



**Rental Housing Part Three:  
Small Scale Solutions to Meet Large Scale Rental Housing Challenges**

*Prepared for the IHC by Ira g. Peppercorn  
October 1, 2015*

The IHC believes that access to decent, safe and affordable shelter is at the core of successful development. Governments around the world have promoted and assisted the development of homeownership opportunities but have generally failed to recognize the important role that rental housing plays. In fact rental housing is the main form of tenure in most cities, especially for low-income households. For those that don't want to or cannot afford to own a home, rental housing is generally their only option. More attention and resources need to be directed to supporting rental-housing initiatives.

In the first note in this IHC series, we discussed the fact that countries interested in building or stimulating affordable housing typically aim towards homeownership solutions financed with mortgages that are not affordable to the majority of the country's population.

There is another fundamental strategy that is often taken: focusing on institutional, medium and large scale housing solutions, either through building public housing, as is the case in China, or through providing land and infrastructure for private housing developments, as is the case in some African countries, such as Rwanda.

What this strategy misses is how rental housing is generally supplied: through actions by individual and small-scale owners. Individual owners comprise the largest segment of landlords in almost all countries. Individuals own 70 percent of all rental units in Mexico, more than fifty percent in the United States and France and two thirds in Germany. Individuals usually own one or a small number of units; in many cases, they may rent out a room in their house or an apartment in the same building in which they live.



In developing countries, these units are often informal and developed outside any regulatory standards or structure. Informal rental is so widespread because their owners choose to keep property “off the books” so that they do not have to pay taxes or face what they consider burdensome laws and regulations. This is common in many Latin American countries. In some cases, landlords build properties on land where the ownership is not clear and then proceed to rent the units.



While individual owners are by no means the same, they do share a number of common features that makes them different than institutional real estate investors<sup>1</sup>: These owners:

- Seek security. Non-payment of rent might be no more than a notation in a financial statement for a large investor but can mean financial disaster for a small owner who owns only one or two units. Because of that possibility, small owners sometimes overestimate the rental risk because they are concerned by the bad stories they have heard. They are, therefore, likely to keep their rental units informal.
- Need income. Their income from rental properties adds to their income and may make an important contribution to their standards of living. A study in South Africa showed that small landlords are likely to have similar demographics as their tenants and that rents are their primary source of income.
- Are likely not to calculate a rate of return. They are likely to rely on rough estimates, such as the gross rate of the first year. They are also more likely to focus on short-term tax benefits. In fact, they might not even care about rate-of-return calculations at all if they are simply looking for additional income or a long-term sense of security for themselves or their children.
- View taxation is a very sensitive issue. Many small owners believe that tax laws discriminate against rental property. Such discrimination is at least partially responsible for pushing rental housing into the informal sector when tax evasion is possible. It can also cause disinvestment if the taxes cannot be avoided. Regulation is a sensitive issue as well, particularly if an owner has any concern about difficulty evicting a nonpaying tenant.

---

<sup>1</sup> Some material in this section was adapted from Peppercorn, I. and Taffin, C., “Rental Housing: Lessons from International Experience and Policies for Emerging Markets,” World Bank, 2013

- Must be able to take possession of the property quickly. They may need the unit for their own use or that of their children, or because they need to sell. Generally speaking, they need quick—and fair—procedures for resolving problems.

Combine these factors with the demographics of tenants, and it becomes obvious that the institutional solutions will not work unless large scale subsidies are provided, which



is not possible when a government does not have a great deal of financial resources. Small-scale solutions that match the demographics of landlords and tenants are necessary.

Take the case of Kigali, Rwanda. The city faces a serious housing challenge with 48.8 percent city's residents live in poor living conditions and 32.2 percent in housing that needs to be upgraded (Planet Consortium 2012).<sup>2</sup> In Kigali's informal settlements, 75 percent are renters (RHA 2014)<sup>3</sup>.

Here, 70 percent of households earn less than 25,000 Rwandan Francs (\$109) per month and only 10 percent earn salaries through formal employment. These are not families that can afford to own and finance developer built housing.

