

Is the Private Rented Sector an Efficient Producer of Housing Service? Private Landlords in Denmark and their Economic Strategies

Hans Skifter Andersen, Danish Building Research Institute and Centre for Housing and Welfare at University of Copenhagen

e-mail: hsa@sbi.dk, Hans.Skifter.Andersen@sociology.ku.dk

Abstract

The private rented sector varies much in size and character between European countries. Several studies from different countries have shown that investors in the sector are a very heterogenous group with many different motives for buying and letting out residential property. This has much importance for the efficiency of the sector. This paper reports the result of a Danish study on private landlords: their background and financial situation, their motives for buying and selling property, their business strategies and their economic return from running properties

Introduction

In most countries in Europe and North America owner-occupation has for many years been the dominant tenure in the housing market and sometimes rental housing has only been a marginal part of the market. In some countries social subsidised housing has made up the largest part of rented housing, while private rented housing, produced on market conditions, has been a small part of the housing stock. Rented housing in many ways differs from owner-occupied housing concerning type of building, size and quality.

Owner-occupation has been the preferred tenure among most households in western countries. The main reason for this has often been very favourable economic returns from investments in homeownership compared to investments in other assets, but it has also been because of better security of tenure in owner-occupation, more power to change and improve dwellings and greater freedom of choice.

For different reasons there has also been a demand for rented housing. An important motive for preference for rented housing often mentioned in the literature (e.g. Dieleman et. al. 1988, Norvik 2000) is lower transaction costs and efforts, which is important for mobile households. It is a fact that the mobility among renters is much higher than among homeowners and that the rate of turnover is much higher in rented dwellings.

The demand for rented dwellings, however, to a great extent comes from households that actually prefer homeownership, but who cannot get access to this sector for financial reasons (Byforum 2003). Because of capital market imperfections homeownership tends to be more difficult to achieve for households with lower incomes and also more expensive for them (Arnott 1987, Clark and Dieleman 1996). Therefore, some households have to rent even if it is against their tenure preferences.

Housing services from the two kinds of tenures are produced by different systems of supply, depending on to what extent they are attached to different legal and other conditions, and are

organized in different ways. A reason for the preferences for owner-occupation could be that the rental sector is less economically efficient in producing housing services.

This paper discuss some conclusions from the literature on the efficiency of the private rented sector will be referred. The economic efficiency of private landlords to a great extent depends on what kinds of landlords are operating in the sector and what kind of economic strategies they pursue. The paper reports the results of a survey among Danish private landlords where their motives for buying and selling their properties and strategies for running the estates have been examined. These results are interpreted in the Danish context, which is very much determined by a strict rent control of most private renting, and are compared to studies from especially United Kingdom..

Is the provision of rental housing economically efficient?

In the literature different arguments have been put forward that the private rented sector is more or less economically efficient than the owner-occupied sector.

Some of the arguments put forward for higher efficiency in the rented sector are that landlords could be more efficient in carrying through administration, maintenance and improvement by greater professionalism and economics of scale (Whitehead 1996, Linneman 1985). It could also be expected that landlords often have a superior credit rating compared to most individual homeowners, which could result in smaller capital costs.

The extent to which these advantages for private renting are present depends, however, on what kinds of landlords are active in the sector. Studies in many countries (Crook and Kemp 1996, Yates 1996, Lundström and Gustafsson 1985, Allen and McDowell, 1989, Skifter Andersen 1998) have shown that the majority of private landlords most often are individuals, many with a single property. In a study of the private rented sector in Britain Crook and Kemp (2002) thus concluded that:

“Although the sector has grown significantly in the last decade, it is still a ‘cottage industry’ owned and managed by small scale individual landlords, few of whom have any qualifications in property, let alone in the letting business. Very few can either achieve economics of scale in managing their holdings or manage market risk through a geographically and otherwise diversified portfolio”

Crook and Kemp (2002) explain the lack of interest from institutional investors in Britain by the structure of the housing stock with many small lot sizes and properties, but also by investors regarding investments in residential property as comparatively more risky. One of the causes mentioned is a lack of market information about the sector and on rents and returns in particular (Yates and Wood 1996). The size and quality of housing varies considerably and prices differ between localities, which makes it difficult to compare rents and decide what rent could be obtained for a particular dwelling.

A classic argument for less efficiency is what Henderson and Ioannides (1983) called the ‘fundamental rental externality’, which arises from the separation of ownership and the use of the dwelling. A consequence of this externality is that tenants have an incentive to ‘over utilize’ their housing in the belief that landlords cannot collect *ex post* for the full damage the tenants cause because it is either not readily observable or not provable in court. Another problem could be

tenants that cease to pay the rent on time. The result is that landlords, to cover their opportunity costs, have to charge higher rents *ex ante* to account for this excessive utilization. Another way to put this is to say that renters tend to take less care of their dwellings, which tends to increase costs of housing provision in the rented sector. This was also shown in a study by Galster (1983), who tested the effect of tenure on maintenance, using a sample of 559 houses in Wooster, Ohio. He found that owners were between 58 and 132 percent more likely to perform maintenance and 84 to 92 percent less likely to have structural problems.

Landlords in principle could try to preclude this problem with 'expensive' renters by trying to avoid renters who are inclined to wear out their dwellings. But in practice it could often be difficult to foresee those renters will take good care of their dwelling and those who will not (Green 2001). The landlords who have the best strategy for selecting renters could, however, have the best possibilities for providing cheaper housing services or gain higher profits.

Moreover, buildings with rental property – at least in Denmark – are often occupied by several (different) households who perhaps have significant difference in tastes. So the property has to be dealt with flexibly by the landlord with alert attention to changing market opportunities (Rothenburg et al,1991). It can be more costly to differentiate the housing services from dwellings in the same building than to treat all dwellings alike, but sometimes it could be necessary to adjust the supply from the same estate to different kinds of demands. Housing tastes are rather individualistic. Therefore, the kind of investment a particular occupant favours most often differs from what would maximize the market value of the premise (Hubert 2005). A risk for the landlord, if he/she does not have a varied and flexible supply of dwellings, is that some of his flats for shorter or longer periods could be vacant. The risk for vacant dwellings could lead to that the landlord has to collect higher rents to cover possible losses as a result of missing rents.

