A reformulation and extension of the maturation theory of Kemeny: the Dutch case of overmaturation in the social housing sector

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Abstract

Kemeny (1995) has drawn attention to the maturation process of the social housing sector. If the housing policy of a country gives the social housing sector opportunities to gain financial strength, to mature as Kemeny calls it, an integrated rental housing market may evolve in which the social sector can compete with the private housing sector. An advantage of this competition is that the private housing sector has less possibilities to gain surplus profits in a tight market. This paper discusses the theory of Kemeny and proposes a reformulation of the maturation process. An extension of the theory is needed to distinguish a dualist rental market which is dominated by the social rented sector and in which the private rented sector is marginalised.

For decades now, one of the characteristics of the Dutch housing policy has been that it has given the housing associations opportunities to become financially independent. Recent research of the Central Housing Fund (2010) shows that in general the financial position of the housing associations is very solid. According to the Central Housing Fund the average amount of equity (solvency) is 67% of the total equity (calculations based on market value of the dwellings).

One of the consequences of the financial strength of the Dutch housing associations is that they have ample opportunities to create a substantial gap between the market rent level and the actual rent of their dwellings. So, there is no level playing field anymore. The Dutch rental housing market is an example of a dualist rental with dominance of the social rented sector. This situation of overmaturation may have destabilising effects for the Dutch housing market.

Keywords: housing associations, maturation, Kemeny, housing market, the Netherlands.

Introduction

The interaction within the rented housing sector between the not-for-profit social rented sector and the for-profit private rented sector has recently been attracting attention again (see, for example, Haffner et al., 2009 and Hulse et al., 2010). Kemeny’s analysis, which he developed especially in his book ‘From Public Housing to the Social Market’ (1995) often forms the theoretical basis of this debate. Kemeny’s theory concerns the mutual relationship between the social rented sector and the private rented sector. This relationship is a dynamic one, and is affected by various factors including the
operation of the housing market, the position of the owner-occupier housing sector and government policy. Kemeny identifies two principal types within which this mutual relationship can be expressed:

- The dualist rental market, which is dominated by the private rented sector and in which the social rented sector is marginalized and often dependent on government support.
- The integrated rental market, in which both categories of landlords compete with each other on an equal footing and both sectors are attractive to large groups of tenants.

Apart from the integrated rental market, Kemeny also distinguishes the term ‘unitary rental market’. Kemeny defines a unitary rental market as ‘a market without regulatory barriers to competition between profit and non-profit providers’ (Kemeny et al., 2005, p. 858). Generally speaking, where regulations do not prevent the social rented sector from competing with the private rented sector, a unitary rental market forms a condition in which an integrated rental market may evolve.

Kemeny emphasizes above all the social advantages of an integrated rented housing sector. In such a market the social rented sector is a genuine alternative for tenants. The competition of the social rented sector produces a situation where the profit motive of the private rented sector, with potentially high rents as a result of profit rent setting, is held in check. Also, households feel less compelled to resort to the owner-occupier housing sector.

This paper puts forward a reasoned argument that Kemeny’s theory is incomplete. There is a third market form which he does not discuss, but which is indeed possible. This is the dualist rental market, in which it is not the private rented sector, but the social rented sector which is dominant. In this rental market it is precisely the private rented sector which is marginalized because overly strong competition in the social rented sector keeps rent levels so low that private landlords are unable to achieve a normal market rate of return on their letting operations. This produces a contracting private rented sector. In order to understand how a dominant social rented sector can develop, it is necessary to look at the process of maturation which leads, according to Kemeny’s theory, to the creation of an integrated rented housing market. This paper reformulates this process of maturation, in order to show that this process can also generate a dualist rented housing market in which the social rented sector is dominant.

A dualist renting housing market dominated by the social rented sector is not only a theoretical possibility, but also occurs in practice. The empirical part of this paper will analyse the rented housing market in the Netherlands, showing that the rented housing market dominated is by the social rented sector. This is one of the reasons why the Dutch housing market functions so poorly. Consequently, the policy proposals to reform the Dutch housing markets also apply to the social rented sector. These reforms do not aim to marginalize the social rented sector, but to restrict the dominance of the social rented sector to bring it into equilibrium again with the private rented sector, which will in turn allow an integrated housing market to develop.

