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A comparison of the rent regulation in the private rental sector in five countries

Marietta Haffner

m.e.a.haffner@tudelft.nl

Marja Elsinga

m.g.elsinga@tudelft.nl

Joris Hoekstra

j.s.c.m.hoekstra@tudelft.nl



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Marietta Haffner

OTB Research Institute for Housing, Urban and Mobility Studies
Delft University of Technology, m.e.a.haffner@tudelft.nl
+31 15 278 3523, +31 15 278 4422

Marja Elsinga

OTB Research Institute for Housing, Urban and Mobility Studies
Delft University of Technology, m.g.elsinga@tudelft.nl
+31 15 278 3246, +31 15 278 4422

Joris Hoekstra

OTB Research Institute for Housing, Urban and Mobility Studies
Delft University of Technology, j.s.c.m.hoekstra@tudelft.nl
+31 15 278 7562, +31 15 278 4422

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Abstract: The private rental sector has been declining in many European countries, while home ownership is increasing. In describing the development of the private rental sector, a variety of authors suggest a causal relationship between the decrease of private renting and rent control. The assumption is that the stricter the rent control, the greater the decrease in private renting. Or conversely: the less rent control the more opportunities for the private rental sector. At the same time, however, an unregulated rental market may result in insecurity for tenants.

This paper focuses on these conflicting interests, and in particular on the regulation of rents and rental contracts from a welfare theory viewpoint. We explore various market inefficiencies in the private rental market and the government regulation of rents and rental contracts. We then present the results of a comparative study that involves France, the UK, Germany, Spain and the Netherlands. For each country we describe the features of the private rental sector, the rent regulation and the rental contracts. Finally we draw conclusions on the differences in rent regulation between countries and the balance between landlords and tenants.

Balance between landlord and tenant?

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1. Introduction

The development of the private rental sector and the way rents are or are not regulated, appear to correlate. Strong rent regulation is said to discourage investment and to produce a shrinking private rental sector. Strong rent regulation was valid in many countries, in particular in the period from the First World War on up until after the Second World War (Van der Heijden & Boelhouwer, 1996). The shrinking of the private rental sector, especially in the period after WWII, went hand in hand with policies to encourage home ownership or to support the social rental sector. Looking back one wonders whether the shrinking of the private rental sector was considered desirable, and whether strong rent regulation was an efficient way to achieve it. An overview of the development of the private rental sector share in the five countries of Europe covered in this article shows that in most, though not all, the share of the private rental sector decreased.

Meanwhile the private rental sector has appeared on many countries' policy agendas. The background for this new focus could be the fact that a choice between social renting and home ownership is considered a limited choice. Furthering private initiative may also play a role. It may also be the case that it is hard for young people to enter home ownership, and governments regard the private rental sector as a good alternative and one which is less costly than social housing. Various instruments are considered to encourage investors to invest in private rental housing and to prevent private landlords from leaving the private rental sector. Rent regulation, and in particular rent deregulation, often is part of this policy package. Rent deregulation means less protection for the tenant and more opportunities to maximize the return on investment for landlords. This is a fascinating search for a balance between the interests of the landlord and the tenant in the private rental sector. This balance depends greatly on the alternatives for the landlords – other investments – and for the tenants – other housing tenures.

The focus in this paper is narrower, omitting the alternatives; we consider the balance between tenant and landlord within a theoretical welfare framework, and explore the systems of rent regulation in five European countries.¹

2. Reasons for rent regulation

According to welfare theory, the most important reason for intervening in a market is efficiency; intervening is justified if economic efficiency is improved (Barr, 1998; Vandenbroucke *et al.*, forthcoming in 2007; Haffner & Boelhouwer, 2006; Doms *et al.*, 2001). If a market operates efficiently, according to this approach society's total welfare is maximised. The resulting distribution of welfare in such a situation, however, does not need to be such that society or politicians are comfortable with it. According to the welfare economy, improving social equality between citizens is a second legitimate reason for the government to intervene in a market and to change the welfare distribution. An example of

¹ For this paper we used information derived from a study for the Flemish government (Vandenbroucke *et al.*, 2007 forthcoming).

rent regulation used as a way to achieve social equality, is the income-linked rents in the social rental sector as applied in Belgium and Ireland. Arnott (1995) finds that the emphasis of traditional advocates of rent controls on distributional concerns has little merit, because of the poor targeting of the redistribution in comparison to other instruments.

