Study on sustainable rental housing with sublease partnership utilizing existing owner-occupied vacant houses

S Watanabe¹, H Sumikura² and M Nagano³

¹ Housing Department, National Institute for Land and Infrastructure Management, Tachihara 1, Tsukuba, Japan
² Department of Architecture, Hiroshima University, Kagamiyama 1-4-1, Higashi-Hiroshima, Hiroshima, Japan
³ Department of Urban Engineering, University of Tokyo, Hongo 7-3-1, Bunkyo, Tokyo, Japan

watanabe-s92bp@mlit.go.jp

Abstract. Despite the increase in vacant houses in Japan, existing owner-occupied vacant houses are not sufficiently converted into rental housing due to homeowners’ anxieties in legal and economic matters. In this study, we explore cases of the housing projects introducing sublease partnerships of owner-occupied houses; the projects by the municipality as a PPP collaboration and the projects introducing a lump-sum payment of a rent as a purely private business. These projects are found to have succeeded in dispersing among parties the costs and the risks a homeowner would take by achieving the three conditions; (1) A deal including renovation work, (2) Fixed-term lease contract and (3) More credible contracting party. The sublease partnership has the potential to convert owner-occupied houses into rental housing. However, some challenges which limit the sustainability of the partnership are pointed out.

1. Introduction

The Japanese government had promoted homeownership policies for decades to resolve serious shortage of housing after WW2. In 1973, the statistics showed housing stock had exceeded the number of households in all the prefectures, but housing market continued expanding. With sales activities and ad campaign nationwide developed by major manufactures and local builders, most people came to show a marked preference for newly constructed houses rather than second-hand ones. Despite a decrease in demand and population, newly constructed houses remained around 900 thousand units annually for a decade and redundancy of existing housing stock has been expanding. According to the statistics, the number of vacant houses and the vacancy rate continues rising for two decades (Figure 1). Based on the governmental definitions, vacant houses are categorized into four groups: house for rent, house for sale, second house and the others. The vacant houses for rent or sale, which are necessary for population shift across markets or getting second homes, account for 54% of all vacant houses in 2018 (Figure 2). On the other hand, the others, which are just unoccupied out of the marketplace of real estate, account for 41%. Particularly, of detached vacant houses, the others account for 79%, and they are considered to possibly have a bad impact on neighboring residential areas in terms of public security. Prolonged abandonment of vacant houses will lead to higher cost for refurbishment or renovation, that means fewer opportunities for them to be used as properties.

However, there are advanced housing projects introducing sublease partnership where they utilize vacant owner-occupied houses as a rental housing. The projects, including PPP in rural areas and pure private business projects in cities, are implemented with ingenious attempts in making partnerships. In this study, we explore cases of these projects by making interviews with the people involved and
analysing contractual and design documents. Examining the advantages and challenges of each project, this study aims to present sublease partnerships applicable to affordable housing in urban and rural areas. The study outcome could contribute to SDG 11_Sustainable cities and communities.

2. Homeowners’ hesitancy in leasing their houses
In general, the homeowners of detached houses in Japan tend to be reluctant to lease out to someone due to legal and economic reasons. When they lease lands and buildings for either residential or business property, a tenant is protected heavily by the Land and Building Lease Law. For example, a lessor cannot evict a tenant without the justifiable reasons that are legally prescribed, and abandonment of rent reduction claim by a tenant is prohibited to be prescribed in a lease agreement. So, it is commonly considered that rental housing business is to be dealt with by sophisticated landlords or experts including real estate agents. Amateur homeowners are likely to feel excessive concern about disputes that might occur with a tenant and uncertain expenditure. That is the first reason for their hesitancy in leasing.