Also higher rates of turnover in rented housing can imply higher costs; at least costs for administration, but sometimes also higher maintenance costs, if the landlords have to have the dwellings done up every time they get a new tenant. This could imply a maintenance sequence that is not economically optimal.

Moreover, the demand fluctuates in the rental market. It can be asserted that demand for rented housing – and especially private renting – to some extent is a residual of the demand for owner-occupied housing (Di Pasquale and Wheaton 1992). This means that the demand for rented housing decreases in periods when demand for homeownership is increasing. It is thus an experience from The United States that rents have stagnated and vacancies increased in periods with high economic growth and increased housing demand, because this increased demand has been implied a shift in demand from rented to owner-occupied housing (Di Pasquale and Wheaton 1992, Skifter Andersen 1993). Finally, sudden changes in housing policy have changed the economic conditions for private renting in ways that were not very easy to foresee. Therefore, investments in residential rental property could be quite risky. These risks imply that landlords have to take relatively higher rents.

Literature on types of private landlords and their motives for investing in private renting

Some of the more detailed studies show that private landlords differ very much in their motives for investing in private renting and in their characteristics as economic agents.

In their study Allen and McDowell (1989) identified six different kinds of landlords in England. They paid attention to the differences between these groups concerning type and size of the

landlords' capital, their sources of finance, their investment practices and their relationships with the tenants and their property. Different kinds of economic and other motives for investing in private renting were identified. Besides economic return on operating the properties other motives were identified such as avoiding cash flow problems, speculation in capital gains, provision of cheap housing for special groups or employees and personal attachment to one or more properties. Based on case studies, Allen and McDowell analysed these six types of landlords and showed pronounced differences in their motives and behaviour.

In other British literature (Thomas et al, 1995) a main division of private landlords has distinguished between: *sideline investors*, who do not let property as a full time job or as their core business but as a sideline interest; *business landlords*, who let property as their main business, and *institutional landlords*, such as the church, charities and government departments, who are non-profit organisations with the task of providing good and cheap housing for certain groups. Only 15 per cent of private landlords in Britain are business landlord (Kemp 2002). 22 per cent are Institutions and 63 per cent are sideline investors, of which 18 per cent is characterized as 'non-investors', who do not view their purchase of the property as an investment, but have other reasons. Sideline investors hold 74 per cent of the dwellings, business landlords 17 per cent (of which 11 per cent are property companies) and institutions 10 per cent (Crook and Kemp 2006 (OPDM)).

Kemp (2004) also referred to a study of landlords' motives for investment in private renting. It showed that only 57 per cent had invested for economic reasons, while 43 per cent had other reasons like to live in the property, to help someone out, to house employees and other. Only four per cent invested solely for capital growth.

An earlier Danish study on private landlords in Denmark and their motives for investments in maintenance and improvement was carried out in the beginning of the 1990s (Skifter Andersen 1998). The study only concerned properties with three or more dwellings in the housing stock built before 1950. The Danish study showed a picture of landlordism, which in many ways is similar to the one, described by Allen and McDowell (1989). Six types of motives were identified in the Danish study that guides the way landlords run their properties.

1. **Long-term economic motives:** This is the kind of motives that in economic theory is expected from investors in rental housing. The greatest importance is attached to the long-term profitability and the administration of the property and the money invested in maintenance and improvements are guided by this motive. It does not matter if there is a budget deficit for some years if the perspective for future gains is good.
2. **Short-term economic motives:** For some landlords it is important that there be an economic surplus from the property every year. This could be because they cannot raise money to finance a temporary deficit or because they are dependent on an income from the property to live on. This motive guides their investment and expenditure on the property. In an economy with inflation short-term economic motives tend to diminish investments.
3. **Speculative economic motives:** Rental housing is seen as just one of a number of possibilities for speculative investments. Expectations of short-time changes in real estate prices are the basis for such speculation while long-term profitability of the estate has little importance, except for its consequences for real estate values.
4. **Income from doing building work:** For building firms or landlords, who are connected with building firms or who are tradesman themselves, there is a strong incentive to buy and

rehabilitate properties with the purpose of obtaining work. For small-scale landlords and tradesmen there is the possibility of escaping taxation of this income by do-it-yourself work.

5. **Property as a personal possession:** For some landlords their property is not just an investment object but also a kind of personal belonging. They attach a separate importance to the appearance and quality of the house and dwellings, and it is important for them to be able to control it. The property is a kind of a personal project where other motives than the strictly economic reasons have a considerable importance.
6. **Service or social motives:** For different reasons it is important for some landlords that the housing services provided for their tenants are of a good quality or as cheap as possible. These motives result in housing that is cheaper or better than would be economically optimal if profitability were the only motive. The reasons could be that the landlord has a kind of non-profit status or is an organisation that completely or partly has an objective to provide housing for certain groups. This also includes companies who want to provide accommodation for their employees.

The study (Skifter Andersen 1998) concluded that the motive normally ascribed to private landlords in economic theory - long-term considerations of incomes and capital gains on the property - are only important to some types of landlords. For other landlords the short-term economy and speculative possibilities plays a dominant role. Also non-economic motives as property relations and service provision are important to many landlords. Below we will try to show the extent of these motives among Danish landlords using new data from a survey among Danish landlords.

The private rented sector in Denmark

In Denmark there are different legislation for different tenures like private renting, social housing, co-operative, owner-occupied flats. It is in principle not possible to transfer dwellings from one tenure to another with some exceptions. Privately owned detached dwellings can always be used as both rented and owner-occupied. Private rented dwellings in multi-storey blocks can be transformed to co-operatives if a majority of the sitting tenants want to buy the whole building. But it has for many years not been possible to transform private rented dwellings in buildings with more than two dwellings to owner-occupied flats.

