

# Rent Stability in the Private Rented Sector Final Report



Prepared for  
The Housing Agency  
on behalf of the  
Private Residential Tenancies  
Board  
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## GLOSSARY OF TERMS

ALUR	Accès au Logement et un Urbanisme Rénové (Access to housing and urban renovation)
BTL	Buy to Let
CGT	Capital Gains Tax
CSO	Central Statistics Office
DECLG	Department of the Environment, Community and Local Government
DHCR	Division of Housing and Community Renewal
DOF	Department of Finance
DPER	Department of Public Expenditure and Reform
DSP	Department of Social Protection
ETPA	Emergency Tenant Protection Act
FMR	Fair Market Rent
HAP	Housing Assistance Payment
HUD	Housing and Urban Development
ITSP	Interim Tenancy Sustainment Protocol
LHA	Local Housing Allowance
LTV	Loan to Value
MBR	Maximum Base Rent
MIR	Mortgage Interest Relief
NPPR	Non-Principal Private Residence
PPRR	Principal Private Residence Relief
RAD	Rental Accommodations Division
RAS	Rental Accommodation Scheme
REIT	Real Estate Investment Trust
SWA	Supplementary Welfare Allowance
TCA	Taxes Consolidation Act
TDR	Test Discount Rate
VAT	Value Added Tax

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Any errors or omissions in the report are solely the responsibility of the authors.

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## EXECUTIVE SUMMARY

*This report sets out to examine the potential for rent regulation in an Irish context should a political decision be made in favour of rent regulation*

- This is the first of two studies on the private rented sector which considers short term and medium to long term options to address the recent escalation in rents, predominantly in the Dublin area<sup>1</sup>. It examines a range of issues in regard to rent stability; including the current tax treatment of the rental sector, the potential for indexation of Rent Supplement and the potential for rent regulation in an Irish context should a political decision be made in favour of rent regulation. The findings are informed by a comprehensive review of rent regulation in other jurisdictions with a developed private rented sector, which examines how they are administered, the pros and cons of different approaches and their impacts.

*Approximately one in five households now renting their home in the private rented sector*

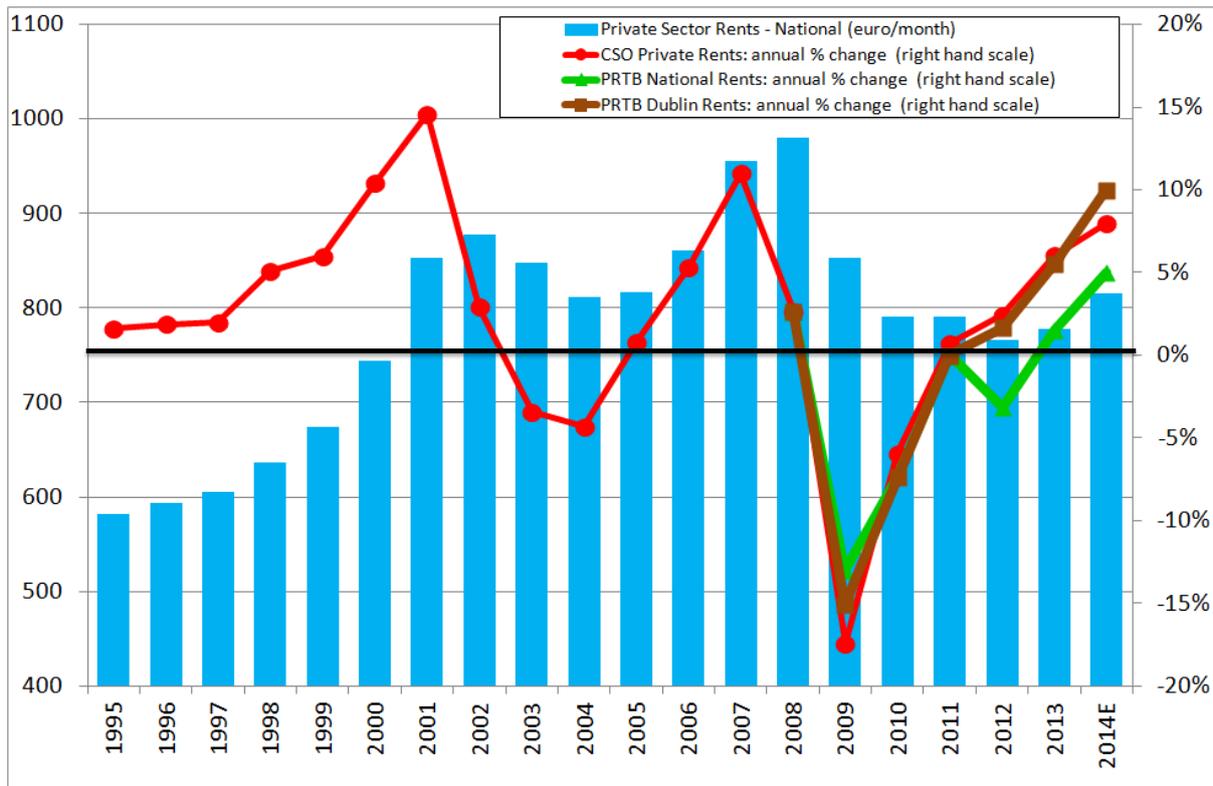
- The rented sector has grown considerably in recent years, almost doubling in size between 2006 and 2011, with approximately one in five households now renting their home in the private rented sector. Increasingly the sector is providing housing for a wide range of households, including households who have postponed house purchase due to a variety of reasons, and others who have lost their homes during the recession, as well as students and individuals and households who choose to rent by choice. The sector also provides homes for those whose rents are paid for by the State through the Rent Supplement and Rental Accommodation schemes.
- As a result the demands on the private rented sector have increased substantially in recent years with the result that the current most pressing problem is how to increase the supply of private housing for rent, particularly in urban areas and most notably in Dublin. However, the underlying assumption is that the level of supply of rented accommodation or social housing will not increase in the short-term and some 'quick-win' solutions are required in the interim to address the recent escalation in rents in Dublin. This is giving rise to significant difficulties for vulnerable households in the Dublin area, a number of whom are being squeezed out of their homes.

*The escalation in rents in a Dublin phenomenon with a clear divergence between the performance of rents in Dublin and in the rest of the country*

- The impact of the economic recession on rent levels is apparent from the PRTB Rent Index data which shows that average rents across the State declined from a value of €1,020 in Q4, 2007 to €762 in Q1, 2013 or by 25.3 per cent. However, rents have been increasing again since 2013 and by Q1 2014 had increased by 3.5 per cent year on year. Rents nationally in Q1 2014 amounted to €788 per month which is in line with levels last seen in 2000.
- In Dublin, the peak to trough decline in average monthly rents was 26 per cent, with rents down from a value of €1,325 in Q4, 2007 to €980 in Q4, 2012. Dublin rents began to recover during 2012 with the annual rate of increase accelerating throughout 2012 and 2013. By Q1 2014 average rents in Dublin were increasing by 8.4 per cent. Rents in Dublin amounted to €1,107 per month in Q1 2014 which is in line with 2009 levels. Using the monthly CSO longer time series for private rents in urban areas, average rents were up by 9.2 per cent in the first seven months of 2014.
- In contrast outside Dublin, the PRTB index shows the annual growth in monthly rents is much more subdued, recording growth of 0.8 per cent in Q1, 2104 when compared with Q1, 2013.

<sup>1</sup> The forthcoming study on the Future of the Private Rented Sector will address supply side issues.

**Figure: 1.1 Trend in Average Private Rents in Dublin and across the State, 1995-2014E**



**Affordability differs depending on whether you are renting in Dublin or outside Dublin, and whether you are renting as a single person or as a couple, where both are working**

- The analysis of affordability suggests that renting as a single person in the Dublin market is not affordable and has not been so for some time. A single person on average earnings of €36,000 paying the monthly rent of €957 for a 1 bed apartment in Dublin would be allocating 41 per cent of net income to the cost of renting. This is the highest proportion of income allocated to rent since 2008, when rents were at their peak.
- Assuming gross earnings are around 70 per cent below the average for a single person (€25,000), affordability would be closer to 55 per cent, which is well above what is deemed to be a sustainable rent (30 per cent of net income). Although affordability for lower income individuals, irrespective of their sector of work would be higher, the likelihood is that single income workers would share with other persons, although this may not always be possible or desirable for some individuals.
- Households earning below the average income are also facing affordability problems in the main cities, most notably Dublin, as competition from medium and high income households is squeezing them out of the market plus there is an inadequate supply of housing at rents these lower income households can afford.

**Market failure in the housing sector generally refers to a situation where there is an inefficient allocation of resources**

- The rental market is particularly prone to market failure due, for example, to information failures between landlords and tenants, changes in or abuse of market power; and delays in adjusting the supply of housing to meet changes in demand.

- The main rationale generally put forward for regulating rents is due to the inadequate housing supply to meet a growing demand, with the associated price escalation negatively impacting on tenants, particularly those on lower income and in receipt of Rent Supplement.

#### ***Market interventions in the form of rent control have evolved over time***

- First Generation Rent Controls introduced during the World Wars sought to mitigate the negative impacts of a shortage of housing by essentially imposing a freeze on rents.
- Due to the negative impacts associated with First Generation Rent Controls, many jurisdictions subsequently amended the regulations to Second or Third Generation Rent Controls or in some cases there was a complete reversal of these policies.
- Second Generation Rent Controls, which permit allowable increases in rent levels or Third Generation Rent Controls, which involve the control of rent increases within tenancies and tenancy decontrol between tenancies, are the most common forms of regulation found today.

#### ***The theoretical justification for rent regulation is relatively weak and is attributed to the unintended consequences which arise for tenants***

- The practice of changing regulations in response to market failure does not address the underlying cause of the problem, namely a lack of supply. Moreover the potential for negative impacts arising from rent regulation can include black market transactions, lower quality housing, reduced mobility and more importantly a negative impact on new and existing supply.
- It is recognised, even with 'perfect' third-generation regulation, which in principle can benefit both landlords and tenants, that there is likely to be a negative impact on supply.

#### ***Any assessment of the performance of rent regulation in isolation from the overall intricacies of the wider housing market is tenuous***

- Recent research on rent regulation by the European Commission acknowledged that the rented sector sits in a broader framework of the housing market and advised policymakers, considering setting controls on both rent levels and rent increases, to bear in mind their broader implications for housing market stability. The Commission stated that such regulations should be considered within the context of existing incentives, subsidies, taxation, the attractiveness of other tenures and other relevant financial regulatory measures.
- Of the jurisdictions reviewed, it is evident that regulations have had varying effects on the individual markets, which in many cases have reflected the stringency of the regulatory environment as well as government policy within the jurisdictions.
- It is apparent that those jurisdictions that have strong rent regulations and a strong private rented sector also have an equitable taxation system in place and in some cases generous depreciation allowances, fiscal benefits and subsidies to promote investment.
- Other factors have also played a role in the performance of the private rented sector. Access to credit and low interest rates have been a factor in attracting investors to the sector, while the efficiency of the planning process has also been noted as a key factor in attracting investment and, in some jurisdictions, a factor in the lack of construction.
- Nevertheless, it is also evident that in some cases there are negative impacts associated with the introduction of regulations, notably unscrupulous behaviour by landlords, black market transactions and the potential for lower quality stock.

***A key feature in the delivery of social housing has been the emergence of Rent Supplement in the provision of long term housing support***

- The Housing (Miscellaneous Provisions) Act 2009 specifically sets out the role of the private rented sector in supporting social housing. This support is provided mainly through the Rent Supplement scheme, the Rental Accommodation Scheme (RAS) and through the leasing initiatives by housing authorities and approved housing bodies. The recent introduction of the Housing Assistance Payment (HAP), which is currently being piloted in Limerick, will also see the private rented sector continue to play a key role in the future of social housing provision.
- There are currently 74,000 persons on Rent Supplement which costs the State €344m in 2013. A total of 43,000 of these recipients are waiting to move over to the Housing Assistance Payment. It is clear that the Rent Supplement Scheme, contrary to its objectives, as a short term income support, is now being used for people who have a long-term housing need, with 57 per cent of recipients receiving Rent Supplement for more than 18 months.
- Given the role now being played by Rent Supplement in meeting long term housing need, it is unsurprising that the number of recipients and the overall cost of the Scheme have increased in the past decade, albeit this has been alleviated somewhat in recent times.
- The decline in costs and numbers is primarily due to the slow economic recovery, the continued migration of long term recipients to the Rental Accommodation Scheme (RAS), the realignment of the minimum contribution to the Differential Rents offered by local authorities<sup>2</sup> and from rent limit reviews.

***The maximum rent limits reflect the national average proportion of Rent Supplement tenancies in the private market***

- Rent limits provide a benchmark for the Department's staff in their respective areas; however these can be adjusted to reflect local market conditions and the circumstances of recipients.
- Other jurisdictions also operate similar methodologies in setting rent assistance payments albeit there are some differences, most notably; limits are reviewed once a year or more often in other jurisdictions, there are penalties for over-consumption of housing (UK) while the rental assistance payment does not affect the amount of rent a tenant wishes to pay for accommodation (USA and UK).
- A number of analyses of Rent Supplement rent limits relative to the 35<sup>th</sup> percentile of market rents suggest that rent recipients seeking accommodation are likely to find it increasingly challenging in sourcing accommodation within the rent limits for certain areas of Dublin. However, this appears to be largely confined to the Dublin area and undoubtedly reflects the wider issue of a lack of supply in the Dublin market.
- It is acknowledged that a short-term temporary measure has been put in place, notably the Interim Tenancy Sustainment Protocol (ITSP)<sup>3</sup>, to help family households in Dublin who can no longer afford their Rent Supplement accommodation. There is already an existing measure under Article 38 of the Social Welfare Regulations 2007 which allows payments to be made in exceptional cases to Rent Supplement claimants across all household types.
- Notwithstanding the above for Rent Supplement recipients, it must also be acknowledged that there are currently no measures in place to help low-income households who are in employment and are not receiving any form of State support but need to be accommodated in the private rented sector.

<sup>2</sup> This has meant that an individual is being asked to pay more for their Rent Supplement dwelling than in the past. However, Minimum Contribution levels are still on the whole below the costs of differential rents

<sup>3</sup> It is understood that a Tenancy Protection Service operated by Threshold on behalf of the four Dublin local authorities has received over 1,700 calls since its establishment in June 2014 with 740 families assessed by Threshold as being at imminent risk of homelessness, in most cases because they can no longer afford their Rent Supplement accommodation.

***The mortgage arrears problem is one of the biggest remaining challenges from the financial crisis***

- A feature of the Irish rental market in the Celtic Tiger era was that the main factor which motivated investors in the buy to let sector was future price growth. However, with the benefit of hindsight, neither high yields nor high capital growth have materialised for investors who bought buy to let properties in the past decade. Their situation has been further compounded by the adverse changes in taxation since 2007.
- The mortgage arrears problem is one of the biggest remaining challenges from the financial crisis which is having an impact on tenants. There were 39,669 BTL loan account in arrears at the end of June 2014 out of a total of around 144,000 BTL mortgage accounts. This figure represents 27.5 per cent of the total BTL mortgage loan accounts or 13 per cent of the total estimated stock of 305,377 units (Census 2011) rented from private landlords. With 144,187 BTL mortgage accounts, this would imply that 104,518 are not in arrears and 161,190 or almost 53 per cent have no mortgage.
- Many of these loan accounts originated between 2003 and 2008, with 2006 accounting for the largest proportion in this group. The BTL sector also has a high concentration of interest-only mortgages, particularly in Dublin, 82% of which are in negative equity. A pressing issue for the buy to let sector is that a significant number of BTL mortgages due to revert to principal and interest repayments in the next twenty four months may further fuel the arrears problem, notwithstanding the improving macroeconomic situation.
- The capacity of rents to meet the much higher principal and interest repayments is an issue which either requires a quick resolution of the BTL arrears or higher rents, which in some cases may be very high and thus have adverse consequences for tenants. Equally the introduction of rent regulations in such a scenario could lead to further arrears. There is a further risk for those investors in arrears if mortgage interest rates begin to rise anytime soon. All of these issues have adverse implications for the supply of rented housing.
- Currently there are no resolution strategies in place for buy to-let (BTL) mortgages, which in many cases is negatively impacting on tenants where properties are in receivership.

***The fiscal changes in the period between 2007 and 2014 have increased substantially the tax burden on the part of landlords***

- The fiscal changes in the period between 2007 and 2014 have increased substantially the tax burden on residential landlords, particularly for those landlords with borrowings taken out in relation to the purchase of investment properties. The restriction on deductions and increased tax [including USC and local property taxes] charges may justify increases in gross rents of approximately 20% to 24%, depending on the personal circumstances of a landlord.

***The tax regime for landlords investing in the residential investment sector is in the main less favourable than for investors in commercial investment property.***

- The main disadvantages arising are in relation to investors of residential investment property who are seeking to utilise borrowings to assist with the purchase of such properties. An interest deduction of 75% as against 100% for the commercial rental sector is the main disadvantage, although the lack of deduction for local property taxes also represents a less favourable position for landlords.
- Without levelling the investment outcomes for individuals leveraging such purchases with investment in the commercial property sector, there is a potential barrier to entry for investment into the private rental sector.

***The medium and long term consequences of capping rents under any rent regulation option may eventually give rise to higher rents in the free market when the market becomes deregulated, due to the potential negative impact on supply***

A total of six rent regulation options to address the issue of rent stability were examined in an Irish context, based on rent stability regulations in place in other jurisdictions. These are summarised below in Table A and Table B sets out their pros and cons and their expected cost to the Exchequer, where these can be determined.

**Table A: Rent Regulation Options**

OPTION	MODEL	INITIAL RENT	RENT INCREASE	TENANCY DURATION
1	Full Rent Control	Set at a level based on historic date to be determined	N/A	N/A
2	Indexed to CPI	Determined by free market	Indexed to CPI	N/A
3	Indexed to CPI within a Tenancy	Determined by free market initially, reverts to prevailing market rent at end of tenancy plus 10% due to supply constraints	Indexed to CPI	4 years
4	Frontloading	Determined by free market initially, plus frontloading of 10% at beginning of tenancy. At end of tenancy rent reverts to prevailing market rent plus frontloading of 10% plus a further 10% due to supply constraints	Indexed to CPI	4 years
5	Variant of German system for 4 years only	Capped at 5% above the average market rent at beginning of tenancy;	In line with the increase in average market rent under this scenario	4 years
6	Operating cost recovery	Determined by free market	In line with the increase in landlords' operating costs	N/A

- The impacts of the regulation were assessed against the trajectory of rents in the free market by looking back retrospectively in the 2000-2014 period to ascertain what would have transpired for rents in Dublin had some form of rent regulation been introduced at that time. The regulated rents derived under each option represent the maximum rents landlords would charge. However, the market and macroeconomic conditions may be such that the actual regulated market rent may, in terms of what tenants are willing to pay, be below this maximum level.
- The period under consideration captures the unprecedented boom in the housing market and the catastrophic bust which followed post 2007. The level of new housing supply increased from around 50,000 in 2000 to over 93,000 at the peak (2007). With 25 per cent of all residential mortgages going to investors in the period 2005-2008<sup>4</sup>, the outturn for housing supply in a rent regulated market could have been very different.
- The likelihood is that the immediate announcement of rent regulation would give rise to the expectation amongst landlords that regulated rents would be lower than what they would otherwise be. The analysis shows that, in reality, that this may not always be the case.
- Average regulated rents in the short term (2000-2003) increase under all six options by less than the free market rent, albeit marginally, with option 6 (operating cost recovery) increasing by the least amount (3.8%). However, the medium and long term consequences of capping rents under either option may eventually give rise to higher rents in the market when the market becomes deregulated, due to the

<sup>4</sup>The Irish Banking Federation has only been measuring the breakdown of loans issued for the purchase of residential property since 2005.

potential negative impact on supply. The latter assumes there are no corresponding measures to protect the existing stock and encourage new supply during the regulated period.

- Overall the annual average percentage change in actual rents over the full period was 0.8 per cent. The corresponding percentage changes are higher in all other Options. However looking at the increase in regulated rents in each four year tenancy: under options 3 and 4 average rents increase by 4.3 per cent per annum in the first four years (2000-2003), 3.8 per cent in the second four years (2004-2007) and fall by 1 per cent per annum in the third four year tenancy (2008-2011). As rents return to the prevailing market rent at the end of each tenancy and assuming there is a reduction in supply, there is a 10 per cent increase in each tenancy decontrol period.
- Average regulated rents in the short term (2000-2003) increase under all options by less than in the unregulated or free market, albeit marginally, with Option 6 increasing by the least amount (3.8%).
- In an assessment of regulated rents versus the unregulated or free market, regulated rents under options 2, 4 and 6 are almost always higher than the free market while rents under option 3 and 5 are higher than the free market from 2004 onwards.

***Rent regulations should lead to a decrease in rents, increasing the attractiveness for tenants and thus boosting demand***

- Tenants are protected against sharp increases in rents and tenure security should be enhanced. The reduced rents, however, result in a reduced supply of rental accommodation due to the impact on landlords' profitability and on rental yields. The size of the rental stock should be lower as a result, a development which would keep upward pressure on rents, notwithstanding the regulation in place.
- None of the options generate a better outcome for the tenant (in present value terms) compared with the unregulated or free market. Option 2 is very close to the free market option with the other options, 3, 5, 6 and 4, in that order, generating higher present values than the free market, leaving the tenant worse off under these options, particularly under option 4. Conversely the best option for the landlord would be option 4, where the maximum income is generated; the worst options being the free market, where the least income is generated (excluding the full rent control option).

***The overriding concern in the Irish market is that any form of rent regulation could potentially reduce the supply and quality of rented accommodation and thus distort the market further, in the absence of any incentives to stimulate supply***

- The impact of rent regulation on supply is uncertain as in any dynamic housing market there will be a range of diverse factors which impact on housing demand and supply. However an analysis of the supply impacts under each option shows that potentially between 52,000 and 89,000 rented properties could exit the sector over time due to the impact on net yields for landlords. Rents tend to be higher the greater the contraction in supply, due to black market transactions.
- The introduction of rent regulation would also affect the efforts to attract new investment in the Irish rented sector, for example as rent regulations would reduce property values and would impact on the pricing equation for foreign investors and their banks. This could lead to a further recapitalisation being required by banks by increasing the write-downs they would have to take on their BTL portfolios.

***Options for achieving rent stability and certainty***

In addition to consideration of the potential for rent regulation, a set of policy options are set out to achieve greater rent stability and certainty in the Irish market. These other measures are focused on

- ✓ Providing better information to ensure the sector is more informed,
- ✓ Improving the situation with respect to the review of rents and the determination of Rent Supplement limits,
- ✓ Enforcing what legislation is in place under the Residential Tenancies Act 2004,

- ✓ Protecting the existing stock,
- ✓ Increasing the supply of rental properties, and
- ✓ Providing targeted tax incentives.

Table C overleaf set out the options, their pros and cons and impacts where these can be determined.

**Cost of Tax Incentive and Rent Stability Measures versus Savings from Rent Regulation**

- Table D summarise the relative costs to the Exchequer of the various rent stability options against the savings generated by the introduction of some form of rent regulation. The total cost, assuming Rent Supplement is increased in line with the free market, is estimated at €16.5m. Taking the cost impact on Rent Supplement under each rent regulation option, the total savings versus the free market are ascertained. The savings range from €23.7m under the full rent control option to an additional cost of €37.8m under the frontloading option. This higher cost reflects the increase of 11 per cent in regulated rents in the first year under the frontloading option. The lowest impact arises for options 2 and 3, with a cost of €3.4m reflecting the current historically low rate of inflation of 1 per cent. With Option 6, following a review of the latest components of the operating cost index using the CSO indices, operating costs have declined by 2.9 per cent in the seven months to July 2014. Assuming an annual decline of the same magnitude would generate a saving in Rent Supplement of €10 million.

**TABLE D: RELATIVE COST FOR EXCHEQUER OF TAX INCENTIVES AND OTHER RENT STABILITY MEASURES VS. SAVINGS FROM RENT REGULATION IN A FULL YEAR**

	Impact on Dublin Rents in Year 1	Impact on Rents in Rest of Country in Year 1	Overall Average Change in Rents in Year 1	Short Term Impact on Rent Supplement Cost
				<b>€m.</b>
<b>Total Current Cost of Rent Supplement</b>				<b>344</b>
<b>Impact of Options on Rent Supplement cost:</b>				
Unregulated/Free Market	10.0%	2.0%	4.8%	16.5
1. Full Rent Control (rents at 2000 level)	-18.2%	-0.8%	-6.9%	-23.7
2. Rent Indexed to CPI	1.0%	1.0%	1.0%	3.4
3. Indexed to CPI within a Tenancy	1.0%	1.0%	1.0%	3.4
4. Frontloading	11.0%	11.0%	11.0%	37.8
5. Variant of German system	3.8%	4.3%	4.1%	14.1
6. Operating Cost Recovery	-2.9%	-2.9%	-2.9%	-10.0

**Summary**

The private rented sector has experienced significant growth in the past number of years with one in five households now renting in the private rented sector. However recent trends indicate that the sector is becoming increasingly constrained, as evidenced by trends in rising rents which, in turn, are impacting on affordability, particularly in Dublin. The mortgage arrears problem is one of the biggest remaining challenges from the financial crisis, particularly for the BTL sector which continues to show an escalation of the number of arrears cases and currently lacks any resolution strategy. While the impact of rent regulation is uncertain, given where the Irish housing market is at present, the introduction of rent regulations in Ireland is likely to exacerbate the current problems being experienced in the market.