This paper focuses on rent regulation for reasons of efficiency and studies the way rent regulation is arranged in the private rental sector. Economic efficiency can only be achieved if four standard criteria are met: perfect information, perfect competition, complete markets and no market failings (Barr, 1998). If these criteria are not met, the government can improve economic efficiency by regulation, for example, or subsidies.

Conditions for perfect information are not generally met in the rental sector: there is actually information asymmetry. The landlord has a greater insight into the quality of the accommodation (also so in relation to the rent of the dwelling) and any possible defects than the tenant. Such a situation can also arise because a housing market consists of segments. There is always only a limited number of homes available to rent. At the same time landlords offer heterogeneous accommodation, so that they have an informational advantage over the tenants. Rent regulation can play a role in reducing this asymmetry by linking a specific quality to a maximum rent.

The criterion of perfect competition requiring that all players have equal power is also often not met. If the accommodation acquires the status of a home for a tenant and the tenant becomes attached to his home, the landlord acquires a monopolistic power to raise the rent. Indeed, the tenant must incur high financial and emotional costs to avoid the rent increase. Arnott (1995) refers here to so-called imperfectly competitive models. The landlord acquires greater market power, because tenants facing high search costs will more readily accept a rental higher than the market rental. To prevent excessive rent increases legislators can regulate rent increases for existing and new rental contracts.

In this line of reasoning any system of rent regulation is set up for the protection of the tenant, either from arguments on information asymmetry or imperfect competition. This advantage for the tenant can turn out to be a disadvantage for the landlord. If rent regulation is strong, return on investment will decrease and in the long run the landlords will exit the private rental market. No new landlords will enter the market. Thus the regulation of rents appears to be a search for a balance between the interests of the tenants and the interests of the landlords, if the aim is a healthy private rental market.

3. Typologies of rent regulation

Arnott introduced two types of rent control in his seminal article of 1995. The freeze on nominal rents he called 'hard' or 'first-generation' rent control, while 'soft' or 'second-generation' rent control usually permits an automatic rent increase percentage related to the inflation rate. Possible undesired effects of rent control are falling property values, benefiting insiders, reducing maintenance, creating excess demand for regulated housing, reducing housing and labour mobility and increasing discrimination against disfavoured groups. Arnott argues that the possible undesired effects of first-generation rent control systems may not be associated with second-generation rent control systems. Based on monopolistically competitive models where the landlords have more market power than tenants for example, he argues that rent control may be able to improve the equilibrium of an imperfect market: "Rent control is then desirable when the distortion is the unavailability of insurance against a sharp and unanticipated rise in rent" (p.108). As the rent control systems are heterogeneous, it may be impossible to generalise about their effects, he warns.

Turner and Malpezzi (2003) with their overview of the empirical literature on the costs and benefits of rent control show an overwhelming geographical bias; the majority of the empirical evidence is based on North American data. Remarkably there is little evidence from Europe with its various types of rent regulation.

From this overview of empirical evidence, Turner and Malpezzi conclude that the effects of rent regulation vary greatly between countries and regions, depending on the specific housing market situation. In general, second-generation rent regulation models seem to perform better than first-generation models. However systematic comparative research on the effects of rent regulation is relatively scarce (see also Arnott, 1995); most of the studies reviewed by Turner and Malpezzi were case studies of one single housing market. This makes it difficult to draw general conclusions.

The typology of Lind

Lind (2001; see also Vandenbroucke, 2007) draws a distinction between five differing types of second-generation rent controls. Lind interweaves in his typology the reasons mentioned in the previous section; There may be imperfect competition and/or asymmetric information which justifies government interventions in the housing market in accordance with the welfare theory.

In the first instance Lind distinguishes rent regulation based on transaction costs. Here he indicates the fact that there is a market imperfection because a tenant must always incur costs if he is to relocate. The landlord can thus impose a higher rent than the market rent on the sitting tenant, the market rent being the rental which would be charged to a new tenant. Lind designates protection against this increase as the 'weaker' rent regulation based on the transaction costs (type A).

Lind indicates the rent control as 'strong' if the rent regulation for the sitting tenant is limited, not to the market rent but to the cost price increase including a reasonable return or yield (type B). In this type of regulation this therefore refers to a more stringent regulation which is not reasoned from the market rent, but from a specific return for the landlord.

