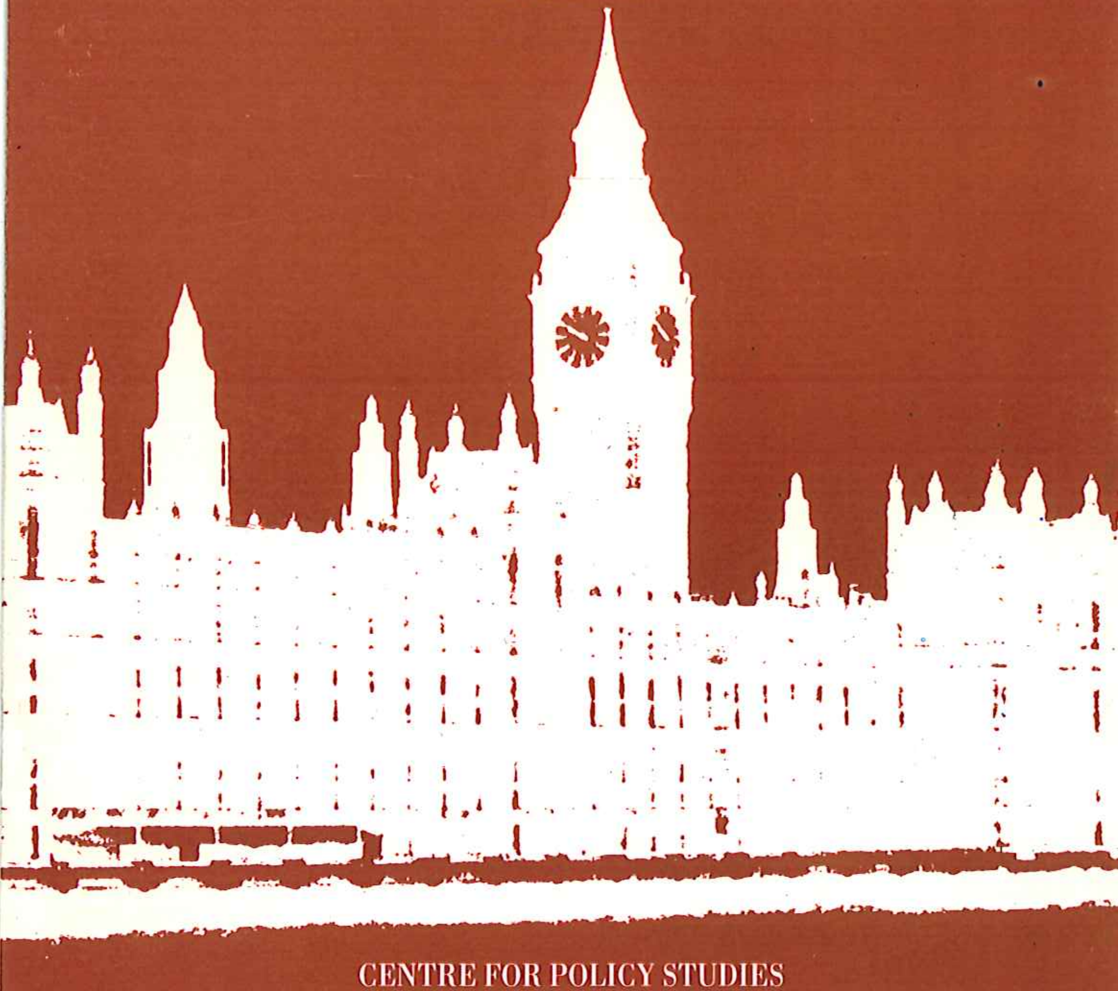
Policy Study No. 81

Lets into Leases

The political economy of rent deregulation

Martin Ricketts



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The political economy of rent deregulation

Martin Ricketts
with a foreword by Ian Gow MP

CENTRE FOR POLICY STUDIES

8 Wilfred Street, London SW1E 6PL
1986

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Support towards research for this study was provided by the Institute for Policy Research

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ISBN 1-869990-00-5
© Centre for Policy Studies, November 1986
Printed in England by G. Donald & Co. Ltd. Osiers Road London SW18

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Foreword

by
Ian Gow MP

The decline in the private rented sector has, in some ways, been inevitable.

Most people, given the choice, prefer to be owners rather than tenants. Owner occupation has been encouraged by successive governments, through the abolition of Schedule A tax, tax relief on mortgage interest, and the exemption of the main house from capital gains tax.

When rent control was first introduced 71 years ago, it was designed to help the tenant. In fact, it has had the opposite result. The twin-evils of rent control and security of tenure have injured the very people whom the Government was trying to assist.

Too often, the dwindling band of private sector landlords are unable, because of low rents, to keep their properties in decent repair. Most landlords, when a tenant leaves or dies, do not seek a new tenant, but sell the property. On 7 October 1986, my successor as Housing Minister said at the Conservative Party Conference:-

> "We have got over half a million empty privately owned flats and houses in England alone. It is a blot on our national scene, it is a simple affront to common sense".

Just so. Meanwhile, the number of homeless increases, and the condition of many privately rented houses and flats deteriorates.

Martin Ricketts and the Centre for Policy Studies have produced an excellent pamphlet and an original proposal – a tradeable property right for regulated tenants, who would be able to assign – at whatever is the current market price – their regulated tenancy for a limited period of years.

Such a proposal has obvious advantages. An existing regulated tenant, living in accommodation too large for his present needs, but unwilling to move because he would lose the benefit of a low rent and security of tenure, would be given the incentive to seek alternative accommodation more suited to his needs. The disadvantage is that a landlord would find himself with a new tenant for a fixed period and there would be a change in the status of the tenancy without the landlord's consent. Most landlords would be likely to welcome the introduction of "tradeable property rights". A possible modification of the scheme would be that such rights would be created only with the consent of the landlord.

Martin Ricketts argues, wisely, that his novel proposal is only part of a wider measure of reform. I hope that the Conservative Party will make a commitment in the next manifesto to de-regulate all *future* private sector tenancies. That is to say that in respect of every tenancy after "the appointed day", the rent and the term of the tenancy should be as agreed between landlord and tenant. This would bring into use some of those half a million empty flats and houses of which John Patten spoke at Bournemouth. It would encourage conversions of houses into flats for rent. Most important, it would bring new investment into the private rented sector.

Such proposals would leave all existing protected private sector tenants unaffected; Martin Rickett's proposal would, however, offer clear benefits to them as well.

For too long, we have put off reform of the private rented sector. Our lack of political courage has contributed to the hardship of the unemployed whose ability to move from one part of the country to another is matched by the scandal of hundreds of thousands of empty homes. If we really care, a rent reform Bill will be the first to be presented in the next Parliament.

Introduction

Few students of the housing market in the United Kingdom would deny that serious and persistent problems exist. Indeed, it is not difficult to make a case that, with respect to certain specified standards, the performance of the housing market has deteriorated. Consider the picture painted by the recent Inquiry into British Housing[1].

Increasing numbers of homeless people often housed provisionally in expensive and inappropriate 'bed and breakfast' accommodation; increasing quantities of empty and dilapidated property; young single people unable to form new households and leave their parents; mothers with young children failing to find shelter following family breakdown and divorce; people looking for employment but discouraged from moving about the country; and the special difficulties faced by a whole range of people in finding accommodation including the mentally handicapped, the elderly, members of ethnic minority groups and those leaving penal institutions.

Official figures indicate that 'homelessness' has continually increased since 1978. The figures relate only to the statutory duty of local authorities to provide accommodation under the Housing (Homeless Persons) Act 1977. Young single people or childless couples are not considered the local authorities' responsibility under this Act and thus they will not be included in the statistics, even if sleeping rough or in a hostel.

Further, people 'accepted' as homeless must have nowhere to go for shelter and must not have brought about their predicament 'intentionally', for example, by voluntarily leaving accommodation elsewhere. The number of households accepted as homeless in England[2] increased from 53,100 in 1978 to 78,240 in 1983. In Great Britain[3] the figure was 94,000 in 1984. As a measure

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1. *Inquiry into British Housing*. A report chaired by HRH The Duke of Edinburgh KG,KT. National Federation of Housing Associations. July 1985

2. op. cit. The Evidence. Information Paper 1

3. *Social Trends*. 1986 Edition. Table 8.21. p.143 HMSO

of the excess demand for accommodation, recorded homelessness is clearly inappropriate since it excludes all those, not actually homeless, who would purchase accommodation if it were available on current terms. The *Inquiry into British Housing* argues that homelessness is "a very approximate barometer of housing shortage" rather than a direct measurement. Accompanying the shortage is the apparently paradoxical existence of increasing numbers of empty dwellings (up to three quarters of a million in England)[4]. Yet local authorities find it necessary to house the homeless in bed and breakfast accommodation, thus prompting the inevitable complaint that "hoteliers are making vast profits from the misery of homeless families."[5]

Many of the empty dwellings are in disrepair and the 1970s saw a rise in the number of dwellings requiring repairs costing in excess of £7,000 (in 1981 prices) from 864,000 to 1,049,000.

A different picture emerges, however, if we look at other general trends in the housing market. Table 1 opposite indicates that the housing stock grew from 13,813,000 in 1951 to 21,061,000 in 1981 and that the excess of houses over households had changed from a deficit of 947,000 to a surplus of 923,000. This in no way demonstrates that there are "too many" houses and takes no account of location and condition, but a general easing of the pressure on housing space is unmistakable. General indicators of trends in housing amenities are likewise favourable. The percentage of households with sole use of bath or shower[7] rose from 83% in 1971 to 97% by 1983. Between 1971 and 1984 the proportion of households with central heating[8] had risen from 34% to 66%.