Table B: Summary of Rent Regulation Options

RENT REGULATION OPTION	PROS	CONS	COST FOR TENANT (PV of Monthly Rent for Dublin Tenant 2000-2014 in 2014 )	IMPACT ON NEW SUPPLY (in absence of any incentives to encourage supply)	LEGISLATIVE ROUTE/ ISSUES	CONSTITUTIONAL RISK	TIMING SENSITIVITY	REGULATORY AUTHORITY
UNREGULATED / FREE MARKET	<ul style="list-style-type: none"> <li>Rents determined by demand and supply</li> <li>New supply would not be adversely impacted</li> </ul>	<ul style="list-style-type: none"> <li>Current market failure not addressed</li> </ul>	€23,352	Positive	<ul style="list-style-type: none"> <li>N/a</li> </ul>	<ul style="list-style-type: none"> <li>N/a</li> </ul>	N/a	<ul style="list-style-type: none"> <li>PRTB under RTA 2004 with further reference to Courts</li> </ul>
1. Full Rent Control	<ul style="list-style-type: none"> <li>Rent ceiling at or below market clearing rent</li> </ul>	<ul style="list-style-type: none"> <li>Fall in rents leads to a reduction in rental units</li> <li>Reduces level of new investment</li> <li>Reduces investment in stock and hence quality</li> <li>Distorts housing market by incentivising owner occupancy</li> <li>Reduces housing and labour mobility</li> <li>Pressure on Exchequer to accommodate those unable to find accommodation in the private market</li> <li>See Legislative Issues</li> </ul>	€20,651	Negative	<ul style="list-style-type: none"> <li>New Rent Control Legislation would be required to fix rents at the 2000 level</li> <li>Former rent control legislation only applied to properties rented at the effective date and limited increases prospectively – if the new legislation is to apply to all properties this will effectively amount to a forced rent reduction</li> <li>Time limitation would need to be considered</li> <li>Legislation would</li> </ul>	<ul style="list-style-type: none"> <li>Risk of successful challenge extremely high as effective expropriation of property rights rather than limitation of rents going forward</li> <li>Level of impact for landlords likely to create groundswell of support for challenge</li> </ul>	<ul style="list-style-type: none"> <li>Emergency legislation could presumably be an option.</li> <li>Constitutional issues may increase process if referred by President to Supreme Court. Significant potential impact on market</li> </ul>	<ul style="list-style-type: none"> <li>Courts</li> </ul>

## Rent Stability in the Private Rented Sector

					need to include specific calculation tools of 200 rent levels.			
2. Rent Indexed to CPI	<ul style="list-style-type: none"> <li>Rent certainty for tenants</li> <li>Allows landlords' costs to keep pace with inflation</li> </ul>	<ul style="list-style-type: none"> <li>Generated the highest annual rate of increase in the short-term</li> <li>Rents higher in every year relative to the free market in 2000-2014</li> <li>Lower inflation target in immediate future would generate poor returns for landlords</li> <li>Rents in 2014 would be back to their peak levels in 2008</li> <li>Landlords costs may increase in excess of the rate of inflation</li> <li>Reduces quality of existing stock</li> <li>Lead to some landlords exiting the sector</li> <li>Reduces new entrants</li> </ul>	€26,252	Negative	<ul style="list-style-type: none"> <li>Could be addressed by amendments to RTA 2004 (under current proposed Residential Tenancies legislation)</li> <li>Benchmark from which increases apply would need to be set</li> </ul>	<ul style="list-style-type: none"> <li>Risk of challenge low</li> </ul>	As above	<ul style="list-style-type: none"> <li>PRTB with further reference to the Courts</li> </ul>
3. Indexed to CPI within a Tenancy	<ul style="list-style-type: none"> <li>Rent certainty within a tenancy for tenants</li> <li>Encourages tenants to take longer leases than the current 18 months</li> <li>Lower maintenance costs for landlords</li> </ul>	<ul style="list-style-type: none"> <li>Lower tenant turnover</li> <li>Biased tenant selection by landlords</li> <li>Lead to some landlords exiting the sector</li> <li>Reduces new entrants</li> </ul>	€27,210	Negative	<ul style="list-style-type: none"> <li>Could be addressed by amendments to RTA 2004 (under current proposed Residential Tenancies legislation)</li> <li>Question of security of tenure would have to be addressed to be effective</li> </ul>	<ul style="list-style-type: none"> <li>Risk of challenge low subject to terms of security of tenure provisions</li> </ul>	As above	<ul style="list-style-type: none"> <li>PRTB with further reference to the Courts</li> </ul>

4. Frontloading	<ul style="list-style-type: none"> <li>Rent certainty within a tenancy for tenants</li> </ul>	<ul style="list-style-type: none"> <li>Higher initial rents</li> <li>Rents are always higher than the free market</li> <li>Two-tier system as long term renters can pay less than new renters</li> <li>Lower tenant turnover</li> <li>Discourages labour mobility</li> <li>Lead to an inefficient labour market</li> <li>Misallocation of house types</li> <li>Landlords seek to rent to short term tenants</li> <li>Lead to some landlords exiting the sector</li> <li>Reduces new entrants</li> </ul>	€29,932	Negative	<ul style="list-style-type: none"> <li>Could be addressed by amendments to RTA 2004 (under current proposed Residential Tenancies legislation</li> <li>Question of security of tenure would have to be addressed to be effective.</li> </ul>	<ul style="list-style-type: none"> <li>Risk of challenge low subject to terms of security of tenure provisions</li> </ul>	As above	<ul style="list-style-type: none"> <li>PRTB with further reference to the Courts</li> </ul>
5. Variant of German system	<ul style="list-style-type: none"> <li>Initial rents capped at 5% above the market rent</li> <li>Average rents recorded the highest rate of increase under this system, assuming it is in place indefinitely; however, more likely to be a short-term solution, assuming supply constraints are addressed;</li> </ul>	<ul style="list-style-type: none"> <li>Landlords can discriminate against tenants favouring tenants who have more secure and stable employment</li> <li>May discourage renting to vulnerable low income tenants or those on Rent Supplement/HAP</li> <li>Lead to some landlords exiting the sector</li> <li>Reduces new entrants</li> </ul>	€28,652	Negative	<ul style="list-style-type: none"> <li>Could be addressed by amendments to RTA 2004 (under current proposed Residential Tenancies legislation</li> <li>Question of security of tenure would have to be addressed to be effective</li> <li>Localised approach would also have to be factored in to legislation</li> </ul>	<ul style="list-style-type: none"> <li>Risk of challenge low subject to terms of security of tenure provisions</li> </ul>	As above	<ul style="list-style-type: none"> <li>PRTB with further reference to the Courts</li> </ul>

**Rent Stability in the Private Rented Sector**

6. Operating Cost Recovery	<ul style="list-style-type: none"> <li>▪ Positive measure for landlords</li> </ul>	<ul style="list-style-type: none"> <li>▪ Landlords are faced with different operating costs</li> <li>▪ Does not provide rent certainty</li> <li>▪ Market rents are highest under this option</li> <li>▪ May not fully cover all operating costs as an average index only</li> <li>▪ Does not allow for any profit</li> </ul>	€28,672	Positive	<ul style="list-style-type: none"> <li>▪ Could be addressed by amendments to RTA 2004 (under current proposed Residential Tenancies legislation)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Risk of challenge negligible</li> </ul>	As above	<ul style="list-style-type: none"> <li>▪ PRTB with further reference to the Courts</li> </ul>
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**Table C: Summary of Rent Stability Options**

RENT STABILITY OPTION	PROS	CONS	IMPACT ON RENT STABILITY	COST TO EXCHEQUER €M
<b>SHORT TERM OPTIONS</b>				
<b>1. PROVISION OF MARKET INFORMATION</b>				
a) Increase data gathered from PRTB registration process	<ul style="list-style-type: none"> <li>Greater awareness of rents and quality of accommodation (BER ratings, age of building) may allow tenants to successfully challenge rent increases.</li> </ul>	<ul style="list-style-type: none"> <li>Increased awareness may lead to more rent review disputes by tenants</li> </ul>	Low	Nil
b) Quarterly rental publication plus online mapping tool.	<ul style="list-style-type: none"> <li>Greater awareness of rents may allow tenants to successfully challenge rent increases if they are excessive.</li> </ul>	<ul style="list-style-type: none"> <li>Increased awareness may lead to more rent review disputes by tenants.</li> </ul>	Medium	Nil
c) Increase awareness of PRTB, rents, rights and obligations.	<ul style="list-style-type: none"> <li>Greater awareness of rights may allow tenants to successfully challenge rent increases.</li> <li>A more educated tenant which may result in more disputes ruling in favour of the tenant</li> </ul>	<ul style="list-style-type: none"> <li>Increased awareness may lead to more rent review disputes by tenants.</li> </ul>	Medium	Nil
<b>2. REVIEW OF RENTS</b>				
a) Extend notice period for rent increase to 3 months	<ul style="list-style-type: none"> <li>Allow the tenant more time to assess the market</li> <li>Allow the tenant more time to collate information and data if they wish to seek a review.</li> </ul>	<ul style="list-style-type: none"> <li>No impact on the level of rent sought</li> <li>Potential destabilising effect on security of tenure of facing notice of a rent review after 9 months rather than 11 months</li> </ul>	Low	Nil
b) Landlord should provide detail of three comparable properties to justify rent increase where possible	<ul style="list-style-type: none"> <li>Seeks to ensure that landlords do not attempt to increase rent based purely on trends in the market</li> <li>Allows consideration of the quality of accommodation on offer</li> <li>Useful in rural areas, where there is likely to be a lack of suitable information available from the PRTB</li> </ul>	<ul style="list-style-type: none"> <li>No impact on the level of rent sought</li> <li>May not be possible in certain locations</li> </ul>	Low	Nil
c) Due weight to PRTB data in disputes	<ul style="list-style-type: none"> <li>May dampen rent increases as other sources, notably, asking rents are higher than the average market rent</li> </ul>	<ul style="list-style-type: none"> <li>No impact on the level of rent sought</li> </ul>	Low	Nil
<b>3. RENT SUPPLEMENT</b>				
a) Review Rent Supplement limits in line with market rents based on market share.	<ul style="list-style-type: none"> <li>Aim to provide a market share of properties.</li> <li>Reduces risk of homelessness.</li> </ul>	<ul style="list-style-type: none"> <li>RS generally seen as a pricing floor by landlords.</li> <li>Will increase the overall average market rent.</li> </ul>	Medium	€16.5m
b) Review Rent Supplement rent limits every 12 months	<ul style="list-style-type: none"> <li>Aim to ensure rents move in line with the market.</li> <li>Consistent with the Residential Tenancies Act 2004</li> </ul>	<ul style="list-style-type: none"> <li>RS generally seen as a pricing floor by landlords.</li> </ul>	Low	Impact on Exchequer will depend on review of rents (upwards or downwards)

c) Extend the Interim Tenancy Sustainment Protocol (ITSP)	<ul style="list-style-type: none"> <li>▪ Increases security of tenure for tenants</li> <li>▪ Will reduce homelessness</li> <li>▪ Aligned with Section 38 of the DSP Social Welfare Regulations 2007</li> </ul>	<ul style="list-style-type: none"> <li>▪ No impact on the level of rent sought</li> </ul>	Low	Only in place since June 2014
<b>4. TAX INCENTIVES FOR RENT SUPPLEMENT/HAP TENANCIES</b>				
a) CGT relief for landlords where letting for minimum of 5 years to Rent Supplement/HAP tenants – Relief will be for time of letting to tenant – not absolute exemption	<ul style="list-style-type: none"> <li>▪ Provides incentive to let to HAP tenants</li> </ul>	<ul style="list-style-type: none"> <li>▪ Might not have perceived benefit for landlords who bought since 2004 due to property price deflation</li> </ul>	Medium	Cost depends on a number of factors but is deferred.**
b) 100% Interest Relief on borrowings for landlords letting for minimum of 5 years to Rent Supplement/HAP tenants	<ul style="list-style-type: none"> <li>▪ Provides incentive to let to HAP tenants</li> </ul>	<ul style="list-style-type: none"> <li>▪ Unavailable to landlords who have no borrowings</li> <li>▪ May distort market in favour of HAP tenants</li> </ul>	Medium	€27.5m
<b>5. INCREASE SUPPLY OF RENTAL PROPERTIES</b>				
a) Extension of Living City Initiative to Landlords	<ul style="list-style-type: none"> <li>▪ Areas covered by relief are perhaps very suitable for provision of rental residential accommodation</li> <li>▪ Extension of relief to investors into sector may allow for access to existing disused stock that is not compliant with housing regulations.</li> <li>▪ Focus is on cities where there is a shortage of supply.</li> <li>▪ Allows conversion of non-residential dwellings into residential uses</li> </ul>	<ul style="list-style-type: none"> <li>▪ EU State aid approval required – this is ongoing for existing scheme</li> </ul>	Low	€17M annually net cost
b) Rent a Room relief	<ul style="list-style-type: none"> <li>▪ Revenue has indicated that there may be 4,073 claimants of relief based on review of Forms 11 and 12. Information likely to be incomplete</li> <li>▪ Potential short term immediate supply response.</li> <li>▪ Incentivise use of space in existing properties in the short term until the supply side is addressed.</li> <li>▪ No reduction in limits proposed but more information required to be publicised.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Tenants not subject to Residential Tenancies Act 2004</li> <li>▪ Tax free threshold has the potential to limit the rate of increase in rents.</li> </ul>	High	NIL
c) Reduce commercial rates for residential units above commercial premises	<ul style="list-style-type: none"> <li>▪ Encourages use of overhead premises for residential purposes</li> <li>▪ Focus would be on cities where there is a shortage of supply.</li> </ul>	<ul style="list-style-type: none"> <li>▪ State Aid issues</li> </ul>	High	Cost would depend on the exemption or rebate. If the exemption route is applied – with the residential portion not being subject to commercial rates

				– then LPT might provide some compensation.
d) Reduce VAT on new housing construction as opposed to sale from 13.5% to 9% for a 2 year period.	<ul style="list-style-type: none"> <li>▪ Time limitation to provide incentive to increase supply.</li> <li>▪ This form of incentive has shown to be successful in hospitality sector.</li> </ul>	<ul style="list-style-type: none"> <li>▪ EU rules to be considered – may not be possible.</li> <li>▪ Supply side measure like this may be undermined by lack of bank funding for investors/ lack of investor appetite</li> </ul>	Medium	Cost – €40m to €60m in a full year depending on new house completions.
<b>6. PROTECTING EXISTING STOCK</b>				
a) Code of Conduct on BTL mortgage arrears:	<ul style="list-style-type: none"> <li>▪ Set out the rules of engagement between the lender and the landlord and tenant.</li> <li>▪ Fully adhere to the requirement of the Residential Tenancies Act 2004.</li> <li>▪ Ensure that the requirements of landlord and tenant law become an explicit consideration in the receivership and repossession processes.</li> <li>▪ Safeguard the private rented sector from volatility arising from a higher scale of repossessions and receiverships.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Legislative implications of recommendations</li> </ul>	Low	
<b>7. VOLUNTARY RENT CERTAINTY LEASE</b>				
a) Introduce Rent Certainty Lease	<ul style="list-style-type: none"> <li>▪ Rent certainty</li> <li>▪ Voluntary arrangement between tenant and landlord</li> <li>▪ Less voids for landlord</li> <li>▪ Assists long term renters.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Information needs to be publicised.</li> <li>▪ May reduce mobility in the sector.</li> <li>▪ May require supply incentives.</li> </ul>	High	
<b>8. OTHERS</b>				
a) Freeze removal of tenant’s Tax Relief for low income tenants at 2013 levels to 2017	<ul style="list-style-type: none"> <li>▪ Provides small measure of relief to low income tenants who are suffering rent increases</li> </ul>	<ul style="list-style-type: none"> <li>▪ May have little real impact on affordability as worth €200 to €400 per annum – higher for individuals over 55.</li> </ul>	Low	€10.2m
<b>9. MEDIUM – LONG TERM OPTIONS</b>				
a) Restore full Interest Relief on borrowings to 100%	<ul style="list-style-type: none"> <li>▪ This is to incentivise investors into the market by non-cash buyers/ funds</li> <li>▪ To equalise the tax treatment with the commercial sector</li> </ul>	<ul style="list-style-type: none"> <li>▪ Cost and current budgetary constraints are the main downsides</li> <li>▪ May encourage property price appreciation.</li> </ul>	Medium	€112M per annum per comments from DOF, based on Revenue study of 2012.
b) Implement supply side measures in Construction 2020	<ul style="list-style-type: none"> <li>▪ Should promote new supply</li> </ul>		Medium	N/A
c) Clear funding strategy for the non-profit housing sector	<ul style="list-style-type: none"> <li>▪ Should promote new supply</li> </ul>		Low	N/A

# 1. INTRODUCTION

## 1.1 ECONOMIC BACKGROUND

Following the costly lessons of a housing policy which promoted and almost enticed people into home ownership for over a decade until 2007, the Government's Housing Policy Statement of June 2011<sup>5</sup> firmly recognises the need for a new vision for the future of the housing sector in Ireland. The vision set out is to be one based on choice, fairness, and equity across tenures and on delivering quality outcomes for the resources invested. The overall strategic objective is *"to enable all households access good quality housing appropriate to household circumstances and in their particular community of choice."* While home ownership will continue to be the tenure of choice for the majority of households, the policy statement recognises that a balanced housing sector needs a strong and well-regulated private rented sector.

Important steps have and are being taken to deliver on this objective. These have included the establishment of the Private Residential Tenancies Board (PRTB) under the Residential Tenancies Act of 2004, the creation of security of tenure and the introduction and enforcement of higher minimum accommodations standards. The Residential Tenancies (Amendment) (NO.2) Bill 2012<sup>6</sup> which is currently before the Oireachtas, will cater for the incorporation of tenancies in the voluntary and cooperative sectors within the remit of the PRTB<sup>7</sup>, the inclusion of a deposit protection scheme and other issues around governance and regulation. This Bill when enacted is expected to go a considerable way towards setting down a common set of rules and equalising the treatment of all tenancies (excluding local authority tenancies), a key objective of government policy.

The rented sector has grown considerably in recent years, almost doubling in size between 2006 and 2011, with approximately one in five households now renting their home in the private rented sector.

Increasingly the private rented sector is providing housing for a wide range of households, many of

whom previously would have had their accommodation needs met by the owner occupied or social housing sectors. Since the collapse in property prices during the recession, the sector has accommodated those households who have postponed house purchase due to a variety of reasons. More recently as a result of legacy issues in the home ownership sector, the private rented sector is accommodating those households who have lost their homes. The sector also provides homes for those whose rents are paid for by the State through the Rent Supplement and Rental Accommodation schemes. Others relying on the private rented sector include students as well as individuals and households who choose to rent by choice. As a result the demands on the private rented sector have increased substantially in recent years with the result that the current most pressing problem is how to increase the supply of private housing for rent, particularly in urban areas and most notably in Dublin.

In the absence of any short-term increase in the supply of rented accommodation or social housing to address the problem, rising rents are generating significant difficulties for vulnerable households, a number of whom are being squeezed out of their homes. This is giving rise to an increasing homelessness problem which has required substantial State funding for the provision of emergency temporary accommodation by voluntary service providers as well as bed and breakfast and private rented emergency accommodation. But the issue of homelessness must also be seen as part of a wider problem which has stemmed from the increase in unemployment and the reduction in disposable incomes since 2008 as much as from the current and ongoing general decline in the supply of available, accessible and affordable rental accommodation and social housing, particularly in the Dublin region<sup>8</sup>.

There is a general consensus that the private rented sector is in crisis in certain locations. This has led to the current study being commissioned by the Housing Agency/Private Residential Tenancies Board (PRTB) to urgently identify policy options for rent stability. This study is the first of two studies underway on the private rented sector for the Housing Agency/PRTB. The second study will examine regulatory issues and attitudes

<sup>5</sup> <http://www.environ.ie/en/DevelopmentHousing/Housing/PublicationsDocuments/FileDownload,26867,en.pdf>

<sup>6</sup> <http://www.oireachtas.ie/viewdoc.asp?fn=/documents/bills28/bills/2012/6912/b6912d.pdf>

<sup>7</sup> The PRTB will become the Residential Tenancies Board following enactment of the legislation.

<sup>8</sup> Implementation Plan on the State's Response to Homelessness May 2014 to December 2016 <http://www.environ.ie/en/PublicationsDocuments/FileDownload,38053,en.pdf>

amongst the main stakeholders - via surveys and consultations - as well as review international experience in regard to regulation and supply measures. The findings of the surveys of landlords, estates agents and tenants are briefly referenced in this report but will be subject to wider analysis in the second study. This second study will seek to advise the PRTB on how the rental sector can be sustainable into the future and play a vital role in accommodating a wide range of households in affordable and good quality accommodation. The second study will be completed in October.

## **1.2 PURPOSE OF STUDY AND TERMS OF REFERENCE**

This first study is specifically focused on options to address the recent escalation in rents. The current law on reviewing rents that is set down in the Residential Tenancies Act 2004 states that rents may not be greater than the open market rent and rent reviews within a tenancy may not occur more frequently than once in every twelve months, unless there has been a substantial change in the nature of the accommodation that warrants a review. However, the recent escalation in rents is giving rise to an increase in disputes in relation to rent increases<sup>9</sup>, with 109 cases in 2013 relating to disputes where the rent was increased by more than the market rate and 999 cases relating to rent arrears. These figures are up from 61 and 719 respectively in 2012.

The Terms of Reference require a range of specific issues to be examined in regard to Rent Stability as follows:

1. The current tax treatment of the rental sector and the effect on rent increases; and the range of possibilities for tax reliefs for landlords and / or tenants (including for particular segments of the market or high demand areas and time-limited initiatives).
2. The potential for indexation of Rent Supplement and possible incentives for landlords to rent to social rented tenants.
3. Scenario testing possible rent regulation including consideration of the pros and cons of different approaches to the regulation of rent increases within a tenancy.
4. Lessons from other countries with a developed private rented sector with (or policies acknowledging the need for) rent

certainty and stability. A range of countries are to be examined: Germany, Belgium, Holland, Sweden, Switzerland, France, the UK and the North American cities.

5. Proposals in relation to both short-term and medium-to-long-term strategies to achieve greater rental stability and certainty including an indication of the likely costs of any measures proposed. This would include consideration of the time lag involved in different policy measures.
6. Legal advice on the basis under which any changes might be introduced and / or operate.

### **1.2.1. Research Advisory Group**

A Research Advisory Group was established by the Private Residential Tenancies Board to assist the researchers by providing advice on content, information and data to inform the analysis and comment on draft material.

Membership of the Advisory Group was as follows:

- Damian Allen, (Alternate Catherine Higgins) Department of the Environment, Community and Local Government
- Anne Marie Caulfield, (Alternate Carmel Diskin) Private Residential Tenancies Board
- Patricia Coleman, (Alternate, Tom Heffernan) Department of Public Expenditure and Reform
- Caren Gallagher; Irish Council for Social Housing
- Aisling Greene, Department of Finance
- Bob Jordan, Threshold
- John Leahy, irishlandlord.com
- Joseph Meehan, Department of Social Protection
- Tim Ryan, Board Member, Chair of Research Committee, Private Residential Tenancies Board
- David Silke, (Chair of Advisory Group) Housing Agency.

The report has been produced by DKM Economic Consultants, the ESRI and Ronan Daly Jermyn Solicitors in response to a request from the Private Residential Tenancies Board and in line with the terms of reference. The contents and conclusions in this report are those of DKM Economic Consultants and associates and the authors are solely responsible for the content and the views expressed.

<sup>9</sup> PRTB Annual Reports 2012 and 2013.

### 1.3 LAYOUT OF REPORT

This report is structured as follows:

*Section 2* contains a brief profile of the private rented sector and an analysis of recent trends in rents and affordability in the private rented sector.

*Section 3* presents a review of the literature on rent regulation and examines the rules governing rent regulation across a range of other jurisdictions. The impacts of rent regulation on individual markets are assessed taking account of the different size and composition of the private rented sector in these jurisdictions but also variations in economic conditions and stringency of the regulatory environment.

*Section 4* examines trends in Rent Supplement recipients and expenditure and sets out the changes which have taken place in rent limits in recent years. This section also contains an examination of the different options employed for the setting of rent limits for rent assistance across a number of other jurisdictions. A number of the key issues raised during the consultation process for the operation of Rent Supplement are highlighted.

*Section 5* sets out the current tax treatment of the rental sector and examines the impact of tax changes over the past seven years, some of which are likely to be partly responsible for the overall increases in rents. There is also a comparison with the situation that exists for commercial lettings.

*Section 6* contains a review of the business of a landlord, provides an analysis of the buy to let sector and a discussion on the key challenges for the private rented sector as a result of the increase in buy to let mortgage arrears since data was first published in June 2012.

*Section 7* sets out the approaches to rent regulation in Ireland and examines a number of scenarios, as well as the pros and cons of each, given the particular circumstances in which the Irish housing market finds itself at this point in time.

*Section 8* sets out the strategies in relation to both short-term and medium-to-long-term strategies to achieve greater rental stability and certainty including an indication of the likely costs of any measures proposed.

The *Executive Summary* contains a summary of findings and options for rent stability.

## 2. POLICY BACKGROUND

### 2.1 OVERVIEW OF THE PRIVATE RENTED SECTOR

The housing market has seen a substantial increase in the number of rented households in recent years. According to Census 2011 the number of households renting from a private landlord more than doubled in the five years since 2006, reaching 305,377. This corresponded to a 110% increase in the period or approximately 160,000 households.

Unsurprisingly, such high growth in this sector over the period has led to a change in the composition of housing provision in Ireland. As shown in Figure 2.1, the share of households privately renting increased by 9 percentage points to 19 per cent between 2006 and 2011. Interestingly, over the same period, all other tenure types recorded a decline, with the share of owner occupied households with a loan or mortgage down by 5 per cent. The proportion of households renting from local authorities and voluntary bodies declined from 11 per cent to 9 per cent over the same period. However, owner-occupation continues to represent the largest share of housing provision at 70 per cent in 2011, albeit down from 75 per cent in 2006.