The third form of rent control distinguished by Lind is the regulation of all contracts where the cost price and a reasonable return form the reference point (type C). This covers both existing and new contracts. Lind believes such regulation can be applied if one pursues the objective of avoiding segregation, and of being able to rent accommodation in an attractive location to households with lower incomes. In fact all households can rent according to cost price, given the possible negative external effects of segregated neighbourhoods. Lind believes this type of regulation comes the closest of all forms to first-generation rent control, certainly if the cost price remains below the market rent, as may be the case in scarce markets. Everyone can rent at a price below the market rent, and market effects are never considered in determining rents.

Lind indicates the fourth type of rent regulation as monopoly-related rent control (type D). Here all tenants are protected against a rent which is higher than the market rent, while again the possible rental price is calculated for a new contract. This type of regulation must prevent landlords using their monopoly positions, which arise because the housing stock is heterogeneous. Lind indicates that this type of regulation does not demand strict rent regulation by definition, but that prohibiting extortionate rents, for example through the penal code, may be sufficient.

The final type of rent regulation is aimed at limiting the short-term price effect which arises from an increase in demand for rented accommodation in an inelastic supply of rental dwellings (type E). The intention is that the long-term market rents are followed by this type of regulation which should protect against peaks in market rental.

These observations by Lind do not entirely match the earlier-mentioned theoretical welfare arguments. For instance, he splits up some of the arguments, like separating the transaction cost motive from the monopolistic motive for regulation. What is furthermore notable is that Lind names overshooting as a reason for rent regulation. Barr (1998) in fact indicates that volatility is intrinsic to the market and should thus not be regarded as a market failure. Possibly temporary measures may be taken, however. Lind also indicates that the type C rent control comes closest to a first-generation regulation. He implicitly assumes that the cost price, which forms the basis for rent regulation, is lower by definition than the market rent.

Observations

Lind's contribution provides us with points of departure which can be used in an international comparison of rent regulation systems. Lind in fact makes it clear that two criteria are crucial for characterizing the different types of rent regulation (see table 1):

- To whom does the regulation apply? To all tenants or only to the sitting tenants?
- What is the basis for regulation? Cost price rental or market rent?

Based on this typology we will discuss some observations.

Table 1 Characterizing rent regulation, using Lind's typology

	Not higher than cost price rent	Not higher than market rent
Sitting tenants	B	A
All tenants	C	D+E

Source: own adaptation Lind (2001)

Sitting tenants or all tenants

Rent regulation can involve a sitting tenant, but also all tenants. The choice for the sitting tenant will often be made from the approach that sitting tenants may not be able to bear rent changes which occur suddenly, when there is no way to insure them, because they must incur high costs to relocate. From this consideration it is reasonable to protect sitting tenants (type A and B). When however the regulation leads to rents being lower than the market rent, what arises is protection of insiders (sitting tenants) at the expense of outsiders (new tenants). Such an argument can play a role in the choice to protect all tenants against rents which are too high (type C, D and E).

Rent regulation only has an effect if the tenant's rent protection is also arranged (tenant security). Reasoning from the criterion of perfect information, by preference the landlord would rather accept a tenant who is known to be reliable: one who pays the rent on time and treats the accommodation with care. In this instance perfect information does not in fact exist; here the tenant has an information advantage over the landlord. In such a situation the landlord would prefer to have the freedom to be able to evict the tenant at any given time. If the rental contracts are short-term or the tenant enjoys no legislative rent protection, a certain degree of rent regulation will also not provide the tenant with sufficient protection. Indeed, if rent regulation does not follow the market rents, in such a situation the landlord could evict the tenant in order to take in a tenant who will in fact pay the market rent. In describing the systems of rent regulation in five European countries we will therefore also consider the length of the rent contracts (leases) and the legal rent protection.

For the sitting tenants, limitations apply with regard to rent increases for the variants A and B. These limitations form a yield limitation for the landlord. However protection of the tenant can also have positive effects for the landlord. Controlled rents ensure that a tenant knows what he is dealing with, and there is a minimal chance that rent increases will be a reason to relocate. Less relocation is favourable for the landlord because moving also costs the landlord money: switchover maintenance and the costs of rental and possibly having the property standing empty. Thus not only a tenant has transaction costs, a landlord has them as well. Only if tenant transaction costs are higher than landlord transaction costs, rent regulation may have a function.

Limiting relocation costs is known by the term ‘turnover minimising’ and in practice appears to occur as an important strategy for optimal return on investment of smaller landlords in particular (Turner and Malpezzi, 2003). In relation to this, there may be a ‘length of tenure discount’ for faithful tenants (Kemp, 2004). In other words, both the tenant and the landlord benefit from a long occupancy and tenant security. Rent regulation can contribute to this but is not necessary for such a balance. After all, the landlord himself can opt for a reasonable rent increase.