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4. *Inquiry into British Housing*. Evidence of the Empty Property Unit, p.77

5. op. cit. Evidence of Gingerbread for Lone Parents and Children. p.83

6. Boleat, M. (1985) *Housing in Britain* Building Societies Association Table 2.9

7. *General Household Survey* 1983 HMSO

8. *Social Trends* 1986 Edition, Table 8.6 p. 135 HMSO

Table 1 Houses and Households. Great Britain 1951-81

1951	13,813,000	14,760,000	–947,000
1961	16,273,000	16,499,000	–226,000
1971	18,833,000	18,547,000	+286,000
1981	21,061,000	20,138,000	+923,000

Source: Housing in Britain Building Societies Association. Table 1.4 p. 8

In 1983 5% of households lived at a density below the bedroom standard[9] compared with 7% in 1971. Between 1971 and 1984 inclusive 3.75 million dwellings were renovated with the assistance of grants.[10]

In 1981, 88% of adults in a sample survey expressed themselves very or quite satisfied with their housing.[11]

General government support to housing including grants to housing associations and individuals, rate fund support to Local Authorities, mortgage interest relief to owner-occupiers, and housing benefit to tenants and owner-occupiers (rate rebates) exceeded £10 billion in the financial year 1983-84.[12]

Taking selected pieces of information from published sources it is possible to create, therefore, two quite different impressions, one of decay and distress, the other of continuing overall improvement. The two views are not, however, irreconcilable. As a single picture, what the information suggests is that a general increase in the quantity and quality of housing services produced has been accompanied by an inefficient system

9. *Social Trends*, op. cit. p. 134

10. *Social Trends*, op. cit. Table 8.19 p. 142

11. *English House Condition Survey*, 1981 HMSO

12. *Social Trends*, op. cit. Chart 8.23. p. 144

of resource allocation. Observed results are precisely what would be expected, given Britain's history of distorting or suppressing the price system in the field of housing. The 'housing problem' in Britain is representative of some of the classic consequences of heavily regulated systems. All students of planning know the story of Soviet factories surpassing their crude production targets while shortages of particular qualities and sizes of the product are rife. In a similar way policy instruments which result in the construction of acres of owner-occupied housing in the new towns and suburbs, and the 'gentrification' of fashionable urban areas, will do nothing for the inner cities unless the price system is helping with its signals.

The greater the variety of types and qualities exhibited by a product the more serious the absence of market signals becomes. Rising incomes, technical changes and social and demographic forces perpetually influence the markets in all products and services. Housing has not been immune from these developments. It is an increasingly complex and varied service and the demands of individuals change with family commitments, changes in location, financial circumstances and fashion. Yet there is no sector of the housing market which has escaped distortion as a result of public policy, and in the privately rented sector attempts to suppress the price system have had particularly unfortunate consequences. The *Inquiry into British Housing* remarks that "most of those commenting on housing shortage indicate that this is caused primarily by the lack of housing to rent".[13] An economist is liable to flinch at the notion that a housing shortage can be 'caused' by a lack of housing, but the point being made is clear enough. The primary manifestation of housing shortage can be found in the rented sector. This is not surprising, for the rented sector, whether public or private, is the most highly regulated part of the housing market.

This pamphlet is devoted to a simple proposition and an equally simple policy proposal (in principle if not in implementation).

The proposition

Deregulation of private sector rents is a *necessary* condition for

13. *Inquiry into British Housing*. The Evidence. p. 10.

improving the allocation of resources in the field of housing. But it is not claimed that deregulation is a *sufficient* condition for solving the "housing problem". The "housing problem" implies some statement of policy objectives and these may be defined narrowly or broadly. At the narrow end of the spectrum attention may be focused on the problem of homelessness, the removal of shortages, and the encouragement of mobility. Broader objectives include the alleviation of housing conditions below certain "socially acceptable" standards. Yet broader objectives also include efficiency in the housing market generally. Rent deregulation will not by itself remove the distortions which affect the housing market including those induced by the tax system. Neither will it by itself ensure that minimum standards are achieved. But without deregulation the existence of homelessness, shortages, labour immobility, dilapidation, empty property and inefficiency will continue.

Even if the above proposition is accepted it by no means follows that deregulation will happen. The political obstacles are enormous and their nature is discussed in section 7 of this pamphlet. A method to circumvent the political difficulties exists, however.

The policy proposal

The property rights of tenants in regulated property should be specified exactly and then made tradeable. This proposal has never, to the writer's knowledge, been given close consideration. A similar proposal by Samuel Brittan[14] that the rights of *public sector* tenants be made tradeable in the interests of greater geographical mobility has not been taken up by policy makers, and this might suggest some powerful opposing political forces. However, when considered in the context of the *private sector*, it is a proposal which, whatever its practical, administrative, or legal obstacles may, upon closer scrutiny, turn out to be, has some extremely attractive political properties. Indeed it seems likely that some version of this basic proposal is the only realistic hope for rapid and comprehensive deregulation as distinct from gradual and ultimately ineffectual tinkering.

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14. Samuel Brittan *Participation without Politics*, Hobart Paper Special, 2nd Ed., Institute of Economic Affairs, (1979) p.25. Also *The Economic Consequences of Democracy* Temple Smith (1977) pp.170-172.

1
Historical trends in the rented sector

The decline in the importance of the private rented sector of the housing market in the 20th century has been spectacular. In 1914, out of a total housing stock of 7.9 millions, 7.1 millions were rented from private landlords. A mere 800,000 dwellings were owner-occupied. About 20,000 were supplied by local authorities.[15] By 1985 the housing stock had reached 21.9 millions of which only 2.3 millions were in the privately rented and miscellaneous group, a proportion of 10.7 per cent. From being the majority sector therefore, private renting has declined over seventy years to become a sector used by a minority of households. In its place owner-occupation has risen from 10 per cent to 62 per cent of the housing stock between 1914 and 1985, while renting from local authorities and new town corporations constitutes the remainder (27.3 per cent in 1985).

Between the wars the absolute rate of decline of the private rented sector was slow. 1.1 million dwellings were sold by private landlords to owner-occupiers during these years, but this was to a large extent counterbalanced by the construction of 900,000 new dwellings for private renting.[16] After the second world war however, decline both absolutely and relatively was rapid. Table 1.1 gives figures for selected years since 1950.

Table 1.1
% Housing stock by tenure.

	Private rented and miscellaneous	Public rented	Owner occupied
1950	53.0	18.0	29.0
1960	31.9	25.8	42.3
1970	18.9	30.6	50.6
1980	12.7	31.2	56.2
1985	10.7	27.3	62.0

Source: Housing in Britain BSA. Table 1.2.

15. *Housing Policy* Technical Volume Part 1. Table 1.23, p. 38. 1977. HMSO.

16. *Housing Policy.* op. cit. Table 1.24, p. 39.

The change from majority to minority tenure is also reflected in the characteristics of tenants. Instead of tenants being taken from all walks of life, ages and income levels, the private rented sector began to house particular groups. Figures taken from the *General Household Survey* illustrate this point (see table 1.2). 30 per cent of heads of household under the age of 25 inhabit the private rented sector, clearly indicating that this group is not spread evenly over the different tenures. Two thirds of tenants in the private furnished rented sector were under the age of 30 and 90 per cent were under the age of 45 in 1983. Private tenants of *furnished* accommodation also exhibit high levels of educational attainment. In 1983 46 per cent of such tenants had a highest qualification level of a GCE 'A' level or above. This compared with 28 per cent for owner-occupiers with mortgages. The *unfurnished* private rented sector by contrast has an elderly body of tenants with 54 per cent above the age of 65 and predictably a low proportion with educational qualifications – 15 per cent with the equivalent an 'A' level or higher qualifications.

Income levels in the furnished and unfurnished rented sectors are lower than in the owner-occupied sector, the former primarily because of the youth, and the latter primarily because of the age of the tenants. The median income was £118 per week and £108 for heads of households classed as 'economically active'. This compares with £163 per week for mortgagors and £106 for public sector tenants. Expenditure on housing also varied substantially between different parts of the rented sector.[17] In the unfurnished sector, average expenditure was £14.42 per week compared with £22.30 in the furnished sector in 1983. For *new lettings* the average weekly charge calculated from the occupiers' reports was £19.93 for unfurnished and £35.49 for furnished lettings.[18]

Standards of amenities are generally lower in the rented sector than in other sectors. Table 1.2 gives figures for the percentages of households lacking a fixed bath or shower and the percentage with central heating. The furnished sector has the lowest

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17. Expenditure on housing includes rent, rates, water charges, maintenance and insurance of structures.

18. Todd, J.E. *Recent Private Lettings 1982-1984* (1986) Table 8. p. 14.

Table 1.2
Selected tenure characteristics 1983

	Outright owners	Mort-gagors	Local author-ity/New town tenants	Privately rented unfurn-ished	Privately rented furnished
Age of occupiers					
% under 30	1	16	12	10	66
% over 65	51	2	34	54	5
Qualification of occupiers					
% with 'A' level or above	17	28	3	15	46
Median income (economically active)					
£ per week	131	163	106	108	118
Expenditure on Housing					
£ per week	10.86	39.89	11.80	14.42	22.30
Amenities					
% lacking sole use of fixed bath/shower	3	–	1	9	29
% with central heating	66	82	58	47	36

Sources: General Household Survey (1983) Table 6.9. *Social Trends (1986)* Tables 8.6 and 8.27

percentage (36 per cent) with central heating, and the highest (29 per cent) without the sole use of a bath or shower. To some extent, this relative lack of amenities reflects the age of rented dwellings. As table 1.3 indicates 54 per cent of new lettings by non-resident landlords was in pre-1919 accommodation, although such accommodation, represents only about 27 per cent of the total stock. The furnished part of the private rented market is also the most crowded tenure with 10 per cent of households below the 'bedroom standard' in 1983. The proportion of all households overcrowded by this definition[19] was 5 per cent.

19. The 'bedroom standard' is defined as follows: a bedroom for each married couple, a bedroom for each person over 21, and a shared bedroom for each 2 persons below 21. Those between the ages of 10 to 21 should share with someone of the same sex.

Table 1.3
Recent lettings by age of building %

	All non-resident landlords
Pre-1919	54
1919-1964	27
1965 or later	14
Not Known	5
	100

Source: Todd, J.E. *Recent Private Lettings 1982-1984* (1986) Table 13. p.26

The importance of the private rented sector to the geographically mobile element in the population is shown by the fact that 35 per cent of new lettings in 1982-83 were to tenants who had moved three or more times in the previous three years. Further, 31 per cent had moved a distance of 20 miles or more.[20]

Information from survey data therefore describes a private rented sector divided into two distinct parts. In one part, young, well educated, mobile people, with low current incomes but presumably fairly bright future prospects live at high densities and pay relatively high rents. In the other part, older, less mobile people, at the end of their career or probably retired, live at low densities and pay relatively low rents for amenities which are generally poorer than those found in the owner-occupied or public rented sectors. This curious combination of features is explicable only in the context of the development of public policy in the years since 1915.

20. Todd, J.E. op. cit. Table II. p. 19.

2
The causes of the decline in private renting

Many different factors have contributed to the reduced popularity of private renting. Since 1914 personal incomes have risen substantially, and owner-occupation offers a degree of independence and security the demand for which might be expected to be strongly related to income. Further, exogenous technical developments have often been suggested as contributing factors. The change towards owner-occupation has been associated with the rapid growth of suburbia in response to the motor car, a growth financed by the development of the building society movement. None of these arguments is wholly conclusive, however. Firstly, the security and independence offered by owner-occupation should not, in principle, be unavailable in other sectors if suitable contracts can be negotiated (see chapter 4). The important question then becomes whether or not security is intrinsically more costly to achieve in the rented sector. Secondly, it is by no means obvious why the construction of new suburban housing should have relied upon building societies which hold financial instruments as assets rather than upon other companies holding physical property as assets. A recent reform introduced in the Building Societies Act 1986 enables the societies to hold up to 5 per cent of their assets in the form of physical property to let. But it is not clear why such institutions could not have developed spontaneously many years ago if the conditions had been suitable. They were not.