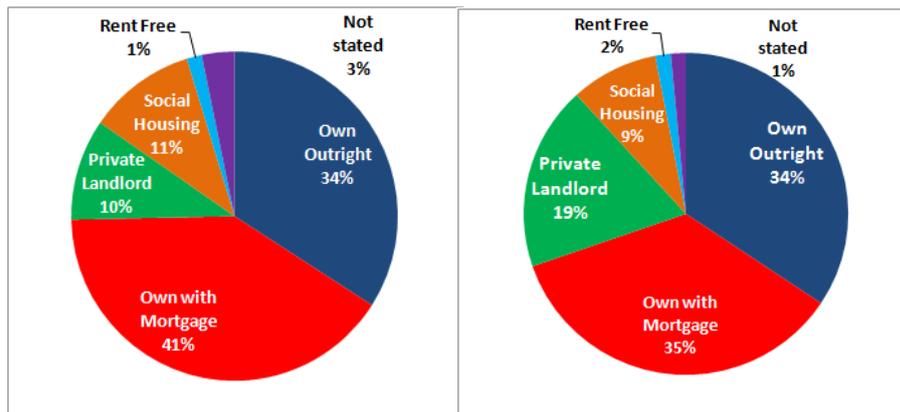
**Table 2.1: Total Private Households by Nature of Occupancy, 2006-2011**

	2006	2011	% change
Own outright	498,432	566,776	13.71
Owner-occupied with Loan or Mortgage	593,513	583,148	-1.75
Rented from Private Landlord	145,317	305,377	110.15
Social Housing Rented	155,989	143,975	-7.70
<i>of which</i>			
- Rented from a Local Authority	105,509	129,033	22.30
- Rented from a Voluntary Body	50,480	14,942*	-70.40
Occupied Free of Rent	21,701	25,436	17.21
Not stated	47,344	24,696	-47.84
<b>All Types of Occupancy</b>	<b>1,462,296</b>	<b>1,649,408</b>	<b>12.80</b>

Source: Based on CSO Census 2011

\* The Irish Council for Social Housing estimate that there are 27,000 tenancies in the voluntary sector. It is believed that the recent inclusion of 'renting from a voluntary body' in the Census has caused some voluntary sector tenancies to be counted under private landlords in error.

**Figure: 2.1 Total Private households by Nature of Occupancy, 2006-2011**



Source: Based on CSO Census 2011

Based on Census 2011 there were 770,375 persons living in the private rented sector with an average household size of 2.52 persons. Semi-detached houses and flats/apartments were the most common types of dwellings: almost one-third were living in semi-detached houses with an average

household size of almost 3 persons; and almost one-quarter were living in purpose built blocks of flats/apartments with an average household size of 2.09. There were around 4,500 bed-sits across the country as a whole with an average of just 1.4 persons per bed-sit.

**Table 2.2: Total Private Rented Households by Type of Accommodation and Population**

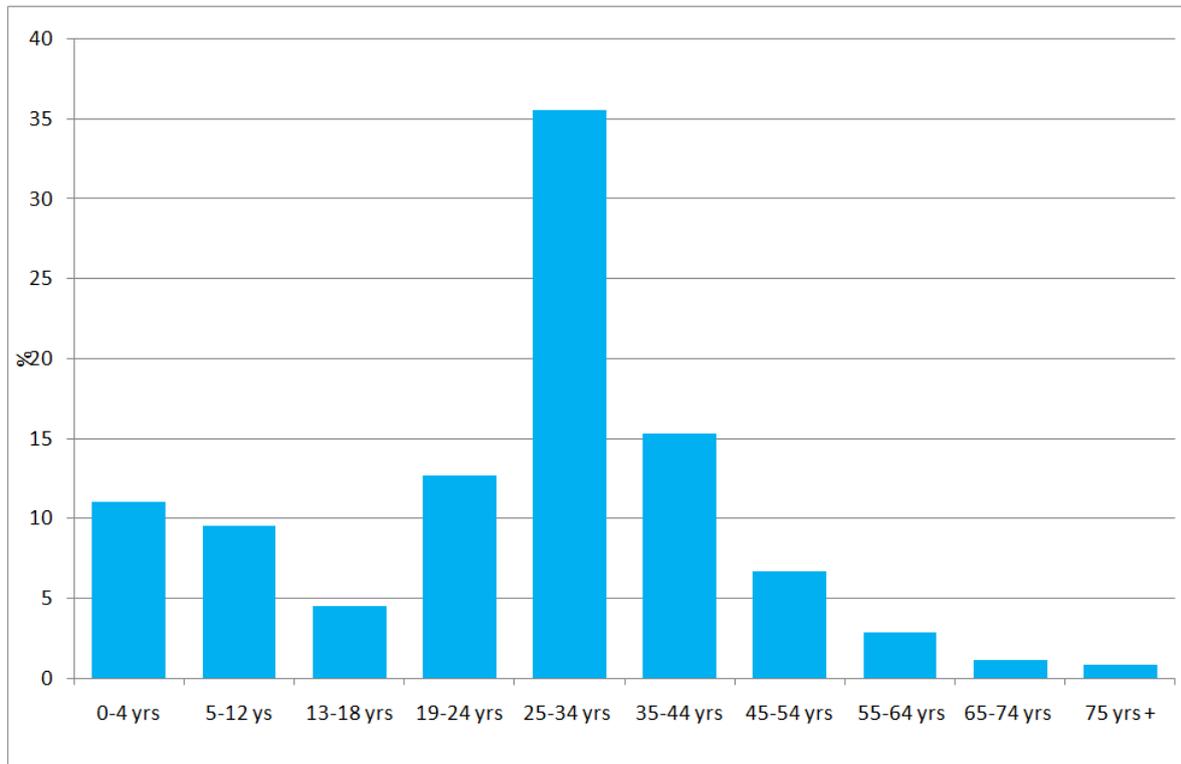
	Households	%	Population	%	Average Household Size
Total	305,377	100	770,375	100	2.52
Detached house	54,970	18	158,158	21	2.88
Semi- Detached house	83,248	27	246,564	32	2.96
Terraced house	51,352	17	131,265	17	2.56
Flat/ apartment in a purpose- built block	84,626	28	176,849	23	2.09
Flat/ apartment in a converted house or commercial building	21,418	7	36,042	5	1.68
Bed-sit	4,475	1	6,259	1	1.40
Not stated	5,288	2	15,238	2	2.88

Source: Based on CSO Census 2011

The bulk of persons in the private rented sector were aged between 25 and 34 years, accounting for 35.5 per cent of those in private rented

accommodation. This was by far the largest group. The next largest, those aged between 35 to 44 years, accounted for 15 per cent.

**Figure 2.2 Distribution of persons within the private rental market by Age**

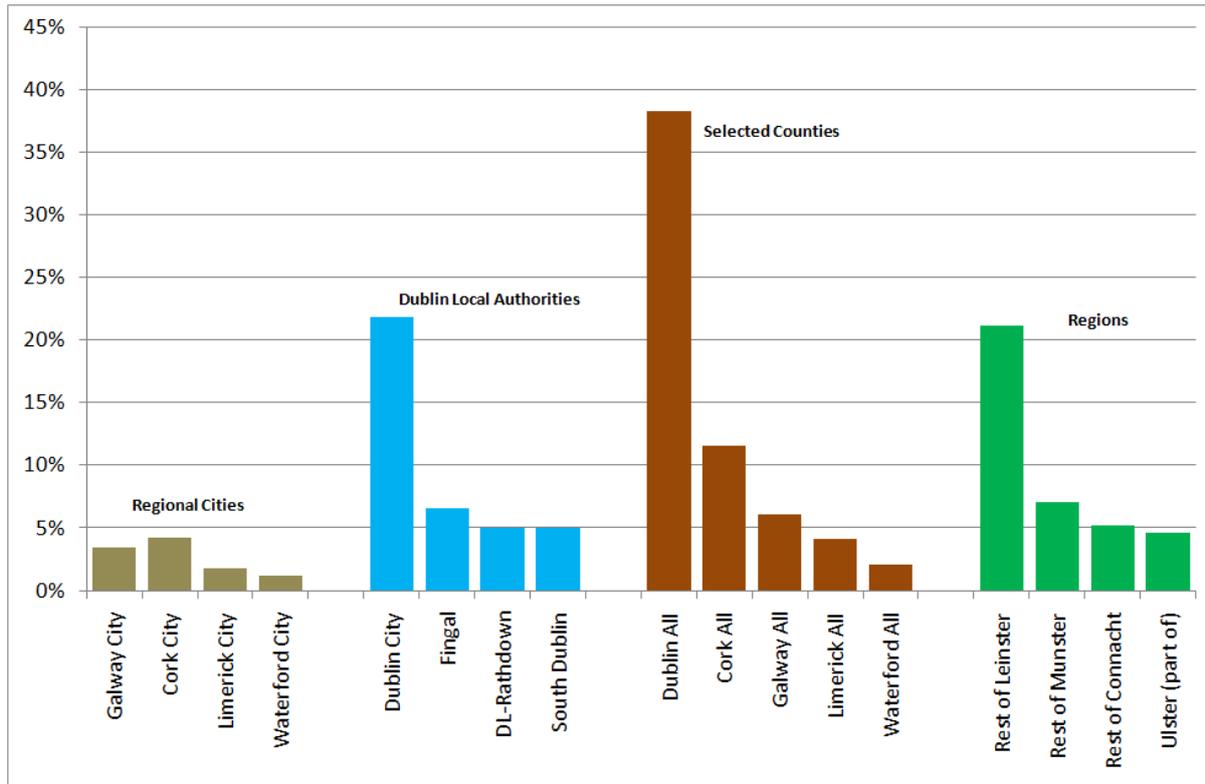


Source: Based on CSO Census 2011

Figure 2.3 shows the distribution of private rented households in Ireland’s cities and their respective counties and in Dublin’s local authorities in 2011. The remaining counties are included in their respective provinces. Across the main cities, Dublin City accounted for 22 per cent of total private rented households, with other cities accounting for 4 per cent (Cork City) or less. Dublin as a whole had 38 per cent of the total private rented households across the State, with Cork ranked a

distant second at 12 per cent of the total. The majority of accommodation is provided in Leinster (59%); excluding Dublin, the rest of Leinster had 21 per cent of the total private rented accommodation. Munster had 25 per cent of the total or 7 per cent excluding Cork (12%), Limerick (4%) and Waterford (2%). In Connacht, Galway represented 6 per cent of total private rented households across the State, split equally between the City and County.

**Figure: 2.3 Distribution of Private Rented Households Across the State**



Source: Based on CSO Census 2011

Figure 2.4 shows the mix of social<sup>10</sup> and private rented tenure according to the 2011 Census across the main cities and counties. The balancing figure, not shown in the chart represents the proportion of owner occupied households.<sup>11</sup> In all cities, with the exception of Waterford City, the private rented sector is much bigger than the social housing sector. Galway City has the highest proportion of households in the private rented sector at 38 per cent compared with 11 per cent in the social housing sector.

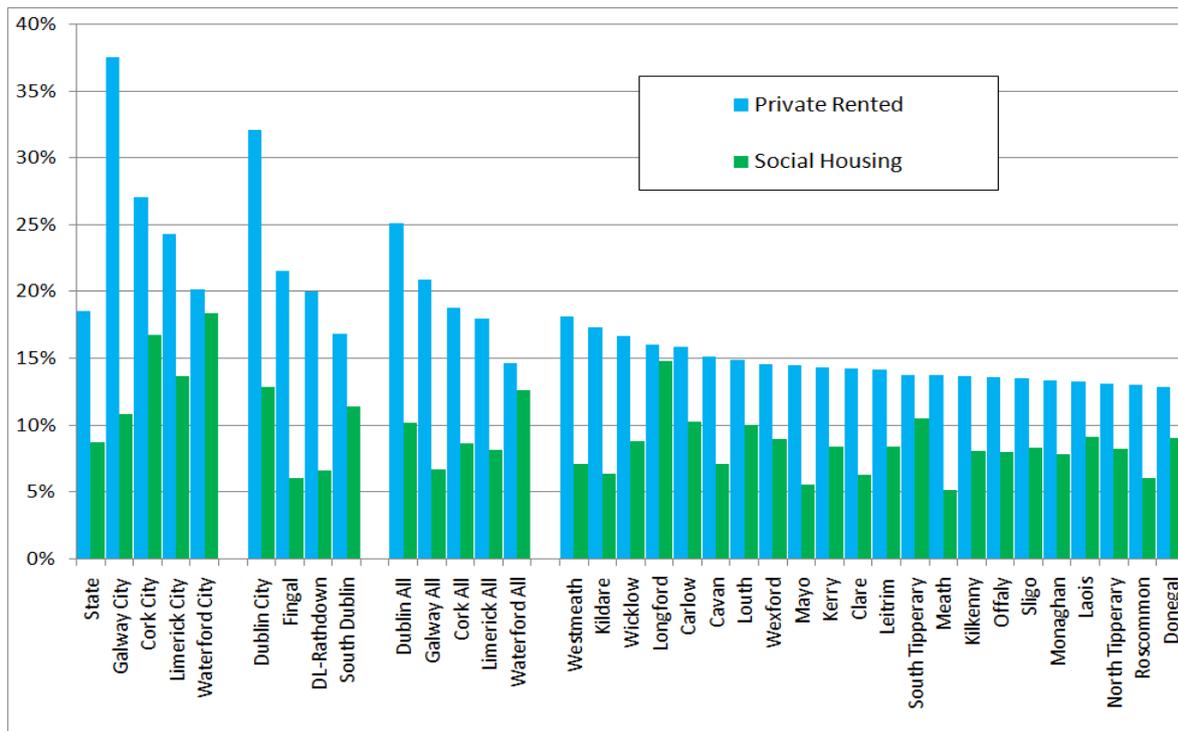
Across the remaining counties the private rented sector accommodates between 18 per cent (Westmeath) and 13 per cent (Donegal) of all households in each county. In Longford each sector accounts for around 15 per cent of all households, while in each of the counties, South Tipperary, Louth and Carlow, around 10 per cent of households are in the social housing sector. Meath had the lowest share of households in the social housing sector in the State at 5 per cent.

After Galway City, Dublin City has the second highest proportion of households in the private rented sector at 32 per cent but only 13 per cent of households are accommodated in the social housing sector. Dun Laoghaire Rathdown and Fingal stand out for their relatively low proportions of households in the social housing sector at 7 per cent and 6 per cent respectively.

<sup>10</sup> Social Housing tenure is defined as rented from a local authority or voluntary body.

<sup>11</sup> In all counties there are a small proportion of households who have rent free accommodation (2%) and an even smaller group who did not state their accommodation tenure (1%).

**Figure: 2.4 Proportion of Dwellings in Private and Social Rented Sector by City and County**



Source: Based on CSO Census 2011

### 2.1.1. Landlords, Tenants and Rented Properties

Information on the size of the private rented sector, in terms of numbers of rented properties, landlords and tenants is relatively sparse.

Census 2011 reported that there were 305,377 private dwellings rented from private landlords with an additional 129,033 rented from Local Authorities and 14,942 rented from Voluntary Housing bodies. In contrast, the 2011 PRTB Annual Report<sup>12</sup> shows that there were 260,144 tenancies registered with the PRTB. This would suggest that there is 85% compliance with the requirement to register a private rented property with the PRTB with some 41,000 properties still unregistered. However, this compliance rate is likely to have increased since then as a new detection policy has seen the number of properties registered with the PRTB reach 282,918 in 2013. Moreover, the launch of the national post codes system will see additional improvement in this area.

As previously noted, there were 770,375 persons living in private rented accommodation in 2011. In contrast the PRTB had 554,567 tenants or 72%

registered. The lower number of tenants registered with the PRTB may be due to a number of factors including:

- Children within families units not being counted by the PRTB;
- Subletting by tenant;
- Under-declaration of tenants by landlords;
- Rent a Room Scheme; and
- Those occupied free of rent.<sup>13</sup>

The 2011 Census does not give an indication of the number of landlords in the State; however the PRTB had 182,800 registered in 2011.

The latest PRTB data indicates that there were 179,026 landlords, 457,208 tenants and 282,918 rented properties in 2013. While the number of properties registered with the PRTB has increased in the past two years, the number of landlords and tenants has declined. These trends may reflect a combination of a change in methodology in data analysis, by the PRTB, some landlords exiting the sector or choosing not to register with the PRTB.

<sup>12</sup> <http://www.prtb.ie/media-research/publications/annual-reports>

<sup>13</sup> According to the 2011 Census there were around 25,500 households who were classified as living in rented accommodation without paying rent. Some of these may be in the private rented sector and may not be registered with the PRTB.

**Table 2.3: Size of Private Rented Sector**

	Census 2011	PRTB 2011	PRTB 2012	PRTB 2013
Landlords	-	182,800	212,306	179,026
Tenants	770,375	554,567	593,382	457,208
Properties	305,377	260,144	264,434	282,918

Source: Based on CSO Census 2011, PRTB Annual Report.

Further data from the PRTB indicates that around 67% of registered landlords have one property, almost 84% have one or two properties and around 90% have three or less<sup>14</sup>. A survey of landlords undertaken for the forthcoming second study revealed that 65 per cent of respondents own just one property. A further 17 per cent have 2 properties and 9 per cent own three properties. Ten per cent of landlords surveyed have more than three properties.

## 2.2 PRTB RENT INDEX

Information on rental trends is available from the PRTB Rent Index which is compiled by the ESRI, and based on the PRTB's own register of tenancies. The PRTB database is the largest in the country and is populated with information on actual/agreed rent, location, six categories of dwelling types, accommodation size and number of occupants and tenancy length. The Index is backdated to Q3, 2007 and is produced quarterly.

Using the PRTB Rent Index it is possible to construct "standardised"<sup>15</sup> rents which allow a monetary value for rents to be calculated in each period. Looking at trends in market rents since the second half of 2007, the index shows that rents rose between the third and fourth quarter of 2007. Rents fell sharply throughout 2008 and 2009. Since then the declines have been much more moderate and there have been some increases, although these have been infrequent. In nominal value terms, the index shows that rents declined from a value of €1,020 in Q4, 2007 to €762 in Q1, 2013. Rents increased again during 2013 and by Q4 2013 were rising nationally by 3 per cent year on year and by 7.1 per cent in Dublin.

The latest data available is for Q1, 2014 and shows the annual rate of increase nationally accelerated to 3.5 per cent. Across the different house types, rents for houses were 1.6 per cent higher, while apartment rents were 5.6 per cent higher than in Q1, 2013. These rates of increase are modest with rents outside of Dublin well below peak levels.

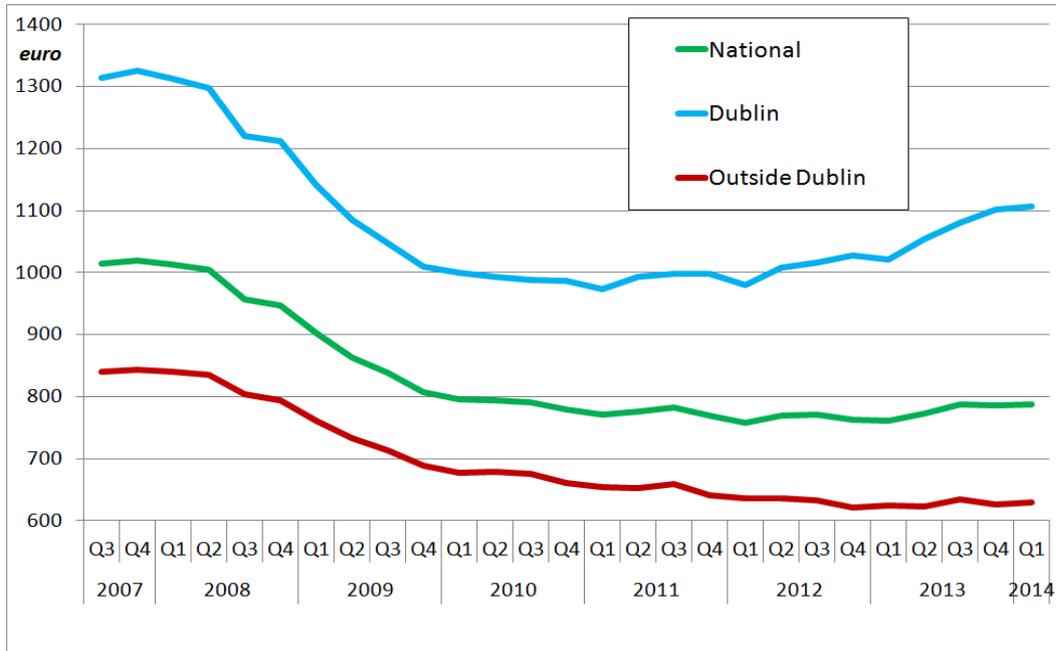
Annual growth in the Dublin market was stronger, up by 8.4 per cent in Q1, 2014, with Dublin house rents up by 6.7 per cent and Dublin apartment rents higher by 10.3 per cent.

In contrast, annual growth in rents for the market outside Dublin was more subdued, recording growth of 0.8 per cent when compared to Q1, 2013. Again the performance differs by property type. The monthly rent for houses outside Dublin increased by just 0.1 per cent, while apartment rents outside Dublin experienced an increase of 2.1 per cent.

<sup>14</sup> There are a number of caveats around this breakdown as the figures may contain duplicates in regard to landlords and tenants.

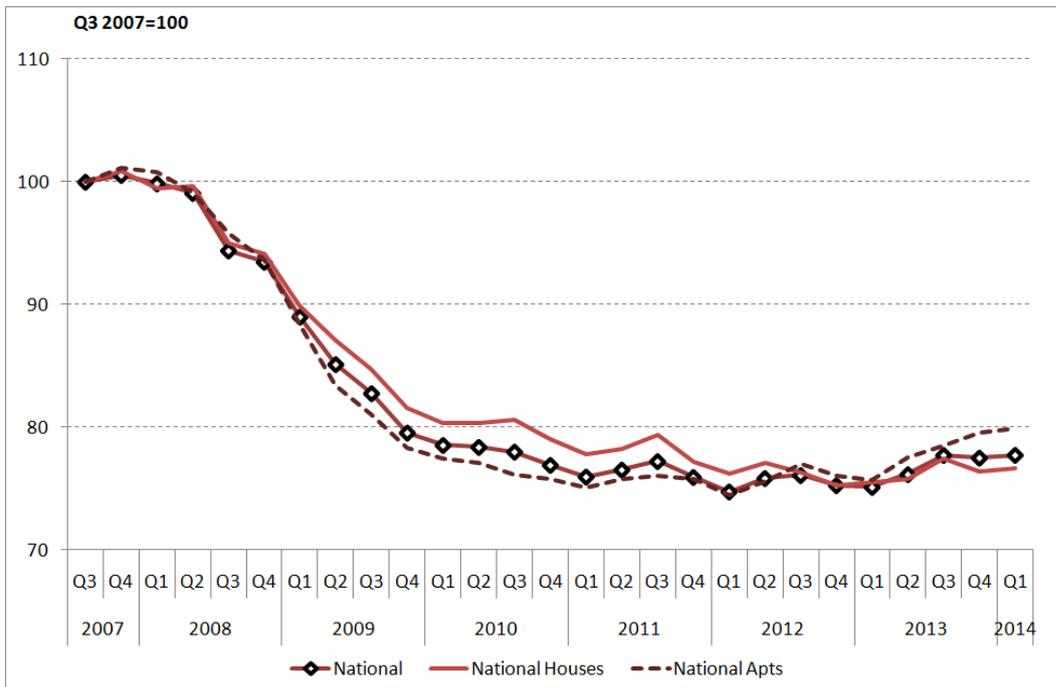
<sup>15</sup> The standardised rent is based on the average rent in the base period which is then updated using the mix-adjusted index.