Market or cost price rent

As market rent and cost price rent will usually differ from each other, the choice for one of these concepts is an important choice. The degree to which a cost price rent regulation is limiting depends on the way in which the cost price is calculated. If a low yield or return is assumed when determining the cost price, then it is relatively unattractive for investors to invest in the private rental sector. New landlords will not enter and there is a chance that existing landlords either dispose of the accommodation or decide upon minimal or no maintenance of the premises.

When the cost price rent is lower than the market rent, forms B and C offer the most protection for the tenant and thus the greatest yield limitation for the landlord. Cost price rent is not lower than the market rent by definition. Temporarily there could be a cost price rent which is higher than the market rent, for example in a housing market in which the supply of dwellings exceeds the demand for dwellings. In this case a landlord would probably prefer a cost price related rent regulation over a market rent related one.

4. Rent regulation in five countries²

In this section we describe the rent regulation schemes and tenant security implemented in the Netherlands, France, Spain, England and Germany. These countries were chosen because of differences in the size and features of the private rental sector: Germany for the large size of the rental sector, France for the medium size of the private rental sector, Spain and the UK for the attention policy makers show for encouraging the private rental sector, and the Netherlands for the relatively large share of institutional investors in the private rental sector³.

Before the country overviews, we first present the general development of the private rental sector in the five countries. Table 2 shows the development of the share of the private rental sector in recent decades. Germany stands out with a very large sector which has grown in recent decades also because of unification with East Germany. The previous social rental

² From Elsinga *et al.*, 2007 forthcoming

³ The selection was made for a study for the Flemish government. The aim of the study was to explore housing policy towards the private rental sector in a number of countries.

sector in former East Germany was labeled as private rental. In France the private rental sector decreased significantly after 1947 but has been stable since the second half of the eighties.

In the overall discussion on the development of the private rental sector, rent regulation and adjustments in rent regulation have played an important role. In the Netherlands, Spain and the UK the private rental sector decreased from over 50% to around 10% of the housing stock. In Spain and the UK this decrease is compensated mainly by home ownership, while in the Netherlands, the social rental sector also appeared to be an alternative for the private rental sector.

Table 2 Development of shares of the private rental sector

	Was	Early this century	Growth?
Germany	about 45% around 1950 in Western Germany	56, reunited Germany	Yes
France	34% in 1963	22	stable since 1988
Netherlands	61% in 1947	11	No
Spain	55% in 1950	11	No
United Kingdom	58% in 1938 (England)	10	yes, from 9% in 1990

Source: based on Elsinga *et al.*, 2007 forthcoming.

4.1 Netherlands

Background information

Reconstruction following the Second World War left an important mark on Dutch housing policy. Rent regulation was originally deployed as an instrument in wage policy. The primary objective of rent regulation was to ensure a certain level of buying power amongst the population.

When the most serious housing shortages diminished in the 1960s, a debate developed about the desirability of liberalizing rent regulation. However, such liberalization did not come about. In the overall period between 1950 and 1970 the affordability of accommodation in the rental sector was secured through a combination of supply subsidies and rent regulation.

A new instrument was launched in 1975: housing allowance. This allowance was actually intended as a temporary measure. The intention was to make rents more market conforming and to compensate the effects of this for the lower income groups through a means tested housing allowance. In this period the opportunity to harmonize rents was also implemented. In other words, when accommodation became vacant and thus available to let the landlord would be free to set the rent within the range of the so-called minimum and maximum reasonable rental. This possibility was tested in a limited number of areas and introduced across the Netherlands in 1976 (Van der Schaar, 1987).

In 1995 social landlords became independent and government no longer provided supply-subsidies. With the so-called conversion, loans from corporations and the government subsidies were offset against each other. Housing corporations are currently independent social entrepreneurs deploying their efforts towards housing lists particularly for those who are unable to provide accommodation for themselves (VROMraad, 2003).

In terms of the national government's affordability policy there remains the rent regulation for both the social and the commercial rental sector, and subject subsidies provided by the national government. In 1989 an important change did in fact occur in rent regulation. From that time the more expensive rental accommodation was liberalized. In other words rent regulations no longer apply for new rentals of dwellings with a rent higher than the so-called liberalization threshold.

