



Optimal rental market regulation

Dr. Peter Pontuch
DG Economic and Financial Affairs
European Commission

CUREMhorizonte, Zürich, 30 September 2015

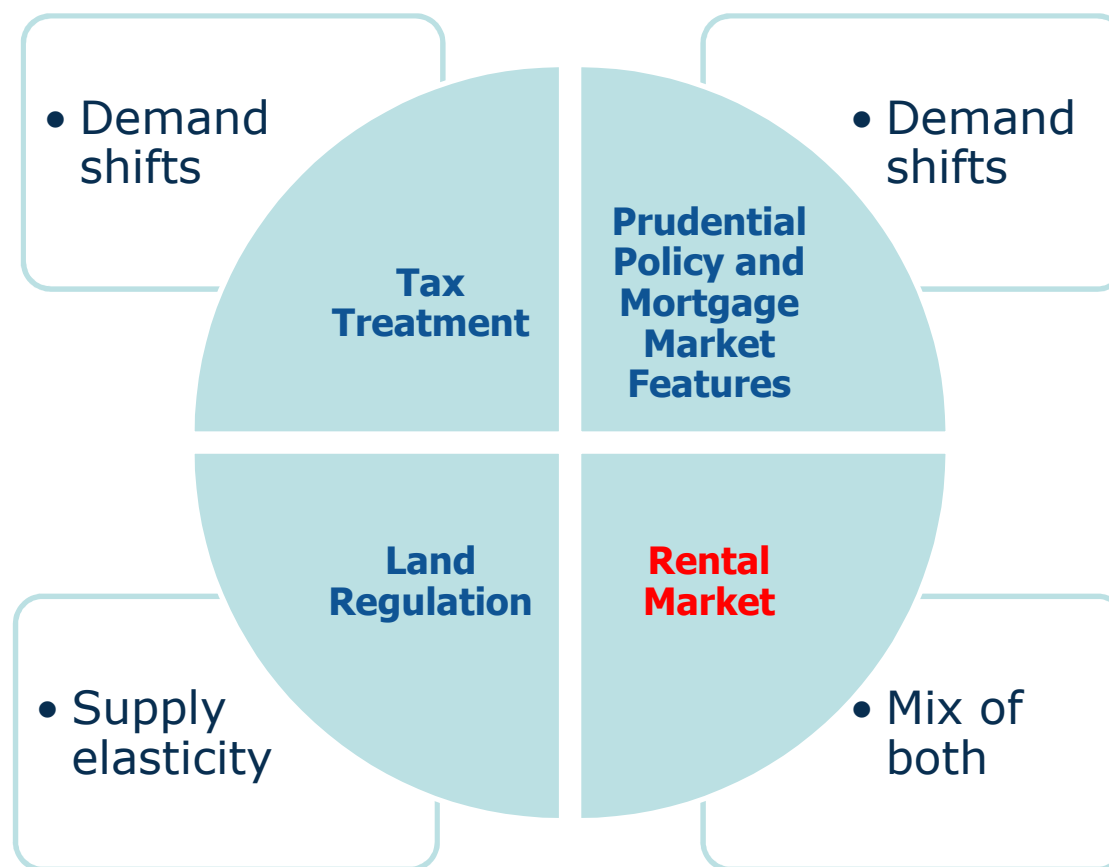




Housing and macroeconomic imbalances: some lessons learned

- ❑ **The link housing markets ↔ credit ↔ construction ↔ current account and competitiveness**
- ❑ **Housing market corrections have adverse impacts:**
 - Consumption and investment
 - Banking sector fragilities and restricted credit to the economy at large
 - Both economic and social distress
- ❑ **Homeownership and occurrence of crises**
 - Countries' starting points differ - historical "legacies"
 - Not high levels, but strong increases in homeownership tended to be associated with imbalances

Housing market demand and supply incentives





The value of rental markets

- ❑ **Key role in a healthy housing market "mix"**
 - As a housing option for credit-constrained households
 - Relevant in specific phases of a person's life-cycle
 - Labour mobility (within and between countries)
- ❑ **Importance for the overall housing market**
 - Rental affects incentives for housing supply (new and renovated)
 - Stabilisation effect on house prices (arbitrage between markets?)
- ❑ **Rental market regulation as part of an integrated housing market strategy**