**Figure: 2.5 PRTB Rent Index, National, Dublin and Outside Dublin (euro)**



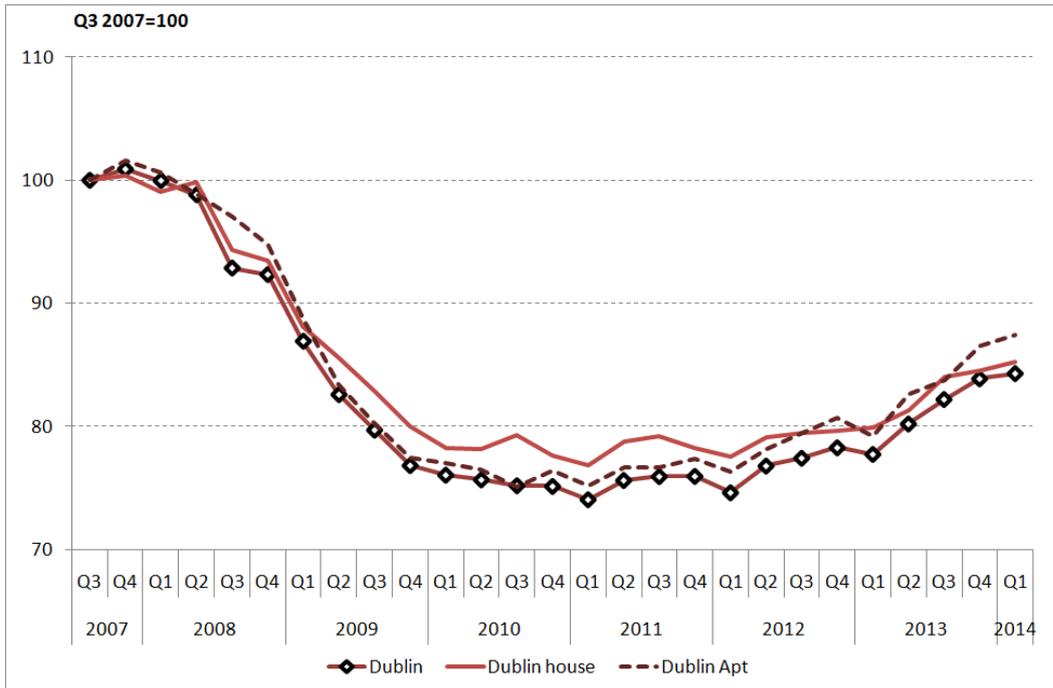
Source: PRTB/ESRI Rental Index

**Figure: 2.6 The PRTB Rent Index – National**



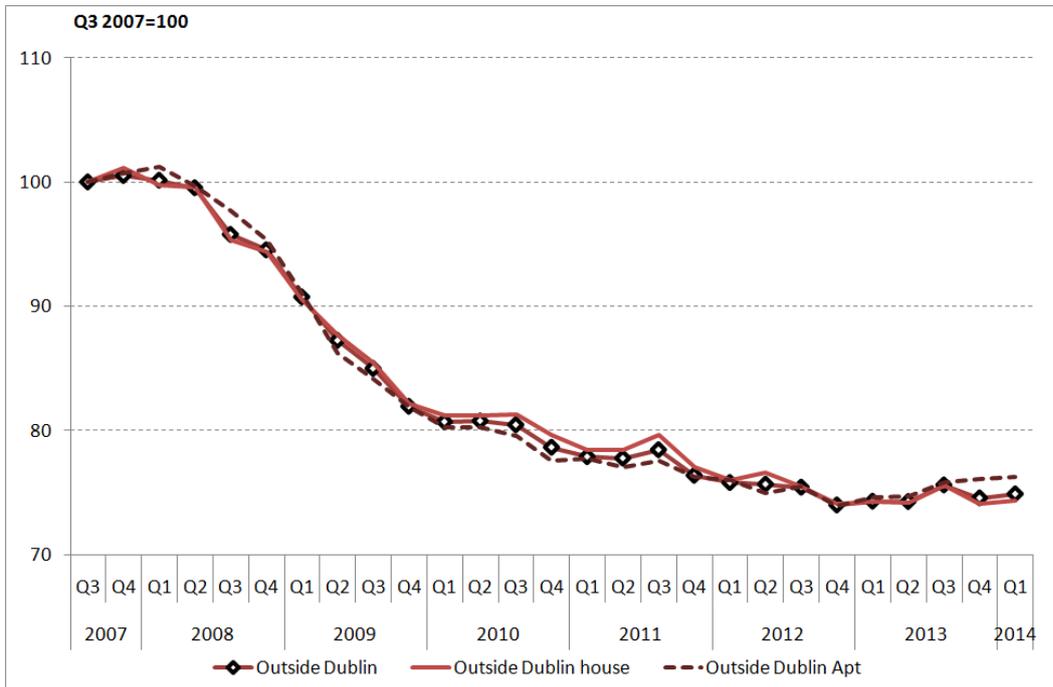
Source: PRTB/ESRI Rental Index

**Figure: 2.7 The PRTB Rent Index – Dublin Properties**



Source: PRTB/ESRI Rental Index

**Figure: 2.8 The PRTB Rent Index – Properties Outside Dublin**

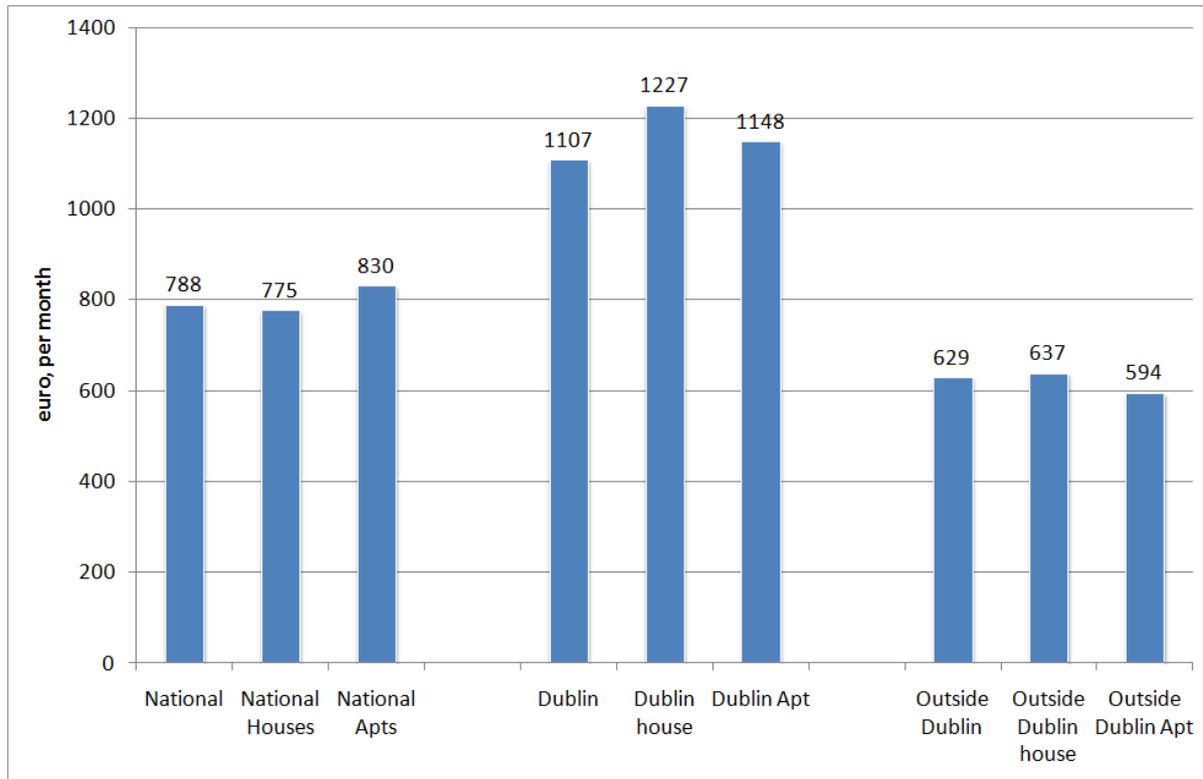


Source: PRTB/ESRI Rental Index

Nationally rent amounted to €788 per month in Q1, 2014, up from €762 in Q1, 2013, an increase of 3.4 per cent. Figure 2.9 shows rental levels for the

various sub-indices produced for the PRTB. It is immediately evident that rents in Dublin are much higher than rents outside Dublin.

**Figure: 2.9 Rents, euro per month, Q1 2014**



Source: PRTB/ESRI Rental Index

### 2.3 AFFORDABILITY IN THE IRISH RENTAL MARKET

Affordability is an essential ingredient in any housing market, allowing households the choice between either renting in the short, medium or long term or becoming home owners. There are a number of factors which determine affordability for renters but ultimately it is likely to be about their capacity to afford the rent for a property type in a location of their choice and which suits their circumstances.

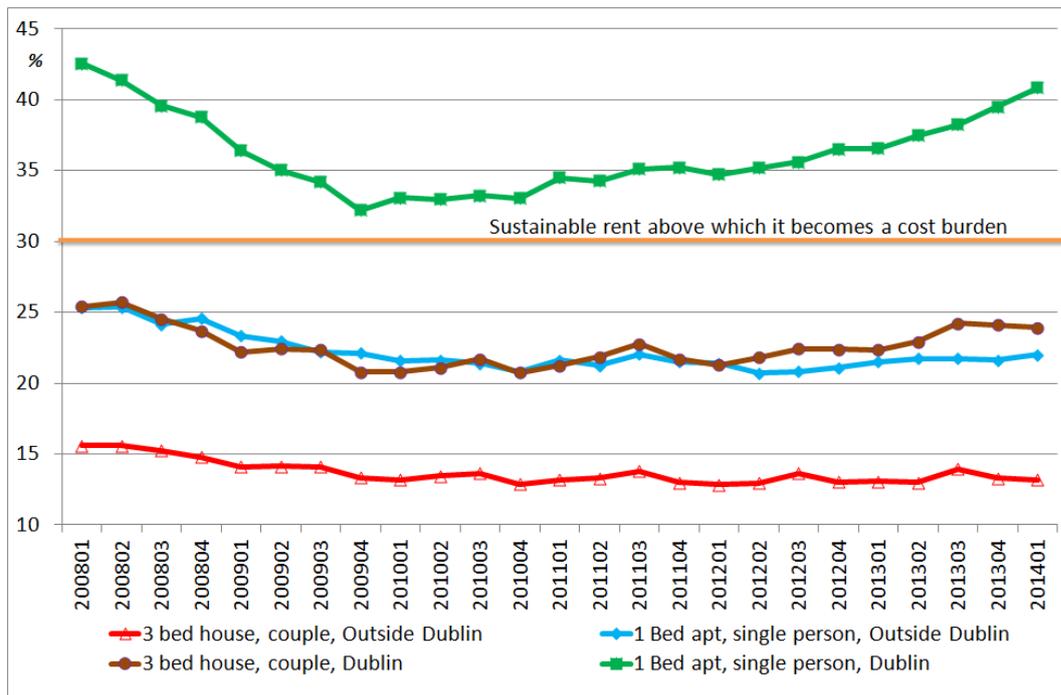
The ability to pay rent is a function of income and thus one simple measure of affordability is the ratio of rent to gross income. However, using net income to measure affordability is more precise, given the impact of austerity measures on disposable incomes in recent years.

Thus combining data from the PRTB Rent Index with data on disposable incomes from the EBS/DKM Housing Affordability Index<sup>16</sup> for home

purchase allows a measure of rent affordability to be derived. This analysis is very dependent on the assumptions made. It uses average rents, nationally and in Dublin, for a 1 bed apartment and a 3 bed house from the PRTB dataset. Disposable income is taken from the *EBS/DKM Housing Affordability Index* and takes into account changes in taxation, social security and other charges on earnings over time. When considering the results it is worth keeping in mind that the incomes of those intending to purchase a property may well be higher than those renting. While this would change the level of the measure the trend should remain the same. What is evident from Figure 2.10 is the extent to which affordability differs depending on whether you are renting in Dublin or outside Dublin, and whether you are renting as a single person or as a couple, where both are working.

<sup>16</sup> [http://dkm.ie/en/publications/affordability\\_index](http://dkm.ie/en/publications/affordability_index)

Figure: 2.10 Affordability in the Rental Sector



Source: PRTB, CSO

The above chart assumes gross earnings for a single person of €36,000 and monthly rent of €957 for a 1 bed apartment in Dublin. This person would be allocating 41 per cent of net income to the cost of renting. This is the highest proportion of income allocated to rent since 2008, when rents were at their peak. Assuming gross earnings are around 70 per cent below the average for a single person (€25,000), affordability would be closer to 55 per cent, which is well above what is deemed to be a sustainable rent (30 per cent of net income). Although affordability for lower income individuals, irrespective of their sector of work would be higher, the likelihood is that single income workers would share with other persons, although this may not always be possible or desirable for some individuals.

Looking at the analysis for the couple in Dublin renting a 3 bed house, the joint gross income is €80,000. The corresponding proportion of net income allocated to the rent is 24 per cent, which is marginally up from the lowest point in the current cycle in Q4 2009 (20.8%) and is broadly similar to the proportion of net income required to fund a mortgage in Q1 2014. A couple spending no more than what is deemed to be a sustainable rent at 30 per cent of net income, would require gross earnings of around €46,000.

However, for households earning below the average income there is an affordability issue in Dublin. In a separate analysis of rent affordability for different categories of employees, using published earnings data from the CSO, those sectors containing the lowest paid workers, notably Wholesale and Retail, Admin and Support Services, Arts, Entertainment and Recreation and Accommodation and Food experienced the worst affordability problems. Moreover, low income workers are being squeezed out by competition from medium and high income workers in supply constrained areas, a development which is further exacerbated by the inadequate supply of housing at rents these lower income households can afford.

## 2.4 CONCLUSIONS

The housing market has seen a substantial increase in the number of rented households in recent years, with one in five households now renting in the private rented sector. There has been a reduction in all other tenure types. Owner-occupation continues to represent the largest share of housing provision at 70 per cent in 2011, albeit down from 75 per cent in 2006. Whether this is a permanent structural change in preference towards renting or just a temporary phenomenon until a normal housing market resumes remains to be seen. Nonetheless the sector needs to adapt for

a range of renters who are opting to rent either for the short, medium or long terms, as well as for those who have no choice but to rent for a range of reasons.

There are no comprehensive figures on the size of the sector but, based on the estimated 85 per cent compliance in regard to registration of tenancies by landlords, according to the PRTB, there are approximately 457,000 tenants, 179,000 landlords and 283,000 properties in the sector. However, based on other sources, there would appear to be a small number of properties and tenancies which are not captured by the PRTB.

Although rents have declined between 2007 and 2013, the PRTB Rent Index shows that rents increased during 2013 and in Q1 2014 were rising nationally by 3.5 per cent year on year and by 8.4 per cent in Dublin. Absolute rents for houses and apartments in Dublin are almost twice the level of rents for the same property types outside Dublin. Thus the rent affordability issue is confined to the Dublin area as rents elsewhere have been increasing by modest rates.

Based on the broad rule of a maximum limit of around 30 per cent of disposable income being equivalent to a sustainable rent, the analysis suggests that renting as a single person in the Dublin market is not affordable and has not been so for some time. For a working couple in Dublin the rent as a proportion of income in Q1 2014 (23.9%) is marginally up from the lowest point in the current cycle in Q4 2009 (20.8%) and is broadly similar to the proportion of net income required to fund a mortgage in Q1 2014. However, for households earning below the average income there is an affordability issue in the main cities, most notably Dublin, as competition from medium and high income households is squeezing them out of the market plus there is an inadequate supply of housing at rents these lower income households can afford.

## 3. RENT STABILITY REGULATIONS

### 3.1 INTRODUCTION

In the past 12 months, there is a growing concern among policy makers and the general public that Ireland is experiencing a shortage of affordable housing, particularly in the private rented sector. As the previous section highlighted, this crisis is most evident in Dublin, which has experienced strong rental price growth in the past year, resulting in deterioration in affordability, particularly for a single person. Notwithstanding the affordability problem experienced by single persons in Dublin, the sector has remained affordable for many couples as well as single persons and couples outside the Capital. Nevertheless, it is evident that many individuals and families are currently experiencing severe affordability problems and in some cases could be at risk of homelessness. Recent figures from Focus Ireland indicate that approximately 39 families a month are becoming homeless in Dublin. These trends in the housing market pose the question as to whether there is a market failure which warrants intervention.

Market failure in the housing sector generally refers to a situation where there is an inefficient allocation of resources. The rental market is particularly prone to market failure due to: information failures between landlords and tenants; changes in market power; and, delays in adjusting the supply of housing to meet changes in demand. The main reason generally put forward for intervening in the market is due to an inadequate supply to meet the growing demand. Since the supply of housing is fixed in the short run, any increase in demand will result in higher prices. However, the lack of supply also fuels problems of information failure and market power. In such a situation, there tends to be mounting political pressure to ensure that tenants do not suffer unduly.

### 3.2 TYPES OF RENT CONTROL

Rent controls were largely first introduced during World War I to mitigate the negative impacts of a shortage of housing during and after the war. While some countries continued to operate rent controls after the war many were discontinued and only re-emerged during World War II. After World War II many countries gradually sought to

remove rent controls. In the United States, with the exception of New York, rent controls were discontinued by 1950. In many European cities<sup>17</sup>, rent controls remained in place considerably longer, up until the 1970s.

Rent controls which were introduced during World War I and World War II were known as *first generation* rent controls and generally involved a rent freeze. Such measures were often seen as crude instruments and are frequently cited as one of the main reasons for declines in the private rented sector, particularly due to an inability to remove or adapt them to changing economic circumstances.<sup>18</sup>

While first generation rent controls were in many cases gradually removed after the war, the 1970s saw the introduction of *second generation* rent controls, particularly in the United States and Canada. The energy crisis of the 1970s is often cited as the main reason for their introduction<sup>19</sup> as well as a move to combat inflation.

Second generation rent controls were not as rigid as first generation controls and generally involved regulations around allowable increases in rent levels, often in line with the rate of inflation. Additional increases were often acceptable subject to certain conditions including: capital improvements to buildings; ensuring landlords' generated sufficient rates of return; and in some instances, in cases of hardship to ensure landlords did not have cash-flow problems. In many cases, regulations did not apply to newly constructed rental properties and in some cases decontrol was allowable once rent levels reached a predefined level.

While the introduction of both first and second generation rent controls were often cited as temporary, this was often not the case in reality. Nevertheless, second generation controls were in many cases subsequently amended and became known as *third generation* rent controls. Third generation rent controls essentially involved regulated rents *within* a tenancy but decontrol *between* tenancies. Various forms of rent control remain in operation today in a number of jurisdictions.

<sup>17</sup> Arnott (1997) Rent Control. Department of Economics, Boston College, USA.

<sup>18</sup> O'Sullivan & De Decker (2007) Regulating the Private Rental Housing Market in Europe. UCD.

<sup>19</sup> *ibid.*

### 3.3 ECONOMIC REVIEW OF RENT REGULATIONS

Across economic literature the theoretical justification for rent regulation is relatively weak and is often associated with unintended consequences for tenants. While the more stringent regulations in the form of rent controls or rent freezes have largely disappeared from many jurisdictions, regulations in the form of rent stabilisation or inter tenancy stabilisation now seem to dominate. Nevertheless, the benefits arising from these second and third generation rent controls are still subject to debate. A review of the literature which follows sets out some of the impacts arising from first generation to third generation rent controls.

#### 3.3.1. Impact on Housing Supply and Investment

Increasing the supply of rental property is critical to offering tenants more choice and better standards of accommodation as well as addressing affordability issues. One of the most commonly cited criticisms of rent regulations is the potential impact they can have on the supply of new property into the sector. The impact on supply is likely to vary according to the stringency of the rent regulations and will undoubtedly be more significant in jurisdictions where rent is controlled compared to jurisdictions where rent is stabilised.

Rent regulations can be viewed as a form of price fixing whereby the controlled price is less than the market price. This is particularly evident among first generation rent controls and to some extent in second and third generation controls. The gap between the controlled price and the market price can result in a widening of the gap between supply and demand.

Walker (1981)<sup>20</sup> cites the analogy of a tax on suppliers, and argues that the difference between the controlled price and the market price is essentially a tax and therefore the only way to avoid this tax is to reduce supply. In contrast, the difference between the control price and the market price is essentially a subsidy for consumers and therefore consumers demand more of the

product than is necessary. Ault (1981)<sup>21</sup> further supports this view and argues that rent controls contribute to any prevailing housing shortage.

These arguments are particularly relevant in the case of first generation rent freezes where there is a significant gap between the controlled rent and the market rent. The impact on supply of such stringent rent control measures was evident in the UK where rent freezes after World War II were associated with landlords exiting the sector as well as being a key factor in limiting new supply (Kemp 2004).

While stringent first generation rent controls have largely been replaced by second and third generation rent regulations, the potential for a negative impact on supply prevails albeit the impact on new construction is often less clear. Lind (2003)<sup>22</sup> argues that the impact of rent regulation on construction will depend on a number of issues including the form of rent regulation but also other policies in place and the overall role of the private rented sector.

Lind's analysis of the Swedish Market in the 1995-2001 period found that rent regulation was only a minor factor in keeping housing construction at very low levels during that period. Other issues included a difficult planning process, the Swedish tax system which favoured condominium purchase, as well as the prospect of higher and more immediate profits from condominium sales than rental apartment developments.

These findings would indicate that the impact of rent regulation on construction cannot be viewed in isolation of other policies that prevail. Nevertheless, rent regulations are often still seen as a contributory factor in the decline of the private rented sector in some jurisdictions. Montague (2012)<sup>23</sup> notes that investors' current interests in the private rented sector would easily be undermined by proposals for rent regulations or enhanced restrictions on gaining vacant possession.

<sup>20</sup> Walker M.A (1981) Rent Control Myths & Realities International Evidence Of The Effects Of Rent Control In Six Countries. The Fraser Institute 1981 Chapter 2: A Short Course In Housing Economics.

<sup>21</sup> Ault Richard W. (1981) Rent Control Myths & Realities International Evidence Of The Effects Of Rent Control In Six Countries The Fraser Institute 1981 Chapter 3: The Presumed Advantages And Real Disadvantages Of Rent Control

<sup>22</sup> Lind, Hans (2003) "Rent regulation and new construction: with a focus on Sweden 1995-2001," Swedish Economic Policy Review, 10: 135-167.

<sup>23</sup> Montague (2012) "Review of the barriers to institutional investment in private rented homes". Department for Communities and Local Government.

In the Netherlands, the decline in the private rented sector, which has occurred since the 1980's, has been associated with the tight regulation of both rents and tenancies that prevail there (Whitehead 2012)<sup>24</sup>. However, once again it is recognised that other issues have also played a role, including subsidies and tax incentives available to owner occupiers.

A 2013 review by the European Commission on the Swedish rental market indicates that rent regulation has an impact in achieving a balance between supply and demand of rented accommodation. In the review, the Commission suggests a more market orientated rented sector in order to improve the supply situation:

*'In order to improve housing market efficiency, further reforms to the rent-setting system might be envisaged to allow market forces to establish an optimal supply of rental housing at an adequate price'.*

One suggestion put forward by the Commission included the introduction of market rents for newly constructed rental units.

The exemption of newly constructed units from rent regulations has been a policy feature adopted by many jurisdictions in an attempt to overcome the potential negative impact on supply. While such a policy should have a positive effect on supply, it has been noted that in many cases investors remain cautious about investing due to a fear that regulations could be extended to new units in the future (Whitehead 2013)<sup>25</sup>.

A rent paper by Prof Dr Tobias Just<sup>26</sup> on the proposed regulations in Germany further highlights this concern. Just sets out that the increase in rents in some cities has been due to a shortage of new builds. It is argued that in response to a shortage in the rental market, the ability of the market to respond should be improved, not further restrained, as evidenced by the recent moves to introduce further rent regulations. The paper concludes that the biggest danger of the proposed new legislation lies in the

real possibility that investors may over-react and drastically reduce their investments in the rental market. Should this occur the measures proposed to ease stressed markets could result in the opposite effect.

It is clear that rent regulations are just one factor in an investment decision and given that rent regulations are often implemented in areas with rising rents and high population growth, investment may remain attractive even after regulations are implemented. However, it is also important to recognise that the attractiveness of investment will also be a function of the policies which prevail in each location. Nevertheless, it is likely that the level of investment will be lower than in a free market.

Whitehead (2012)<sup>27</sup> sets out that one of the core arguments against regulation is that, regardless of policy makers' initial objectives, rent regulations reduce the incentives for landlords to provide accommodation and often lead to established landlords leaving the sector when they would prefer to remain. While recognising that this issue is fundamental in the case of first-generation regulation, it is set out that such problems are: *"very likely to occur even with 'perfect' third-generation regulation, which in principle can benefit both landlords and tenants"*.

### 3.3.2. Protecting the Vulnerable

It is often argued that rent regulations while not addressing the housing shortage may in fact address some of the negative impacts associated with a housing shortage. One of the arguments often put forward in favour of rent regulations is that it protects vulnerable tenants who are not in a position to sustain large increases in rents. This is certainly the case where rent increases are regulated for long periods of time and where there is strong security of tenure for tenants, such as in New York.

Research undertaken by the Furman Center for Real Estate and Urban Policy in New York notes that stabilized units are generally home to lower income and minority households than market-rate units. Nevertheless, it is noteworthy that since there is no income test for tenants seeking to rent a stabilized apartment, some of the people who enjoy the benefits of rent stabilisation are not low-income households. The majority of people in

<sup>24</sup> Whitehead (2012) The Private Rented Sector in the New Century. A Comparative Approach. Med dansk sammenfatning

<sup>25</sup> Whitehead, C.W. and Scanlon, K. (2013) (with CCHPR) "Building the Rented Sector in Scotland". Homes for Scotland. November 2013.

<sup>26</sup> Prof. Dr. Tobias Just, (2014), Mietpreisbremse: Droht den Mietern ein neuer Kobra-Effekt?, Immobilien und Finanzierung, page 236 Universität Regensburg Und Irebs Immobilienakademie

<http://www.irebs-immobilienakademie.de/irebs-standpunkt/irebs-standpunkt-nr-28/>

<sup>27</sup> *ibid*

rent-regulated apartments in Manhattan make far above the poverty level. This would indicate that long term rent stabilisation regulations tend to favour incumbents over new comers to the market.

However, while these regulations may benefit the tenant in terms of rent levels, it has been noted that in many cases the overall benefit to the tenant is diminished in the medium to long term particularly as landlords will seek to reduce maintenance costs. While such a situation may be alleviated somewhat where landlords can reasonably expect future rent increases, such as is the case in rent stabilisation, tenancy regulation or cost pass through provisions, there may still be an incentive for landlords not to respond to tenants complaints promptly in the hope that the tenant will vacate the property and so the rent can revert to the market level.

While tenancy regulations have become more prevalent in recent times, particularly to address some of the aforementioned issues, these regulations may result in landlords frontloading rent increases at the outset of the tenancy due to the limited ability to increase rents in later periods. The potential for such practices have been highlighted in a number of research papers including Basu and Emerson (2000)<sup>28</sup> and Cuerdo *et al* (2014)<sup>29</sup>. In such a situation the tenant is worse off. Alternatively, even where the landlord does not front load the rent, tenants may be subject to significant rent increases at the end of the tenancy when the rent reverts back to the market particularly if supply is constrained.

The desire for market rents by landlords may also result in a preference for short term tenancies particularly in a supply constrained environment. Ball (2010)<sup>30</sup> indicates that behaviour which favours short term over long term tenancies can result in unfortunate outcomes for the most vulnerable households, as their opportunity to live in rental property for long periods of time is restricted.

Furthermore, in situations where rent regulations operate in a supply constrained market; there is also the potential for landlords to have more flexibility in their choice of tenant. In some cases this may be influenced by illegal black market payments or a premium for a unit if the rent is to be pegged for the duration of the tenancy. Alternatively, it may be based on a judgement by the landlord as to the reliability of the tenant, the possibility of damage and so forth. Thus, it is likely that if the landlord has any prejudices they will be more likely to choose tenants in a discriminatory manner which is likely to disadvantage minority groups or low income households.

Thus, while rent regulations can be beneficial for vulnerable low income groups there is still the potential for adverse impacts arising from them. Moreover, vulnerable groups that are currently outside of the private rented sector may be even more disadvantaged in seeking to enter the sector than incumbents. Nevertheless, some proponents of rent regulations argue that rent regulations have the potential to create diverse communities and provide affordable accommodation options, which in turn can have a stabilising impact on neighbourhoods<sup>31</sup>.

### 3.3.3. Quality of Housing

The potential impact of rent regulations on the quality of housing relates to the prospect of landlords not actively maintaining the property. While this may be alleviated through cost pass through provisions, the desire to revert to the market rent may make these provisions less than satisfactory. This would be particularly relevant where landlords may be able to seek out the highest paying tenant.

In many jurisdictions, the application of rent regulations often exempts new rental units, in an attempt to stimulate supply. However, this can result in regulated units being older and of a lower standard, particularly where the return for the landlord is insufficient to promote repair and maintenance work. Moreover, the need for affordable housing at the lower end of the market often makes the most vulnerable tenants accept accommodation which is below expected standards.

<sup>28</sup> Basu, K. and P.M. Emerson, (2000), "The Economics of Tenancy Rent Control", *The Economic Journal*, Vol. 110.

<sup>29</sup> Cuerdo, et al (2014) "Rental Market Regulation in the European Union" *Economic Papers* 515 | April 2014 European Commission.