Rent regulation and security of tenure

The current rent regulation encompasses a maximum rental rate and a maximum annual rental increase, and applies to both the social and the private rental market. There is however a maximum; dwellings with a rent higher than €615.01 (in 2006) fall within the so-called liberalized area and are exempt from the rent regulation. The liberalized accommodation comprises 5% of the housing stock.

The maximum rent for a dwelling is based on the so-called quality points. The points system provides a picture of housing quality. To a degree it involves objective characteristics of the home: the surface area and the home's facilities. The rental committee establishes the points for the housing conditions. Mainly considered here is the presence of facilities such as shops, public transport, schools etc. The maximum annual rent increase is the subject of political decision-making. In recent years it has been inflation plus a specific percentage. After years of stormy discussion about making rent regulation more flexible, in 2007 it was decided to implement a maximum rent increase of 1.1% (= inflation). The maximum annual rent increase applies to both social and private rental accommodation with a rent of maximum €615.01 (2006). A distinction was made between social and commercial landlords in one section of the rent regulations. This difference is for the total rent increase. For the social rental sector there is a so-called maximum average rent increase which is generally lower than the maximum rent increase. For 2006 the maximum rent escalation was 2.5%. Rent in the social rental sector averages 70% of the maximum rent. In the commercial sector rent is 83% of the maximum (Ministerie van VROM, 2003). Rents for most dwellings, certainly those in the social rental sector, are thus well below the maximum.

A lease in the Netherlands is generally for an indeterminate period. This means that at its commencement, neither landlord nor tenant knows how long they want the rental to last. Generally in the Netherlands a tenant has a one-month notice period. Although in the commercial rental sector there can often be leases of one-year minimum. A landlord may only cancel occupancy under specific circumstances, as described in the Civil Code, such as when a tenant does not behave as a good tenant or when the landlord urgently needs the home for himself. In other instances the landlord may thus not break the lease.

4.2 France

Background information

Within the French housing stock, 56% of the dwellings belong to the owner-occupancy sector, 38% to the rental sector and 6% to the 'other' category (this mainly involves farms and dwellings where occupants live free of charge). One can distinguish three segments within the French rental sector.

First there are the dwellings that are truly 'social', which means that they aim uniquely at the lower income segments of the population. These social rental dwellings are usually built with the help of subsidized loans only available to social rental landlords: the so-called HLMs (Habitations à Loyer Modéré) and the SEMs (Sociétés d'Economie Mixte).

There is an intermediary segment immediately above the social rental segment. Both social rental and private rental landlords may own dwellings in this segment. These landlords

receive a certain amount of financial state support, in the form of cheap loans, subsidies and/or fiscal concessions. In return for this support, landlords have to meet certain obligations with regard to setting rent and the income of the tenants.

Finally, there is an unsubsidized private rental segment. The rental dwellings in this segment are accessible to all households, regardless of income. Only this latter sector will be included here.

Rent regulation and security of tenure

In the unsubsidized private rental sector, leases are three years for individual private landlords and six years for institutional private rental landlords such as commercial companies (Donner, 2000, p. 270). The initial rent can be set freely for new or refurbished private rented properties. The initial rents of existing private rented dwellings are set on the basis of reference dwellings: dwellings in the same region with comparable characteristics to the rental dwelling for which the rent needs to be set. During the term of the lease, the annual rent increase cannot be higher than the INSEE index of reference rents. This is an index calculated on the basis of three other indices: the index of consumer prices, the index of maintenance and renovation costs and the index of construction costs.

At the end of the lease the tenant normally has the right to renew it, unless the landlord has a good reason for not doing so (for example because he or she wants to occupy or sell the dwelling). If the lease is renewed, the landlord can opt to have a new rent set based on reference dwellings. If the landlord does not take such initiatives, the former rent will remain in force. If the tenant does not agree to the new rent after renewal of the contract, a conciliation committee must try to resolve the conflict. If this committee does not succeed, the court has to decide (Langsether and Medby, 2005).

4.3 Spain

Background information

Spain is a country of homeowners. Of all Spanish dwellings, 81% are owner-occupied, 11% belongs to the rental sector and 8% belongs to the 'other' category (these are mainly dwellings provided rent-free). The large majority of Spanish rental dwellings are owned by private landlords. The share of the social or subsidized rental sector is very limited. Nevertheless this does not mean that there is no social housing in Spain. In contrast with most other European countries, Spanish social housing is mainly delivered through the owner-occupancy sector (see Hoekstra and Heras, 2007).