Private renting in Denmark makes up 450,000 dwellings, which are 18 per cent of all housing in the country. The majority of these dwellings are located in multi-unit buildings with 3 or more dwellings.

Table 1 Private rented dwellings in Denmark 1.1.2004.

	Number of dwellings	Per cent
Without kitchen	25.225	6
Rented, but with status as owner-occupied	145.345	32
Other properties with one dwelling	5.615	1
Properties with 2 dwellings	29.850	7
Properties with 3-5 dwellings	47.270	11
Properties with 6-10 dwellings	55.015	12
Properties with 11-20 dwellings	42.650	9
Properties with >20 dwellings	99.695	22
Unknown	1.350	0,3
Total	452.015	100

Six percent of the dwellings are without kitchens, some of which are in student hostels etc. One third are homes or flats that could be sold as owner-occupied housing, but for different reasons are let out. Only 245,000 dwellings are located in properties with three or more dwellings, corresponding to 54 per cent of private renting and about ten per cent of the total stock. Two out of three are constructed before 1940 and 13 per cent lack some kind of facilities like bathroom or modern heating. Private renting in Denmark contains some of the smallest dwellings in the country with the lowest quality.

Like most other countries in Europe the Danish private rented sector has been in decline for many years. Before the Second World War it was the dominant sector but after the war social housing began to take over new rental house building. The real blow to private rented housing came in the last part of the 1960s when higher inflation increased the value of tax deductions and made owner-occupied housing much more economically attractive. New, private rented housing did not receive direct production subsidies as social housing, which made it difficult to build housing at affordable rents.

Moreover, the older stock decreased by about one third from the middle of the 1960s to the end of the 1980s. Besides demolition of old and neglected buildings, the main reason was a conversion of dwellings to owner-occupied flats, which were made possible from 1966. This transformation of tenure was, however, partly stopped in the 1970s and totally prohibited after 1980. Instead a great number of private lettings were transformed into cooperatives the following years after an act was passed in parliament. This act ordered landlords, who intended to sell their property, first to give an offer to sitting tenants, who wished to form a cooperative.

Danish regulation of private renting

Danish tenants have a high degree of security and it is difficult for landlords to give tenants notice to quit in housing with status as rented. Only in dwellings with status as owner-occupied (detached houses and owner-occupied flats) it is possible to make time limited contracts.

Denmark still has a strict rent control in up to 200,000 lettings in private properties. It is used in properties with more than 5 dwellings built before 1991 in municipalities where the local authorities have decided to impose rent control.

Since 1976 rents in Danish private rented housing have been regulated according to a principle called "rent determined by expenditures". Certain rules are laid down by legislation as how to calculate the rent in every estate. The rent is determined by adding up the budgeted running costs such as cleaning, taxes, insurances etc. plus a certain amount per dwelling for administration. Further fixed transferences for maintenance are included, and there is a fixed so-called capital yield to the landlord, which has been of the same size since 1976. Rents can be raised at any time, but the landlord has to inform the tenants in advance and to provide them with written proof that the new rent is justified by higher expenses.

Furthermore, it is possible to raise the rent in connection with improvements. The allowed increase is, in principle, within certain limits, calculated on the basis of the repayments and interests on the loans necessary to finance the improvement and on the interests on capital contributed by the

landlord himself. In case of disagreement over the budget and rent increase the tenants can complain to a board of appeal, called the rent tribunal, which can settle the dispute.

In accordance with Danish housing legislation the landlord is obliged to carry out the necessary maintenance on his estate and he/she can be ordered by the rent tribunal to repair building defects if the tenants complain about them. If the landlord does not follow such orders he/she can be deprived of his right to administer his property.

Because of rent control it could be expected that rents in private renting in Denmark are seldom in accordance with market rents. On average rents per square meter sum up to 820 DKK per square meter (gross) per year in 2005, corresponding to about 120 Euro per net square meter. In our study the responding landlords, however, estimated that rents on average would only increase by ten per cent if rent control was abolished. But in Greater Copenhagen the rents are only 12 per cent higher than the average for the country. It is thus most often in the capital that rents are somewhat below market levels.

Despite rent control, purchase prices on private rented property have increased by more than 200 per cent since 1995. There are different reasons for this development. In the last ten years there has been a possibility for private landlords to avoid rent control if they invest a certain amount of money per square meter in their dwellings. But it is only possible to do this in vacant lettings. In all, 28 per cent of lettings under rent control has in this way been transferred to the free market. This has especially in Copenhagen had an effect on rents. Another reason for increasing prices is that property and land prices in general have increased. But perhaps most important is the possibility to transfer private rented properties to cooperatives. Prices on cooperative flats have increased very much in recent years in line with the general increase in property prices. This has increased the interest of tenants in buying their flat and increased the price that a landlord can get from the tenants if he/she wants to sell. This means that the development of capital values in the private rented sector is not as much a result of increasing economic yields from running the properties, as of increasing prices on cooperatives and real estate property in general.

In 2007 there are signs that property prices are declining and some places falling. This has resulted in an increased interest among landlords to sell their properties to realize their capital gains. Some of the big pension funds have already done so.

The present study of the private rented sector in Denmark

A new study of the private rented sector in Denmark has been conducted in 2007. It is based on data from a survey among 385 private landlords with properties containing three or more dwellings and on data from public registers on all private landlords and properties with private renting. In the survey landlords were asked about motives for buying and selling property and factors that influence such decisions, strategies for letting and running properties, and data about rents and expenses and economic returns.

A population of landlords was drawn from a database on all landlords in Denmark and their properties. The database contained data on the type of landlord and data on each of their properties. For each landlord one of his properties was chosen at random for the survey. Letters were sent to 2000 selected landlords asking them to answer a questionnaire on the internet on their motives for buying and running properties, on factors that influence their investment behaviour and on their selection of tenants. Moreover, they were asked about the expenditures and returns on the selected property.

