Rent control: a miracle solution to the housing crisis?

Jean Bosvieux

The sharp rise in housing costs in France since the end of the 1990s has generated much debate on the subject of rent control policy, abandoned in 1948 and reintroduced in 2012 by the newly elected left-wing government. While some defend the need to protect tenants, Jean Bosvieux highlights the counterproductive effects of such measures, instead defending a policy of building affordable rental housing.

Rent control was one of the key issues debated during the 2012 French presidential campaign. Paradoxically, this issue has attracted a certain amount of controversy, despite the fact that annual rates of growth in private-sector rents are currently more stable than at any time in the last 30 years, if not longer (see graph 1). However, it is true that rents have increased, on average, more rapidly than inflation over the last 20 years, and that, for the poorest households, the proportion of household budget dedicated to rent has risen continually. Furthermore, rental rates in Paris – generally two to three times higher than in the rest of France – have come under particular scrutiny from the media. On the one hand, there are those who advocate greater rent control, citing the existence of exorbitant rents (particularly in Paris), while, on the other hand, those who support the market determination of rents argue that limiting rents would lead to a reduced supply of rental housing and increased deterioration of housing stock.

Graph 1

Expressed in these terms, the debate becomes somewhat simplistic. In reality, there are very few countries where the rental market is completely free; similarly, there are very few places where a wholesale rent freeze is in force. In order to clarify this issue, we first need to define what is meant by "rent control" before trying to measure its consequences on the way the market operates. In all cases, the regulation of rental markets involves the development of a balanced supply of housing, i.e. a supply of housing that is adapted to all budgets and thus open to all potential tenants.

What is meant by "rent control"?[1]

The most extreme form of rent control is the freezing of rents, with occasional upward adjustments to compensate partially for inflation where necessary. This "first generation" of rent control was the norm in Europe during the interwar period and World War II, and, in certain countries and local authorities, continued into the 1980s. In North America, this form of rent control appeared during World War II, but was abandoned around 1950, except in New York City.

The period immediately after the 1973 oil crisis was characterised by high inflation. In jurisdictions that had retained first-generation rent control, the gap between authorised rents and the equilibrium rent widened. In the United States and Canada, many local authorities reintroduced rent control, albeit in a more flexible form. Leaving aside the sometimes significantly different operating methods, these measures generally allowed for an annual increase fixed by a legal rate, without excluding the possibility of additional increases to account for rising costs and ensure continued profitability for landlords. This second generation of rent regulation tended to be known as "rent stabilisation" rather than "rent control". In the 1970s and 1980s, these second-generation measures replaced the older forms of regulation in many European countries. In France, rent control had been partially lifted by the "1948 law" that limited regulation to housing units built before this date only.

Since then, rent control has become a less prevalent political issue. Certain countries or local authorities have retained their rent control schemes but, because of reduced rates of inflation, rents have deviated little from the market equilibrium rate. In most American cities, for example, the scope of rent control is reduced by various deregulation measures that exempt ever greater numbers of dwellings from regulation. In many cases, rent control has been completely abolished; in others, it has evolved: today, the measures enforced are typically restricted to limiting rent increases during tenancies and/or when tenancies are renewed, with landlords generally having a free hand in setting rents when a new tenant moves in.

Nonetheless, some important differences between national regulations in Europe do exist, particularly with regard to rent levels when a new tenant moves in (reletting) or when tenancies are renewed. In England – as has been the case in France since 1997 – there are no restrictions on relet rents, but, unlike France, there are also no restrictions when tenancies are renewed, which very often takes place every six months. In Denmark, there are no less than five different rent regulation schemes, depending on the age of the building, with the most restrictive scheme applying to the oldest housing. In the Netherlands, where the private rental sector now represents only 8% of housing stock, rents are capped. In Sweden, rents are determined locally via negotiation between representatives of landlords and tenants, with social housing rents acting as benchmarks.

The effects of rent control

As we have seen, different forms of rent control have existed at different points in time and in different places. For this reason, generalisations with regard to rent regulation are not particularly relevant; furthermore, such broad judgements typically proceed from ideological positions than to solidly founded analyses. One thing is certain, however: the freezing of rents or an overly restrictive regulations inexorably leads to reduced supply in the rental sector, hampers residential mobility and can lead to the development of corrupt practices (e.g. bribery). Indeed, France has experienced this first-hand: it was the shortage of rental housing and the poor quality of housing stock – of which

[1] See Richard Arnott's article "Tenancy rent control" (Arnott 2003), which inspired much of this section of the text.