<sup>30</sup> Ball, Michael (2010) "The UK Private Rented Sector as a Source of Affordable Accommodation". JRF programme paper: Housing Market Taskforce. York: Joseph Rowntree Foundation.

<sup>31</sup> Rent Control In The District Of Columbia: An Analysis Of The Quality, Condition, Maintenance And Economic Impact On Housing Accommodations. Robin Miller. Washington, DC. August, 2010.

Research on the Flanders region of Belgium highlights that with the private rental sector contracting, the proportion of vulnerable households which depend on the sector is increasing. In some cases this can result in the agreed rent for a property not being in line with the quality of the rented premises since the demand for cheaper housing exceeds the supply (Winters and Vermeir, 2013)<sup>32</sup>.

### 3.3.4. Household and Labour Mobility

Since the introduction of rent regulations can impact on the supply of rental housing and also taking account of the fact that in many cases rent will be lower than in the free market, rent regulations tend to reduce the mobility of households. The reduction in mobility can result in a mismatch in the allocation of property and also adversely impact the allocation of workers.

These impacts can be seen where young, growing families stay in units that are too small for their needs while older families whose children are leaving home will hold onto larger units rather than relinquish a rent regulated unit. Clearly this results in an inefficient use of the current housing stock. The reduction in mobility will also negatively impact new renters in the market since rent regulations favour incumbent tenants.

Research undertaken by Krol and Svorny (2005)<sup>33</sup> finds that tenants in rent controlled units are likely to have longer commute times, and thus additional fuel costs as well as higher vehicle wear and tear. They note such findings can be particularly detrimental to economically vulnerable groups' participation in labour markets.

Moreover reduced mobility may have an impact on employment levels as individuals will not move to take up employment elsewhere due to the loss of a rent regulated unit. While the impact of reduced labour mobility will be more pronounced in a rent controlled environment, it will also be evident in rent stabilised environments as tenants will not want to revert to market rent until absolutely necessary.

### 3.3.5. Home Ownership

The potential impact of rent controls in fuelling home ownership is also well documented. Friedman and Stigler<sup>34</sup> (1946), suggest that rent controls led to higher rates of home ownership as landlords chose to sell at uncontrolled prices rather than continuing to rent out their properties at the controlled price. This argument is supported by trends in the UK which saw a large number of landlords leave the sector with many sitting tenants buying the properties. Research undertaken by Fetter<sup>35</sup> (2013) indicates that rent control may explain 65 percent of the urban increase in home ownership in the United States during the early 1940's. The analysis of rent regulations across cities in the United States indicate that where rent controls were more severe there were greater increases in home ownership.

While such findings largely relate to first generation rent controls, which do not operate as pervasively as previously, rent stabilisation may also lead to a reduction in rental stock and a move towards home ownership by tenants. However, in many jurisdictions, such trends were also fuelled by government policies which supported home ownership. Research on the Swedish rental market suggests that part of the rental stock shortage is due to rental units being sold as landlords exit the sector due to dissatisfaction with regulations, coupled with a desire for home ownership among individuals. Such behaviour is likely to become more prevalent in jurisdictions experiencing strong house price growth and will undoubtedly impact poorer tenants due to an inability to obtain finance for purchase and the subsequent decline in the rental stock.

### 3.3.6. Black Market Transactions

Finally the introduction of rent regulations has also been associated with black market transactions. These often take the form of "key" or "furniture" money in order to avail of a rent regulated unit, or in some instances incumbent tenants subletting units at a profit.

The European Housing Market Review highlighted that rent regulations in Sweden have encouraged

<sup>32</sup> The evolution of the private rental market in Flanders. Sien Winters and Diederik Vermeir (2013).

<sup>33</sup> Krol, Robert and Svorny, Shirley (2005) "The effect of rent control on commute times". *Journal of Urban Economics*, 58(3): 421-436.

<sup>34</sup> Friedman, Milton, and George J. Stigler. 1946. "Roofs or Ceilings? The Current Housing Problem." *Popular Essays on Current Problems*.

<sup>35</sup> Daniel K. Fetter. *The Home Front: Rent control and the rapid wartime increase in home ownership*. October 28, 2013. Wellesley College and NBER.

black-market transactions with the result that existing tenants often receive significant payments for sub-letting or undercover payments from new tenants before agreeing to vacate the property.

Tenant advocacy groups suggest that black market transactions are also currently evident in Ireland under the Rent Supplement system, which is a form of rent regulation. They suggest that some tenants pay landlords top up payment in excess of the rent limits set in order to secure accommodation; however it is not known how prevalent such practices are. The introduction of the new HAP payment, which involves direct payment of rent to landlords via the local authorities, may reduce the incidence of illegal top ups.

### 3.3.7. Summary

Economists would generally view rent control as a second best option, dealing with the symptoms of the problem rather than with the cause. The practice of changing regulations in response to market failure does not address the underlying cause of the problem. In the majority of cases, the need for rent regulations has arisen due to a lack of supply of rental housing; however, the introduction of regulations in some cases can have a detrimental effect on new supply. In recent times many jurisdictions where rent regulations are in operation have introduced incentives to increase investment in the sector.

Proponents of rent regulations may argue that initial introduction of rent regulations on a short term basis may have merit; the reality is that the politics of regulation is such that it becomes increasingly difficult to remove such provisions in the future. In particular, Schmid (2009)<sup>36</sup> highlights the importance of political motivations rather than market developments as the main driver of fluctuations in tenancy law. Moreover, given that rent regulations will eliminate price signals from the market, it also becomes increasingly difficult to determine which markets continue to suffer from lack of supply and in which markets rent regulations should be removed. There is also the added requirement to ensure legislation is sufficient to provide security of tenure which cannot be abused by landlords.

<sup>36</sup> Schmid, C.U. (2009), "General Report on European Tenancy Law," European University Institute Research Project on Tenancy Law and Procedure in the EU.

While the form of rent regulations can vary from first generation stringent rent control to third generation tenancy controls, there still exists the potential for a number of negative impacts on the market, including black market transactions, lower quality housing and reduced mobility not to mention the impact on supply. As Arnott (2003)<sup>37</sup> explains, any decision around intervening in the market needs to be assessed on a case by case basis and not on ideological grounds. This is particularly relevant for rent regulations given how housing markets, economic conditions, government policies and demographics can vary across jurisdictions.

## 3.4 RENT REGULATIONS IN OTHER JURISDICTIONS

A review of a number of countries across Europe and America reveals the degree to which rent regulations operate today. In undertaking this review, particular emphasis was placed on countries which have a strong private rented sector. Taking account of these criteria, Germany, Belgium, the Netherlands, Sweden, Switzerland, France, the UK and some cities in North America were reviewed. However, prior to setting out the operation of rent regulation in each jurisdiction, the profile of the private rented sector in each of the European jurisdictions is presented.

### 3.4.1. Profile of the Private Rented Sector in other Jurisdictions

The rental of dwellings from private landlords is a sector of residential markets which varies significantly in both scale and importance internationally. In many developed countries worldwide, the private rented sector has reduced from being the tenure of choice in the last century to a minority option today. The decline in the private rented sector in many cases reflects the impact of expanded social housing along with household preferences for owner- occupation.

Table 3.1 sets out the population by housing tenure across the European jurisdictions reviewed. The most up to date information relates to 2012; however it is anticipated that there are unlikely to have been any significant changes since then. It is evident that in many of the European countries selected the population residing in the private rented sectors is larger than the EU27 average of 12 per cent. In particular, the proportion of

<sup>37</sup> Arnott R. (2003) Tenancy Rent Control Swedish Economic Policy Review 10 (2003) 89-121.

residents in the private rented sector in Germany is relatively high by Western European standards, accounting for 36 per cent of the population, almost in line with that of owner occupation. The private rented sectors in Sweden and France represent in excess of 20 per cent of the population, while in both Ireland and the UK it stands at 18 per cent. Of the European countries reviewed, the Netherlands has a relatively undersized private rented sector at just 8 per cent of the population.

The relatively low proportion in the Netherlands is likely to be a reflection of the sizeable social rented sector there which accommodated 31 per cent of the population in 2012 compared to a EU27 average of 12 per cent. Germany (22%), UK (20%), France (15%) and Sweden (14%) also have strong social housing sectors relative to the EU

average, while in Ireland and Belgium, the social rented sector accounted for only 7 and 9 per cent of the population respectively.

**3.4.2. Forms of Rent Regulations**

In general rent regulations were first introduced during the period of the World Wars, in response to the housing shortage which occurred at that time. Such regulations were known as first generation rent controls and essentially involved a rent freeze. However, due to the negative impacts that often resulted from these controls, many jurisdictions subsequently adjusted regulations in order to become less onerous while in other cases there was a complete reversal of the the policies.

**Table 3.1: Population by Housing Tenure for Selected Jurisdictions**

	Owner Occupier (%)	Private Rented (%)	Social Rented (%)	Rent Free/ Other (%)
Belgium	63	23	9	5
France	58	22	15	5
Germany	40	36	22	2
Ireland	72	18	7	3
<i>Ireland (Households) *</i>	70	19	9	3
Netherlands	58	8	31	3
Sweden	58	23	14	5
Switzerland**	35	58	3	4
UK	58	18	20	4
EU27	<b>66</b>	<b>18</b>	<b>12</b>	<b>4</b>

Source: European Quality of Life Survey (2012)  
 \* 2011 Census of Population (based on households).  
 \*\*Private Rented Sector in the New Century. University of Cambridge 2012

Some jurisdictions which had removed rent controls after the World Wars did subsequently re-introduce them in the 1970s. In Washington DC, rent regulations were reintroduced in response to the energy crisis of the 1970s and in an attempt to curb inflation at that time. In Switzerland, rent regulations were introduced in 1972 due to significant rent increases in the previous two year period.

In those jurisdictions where rent regulations are in place, second and third generation rent stabilisation measures are the norm. In recent months, some jurisdictions have been considering the introduction of additional rent regulation measures in response to large rent increases, most notably Germany and France. In general, rent regulations cover both initial rents and also the method for rent increases.

Initial rent setting can vary from being freely determined by the market, to being subject to a rent cap. Initial rent ceilings are in effect in both the Netherlands, where initial rents are set based on a points system, and in Sweden, where rent ceilings are set through negotiation between public housing companies, tenants unions and private landlords. In the United States, Washington DC also operates a capped initial rent which is pegged at the rent ceiling for the unit as of April 30, 1985. Ireland, Switzerland, Belgium, the United Kingdom and Ontario allow for initial rents to be freely determined between the landlord and the tenant. Germany also allows initial rents to be set by the market, however it is an offence to charge in excess of the market rent and so there is an incentive to set rents in line with the market average. Germany is currently proposing a new

system for initial rent setting to be capped at 10 per cent above the average market rents.

The policies in relation to rent increases within a tenancy also vary significantly. In the majority of jurisdictions rent regulations stipulate that rent increases are only allowable once every 12 months. In both Ireland and the UK, rent increases are set to be allowable in line with market rents every 12 months. Germany also sets out that rent increases must be in line with market rents; however it sets out that for rental units whose rent is significantly below the average market rate, rent increases must not be greater than 20 per cent over a three year period and in areas of housing shortages this limit has been reduced to 15 per cent.

In some cases while the initial rent is freely established between landlord and tenant, rent regulations apply for the period of the tenancy. For instance, in Ontario, rents are adjusted within the tenancy in line with changes in the consumer price index while in Belgium; adjustments in rents

are in line with a health index. Other jurisdictions such as the Netherlands and New York, have rent adjustments set by the Government while in Sweden rent changes are determined by negotiation between landlords, tenant associations and public housing bodies.

In many cases there are exemptions from rent regulations or allowances for additional increases beyond the rent increase limits set. Exemptions from rent regulations often apply to new rental units or to rental units where the rent has reached a maximum threshold or in some cases based on the income of tenants. Additional allowances are often permissible in the case of investment in the unit, the provision of additional services for the tenant or in some instances in the case of hardship of the landlord.

A short synopsis of the practices in other jurisdictions is set out in Table 3.2 while more detailed information is provided in Boxes 1 to 11 overleaf.

**Table 3.2: International Overview of Rent Regulations**

Country	Initial Rent Setting Regulated	Rent Increases Regulated	Exemptions
Belgium	No	Yes	Short term contracts
France	Yes	Yes	Let for the first time Renovation cost is greater than one year’s rent
Germany	Partial	Partial	Relay leases, fixed rent contracts and index linked contracts
Ireland	No	No	N/A
Netherlands	Yes	Yes	Rent in excess of €700/month
Sweden	Yes	Yes	Newly constructed rental properties (but prior agreement on the rent level from a local tenants’ association) Privately let tenant-owned apartments and one-dwelling buildings (since February 2013)
Switzerland	No	No	N/A
UK	No	No	N/A
New York City*	Yes	Yes	On vacancy and legal rent reaches \$2,500 + Legal rent of \$2,500 + and tenants annual federal adjusted gross incomes is \$200,000 + for each of the two preceding calendar years
Washington DC**	Yes	Yes	Federally or District-subsidised units. Built after 1975. Owned by a private individual - no more than 4 rental units in the District. Vacant when the Act took effect
Ontario**	No	Yes	Not occupied for any purpose before June 17, 1998; No part of rental unit has been previously rented since July 29, 1975; or No part of the building was occupied for residential purposes before November 1, 1991.

**BOX 1: BELGIUM**

Rent controls operated in Belgium after World War II. They were originally introduced as temporary rental laws to curb inflation by blocking rents or imposing a limitation of rent increases to a certain maximum. Rent controls were also combined with the prolongation of the existing rental agreements in order to ensure security of tenure for tenants. However, due to legal uncertainty around these regulations, new bills that aimed to address these issues were submitted at the end of the 1970s however it was not until 1991 that separate rental legislation was included in the Civil Code (House Rent Act). The House Rent Act set out rental legislation that is still in practice today.

The 1970 National Housing Code established the legal basis for housing policy in the three regions of Belgium. While housing policy in Belgium was decentralised to the three regions of the country in the 1980s, rental legislation was not included in the transfer and remains the responsibility of the federal government. However, from 1 July 2014 the regions are now competent and responsible for the legislation concerning both private and social tenancy law.

**Initial Rents**

The House Rent Act sets out that tenants and landlords are free to determine the rent for a property.

**Rent Increases**

The legislation does allow for the rent to be adjusted each year in line with the cost of living ('Health index'). The Health Index is the consumer price index excluding 'unhealthy' products such as alcohol and tobacco. After the nine year period rents are reset based on market rents and the indexation will commence again. Rents can also be reviewed if certain objective criteria are met.

Generally, the rent may be adjusted at the end of a three-year period subject to negotiations between the landlord and the tenant. In the event that both parties cannot reach an agreement then a 'justice of the peace' will decide. Generally, rent increases are allowed if 1) the rent is at least 20% different from the actual rent because of changed circumstances; or 2) if the landlord can prove that the work necessary to reach the minimum quality will increase his costs by at least 10%.

**Exemptions**

For short term contracts, rent is controlled for the duration of the contract and neither the landlord nor the tenant can terminate the lease. Short term contracts can be extended once at the same rent. If the short term contract is not terminated at the end of the second period it is automatically seen as a standard nine year contract, in which case the annual rent indexation will apply, as well as a rent recalculation every three years. Other conditions may also deem a 9 year contract to be in place. If the tenant terminates the contract at the end of the period, the landlord will be free to set the rent for the new tenant, however, in the event that the landlord terminates the contract and enters into a new contract with another tenant the indexed rent may not be higher than that of the old contract.

**Current Issues/Impacts**

Since World War II, the PRS in Belgium has been shrinking in size, however one of the main reasons for this has been the focus on homeownership through tax incentives and premiums, as well as low interest rates and favourable economic conditions, which have contributed to increasing homeownership (Whitehead 2012).

One of the main purposes of rent regulations was to prevent systematic new short-term tenancy contracts of short duration between the same parties or with another tenant, each time at a higher rent. However, while the House Rents Act sets out the principle of the nine year lease, according to Tratsaert (2012), more than half of leases are for a period of three years or less.

**BOX 2: FRANCE**

The private rented sector accounts for approximately 25 per cent of households in France. There are a series of regulations governing the rental sector.

**History of Rent Regulation**

The 1948 Rent Act decontrolled all new buildings and conversions while leaving in place strong security of

tenure. This legislation is particularly important as it represents a dividing line with properties occupied before 1948 subject to stronger rent control. A period of liberalisation of rent controls changed in 1982 with strengthening of tenants' rights and the introduction of rent controls across the entire stock. However, as a consequence of these rent controls, construction levels declined and so a series of tax benefits for private sector landlords were introduced in 1986. This freed the rents of new and vacated units and allowed them to be revised annually in line with the construction price index. Because rents increased dramatically in some areas following the passage of the 1986 law, the government reintroduced stricter controls under the Mermaz-Malandain Law in 1989. As a result of this law, rent setting is uncontrolled for new contracts but the annual rent increase is regulated over the period of the lease. When a contract is renewed for a sitting tenant, the rent is based on the old rent or rents for similar properties in the same area. From 2006, the annual adjustment has been based on the National Institute for Statistics and Economic Studies Rent Reference Index, which was calculated on the basis of three indices: cost of living, maintenance and renovation costs and construction costs. Since 2008, annual rent adjustments have been based on the cost of living index alone.

Rent controls were introduced in France in 2012 to slow the pace of rent increase. These controls limit the rate of increase in a number of French cities.

### Initial Rents

The initial decree (from 2012) regulated the rate of increase on renewals and re-letting. The ALUR law (Sept 2013) regulates the level of rents in high pressure areas. To regulate the rent levels, a median benchmark rent per sq.m, per geographic area (neighbourhood, district, etc.) and per type of accommodation (one-bedroom flat, two-bedroom, etc.) is determined once a year.

### Rent Increases

In the absence of any major renovation the change in rents is limited to the increase of the rental benchmark index. These have been added to in 2013 when the level of rent was regulated in a number of areas designated as high pressure areas. Rent observatories will produce data on representative rents to set a benchmark for rents in different areas.

### Exemptions

Only properties that are being let for the first time or have been renovated, where the renovation cost is greater than one year's rent, will be uncontrolled.

### Current Issues/Impacts

The decree on rent control for France took effect on August 1, 2012 for a year with the aim of lowering market rents. The French research institute, ofce, have raised a number of concerns<sup>38</sup>. Their view is that the measure will only be positive for tenants if there is not a negative impact on rental supply and if landlords do not seek to offset future rent control by raising the rent at the time of the first letting. In addition, improvements or maintenance work may be postponed due to the lengthening of the period over which the landlord would get a return on this investment. However, the institute does point out that the decree may encourage some investment as major innovations (in excess of one year's rent) allows landlords to freely set the rent for the property.

#### Market Rent versus Asking Rents

Further analysis in September 2013 took the view that the while the decree had some impact on rent increases, overall it was minimal<sup>39</sup>. Factors identified as contributing to the reduced impact included the non-existence of benchmark rents, a lack of information about owners and tenants and a lack of recourse. A new Bill, the ALUR law, aims to regulate the level of rents in contrast to previous measures that had focussed on changes in rents. As a result of the measures under the ALUR law there will now be a reference benchmark rent based on the entire rental housing stock. They estimate that the existing "market" rent measure, based on vacant housing available for rent (i.e. asking rents), is almost 10 per cent above the average for all rents (i.e. market rent). Thus, by changing the reference measure to the "market rent", this should help bring about lower rents over time.

<sup>38</sup> Le Bayon, S., P. Madec, and C. Riffart, (2012) "Rent control: What is the expected impact?" *ofce* August 2<sup>nd</sup>.

<sup>39</sup> Le Bayon, S., P. Madec, and C. Riffart, (2013) "Rent control: will the ALUR law be sufficient?" *ofce* September 19<sup>th</sup>.

**BOX 3: GERMANY**

Rent regulations in Germany largely resulted from the housing shortage following WWI which continued for a period after WWII also. However, these policies failed to attract investment into the housing market and resulted in a move towards gradual liberalisation in the 1960s. The relaxation of the regulations had the aim of ensuring sufficient housing without anti-competitive cartels, giving sufficient returns for landlords to encourage investment and to supply sufficient housing for the population. Following on from this, the 2011 Tenancy Reform Act further simplifies the tenancy law. These reforms were deemed necessary to adapt tenancy law to changes in society: increased mobility of tenants, new forms of cohabitation, and the conservation of energy<sup>40</sup>.

German rental law is complicated. It is covered by close to 100 clauses in the German Civil Code. There are numerous lease templates and thousands of legal cases per year regulate the relationship between landlords and tenants.<sup>41</sup>

**Initial Rents**

For a new lease agreement, the tenant and landlord agree a rent between them, which they are free to determine. High demand for rental properties in some markets has led new rents to increase strongly, which in turn affects the average market rents which are used to guide rent increases for existing tenants (described below).

**Rent Increases**

At least 12 months after the tenant moves into the property (after signing of the lease) or at least 12 months after the last rent increase, the landlord can indicate to the tenant that he/she intends to increase rent. This is usually done by reference to the average market rent in the locality. Since 2001, official “*Mietspiegel*” (Tables Reflecting Local Rents), have been compiled by the local authorities. They include information on the basic rent spread and average rent for rented properties by location, age of building and facilities in rented property.

If such a local Table is available, the landlord has to utilise the figures contained in it. If the landlord for some reason uses other local comparators, he/she must at least reference the Tables if they are available for the locality. Other comparators allowable are three comparable apartments which pay as much as the increased rent or an expert evaluation. The increase only becomes valid when the tenant has agreed to the rent increase voluntarily or is ordered by a court to comply. The tenant is granted three months to examine the rationale behind the proposed increase and can get help from the local and national tenant associations. Landlords cannot increase rents which are considerably lower than the local market rate by more than 20% over three years. From 1<sup>st</sup> May 2013, local authorities with areas of housing shortages have been allowed to cap this increase to 15% in an effort to keep housing affordable.

**Exemptions**

Relay leases, fixed rent contracts and index linked contracts are excluded from any such rent increases. Rent increases without reference to local average rates are only allowable in association with modernisation and energy efficiency modifications to the building or apartment. Increasing the energy efficiency of the housing stock can also result in protected rents being increased.

**Current Issues/Impacts**

Subsidies to new construction for the rental market, along with generous depreciation allowances and fiscal benefits available to PRS landlords are cited as key factor that have resulted in a large private rented sector in Germany (Whitehead 2012). Moreover, strict mortgage finance regulation and low loan-to-value ratios, largely tenure-neutral tax treatment, and the inclusive nature of supply-side subsidy entitlement all play a role.

Recent trends show that core rents in Germany (excluding operating costs) have increased by 16.8% between

<sup>40</sup> The German Private Rented Sector- A Holistic Approach. Jonathan Fitzsimons March 2014. The Knowledge Centre for Housing Economics

<sup>41</sup> <http://mieterbund.de/index.php?id=mietrecht>

2000 and 2012, which is below the consumer price index (including rents) of 22.2% over the same period. Operating costs (heat, electricity, management fees etc) have risen more strongly at 27.8%.<sup>42</sup> Rents for “Altbau” (old stock) rose by more (16.9%) than newly built accommodation (13.7%). Altbau typically refers to historic buildings closer to central areas in towns. These apartments are more desirable as they often offer more generously proportioned rooms in nicer locations. Data show that there is a significant spread between the top regions (Hamburg, Bavaria and Berlin), which are all recording increases of over 10%, and the regions at the bottom of the table (all from the former East Germany), where the differential is much lower and even close to zero in Saxony and Saxony-Anhalt.

In 2012, 200,000 new units were built. However the estimated demand was 224,000 units, leaving a short fall of 24,000 units.<sup>43</sup> This has resulted in rising prices and rents and shortages of suitable accommodation, particularly for lower income households.

#### Proposed New Rent Control Measures<sup>44</sup>

New rent control measures (*Mietpreisbremsen-Regelung*) were part of the Programme for Government in 2013 and draft legislation to that effect was tabled in April 2014. The final details are still being finalised by the Coalition parties. It is anticipated that the draft legislation will enter the parliamentary process in the second half of 2014 to be effective in 2015, if all goes according to plan.

The proposed measures will be applied in cities/areas where the housing market is under pressure. These areas are to be identified by the *Länder* governments. Such an assignation can only be made for a five year period. The *Länder* governments in turn will need to pass the required regulation to enable them to enact the new legislation.

The latest proposals entail the following (subject to change as lobbying continues), in addition to the earlier described capping of rent increases already in existence:

- Rent control will be extended to new leases, which were previously exempt from controls.
- Rents for new leases in affected areas will also be controlled and can only be set at a maximum of 10% above the average local rents. This is aimed at keeping the local average rates low, which are reflected in the Mietspiegel.
- Newly built or significantly renovated apartments are exempt from this rule.
- If the previous rent was above the local average, it need not be lowered for the new tenant.
- Landlords will not be able to automatically charge fees for estate agents’ services to tenants any more. Instead, these substantial fees (up to two monthly rents) will have to be paid by whoever orders their services. “He who orders pays”.

It is possible that some legal challenges to the constitutional court may be forthcoming. This has been strongly hinted at by the landlords’ associations Haus & Grund.<sup>45</sup> Publication. Ever since the new *Mietbremse* regulation has first been mooted during the 2013 election campaign, the arguments from the public have been divided along predictable lines. It is expected that these new rent controls will not be in place before 2015/16.

#### Box 4: Ireland

Rent controls were introduced in Ireland during World War I and operated on essentially the same basis up until 1960. In 1960, the Rent Restrictions Act brought in significant changes to the regulations and provided permanent control over units covered by the previous acts and generally provided rent control on unfurnished dwellings and decontrolled a number of dwellings subject to certain criteria. In 1981 following a constitutional challenge, the Supreme Court found that Parts II and Parts IV of the Rent Restrictions Act 1960-1967 were unconstitutional (See Section 7 of this report) and subsequently introduced the Housing (Private Rented Dwellings) Acts of 1982-1983 which sought to phase out the formerly rent-controlled sector. The rent controlled sector has essentially disappeared in Ireland today.