Two major forces at work during most of the twentieth century have been remorselessly eroding the capacity of the private rented sector to compete in the housing market. These forces are the growth of the income tax and the imposition of rent control.

(a) **The income tax.** At the beginning of the twentieth century fewer than one million people paid income tax. The rising level of public expenditure during and after the first world war resulted in around four million income taxpayers by 1939. Even at that time however, the income tax was of concern only to one fifth of

the working population. The years after the second world war saw a continuing rise in public expenditure and at the present time virtually the entire working population pays income tax. This trend had important consequences for the housing market because not all forms of income are taxed at the same rate. A landlord investing in rented property would have to pay tax on the flow of rent payments he receives. An owner-occupier inhabiting identical property does not pay tax on the value of the services which the housing stock yields. Until 1963 a tax on the imputed rental value of owner-occupied houses did exist under Schedule A, but estimates of this imputed rent tended to be well short of realistic market levels, especially after the onset of the post-war inflation. By the time Schedule A tax was abolished for owner-occupiers one of the 'justifications' for its abolition was that it yielded very little revenue and politicians were not prepared to face the political consequences of reinstating it.[21] With the income generated by the stock of owner-occupied housing taxed at lower rates than that generated by rented housing the drift into owner-occupation began. The drift accelerated after the second world war, and became a stampede with the inflation of the 1960s and 1970s. Britain became a nation of owner-occupiers at about the same rate as it became a nation of tax avoiders.[22]

(b) **Rent control.** If the provisions of the income tax were sufficient to ensure a constant undermining of the private rented sector, the combination of the income tax with rent control added to the forces leading to contraction. Rent control was first introduced in 1915 as a short-term wartime expedient when rents were frozen at their 1914 levels and tenants were given security of tenure. At the end of the war progress towards decontrol was very slow. In 1923 some property of high rateable value was decontrolled ('block decontrol') and decontrol at the expiry of a

21. The political forces acting in the housing market are examined in more detail in chapter 6.

22. The non-taxation of imputed income from owner-occupied housing is not the only fiscal advantage enjoyed by the owner-occupier. An owner's principal residence is also exempt from capital gains tax unlike a landlord's portfolio of houses or indeed a renter's portfolio of financial assets.

tenancy was introduced ('creeping decontrol'). Nevertheless by 1939 much of the rented stock was still controlled and the second world war resulted in full rent control once more.

Post-second world war attempts at decontrol were no more successful than those which followed the first war. In 1957 the Conservative Government decontrolled some property of high rateable value and instituted creeping decontrol elsewhere. The well-publicised activities of certain landlords who attempted to harass their tenants into moving out then provided the justification for a new system of 'rent regulation' introduced by the Labour Government in 1965. It is this system, since extended to furnished lettings, which still constitutes the legal framework today. Either landlord or tenant can apply to a rent officer for a 'fair rent' to be fixed. The concept of a 'fair rent' has always been mysterious but in practice it has implied rents well below market clearing levels and indeed below levels sufficient to persuade existing landlords to re-let.

3
The effects of rent regulation

Most of the characteristics of the private rented sector presented in chapter 1 are consistent with the predicted consequences of rent regulation.

(a) **Sales of property to owner-occupiers.** Rent regulation with security of tenure radically affects the property rights held by landlords and tenants. This will be discussed in more detail in chapter 4 and its policy implications developed in chapters 6 and 8. Here it is merely necessary to note that the value of a property with an incumbent tenant at a regulated rent will be well below its vacant possession value. Because the tenant's rights in the property have no market price attached to them both landlord and tenant will have a mutual interest in realising the capital gains which will accrue as a result of transferring the property to owner-occupation. Bargaining between landlord and tenant could be protracted and costly but an agreement that the tenant should purchase the property at a price somewhere between the present value of the net stream of regulated rent payments and the freehold value should be beneficial to both parties. As was noted in chapter 1 this has happened on a large scale since rent control was first introduced.

(b) **The supply of new lettings.** Rent regulation will adversely affect the willingness of property owners to let their accommodation to tenants. However, the *quantitative* impact will depend upon many more detailed considerations about the way rent regulation is implemented. Three factors are of particular importance. Firstly, the level of regulated rents and the return that these represent on capital employed will affect investment decisions. Secondly, *expectations* about regulated rent levels or future changes in the regulatory environment will be crucial. Thirdly, there is the simple question of whether or not rent regulation applies to new lettings. Between the wars, for example, new lettings were not subject to control and this explains the existence of substantial new construction in the rented sector at a time when many people in the market could still remember an era of no controls. After the second world war

however, new dwellings were controlled, and the competitive position of the rented sector was fatally weakened. Controlled rents were eroded by inflation, rates of return fell below those available elsewhere, and any lingering ideas that intervention was merely temporary disappeared entirely.

(c) **The quality of the housing stock.** Low rates of return in rented housing inevitably result in a process of disinvestment and an attempt by landlords to retrieve some of their capital. One way of accomplishing this objective if sale to owner-occupation is not possible is to filter the property down and divert the maintenance stream to alternative uses. In a competitive market such behaviour would reduce the rental value of the property, but with rents below market clearing levels this no longer follows under rent regulation. The poor condition and relative lack of amenities which still characterises the private rented sector reflects to some degree the low income level of the remaining tenants, but it also indicates the severe disincentive to maintenance and improvement which is the consequence of rent restrictions.

Short of deregulation, two options confront policy makers wishing to counter this tendency to dilapidation. One is to fine a landlord by a reduction in the regulated rent if dilapidation occurs (the stick), and the other is to bribe the landlord with grants to invest in specific amenities (the carrot). The former option would require an army of inspectors and administrators and would force the authorities to face the unanswerable question of how much a particular landlord should be compelled to invest in such an unprofitable business. Rejecting the imposition of this flagrant injustice and the offering of grants has been the preferred way out. Although it is possible for a grant to bring the expected return on the landlord's contribution up to commercial levels, if a rise in the regulated rent is permitted, the take-up of these grants has always been much greater by owner-occupiers. Further, a great disadvantage of the system is that it does not actually change the structure of incentives in the rented sector once the grant-aided work has been finished. There still remains an incentive not to maintain the property, and the policy seems as likely to produce a cycle of dilapidation – renovation – dilapidation as a steady improvement.

(d) **The use of existing housing assets.** At each point in time the price system is simply a way of allocating a given stock of assets between competing claimants. Those who value the assets most in terms of the willingness to pay for them use more than people who value them least. This principle has always offended people who correctly point out that willingness to pay a market price will depend upon income levels and that some protection for poor people may be required. Providing this protection through rent regulation means, however, that the function of the price system in inducing people to economise on the use of housing space is lost. Some people will live at much lower densities than they otherwise would, and others will either be entirely homeless or forced to compete for space in any vestiges of the uncontrolled market that remain. The simultaneous existence of an unfurnished regulated sector with low densities, and homeless households crammed into expensive hotel accommodation is therefore not in the slightest degree paradoxical.

The difficulty of finding accommodation will impose increasing search costs on tenants, and those lucky enough to find rented rooms will not, except by a happy accident, find they are buying the quantity or quality which they would prefer. Indeed it is possible that tenants will consume less housing service under rent control than they would have consumed in an unregulated market. There comes a point, therefore, at which it is not clear that tenants as a group derive any net benefit from a controlled system when compared with an uncontrolled one, and long before this point is reached any net benefit that does exist is likely to be distributed randomly. In a study of rent control in New York, Olsen[23] estimated the losses to tenants of failing to find appropriate accommodation and compared them with the benefits of lower rents. He found that benefits varied widely among similarly situated tenants (in terms of age, income and

23. Olsen, E.O. *An Econometric Analysis of Rent Control*, Journal of Political Economy Vol. 80, No. 6, pp. (1972) 1081-1100

family circumstances) and concluded that "rent control is a very poorly focused redistribution device."[24]

(e) **Geographical mobility.** One of the most important effects of rent regulation is to inhibit the mobility of households. A tenant who moves to another area will face higher housing costs, not merely because of inter-regional variations in prices which will exist in any case, but because moving involves giving up the right to a regulated tenancy. The tenant's property rights cannot be transported around the country but are tied inextricably to a particular property in a particular location. A study by Minford, Ashton and Peel[25] (1986) has estimated that housing distortions of this type, including subsidies in the public rented sector, increase the unemployment rate significantly (around two percentage points in 1979).

(f) **Choice of tenants.** At first sight it appears inconsistent that rent control is expected to reduce mobility, while the information presented in chapter 1 revealed that the sector housed the most mobile elements in the population. To reconcile these apparently conflicting points it is necessary to understand the incentives faced by landlords in the regulated market. Under the present system a rent is only registered upon application to the rent officer by landlord or tenant. There is therefore a sector of the market (primarily furnished) in which rents are set by negotiation, but always with the possible intervention of the rent officer acting as a constraint on the landlord. The worst possible outcome, from the landlord's point of view, is that a rent is agreed but that it is then reduced by the rent officer and the tenant

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24. This general conclusion has been reiterated by a stream of writers including among many others Paish, F.W. (1950) *The Economics of Rent Restriction*, Lloyds Bank Review, April (p. 4); Needleman, L. (1965) *The Economics of Housing*, Staples Press, London (pp. 162-63); Aaron, H.J. (1966) *Rent Controls and Urban Development: A Case Study of Mexico City, Social and Economic Studies*, December *(p. 321); Lindbeck, A. (1967) Rent Control as an Instrument of Housing Policy* in Nevitt, A.A. (ed) *The Economic Problems of Housing* International Economic Association, Macmillan, (p.64); Robinson, R. (1979) *Housing Economics and Public Policy*, Macmillan, London (p. 94)

25. Minford P. Ashton, P. and Peel, M. (1986) *The Effects of Housing Distortions on Unemployment*, Mimeo, Department of Economic and Business Studies, University of Liverpool

remains in the property for the next thirty years. A simple way of avoiding this disastrous outcome is to make sure the the tenant has every personal reason to leave in a relatively short time. By picking young and highly educated tenants the landlord knows that the tax advantage of owner-occupation or the demands of a developing career will soon induce the tenant to leave and vacant possession of the property can be regained. Alternatively, the landlord can pick already professionally qualified people for whom renting only makes sense if the expected duration of their stay is quite short, and the transactions costs of buying and selling a house are not worth incurring. Rent regulation thus induces landlords to discriminate against poor households both because the probability of referral to the rent officer is likely to be perceived as greater for these households than for richer housholds, and because the expected duration of their stay is longer. The introduction of the shorthold tenancy in 1980 may have reduced this disadvantage of poorer households however, and this is discussed more fully in chapter 7.