Reformulating the process of maturation

According to Kemeny’s theory, the process of maturation is the process whereby a dualist housing market in which the private rented sector dominates can develop into an integrated rented housing market. A further condition for this development is that regulations do not stand in the way of an integrated rented housing market. Kemeny distinguishes two factors underlying the process of maturation: historic cost renting in the social rented sector, and annual inflation. According to Kemeny, this produces an ever-widening gap between the rent level for new rented housing and the rent level for older housing. ‘Where individualist historic costs determine rents a mature housing stock will mean that rents will show a declining gradient from new to old unmodernized dwellings’ (Kemeny, 1995, p. 43). In order to prevent older dwellings from being relatively cheap, the rents for old rented property can be raised by means of rent pooling, in order to use this extra income to lower the rents for new rented housing. In Kemeny’s analysis, because of this reduction in rents the social rented sector will create a strong competitive position for itself over time compared to the private rented sector, resulting in an integrated rental market.
The same gap can be seen between the level of debt with new rented housing and that with older rented housing. The older the dwelling, the smaller the debt. ‘The process of maturation refers to the growing gap between the per-dwelling outstanding debt on existing stock and the average new debt per dwelling that is either built, acquired, or renovated. This gap is the result of the inflation of construction costs’ (Kemeny, 1995, p. 41). At a business level, because of the process of maturation there is a widening gap between the value of the dwellings and the value of the debt. In essence, it therefore concerns capital formation in the social rented sector, as a result of which the social rented sector becomes independent and can compete with the private rented sector.

In Kemeny’s analysis, cost renting plays an important role. Cost renting exists where the rents ‘cover only actual incurred costs of a stock of dwellings’ (Kemeny, 1995, p. 34). He compares this to profit renting, whereby the rent level is at the maximum that the market can bear. Cost renting is not an unequivocal concept. Two forms of cost renting can be identified:

- Cost renting based on historical costs of the dwellings, without taking account of future price inflation;
- Cost renting based on user costs, whereby the effect of the future price inflation on the value development of the dwelling is taken into account.

If there is price inflation, or such inflation is to be expected, cost renting on the basis of user costs will lead to a lower rent level than cost renting on the basis of historical costs. After all, price inflation will lead to an indirect return for the landlord, which means that the direct return and the cost rent can be lower. The advantages of inflation, as Kemeny describes via the maturation process, therefore only arise where cost renting is based on historical costs. This is no longer the case if the user costs are taken as the basis for rent-setting. The advantage of inflation has already been taken into account. If the level of inflation is as expected, the process of maturation as described by Kemeny will not occur. It is generally accepted that user costs in the owner-occupier as well in the rented housing sector form the right basis for calculating the costs of the housing services (see also Rosen, 1985; Hills, 1991; Conijn, 1995).

As the criterion for the level of maturation, Kemeny uses ‘the ratio between the average debt per exiting dwelling and the average debt per newly acquired dwelling’ (Kemeny, 1995, p. 44). This approach assumes that the debt is linked to the dwelling, which is neither necessary nor self-evident. If corporate finance is involved, maturation according to Kemeny’s definition will no longer be measurable. A usable criterion for the level of maturation in the social rented sector is the amount of equity capital (solvency) in the social rented sector. If the social rented sector has little or no equity capital, its competitive position compared to the private rented sector is weak and its dependence on the government, e.g. through subsidies, is great. As the amount of equity capital available grows, the more competitive the sector will be and its dependence on the government will be reduced. The causes that may lead to a growth in equity capital are varied. The factor of cost renting on the basis of historical costs referred to by Kemeny is important because this way of cost renting has been applied in the past, partly because little or no inflation was expected. The fact that there has been higher inflation during the past decades than had been expected beforehand plays a significant role in the growth of equity capital. But it is not the only factor, and perhaps not the most important either. Also very important are the sharp price rises which the owner-occupier housing sector has experienced in many countries. These price rises, which are once again on the wane, are the result of all sorts of factors in the owner-occupier housing market (Girouard et al., 2006). Because of this, the market value of rented housing has also risen sharply, and with it the amount of equity capital in the social rented sector. It is going too far in this context to present a full analysis of the factors determining whether or not the equity capital in the social rented sector has risen. This analysis will also show differing results in each country. It is important for the purposes of this paper to measure the extent of and changes in the maturation of the social rented sector by the extent and the changes of the equity capital in the social rented sector.
Competitiveness of the social rented sector