Why we need rental market regulation

- ❑ **Protect the tenant and the landlord where they are vulnerable**
 - Landlord: mitigate asymmetric information, guarantee property rights
 - Tenant: need of predictability, reflect search&moving costs, social aspects

- ❑ **Need to align incentives for both parties to ensure that the market functions well**
 - Ensure a return on investment for the owner
 - Provide a genuine long-term solution for housing needs for the tenant



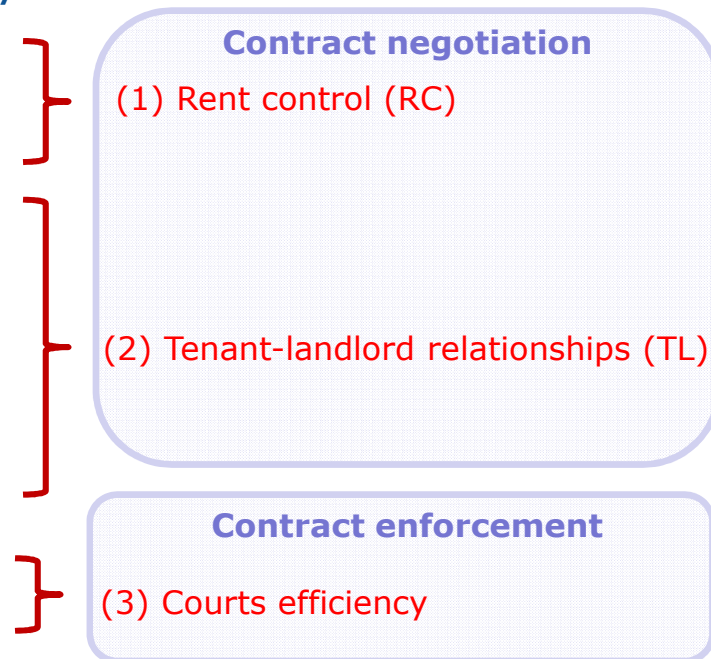
Main aspects of rental regulation

- Following previous OECD work 7 aspects in rental regulation were collected and analysed:
 1. Rental level control
 2. Rental increases control
 3. Deposit requirements
 4. Justified reasons for tenant eviction
 5. Eviction notification requirements
 6. Duration of contracts
 7. Procedural formalism

Extracting and identifying main dimensions

- Data analysis reveals three main components: rent control, tenant-landlord relationship, and court efficiency.

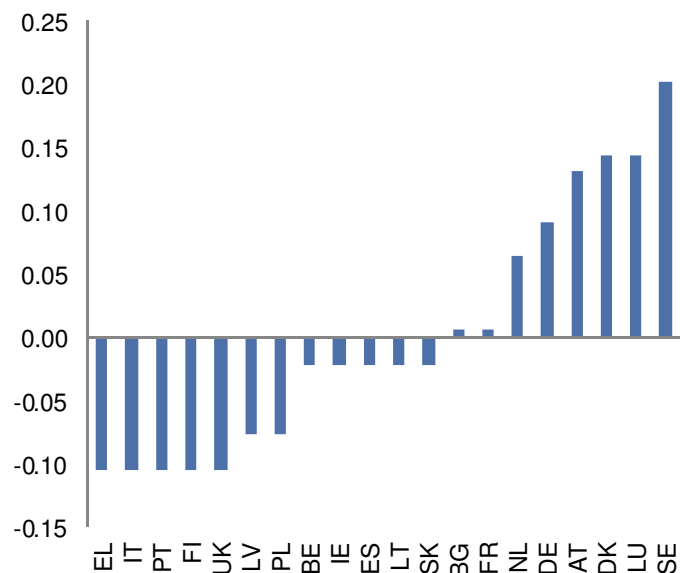
1. Rental level control
2. Rental increases control
3. Deposit requirements
4. Justified reasons for tenant eviction
5. Eviction notification requirements
6. Duration of contracts
7. Procedural formalism