4

The significance of 'tenure'

In chapters 1,2 and 3 we have charted the decline of the private rented sector, described the changing composition of its tenants, and discussed the general effects of the major instruments of housing policy, especially rent regulation. At this stage it is necessary directly to confront the question – why is the rented sector important? Could we not do without it? Should we simply watch the sector die away, a fading echo of Britain's Victorian past? Why not let the owner-occupied sector advance still further until virtually all households own their homes with perhaps a small public 'rented sector of last resort'? Whether consciously or unconsciously, the broad thrust of British housing policy in the last twenty years appears designed to produce such an outcome. It is a strategy with some important attendant disadvantages.

Housing 'tenure' relates ultimately to the question of the form in which people wish to hold assets and the ways in which property rights in the physical housing stock are divided and apportioned. 'Ownership' in its popular sense implies that all the rights to use or change a particular asset are concentrated together. This does not necessarily imply that a single person holds these rights. Property rights may be 'collectively' owned, in which case the group of owners must use some collective decision-making procedure to determine how the resources will be used. Very often, however, different rights to use a given resource can be held by different people. An owner of a lake can sail a boat on it or fish in it. But the right to sail and the right to fish from the shore are separate and could in principle be held by different people. This is precisely what happens when an 'owner' sells licences to sail or fish to different individuals.

In the case of housing, the variety of contracts which are possible is enormous. A landlord who lets accommodation assigns rights of use to the tenant in return for a specified rent. Restricted rights to enter and inspect the accommodation for the purposes of repair and maintenance are usually retained, and each party will have the right to end the agreement on specified terms. The amount of notice may differ between the parties, and different contracts will embody different amounts of 'security' for the tenant. Where agreements are very short-term, rents will be renegotiated frequently to reflect changes in market conditions. If, on the other hand, a landlord agrees to let for a long period of time at a given rent there will be an element of 'insurance' provision in the contract. The landlord can sell the right to the rental flow from the property to anyone who will offer an acceptable price. The tenant's rights of use are not usually tradeable in this way, although there is no reason in principle why they should not be. We would normally expect the landlord to be responsible for maintenance where short term agreements are involved. Deterioration will have an adverse effect on the market value of the landlord's rights and the tenant will have an incentive to make maintenance expenditure only of the shortest term variety. Very long term exchangeable rights of use would clearly change the incentive structure and make it possible for tenants to take responsibility for repairs.

On a functioning rented housing market people would choose which of this great variety of possible arrangements was most appropriate for their purposes, and prices would vary according to the details of each agreement and the property rights assignments which they contained. As has already been seen, public policy has suppressed this market, and we confront the question – does this matter? Consider, for example, the following argument. All rental contracts have at least one thing in common. The user of an asset (the tenant) does not have to hold wealth in the form of that asset. The tenant purchases 'housing service' which is a *flow* produced by a *stock* of housing assets. Housing stock is held by the landlord. Rental contracts are not the only ones however which permit people to purchase a flow of housing service without accumulating net wealth to the value of the housing stock. When a person purchases a house by means of a 100% mortgage, he or she does not have to possess any net assets. The *physical* asset of the housing stock is precisely matched by an offsetting *financial* liability. Monthly mortgage payments might then be regarded primarily as payments for housing service. The landlord changes his name to mortgagee and the tenant to mortgagor. The mortgagor pays interest instead of rent and takes over responsibility for repairs and maintenance. Apart from a renaming of financial flows nothing of consequence, it might be argued, has happened. The suppression of the market in rented housing according to this line of reasoning is of little significance. It has simply resulted in institutional developments in the field of financial intermediation which superficially change the appearance of things but not the substance. Erstwhile landlords shelter behind the respectable though rather impersonal protection of the building societies.

It is important to understand what is wrong with this argument since it may underlie some potentially serious mistakes in housing policy. Essentially the argument presupposes a world of perfect capital markets, perfect certainty and no transactions costs. Under such conditions 'tenure' would cease to have any significance and financial arrangements in the 'owner-occupied' sector could mimic anything available in the 'rented' sector. Yet modern economic theory increasingly emphasises that some of the most important features of contractual relations are governed by considerations of uncertainty and transactions costs. It is amazing how easily problems dissolve when these issues are assumed away. Exclusive reliance on owner-occupation has the following major disadvantages under conditions of uncertainty.

(a) In a world of uncertain markets it *matters* that an owner possesses exchangeable property rights in housing stock whereas a tenant does not. An owner must bear the consequences of any change in the market valuation of the stock which he holds. For most people, outright ownership of their home implies that a large proportion of their personal wealth is tied up in a single asset. No doubt it is reassuring to reflect that historically and on the average, housing stock has proved to yield real capital gains and that after-tax returns have been very acceptable. It is also true that ownership of a house may confer a form of satisfaction in itself which is not available from the ownership of other assets. Nevertheless, the curious risk-bearing aspects of owner-occupation cannot be disguised. There can be no absolute guarantee that all classes of property will always appreciate in value. Further, changes in local house prices can vary considerably and depend upon the development or otherwise of neighbouring amenities, planning decisions, changes in fashion, and trends in general or local economic conditions. For each person to own the house in which they live runs directly counter

to the idea that risk-averse people will prefer to hold a small stake in a wide variety of property than a big stake in a single item. From a purely risk-sharing point of view the holding of shares in a large real-estate company would appear more logical than owner-occupation for people with modest income and wealth.

(b) Purchasing a house by borrowing the money has further interesting implications for the bearing of risk. Any student of economics will be aware that highly 'geared' companies (those with high debt-equity ratios) are more risky than less highly geared ones. The risk of bankruptcy increases because debt obligations cannot be easily altered just because the company encounters unfavourable circumstances. Yet mortgagors, and especially first-time buyers, are often financially extremely vulnerable because of high gearing. A person with few existing assets who borrowed two and a half times his annual income to speculate on the commodities markets would be considered to be taking considerable risks. Housing is apparently considered to be different. The term 'as safe as houses' may come to have increasingly ironic connotations however, as home ownership extends further down the income scale and to classes of housing assets which are far from absolutely safe.

In 1969, 2,930 properties were taken into possession by building societies[26] because of arrears. This number had fallen to 1,060 in 1973. By 1984, however, the figure was 10,950 or 0.17% of outstanding mortgages. This proportion appears small, but it represents action which is taken only as a very last resort when all possibilities for extending the term of the mortgage or for further borrowing are exhausted, and in no way fully reflects the extent of possible financial problems which people may face. Any mortgagor having to sell a property and finding the market value depressed since the date of purchase will know all about the problems of 'gearing'. High gearing is a marvellous thing providing that prices can move only one way. Evictions and financial difficulties occur in rented markets of course, but there the distress would at least not be compounded by a simultaneous speculative capital loss.

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26. Building Societies Association. Bulletin No. 43 July 1985. p. 18. Table 1.

(c) In past years, especially the 1970s, rapid inflation has served to disguise some of the potential financial problems of owner-occupation. A capital loss in real terms on a house was rare, but a loss in money terms would have been even rarer during these years. A sustained move back towards much lower rates of inflation would be expected to expose the dangers more clearly, especially at the cheaper end of the market. Even if such a low-inflation world does not materialise in the late 1980s and 1990s however, it in no way follows that inflation miraculously solves the problem of risk sharing or gearing. A person whose house appreciates at a rate substantially below the general rate of inflation may be quite capable of servicing a mortgage debt, but such a person will have paid dearly for his or her housing.

Inflation also presents problems for the owner-occupier by being associated with high nominal rates of interest. These high nominal interest rates have the effect of a more rapid repayment of capital than would otherwise have occurred. Providing a house appreciates in line with inflation the 'inflation component' of the interest payment is reflected in a higher market value of the house and hence becomes part of the owner's equity stake. A renter in an equivalent house would pay the landlord a rent related to the prevailing 'real' rate of return, and the landlord would achieve the remaining inflation component through appreciation in the value of his property. Once more it is possible to argue that owner-occupation could mimic the rented sector by means of low-start mortgages or 'negative amortization' mortgages. The mortgagor pays a 'real' interest rate and the inflation component is added to the outstanding mortgage year by year thus keeping its real value constant (or more likely in gentle decline). If inflation of all assets proceeded at the same perfectly anticipated rate, no doubt such financial mechanisms would be widely used. But in practice inflation is variable and difficult to predict, and the costs of coping through the development of new financial contracts are substantial. Further, the negative amortization mortgage increases the risk that, over time, the outstanding mortgage exceeds the market value of the house and an owner-occupier with no other marketable assets becomes effectively bankrupt.

(d) From section (c) it is evident that tenure influences the time-

profile of personal saving as well as the risk characteristics of asset holdings. In a world of zero transactions costs, as we have seen, this would not be the case and financial institutions could offer contracts which permitted any time-profile of savings that was desired. In practice, available contracts imply a fairly rapid repayment rate even when the mortgagor is very young or relatively poor. A person who expects his or her income to rise over time and fall after retirement would not necessarily wish to save rapidly in earlier years. A typical life-cycle might involve a low level of saving initially, a rising level in the years of high earnings, and dissaving in retirement. It is interesting that in some countries where the rented sector is less restricted than in Britain, people do not typically buy their houses until much later in life than is common here,[27] a fact which conforms easily with expected patterns of asset accumulation. There is nothing intrinsically wrong with owner-occupation at a young age if it is freely chosen and possible alternatives are not artificially foreclosed. But some comparative evidence suggests that restrictions on rented housing have resulted in savings decisions which are distorted by the terms of available financial contracts in a single market – the market for owner-occupied housing.[28]

(e) A final important difference between the owner-occupied and rented sectors concerns mobility costs. In the case of owner-occupation the decision to move geographically is inextricably bound up with a changed portfolio of asset holdings. Greater search costs will be involved because the consequences of a mistaken decision are so much more serious than would be the case in the rented sector. Further the costs of re-assigning ownership rights involving legal searches and so forth are greater than the costs of re-assigning a tenancy. The frustration and anxiety of simultaneously buying and selling owner-occupied housing in different locations in Britain will not be

27. See chapter 5

28. Some of the force of this argument is reduced by the existence of mortgage renegotiation. A householder who moves (or even one that does not) may negotiate a new mortgage and spend some of the accumulated equity. This 'leakage' is often considered undesirable or even underhand since it enables interest payments on borrowing for non-housing purposes to attract tax relief.

underestimated by anyone who has experienced the legal delays, the fragile 'chains' (though not in Scotland) and the prosperous estate agents.

