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Rent Certainty is not Rent control

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The housing crisis and the debate about rent control should result in a beneficial change to the regulation of the sector but the opportunity could be lost for want of clarity of thinking about the nature of rent certainty and the distinction between it and rent control.

At present rent is regulated by the Residential Tenancies Act 2004 (RTA 2004) which provides that rent can only change once a year and cannot be more than the market rent. Many argue a greater degree of rent certainty is required and that rent should not be allowed to increase by more than the Consumer Price Index for at least a number of years from the start of the tenancy. In a time of acute housing scarcity others see the necessity for freezing rents to prevent existing tenants who cannot afford rent increases losing their homes.

During World War 1 such a rent freeze was imposed by Rent Restrictions Acts and tenants were given security of tenure resulting in a form of rent control which endured for most of the 20th century. This made investing in residential property uneconomic for landlords and the state responded by directly providing social housing and heavily supporting owner occupation. Getting rent regulation wrong can lead to major problems.

As was the case during the early stages of the Celtic tiger in the 1990s, rapidly rising rents are now generating demands for legislative solutions to economic problems and rent control is again frequently put forward as a necessary solution to tenant difficulties. The then government created the Commission on the Private Rented Residential Sector and its report, published in 2000 recommended a reformation of the law to achieve a balance between the interests of landlords and tenants. This resulted in the 2004 Act. Then as now the research evidence about the adverse effects of rent control was abundant, unequivocal and compelling and rent control as traditionally understood was not recommended but the limited form of rent certainty mentioned above was.

It is predictable that rent controls coupled with long term security of tenure will act as a disincentive to landlords even if rents were indexed to the CPI. Landlords would not increase the supply of accommodation in response to increasing demand, the normal market response to rising rents, Indeed where possible it is likely that many landlords would get out of the market thus actually reducing supply and in a short time the housing problem would get even worse. Rent control would end up protecting existing tenants but at the expense of future tenants.

Many advocates for rent certainty fully appreciate the damaging nature of rent control and protest that they are proposing something very different. They point to other jurisdictions, often countries where renting is a significant feature of the housing system, and say that well thought out mechanisms for regulating rent increases do work.

The overwhelming evidence on the issue, it is argued, is against more far-reaching rent controls and not the modest measures of rent certainty they advocate.

Undoubtedly the case for rent certainty has merit and what might be called a weak form of rent certainty has existed here for more than 10 years. As we will see later this could be strengthened to the benefit of tenants and with limited or no real consequence for landlords.

Those opposing rent controls perceive any measure providing for more rent certainty as a thin edge of the rent control wedge and see the case against rent control as so compelling that it is best to hold the line.

This fails to recognise the crucial difference between rent control and a well thought out provision for rent certainty which must be understood if the debate can be moved on.

The starting point for this is to note that rent regulation of any sort is not practicable without some conjoined measure of security of tenure. Indeed it is not the control of rent which is the crucial impairment. Rather the problem is the enforced continuation of the tenancy at the tenant's discretion on a restricted rent which can differ from the market rent usually to the benefit of the tenant. This creates an incentive, if not an imperative, for the tenant to stay in their accommodation however unsuited it becomes for their needs and would result in a long term loss for the landlord. This is the factor reduces the willingness of investors to provide additional accommodation even if rents are rising.

Understanding the motivation of landlords is crucial here. A property investor has a number of objectives. The first is to get an annual return which is comparable with investment returns from other investment media. Other such returns can increase with market conditions as would rent in a free market. The second is to benefit from any increase in capital resulting from the general increase in property values resulting from economic growth. A third objective is to have an investment that can be disposed of quickly for full value in the event of the investor's circumstances changing or should they judge that alternative investment media will produce better returns. The supply of rental property is dependent on the investment being attractive both in rental and capital terms and on liquidity, the ability to turn the investment into cash quickly.

The advocates of rent control argue that the investment can be protected by rent indexation. True but not wholly true. Investment value is determined by a multiple of the passing rent which if it was below the market rent would result in a loss to the landlord.

Moreover there is a problem when rents fall relative to the CPI. The passing rent of a controlled tenancy could be above market rent and tenants would leave. For landlords to get the benefit of indexation tenants would have to be forced to remain paying rents higher than those prevailing in the market. This is akin to what happened in the commercial sector and gave rise to the abolition of upward only rent reviews. Such a measure is not likely to be provided for in legislation and nor should it. Hence in reality, landlords know that they will not benefit from the certainty indexing is supposed to provide.

All this suggests that simply indexing rents for the duration of a tenancy would not work and points to the need for rents to be periodically rebased to market rates if a measure of rent certainty were to be introduced. It also suggests an option.

As noted above the RTA 2004 currently provides for some security of tenure and a limited regime of rent certainty. Rents can't be higher than market rents and can't be increased more than once a year. These arrangements could be reformed by providing that for the duration of the statutory four year Part 4 Tenancy, the rent could only increase along with the CPI but at the end of that tenancy the rent would be rebased to the market rent.

This would change the terms and conditions of the bargain between landlords and tenants at the outset of the tenancy. The rent on these terms would be set in a free market by the interactions of landlords and tenants and as such is not controlled.

By way of analogy the state sets the terms and conditions of transactions between buyers and sellers of goods and services by way of the Supply of Goods and Services Act which specifies the terms and conditions of trade but does not determine prices which are left to the market.

Fixing the rent to the CPI for the duration of the Part 4 Tenancy changes the statutory terms and conditions of a rental agreement. It does not control the rent. The rent will be determined in the market and would reflect the new statutory regulation. Such a measure would improve the rental sector by giving both landlords and tenants greater certainty.

Similar provisions exist in other jurisdictions with very active investment interest in residential property. Indeed in Germany at present where rent certainty similar to the proposal above exists, unprecedented amounts of capital are now available to finance property groups investing in residential investment.

Where a property was let at a market rent or where vacant possession could be obtained readily, a purchaser would be largely indifferent to the encumbered state of the property and the market price would be largely the same whether the property was sold with vacant possession or tenanted. An investor would achieve their objective by buying the property with the tenant in situ and an owner occupier could deal with the situation after purchase if necessary.

Under the proposed regime of rent certainty a landlord gets market rent and if needed can recover vacant possession and sell for full value at market prices. This contrasts with rent control where the value of the property will be permanently impaired and the rental return compromised with the combined effect of reducing the incentive to invest in residential property to the detriment of all but those tenants in occupation at the time the rent control is imposed.

October 29th 2015