To achieve a sufficient response from the relatively few landlords with many properties and dwellings the sample was composed so that there was a higher representation of landlords with many dwellings. Weighing the data in the final analysis rectified this.

The response rate in the survey was not very good, which is a common experience with internet based surveys. It was however, mostly the 'small landlords' who had a bad response rate, while it was quite good for 'big landlords' with many properties. Because of the detailed data in the database, from which the population was selected, it was, however, easy to correct for the different representation of different groups of landlords by weighing the sample. Yet, the low response rate and the method used for selection of properties do mean that there is some uncertainty connected with the results of the survey.

Private landlords in Denmark

The respondents in the survey were asked to characterize themselves as landlords by choosing among eight possibilities shown in Table 2, which shows all landlords in the weighted population distributed on kinds of landlords. Moreover, the share of properties and dwellings owned by the different kinds of landlords is shown; the average number of dwellings owned by each and the average year when they bought their first property.

Professional landlords – either individuals or property companies – own more than 50 per cent of dwellings. Moreover financial institutions (pension funds, banks or insurance companies) are calculated to have 18 per cent, but the figures are not quite reliable because of the small number of respondents. It is typical for professional landlords that every landlord has many properties and dwellings and that the properties owned are relatively large. This is especially common among the – few – financial institutions.

Table 2 Different kinds of landlords having at least one property with three or more dwellings distributed on their share of landlords of properties and dwellings.

	Share of all landlords %	Share of properties	Share of dwellings	Properties per landlord	Dwellings per landlord	Dwellings per property	Average year first property was bought	Number of respon- dents
Private individuals landlordism as main business	11	19	15	16	131	8	1985	45
Private individuals landlordism sideline business	40	14	8	3	18	6	1990	149
Property companies landlordism main business	24	33	38	12	154	13	1989	93
Property companies mainly commercial lettings	1,9	1	1	3	39	14	1979	10
Companies other business as main occupation	7,9	5	3	6	43	7	1993	29
Independent non-profit institutions	7,3	6	10	8	130	17	1930	29
Pensions funds, banks or insurance companies *)	1,7	10	18	53	2019	38	1974	6
Building companies *)	0,4	0	0	2	8	5	1999	2
Other	5,3	12	8	20	143	7	1967	19
All landlords	100	100	100	9	115	13	1983	382

*) These figures are somewhat unreliable due to the small number of respondents

The independent non-profit institutions own about ten per cent of dwellings. Their properties are larger than average and they have been in the business for many years. On average their first property was bought in 1930, which means that many of them have a history back to the 1920s.

Sideline investors can be both individuals and companies either with other business or with commercial properties as the main business. Private individuals with private renting as a sideline business constitute more than half of the owners, but only possess 14 per cent of dwellings. Companies own about 5 per cent of the dwellings. It is typical for all sideline investors that they only have a few, and smaller, properties.

Motives for buying properties

The landlords were asked about their original motives for buying their properties. They could choose between nine possible answers presented in Table 3, which shows the distribution of the answers on the most important motive and the three most important motives for all respondents. Moreover is shown the most important motives for selected groups of landlords.

Table 3 Motives for the acquisition of properties. Most important motive and three most important motives.

	Most important Motive All landlords	Three most important motives *)	Most important motive				
			Property companies with landlordism as main business	Private individuals with landlordism as main business	Private individuals with landlordism as sideline business	Independent non-profit institutions	Pensions funds, banks or insurance companies
User motives							
Wanted to live in the property	8	13	1	2	15		
Housing for children or family	3	9	1		7		
Housing for employee	1	3				11	
Housing for specific groups	7	10	2		2	61	18
Use property for own commercial activities	1	1	1				
Inherited the property or got it by accident	8	9	3	5	12	7	
Economic motives							
Business with building activities	5	10	7	10	3	4	
Letting out as a source of income	31	47	52	61	23	4	27
Investment	32	62	32	17	37		55
Other	1	3					
No answer	3		1	5	1	14	
All	100	165	100	100	100	100	100
All user motives	20	32	5	2	24	72	18

*) Percentages do not add to 100 as multiple responses were possible

Economic motives for buying rental properties are clearly the most common. To obtain business and running income by letting out is the most important motive for one third of the landlords. Moreover, acquisition of rental properties as an investment is the most important motive for another one third. These motives were also one of the three most important motives for respectively 47 and 60 per cent of all landlords.

It can, however, also be seen that motives connected to the use of properties are important. In total 20 per cent of landlords had as their main motive for buying properties somewhere to live or have business premises in the property or use the dwellings for family, employees or special groups. One

third of all landlords had this as one of the three most important motives and it concerned more than half of all lettings.

Eight percent became landlords by accident because they inherited a property or acquired it for other reasons and for 22 per cent this was one of the three most important reasons. Moreover, five per cent bought properties to obtain business with building activities and this was one of the three most important motives for ten per cent.

There are, however, marked differences between motives for having properties among different kinds of landlords. It is, as could be expected, especially sideline investors and independent institutions that have bought their properties because they wanted to use it for different purposes or because they got it by accident. Also some of the pension funds have a motive to get accommodation for members. For professional landlords – especially individuals – the main motive is to obtain a source of income. It is mostly professional companies that see their properties as investments but also a relative high share (37 per cent) of the individual sideline investors considers their properties as an investment. This is, however, most common among pension funds and other institutional investors.

Based on the information on different kinds of landlords and their motives for having rental properties a new more simple classification of landlords has been worked out. The following types of landlords were defined:

1. *Business landlords*: Landlords (individuals or companies) letting out as their main business plus institutional investors.
2. *Sideline investors*: Landlords who bought their properties for investment purposes, but do not have it as their main business
3. *Property users*: Landlords who acquired their properties because they wanted to use them by themselves (one of the three most important motives) or make them available for family or employees (not Independent institutions)
4. *Non-profit landlords*: Independent institutions with the purpose of providing housing for specific groups

Strategies for running residential property

In a section above were referred to earlier studies on the kinds of motives and strategies that guide different kinds of landlords in the operation of their rental properties. It has been shown in these studies that landlords are guided by many other motives than should be expected from the theoretical economic literature on housing investments and that some non-economic motives have a considerable importance for some landlords (Skifter Andersen 1998, Allen and McDowell 1989).