Owner occupation is also susceptible in principle to 'lock-in' effects. Again the history of continually rising house prices disguises this possibility, but where prices are depressed or falling, owner-occupiers may find it difficult to move because they cannot pay off the outstanding mortgage from the proceeds of the sale. As a general problem this may not seem widespread. But the more owner-occupation moves into marginal and risky areas, the very geographical areas subject to outward migration and long-term decline, the more serious the problem. Owner occupation is as capable of cementing people into such locations as the public rented sector.[29]

The purpose of this section has not been to attack owner-occupation as a desirable form of housing tenure. There are many advantages attached to the sector – the establishment of a particular pride and interest in a property and location, clear incentives towards care and maintenance, possible political benefits in the form of greater social stability. But desirable incentives are usually purchased at the price of greater risk-taking. The case for 'profit sharing' schemes involves exactly the same trade off: improved incentives for workers and managers but greater variability of return. There is no economic principle which says that the benefits of greater incentives will always and everywhere dominate risk-sharing losses. If such a principle were true the insurance industry would be in rapid decline. All economic institutions involve some compromise between risk-sharing benefits and losses of individual incentives in a world of positive monitoring and transactions costs. This section has merely served to demonstrate that in such a world *tenure does matter*, and that tenure differences reflect different solutions to the problems of risk taking, incentives, capital accumulation and mobility costs. Public policy which inhibits the private rented sector is thereby closing options which would be freely chosen by many people were the opportunities available.

29. With perfect capital markets these lock-in effects would not occur. People would simply borrow enough to discharge their financial obligations and move. The problem is that there would be no collateral security to offer for such a loan, and in an uncertain world this naturally discourages lenders.

5
Overseas experience

Housing policy in other countries inevitably reflects a variety of social conditions and historical experience. The range of policy instruments which has been applied and the diversity of institutions developed to cope with housing problems is considerable, and a full survey here is clearly impossible. Nevertheless, underlying the diversity there are some common threads, and it is important to examine foreign experience to see whether there are lessons to be learned for British housing policy. In this chapter we make some broad observations about the role of the rented sector in other housing systems.

After 1945 a principal objective of housing policy in many countries was the achievement of high rates of new construction. In Europe war damage was enormous, and even in areas which had escaped destruction many years of low maintenance had taken a toll. Countries like the United States, Canada and Australia had not experienced the widespread destruction of housing stock but they faced high rates of population increase. The population of Australia increased by 51.5 per cent between 1951 and 1971 whilst that of Canada increased by 53.7 per cent. The housing stock over the same period rose by 90 per cent in Australia and 77 per cent in Canada.[30]

Strategies for achieving historically high rates of building varied. In Britain considerable emphasis was placed on the provision of public rented housing, whereas in Canada and the United States the focus was on creating new types of mortgage insured against default by the government, thus encouraging easier terms and greater access to capital markets for poorer people. In the European countries, measures to increase the rate of new building were frequently combined with rent controls to prevent landlords benefiting from housing shortages. Germany controlled the rents of all pre-1948 dwellings; the Netherlands introduced rent control after 1945 for similar reasons; in Sweden rents were frozen at existing levels after 1946; and in Britain, as we have seen, rent control continued after the war.

30. *Housing Policy*. Technical Volume Part III. (1977) p.161, p.166. HMSO

As the most obvious manifestations of housing shortage subsided in the late 1950s and 1960s all countries then began to face the more complex problems of resource allocation discussed in the introduction. Reform in the private rented sector was usually an important component of each country's response. In West Germany an Act of 1960 provided for decontrol of pre-1948 dwellings by geographical area until only a few major cities remained subject to partial control. Denmark responded to an increasing gap between rents on older (controlled) dwellings and rents on new dwellings by moving to a system of 'economic rents'. These are not market rents but, unlike British 'fair rents', the rate of return available on rented housing is an important criterion. The 1975 'Housing Pact' for example, defined an economic rent as providing a yield of 7 per cent on the 1975 assessment of the property. By the early 1970s the Netherlands had also greatly relaxed rent control. Unsubsidised housing built after 1945 was subject to no rent controls while such housing built before 1945 in certain 'liberalised areas' was also free of controls. Sweden decontrolled most of the rented stock in 1968 and moved to 'user value' as the determinant of rent levels. This generally involved negotiation between landlord and tenant with appeal to a rent tribunal which could fix a rent by comparison with other like property in an area. The non-profit sector is important in Sweden and is used by tribunals as a benchmark for comparison.

A generally firmer commitment to decontrol in many countries compared with the U.K. is reflected in the different structures of housing tenure. The figures in Table 5.1 opposite must be interpreted cautiously, since definitions vary from country to country. Nevertheless, it is apparent that Britain is distinguished not so much by a low overall proportion of rented housing, but a high proportion of public sector rented housing. In West Germany only 3 per cent of the housing stock is in the public sector and in spite of a relatively low proportion of owner-occupied housing 79 per cent of dwelling units are owned by individuals rather than by public authorities or corporations. In Denmark the public sector is likewise very small with 35 per cent of the stock rented privately or by housing associations. The large rented sector in the Netherlands is primarily comprised of housing association lettings and only 8 per cent of dwellings were rented from private landlords. Sweden is noted for a substantial hybrid sector of tenant-ownership in condominiums and the figure recorded in the table for the public sector (23 per cent) includes lettings of municipal housing companies. In fact only 3 per cent of dwellings are recorded as 'public rented' in Sweden.

Table 5.1
Housing Tenure %

	West-Germany 1978	Denmark 1980	Netherlands 1982	Sweden 1980	U.K. 1982
Owner-occupied	37	52	44	42	56
rented	63	42	56	42	44
of which public sector	(3)	(4)	(9)	(23)*	(33)
Condominiums				16	
Unknown		6			

* *Includes the lettings of municipal housing companies*
Source: Mark Boleat 1986 *Housing in Britain* Building Societies Association. Various tables in Chapter 7

Even in countries like Canada and Australia which have higher levels of owner-occupation, the rented sector has an important role to play. The proportion of owner-occupation reached 66 per cent in Canada in 1961 but declined to around 60 per cent by the early 1970s and has since recovered to 63 per cent in 1982.

Similarly, in Australia the proportion of owner-occupation reached 70 per cent in 1961 but declined to 67 per cent by 1971 and was 68 per cent in 1981. In both countries the rapid development of urban areas led to a change in construction from single houses to flats or other forms of higher density housing which were rented or organised as condominiums. By the early 1970s the objective of a wider choice of tenure for low-income earners, a recognition of the role of renting for the young and the mobile, and dissatisfaction with the distribution of aid to owner-occupiers was reflected in housing policy.[31]

This brief review of recent experience in housing markets overseas suggests a few broad observations;

31. *Housing Policy*. Technical Volume Part III (1977) pp. 161-170 HMSO.

(a) A move towards deregulation of rented markets could be observed in many countries as crude shortages declined after the war. This deregulation process has produced rented markets which if not always relatively bigger than in Britain are generally less dominated by the public sector and more responsive to price signals.
(b) The low proportion of *private* rented housing in Britain is reflected in the relatively high proportion of young people who own their housing. In 1982, 30 per cent of heads of households under the age of 25 were owner-occupiers in Great Britain. Even in Canada and Australia with traditionally larger owner-occupied sectors, the equivalent proportions are only 17 per cent and 23 per cent respectively.[32] As Boleat (1985) remarks "it is not unreasonable to suggest that this reflects the lack of available rented housing in Great Britain rather than natural tenure preference." (p.11). At the other extreme only 4.4 per cent of heads of household under the age of 25 are owner occupiers in West Germany.
(c) It is not generally true that higher levels of owner-occupation are simply a sign of wealth and that richer countries will be those with large owner-occupied sectors. Some of the highest levels of recorded owner-occupation are in the poorest countries in the world. Bangladesh headed this particular league table in 1981 with a figure of 90 per cent.[33] Among the industrialised countries tenure structure varies as we have seen, but again there is no clear relationship between income and tenure. Switzerland had the smallest owner-occupied sector at a mere 30 per cent[34] in 1980 yet has a reputation for high standards. Similarly in West Germany 59.8 per cent of households rented their housing[35] in 1982 and the proportion in some urban areas was still higher. The idea that

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32. Boleat, Mark (1985) *An International Comparison of Housing Tenure by Age*, BSA Bulletin No. 43. Tables 4 and 5. pp. 7-11

33. Boleat, Mark (1984) *Housing tenure: An International Comparison*, BSA Bulletin No. 40. Table 1, p. 11

34. Boleat, Mark (1986) *Housing in Britain*, Building Societies Association. Table 7.15. p. 32.

35. Boleat, Mark (1985) op. cit. Table 9

renting is an outdated form of tenure inappropriate for modern conditions is a parochial delusion. There is nothing particularly sophisticated about owner-occupation, which is as likely to flourish in environments where capital markets are primitive, and ideas about tradeable property rights undeveloped, as it is in an advanced economy. Where capital markets are highly developed sophistication is required for the development of financial instruments which make owner-occupation attractive even in certain risky geographical areas and to people on lower incomes, but sooner or later such attempts encounter the problems discussed in chapter 4. At that point the importance of rented housing cannot be overlooked and attention becomes focused on the possibilities for reform in rented housing markets.

6
Deregulation – the political problem

Whatever the purely intellectual case for rent deregulation the political problems of putting such a policy into effect are substantial. If ideas alone were all that determined public policy rent control could not have survived for so long. It would be a difficult task to find an economics text book or book on social policy which did not draw attention to the pernicious long term consequences of rent control. Most economists are taught that it is more efficient in competitive markets to achieve income redistribution objectives by means of cash transfers than by direct intervention to influence money prices.

At the level of general economic principle therefore, the case against rent control is relatively uncontroversial. Controversy is associated much more with the problem of abolishing rent control, and especially with the short run consequences of deregulation.

Housing service has a number of characteristics which make deregulation a politically difficult objective to achieve.

(a) Housing is one of the most capital-intensive of services. The stock of capital which produces housing services is in relatively inelastic supply in the short run. There is some disagreement about the extent to which supply might be augmented in the short run by the use of empty property and the letting of space at present underutilised. Nevertheless there are likely to be some delays before higher prices resulted in more space to let.

(b) Even in the long run, the existence of planning regulations and limitations of space for housing in particular areas implies that the housing stock cannot increase without upward pressure on prices. This means that changes in public policy result in capitalisation effects. The value of tax allowances available to owner-occupiers for example, is to some extent capitalised in the value of owner-occupied houses which are then more expensive than they otherwise would have been. Similarly, the end of rent control would see a substantial rise in the asset value of rented

housing as the higher level of future net rents was capitalised into prices.

(c) A further characteristic of housing service is its extreme immobility. Even capital intensive commodities can, in principle, be fairly cheap to transport so that changes in the geographical distribution of the population do not necessarily entail investment in new plant. In the case of housing, however, it is obvious that consumption occurs at the location of the capital and that demographic changes constantly require adjustments to the stock of capital. These adjustments take place gradually in response to changes in prices and rents, changes which involve significant effects on incomes and wealth.