The competitiveness of the social rented sector is an important factor in the maturation process (Oxley et al., 2010; Elsinga et al., 2010). The amount of equity capital in the social rented sector has a considerable influence on the competitiveness of the social rented sector compared to the private rented sector. Before discussing this relationship further, the concept of competitiveness will be placed in a broader context. The competitiveness of the social rented sector depends on a range of factors. These are:

- **The availability** of social rented housing. The greater the share of the social rented sector in the housing market, the more it will contribute to competitiveness.

- **The accessibility** of social rented housing. The fewer restrictions there are for households to rent accommodation in the social sector, the more it will contribute to competitiveness.

- **The composition** of the social rented sector. The more heterogeneous the social rented sector is in all kinds of characteristics (such as price category, quality category, type), the more it will contribute to competitiveness.

- **The presence of specific obstructive regulations**. The fewer obstructive regulations there are specifically targeting the social rented sector, the more it will contribute to competitiveness.

- **The price/quality ratio** of social rented housing. The lower the price/quality ratio of the social rented sector compared to private rented housing, the more it will contribute to competitiveness.

Various factors therefore affect the competitiveness of the social rented sector compared to the private rented sector. It is the combination of these factors that is crucial. If there is a large amount of social rented housing available but access to it is subject to stringent restrictions, this will impair its competitiveness. The amount of equity capital is an important underlying factor for the competitiveness of the social rented sector. If the equity capital is greater, there are more opportunities to influence positively the above-mentioned competition factors. This applies in particular to the price/quality ratio of social rented housing. The more equity capital the social rented sector has, the more able the sector will be financially to set lower rents. The relationship between the amount of equity capital of the social landlord and the level of rents deserves further examination.

Equity capital and the rent level

A private landlord will exploit the opportunities offered by the market to increase his rents. After all, his aim is to make a profit. In principle there is no upper limit, unless this is laid down by the government through rent regulation. However, there is indeed a lower limit. He will not want to continue as a landlord in the long term if he cannot achieve a market rate of return. If this is not possible, he will (eventually) pull out of the rented housing market. The user costs formula gives the relationship between the market rate of return and the market equilibrium rent level. This relationship can be expressed in the following simplified version of the user costs:

\[ UC = r \times W + MA + MG + D - p \times W \]

Whereby:
- **UC**: user costs
- **r**: desired market rate of return
- **W**: market value of dwelling when sold
- **MA**: maintenance costs
- **MG**: management and other costs
- **D**: depreciation
- **p**: (expected) price increase of the value of the dwelling

If the landlord receives the user costs as rent, he will achieve the desired market rate of return ‘r’, partly as direct return via the net rent (UC – MA – MG) and partly via the indirect return (p x W – D).
If the rent is structurally lower than these user costs, the alternative income on the rented dwelling is higher. He can achieve this by selling the rented dwelling and using the proceeds elsewhere to achieve a market rate of return.

The situation in the social rented sector is fundamentally different, for two reasons. Firstly, the not-for-profit social landlord is not aiming to achieve a market rate of return. If the return from the letting is lower than that on market terms and this lower rate of return does not threaten his financial continuity, the social landlord will not need to change his policy. Secondly, the rented dwelling is generally the prime means for the social landlord to achieve his social objectives. Providing accommodation for households which cannot find any other alternative in the housing market which they can afford is the primary objective of the social landlord. The sale of rented housing, merely because the rate of return is not in line with the market, therefore does not fit in with the objectives of the social landlord. Of course, there may be other reasons for the social landlord to sell rented housing. These reasons are in general not to do with increasing the rate of return, but in improving social performance.

For the social landlord the rate of return on rented housing is a precondition for being able to cover the financing costs. The amount of the return needed depends in particular on the following factors:

- the costs to finance the loan capital;
- the desired return on the equity capital;
- the ratio between equity and loan capital.