In the survey nine different strategies were presented for respondents and they were asked to prioritise their importance for them. They were:

1. Economic surplus every year in every property
2. Yearly surplus for all properties as a whole
3. Long term economic return
4. Short time capital gains
5. Increase of property values by renovation

6. Increase of rental incomes by renovation
7. To keep the property clean and tidy
8. To satisfy tenants
9. To avoid conflicts with tenants

The two first strategies are connected to landlords for whom short-term economic motives and the properties as a source of running income are important. It is of greatest importance in the first strategy. The third strategy is typical for investors with long-term economic motives. The fourth and fifth strategy are expected to belong to investors with speculative economic motives. The seventh strategy could be followed by landlords with, what we earlier called 'property motives', where the property is seen as a personal possession, but could also be seen in connection with the two last strategies: to satisfy or avoid conflicts with tenants. These strategies are expected to be connected to 'service motives'.

In Table 4 is shown the most important strategy chosen by the different types of landlords and also which strategies were among the three most important.

Table 4 Strategies for running residential properties among different types of landlords in Denmark

	Business landlords	Sideline investors	User landlords	Non-profit landlords	All
Most important strategy					
Economic surplus every year in every property	34	53	33	2	37
Yearly surplus for the properties as a whole	15	8	7	14	13
The long term economic return	24	18	15	4	21
Short time capital gains	1	2	4		1
Increase property values by renovation	7	1	1		4
Increase rental incomes by renovation	7	1	1		4
Keep the property clean and tidy	9	6	9	19	9
To satisfy tenants	3	9	17	12	6
To avoid conflicts with tenants	0	1	8		1
Other			4	50	3
All	100	100	100	100	100
Three most important strategies					
Economic surplus every year in every property	36	60	42	10	41
Yearly surplus for the properties as a whole	30	17	24	16	26
The long term economic return	40	30	29	12	35
Short time capital gains	18	15	12	3	16
Increase of property values by renovation	38	23	17	9	31
Increase of rental incomes by renovation	32	10	7	4	24
Keep the property clean and tidy	27	23	40	29	26
To satisfy tenants	30	60	63	32	39
To avoid conflicts with tenants	9	7	33	5	9
All	260	246	268	122	247

*) Percentages do not add to 100, as multiple responses were possible

The results as a whole support the expectations formulated above. It is shown that there are significant differences in the strategies followed by different kinds of landlords.

The most frequently mentioned strategy is to have an economic surplus every year from each or from all properties. This is the most important strategy for fifty per cent of all landlords and 67 per cent has this as one of the three most important strategies. As expected it is most important for sideline investors, who cannot afford to have a deficit, but it also has importance for half of all business landlords. It is of least importance as the most important strategy for non-profit institutions and property users, but is often among the three most important strategies for property users.

The long-term economic return is not an important strategy for most landlords. It is the first strategy for only 15 per cent and one out of the three most important strategies for only one third of all landlords. It is most commonly found among business landlords, and is also most important for 18 per cent of sideline investors and for 30 per cent it is mentioned as one of the three most important motives. But 60 per cent of business landlords and 70 per cent of sideline investors do not have long term economic return as one of the three most important strategies. It is even less important for users and nearly without importance for non-profit landlords. As shown earlier there are, however, large differences between landlords considering the number of properties and dwellings they let out. The analysis above therefore does not give the right impression of how common the different strategies are used in the private rented sector in Denmark. More than half of all dwellings are owned by landlords whose primary strategy it is to achieve a good long term economic return.

To gain economic return by renovating properties is seldom the most important strategy, but it has some importance as about one third of landlords mention it as one of the three most important strategies. It is especially business landlords that want to do this, but also sideline investors sometimes focus on renovation of their properties. While business landlords often want to increase rental incomes the other types of owners mostly are interested in increasing property values. A possible explanation of this is that business landlords more often use renovation to get rid of rent control.

For independent institutions keeping the property clean and tidy and satisfying tenants needs were often the most important strategies. Also property users are – as could be expected – very concerned with these issues. It also has some importance for business landlords. Sideline investors are least concerned about the appearance of the property, but often with the satisfaction of tenants.

Factors that influence investment behaviour

Scanlon and Whitehead (2006) discussed what kinds of factors influence the investment behaviour of private landlords as it appears in the buying and the selling property. They point to the fact that there are considerable transactions costs that tend to limit the extent to which private landlords will react to changes in the economic return by buying or selling rental property. Moreover, it is often difficult to compare the returns from property with other investments. They identify the most important factors that could influence expected returns and investment behaviour as: development in house prices, rental demand, changes in taxes and changes in interest rates. A survey among a sample of landlords in Britain showed that the most important reasons for increasing the portfolio of properties were ‘Stable/low interest rates’ and ‘Steady/rising house prices’, while worsening alternative investments formulated as ‘Poor stock market performance’ only motivated 21 per cent to increase their portfolio. The most important reasons for decreasing the portfolio were measured as ‘Rising interest rates’ and worsening personal financial situation Scanlon and Whitehead, 2006).

Falling house prices and improving stock market were only of a minor importance (15 and 4 per cent).

In our survey landlords were asked if they were prepared to buy more properties and if changing conditions could motivate them to do this. The possible changes were: Increased local demand for rental housing, expectations of increasing property prices in coming years, decreasing interest rates, decreasing return on alternative investments and abolishment of rent control.

Their answers are shown in Table 5.