(d) Housing is a commodity which every voter purchases. Expenditure on housing takes a significant proportion of net incomes, the precise figure depending upon how this expenditure is measured. Consumers' expenditure on housing as a proportion of total consumers' expenditure according to national income accounting conventions[36] was about 14 per cent in 1984. The outgoings of many people on housing as a proportion of their incomes will be even higher, of course, especially if the interest payments of new mortgagors or the rent payments of those in lettings outside the rent acts are considered.

The combined effect of these four characteristics of housing – its capital intensity, supply inelasticity, immobility, and expense, is to make it a commodity of great political importance. Voters will find it in their interests to become informed of the way that changes in policy will affect them, and politicians will be wary of taking steps which might imply substantial redistributional consequences. Removing rent control is a classic instance of the political pitfalls which accompany housing reform. Politicians will reason that in the short run shortages would be reduced by a sharp increase in rent levels. This would be opposed by the tenants in regulated property. Landlords on the other hand would benefit, and this would be reflected in an immediate capitalisation of the higher future revenues in property values. Thus the redistributional effects would be

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36. Expenditure on housing includes repairs, maintenance, rates, water charges and the imputed rent of owner-occupied dwellings. It excludes mortgage interest payments. *United Kingdom National Accounts* (1985). Table 4.9 HMSO.

transparent and would favour the numerically smaller group (the landlords) compared with the larger group (the tenants). Further, efficiency gains from reallocation of the stock of existing rented dwellings, as underoccupation is discouraged, would not always be perceived as such. Elderly people reluctantly having to move from their accommodation in the face of rising rent levels after years of occupation would be unlikely to commend the policy either to the voting population or to the politicians. Once an inefficient system of resource allocation is established, the very process of changing it can have associated adjustment costs which discourage attempts at reform.

In the long run the benefits of rent deregulation in the form of greater investment in rented housing, lower levels of homelessness, more accommodation available for mobile households and so forth would be realised. But politically the speed and magnitude of this supply response is crucial. An important consideration here is the climate of expectations concerning the future course of public policy. Only if there is confidence that deregulation will continue will prospective landlords be prepared to risk entering the market. After seventy years of intervention and opposition, a climate of confidence would be difficult to create. Housing is a specific type of capital asset which, given planning and zoning restrictions, cannot easily be transferred to alternative uses. It is therefore extremely vulnerable to 'hold up' through the political process. If rent restrictions are introduced there is little that a landlord can do to avoid a political 'mugging' in the short run and a capital loss has to be accepted. Price controls in fields where capital can be transferred to other uses will not be so serious for capital owners, and conversely the absence of 'hold-up' potential will make price control a less attractive policy to politicians and easier to reverse. Knowledge of the vulnerability of rented housing investments will make the establishment of confidence and trust between landlords and politicians extremely difficult.

These problems have played a part in slowing the pace of reform in housing markets for many years. Committees of inquiry in the inter-war years expressed the fear that decontrol would increase rents. The Ridley Committee[37] noted that "the

37. *Report of the Interdepartmental Committee on the Rent Restrictions Act.* CMD No 5621. Dec. 1937 p11. HMSO.

ground on which [the Rent Restrictions Acts] have since been periodically extended has been that the continued shortage of houses might result in the exaction of scarcity rents if control were removed". In the post-war years Phelps Brown and Wiseman[38], anticipating public choice theory, observed that "there are more tenants than landlords and the tenants have both a subsidy and a vote: a vested interest develops which may make (the abolition of rent control) politically difficult." Fear of the political consequences of decontrol was clearly apparent in the 1959 general election, when the Conservative manifesto as reported by Macrae[39] contained the specific pledge: "In the next Parliament we will take no further action to decontrol rents. More houses must be built, and recent rent legislation given time to have its full beneficial effect in increasing house room." It would be surprising if the same factors did not underlie the present government's reluctance to introduce a comprehensive measure of deregulation.

At the root of the political dilemma lies the difficulty of generating incentives to owners of property to produce *additional* rented housing space without giving rise to a substantial redistribution of income between *existing* landlords and tenants. In principle, at least, if existing arrangements are inefficient it should be possible to devise reform proposals which confer social benefits without making anyone worse off. Economists would express this in the language of welfare economics by saying that Pareto improvements in social welfare or at least approximate Pareto improvements (changes which harm no-one) are potentially available. Unfortunately, the devising of practical policy instruments which have such properties is not easy.

From the standpoint of democratic politics the 'ideal' instrument of reform would have the following properties:

(a) It would leave all voters at least as well off as they were before the change.

(b) It would yield benefits quickly.

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38. Phelps Brown (F.H.) and Wiseman (J) *A Course in Applied Economics* 2nd ed 1964. p.380 Pitman

39. Macrae(N) *To Let?* Hobart paper no. 2 (1960). p.13. IEA

(c) Benefits would be capitalised in some marketable asset thereby making them transparent.

(d) Benefits would accrue to politically the most influential groups.

(e) Any associated costs of the reform would not be capitalised in the price of a marketable asset, or would be spread widely over a range of assets.

It is instructive to consider several housing reforms in the light of this list of characteristics. Reform of the tax provisions for owner-occupied housing has long been advocated by academic economists, for example. That it has not been enthusiastically adopted is easily understandable. Removal of mortgage interest tax relief would be expected to have an immediate effect on the price of owner-occupied housing. Thus the private costs to owner-occupiers would be transparent and reflected in a marketable asset. Offsetting *private* benefits in the form of lower rates of income tax take the form of a long-run stream of uncertain size and duration. In so far as some of these benefits are capitalised in the prices of other assets, the effect is widely diffused and difficult to quantify. Further, the social benefits of a better allocation of investment between housing and other assets and the more neutral treatment of different tenure sectors would appear only gradually.

Contrast this picture with the policy of selling council houses. In the past the principle of 'pooled historic cost rents' enabled tenants to benefit from capital gains on the public stock of rented housing. The right to such benefits was never very firmly established however, and was certainly not privately assigned to particular tenants. Selling council houses to the incumbent tenants at below market prices has the effect of transforming an ill-defined collective right to a subsidy into a privately assigned and exchangeable right with a capitalised market value. The private benefit to new homeowners is transparent and often substantial. Any costs to other groups associated with the policy, for example through tax revenue losses brought about by additional mortgage interest allowances are widely spread and not capitalised in any specific asset. Further, many of the social benefits deriving from greater incentives to maintenance and the removal of some of the impediments to mobility (but see chapter 4(e)) would be rapidly observed.

As we have seen the simple removal of rent regulation has some unattractive political properties. The benefits to landlords are capitalised but the more numerous existing body of tenants are still substantially and adversely affected. This presents a serious problem. Is it possible to think of policy proposals which would produce the gains from deregulation and stand a serious chance of political survival? In the next two chapters this issue is explored. The first strategy is to ignore the bulk of existing lettings and concentrate policy entirely *at some specified margin.* This is essentially what has been attempted in the recent developments of shorthold and assured tenancies discussed in chapter 7. The second strategy is to consider more comprehensive reforms to see whether the objective of deregulation can be achieved even allowing for political constraints. The properties of various proposals are considered in chapter 8.

7
Recent developments

The 1980 Housing Act introduced the shorthold tenancy. By letting property to shorthold tenants a landlord is able to gain repossession after a specified time (i.e. security of tenure is limited to the time period mentioned in the lease). The minimum duration of a shorthold letting is one year. Initially it was a requirement that a fair rent should be registered for all shorthold lettings. This requirement continues in London but has since been waived for areas outside London. Tenants outside London are still free to appeal to the rent officer to set a fair rent, but it is no longer necessary that a fair rent is registered at the start of a shorthold tenancy. Shorthold tenancies were introduced by Parliament with the object of providing reassurance to potential landlords. A landlord would not face the risk of a considerable capital loss in the event of a tenant successfully applying to the rent officer for a fair rent to be set and full security of tenure guaranteed. Thus the overall prospects attached to letting accommodation would be improved from the landlord's point of view and some encouragement would be expected to the supply of lettings. The survey of recent private lettings (Todd 1986) reports a wide awareness of the shorthold system although some disagreement between landlords and tenants over the degree of security of tenure. Only 4 per cent of occupiers of recent lettings described their tenancies as 'shorthold' compared with l4 per cent of landlords. Conversely 21 per cent of occupiers of recent lettings described their agreement as having a stated fixed term with full security of tenure compared with only 8 per cent of landlords[40] Table 7.1 summarises the distribution of new lettings by type and by the characteristics of the landlord. The private rented sector includes accommodation supplied by employers to employees and this explains the high proportion of lettings by companies or institutions 'not accessible to all'. Shorthold tenancies are used particularly by individual landlords with 20 or more lettings. For this group of landlords 34 per cent of recent lettings were described as within the Rent Act but with restricted security of

40. Todd, J.E. op. cit. Table 1. p. 8.

security of tenure (i.e. shorthold tenancies). The same type of landlord also exhibited a relatively high proportion of recent lettings which were recorded as 'outside the Rent Act'. Large individual landlords and company landlords reported that over 20 per cent of recent lettings were outside the Rent Act, and the figure in London is even greater. Todd (1986 p.9) reports that "in the capital, those faced with looking for accommodation that was generally accessible to the public were likely to find that nearly half of the available lettings that had a non-resident landlord were outside the Rent Act". This high proportion of lettings 'outside the Rent Act' reflects the growth in the early 1980s of the 'non-exclusive occupancy licence'.

Table 7.1
New letting by individual landlords

	One address		More than one address		Company	Insti-tutions	All
	One letting	Two or more	Under 20 lettings	20 or more			
	%	%	%	%	%	%	%
Not accessible to all	24	1	12	1	27	90	31
Outside the Rent Act	–	6	9	27	21	1	10
Within the Rent Act							
Restricted security	20	10	18	34	14	2	15
Security of tenure	55	82	60	38	38	8	44
	100	100	100	100	100	100	100

Source: Todd (1986.) *Recent Private Lettings 1982-84.* Table 14

The non-exclusive occupancy licence developed as a means of circumventing the Rent Act altogether. Instead of a 'tenancy' the user of accommodation purchased a 'licence' from the owner. This 'licence' in its detailed provisions could be indistinguishable from a 'tenancy' but it was not clear until recently whether the protection of the Rent Acts would extend to 'licencees'. A recent judgement by the House of Lords in the case of Street v. Mountford held that an agreement which had the necessary characteristics of a tenancy was a tenancy even if it were described by the parties to the agreement as a licence. This judgement does not, of course, imply that all non-exclusive occupancy licences are in fact tenancies and thus subject to the Rent Act. It does however, mean that many 'licences' are likely to be treated as tenancies by the courts, and that landlords will have to ensure that future agreements differ from tenancies by more than the simple substitution of the word 'licence.' The crucial factor will be for the landlord to establish that the licence is truly 'non-exclusive' by clearly retaining the right to permit other people of his or her choice to use the accommodation.