There is another reason with respect to economic affairs. Under the stereotypical market convention of the rental housing business, a lessor is supposed to repair at their own expense to the level where a tenant can live a normal life. But the other vacant houses are higher aged than the average of the total housing stock. It would take more than 2 million yen (US$ 1,800 equivalent) to refurbish a typical vacant house aged over 35 years. Meanwhile, few financial institutions make a loan product for refurbishment work with as low in interest as for building or purchasing an owner-occupied house. Such an expensive refurbishment work would be a difficult option for a homeowner to make unless he or she can cover the expense with his or her funds.

3. Sublease projects as PPP in rural areas
Many municipalities in rural areas are carrying out policies concerning the promotion of migration into their towns. While migrating families usually want to rent a house rather than purchase because of uneasiness about their future livelihood, there is a very limited stock of private rental housing and few real estate agents there. Reluctant to develop new public housing by investing lots of money, some municipalities find potential in vacant owner-occupied houses increasing there and utilize them as local resources by introducing sublease partnership. We explored the cases of two municipalities; Iinan town and Yusuhara town (Table 1) and examined the pros and cons of the partnerships.

3.1. Scheme and characteristics of the projects
As described above, how to disperse among parties the costs and the risks a homeowner would take is important in making their owner-occupied houses leased out. On the other hand, in rural areas, where rent is very low, a private rental business cannot make enough profit. Some municipalities started the housing projects and succeeded in dispersing costs and risks in master lease contracts due to the three following conditions; (1) A deal including not only paying rent but also renovation work, (2) Fixed-term lease contract and (3) More credible contracting party.
Almost all the homeowners involved in the projects don’t regard the projects as a profitable business. With low or no rent paid by the municipality, the homeowners are content in a renovation conducted at municipalities’ expense. Most of the leased houses were renovated with the renewal of household equipment, repair interior finishing, and, in some cases, seismic reinforcement and installing new insulation materials. Yusuhara town pays no rent and subleases at 15,000 yen (US$ 137 equivalent) per month. Meanwhile, homeowners have their houses upgraded with up to 5.7 million yen (US$ 52,000 equivalent) and maintained by the town and are exempted from real property tax.

The municipalities have to recover their investments with low rent difference. So, they make a long-term contract of ten years (generally, two or three years for leasing residential building). Yusuhara town, according to their scheme, will recover their expenses up to 1.6 million yen (US$ 14 thousand equivalent) within ten years. On the other hand, it promises homeowners to return houses on termination of contracts by a fixed-term lease contract. This type of contract, which came into effect with the revision of the law in 2000, allows a lessor to refuse to recontract with a tenant who is in breach of contract or arrear of rent. Thus, it builds a sense of ease for homeowners.

Amateur homeowners tend to hesitate to make a contract with a strange renter even if conditions (1) and (2) are met in a direct lease contract. Most importantly, a contract with the municipality, which is a more credible entity, would build more a sense of ease for homeowners. In this respect, sublease by municipality makes sense in encouraging vacant owner-occupied houses to be leased out.

3.2. Challenges in sustainability

There were no provisions concerning the responsibilities of repair and maintenance in the master lease arrangements of the two towns. In the first place, rent paid to homeowners was very low or free, and, presumably, the municipality thought it was unfair to ask homeowners to bear costs for repairs. Therefore, municipalities bear all the repairs due to leaks, damage to exterior walls, and malfunctions of equipment. For Iinan town, which started the project in 2009, the increase in cost for repairs has become a big issue. The town regards over-concentrated responsibility for repairs and maintenance as high risk and has no idea to recontract with the homeowners, developing new public housing instead. This PPP scheme can hold down initial investment but requires great consideration of high risks with repair and maintenance due to long contract terms and aged deterioration of older houses.

4. Sublease projects as a purely private business in urban areas

In urban areas, rent can be set higher and it is possible to make a private rental service make profitable. There are some owner-occupied houses converted into rental housing, but the number of them is extremely small compared with the other vacant houses. As described in the previous chapter, it is important to disperse the costs and the risks homeowners would take to make their houses converted to rental housing. We explored cases of two housing projects which were proposed by Osaka Real Estate Consulting Association and put into practice by the associate members (Table 2) and found sublease partnership with a combination of lump-sum payment has potential.