Table 5 Share of landlords (per cent) who want to buy more rental properties, and under what conditions

	Business landlords	Sideline investors	User landlords	Non-profit landlords	All
Will not buy under any circumstances	28	45	68	63	43
Will buy under all circumstances	34	9	14	3	18
Conditions that should improve					
Local demand for rental housing increases	4	10	2	6	7
Property prices is expected to increase in coming years	4	9	5	9	7
Interests is expected to decrease	5	6	0	6	5
Return on alternative investments is expected to decrease	8	9	3	3	7
Rent control is going to be abolished	23	16	8	15	18

Note: More than one answer is permitted

The results show considerable differences between the different types of landlord concerning their readiness to invest in more properties and what factors influence their decisions. It can be seen that changes in economic conditions for investing in residential properties in general only have small effects on landlords' interest in investing in more properties, except for a change in rent control.

About 40 per cent of the respondents do under no circumstances want to invest in more rental properties. A further 18 per cent had decided to invest in any case. Non-profit landlords and property users are the most reluctant to invest. Business landlords most often intend to buy more properties.

For about one third of all landlords their decision to invest depends on a change in conditions. Some of these possible changes are mentioned in the bottom of the table. An increase in the local demand for rental housing will only have an influence on seven per cent of landlords – mostly on sideline investors. This small effect can be explained by the effects of rent control, which results in that lack of demand, which is only found in a few places in Denmark.

Expectations of increasing property prices have the same small effect and also most often on sideline investors. Surprisingly, business landlords do not seem to be influenced by this. It could be because they have more long-term considerations. A little more important is if returns on alternative investments are expected to go down.

The change, however, that could have the greatest influence on investments is abolishment of rent control. This could motivate 18 per cent of landlords to invest more. It is of most importance to business landlords.

In a similar way the conditions under which landlords want to sell their properties was also examined (Table 6). The possible changes that could spur landlords to sell is: decreased local demand for rental housing, expectations of decreasing property prices in coming years, increasing interest rates and increasing return on alternative investments.

Table 6 Share of landlords (per cent) who want to sell some of their properties, and under what conditions

	Business landlords	Sideline investors	User landlords	Non-profit landlords	All
Will not sell under any circumstances	40	47	72	62	48
Will sell under all circumstances	6	8	8	7	7
Sell under changed conditions					
Local demand is decreasing	10	6	4	2	7
Interest rates are increasing	2	1	2	0	1
Property prices will stagnate in coming years	4	2	0	0	2
Property prices will fall in coming years	7	4	0	0	4
Return on alternative investments is expected to increase	33	22	12	15	25

Note: More than one answer is permitted

There is also a considerable inertia in private landlords' willingness to sell their properties regardless any changes in the conditions for investment. Nearly half of all landlords will not sell under any circumstances. This also applies to business landlords, but mostly to user landlords.

Changes in the conditions for investments also have small effects except for a change in the return on alternative investments. The relatively strong effect of increasing interest rates found in the English study of Scanlon and Whitehead is not found here. For business landlords a decrease in local demand for rental housing or decreasing property prices has some importance.

Incomes and returns on investments in private renting

In the Danish study information has been collected on incomes and expenditures in private rented properties and on expected sales values and increases in prices during the last five years. In Table 7 is shown figures on incomes and expenses for a representative sample of properties for different groups of landlords and different locations of the property.

Table 7. Incomes, expenditures and return plus estimated sales value Euro per square meter per year in a representative sample of private rental properties, 2005

	Total gross incomes	Expenditures administration	Expenditures maintenance	Surplus before taxes	Estimated sales value	Share of properties per cent
Cities and suburbs						
Business Landlords	131	48	32	51	2,361	40
Sideline investors	83	25	12	45	1,439	18
Users	73	25	9	40	1,918	6
Non-profit	122	119	16	-13	2,946	3
All	113	43	24	46	2,227	66
Towns and rural areas						
Business Landlords	90	28	9	53	958	9
Sideline investors	84	21	9	54	702	19
Users	54	21	12	22	880	2
Non-profit	99	13	4	81	533	3
All	85	23	9	53	745	85

The average gross income from the properties was about 800 DKK per square meter (gross area measure) per year in 2005 corresponding to about 120 euro per net square meter. Incomes, however, vary much between the more and less urbanised parts of the country, as can be seen from Table 9.

There is a marked difference in the economics of properties owned by different types of landlords also when taken into account that differences exist in the location of the properties owned by these types of landlords. Business landlords have a much higher gross income from the properties than sideline investors and even more than the ‘users’ get. Non-profit landlords have incomes at the same level as business landlords.

These differences in incomes can to some extent be explained by the different quality of the properties. As can be seen from table 7 the estimated sales values for business and non-profit landlords are much higher than those of the sideline investors and users. It can be seen from Table 8 below that the proportion between income and property value (gross yield) is almost the same for business and sideline investors. But it is considerably lower for users.

More surprising large differences in expenses are defrayed by different types of landlords. The non-profit landlords have very high expenditures. This can be explained by the high service these landlords tend to supply. Users and sideline investors have low expenses, which to some extent could be explained by having small properties and by doing administrative work themselves to minimize taxation. The rules for Danish rent control could be a reason why business landlords have higher expenses for administration because they automatically get all these expenses paid by the tenants and therefore have no incitements to reduce them.

The expenses for maintenance are even more varying between types of landlords. Business landlords are using much more money on maintenance than other landlords, but only in the more urbanized parts of the country where demand for rented housing is much stronger. One explanation

for the low figures for sideline investors and users could be that some of them make maintenance as do-it-yourself work or as undeclared work.

As a result of lower expenses sideline investors receive almost the same economic surplus per square meter as business landlords – especially in towns and rural areas. Users and non-profit landlords get (in average) a lower surplus.