<sup>42</sup> <http://mieterbund.de/index.php?id=37>

<sup>43</sup> Institut der deutschen Wirtschaft Koeln (2014), Immobilien Monitor

<sup>44</sup> Source: Bundesministerium der Justiz und fuer Konsumentenschutz (Department of Justice and Consumer Protection) [http://www.bmju.de/DE/Themen/Gesellschaft/Mietpreisbremse/FAQ/\\_node.html](http://www.bmju.de/DE/Themen/Gesellschaft/Mietpreisbremse/FAQ/_node.html)

<sup>45</sup> Haus & Grund Report 1.2014 <http://www.hausundgrund.de/hug-report.html>

### Initial Rents

The Residential Tenancy Act 2004 sets out that tenants and landlords are free to determine the rent for a property but sets out that the rent must not be greater than the amount of the market rent for that tenancy at that time.

### Rent Increases

The legislation also provides that rent increases can take place once every 12 months and again sets out that the rent must not be greater than the amount of the market rent for that tenancy at that time. Landlords are obliged to provide at least 28 days written notice of any rent increase. Market rent is defined in the legislation as:

*“the rent which a willing tenant not already in occupation would give and a willing landlord would take for the dwelling, in each case on the basis of vacant possession being given, and having regard to the other terms of the tenancy, and the letting values of dwellings of a similar size, type and character to the dwelling and situated in a comparable area to that in which it is situated”.*

It is our understanding that in the event of a dispute in relation to rent setting the PRTB tribunal will take account of whatever information is presented by both the landlord and the tenant. In some cases this may be the PRTB Rent Index or alternatively rental asking price data from other sources.

### Exemptions

An additional rent increase may occur within the 12 month period if a substantial change occurs in the nature of the accommodation provided under the tenancy, and if that change would result in the rent being different to what the market rent for the tenancy would have been at the time of that last review or the commencement of the tenancy.

### Current Issues/Impacts

According to the PRTB Index market rents fell sharply throughout 2008 and 2009. Rents increased again during 2013 and by Q4 2013 were rising nationally by 3 per cent year on year and by 7.1 per cent in Dublin. There is now an increasing concern as to affordability of rented accommodation particularly in Dublin.

## Box 5: The Netherlands

Like many other European countries, the Netherlands introduced rent controls to deal with wartime shortages which lasted up to 1951, which was subsequently followed by a range of differentiated rent increases. In 1967, annual rent increases were introduced and decontrol began in areas with a housing surplus of 1.5 percent or more. A national points index of housing quality was introduced in 1971 and in 1979 rent controls were extended across the country and essentially reversed the decontrol which had previously taken place. Rent regulation in the Netherlands has three strands: the maximum permitted rent level, the permitted rate of annual adjustment, and regulations dealing with tenant protection.

### Initial Rents

Maximum rent permitted is based around a points system, whereby the maximum rent is determined based on the number of points a property is awarded. Points are on the basis of the quality of the dwelling (size, facilities, type of heating etc.) and the facilities of the surrounding area (availability of shops, schools, public transport etc.). Since 2011 additional points have been awarded to properties in areas of supply shortage, with a view to increasing supply through a higher initial rent for new rental contracts. Properties scoring points above a set maximum are in the deregulated section of the market.

### Rent Increase

The maximum rent increase permitted is calculated by the government, taking account of the cost of living, wages and building costs. Since 2007 the maximum rent increase has been set by government based on the consumer price index.

For new tenants, rents are agreed between the landlord and the tenant up to the maximum permitted rent based on the quality points for the property. If the tenant is dissatisfied with the proposed rent there is the option of going before the local rent committee where the points system would be applied. Tenants have strong security of tenure with leases generally being of indefinite length. The notice period is between 3 and 6

months depending on how long the tenant has lived in the property.

### Exemptions

The government began to liberalise the rented sector in the 1990s and continues to allow units to become deregulated when rent reaches €700 per month.

### Current Issues/Impacts

The size of the private rented sector in the Netherlands has declined since the 1980s which has been associated with the tight regulation of both rents and tenancies. The number of private rented dwellings fell from 982,000 in to 646,000 in 2010. Other issues include subsidies and tax incentives available to owner occupiers (Whitehead 2012).

The literature suggests that the impact of regulation in the Netherlands has been to reduce the size of the non-regulated sector and leaving a rental market dominated by the regulated rental sector. Vandevyvere and Zenthöfer (2012) have expressed some concerns about the welfare consequences of rent regulation in the Netherlands<sup>46</sup>. They argue that social sector landlords keep rents below the maximum rent level and below the market rent. Thus, the gap between the regulated rent for social housing and the unregulated sale price has created a wedge between the rental and homeownership market. This has two consequences: low income earners are driven into the rental market, and there is a lack of flow between the property rental and property ownership markets. They also point to the fact that income eligibility is only checked upon entry into social housing but not subsequently. This limits mobility and favours those *in* social housing rather than those *seeking* social housing. However, in a recent change landlords are allowed to seek higher rent increases in 2013 and 2014 from households with higher incomes.

In 2013 media reports noted that the demand for rental housing outside the rent-controlled sector is increasing primarily due to the fact that people who want to buy are often unable to get finance which is pushing them into the rented sector, while those individuals who have bought a new house but are unable to sell their original property are also renting these out. In 2013, 75% of newly built homes in the Netherlands were being offered for rent, compared with 50% before the housing crisis<sup>47</sup>. More recent reports in 2014 note significant changes in the market have taken place over the past year and point out that since the housing market is recovering, fewer private owners are renting out their unsold property. They also note that the number of private flats and houses offered for rent in the first quarter of 2014 was down almost 24% compared with the first three months of 2013, - while the strongest demand is for properties with rents of between €700 and €1,000 remains.

## Box 6: SWEDEN

Rent controls in Sweden date back to the early 1920s before being amended several times and are currently based largely on the 1978 Rent Negotiation Act. The regulatory system in Sweden is largely based on three pillars: actual standard of living, comparable properties in the vicinity, and a collective rent negotiation system<sup>48</sup>.

### Initial Rent

Traditionally, rent increases in Sweden were determined by negotiation between publicly owned housing companies and the Swedish Union of Tenants, with private landlords obliged not to surpass the price ceiling established during these negotiations by more than a maximum of 5%.

### Rent Increases

Rent increases are determined by a rent valuation model which is based on a set of characteristics defined as the so called utility value of any given dwelling, including factors such as the level of standard, services offered and the condition of the dwelling<sup>49</sup>.

<sup>46</sup> See also van Dijk and Romijn (2010).

<sup>47</sup> [http://www.dutchnews.nl/news/archives/2013/01/rental\\_housing\\_market\\_grows\\_as.php](http://www.dutchnews.nl/news/archives/2013/01/rental_housing_market_grows_as.php)

<sup>48</sup> Liabäck & Skogsäter (2013) Refurbishment Effects in Residential Areas. The Case of Högsbohöjd. Chalmers University of Technology. Göteborg, Sweden 2013.

<sup>49</sup> European Commission In-depth review for Sweden in accordance with Article 5 of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances.

Following a complaint to the European Commission, the 1978 Rent Negotiation Act was amended in January 2011 and now stipulates that rent levels can be set in accordance with comparable apartments in the area. This is in contrast to previous legislation that only allowed comparison to semi-public housing properties. Thus, negotiations now take place between public housing bodies, the Swedish Union of Tenants and the Swedish Property Federation.

In addition a new rent adjustment model was developed for Stockholm with the aim of adjusting the utility model to focus on the the location of the building and thus tenants' real preferences. The model has been contentious between the negotiating parties with landlords looking for rent increases in the region of 10-15%. The Rent Tribunal is currently assessing landlord's requests of roughly 10-15% rent increases for a number of pilot properties.

### Exemptions

Newly constructed rental properties are exempt from rent controls and in theory can charge market rents. However, in order to do so, the landlord must obtain prior agreement on the rent level from a local tenants' association in order to avoid a situation where the rent can be questioned by the Rent Tribunal. Since this exemption only covers the first fifteen years after which rents can be referred to the Tribunal on the basis of not being comparable to other units in the area, landlords tend not to charge the full market rent. Since February 2013, privately let apartments - tenant-owned apartments and one-dwelling buildings may be let at a rent linked to the market value of the property. Recent media reports suggest that this has caused a surge in rent levels often in the region of 20%<sup>50</sup>.

### Current Issues/Impacts

Statistics in Sweden may suggest that part of the stock shortage is due to rental units being sold as landlords exit the sector due to dissatisfaction with regulations. Between 1990 and 2010 circa 100,000 rental units exited the sector in Stockholm (European Commission Review).

Lind's analysis of the Swedish Market in the 1995-2001 period found that rent regulation was only a minor factor in keeping housing construction at very low levels during that period. Other issues included a difficult planning process, the Swedish tax system, the high cost of construction and the possibility to earn higher and more immediate profits for a developer that built and sold condominiums rather than rental apartments.

A public inquiry into the rental sector in 2012 criticised the current system and proposed a more gradual move to market conditions. Some suggestions put forward included incentives to increase investment in the sector and a greater weight on geographical location in the utility model. The European Housing Market Review also highlights that the rent regulations in Sweden have encouraged black-market transactions with the result that existing tenants often receive significant payments for sub letting or undercover payments from new tenants before agreeing to vacate the property. As a result of the lack of supply, the Stockholm Housing Service operates a queuing system with future tenants often waiting up to 14-17 years for city centre locations. In contrast, in other parts of the country where there is over supply of rental properties, the regulations often result in a higher rent than would be suggested by market conditions. This is primarily due to the utility value system where rental properties in undesirable areas with high unemployment attract high rents due to high quality well serviced housing.

### Box 7: Switzerland

Having abolished rent controls in 1970, Switzerland re-introduced them in 1972 due to large rent increases that occurred in the previous 2 years. The aim of the rent controls is to protect tenants from unjustified eviction and excessive profits.

### Initial Rent

The initial rent can be agreed by the landlord and the tenant. Rents are considered acceptable as long as they ensure normal profits. The system of rent controls in place is viewed as being 'second generation' rent controls. The initial rent can also be challenged if the tenant was compelled to sign the lease agreement

<sup>50</sup> <http://www.scancomark.com/Market/Persistent-increases-in-rents-in-Stockholm-partly-driven-by-a-new-law-111408042013>

because of a personal or family situation or because of conditions on the local housing market, and when the landlord raised the initial rent considerably over that of the previous lease.

### Rent Increases

Rent increases are permitted if ownership of the property changes or there is a change in tenants, provided the increase is necessary to ensure a reasonable return on the owner's equity, given rent levels in the locality. A tenant can challenge a rent increase within 30 days of occupying a unit. Rents are held to be fair and any change to be justified when the change is within the local range for comparable dwellings, justified by higher costs, such as mortgage rates, maintenance, renewals, compensating the landlord for inflation on the equity capital, or following a special payment plan of which the tenant is aware.

Rents are held to be unfair when the resulting profits are judged to be excessive, or if they are based on what is felt to be an excessively high purchase price. In principle, rents can be adjusted upwards following increases in mortgage interest rates, but landlords who do this may also be required by their tenants to reduce rents if interest rates fall. Within this legal framework, most landlords tend to set rents according to costs. Profits that do not exceed the official reference mortgage rate by more than 0.5 percent are permissible in most jurisdictions.

Because rents are adjusted in line with changes in mortgage interest rates, regardless of how the dwelling was actually financed, there is some debate about whether to change this and to link rents to the consumer price index. There have been several unsuccessful attempts to do this. In 2005, the government proposed that tenants should be allowed to choose between index- and cost-related rents. The proposal met with resistance and was abandoned. Similarly, 2008 proposals to do away with the link between rents and mortgage interest rates by replacing the cost rent with an indexation scheme were also abandoned.

Security of tenure is high. Tenancies are unlimited (or indefinite), and can be terminated by a minimum of three months' written notice. Notices given by either landlords or tenants can be challenged if they are felt to violate the basic principles of good faith. The right to appeal against notice was introduced in 1990, which increased the protection of tenants from eviction. However, the landlord can give notice in the case of urgent personal requirements or if the tenant is in rent arrears or has seriously failed to care for the property. The tenant can challenge evictions, rent increases or an excessive initial rent before the Arbitration Authority. However, it seems that challenging the initial rent is rare. If the appeal is accepted the landlord cannot request an eviction or rent rise for another three years. Generally, the Swiss regulatory system is designed to support long-term rental tenure (Bourassa et al. 2009).

### Current Issues/Impacts

According to The Private Rented Sector in the New Century<sup>51</sup>, the large size of the sector is linked to the general structure of the housing market, where regulation is designed to enable reasonable returns for private and institutional investors and owner-occupation receives no substantial fiscal benefits. It also notes that on the supply side the incentives to invest come from relative security of income and to a limited extent from expected capital gains. Nominal rates of return are thought to be of the order of 6 percent, which is high by international standards.

Media reports suggest that population growth and increasing property prices has caused demand to increase significantly for both renting and purchasing. In some areas such as Zurich, Geneva and Basel, only a tiny fraction (0.10, 0.33 and 0.45 percent respectively) of rental properties are available at any one time.

As a result, competition for affordable housing is fierce, and tenants will typically have to apply for a property, providing almost as much information as if they were applying for a job<sup>52</sup>.

## BOX 8: UNITED KINGDOM (EXCLUDING SCOTLAND)

### History of Rent Regulation

Rent controls were first introduced in the UK during World War I under the Increase of Rent and Mortgage Interest (War Restrictions) Act and were extended after WWI albeit they did not apply to new developments.

<sup>51</sup> [http://www.lse.ac.uk/geographyAndEnvironment/research/london/pdf/The-Private-Rented-Sector-WEB\[1\].pdf](http://www.lse.ac.uk/geographyAndEnvironment/research/london/pdf/The-Private-Rented-Sector-WEB[1].pdf)

<sup>52</sup> [http://www.expatica.com/ch/housing/renting/How-to-rent-an-apartment-in-Switzerland\\_12217.html](http://www.expatica.com/ch/housing/renting/How-to-rent-an-apartment-in-Switzerland_12217.html)

Following the onset of World War II, rent controls were extended to all rented properties with rents set at the levels which prevailed in September 1939. Controls continued after the war. In 1953, newly built and converted dwellings were decontrolled while limited rent increases were allowed for properties leased before September 1939 which had been maintained to an appropriate standard. The 1957 Rent Act further limited the application of rent controls so that more valuable houses were decontrolled as were any new tenancies. The 1965 Rent Act introduced regulated tenancies with long-term security of tenure where the rent could be determined by the market and, where a disagreement arose, the matter would be referred to a rent officer to assess fair rents. In 1974, furnished rentals were brought under this regulation while tenancies with a resident landlord were excluded. The 1980 Housing Act converted the remaining 400,000 controlled tenancies into regulated tenancies. This system remained in place until the 1988 Housing Act which specified that all new private sector tenancies entered into on or after 15 January 1989 would be either assured or assured shorthold tenancies and were not regulated. Any regulated tenancies prior to this continue to be subject to the fair rent regime which entitles them to a fair rent as determined by the Valuation Office Agency Rent Officer. The majority of tenancies in the UK are now exempt from rent regulation

### **Rent Increases - Regulated Tenancies**

In determining a fair rent, rent officers/ assessment committees take into account the age, character, locality and state of repair of the dwelling but disregard any premium resulting from a scarcity of similar accommodation in the area. Thus, a fair rent is what a landlord could achieve in a market in which the supply of and demand for accommodation are in balance. Once a fair rent is registered by the rent officer it becomes the legal maximum that is chargeable for the tenancy and is reviewable every two years. Tenants and landlords have the right to appeal against a fair rent set by a rent officer to a First-Tier Tribunal Property Chamber. Following a number of high profile cases in relation to rent increases assessed by rent officers, the Rent Acts (Maximum Fair Rents) Order 1999 limited the increase in fair rents such that where applications for re-registration are made, the fair rent increases will be limited to RPI (retail prices index) + 7.5 per cent for the first re-registration and RPI + 5 per cent for subsequent re-registrations. In the event that there is no existing fair rent registration for the property, these limits will not apply.

### **Non Regulated Tenancies**

For tenancies that commenced after 1989, rent increases depend on the type of tenancy. Rent increases are limited to once every 12 months for periodic tenancies, while for fixed term tenancies, rent increases can only occur if agreed with by the tenant or else at the end of the fixed term. In all cases the rent must be fair and realistic and thus in line with local rents. If tenants deem the rent to be unfair, it can be referred to the rent assessment committee. Landlords are obliged to give a minimum of one month's notice of any rent increase if rent is paid weekly or monthly or 6 months' notice if the tenancy is a yearly tenancy. In cases where repairs or improvements to a controlled property merit at least a 15% increase over the existing registered rent, then landlords will charge that amount.

### **Current Impacts/Issues**

The relaxation of regulation, combined with the introduction in the mid-1990s of Buy to Let mortgages has been noted as the main reason for strong growth in the private rented sector in early 1990s. It has also been noted that the change in default tenancy from assured tenancies to assured shorthold tenancies was probably a key factor responsible for the strong growth of the private rented sector since it made private rented dwellings more attractive as collateral for mortgage loans, since lenders could be relatively certain of being able to sell an untenanted property in the event of possession, which had not previously been the case.

Recent rent increases in the UK caused the Labour Party to pledge to legislate to make three-year tenancies the standard in the British private rented sector to give people who rent the certainty they need, with these new longer-term tenancies limiting the amount that rents can rise by each year too. Ed Miliband also said that Labour would act to tackle a shortage in housing which has helped fuel the rapid rise in both house prices and rents<sup>53</sup>. However, Steve David, Educational Director at the Institute of Economic Affairs has suggested that the introduction of rent regulations will see existing properties decay and landlords exit the sector. He advocates that the real issue is the shortage of housing caused by the planning laws.

<sup>53</sup> <http://uk.reuters.com/article/2014/04/30/uk-britain-labour-rent-idUKKBN0DG1X020140430>

### Box 9: New York

**Rent Regulation** in New York takes one of two forms: Rent Control and Rent Stabilisation.

Rent Control was established after World War II and the housing shortage which occurred following the war. Controls are still in place in municipalities that have not declared an end to the post-war rental housing emergency including New York City, Albany, Erie, Nassau and Westchester counties. Rent controls generally apply to buildings constructed before 1947 and tenants (or their lawful successor such as a family member, spouse, or adult lifetime partner) must have been living in that apartment continuously since before July 1, 1971. While the use of the word rent control generally implies a rent freeze, in the current situation there are allowable increases in the rent levels as set out below.

#### Rent Increases

The operation of rent controls limits the rent an owner may charge for an apartment and restricts the right of any owner to evict tenants. As such tenants are considered "statutory" tenants and owners are not required to offer renewal leases. Rent increases are allowed based on an assessment carried out by the New York State Division of Housing and Community Renewal which seeks to determine the costs for owners of operating the building plus a reasonable profit.

In New York City, the Maximum Base Rent (MBR) system determines a maximum base rent for each unit which is adjusted every two years in line with operating costs. Owners who provide essential services and have removed violations can increase rent levels by up to 7.5 per cent each year until the maximum rent is reached. However, tenants can oppose any increase in rents if the building has violations or owner's expenses do not warrant an increase. In addition, rents can be increased to cover increases in fuel costs<sup>54</sup> and in some cases, to cover higher labour costs.

In addition, both within New York City and the Emergency Tenant Protection Act (ETPA) counties, rent increases can occur in one of three ways:

- with the written consent of the tenant in occupancy, if the owner increases services or equipment, or makes improvements to an apartment;
- with Division of Housing and Community Renewal (DHCR) approval, if the owner installs a building-wide-major capital improvement; or
- in cases of hardship with DHCR approval.

Rent Stabilisation is in operation in New York City and in the counties which have adopted the Emergency Tenant Protection Act (ETPA) including Nassau, Westchester and Rockland counties. In New York City rent stabilisation generally covers buildings of six or more units built after 1947 and before 1974. It also applies to tenants in buildings built prior to February 1947 but who moved in after June 30, 1971 as well as buildings with three or more apartments constructed or extensively renovated on or after January 1, 1974 with special tax benefits. This latter category is only subject to stabilisation while the tax benefits continue or, in some cases until the tenant vacates. Outside of the City, rent stabilisation applies to non-rent controlled apartments in buildings of six or more units built before January 1, 1974, however, in some instances it is limited to buildings of a specific size such as 20 or more units.

#### Rent Increases

In New York City and each of the counties where rent stabilisation is in operation, Rent Guidelines Boards set maximum allowable rent increases. The increases are set once a year and are effective for leases beginning on or after October 1st of each year. In addition, owners who sign vacancy leases are entitled to collect vacancy increases. A vacancy lease arises where a person rents a rent stabilized apartment for the first time. The rent under a vacancy lease cannot exceed the last legal regulated rent and the applicable vacancy increase. In addition, rent increases are also allowable during the period of the lease provided the lease allows for the collection of an increase during the lease term. Increases are allowable:

- with the written consent of the tenant in occupancy, if the owner increases services or equipment, or makes improvements to an apartment;

<sup>54</sup> This adjustment is based on fuel price changes during the prior year. The rent adjustment may go up or down depending on the price of various types of heating fuel. It is applied to rent controlled apartments only.

- with DHCR approval, if the owner installs a building-wide major capital improvement; or,
- in cases of hardship with DHCR approval.

Rent Stabilisation also offers additional protections to tenants including an entitlement to have their leases renewed<sup>55</sup>, receive required services and not be evicted except on grounds allowed by law. A family member of a rent stabilised tenant may have the right to a rent stabilized renewal lease or protection from eviction when the tenant dies or permanently leaves the apartment such to certain conditions<sup>56</sup>. If tenants' rights are violated, the DHCR can reduce rents and levy civil penalties against the owner. Rents may be reduced if the owner fails to provide required or essential services, or fails to make necessary repairs for an individual apartment or building-wide such as a lack of heat/hot water, unsanitary common areas (halls, lobby), and broken door locks.

### Exemptions

Rent controlled apartments can only be passed down within a family subject to a number of conditions<sup>57</sup>. In the event that a rent controlled apartment becomes vacant it either becomes rent stabilised or if the building has less than six units becomes deregulated.

In both rent control and rent stabilized apartments, some tenants including those with a disability, as well as tenants who are 62 years or older, may qualify for full exemption or partial exemption from rent increases. This exemption applies to tenants in rent controlled and rent stabilized apartments in New York City and in municipalities that may authorize the exemption program.

In more recent years, Rent Laws have allowed apartments to become deregulated from rent controls and rent stabilisation. The 2011 Rent Act sets out that where an apartment becomes vacant and the legal rent reaches \$2,500 or more, the apartment qualifies for permanent deregulation and would no longer be subject to either rent stabilisation or rent control<sup>58</sup>. In addition, if an apartment has a legal rent of \$2,500 or more and is occupied by persons whose total annual federal adjusted gross incomes as reported on their New York State Income Tax returns, is in excess of \$200,000 for each of the two preceding calendar years, **the apartment is deregulated**. Tenants under the Disability Rent Increase Exemption and the Senior Citizen Rent Increase Exemption are exempt from this application process. New rental properties are also exempt from rent regulation.

### Current Issues/Impacts

According to the 2013 Annual Review there are approximately 43,000 buildings and 900,000 units under the rent- stabilization system, and approximately 33,800 units under Rent Control in New York. The most recently available New York City Housing and Vacancy Survey shows that there are 1,025,214 rent-regulated units in the city, representing 47 percent of the city's total rental housing stock. In the thirty year period from 1981-2011, 213,000 regulated units exited the market, while some 390,000 market units were developed.

Rent control apartments are generally occupied by an older, lower income population who have been in occupancy since July 1, 1971, or by their lawful successors. Research undertaken by the Furman Center for Real Estate and Urban Policy in New York notes that since there is no income test for tenants seeking to rent a stabilized apartment, some of the people who enjoy the benefits of rent stabilization are not low-income households. However, the research does note that stabilized units are generally home to lower income and minority households than market-rate units. Nevertheless, it is noteworthy that the majority of people in rent-regulated Manhattan apartments make far above the poverty level.

<sup>55</sup> Leases may be renewed for a term of one or two years, at the tenant's choice

<sup>56</sup> See footnote 9. <http://www.nyshcr.org/Rent/FactSheets/orafac30.htm>

<sup>57</sup> A family member has the right to a renewal lease or protection from eviction if he/she resided with the tenant as a primary resident in the apartment for two (2) years immediately prior to the death of, or permanent departure from the apartment by the tenant. The family member may also have the right to a renewal lease or protection from eviction if he/she resided with the tenant from the inception of the tenancy or from the commencement of the relationship. If the family member is a senior citizen or disabled person, then the minimum period of co-occupancy is reduced to one (1) year. The first family member to establish succession rights on or after June 20, 1997 is not required to pay the owner a vacancy increase. However, the owner will be entitled to collect the vacancy increase from the next family member, called the second successor, who is entitled to receive a renewal lease or to remain in possession

<sup>58</sup> Effective from 24 June 2011. The Rent Code Amendments of 2014 require owners to provide the first tenant of a newly deregulated apartment with a DHCR promulgated notice detailing the last legal rent, the reason for deregulation and detailed calculations.

Some also argue that if rent controls/regulations were eliminated neighbourhoods lose the diversity which is the strength of New York City.

Other recent trends indicate that Rent-Regulated tenants are often being excluded from using new amenities such as gyms and playrooms introduced in their buildings which landlords say are only available to market-rate tenants<sup>59</sup>.

#### BOX 10 WASHINGTON DC

The District's rent control law was enacted in 1975. The current legislation is the Rental Housing Act 1985 which has been amended on a number of occasions since then. Subsequent regulations were enacted under the D.C. Municipal Regulations, Title 14, Chapter 42. The Rental Accommodations Division (RAD) of the DC Department of Housing and Community Development is responsible for administering all aspects of the Act and as such all rental units must be registered with the RAD. Rent controls were introduced primarily to deal with the increase in inflation and the nominal rents due to the energy crisis of the 1970's.

#### Rent Increases

A landlord can increase rent either in line with changes in the Consumer Price Index for Urban Wage Earners and Clerical Workers as published by the Rental Housing Commission or ten percent of the previous rent for the rental unit, whichever is the lesser. Rent increases in controlled units are only permitted once every 12 months and tenants must receive a minimum of 30 days notification of proposed increases. For elderly tenants (age 62 or over) and tenants with disabilities, the annual increase can be no greater than the Consumer Price Index or five percent of the previous rent for the rental unit.

It is possible for landlords to request a larger rent increase on the basis of hardship<sup>60</sup>, capital improvements, adjustments of services and facilities, substantial rehabilitation, or a voluntary agreement with 70 percent of the tenants.