Bertrand de Jouvenel (1948) gave an arresting description – resulting from over 30 years of frozen rents, that led to the 1948 law mentioned above. It was also this experience that led many American cities to relax or abolish their rent control measures.

Excessively strict rent regulation can also encourage the development of shadow markets. This happens when regulation concerns only part of the housing stock: in the regulated sector of the market, it is in tenants' interests to remain in their accommodation, and the overall supply diminishes, while new tenants have no choice but to find accommodation in the "free market" sector, which, owing to high demand, becomes increasingly expensive. As a result, the gap between rents in the two sectors gradually widens.

The results of various (mostly American) studies – both theoretical research and empirical research based on real experiences – converge on these different points (Jenkins 2009).

However, as noted above, very few rent regulation measures currently in force actually involve rent freezing. In Germany, for example, a reference-based system is in place, and this does not seem to generate undesirable effects. Here, "freedom is the general rule, but tenants can turn to the courts if they feel that the rent imposed is usurious, i.e. more than 20% higher than rents for equivalent accommodation" (Rougie *et al.* 2011). Rent increases are regulated, but with a decidedly light touch, with rises of up to 20% over three years authorised.

Barring the very unlikely event that rented social housing were to be transferred to common law, the transposition of the German model to the French context is possible in the private sector only. The effect of such a measure would be to condense the range of rents in this sector and, in the short term, slightly reduce the average rent. However, a simulation conducted by OLAP (Observatoire des Loyers de l'Agglomération Parisienne – "Paris Region Rent Observatory") with regard to rents in Paris shows that this effect would be minimal: limiting rent increases to 20% above the average rent would reduce the average rent by 3% at most.

Regulating rent efficiently without reducing demand: a challenge?

The market rent is the result of an interaction between supply and demand. When demand is high and supply limited, rents are high. This is the case in the French capital: within the Paris urban area, rents decrease the further out from the centre one goes, as the city of Paris proper (*intra-muros*) is the most sought-after location.

Obviously, it is possible to prevent or limit rent increases by bypassing market forces. But although rents can be regulated, property sales prices cannot – and if rent increases do not follow property price increases, rental yields decrease. It is true that long-standing tenants can afford to get by on moderate incomes, owing to specific rent-regulated contexts; however, if the difference becomes too great, landlords will almost certainly try to recuperate the missing capital by selling the property in order to make a profit. This reasoning, developed in a study by André Massot (1994) – who added that this process was already under way in the absence of any regulation of rents – is all the more applicable under a rent regulation scheme. One could argue that it is no longer 1994 and that much has changed since; it is true that yields on alternative investments (bonds and equities) have fallen, but yields on property lets have also fallen considerably: between 1996 and 2011, rents increased by 39% while the average price of existing property rose by 158%.[2] According to a study by the EDHEC business school (Grégoir *et al.* 2010), the average yield from property rental in Paris has fallen by half in the space of a few years: in 2004, it amounted to just 2.49%, compared to 5.14% in 1997, and it has fallen further since.

These low levels of profitability have led institutional investors to move out of property rental and have made it necessary to introduce tax incentives in order to prevent the collapse of the private

[2] Sources: national rent index (produced by INSEE, the French National Institute for Statistics and Economic Studies) and the Notaires–INSEE index (produced jointly by INSEE and the French national solicitors' network) of prices for existing property (produced since 1996). These sources concern changes across France as a whole.

rental sector. Herein lies one of the key differences between France and Germany, where landlords can count on higher yields and where both public and private institutional investors hold a significant proportion of rental housing stock. Indeed, Germany is one of the only developed countries not to have experienced rising property prices between 1996 and 2008. The reasons for this are no doubt manifold, and most likely include demographic factors, property taxation policy, the way the rental sector is organised, and also possibly the fact that home-ownership has not been encouraged. Moreover, Germany does not have any urban area the size of Paris; the only comparable case in Europe is London, where rents are even higher (and significantly so) than in Paris.