The costs to finance the loan capital will depend on the way in which the social landlord has obtained the finance. Cheap government loans or loans at market interest rates on the capital market; many options are available in practice. There is also no unequivocal answer to what the desired level of return would be on the social landlord’s equity capital. On the one hand, the social landlord is not aiming to make a profit, which means that the return on his equity capital does not need to be maximized or on market terms. After all, there are no commercial shareholders to impose requirements on the social landlord regarding the level of return. The desired return on the equity capital, and with it the desired growth of the equity capital, depends above all on the social landlord’s growth strategy. A desired growth in social rented housing stock demands more equity capital, whereas in a contracting market the equity capital could fall. Finally, the relationship between equity and loan capital is important. The greater the relative amount of equity capital, the lower the desired level of return may be.

It is actually all about the weighted average cost of capital. The fact that the weighted average cost of capital of a social landlord can be relatively low with a high level of equity capital can be illustrated with a simple example. Let’s assume that the ratio between equity and loan capital of the social landlord is 50:50, the financing costs of the loan capital are on market terms at 6% and the desired growth of equity capital is equal to the price inflation of 2%. The weighted average cost of capital in this example is then 4%. This relatively low weighted average cost of capital, which is equal to the desired return ‘r’. This rate of return can be used to calculate the user costs shown above and leads to a relatively low rent level. Let’s also assume that maintenance, management and other costs together amount to 1.7% of the value of the dwelling. The relatively low weighted average cost of capital then leads, according to the formula of the user costs, to a rent level of 3.7% of the value of the dwelling. If a private landlord requires a market return of 6%, in this example the user costs for the private landlord are 5.7%. The rent level that a private landlord needs for a market return in this example is more than 50% (5.7 / 3.7) higher than the rent needed by a social landlord who has 50% in equity capital. This example illustrates how the process of increasing maturation of the social rented sector, which is shown in a rising level of equity capital, can lead to the situation in which the social landlord is enjoying a considerable competitive advantage over the private landlord. This advantage can become so great that the social landlord who charges relatively low rents makes it impossible for the private landlord to achieve a market rate of return through operating the dwelling.
Three market forms within the rented sector

It has been shown above that Kemeny distinguishes two market forms in the relationship between the social and the private rented sector: the dualist rental market in which the private rented sector dominates, and the integrated rental market in which both categories of landlords are more or less equal competitors. In an empirical analysis of the rented housing market in the Netherlands, however, he does draw the conclusion that non-profit renting dominates, which also affects the way the private rented sector operates. ‘It even seems that a dominating non-profit sector might crowd out profit investors, because they would no longer be able to earn a reasonable profit’ (Kemeny et al., 2005, p. 869). This does not lead him to draw the conclusion that there is a third market form in the Netherlands. He places the Dutch rented housing market in the dual-integrated framework, and according to him it is not yet even an integrated rental market. On the contrary, for three countries studied, including the Netherlands, he concludes that ‘none can be said to be fully integrated’ (Kemeny et al., p. 870). As will be shown in the empirical part of this paper, it is worth distinguishing a third market form, in which maturation has developed so far that it has led to overmaturation. As a result, the social rented sector no longer makes a positive contribution to the functioning of the housing market. The poor functioning of the Dutch housing market can partly be attributed to the overmaturation of the social rented sector.

Table 1 shows the three market forms which can be distinguished. Apart from the two market forms that Kemeny describes, a third has been added. This third market form is characterized by the dominance of the social rented sector and a marginalized private rented sector. This is also a dualist market form, precisely the opposite of a dualist market form in which the private rented sector dominates.

Table 1. Characteristics of the three types of rental markets

<table>
<thead>
<tr>
<th></th>
<th>Profit sector dominating dualist rental market</th>
<th>Integrated rental market</th>
<th>Non-profit sector dominating dualist rental market</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Degree of maturation non-profit sector</strong></td>
<td>Under mature</td>
<td>Mature</td>
<td>Over mature</td>
</tr>
<tr>
<td><strong>Market position of non-profit sector</strong></td>
<td>Marginalized compared to profit sector</td>
<td>Equal competitor with the profit sector</td>
<td>Dominant compared to profit sector</td>
</tr>
<tr>
<td><strong>Financial position non-profit sector</strong></td>
<td>Weak financial position</td>
<td>Healthy financial position</td>
<td>Very strong financial position</td>
</tr>
<tr>
<td><strong>Brick and mortar subsidies</strong></td>
<td>Non-profit is subsidized by the government</td>
<td>No subsidies or equal subsidization in both sectors</td>
<td>Implicit subsidization by non-profit sector</td>
</tr>
<tr>
<td><strong>Rent level</strong></td>
<td>Below market equilibrium</td>
<td>More or less equal market equilibrium</td>
<td>Below market equilibrium</td>
</tr>
</tbody>
</table>