Rent regulation and security of tenure

Spain had very strict rent regulation for some time. This suddenly changed in 1985 when the Ley Boyer came into force and rent regulation was almost completely liberalized. But the new law produced insecurity for tenants and instability in the rental housing market. Rent regulation was thus revised once more.

The 1994 Urban Tenancy Act (Ley de Arrendamientos Urbanos) aimed at restoring a specific balance between tenants' and landlords' interests (Blas Lopes, 2004, p. 3). This law is still in force today. Its main components are described below.

In the Spanish private rental sector, the usual lease term is five years, although longer contracts are also possible. Leases shorter than five years are only possible if the landlord expressly states in the lease his intention of recovering the dwelling for personal residence at a given date. During the five-year term of the lease, it is automatically renewed annually. Tenants can end the lease by giving notice at least 30 days before the annual renewal. During the five-year period, landlords may only end the lease if the tenant does not pay his rent, severely damages the dwelling or carries out illegal activities (Blas Lopes, 2004, p. 11). But

the eviction of tenants generally requires long and complex juridical procedures. Partly as a consequence, many homeowners are reluctant to rent out their dwellings and there is considerable vacant accommodation in Spain (Hoekstra and Vakili Zad, 2006). Once the duration of the lease has been completed, if none of the parties serves notice of their intention to terminate the contract one month before it ends, the lease is renewed annually, up to a maximum of three years (Blas Lopes, 2004, p. 7).

Setting rent at the beginning of the lease is not subject to conditions. But during the first five years of the lease, the annual rent increase may not be higher than the index of consumer prices. For leases lasting longer than five years, parties are free to agree on new rent increase conditions after year five of the contract. But if nothing was agreed at the conclusion of the lease, the consumer price index will serve as the basis for the rent increases during the whole term of the lease (Blas Lopes, 2004, p. 40).

After the lease has expired, the landlord is free to decide whether he/she wants to keep on renting the dwelling, and if so, to which tenant (to the current tenant or to a new one). If the landlord decides to rent the dwelling to the current tenant, new negotiations about the rent take place. In principle, the landlord then has the opportunity to ask a significantly higher rent. However, if he/she is satisfied with the current tenant and this tenant wishes to continue occupancy, the rent in the new lease will often be very similar to the rent in the old contract.

4.4 England

Background information

The private rental sector, with a market share of 11.3% in England (2005) and a market share of 10.8% in all of the UK, has become an extremely heterogeneous sector (Kemp, 1998, 2004).. In contrast with most European countries the private rental sector also includes the so-called houses in multiple occupation (HMOs): accommodation with shared facilities, such as student housing. Bed-sitters are also considered HMOs. In 1996 about one-fifth of the more than two million private rental homes were HMOs. Accommodation provided by armed forces and health authorities, both public authorities, are also regarded as private rent. Thus the private rented sector is very diverse. An important characteristic is that about half of the accommodation is rented furnished.

In 1981 at 11% the UK private rental sector achieved the status of the tenure form with the smallest share of housing stock. In 1990 it bottomed out at 9.1% and after that it increased to 9.8% in 2000.

Rent regulation and tenant security of tenure

As in many other European countries, the shrinkage of the private rental sector since the early part of the last century can also be attributed mainly to strict rent regulation (Kemp, 1998, 2004). The Thatcher government which took office in 1980 intended to halt this trend, and introduced the so-called regulated tenancies where fair rents determined by rent officers had to balance the interests of landlords and tenants. With the 1988 Housing Act, rent regulation for new leases in the private rented sector was abolished. All new leases were to use market rents, to be negotiated between the tenant and the landlord. It seems to be customary that the landlord (or intermediary) makes a rent proposal, which the tenant will accept rather than negotiate about.

The 1988 Housing Act also introduced the concept that assured tenancies were to be the standard contract, while assured shorthold tenancies were allowed. This latter form of a contract is a temporary one with a length of the lease from six months to five years. From February 1997, all new tenancies were to be shorthold tenancies, unless otherwise agreed in writing. It is thus no surprise that at the beginning of this century assured shorthold tenancies

had reached a market share of more than half, with assured tenancies at around 15%, while regulated tenancies had decreased to about 5% (ODPM, 2004).

In practice most landlords will grant a tenancy for six months and will then extend the lease from month to month. Thus security of tenure has been reduced to six months (see also Cowan & Laurie, 2006 version). This security may even be broken if the tenant runs into excessive rent arrears, for instance. After the six-month period the notice to quit has been set at two months for the landlord, and at one month for the tenant.