Returns on investments

Different measures can be used to calculate returns on investments in properties. In Crook et. al. (2002) the following measures are used:

- gross rental yield = annual rental income as percent of capital value of property
- net yield = rental incomes minus management and maintenance expenditures
- net net yield = minus losses due to void periods and rent arrears
- post tax returns: varies depending on the landlords' tax liability

Based on the data above the average gross and net yield has been calculated as the proportion between the economic net surplus divided by the estimated sales value. Moreover, based on data on an estimated yearly increase in sales values, the total return has been calculated as the sum of the net yield and a relative increase in property value (Table 8).

Table 8. Calculated gross and net yields, average yearly increase in property value and total return, as a per cent of estimated sales values 2005. Expenses for improvements DKK per square meter 2005.

	Gross yield	Net yield	Increase in property value	Total return	Expenses for improvement DKK per sq. m.
Cities and suburbs					
Business Landlords	5.5	2.2	17	19.0	402
Sideline investors	5.7	3.1	9	12.3	222
Users	3.8	2.1	5	7.4	19
Non-profit	4.1	-0.4	7	6.2	56
All	5.1	2.1	13	15.2	402
Towns and rural areas					
Business Landlords	9.3	5.5	11	16.3	316
Sideline investors	12.0	7.7	6	13.7	169
Users	6.2	2.5	10	12.8	91
Non-profit	18.5	15.2	6	21.2	16
All	11.4	7.1	10	17.5	242

The average net yield for properties in the Danish private rented sector was quite small in 2005 – only 2.4 per cent of the estimated value of the properties. It can be compared to a market interest for bonds in Denmark at about 5-6 per cent. Based on the landlords' own estimation of the increase in the sales value of their property during the years 2001 to 2005 it can be calculated that there has been an average yearly increase in sales prices at about 13 per cent. This leads to a total return on rental residential property at about 15 per cent in these years. It is, however, not to be expected that the increases in sales prices will continue, as there has been a decline in the market in 2006 and 2007.

Business landlords have experienced the highest relative increases in property values. This could be explained by their much higher expenses for improvements (the column to the right in table 8), some of which has been used to escape regulation. But perhaps also by their greater ability to invest in properties in locations with higher potentials for demand and increasing prices.

Because of capital gains business landlords have received the highest total profits at the same time as they have used more money to maintain and improve their properties. The other types of landlords have to some extent received their present economic surplus by leaving maintenance and improvements undone.

Conclusions

The purpose of this study was to contribute to a discussion of to what extent the private rented sector is an efficient producer of housing service by using the results from a study of what kinds of landlords are operating in the sector in Denmark and what kind of economic strategies they pursue.

The results of the study are subject to some uncertainty because of a low response rate. Moreover, it must be interpreted in the Danish context. The sector in Denmark makes up about 18 per cent of the housing stock of which about half is subjugated to rent control. In general investors in private renting have a difficult job because it is difficult to compare returns in this sector with other investments and because the market can make drastic and sometimes unexpected changes over time. Therefore it is an experience from many countries – especially Britain - that professional investors often tend to avoid this sector. It could be expected that the strict Danish rent control to a greater extent would deter professional investors to enter the sector, but this does not seem to be the case. The composition of landlords in Denmark does not deviate markedly from landlords in many other countries and compared to Britain, where there is no rent control, there is a greater share of dwellings owned by professional landlords (business landlords) in Denmark. It has not been the purpose of this article to identify the reasons for this contradiction, but there could be two explanations. The first is, that returns on Danish properties in the private rented sector have not been so bad – partly because of increases in property values and possibilities to avoid the regulation by investing in renovation of dwellings -; the second is that rent control has resulted in a very stable surplus demand for private renting in most of the country, which has diminished economic risks.

As have been shown in studies from other countries, many landlords in Denmark are so-called sideline investors, who do not let out residential property as their core business, or are other kinds of investors, who have other motives than is expected in economic theory. Many Danish landlords originally have acquired their properties for many other reasons than to make an optimal investment. For 20 per cent of landlords it is most important to get control of the use of the property – either because they want to live there, have business premises or to make housing available for family or for other specific groups. One third of all landlords have this as one of the three most important motives and it concerns more than half of all lettings. Other landlords have bought because they want occupation with building activities or to make a return by investing in this. Moreover, eight percent have inherited the property or got it by accident in other ways.

For only about 30 per cent the main purpose for buying properties is to make a good investment. For another 30 per cent, it has been as a form of occupation for themselves and to obtain a source of income. However, 60 percent have the investment motive as one of the three most important motives and nearly half have the earning motive.

The fact that many landlords did not acquire their properties with the primary purpose of investing their money, but for other reasons, is mirrored in the fact that nearly half of all Danish private landlords under no circumstances intend to sell their properties. Changes in local demand, interest rates, property prices and returns on alternative investments do not have any influence on their intentions to keep or sell their properties. At the same time nearly half of landlords do under no circumstances want to buy more properties.

Landlords' strategies for running their estates are closely connected to their motives for acquiring them, where other than economic strategies play an important role. A considerable share of landlords (25 per cent) have as their most important goal to either keep their properties clean and tidy, or to make tenants satisfied or to avoid conflicts with tenants. These objectives are one of the three most important goals for 60 per cent of landlords owning 76 per cent of all lettings. It could be expected that some of these landlords will use more money on their properties than is economically optimal in order to obtain these goals.

Obtaining a good long-term economic return is only the most important goal for 15 per cent of landlords and is one of the three most important goals for one third of all landlords. But these landlords own more than half of all lettings.

Short time economic considerations are the most important goal for 40 per cent of landlords possessing 27 per cent of lettings. Considering that properties are long-term investments, which sometimes demands large expenses for maintenance and improvement resulting in negative short-time returns, this focus on the short-time economy could lead to a less than optimal economic operation of properties.

As a consequence of these differences in strategies there are considerable differences in incomes, expenses and returns in properties owned by different types of landlords. Sideline investors – and especially user landlords - in general have properties of much lower value and with much lower rental incomes than business landlords. The greatest differences, however, appear when looking at the expenses on the properties, where sideline investors and users have much lower expenses for both administration and maintenance. This can partly be explained by more do-it-yourself work, but also is a sign of defective administration and insufficient maintenance. Moreover, business landlords invest much more in improvements of the properties, which to some extent can be explained by the system of rent control. In the end, however, business landlords in recent years have obtained a much higher total return from running their properties than sideline investors and users. This is not obtained by a higher running surplus from their properties, but by larger capital gains.