As a move towards deregulation the shorthold tenancy is helpful but not decisive. In London the requirement to register a rent has reduced its popularity and induced landlords to seek greater returns through the use of 'licences'. Outside London shorthold is widely used as a form of tenancy but this should not be taken as a reliable indicator of the 'success' of the scheme. The private rented sector responded to rent regulation by housing young and mobile tenants long before the shorthold tenancy was introduced as was seen in chapter 3. It is therefore not surprising that a large proportion of new lettings are shorthold as landlords seek to take advantage of the extra security associated with them.

A substantial impact on the supply of lettings is much more difficult to demonstrate than the simple popularity of shorthold. Some *indirect* evidence that supply has been significantly influenced can be inferred from landlords' responses to questions about their intentions. Of those landlords with more than 20 lettings, 32 per cent expected to increase their lettings in the future.[41] This was the highest proportion exhibited by any category of landlord. Conversely, only 19 per cent of large individual landlords expected their lettings to decrease – the lowest proportion except for company lettings. Thus, the landlords taking most advantage of shorthold provisions were those with the most positive attitude to the future provision of accommodation. They were however, also most active in the use of non-exclusive occupancy licences, and it is not clear therefore that shorthold lettings are alone responsible for the more positive attitude.

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41. Todd, (J.E.) op. cit. Table 14. p. 28.

Apart from a general if mild encouragement to supply, the introduction of shorthold tenancies should in principle have been associated with other consequences. Before shorthold a landlord could only ensure a short duration to a tenancy by choosing people as tenants who could be expected to move quickly. These would be primarily high-income, professional and young. The existence of shorthold means that discrimination against lower income, older, less geographically mobile people is not so essential for the landlord and that these groups should find it somewhat easier to compete in the rented market. Again the survey evidence of recent lettings indicates that 16 per cent of shorthold lettings had a head of household of sixty years of age or more – the highest percentage of all letting types. Similarly, 77% of new shorthold lettings had heads of household who were married or living as married – a far higher percentage than other types of letting with the exception of accommodation tied to a job. A tentative inference here is that shorthold is proving useful in reducing the disadvantage attached to age or marriage in finding rented accommodation.

A second experiment initiated in the 1980 Housing Act was the introduction of the assured tenancy scheme. This allows a landlords approved by the Secretary of State for the Environment to build new accommodation to let at rents and on terms negotiated freely in the market, but subject to the Landlord and Tenant Act 1954. The hope was that substantial private sector finance would be attracted by the scheme especially from sizeable financial institutions. Table 7.2 records the progress of the scheme since 1983.

Table 7.2
Assured tenancies: lettings 1983-1986

	Number of Approved Bodies	Number of Assured Tenancies
1 April 1983	67	44
1984	133	224
1985	163	405
1986	188	609

Source: DOE. Assured Tenancies: Monitoring Exercise 1986.

By April 1986 there were 188 approved bodies of which 46 had constructed new dwellings and were letting accommodation. The largest participant is the Abbey Housing Association with 69 lettings. The number of assured tenancies grew slowly from 44 in 1983 to 609 in 1986 and is projected[42] to rise to around 1500 in 1988. Even this slow rate of progress seems to have depended considerably on the special capital allowances available for expenditure on construction by approved landlords and introduced in the 1982 budget. The first-year allowance of 75 per cent provided an attractive prospect for organisations looking for a tax shelter. In 1984, however, it was announced that the first year allowance would be reduced in steps of 25 per cent and would fall to zero in the financial year 1986-87.

The very modest response to the assured tenancy scheme suggests that large scale new construction of dwellings to let is not a very attractive commercial proposition unless deregulation is combined with substantial additional fiscal incentives. This conclusion should be tempered by the fact that the scheme applied to approved institutions only and was not available to all investors individual or corporate who might have found it attractive. Further, the very long-term nature of investments in rented housing make them vulnerable to fears about political changes and the possibility that assured tenancies might be regulated by a future Labour government. Nevertheless, when allowance has been made for these factors, it is still likely that the scope for privately financed newly built rented housing is limited in the absence of more wide ranging reform. Building anew to modern high standards is expensive and those occupiers who can afford rents which offer the landlord a commercial return are likely to be in a position to buy. That the present tax system gives occupiers a considerable incentive to buy rather than rent was seen in chapter 2. Some doubt was cast on the wisdom of this policy in chapter 4, but while it continues the rented sector will inevitably be confined to lower quality, riskier accommodation, and to those richer tenants with some special or temporary reasons to rent. It is not clear that building new housing is sufficient to attack shortages of these classes of accommodation.

Recognition of these basic problems with the assured tenancy scheme has led to further reform proposals embodied in

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42. *DOE. Assured Tenancies: Monitoring Exercise 1986.* Annex C.

the Housing and Planning Bill. Assuming that these proposals are implemented the assured tenancy scheme will be extended to existing dwellings which have been substantially improved, renovated or converted. The impact of this extension to the scheme will depend upon how substantial the investments have to be to qualify, how restrictive the authorities are in their procedures for determining approval of landlords, and whether all-party support can be achieved. In principle, however, the prospects for a more enthusiastic response on the part of landlords should be brighter than for the original scheme.

Both the shorthold and assured tenancy schemes exemplify the advantages and disadvantages of concentrating policy entirely at a particular margin. By leaving existing agreements untouched and maintaining the system of rent regulation intact much political opposition is sidestepped. But in seeking out ways of encouraging new tenancies policy tends to become focused narrowly and fails to exert pressure across the entire front. In the sphere of economic policy, unlike that of military strategy, there is more to be hoped for from an even advance over a wide area than from a sudden breakthrough at a particular point. Thus the shorthold provisions reinforce an already long established trend in the rented market to reduce the duration of tenancies, while the assured tenancy scheme concentrates on 'approved' bodies undertaking substantial investment. In chapter 8 we consider whether there are ways of initiating more comprehensive measures of deregulation.

8
Paths towards rent deregulation

(a) **Sudden deregulation.** The most direct and obvious measure would be a rapid winding-up of the whole machinery of rent regulation. An optimistic view would hold that decisive action taken at the beginning of a government's term of office could yield substantial benefits in the form of reduced levels of homelessness and a greater supply of rented housing. The contrary view has already been set out in some detail in section 7. Politically, the redistributional consequences of sudden deregulation are adverse for the political party undertaking it, and a stated committment to deregulate in this way could substantially reduce the chances of electoral success. Once implemented the looked-for benefits might never materialise if opposition parties threatened to re-impose regulation.

(b) **Phased deregulation.** Some of the pitfalls of sudden deregulation could be avoided by a programme of phased deregulation. This might be accomplished in various ways. Deregulation could occur at the expiry of existing regulated tenancies, by class of property (rateable values), or by geographical area. As was seen in chapter 2 'creeping decontrol' and 'block decontrol' have been attempted in the past but not with great success. Phased decontrol by class of property or geographical area is flawed for the following reasons. Political forces dictate that deregulation can occur in those areas where market conditions are favourable, that is where shortages of rented housing are not great and upward pressure on rents will be limited. This, however, reduces deregulation to a *symbol* or *indicator* of lower pressures in the rented housing market rather than an active policy instrument helping to bring about these conditions. If the objective is to influence the allocation of resources in rented housing, deregulation must be introduced even, or perhaps especially, where shortages exist. The alternative is merely to remove regulation where it is of little consequence anyway. To deregulate in areas of shortage however, opens up all the problems of sudden deregulation but with the added ingredients of protracted political lobbying and an inevitable sense of horizontal inequity in the treatment of

different areas. Allowing landlords to re-let at unregulated rents at the expiry of the existing tenancy is the simplest method of gradual deregulation. Historically the main danger is the possibility that some landlords impatient to be rid of an incumbent tenant will resort to illegal harrassment. In paragraph (d) a scheme to protect tenants from these possible effects will be discussed.

(c) **Capital value rents.** An alternative scheme proposed in the *Inquiry into British Housing* (1985) is to maintain the administrative structure of rent regulation but to change the basis upon which rents are set. Instead of 'fair' rents, the Rent Officer would set a rent related to the vacant possession capital value of the relevant property. The objective would be to give the landlord a 'fair and reasonable' return on his investment. 'Fair and reasonable' in this context could be interpreted as meaning 'that minimum return sufficient to induce landlords to hold a stock of rented housing large enough to meet the demand for rented accommodation at the stipulated capital value rents.' Interpreted in this way, the capital value rents proposal amounts to a form of long-run marginal cost pricing in the rented housing market. Rents would not be set to clear the market at each point in time, for this would produce excess profits. Instead they would be set to give a return sufficient to induce landlords to add to the stock until the market clears at those rents.

As with all schemes for marginal cost pricing this particular suggestion requires that administrators have knowledge which they are in fact most unlikely (some would argue totally unable) to possess. In practice, the idea would reduce to a trial-and-error process by which rents were increased until some apparently satisfactory level of investment expenditure materialised. Making suitable adjustments to rent levels for different services provided in different types of property in different areas would pose formidable problems. Further, by restricting rents below short run market clearing levels the rate of new investment would be likely to be modest. This raises familiar dangers. The slower the supply response the more the policy can be portrayed as a simple redistribution of income in favour of landlords with limited accompanying advantages. Even fairly large rises in rents will not necessarily produce a commercial return to rented property. In 1975 for example, the ratio of registered rents to selling prices of property was estimated as about 3.4 – 3.8 per cent. After allowing for repair maintenance and management expenditure the implied gross yield was about 2 per cent.[43] The British Property Federation reported the same figure in their evidence to the Inquiry into British Housing in 1985 (p.41). Regional variations are large and unregistered rents or unprotected sectors of the market yield higher returns than this to landlords, but a significant supply response could not be expected until rents have risen to perhaps two or three times present protected levels.[44]

Once more the fundamental political problem of reform is confronted. Is it possible to introduce a comprehensive measure of deregulation which will make use of market incentives but will not adversely affect the existing body of protected tenants? All the measures so far discussed fall foul of this problem. Either they protect tenants from rent increases and are ineffective, or they seriously address the rents problem but are likely to create such political difficulties that the ultimate success of the scheme is open to doubt. There does exist an option which helps to overcome this dilemma, however, and it is the nature of this policy option which is discussed in the next paragraph.

(d) **Creating tradeable property rights.** The rented housing market is inefficient. If this proposition is true a proposal for reform should be devisable which has widespread attractions.

The problem with most proposals publicly discussed is that they implicitly deprive tenants of a valuable property right (the right to use accommodation at a regulated rent) without compensation. Of course it is possible to argue about whether tenants should have been protected in the first place, but this does not change the status quo. Property rights are therefore at the root of the problem of reform. Once this is recognised it is possible to consider policy proposals which give part or all of the capital gains available from deregulation to the tenants rather than to the landlords. What is required is a clear specification of

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43. *Housing Policy* Technical Volume. Part II. p. 76. HMSO.