4.5 Germany

Background information

Unlike most of the other countries under consideration here, Germany still has a large private rental sector (about 55% of stock in 2003). One of the reasons for this is its temporary bricks-and-mortar subsidy system. For this system the standard division of the housing stock used is based on whether bricks-and-mortar subsidies are provided for (new-build) homes (Haffner, 2005). Germany officially only has private landlords, who own 60% of stock (2003) and who let rented property, in some cases with bricks-and-mortar subsidies (about 5% of stock) in order to make rents (more) affordable. The subsidies are used to enable subsidized, rented homes to be let on a temporary basis. This ‘social rental’ system is not considered private rent for the purposes of this study, as rents are regulated in a separate system.

Rent regulation and tenant security of tenure

German law allows several methods of rent control in the private rented sector. For instance, rent changes for sitting tenants can be based on the rents of three similar rental dwellings. Or it can be based on a ‘Mietspiegel’, a database with local reference rents (Haffner, 2006). The bigger a municipality, the bigger the chance will be that there is a Mietspiegel in place (Deutscher Bundestag, 2003; Bundesministerium für Verkehr, Bau- und Wohnungswesen, 2001).

A Mietspiegel is a database that keeps track of non-subsidised rents agreed in all contracts between landlords and tenants in the four years before the reference date for the Mietspiegel. These rents collected and calculated for a Mietspiegel are known as local reference rents. These reference rents are based on the comparable characteristics quality of buildings and dwellings, and location.

The main purpose of a Mietspiegel is to enable rent increases to be set in line with market rents. In increasing rents, a landlord can use the Mietspiegel to find out what rents have been charged for homes of similar quality during the four years before the Mietspiegel’s reference date. The landlord sets the rent increases for his own property based on this. As the landlord has to obtain the tenant’s permission for any rent increase, the Mietspiegel makes this easier – a stronger judicial position. Rents for new leases are not formally bound by the local reference rents in a Mietspiegel; they can be negotiated freely, as long as they are not considered usury rents before criminal law.

Rent regulation for sitting tenants is important, because tenant security is strong. Tenancies are usually set for an indefinite length of the lease. The notice to quit for the tenant depends on the length of stay. The notice to quit for the landlord is set at a maximum of three months. But landlords may only terminate a tenancy for special reasons, such as a tenant causing trouble or the landlord needing the dwelling himself.

With the changes of the Rent Law Reform Law from 2001 it has become possible to compile a so-called scientific Mietspiegel instead of a normal one. Such a Mietspiegel has to be compiled along scientific lines and approved by the municipality or the umbrella organizations of landlords and tenants. It must also be updated after two years – inflation may

be used – and recompiled after four years. The advantage is that rent rises are easier to implement than with a normal Mietspiegel, especially where the rent is lower than the maximum local reference rent according to the Mietspiegel.

5. Countries compared

Table 3 shows an overview of the types of rent regulation that we found in these five European countries. Table 3 is adapted in comparison to table 1. The most important change that needed to be made was the distinction between running contracts and new contracts, instead of sitting tenants versus all tenants. No rent regulation is a type we also had to add. Finally we added information on tenure protection in the table; for the sitting tenants (existing contract) the length of the contract is shown in brackets.

Table 3 Rent regulation in five European countries, (length of the rent contract/lease)

	Cost price regulation	Market rent regulation	No regulation
New contract	Netherlands: regulated stock	France: existing dwelling	England, Germany, Spain, France: new or renovated dwelling Netherlands: regulated stock
Existing contract	Spain (5 year) France (3–6 year) Netherlands (permanent)	Germany (permanent)	England (6 months) Netherlands: non-regulated stock (permanent)

Table 3 shows that most new contracts are not regulated. The regulated sector in the Netherlands and new or renovated dwellings in France are exceptions. In France a market-rent-based regulation is applied. For the Netherlands we characterized the points system (a system reflecting the quality of the dwelling) as a kind of cost-based regulation. In most cases rent increases for sitting tenants are regulated. Spain and France protect sitting tenants with running contracts by increasing rents by an index representing inflation. In the Netherlands the maximum rent increase for the regulated stock is a political decision, and each year the government decides on the maximum annual rent increase normally expressed as inflation plus a certain percentage. Germany is the only country using a market-led rent regulation for running contracts. Rent regulation for sitting tenants with indefinite contracts is based on reference rents that follow market rents. If a Mietspiegel is in place, rents in fact lag behind because of the way they are determined. An extra regulation makes sure that rents do not increase by more than 20% in three years for running contracts. The UK is the only country without rent regulation for sitting tenants. All contracts are subject to market rents and tenant security is limited to six months. This effectively means that rents are not regulated and there is little security of tenure.