In the dualist rental market which is dominated by the social rented sector, the social rented sector has a strong financial position, as can be seen in a relatively high solvency level. As the required return on the equity capital for a social landlord can be lower than would be the case on market terms, the social landlord is able to set the rents lower than a market rent which is based on the user costs. The difference between market rent levels on the basis of user costs and the actual rent level is an implicit subsidy which the social landlord provides. The greater the amount of this implicit subsidy, the more difficult it is for the private landlord to compete.
The Dutch rental housing market

In the Netherlands, 82% of the rented housing sector comprises social rented housing. Of the remaining 18% of rented housing, a small proportion is owned by pension funds and insurance companies, and a large proportion is owned by small-scale private individuals. In virtually all rented housing (93%), rent regulation applies. Table 2 gives an overview of the rented housing stock according to type of landlord and whether or not it is regulated. The table shows that regulated social rented housing (79%) dominates the rented housing market. In addition, also most of the private rented dwellings are regulated.

Table 2. The composition of the Dutch rented housing stock, numbers in millions, percentages shown within brackets, 2009

<table>
<thead>
<tr>
<th></th>
<th>housing associations</th>
<th>private</th>
<th>total</th>
</tr>
</thead>
<tbody>
<tr>
<td>regulated</td>
<td>2.3 (79%)</td>
<td>0.4 (14%)</td>
<td>2.7 (93%)</td>
</tr>
<tr>
<td>deregulated</td>
<td>0.1 (3%)</td>
<td>0.1 (4%)</td>
<td>0.2 (7%)</td>
</tr>
<tr>
<td>total</td>
<td>2.4 (82%)</td>
<td>0.5 (18%)</td>
<td>2.9 (100%)</td>
</tr>
</tbody>
</table>

Source: WoON 2009

In the Dutch rent regulation, three elements are of particular importance:

- For existing tenancy agreements, the annual rent increase is determined by the government. During the past few years the rent increase has been equal to the rise in the consumer price index for the preceding year.
- There is a rent ceiling that sets a maximum rent with a new tenancy agreement. This maximum is determined on the basis of an administrative system which determines the quality of the rented housing according to a points system.
- Existing tenancy agreements cannot be terminated in practice by the landlord.

The Dutch rent regulation therefore protects the sitting tenant above all, and can be regarded as a third generation of rent control (Arnott, 1995). The effect of rent regulation, however, is not as great as it may appear at first sight. For 66% of regulated rented housing, the rent ceiling does not actually have any limiting effect because either the dwelling can be deregulated on the basis of its relatively high quality after the sitting tenant has moved out, or the market rent is lower than the rent ceiling (Conijn and Schilder, 2011b). Besides the rent regulation, also the rent policy of the social landlord has a considerable effect on the rent levels in the Netherlands. Social landlords generally set rents for new tenancy agreements at a lower level than is permitted based on rent regulation. Among social landlords the rents are on average 70% of the regulated rent ceiling. This pricing policy of the social landlords also sets limits on the extent to which private landlords can increase the rents. If the difference with rent levels in the social rented sector becomes too great, it is worth waiting until a social rented dwelling becomes available.

Table 3 gives an overview of the rent level as a percentage of the market value of the rented dwelling. There is a significant difference between the rents in the regulated rented sector and the deregulated rented sector. In the regulated rented sector, rents are on average 3.2% of the market value of the rented dwelling, whereas in the deregulated rented sector the rent level is on average 4.5%.