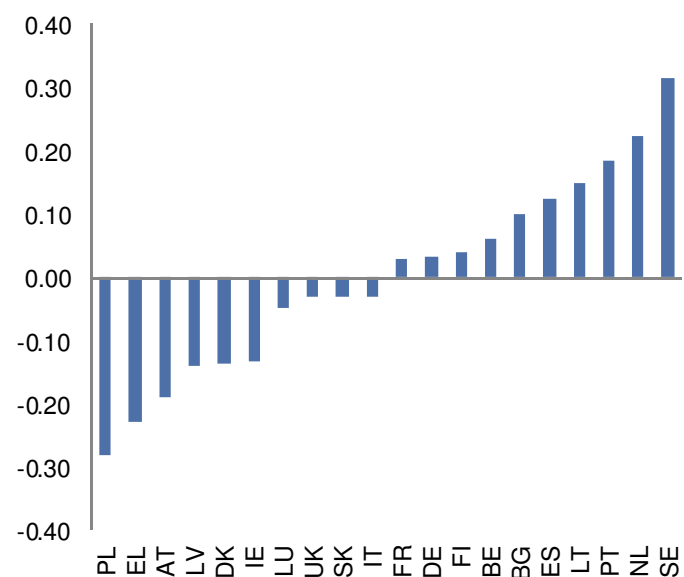
Composite indicators of rental market frictions

- Indicators measure the degree by which countries create frictions through rent controls or through restrictions of the tenant-landlord relationship.