44. In January 1985 registered rents yielded a mean gross rate of return of about 2-3% in London and 4-5% in the rest of England.

a tenant's property rights and in addition the freedom to trade these rights on the deregulated market.

Under existing arrangements a tenant's right to a regulated tenancy is clearly valuable to the tenant. But it is not an exchangeable right and this lack of tradeability simultaneously contributes to the continuing decline of the rented sector and imposes a daunting barrier to reform. The sector declines so long as the sum of the market values of the landlord's and tenant's interests in rented property is less than its freehold value. Most reform proposals concentrate on bringing the market value of the landlord's interest alone up to the freehold value. The alternative is to establish a positive market value for the tenant's interest.

Many differing varieties of this basic proposal could be imagined depending upon the rights assigned to the tenant. The most favourable from the point of view of the tenants would be to assign to the occupants of regulated dwellings the rights to the tenancy in perpetuity. Any tenant wishing to move could then sell his rights at their market value and use the proceeds, to buy another regulated tenancy or for any other desired purpose, including the payment of those higher rents prevailing in the newly deregulated market. Tenants wishing to stay in their accommodation would be able to do so at the regulated rent. They would be less subject to harassment by landlords who would now have to concentrate on buying out the tenant if vacant possession was desired. The higher deregulated rents turned out to be, the more valuable the market value of the tenant's property rights, and existing protected tenants thus would have no interest in impeding a return to market-determined rents. Because new tenants might find it difficult to borrow the possibly large capital sums required to buy tenancy rights, buyers in this market could be companies or even perhaps local authorities. These institutions could then license new occupants at market determined prices.

Landlords of regulated property would gain nothing from the process of deregulation under this proposal. Some landlords who expected to obtain vacant possession in a relatively short period of time could stand to lose substantially as this prospect is removed. This suggests that a scheme slightly less generous to tenants would be preferable. Occupancy rights could be assigned for a specified period of time instead of for an indefinite time period. Tenants would receive what amounted to a tradeable occupation licence with a specified term of perhaps five or ten years. Options might even be considered which linked the duration of this licence and hence its market value to the length of time a tenant had inhabited a regulated property. This would limit the 'windfall' accruing to very recent tenants rather as the discount available to council house buyers depended upon length of tenancy.

It would be important to arrange the assignment of property rights in ways which did not result in landlords becoming worse off. If substantial losses were anticipated, landlords might be tempted to harass tenants into moving *before* the legislation were passed. Conversely, tenants, anticipating the receipt of a valuable asset, would be inclined not to move out. Indeed it is a shortcoming of the scheme that, whatever the consequences which *follow* its introduction, the period *preceding* its introduction would be likely to accentuate the problem of immobility which, as has been seen already, always accompanies rent control. A further predictable consequence would be a deluge of applications from tenants to the rent officer in the months just prior to implementation. These factors suggest that the scope of the scheme might be better confined to the unfurnished sector of the market or to tenants who have occupied the relevant accommodation for more than a certain minimum period of time. It would also be necessary to exempt shorthold tenancies and housing association lets from the provisions of the scheme.

For the landlord the creation of tradeable occupation rights with a specified term would have very similar effects to a system of *phased* deregulation. The term structure of licences would determine the time profile over which landlords would recover completely the full package of rights in the accommodation. The advantage over a simple scheme of phased deregulation is that the tradeability of interim occupation rights would result in immediate market responses equivalent, or almost so, to a measure of *sudden* deregulation. Further, these responses could occur without threatening the welfare of existing regulated tenants. An old age pensioner, for example, would now have choices previously unavailable. The pensioner could move closer to other family members or into more appropriate accommodation without sacrificing the value of a regulated tenancy. This could be sold to the landlord if the landlord were interested in gaining the occupation rights ahead of schedule, or to any other person or institution willing to offer an attractive price.

Setting the term structure of occupation rights so as to leave landlords and tenants at least as well off as they are at present would be a difficult trick to perform. Further, there is always a chance that, *ex post* tenants or landlords could find themselves worse off, even if *ex ante* they judged themselves to be better off. To take an obvious, if extreme example, a tenant aged seventy five who is granted a twenty-year tradeable occupation licence would be likely to feel this was an advantage given life expectancy and personal circumstances. Yet it is not impossible that at the end of a further twenty years the tenant could still be resident at a sprightly ninety five years of age when the licence expired[45]. Similarly, a landlord's relief at the prospect of deregulation might be tempered after a few weeks by the knowledge (say) that the tenant had long planned to emigrate and was now leaving enriched by the sale of his occupation licence. Cases such as these cannot be avoided. The future is unknowable, and all individual decisions are based upon expectations and conjectures which may turn out to be wrong. No public policy is capable of changing this. Providing tenants and landlords expect that they have something to gain from a policy at the time of its implementation, there is nothing further that can be done.

Maintenance expenditure on rented housing should be encouraged following the implementation of the property rights scheme. However, the incentives built into the scheme are complex. The longer the term of an occupation licence, the more the tenant or licencee will find that the market valuation of his or her rights will be influenced by maintenance. Only those investments of a very long-term structural kind will involve the landlord, and here there might be problems of bargaining over the division of responsibility. As the outstanding term of the licence declines, licencees will reduce the amount and shorten the time horizon of their investments, while landlords will gradually

45. A suitably framed insurance contract could avoid the hardship implied by this particular case.

find it in their interest to undertake more of the work. The bargaining framework would therefore be continually changing and rather complex, and thus it would be optimistic to assume that tradeable occupation rights would finally solve the problem of maintenance expenditures. Tradeable rights will make the costs of failing to agree about the division of responsibility for maintenance more transparent, however.

The administrative and legal complexities involved in implementing a proposal of this kind would no doubt be considerable. But the advantages, both political and economic, compared with alternative reform proposals are impressive. Consider the list of characteristics suggested in chapter 6 for the 'ideal' instrument of reform.

(a) Voters should as far as possible be unharmed by the reform. The assignment of tradeable rights to tenants should ensure that this objective is at least approached.

(b) A reform should yield social and private benefits quickly. The social benefits of greater housing supply, greater mobility, increased efficiency in the allocation of the stock, and lower levels of homelessness, are inevitably long-term objectives. However, by permitting the market to give clear signals the chances of a rapid response must be greater than for other proposals which restrict rents to 'reasonable' levels or which phase changes gradually.

(c) Private benefits should be capitalised in a marketable asset. The creation of tradeable property rights is designed to satisfy this condition. Private benefits accrue to the tenant in the form of the present value of the future flow of market rents in excess of the regulated rent.

(d) Private benefits should accrue to the politically most powerful group. Tenants have always been considered of greater political significance than landlords. Under this proposal existing regulated tenants receive a windfall.

(e) Associated private or social costs should be spread widely. In the unregulated market accommodation should be more readily available but the generally higher price will have implications for housing benefit payments. The size of this effect is difficult to calculate since it is not inconceivable that some rents would fall in a deregulated market and expenditure on bed and breakfast accommodation would be saved. In the event of higher total

payments, however, the burden would be spread over the tax paying population.

Related to the five features highlighted above are some other significant advantages of the property rights scheme. The scheme creates a vested interest which opposes attempts to revert to non-tradeable rights and by implication to reintroduce regulation. By making the scheme difficult to reverse because reversal would involve confiscating valuable property rights, new landlords would have greater confidence, and the problem of establishing trust between landlords and politicians would be mitigated. A greater supply response might therefore be expected than would occur in the context of sudden deregulation without tenant compensation and the temptation to landlords to desert the rented sector would be reduced. The similarity with the successful policy of giving council tenants the right to buy their houses should be noted. In both cases tradeable, privately assigned property rights are established where non-exchangeable rights existed before. In both cases fairly rapid capital gains could be expected to accrue to ex-tenants.

No scheme can provide a cast iron guarantee that rent regulation would not be reintroduced in the future. With the passage of time the market value of occupation licences would be expected gradually to fall as the expiry dates approached and as shortages in the rented housing market were reduced. A point would come at which the residual value of an occupation licence would fall below the potential value to the tenant of a renewed policy of rent control. Nevertheless, by delaying this date, the creation of tradeable occupation rights would give the market time to respond, and thus to create conditions less likely to result in a successful political campaign to reimpose controls.

9
Summary and conclusions

Conditions in the housing market suggest that resource misallocation is occurring on a large scale (introduction and chapter 2). The rented sector has declined both relative to other sectors and in terms of absolute numbers of dwellings for many years (chapter 1). Yet the sector has attributes which should make it attractive to a wide variety of occupants especially the young, the mobile and the relatively poor. Owner occupation would not necessarily be chosen by these or other groups if alternatives were available (chapter 4). Other countries have recognised the importance of rented housing and several have private rented sectors exceeding 40 per cent of the stock of dwellings (chapter 5). There is no systematic relationship between income per capita and tenure structure across countries. Public policy appears to play a more decisive role than income.

Any serious attack on the problem of homelessness will involve a measure of deregulation. Deregulation is clearly not a panacea, however. It will not by itself produce a luxury apartment for every homeless family. The standard of accommodation in a deregulated market will depend upon the purchasing power which tenants can wield and this will to some extent depend upon other welfare policies. Neither will deregulation inevitably cause an explosion of interest in private renting since the tax system gives most people ample cause to own their homes (chapter 2). A substantial switch towards renting would require either that landlords were given tax incentives which permitted them to compete with owner-occupation or that owner-occupiers faced a less advantageous tax regime. Finally, deregulation is not a totally reliable vaccine against urban blight or inner city decay. It will not prevent marriage breakdowns (it is more likely to increase them by providing alternative accommodation) or reduce the crime rate. Deregulation will simply ensure that a whole range of rented accommodation from the minimum standard tolerated by law to the luxury flat or house is always available to potential tenants at a price determined in a competitive market. It will encourage the efficient allocation of the housing stock, permit greater geographical mobility, reduce homelessness, and increase expenditure on repair and maintenance of rented property.

Achieving the potential benefits of deregulation has always presented formidable political problems (chapter 6). Recent reform has concentrated on welcome but marginal changes which leave the bulk of regulated tenancies untouched. Shorthold and assured tenancies have not so far radically changed supply conditions in the rented sector (chapter 7). More comprehensive measures of deregulation which involve substantially higher rents for existing tenants in regulated property will be fiercely opposed, and these uncertain political conditions are unlikely to imbue potential landlords with the confidence to increase supply. A method of circumventing this difficulty which should be given serious consideration is to make existing tenancy rights tradeable (chapter 8d). Comprehensive deregulation would then confer windfall gains on those tenants paying registered rents, and give them a vested interest in making the policy endure.

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