Table 3: Rents as a percentage of the market value of rented housing, 2009

<table>
<thead>
<tr>
<th></th>
<th>housing associations</th>
<th>private</th>
<th>total</th>
</tr>
</thead>
<tbody>
<tr>
<td>regulated</td>
<td>3.2%</td>
<td>3.1%</td>
<td>3.2%</td>
</tr>
<tr>
<td>deregulated</td>
<td>4.5%</td>
<td>4.5%</td>
<td>4.5%</td>
</tr>
<tr>
<td>total</td>
<td>3.2%</td>
<td>3.5%</td>
<td>3.3%</td>
</tr>
</tbody>
</table>
'Mixité': an urban and housing issue?

Source: WoON 2009

In the foregoing part of the paper it was stated that the private landlord requires a rent level of 5.7% of the market value of the rented dwelling to achieve a market return. There are two reasons why the private landlord cannot achieve this rent level in the Dutch rental housing market:

1) There are substantial tax subsidies in the owner-occupier housing sector in the Netherlands, partly through the tax-deductibility of interest. This preferential tax treatment means that the market rent is not 5.7%, but on average 4.5% of the market value of the rented dwelling. If market rents were higher, many tenants would find it cheaper to buy than to rent (Conijn and Schilder, 2011b).

2) Furthermore, as already stated, in the regulated sector there is a further price-lowering effect due to rent regulation and the rent policy of the social landlords. As a result, the regulated rented sector has rents that fall well below the user costs.

Rent levels in the Netherlands are inadequate to allow a market return to be achieved, and so two aspects will be considered further in this paper. Firstly, the fact that the relatively low rents do not constitute a major problem for the social landlords. Secondly, the low rents are the main reason for the private landlord to pull out gradually from the Dutch rented housing sector.

The assets of the Dutch housing associations

It has been described above that the degree of maturation can be measured against the amount of equity capital held by the social landlord. In Dutch housing associations, the dwellings themselves are the most important assets. The valuation of the dwellings is therefore crucial in determining the amount of equity. Various methods for the valuation are possible:

- valuation based on historical costs
- valuation on the basis of operating value
- valuation on the basis of market value when let
- valuation on the basis of market value when vacant

A valuation of the dwellings based on historical costs is still partly used by the housing associations in drawing up their annual accounts. This valuation, however, has no economic relevance because it gives no information on the return the dwelling can generate. The operating value is a valuation based on a continued letting by the social landlord. In this case, the value is equal to the net present value of the future cash flows (rents less operating costs) which are the result of the policy being continued. In this valuation, a low rent leads to a low value. The two other valuations are based on the market. In the first case, when making the valuation account is taken of the fact that the dwelling is let and that as a consequence of tenancy protection in the Netherlands the tenancy agreement cannot be terminated. In the second case, the valuation is based on a fictitious situation where the dwelling can be bought in a vacant state. The latter valuation is determined in practice in the Netherlands by the owner-occupier housing sector. The level of the three relevant valuations will vary widely (CFV, 2010, p. 114). The operating value is the lowest value and in 2009 amounted to an average of € 37,900 per dwelling. The market value when vacant is the highest of the three and is on average € 153,000 per dwelling.

Table 4. The average value of housing association dwellings in accordance with three valuation criteria, 2009

<table>
<thead>
<tr>
<th>Valuation Type</th>
<th>Average Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating value</td>
<td>€37,900</td>
</tr>
<tr>
<td>Market value when let</td>
<td>€98,400</td>
</tr>
<tr>
<td>Market value when vacant</td>
<td>€153,000</td>
</tr>
</tbody>
</table>

Source: CFV, 2010, p. 114

There are various reasons why the value gap between the market value when vacant and the operating value of social rented housing in the Netherlands is so wide. The main reason is that the rent levels of
housing association dwellings are relatively low. This accounts for 48% of the value gap (Conijn and Schilder, 2011a, p. 118). In order to obtain a good understanding of the financial position of Dutch housing associations, the operating value is not a usable basis for valuation because the relatively low rent has already been allowed for in this value. The market value when let will be taken as the basis for determining the financial position of the Dutch housing associations.