Rent control friction indicator



Tenant-landlord relationship friction indicator



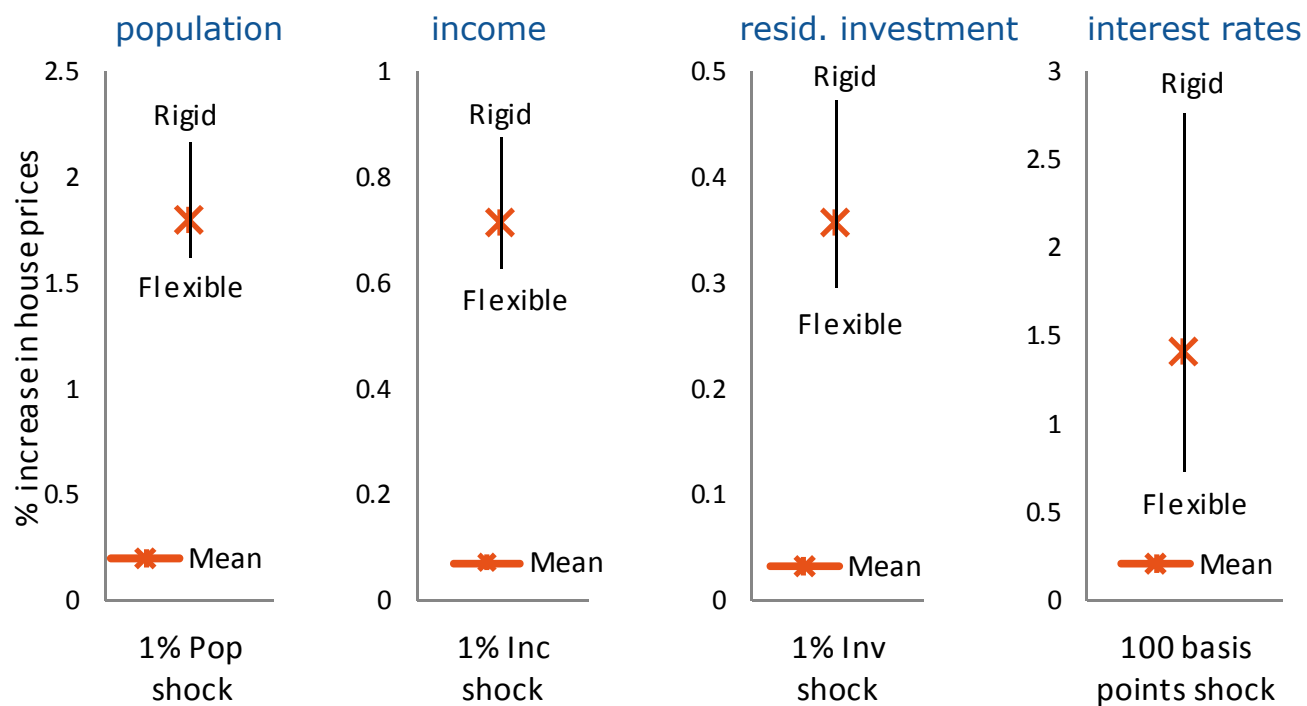


Effect on house price volatility

- The two indicators of frictions were used in a model of house prices on a panel of 15 EU countries (Cuerpo et al., 2014).
- **Main finding:**
 - ✓ Rent controls **amplify housing market volatility**: higher house price response to shocks to fundamentals (e.g. income, interest rates).
 - Possible transmission channels: low availability of rental dwellings, less responsive housing supply etc.
 - ✓ The regulations of tenant-landlord relationships have **less direct influence** on house price developments.
 - Balanced regulation can be used to ensure that a private market develops.

Effect on house price volatility

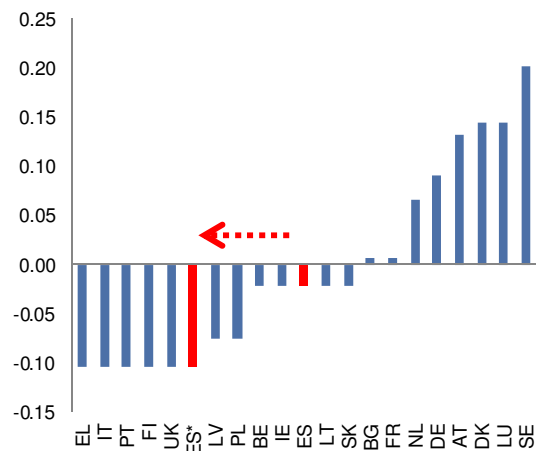
Response of real house prices to shocks under different rent control regimes (minimum, average, and maximum rent control in the sample)



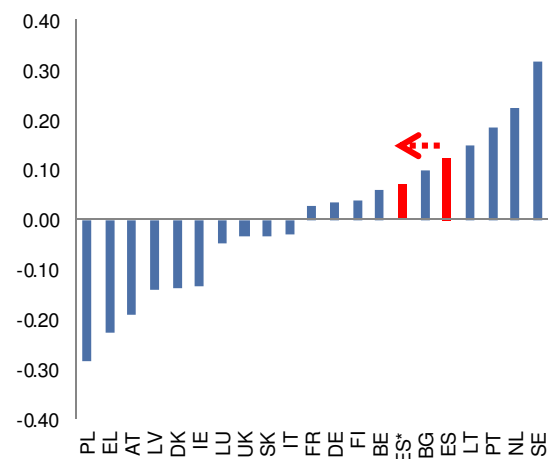
Rental market reform in Spain, 2013

- Liberalized rent-setting of new leases
- Minimum contract duration reduced to 3 years
- Termination by tenant anytime (notice and possible penalty), by landlord for personal use or if change of owner

Spain before and after reform, RC



Spain before and after reform, TL





Other recent rental market reforms

Some countries aimed at higher flexibility...

- Portugal: phasing out a long-standing rent control system
- The Netherlands: better linking rent changes to income (social rental) to encourage tenure mobility, refocus housing associations on social housing

...while others went for rent-control measures

- France and Germany recently introduced rent-control mechanisms in cities with tight housing markets
- Relative rent controls ("benchmark" rent levels), rather than absolute ones



Conclusion and policy recommendations

- Some ideas for an optimal rental market regulation:
 - ✓ Strict **rent controls** can hinder the functioning of the housing market (we can fix prices **or** quantities, but not both).
 - Potential adverse effects on housing supply.
 - More targeted policies seem preferable to pursue social objectives.
 - ✓ Qualitative **contract regulation** does not have an obvious negative impact on housing markets:
 - Balance between (i) security and predictability for tenants, and (ii) ensuring property rights for landlords.
 - Some asymmetry is needed (tenant: right to stay but flexibility to leave)
 - ✓ Efficient contract enforcement as a necessary condition for rental markets.¹³





Thank you!