The Government's current policies on affordable housing are to stimulate new construction of owned affordable housing that will be purchased through mortgage finance or cash. Yet these solutions are only accessible to those earning more than double the median income.

So, given the owners' needs and the tenants' resources, what can a country do to provide more affordable rental housing that will actually impact the majority of the population?

- The first step is to do something Rwanda has already done: make its land markets more efficient and transparent. Most African countries have land systems that rank towards the bottom of Doing Business' rankings<sup>4</sup>. Kenya is 136, Sierra Leone is 158, Nigeria is 185, and Uganda is 125 out of 189 countries<sup>5</sup>. This keeps land concentrated in the hands of a few and opens it up to

<sup>2</sup> Planet Consortium, Housing Market Demand, Housing Finance, And Housing Preferences For The City Of Kigali, 2012

<sup>3</sup> Rwanda Housing Authority, "Profiling and Providing Indication of the Status Quo and Trends in Informal Settlements and Propose Mechanisms for Their Upgrading in Kigali City," 2014

<sup>4</sup> Doing Business is a project of the World Bank. This project provides objective measures of business regulations for local firms in 189 economies and selected cities at the subnational level.

<sup>5</sup> "Doing Business, Measuring Business Regulations, World Bank, 2015



corruption. Yet Rwanda is one of the top countries in the world, ranked at 15. Rwanda did this by engaging in a process of land and registration reform that made its land processes more efficient and less costly, including the abolishment of the 6 percent registration fee by the Rwanda Revenue Authority in 2008.



- Another key element is ensuring that building codes are not a barrier to formality. They should be performance based, not input based, another step Rwanda took. Kenya, on the other hand, has a country wide building code that is based on British law from 1947, which mandates the use of particular building materials and, in essence, says that materials and processes are acceptable if they are acceptable under the British codes.
- Landlord-tenant regulations are a third factor. When landlords perceive that these regulations are too stringent and that they will have difficulty evicting a tenant for non-payment, they will either not invest in rental housing or will keep it in the informal sector. Of course, landlord-tenant regulations must be balanced to ensure fairness to the tenant so that they cannot simply be evicted for any reason.
- Regulations regarding density are also important. Required lot sizes that are too large or prohibiting multi-story buildings force housing into a city's periphery or again cause housing to be built informally in a city's core.
- Taxation should be fair, reasonable and should not penalize rental housing in comparison to other alternative investments, especially if they are less risky. This is not only true of rental income, it also should hold for critical inputs into housing construction, such as cement.

Focusing on the regulatory environment, however, is not enough. Ways must be found to expand both the supply of rental housing and improve the living conditions in rental housing, especially in informal settlements. These may include:

- Stimulate the expansion of funding to small property owners to improve or expand their properties for rental units. This may be done through stimulating the micro-finance sector. It may also be done through the provision of small government grants or low interest loans in exchange for moving property from informality to formality.
- Encourage incremental building on safe foundations, with a small core unit. This is the way people build naturally in developing countries. As the family earns more money over time, the house can later be expanded, often for other family

members or for a rental unit. An example of this is the Akiba Mashinani Trust in Nairobi, Kenya.

- Build on the charitable, cultural traditions that exist in the country. Rwanda, for instance, has the tradition of “Umuganda,” where people come together for a common purpose for one day each month. This has and can be used to build affordable housing.
- Ensure that mortgage laws and underwriting standards classify small, multi-family properties in the same manner as single-family homes. This is the case in the United States, where up to four unit properties can qualify for FHA mortgage insurance. This allows families to buy homes that they otherwise could not afford because of the additional rental income and provides rental units, sometimes for other members of an extended family.
- Pilot infrastructure improvements projects in low income neighborhoods that encourage in-situ development. The issue for urban rental housing in developing countries is not just about the units themselves; it is about the conditions in the neighborhood overall, particularly in regard to water, sewer and sanitation.

What this means is that there is no simple solution that will increase the rental housing supply by thousands of units at a time. It means that incremental steps must be taken that, together, will not only increase the supply of affordable housing but also will improve the living conditions of many families within a city. This can only be done by matching the solution with the needs of the owners and the resources of those living in rental housing.