4.1. Scheme and characteristics of the projects

As shown in Figure 4, the business operators rent from a homeowner and sublease to a renter. As in the case in the projects of the municipality, both master lease and sublease are made by fixed-term lease contract (condition (2)), and the sublessor are thought to be more credible than ordinary renters (condition (3)). Most importantly, a business operator shall pay rent in a lump sum for two or three years in advance so that homeowners can divert it directly to the initial cost for renovation work. In case of house T, the LLP paid to the homeowner about 2.1 million yen (US$ 20 thousand equivalent) initially, then she conducted renovation with the paid money and her funds. The operator could recover the initial payment within three years. Naturally, it made a profit just by the rent difference during the contract term of four years. Additionally, the business isn’t deemed as a joint project because the renovation was conducted at the homeowner’s expense, which means it was a path-
through business. Thus, this scheme is beneficial to a homeowner and a subleasing operator. In respect that lump sum rent was converted to expenditure for renovation, the partnership meets condition (1).

4.2. Sublease as a transitional approach
In these projects, on the premise that the status of a sublessor will be taken over by the homeowner, the master lease term is set to four years, which is shorter than the five-year term for sublease. Sublessors are essentially responsible for vacancy risks and repair costs during the contract term. To balance mitigating these risks and securing profits, contract term in the master lease was set to four years. This partnership is a transitional approach leading to a direct contract between a homeowner and a tenant.

Table 1. The surveyed projects by the two towns in rural areas.

| Town   | Initial year | Houses | Master lease term | Master lease rent [yen/m.] | Sublease term | Sublease rent [yen/m.] |
|--------|--------------|--------|-------------------|---------------------------|---------------|------------------------|
| Yusuhara | 2012         | 41     | 10 yrs.           | free                      | not more than 10 yrs. | 15,000                 |
| Hiran   | 2009         | 11     |                   | 10,000                    |               | 20,000                 |

Table 2. The surveyed sublease projects with a lump-sum payment of a rent in cities.

| Project | Homeowner’s funds | Lump-sum payment | Master lease term | Master lease rent [yen/m.] | Sublease term | Sublease rent [yen/m.] |
|---------|-------------------|------------------|-------------------|----------------------------|---------------|------------------------|
| house F | 0                 | 2,100            | 10 yrs.           | 70,000                     | 60            | 125,000                |
| house T | 1,179             | 2,142            | 48 months         | 85,000                     | 60            | 105,000                |

* 1,000 yen

Figure 3. Business scheme and stakeholders of the sublease project by Yusuhara town

Figure 4. Business scheme and stakeholders of the sublease projects with a lump-sum payment of a rent in case of house T (Toyonaka city)

5. Discussion and Conclusion
We found that sublease partnership, which distributes owners' risks and costs to sublessors, has the potential to convert ordinary owner-occupied houses into rental housing for family households in urban and rural areas. Sublease of vacant houses by a municipality is an applicable and effective method for housing in rural areas. However, the repair risk is chronically too biased to the municipality, which limits the sustainability of the partnership itself. To reduce the risks, making contract terms in master lease shorter with a rent lower or making contract terms in sublease longer with a rent higher depending on renovation work would deserve consideration. On the other hand, sublease introducing lump-sum payments in urban areas is a highly applicable method as a purely private business. Sublease partnership should be designed as a transitional approach for several years before a direct contract between a homeowner and a tenant to reduce the risks and secure profits. Meanwhile, for family households who want to inhabit longer than contract terms of master lease, the succession of the status of a sublessor should be prescribed in master lease agreement.

6. Reference
[1] Statistics Bureau of Japan, Ministry of Internal Affairs and Communications, Housing and Land Survey 1998–2018