It can be concluded from this Danish study that a large share of private landlords in Denmark – like in many other countries – are motivated by many other motives for buying and operating rental properties than the most rational economic objectives and that it can be expected that the many small landlords and sideline investors will not be able to achieve the higher efficiency in management that could be an advantage for private renting compared to other sectors on the housing market. There are, however, two possible consequences of this. One is that housing services from the sector tend to be more expensive or of a lower quality. In the rent-controlled sector in Denmark it is most likely that it tends to have a lower quality. But another possible outcome is that the high focus on satisfying tenants could lead to higher quality of housing services than is economic optimal. In this case the consequence is a reduced economic return to landlords.

References

- Allen J. and L. McDowell 1989: *Landlords and property. Social relations in the private rented sector*, Cambridge Human Geography, Cambridge University Press.
- Arnott, R. (1987) Economic Theory and Housing. In Mills, E. (ed.) *Handbook of Regional and Urban Economics*, Vol. 2. Amsterdam: North-Holland
- Clark, W.A.V. & F.M. Dieleman (1996), *Households and Housing; Choice and Outcomes in the Housing Market*. New Jersey: CUPR Press.
- Byforum (2003). *Det danske boligmarked – udvikling i boligforsyning og boligønsker*. Copenhagen
- Crook A. D. H. and P. A. Kemp 1996: The Revival of Private Rented Housing in Britain, *Housing Studies*, 11, pp. 51-68.
- Crook, A. D. H. & Kemp, P. A. (2002). Housing Investments Trusts: A new Structure of Rental Housing Provision? *Housing Studies*, Vol. 17, No. 5, 741-753
- Crook, A. D. H. and Kemp, P. A. (2002) *Investments Returns in the private rented sector*. A Research Report for the British Property Federation.
- Dieleman, F. M., Clark W. A. W. and Deurloo, M. C. (1988). A Comparative View of Housing Choices in Controlled and Uncontrolled Housing Markets. *Urban Studies*, 26, 457-468
- DiPasquale, D. & Wheaton, W. (1992). *Journal of Urban Economics* 31:337-359
- Galster, G. (1983). Empirical Evidence on Cross-Tenure differences in Home Maintenance and Conditions. *Land Economics* 59: 107-13.
- Green, R. K. (2001). Homeowning, Social Outcomes, Tenure Choice, and U.S. Housing Policy. *Cityscape: A Journal of Policy Development and Research* • Volume 5, Number 2 • 2001. U.S. Department of Housing and Urban Development • Office of Policy Development and Research
- Henderson, J. V. and Ionnides, Y. (1983). A Model of Housing Tenure Choice. *American Economic Review*, Vol. 83, pp. 98-113.
- Hubert, F. (2000). *The Economic Theory of Housing Choice*. Berlin: Humboldt University.
- Hughes, J. (1996). *The Cutting Edge. The Individual Investor and the Revival of Privately Rented Housing*. RICS Research. The Royal Institution of Chartered Surveyors
- Kemp, P (2004) *Private Renting in Transition*. Plymouth: Chartered Institute of Housing
- Linneman, P. (1985) An Economic Analysis of the Homeownership decision. *Journal of Urban Economics* 17: 230-46.
- Lundström S. and B. Gustafsson 1985: *Privatägda hyresfastigheter. Underhåll och ombyggnad vid ägareskiftet* (Private rental properties. Maintenance and improvement after purchase), The Swedish Council for Building Research, Stockholm.

- McAllister, D. (1967). The Demand for Rental Housing: An investigation of Some Demographic and Economic Determinants. *The Annals of Regional Science*, vil 1. no. 1.
- Montezuma, J. (2006) a Survey of Institutional Investors' Attitudes and Perceptions of Residential Property: The Swiss, Dutch and Swedish Cases. *Housing Studies*, Vol. 21: 883-908.
- Nordvik, V. (2000) Tenure Flexibility and the Supply of Private Rental Housing. *Regional Science and Urban Economics* Vol. 30, No. 1 59-76
- Nordvik, V. (2000) Cost Dispersion, Re-entry Costs, and Rental Housing Markets. *Journal of Housing Economics* Vol. 9, No. 3 129-149
- Office of the Deputy Prime Minister (ODPM) (2006). *Private landlords in England*.
- Rothenburg, J. et. Al. (1991). *The Maze of Urban Housing Markets*. The University of Chicago Press.
- Scanlon, K. and Whitehead, C. (2006) The economic rationality of landlords. Paper prepared for *ENHR Housing Economic Workshop*, Copenhagen Business School, Denmark.
- Skifter Andersen, H. (1993). *Hvordan fungerer et ureguleret boligmarked? Erfaringer fra USA* (How does an unregulated housing market work? Experience from United States). Horsholm: Danish Building Research Institute.
- Skifter Andersen, H. (1998) Motives for Investments in Housing Rehabilitation among Private Landlords under Rent Control. *Housing Studies*, Vol. 13: 177-200.
- Thomas, A., and D. Snape (1995), *In From the Cold—Working with the Private Landlord*, London: Department of the Environment.
- Whitehead M. E. (1996): Private Renting in the 1990s, *Housing Studies*, 11, pp. 7-12.
- Yates J. 1996: Towards a Reassessment of the Private Rental Market, *Housing Studies*, 11, pp. 35-50.
- Yates, J. and Wood, G. (1996) Supply Incentives for Private rental Housing. Paper prepared for *ENHR/SBI Housing Research Conference*, Helsingor, Denmark.
- Yates, J. (1996) Towards a Reassessment of the Private Rental Market *Housing Studies* Vol. 11, No. 1 35-50