In addition, landlords may increase rent when a rental unit becomes vacant, however, this is limited to twelve percent of the previously authorized rent ceiling for the unit<sup>61</sup>; or the amount required to increase the rent ceiling for the rental unit to equal the rent ceiling of a previously registered, substantially identical rental unit in the same housing accommodation<sup>62</sup>.

#### Exemptions

All rental units in the District of Columbia are subject to rent controls with the exception of units that are:

- Federally or District-subsidised
- Built after 1975
- Owned by a private individual who owns no more than four rental units in the District
- Vacant when the Act took effect

In addition, any rental unit that is not registered with the RAD is automatically subject to Rent Controls regardless of whether it should be exempt.

#### Current Issues/Impacts

A review of the impact of rent controls in the District Of Columbia on the quality, condition, maintenance and economic impact on housing accommodations found that capital improvement and substantial rehabilitation do not always make economic sense to the owner of a housing accommodation and therefore are not always available as mechanisms to increase rents on rent controlled units. Moreover, the study notes that newly constructed non-controlled units located less than a mile away from controlled units are receiving rents more

<sup>59</sup> <http://www.nytimes.com/2014/05/18/realestate/rent-regulated-tenants-excluded-from-amenities.html>

<sup>60</sup> Under the Act, housing providers are allowed to raise rents enough to earn a 12% rate of return on the housing provider's rental property investment.

<sup>61</sup> Provided no other twelve percent vacancy rent ceiling adjustment has been taken within the preceding twelve month period;

<sup>62</sup> Substantially identical rental unit refers to a unit that is subject to the Rent Stabilisation Program, has essentially the same floor plan, square footage, comparable amenities and equipment, comparable location with respect to exposure and height (if exposure and height have previously determined rent), and is in comparable physical condition as the rental unit whose rent ceiling is being adjusted; and is located in the same building or in a similar building within the same housing accommodation or multi-building housing complex.

than double the rents in the controlled properties.

Others argue that the additional increases allowed under rent controls effectively make them redundant with too many loopholes exploited by landlords. A recent case notes a landlord seeking a rent increase of 62% with the result that the city approved a 37.1% increase. However, following a long court case, some tenants obtained rent increases of 18 percent rent. Other tenants are still waiting for their case to be heard, four years after the issues first arose. In the mean time, the apartment building went into receivership due to the landlord's inability to pay his utility bill<sup>63</sup>.

There is also evidence of bidding wars emerging among D.C.-area renters particularly for privately run homes in desirable locations<sup>64</sup>.

### Box 11: ONTARIO

Rent Controls were first introduced in Ontario under the National Housing Act 1944 following the end of World War II. These controls were subsequently repealed and modern day rent controls were enacted under the Rent Control Act in 1975. The reintroduction of rent controls in 1975 occurred at a time when construction of new rental units had declined significantly (possibly due to the removal of tax incentives for construction), vacancy rates had fallen to about 1% while inflation (circa 12%) and interest rates (21% in 1981) was increasing significantly throughout the 1970-1980 period. All these factors were contributing to significant rent increases for tenants at a time when landlords could increase rents more than once every 12 months. The subsequent Tenant Protection Act of 1997 allowed for a rental unit built or first occupied after November 1, 1991 to be exempt from rent controls. Subsequent Acts have maintained rent controls and current controls are allowed for under the Residential Tenancies Act, 2006<sup>65</sup>.

#### Initial Rents

In the case of tenant turnover, the rent is temporarily freed from rent control at the time a tenant vacates a unit and is re-controlled at the rent agreed to by the new tenant.

#### Rent Increases

A landlord can increase rent in line with the Rent Increase Guideline issued by Government. The Guideline is based on the Ontario Consumer Price Index (CPI) for goods and services averaged over the 12-month period. In 2012, a Bill was introduced which limited the annual rent increase guideline beginning in 2013 to a maximum of 2.5%<sup>66</sup> for at least four years. Landlords must give tenants 90 days written notice of any rent increase and may only apply the increase if at least 12 months has lapsed since the tenant first moved in, or since his or her last rent increase. Landlords can request a 0.8 per cent increase in 2014 from tenants, while the cap is set at 1.6 per cent for 2015<sup>67</sup>.

A landlord can apply for a rent increase that is above the guideline amount if there is:

- An extraordinary increase in the cost for municipal taxes and charges or utilities or both for the residential complex or any building in which the rental units are located<sup>68</sup>;
- Eligible capital expenditures incurred respecting the residential complex or one or more of the rental units in it<sup>69</sup>; or,
- Operating costs related to security services provided in respect of the residential complex or any building in which the rental units are located by persons not employed by the landlord.

<sup>63</sup> [http://www.washingtonpost.com/opinions/jonetta-rose-barras-want-more-affordable-housing-remember-the-renters/2014/05/14/cf216d7a-db7a-11e3-bda1-9b46b2066796\\_story.html](http://www.washingtonpost.com/opinions/jonetta-rose-barras-want-more-affordable-housing-remember-the-renters/2014/05/14/cf216d7a-db7a-11e3-bda1-9b46b2066796_story.html)

<sup>64</sup> <http://www.washingtonpost.com/express/wp/2014/08/15/to-win-rental-homes-local-renters-get-creative/>

<sup>65</sup> [http://www.e-laws.gov.on.ca/html/statutes/english/elaws\\_statutes\\_06r17\\_e.htm#BK8](http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_06r17_e.htm#BK8)

<sup>66</sup> There is a provision for review of the 2.5% limit in 2016.

<sup>67</sup> <http://news.ontario.ca/mah/en/2014/06/ontarios-2015-rent-increase-guideline-set-at-15-per-cent.html>

<sup>68</sup> An increase in costs for taxes or utilities is considered "extraordinary" if it is greater than the guideline plus 50% of the guideline.

<sup>69</sup> Capital expenditures must be completed and paid for within an 18-month period that ends 90 days before the date of the first rent increase requested in the application. A capital expenditure is eligible if it: is necessary to protect or restore the physical integrity of the complex, is necessary to maintain health, safety or housing standards, is necessary to maintain plumbing, heating, mechanical, electrical, ventilation or air conditioning systems, provides access to persons with disabilities, promotes energy or water conservation, or maintains or improves the security of the complex.

Rent increases arising from capital expenditures and operating costs for security services cannot be more than 3% above the guideline in any one year, however the balance in excess of 3% can be taken in the following two 12-month periods, at a rate of up to 3% above the guideline per year. There is no limit in relation to increases arising from the cost for municipal taxes and charges or utilities.

An increase in rent may also be allowed where the landlord and tenant agree to increase the rent if,

- the landlord has carried out or undertakes to carry out a specified capital expenditure in exchange for the rent increase; or
- the landlord has provided or undertakes to provide a new or additional service in exchange for the rent increase.

In such circumstances the increase must not be more than 3 per cent of the previous lawful rent charged. Rent increases in these situations do not require the 90 day written notice period. A tenant who enters this agreement may cancel the agreement by giving written notice to the landlord within five days of signing it. Similarly a tenant or former tenant may apply to the board for relief if the landlord failed to fulfil the undertakings set out.

### Exemptions

Rent control does not apply to rental units if

- it was not occupied for any purpose before June 17, 1998;
- it is a rental unit no part of which has been previously rented since July 29, 1975; or
- no part of the building, mobile home park or land lease community was occupied for residential purposes before November 1, 1991.

### Current Issues/Impacts

The rent increase guideline covers about 85 per cent of private residential units in Ontario. Tenants in non controlled units are subject to rent increases as determined by their landlords. Rent increases in non controlled units are limited to once every 12 months and are subject to a 90 days' notice in writing. Recent press coverage indicates that many tenants in non controlled units are unaware that their rent can increase at the discretion of the landlord. Some tenants indicate rent increases ranging from circa 10 per cent up to 80 per cent. Some tenants are also suggesting that landlords are using the law to single out tenants<sup>70</sup>. In contrast, the Federation of Rental Housing Providers of Ontario argues that the costs of operating apartment buildings far exceed the 2.5 per cent rent hike guideline a year.

One of the arguments put forward against rent controls was the impact on new supply of rental units. Some proponents of rent controls will argue that the regulations did not impact on new supply as the investment in the sector had diminished in the early 1970's due to the removal of tax incentives. However, the Federation of Metro Tenants Associations are now suggesting that the exemption for non controlled units should be removed as it has not contributed to the construction of rental units (purpose built rental apartment blocks) but rather fuelled the construction of condos (Individual units that people can purchase to own and rent out as an investment)<sup>71</sup>.

<sup>70</sup>[http://www.thestar.com/business/real\\_estate/2013/05/31/pressure\\_mounds\\_for\\_ontario\\_to\\_extend\\_rent\\_controls\\_to\\_all\\_tenants.htm](http://www.thestar.com/business/real_estate/2013/05/31/pressure_mounds_for_ontario_to_extend_rent_controls_to_all_tenants.htm)

<sup>71</sup><http://o.canada.com/business/rent-increase-loop-hole-leaves-ontario-renters-vulnerable>

### 3.4.3. International Evidence of the Impact of Regulations

The performance of the private rented sector needs to take account of and should be understood in the context of the wider housing market. As has been pointed out on numerous occasions, taxation, subsidies and financial markets have a significant role in the performance of the housing market (Cuerpo, *et al*, 2014). A 2012 review of rent regulations across Europe concluded that there is no direct and easily predictable relationship between regulatory regimes and the size of the PRS. Rather it found that the size of the sector depends crucially on the attractiveness of other housing options; on tax and subsidy systems and other policy instruments; and on fundamental issues of profitability and consumer choice (Whitehead 2012)

The rules governing rent regulation across the various jurisdictions have been set out previously. These regulations have had varying effects on the individual markets, which in many cases has reflected the stringency of the regulatory environment as well as government policy within the jurisdictions.

The role of taxation in the performance of the private rented sector is particularly evident across a significant number of jurisdictions. In some cases, inequitable tax treatment has played a significant role in promoting home ownership as the expense of the private rented sector, most notably in Belgium and the Netherlands. In contrast, the tax treatment of the private rented sector in Germany and Switzerland has played a key role in promoting a strong rented sector. The large private rented sector in Germany is in large part the result of generous depreciation allowances and fiscal benefits available to landlords along with subsidies for new construction in the rental market. While these policies promote the private rented sector the tenure-neutral tax treatment is also a factor. Similar trends are seen in Switzerland where fiscal policies are tenure neutral, due to taxing the imputed rental income of homeowners, and where regulations seek to ensure a reasonable profit for landlords, of circa 6 percent nominally.

Of course other factors have also played a role in the performance of the private rented sector, including the financial markets as well as other Government policies. Access to credit and low

interest rates have been a factor in attracting investors to the sector. This is particularly evident in the UK where a relaxation of regulation, coupled with the introduction of Buy to Let mortgages have fuelled strong growth in the sector in the past two decades. The efficiency of the planning process is also a key factor in attracting investment and has been noted as one factor in the lack of construction in the early nineties in Sweden and more recently as the real issue behind the shortage of housing in the UK.

Depending on the structure of the rental stock, the return to investors is also particularly important in the overall growth of the sector. In some jurisdictions, such as Ontario and Sweden, the rented sector has traditionally comprised large purpose built rental apartment blocks. However, given the possibility of earning more immediate returns from the development of condominiums, some developers may opt for this type of development over rental blocks. Such trends have been evident in Sweden in the past where condominiums for sale dominated construction in the late 1990s. Similarly in Ontario, investment in rental apartment blocks diminished in the early 1970s, at the same time as the removal of tax incentives for rental construction, and has since been dominated by the construction of condominiums. Such trends will undoubtedly lead to more individual landlords and potentially a smaller rented sector.

The review of jurisdictions also highlighted some additional impacts of rent regulations outside of supply side issues. In some instances exemptions from rent regulations have been adopted in an attempt to stimulate supply in the market. While such policies may appear well founded, they can have a negative impact for some tenants. In Ontario, tenants in non controlled units are often subject to particularly high rent increases. Furthermore, tenants believe that the ability to increase the rent indiscriminately in non controlled units is being used by landlords to single out non desirable tenants. Given that tenants are generally attracted to rent regulated units, it is likely that new entrants to the market will be accommodated in non controlled units and thus at a disadvantage compared to incumbents.

There is also some evidence of unscrupulous behaviour by landlords to the detriment of rent regulated tenants. In New York, rent regulated tenants have recently been excluded from using new amenities introduced in their buildings, with

landlords arguing that the amenities have been put in place to attract market rate tenants and so are for their use only. The potential for unscrupulous behaviour has also been raised by the French Research Institute, ofce, who recently raised concerns in relation to the potential for landlords to offset future rent control by raising the rent at the time of the first letting. Other negative effects of rent regulations are evident in Sweden where there are significant black market transactions by both the landlord and tenant.

The impact of regulations on the quality of the rented stock has been highlighted in Washington DC, where research suggests that capital improvement and substantial rehabilitation works do not always make economic sense. However, it has also been suggested that the potential to increase rent for works to the unit is being exploited by landlords to excessively increase rents. In Ontario, landlords argue that the costs of operating rent regulated apartment buildings far exceed the 2.5 per cent per annum rent hike guideline a year issued.

From the preceding analysis it is evident that the overall size of the private rented sector is a function of a range of factors including, taxation, subsidies and financial markets. Those jurisdictions that have strong rent regulations and strong private rented sector also have an equitable taxation system in place and in some cases subsidies to promote investment. However, it is also evident that in some cases there are negative impacts associated with the introduction of rent regulations, notably unscrupulous behaviour by landlords and the potential for lower quality stock.

### 3.5 CONCLUSIONS

The degree of rent regulation has varied across time. Rent controls which were introduced during World War I and World War II were known as first generation rent controls and generally involved a rent freeze. However, in many cases these were gradually removed and replaced by second or third generation rent controls. These regulations were not as rigid and generally involved regulations around allowable increases in rent levels. Various forms of rent control remain in operation today in a number of jurisdictions.

In general, rent regulations cover both initial rents and also the method for rent increases. Initial rent setting can vary from being freely determined by the market to being subject to a rent cap. The

policies in relation to rent increases within a tenancy also vary significantly. Some jurisdictions allow increases in line with the market, while in others rents are adjusted within the tenancy in line with an index. Other regions have increases determined by the Government or by negotiation between relevant parties. Additional allowances are often allowable in the case of investment in the unit, the provision of additional services for the tenant or in some instances in the case of hardship of the landlord. Exemptions from rent regulations also often apply to new rental units or to rental units where the rent has reached a maximum threshold or in some cases based on the income of tenants.

Across economic literature the theoretical justification for rent regulation is relatively weak and is often associated with unintended consequences for tenants. While the form of rent regulations can vary from first generation stringent rent control to third generation tenancy controls, there still exists the potential for a number of negative impacts, including black market transactions, lower quality housing and reduced mobility, not to mention the impact on supply.

It is also evident that the overall size of the private rented sector is a function of a range of factors including, taxation, subsidies and financial markets and not solely regulation. Those jurisdictions that have strong rent regulations and strong private rented sectors also have an equitable taxation system in place and in some cases subsidies to promote investment. It is also evident that in some cases there are negative impacts associated with the introduction of rent regulations, notably unscrupulous behaviour by landlords and the potential for lower quality stock.

Economists would generally view rent control as a second best option, dealing with the symptoms of the problem rather than with the cause of the problem, notably a lack of supply. While some may argue that initial introduction of rent regulations on a short term basis may have merit, the reality is that the politics of regulation is such that it becomes increasingly difficult to remove such provisions in the future. Any intention to introduce rent regulation in an Irish setting needs to take account of the particular circumstances which prevail here at present and the reasons for the lack of new supply to the sector which is likely to be a function of the financial markets, taxation in the sector and the level of return available to both property developers and landlords.

## 4. RENT SUPPLEMENT AND THE PRIVATE RENTED SECTOR

### 4.1 INTRODUCTION

Social housing provision in Ireland generally takes three main forms, as follows:

- Local authority housing, where housing is allocated according to eligibility and need, and where rents are based on the household's ability to pay;
- Voluntary and co-operative housing, which is provided by approved housing bodies under Section 6 of the Housing (Miscellaneous Provision) Act, 1992; and,
- Private rented housing supported by the Rental Accommodation Scheme administered by the Department of Environment (DOE)

Another key feature in the delivery of social housing has been the emergence of Rent Supplement in the provision of long term housing support. While Rent Supplement was originally intended to act as a short-term income support, the scheme has over the past number of years become a form of long-term housing support for a significant number of households in the State.

Following the economic recession and with increased pressure on reducing Government debt, the delivery of social housing has shifted from a capital grant funded programme to one funded out of current expenditure. Arising from this shift in policy, the demands on the private rented sector in addressing social housing need have increased substantially.

The Housing (Miscellaneous Provisions) Act 2009 specifically sets out the role of the private rented sector in supporting social housing. According to the act:

*“a housing authority may, in accordance with the Housing Acts 1966 to 2009 and regulations made there under, provide, facilitate or manage the provision of social housing support..... social housing support may include... entering into and maintaining rental accommodation availability agreements”*

Specifically, the introduction of the social housing Leasing Initiative and the Rental Accommodation Scheme (RAS) has resulted in an increased role for the private sector in long-term social housing supports. The Social Housing Leasing Initiative involves housing authorities leasing properties from private property owners for the purposes of providing accommodation to households on social housing waiting lists, while the RAS<sup>72</sup> involves local authorities leasing properties from private landlords to accommodate households who are 18 months or longer in receipt of a Rent Supplement.

More recently, the introduction of the Housing Assistance Payment (HAP), which is currently being piloted in Limerick, will also see the private rented sector continue to play a key role in the future of social housing provision. The HAP initiative will see Rent Supplement tenants with a long-term housing need move to the new payment scheme under the auspices of the local authorities. The HAP has been introduced following recognition of Rent Supplement's deficiencies in providing long term housing support, particularly, the 30 hour rule, which means a person loses the support in full once they've found full-time employment<sup>73</sup>.

Over time, it is envisaged that HAP will become the entry point for all persons who require long term social housing, with Rent Supplement reverting to its original intended scope as a short term income support for persons temporarily unemployed. It is evident from the combination of these schemes and the significant numbers on Rent Supplement that the private rental market will continue to be a key feature of social housing delivery in the future.

### 4.2 RENT SUPPLEMENT

The central focus of Rent Supplement is to provide an unemployed person with additional income support to facilitate the continued payment of their rent.

Currently Rent Supplement is payable in Ireland to households in the private rented sector who are in

<sup>72</sup> In return for signing up to the scheme landlords receive the rent directly from the local authority. Tenancies are governed by the Residential Tenancies Act 2004. The rent may not exceed the current SWA Rent Supplement rent levels.

<sup>73</sup> A key feature of the new payment will be the direct payment of rent by the local authority to the landlord with a contribution by the household paid directly to the local authority. In the case where households are relying on social welfare payments this contribution will be made through deduction at source.

receipt of social welfare payments and are unable to meet their housing needs. They are part of the Supplementary Welfare Allowance Scheme. In general, a person may qualify for Rent Supplement if:

- They pass the habitual residence condition; and
- They have been living for 6 months out of the last 12 months in private rented accommodation, using their own means for their rent; Or
- Alternatively, they have been assessed as having a social housing need by their local authority in the past twelve months;
- Their accommodation is suitable for their needs and the rent is reasonable; and,
- They are not in full-time employment (employment for 30 hours a week or more) or education.

The Rent Supplement Scheme is based on the premise that after a person pays their rent, they should have at least the amount of the weekly supplementary welfare allowance (SWA) appropriate to their circumstances, less a minimum contribution of €30 for a single person or €40 for a couple, which is the housing element of their social welfare payment. A single person in receipt of SWA should have €156 left after paying their rent. The corresponding amount for a couple is €270.80. See Table 4.1 for the rates of SWA payable in 2014.

**Table 4.1: Current Rates of Supplementary Welfare Allowance, 2014**

	€
Personal Rate	186.00
Increase for Qualified Adult	124.80
Increase for each Child	29.80
Dependant	

Source: Department of Social Protection

Rent Supplement is generally not payable in cases where the rent being charged is greater than a maximum rent limit set out for each county or area; however in exceptional circumstances, such as ill health or where there is a risk of homelessness, the maximum rent limit can be exceeded.

#### 4.2.1. Expenditure on Rent Supplement

Over the past decade, there has been an escalation in the number of people receiving Rent Supplement and in the overall cost of the Scheme,

albeit this has been alleviated somewhat in recent times.

Generally, the increase in the number of recipients can be attributed to:

- the addition of a Housing Needs Assessment to the eligibility criteria of the Rent Supplement Scheme in 2005, whereby anyone with a housing need was entitled to Rent Supplement; and,
- the impact of the 2007 economic crash which saw a significant increase in unemployment.

However, the upward trend in recipient numbers stabilised in 2010 and 2011 and has subsequently declined substantially since 2012, which largely reflects the slow economic recovery that is underway along with the continued migration of long term rent supplement tenants to RAS.

Expenditure increases have also been contained and have returned to levels last seen in 2004. While some of this reduction reflects the decline in the number of recipients, it is also due to the realignment of the minimum contribution to the Differential Rents offered by local authorities<sup>74</sup> and from rent limit reviews which reflected the decline in market rents. For instance, between 2011 and 2012, there was a reduction of approximately €80 million in the cost of operating the scheme which can be attributed to:

- A reduction in recipient numbers due to RAS transfers and increased economic activation (€25 million),
- A reduction in rent limits (€20 million), and
- An increase in the customer contribution (€35 million).

Table 4.2 summarises some key trends.

<sup>74</sup> This has meant that an individual is being asked to pay more for their RS dwelling than in the past. However, Minimum Contribution levels are still on the whole below the costs of differential rents

**Table 4.2: Trends in Numbers of Recipients and Expenditure on the Rent Supplement Scheme**

Year	Recipients	% Change	Cost €000	% Change
2004	57,874	-3.5%	353,762	6.7%
2005	60,176	4.0%	368,705	4.2%
2006	59,861	-0.5%	388,339	5.3%
2007	59,726	-0.2%	391,466	0.8%
2008	74,038	24.0%	440,548	12.5%
2009	93,030	25.7%	510,751	15.9%
2010	97,260	4.5%	516,538	1.2%
2011	96,803	-0.5%	502,747	-2.7%
2012	87,684	-9.4%	422,536	-16.0%
2013	79,788	-9.0%	372,909 <sup>1</sup>	-12.0%
2014	76,237 <sup>2</sup>		344,100 <sup>3</sup>	-7.7%

Source: Department of Social Protection

1 Provisional Outturn. 2 Figure at end May 2014. 3 2014 Revised Estimate

#### 4.2.2. Distribution of Rent Supplement Tenancies

As expected an analysis of the profile of Rent Supplement tenancies reveals that significant proportions are located in key urban areas. Dublin City accounted for largest proportion of recipients in the country (30%), followed by Cork (11%), and County Dublin (7%). Of the other urban counties, Galway accounted for 5 per cent of recipients while Limerick and Waterford had 4 and 2 per cent respectively.

One issue with the Rent Supplement Scheme is the significant proportion of recipients that remain on RS for long periods. It appears a contributing factor to the long term duration of some recipients is due to the addition of a Housing Needs Assessment to the eligibility criteria of the Rent Supplement in 2005. Thus, it would appear that a significant proportion of recipients are using Rent Supplement as a pathway to Social Housing.

As set out in Table 4.3, approximately 43,000 - or 57% - of the total Rent Supplement recipients had been receiving payment for more than 18 months as of August 2014. Even more stark is the fact that 30 per cent of recipients have been in receipt of rent supplement for over 3 years.

The long term duration of many Rent Supplement recipients is contrary to its objectives, as a short term income support whilst a person is temporarily unemployed. It is clear that the Scheme is now being used for people who have a long-term housing need

**Table 4.3: Distribution of Recipients by Duration on Scheme 2014**

Duration	Numbers	Proportion
Total	75,204	100%
Of which more than:		
3 months	6,508	9%
6 months	5,451	7%
9 months	6,472	9%
12 months	9,976	13%
18 months	7,809	10%
24 months	6,773	9%
30 months	5,462	7%
36 months	8,414	11%
48 months	5,805	8%
60 months	4,003	5%
72 months	4,340	6%

Source: Department of Social Protection

This prompted the Government in July 2004 to introduce a Rental Accommodation Scheme (RAS) to cater for the accommodation needs of people who are in receipt of Rent Supplement for more than eighteen months. There are around 12,595 landlords registered nationally under the RAS. As set out in Section 4.2.1, one of the key reasons for the reduction in the number of RS recipients has been the transfer of recipients to the RAS scheme. In 2011 and 2012 approximately 36,000 long term Rent Supplement recipients were transferred to RAS.

Moreover the phased introduction of the HAP will further address this issue. The expectation is that individuals with a Housing Needs Assessment will

no longer qualify for Rent Supplement but will be able to source accommodation under the HAP scheme. Of course the costs of all these schemes are borne by the Exchequer and so while the costs of Rent Supplement will decline in line with the transfer of long term recipients, the costs of RAS and HAP will be increased further.