Finally, tenant protection differs between countries. In Germany and the Netherlands tenants enjoy rent protection without a time limit. In France and Spain there is a time limit on the

security of tenure, of 3 to 6 years in France and 5 years in Spain. In the UK the short lease contract with protection for six months is the standard contract in the private rental sector. There is no clear correlation between tenure protection and rent regulation. On the one hand there is the UK: low tenure protection and no rent regulation. On the other hand there is the Netherlands with high tenure protection and rent regulations which are as strong for sitting tenants as for new contracts. Germany appears to combine a strong tenure protection with a limited rent regulation (only for new tenants and based on market price). Spain and France are somewhere in-between.

In most countries rent regulation denotes protecting the sitting tenant with an ongoing contract. This arises from the idea that the tenant is essentially trapped if the landlord wields his market power to set the rent higher than the market rate. For new contracts such protection appears to be less requested.

In all the regulation types listed in table 3, it must be noted that the tenant is protected, and that in principle the landlord forfeits his maximum achievable yield in terms of the entirely free determination and adaptation of the rents. One also needs to realize that rent regulation will never provide protection for the landlord. If market rents fall below the floor of the regulation, the regulation will lose its function, at least if the market is somewhat transparent.

6. Balance between tenant and landlord?

Protection for the tenant at the expense of the landlord

Rent regulation offers the housing consumer protection against an increase in rents. The assumption is that the costs a tenant needs to make when relocating are higher than the costs of the landlord of finding a new tenant. Against the advantage for the tenant there is a disadvantage for the landlord. Rent regulation limits the yield or return for the landlord. If rent regulation is too strong and it is impossible for the landlord to realize a satisfactory return on his investment in the rental dwelling, he will withdraw (over time) from the rental market, so that supply will decline. Neither will new entrants be attracted to the rental accommodation market.

Rent regulation appears to specifically protect the tenant, and offers few benefits for the landlord. However there could be an indirect positive effect for landlords. A broadly accepted rent regulation could have a positive effect on the image and popularity of the private rental sector, and thus on individual landlords. Also, the rent regulation may aid the landlord in a turnover minimizing strategy that allows consistent returns.

Ultimately rent regulation is a compromise between protecting the tenant and protecting the landlord's yield requirements. On balance rent regulation is advantageous for society if the benefits for the tenant are greater than the costs for the landlord. The theoretical view shows that rent regulation can be deployed to compensate for market failures.

Different types of rent regulation

The above distinguished various types of rent regulation. Rent regulation offers more protection to the tenant against higher costs for the landlord, the greater the group of tenants falling under the regulation and the lower the reference rent is the lower the return on investment for the landlord. When we rank the five countries from least to most regulated, England must be regarded as the first. In essence this country does not have rent regulation for either existing or new contracts. Germany then follows with regulation based on the market rents for sitting tenants. Spain is next with a cost-price related regulation for sitting tenants, followed by France with a similar regulation for sitting tenants, but also a market-

rents related regulation for new leases. The Netherlands has the strongest regulation; both for existing contracts and for new ones it has a non-market-rate-related regulation.

A balance between tenures and the role of private renting

For landlords the private rental sector competes with other investments. If the return on investment is not satisfactory, private landlords may decide to invest in other assets as pointed out earlier. For the tenants the private rental sector is competing with other tenures in the housing market: home ownership and social rental dwellings. The balance between landlord and tenant depends on the role of private renting and the extent to which the private rental sector can be a satisfactory temporary or more permanent housing solution. This all depends on the total set of tenure arrangements: the features of the housing market, housing policy and the institutional context.

In Germany private renting seems to be more than a temporary solution; private renting is the major housing tenure. There is a stable balance between tenant and landlord by strong security of tenure and market-related rent regulation.

In the home-owning countries of Spain and the UK, private renting may in general be more of a temporary or second-best solution. Rent regulation for sitting tenants, more or less tenure security and in particular a satisfactory return on investment for the landlord are issues in the policy debate. Since the growth of home ownership appears to reach its limits and governments are aloof from investments in social housing, there is renewed housing policy interest in the private rental sector.

The Netherlands and France are somewhere in the middle; they are both countries with a larger social rental sector and a history of rent regulation. In both countries there has been a lively debate on rent regulation in the private rental sector in recent decades.

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