Table 5. A summary balance sheet of Dutch housing associations based on market value when let, in billions of euros, 2009

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dwellings, in operation</td>
<td>242</td>
</tr>
<tr>
<td>Equity</td>
<td>180</td>
</tr>
<tr>
<td>Dwellings, in development</td>
<td>9</td>
</tr>
<tr>
<td>Loans</td>
<td>77</td>
</tr>
<tr>
<td>Other assets</td>
<td>15</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>9</td>
</tr>
<tr>
<td>Total assets</td>
<td>266</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>266</td>
</tr>
</tbody>
</table>

Source: CFV, 2010, p. 113

It has been explained above that a social landlord may have a low required return if he has a high level of equity capital. Dutch housing associations possess a relatively large amount of equity capital. The return to be obtained from operating the rented dwellings can therefore be very low. It concerns in particular the direct return. The indirect return, which is determined by the price changes of the dwellings, is determined above all by exogenous factors. All the housing associations have a combined net rental income of €5 billion. With a market value of the dwellings when let of €242 billion, the direct return is only 2% (CFV, 2010, p. 118). The direct return on the equity capital is even lower because there is negative leverage compared to the interest rate on the loans, which is higher. The direct return on the equity capital is no more than 1% (CFV, 2010, p. 118).

In a slightly different context, a recent analysis explored how high the loss of return for the Dutch housing associations is compared to a benchmark on market terms (Conijn and Schilder, 2011a). The direct return for housing associations is on average 2.5% lower than the market benchmark. This loss of return is caused to a minor extent by the fact that operating costs of social landlords are higher than the benchmark. This produces a loss of return of 0.5%-points. The difference between the market rent and the actual rent level accounts for the most of the loss of return. The difference in rent produces a loss of return of 2.0%-points. Because of the considerable amount of equity capital on which no required market rate of return applies, housing associations can afford this loss of return. Overmaturation is also expressed in this high level of equity capital.

The marginalization of the private rented sector

It has been shown above that rents in the Netherlands are too low to generate a market return. Although this is not a problem for the social rented sector, it is indeed a problem for the private sector. The nature of the problem has already been touched on above, and a further detailed discussion would be useful, making a distinction between new building of rented housing by private landlords and the existing housing stock held by private landlords.

If newly built rented housing has a rent level that on average is too low to achieve a market return, there are two options:

- the government subsidizes the difference between the rent level that is required to achieve a market return, and the actual rent level; this was the case in the Netherlands for many decades...
following the Second World War; these bricks-and-mortar subsidies were abolished more than ten years ago because the social landlords, as a result of their capital position, no longer required a subsidy.

- without a subsidy from the government, the private landlord will generally not build new rented housing; only in niche markets where a market return can still be achieved will new rented housing be built by private landlords.

This latter scenario is in fact the case today. Since the end of bricks-and-mortar subsidies, the building of new rented housing for private landlords has fallen to a very low level. On the other hand, the building of new rented housing for social landlords, despite the fact that there are no longer any subsidies from the government, has increased sharply during the past few years. In 2002 social landlords built 13,600 new rented homes; in 2010 this figure was 29,300 (CFV, 2011).

Within the existing rented housing stock owned by private landlords, the relatively low rents have had a downward effect on the operating value of the dwellings. The operating value is equal to the net present value of the future cash flows. The lower the rents, the lower the operating value, which in turn creates a value gap compared to the value of the dwelling when vacant. The above shows how large the value gap in social rented housing is. No details are available on the value gap with private landlords. It is expected that the value gap there will be less, but still substantial. The value gap is less than with social landlords because the operating costs are lower. The value gap encourages the private landlord to seek arbitrage behavior. The sale of the dwelling to the builder-owner after the sitting tenant has moved out generally produces a higher return than a continuation of the tenancy at a rent that does not generate a market rate of return.

On the basis of this analysis, a decline in the size of the private rented sector may be expected, and Table 6 shows that this is actually the case. In the period from 1947 to 2008 the total housing stock increased by more than 330%. The number of private rented dwellings, on the other hand, has fallen significantly. Soon after the Second World War the share of the private rented sector in the Dutch housing stock was 60%, and this had fallen to 11% in 2008.