Supply, demand and the Parisian exception

Does this mean that public authorities no longer have any means of regulating rents? No, of course not! They can take action in terms of supply, by encouraging an increase in the amount of rental-sector housing stock available. Indeed, this is the path that has been followed, with a certain degree of success, since the 1980s: the private rental sector has grown by some 1.4 million housing units, more or less reaching the level attained at the end of the 1970s. This was necessary in order to respond to rapidly increasing demand, and it is this growth in supply that has prevented rents from skyrocketing. However, any attempt to impose rents below the market price would have proved problematic: even in the presence of a quantitative objective, any policy that attempts to impose rent ceilings significantly below market rents will not work without sufficient compensatory measures in return. Individuals seeking to invest in property simply do not have the same motivations as social landlords – as illustrated by the disappointing results of "*conventionnement privé*" (private landlords agreeing to rent at a price lower than the market rate, in return for public subsidies or tax incentives) and confirmed by the experience of the Besson incentives.[3]

This observation justifies pursuing, or even stepping up, the development of an increased supply of low-cost and very low-cost rented social housing. It is true that private-sector rents are too high compared with the income levels of a growing number of households, particularly – but not exclusively – in the tightest markets. Only the construction of low-cost rented housing, managed by institutional landlords, can respond to the needs of these populations.

However, this solution cannot be applied to the Paris region, which constitutes a special case. In Paris *intra-muros*, the amount of private rental housing can hardly be increased – unless the city were to develop vertically, which would seem virtually impossible in view of the already very high population density. An adjustment between supply and demand can therefore be achieved in only two ways: via the market (i.e. prices), or via the administrative allocation of housing. In either case, it amounts to disqualifying surplus demand by ignoring it or by introducing qualification criteria. An enforced rent reduction via rent capping would create another criterion, in addition to the official price, to eliminate surplus demand: it would foster corrupt practices and encourage those tenants lucky enough to be selected to remain in their dwelling for longer. Above all, it would lead to a reduction in rental housing stock in favour of property ownership, thus ultimately reducing access to rented housing.

3 This tax incentive for investment in new rental property, in place between 2000 and 2002, was available only for landlords whose rents did not exceed a ceiling rate set below the market rental value.

Bibliography

Arnott, R. 2003. "Tenancy rent control", *Swedish Economy Policy Review*, no. 10, pp. 89–121.

Grégoir, S., Hutin, M., Maury, T.-P. and Prandi, G. 2010. *Quels sont les rendements de l'immobilier résidentiel en Île-de-France ?*, Croix: École des Hautes Études Commerciales du Nord (EDHEC Business School).

de Jouvenel, B. 1948. "« No vacancies » (Rien à louer)", in Bloch and Olsen (dir.). 1981. *Rent Control: Myths & Realities*, Vancouver: The Fraser Institute, pp. 198–197.

Jenkins, B. 2009. "Rent Control: Do Economists Agree?", *Econ Journal Watch*, vol. 6, no. 1, p. 73-112.

Massot, A. 1994. *Fiscalité successorale et patrimoines locatifs*, Paris: IAURIF.

Rougie, I., Girometti, L., Couëtoux du Tertre, I. and Vorms, B. 2011. "Marché transparent, marché pacifié ? Le rôle des miroirs de loyers en Allemagne", *Habitat Actualité*, Paris: ANIL/ANAH.

Jean Bosvieux, a statistician and economist, is research director at ANIL (the French National Housing Information Agency). Having occupied various roles at the Agency, he has developed a keen interest in a wide range of issues associated with the housing economy, in particular the operation of housing markets and the impact of public policy.

He recently published "Incitations fiscales à l'investissement locatif : succès quantitatif, ciblage imparfait" ("Tax incentives for rental investment: a quantitative success, imperfectly targeted"), *Regards croisés sur l'économie*, no. 9, 2011/1, pp. 162–171; and, in conjunction with Bernard Coloos, "Accession à la propriété, mobilité résidentielle et emploi" ("Access to home ownership, residential mobility and employment"), *Habitat Actualité*, ANIL, January 2011.

To quote this article:

Jean Bosvieux, translated by Oliver Waine, "Rent control: a miracle solution to the housing crisis?", *Metropolitics*, 21 November 2012. URL: http://www.metropolitiques.eu/Rent-control-a-miracle-solution-to.html.