Table 6: Dutch housing stock by tenure, 1947-2008

<table>
<thead>
<tr>
<th>Year</th>
<th>owner-occupier (%)</th>
<th>social rented (%)</th>
<th>private rented (%)</th>
<th>total (x 1,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>28</td>
<td>12</td>
<td>60</td>
<td>2,117</td>
</tr>
<tr>
<td>1956</td>
<td>29</td>
<td>24</td>
<td>47</td>
<td>2,547</td>
</tr>
<tr>
<td>1967</td>
<td>32</td>
<td>35</td>
<td>33</td>
<td>3,450</td>
</tr>
<tr>
<td>1971</td>
<td>35</td>
<td>37</td>
<td>28</td>
<td>3,729</td>
</tr>
<tr>
<td>1975</td>
<td>39</td>
<td>41</td>
<td>20</td>
<td>4,281</td>
</tr>
<tr>
<td>1981</td>
<td>42</td>
<td>39</td>
<td>19</td>
<td>4,957</td>
</tr>
<tr>
<td>1985</td>
<td>43</td>
<td>41</td>
<td>16</td>
<td>5,384</td>
</tr>
<tr>
<td>1989</td>
<td>45</td>
<td>41</td>
<td>14</td>
<td>5,802</td>
</tr>
<tr>
<td>1995</td>
<td>48</td>
<td>39</td>
<td>13</td>
<td>6,192</td>
</tr>
<tr>
<td>2000</td>
<td>51</td>
<td>36</td>
<td>13</td>
<td>6,590</td>
</tr>
<tr>
<td>2005</td>
<td>55</td>
<td>34</td>
<td>11</td>
<td>6,859</td>
</tr>
<tr>
<td>2008</td>
<td>57</td>
<td>32</td>
<td>11</td>
<td>7,043</td>
</tr>
</tbody>
</table>

Source: Haffner et al. (2009) and Ministry of Housing (2009)

Two major causes can be attributed to this marginalization of the private rented sector. Firstly, as in other Western countries the share of home ownership has increased sharply in the Netherlands. Secondly, the share of the social rented sector from 1947 to 2008 has increased. Since 1985 the share of the social rented sector has also declined, but in numerical terms the social rented sector remains the same overall. There is no Western country in which the share of the social rented sector is as large as in the Netherlands. It is expected that the share of the private sector will fall further in the future.
Discussion

Kemeny’s theory, which concerns the relationship between the social and the private sector, distinguishes two main types: the dualist rental market which is dominated by the private rented sector and in which the social rented sector is marginalized, and the integrated rental market whereby both categories of landlords are more or less in balance. It would be useful to add a third main type to this theory: the dualist rental market in which the roles are reversed: a dominant social rented sector and a marginalized private rented sector. In this context the process of maturation of the social rented sector has also been reformulated. Maturation is the extent to which the social rented sector possesses its own equity capital (solvency ratio). The growth of equity capital can have a number of causes, not only as a result of the combination of historical cost renting and inflation. Price increases in the owner-occupier housing sector are extremely important. If the process of maturation continues to such an extent that it leads to overmaturation, after a period of time the dualist rental market may develop, with a dominance of the social rented sector. This extension to Kemeny’s theory is not only desirable from the point of view of symmetry and aesthetics, but also because the Dutch rented housing market is a clear example of a dualist rental market with a dominant social rented sector. By not identifying this third main type, a variety of publications wrongly typify the Dutch rented housing market as an integrated rental market (Kemeny et al., 2005; Hoekstra, 2010).

The dominance of the social rented sector in the Netherlands has been identified in a range of publications as one of the main factors causing the housing market to perform so badly (Donders et al., 2010, Werkgroep Wonen, 2010, CSED, 2010). The relatively low rent level for social rented housing compared to market rents is an implicit subsidy that is ineffective and leads to a loss of welfare (Donders et al., 2010; Schilder and Conijn, 2011). Partly because of the relatively low rents, the Netherlands still has a form of rationing in the rented sector which is expressed in long waiting times for social rented housing which can be as much as 10 years. In addition, there is a debate on the lack of a level playing field which favours the social landlords over the private landlords. Decisions by the European Commission aim to restore this level playing field. A range of publications wrongly create the impression that this and other policy measures will threaten the integrated rental housing market and will risk marginalizing the social rented sector (Elsinga et al., 2008; Hoekstra, 2010). It cannot be ruled out that the social rented sector will be marginalized in the future, but for the time being the policy measures can be regarded above all as an attempt to create an integrated rental market by reducing the dominance of the social rented sector.
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