### 4.3 RENT LIMITS

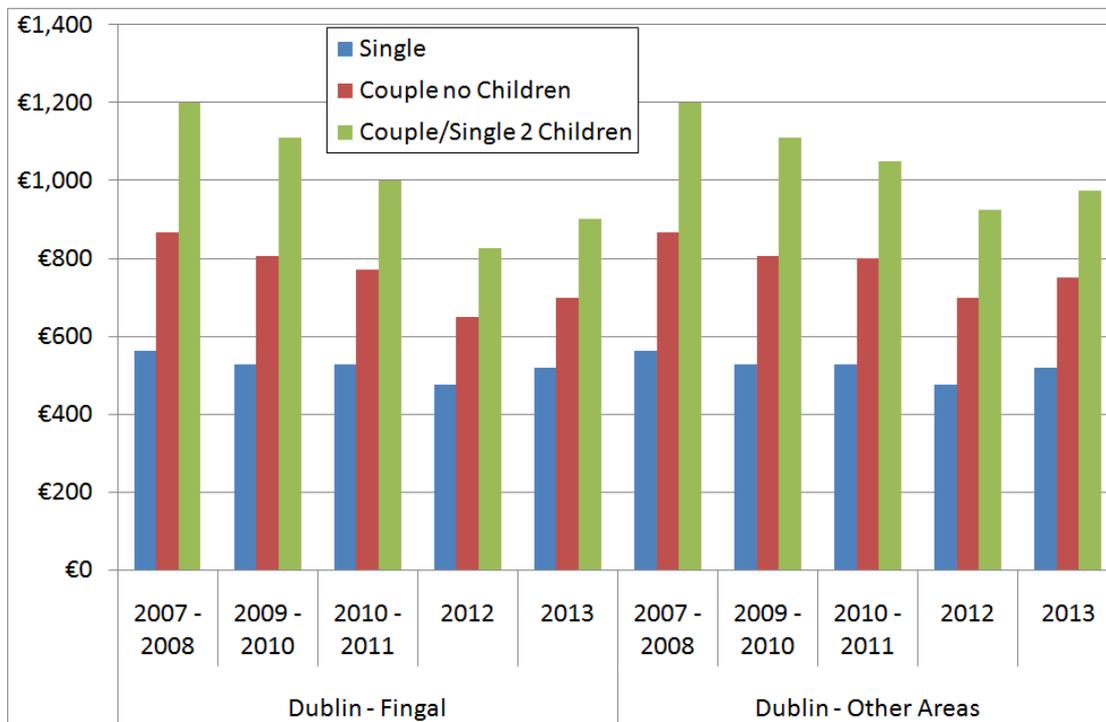
#### 4.3.1 Trends in Rent Limits and Minimum Contributions

A number of changes to Rent Supplement rent limits and the minimum contributions applicable have taken place since 2009. The current minimum tenant contribution of €30 for a single person, as detailed in Section 4.2, has more than doubled in the 2009-2013 period. In January 2009, the contribution increased from €13 to €18, and was followed by a further increase to €24 in May 2009 before increasing again to the current €30 level in 2012. The increase in the minimum contribution is part of on-going strategy to realign the Rent Supplement minimum contribution to differential rents charged by Local Authorities. This was deemed necessary to ensure that individuals would not be reluctant to transfer from Rent

Supplement to Local Authority Sponsored housing solutions.

The maximum rent limits have also been reduced over the past number of years. In June 2009, the rent limits were reduced by 6-10 per cent, while there was a further reduction of circa 11 per cent in June 2010 and an average of 13 per cent in January 2012. The reductions in rent limits were undertaken to reflect the fall in rent levels evident in the wider market at that time. However, the most recent Rent Limit Review in January 2013, which came into force in June 2013, increased the rent limits in some areas, to reflect the changing market conditions. In 2013, rent limits increased across household types in Dublin, Galway, North Kildare and Bray. Rent limits increased by a weighted average of some 9 per cent in Dublin. Other counties saw some increases for particular household types while there were reductions in some rural counties reflecting market conditions in those areas. Figure 4.1 sets out the trends in rent limits in the Dublin areas from 2007-2013 for single persons, couples and a couple with two children.

Figure 4.1 Trends in Rent Limits in Dublin Areas 2007 – 2013



Source: Department of Social Protection.

Rent limits provide a benchmark for the Department's staff in their respective areas. Rent

Supplement rent limits are generally set at the 35<sup>th</sup> percentile of the available market rent to ensure

that 35 per cent of the relevant market is suitably priced for Rent Supplement recipients. The 35<sup>th</sup> percentile reflects the national average proportion of Rent Supplement tenancies in the private market, albeit there are some adjustments to reflect local markets.

In deriving the 35<sup>th</sup> percentile the Department of Social Protection (DSP) make use of data from the PRTB registered tenancies, publicly available data including the CSO rental indices, the Daft.ie Rental Report and websites advertising rental properties. At present, maximum rent limits are reviewed every 18 months. The current rent limits are set out in Table A.1 in Appendix 1<sup>75</sup>. These rent limits are currently under review by the DSP.

#### 4.3.2. Current Rent Limits v Market Rents

An analysis of the current Rent Supplement rent limits relative to the 35<sup>th</sup> percentile using the PRTB rent data was undertaken to ascertain if limits have kept pace with the change in market rents. The first analysis focused on the Dublin market and reviewed the rent limits for a couple with three children seeking to rent a 3 bed house (Figure 4.2) and a couple renting a one bed apartment (Figure 4.3).

In determining the 35<sup>th</sup> percentile of PRTB rents, the list of new rents registered with the PRTB in Q1 2013 and Q1 2014 was used<sup>76</sup>. It is important to point out that the 35<sup>th</sup> percentile of rents registered with the PRTB will include those on Rent Supplement and so these rents are likely to be lower than what prevails in the free market.

Figure 4.2 shows the maximum rent limits which were in place in Q1 2013 and the current rent limits for a couple with three children relative to the 35<sup>th</sup> percentile of PRTB rents for a 3 bed property. As is illustrated in the chart, the 35<sup>th</sup> percentile of rents are in line with Rent Supplement limits in only a few areas of Dublin, notably Dublin 10, Dublin 22 and Dublin 24. While in other areas, including Dublin 1, 2, 4 and 6, the 35<sup>th</sup> percentile of rents are well in excess of the maximum limits

A further analysis of rent limits for a couple and a single person relative to the 35<sup>th</sup> percentile of

market rents for a one bed apartment also shows similar trends (Figure 4.3). In this instance the 35<sup>th</sup> percentile of market rents are in line with Rent Supplement limits for a couple and a single person in Dublin 5, 10 and 22. However in other areas, notably Dublin 2, 4, 14, 16 or 18 the 35<sup>th</sup> percentile rents are well in excess of the rent limits, particularly for a single person living alone.

The preceding analysis indicates that Rent Supplement tenants seeking accommodation in the market today are more challenged in sourcing accommodation in certain areas of Dublin. However, these trends are also likely to reflect the relative proportion of Rent Supplement tenants across the Dublin postcodes. Consultations undertaken suggest that some areas of Dublin are highly concentrated with Rent Supplement while other areas have a relatively low proportion.

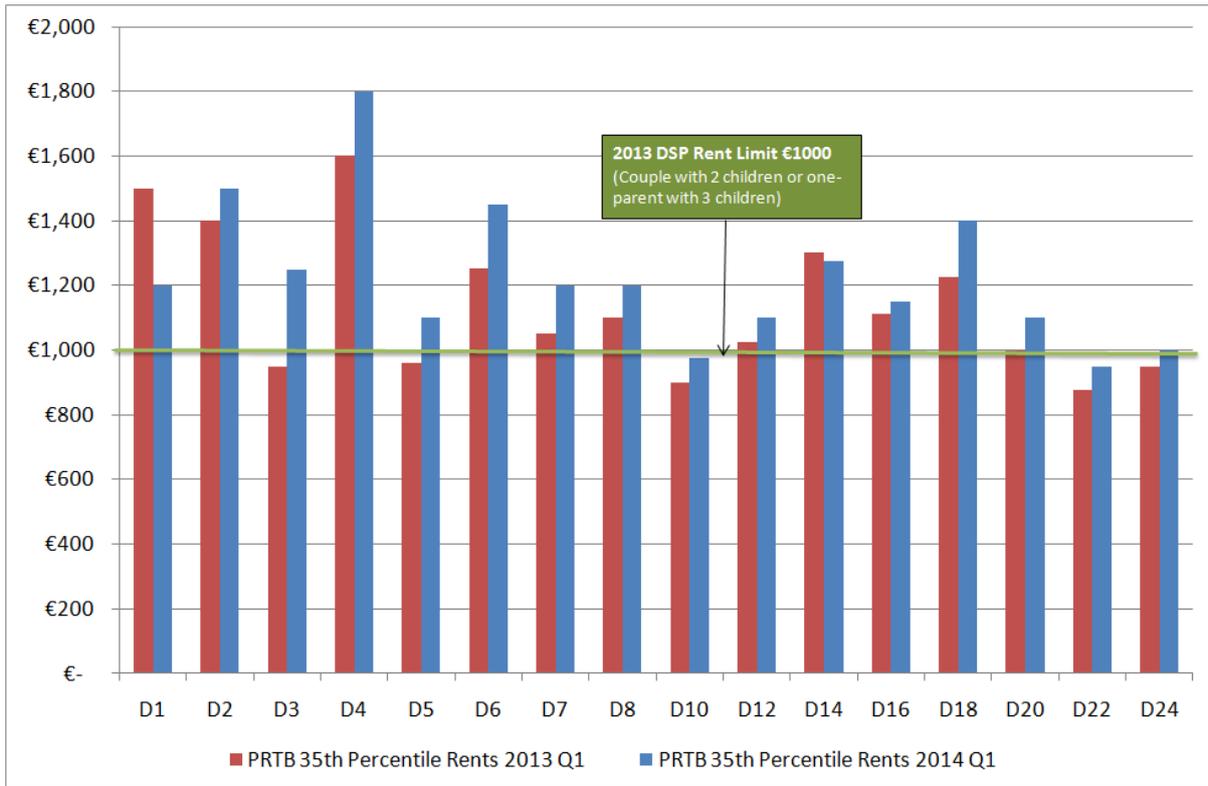
A separate analysis of the 35<sup>th</sup> percentile of market rents for a 3 bed house in the counties outside Dublin and the rent limits as set by the DSP is set out in Figure 4.4. This analysis would seem to suggest that at a county level, rent limits are sufficient to meet the 35<sup>th</sup> percentile of market rents. Once again this analysis highlights how the key issues affecting the rental market at present are largely concentrated in Dublin.

On the basis of the above analyses, it appears that the market for Rent Supplement tenants has become increasingly restricted in recent times and that tenants may be increasingly challenged in sourcing accommodation within these limits in Dublin. This undoubtedly reflects the wider issue of a lack of supply in Dublin.

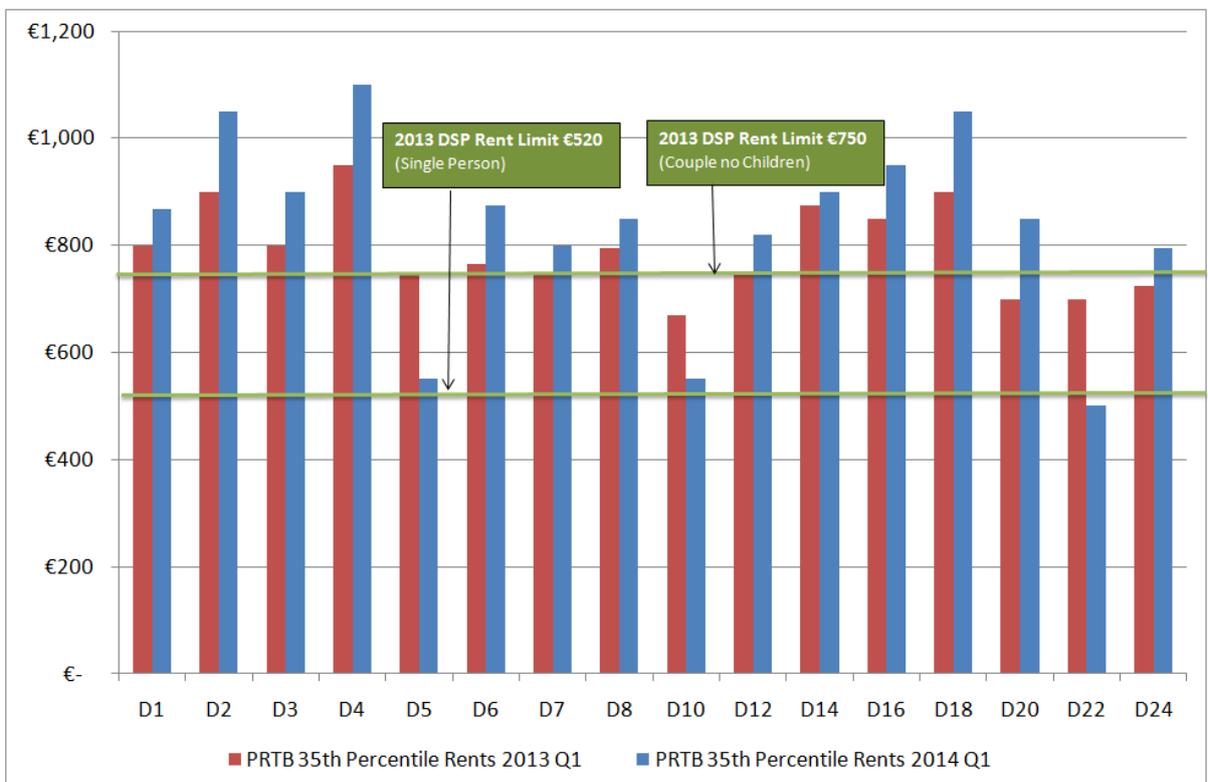
<sup>75</sup> Exceptions to these amounts may be allowed in exceptional circumstances.

<sup>76</sup> In some areas the number of rent registrations (sample size) reported to the PRTB was very low, which may possibly reflect landlords underreporting rent increases during tenancies.

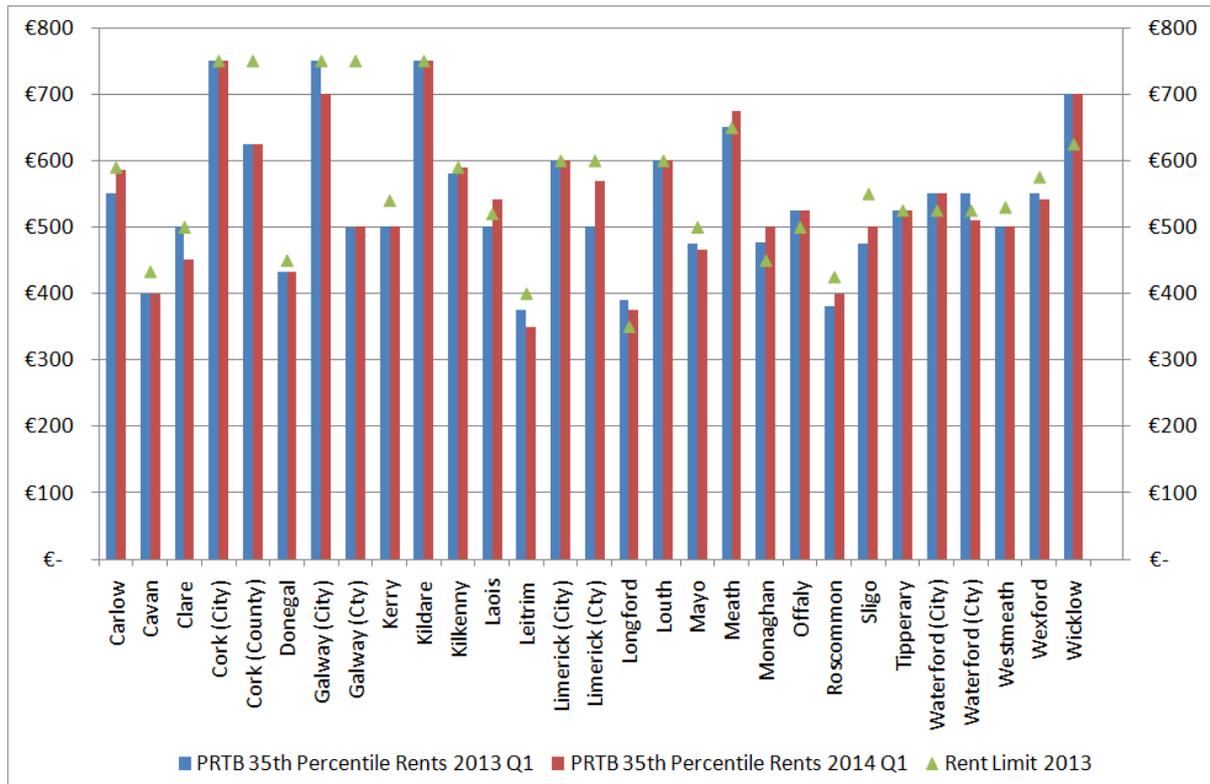
**Figure: 4.2 DSP Rent Limits for Couple with 3 Children Vs 35<sup>th</sup> Percentile PRTB Rents 3 Bed House in Dublin**



**Figure: 4.3 DSP Rent Limits for a Couple and Single Person Vs 35<sup>th</sup> Percentile PRTB Market Rents 1 Bed Apartment in Dublin**



**Figure: 4.4 DSP Rent Limits for Couple with 3 Children Vs 35<sup>th</sup> Percentile PRTB Market Rents 3 Bed House across the Counties**



#### 4.3.3. Rental Assistance Abroad

The setting of rent limits for rent assistance abroad varies across jurisdictions. A review of policy in the UK, the USA and Australia reveals a number of different options for setting rent limits.

##### United Kingdom

In the UK, Housing Benefit is paid if an individual is on a low income and needs assistance with all or part of their rent. The benefit is available for both the employed and the unemployed. The amount of Housing Benefit is based on one's income, individual circumstances and the Local Housing Allowance (LHA) rate. The benefit does not affect the amount of rent a landlord may charge or an individual may pay.

Rent Officers are responsible for the determination of the LHA and calculate allowances for shared accommodation (room in a shared property), 1 bedroom, 2 bedroom, 3 bedroom and 4 bedroom units. The rate that applies varies depending on the composition of the household and the Broad Rental Market Area in which the rented property is located. Housing Benefit may be

reduced if you live in council or social housing and have a spare bedroom. The reduction is:

- 14% of the 'eligible rent' for 1 spare bedroom; or,
- 25% of the 'eligible rent' for 2 or more spare bedrooms.

In 2014 the LHA was set at the lower of:

- the 30<sup>th</sup> percentile of a representative sample of private sector rents paid within each Broad Rental Market Area, provided by landlords, letting agents and tenants, or
- the existing LHA rate plus 1%.

The 2014 rates were determined and issued during January, and become effective in April. The LHA is reviewed once a year.

##### United States

In the United States, the housing assistance payment provided under the U.S. Department of Housing and Urban Development (HUD) housing choice voucher programme provides rental assistance to tenants. The program is administered by public housing agencies and is available to US citizens and specified categories of non-citizens who have eligible immigration status. The

payment is subject to limits on total annual gross income and family size<sup>77</sup>.

Payment standards are used to determine the assistance payment which the public housing agency pays directly to the landlord. A range of payment standards exist and are based on the Department's schedule of fair market rents for the relevant area. The fair market rent is set at either the 40<sup>th</sup> or 50<sup>th</sup> percentile of rents charged for standard rental housing in the area. The public housing agency can set its payment standard from 90 percent to 110 percent of the published fair market rents (FMRs), and may set them higher or lower with HUD approval. The 50<sup>th</sup> percentile FMR may be employed where higher payment standards are necessary to increase housing choice throughout an area. This may be the case where higher rent levels are needed to ensure that more voucher holders will be successful in finding suitable accommodation. The payment standard is generally set to reflect the rent for a moderately-priced dwelling unit in the local housing market.

The maximum assistance provided is generally the lower of the payment standard less 30% of the family's monthly adjusted income or the gross rent for the unit minus 30% of monthly adjusted income. While the assistance is paid directly to the landlord, the payment does not affect the amount of rent a landlord may charge or the family may pay. As such it is possible for the tenant to rent a unit that is above or below the payment standard; however the family must pay 30% of their monthly adjusted gross income for rent and utilities. In the event that the rent is in excess of the payment standard the tenant is required to pay the additional amount<sup>78</sup>.

It is also necessary for the housing agency to inspect the accommodation on commencement of the agreement to establish that the rent requested is reasonable. Furthermore, income and family composition are reviewed at least annually with the accommodation also inspected to ensure it meets minimum housing quality standards. Whenever the fair market rent increases or decreases, the housing agency must ensure that its

payment standard amounts remain within the basic range. Currently the payment standard is reviewed annually and a waiting list operates for the programme.

### Australia

In Australia, the Commonwealth Rent Assistance is an income supplement payment to individuals living in private rental accommodation. The assistance payment is available to individuals who are eligible for a social security income support payment, which is more than the base rate of Family Tax Benefit Part A (child benefit)<sup>79</sup> or a service pension.

The assistance payment is set at a rate of 75 cents for every dollar of rent paid above a specified threshold until the maximum rate is reached. The maximum rates and thresholds vary according to the family situation and the type of accommodation. Rent thresholds and maximum rates are indexed in March and September each year to reflect increases to the Consumer Price Index (CPI). The amount of the assistance varies depending on individuals' circumstances and the amount of rent they pay.

Recent research has criticised the indexing of rent assistance to CPI as it has not kept pace with movements in national rents.

### Summary

It is evident that in the jurisdictions examined, rent assistance payments are reviewed once a year or more often. In addition, in the US, while the assistance is paid directly to the landlord, the payment does not affect the amount of rent a landlord may charge or the family may pay. Similarly in the UK, the individual has discretion over the amount of rent they pay, however in the UK, penalties exist for over-consumption of housing in the form of a spare bedroom deduction.

## 4.4 ISSUES WITH RENT SUPPLEMENT

Following a review of the Rent Supplement scheme and based on a range of consultations with relevant stakeholders a number of issues in relation to the scheme have been identified.

### Top Up Payments

Rent Supplement is based on the premise that the rent paid will not be more than the maximum rent limit set for the area. In exceptional circumstances

<sup>77</sup> Family income may not exceed 50% of the median income for the county or area in which the family chooses to live and the PHA is required by law to provide 75 percent of its vouchers to applicants whose incomes do not exceed 30 percent of the area median income.

<sup>78</sup> Whenever a family moves to a new unit where the rent exceeds the payment standard, the family may not pay more than 40 percent of its adjusted monthly income for rent.

<sup>79</sup> <http://www.humanservices.gov.au/customer/services/centrelink/family-tax-benefit-part-a-part-b>

rent can be paid above the maximum limits, for instance in cases where the person's housing needs require additional support, such as a person with disabilities. It is also possible for the Community Welfare Office locally to set lower rates than the maximum in cases where the local market dictates lower rental prices. In the event that the actual rent is higher than the local maximum, an application can be made to the Community Welfare Officer who will consider the request and decide based on the merits of the case.

In completing the Rent Supplement application form, both the landlord and tenant must declare that the information provided is accurate with the form clearly stating that a false statement or withholding information may lead to prosecution. However, some studies by tenant advocacy organisations have highlighted that in some cases, due to a lack of accommodation within the rent limits set, some tenants resort to renting higher priced accommodation with the result that landlords and tenants provide false information in relation to the actual amount of rent paid. In such a situation, the tenant will pay a top up in excess of the rent limits to the landlord. Given that the top up payments are provided from social welfare payments the result is that tenants may have inadequate levels of income after rental costs.

The payment of top ups was highlighted in research carried out by Focus Ireland<sup>80</sup> which reported that some tenants believed there was no alternative but to pay a top-up due to difficulties in securing private rented accommodation in the first instance and landlords' unwillingness to reduce the rent to the relevant rent limits set. While there is the risk of prosecution of the landlord for taking a top up payment, a 2008 report by CrossCare<sup>81</sup> highlighted difficulties in proving that landlords are taking top up payments, and cited how additional rental costs were deemed to relate to external services provided such as hallway lighting, waste collection and so forth. While the aforementioned studies highlighted the issue of top up payments, there is no indication of how prevalent these practices are.

A recent review of DSP data shows that in 1,000 cases reviewed, there were only 3 cases of top ups identified. Moreover, there is the possibility that

some individuals are confusing top ups with the minimum contribution payment. Nevertheless, given that the Department states that if your actual rent is higher than the local maximum, you may be refused Rent Supplement<sup>82</sup> entirely; tenants have little incentive to highlight the issue. If such practice is widespread, this is clearly an additional strain on Rent Supplement tenants. However, the introduction of the new HAP payment may reduce the incidence of illegal top ups.

#### Adjustments to Rent Limits

Currently rent limits are reviewed every 18 months and are adjusted accordingly. However in the event that the rent limit is reduced, with the result that the rent currently being paid is above the maximum limit set, the tenant is advised to renegotiate their rent with their landlord. In some cases this may involve the tenant breaking the terms of the RTA Part 3 tenancy which sets out that rents can only be adjusted once every 12 months or 12 months after commencing the tenancy. In such a situation, a voluntary agreement may be reached between the landlord and the tenant. However, in the event that the landlord does not reduce the rent to the new limits, a departmental representative will discuss the options available, which may include seeking alternative accommodation where it is cost beneficial to do. Some tenant advocacy organisations have suggested that this practice has put an additional strain on Rent Supplement recipients and that it has also created a negative attitude towards Rent Supplement by landlords.

#### Payment in Arrears

Finally, Rent Supplement is paid in arrears, which is contrary to the normal practice in the private rented market. This practice may act as a disincentive to landlords to take Rent Supplement tenants. Furthermore, the legislative provisions governing Rent Supplement set out that the Department's relationship is with the tenant and that there is no contractual relationship between the landlord and the Department of Social Protection. This reflects the status of Rent Supplement as a temporary income support. Since the majority of Rent Supplement payments (with the exception of 20% paid to persons other than the tenant) are paid directly to the tenant, there is a concern that landlords may not receive the payment from the tenant.

<sup>80</sup> Out of Reach: the Impact of Changes in Rent Supplement, Focus Ireland, 2012.

<sup>81</sup> [http://www.crosscare.ie/images/uploads/rent\\_supplement\\_report\\_08.pdf](http://www.crosscare.ie/images/uploads/rent_supplement_report_08.pdf)

<sup>82</sup> <http://www.welfare.ie/en/pages/rent-supplement.aspx>

This may act as a disincentive to landlords given that in the event of a dispute with the tenant over the payment of rent, Rent Supplement will cease to be paid to the tenant and so the landlord will not be able to obtain the rent owed, albeit the Department advises that such issues are very isolated occurrences. It is understood that this issue will be addressed for long term Rent Supplement tenants on their transfer to HAP, whereby the local authority will pay the rent directly to the landlord while the tenant contribution will be paid to the local authority.

#### 4.5 ADDITIONAL STATE ASSISTANCE FOR LOW INCOME HOUSEHOLDS

##### 4.5.1. Interim Tenancy Sustainment Protocol

In view of the current supply difficulties, the Dublin local authorities, in conjunction with voluntary organisations have introduced the Interim Tenancy Sustainment Protocol (ITSP) so that families at risk of losing existing private rented accommodation can have more timely and appropriate interventions made on their behalf. The objective of this protocol is to address rent concerns based on assessed need as agreed by the DSP. DSP take referrals from Threshold as the lead provider where income inadequacy is identified as an issue with a view to increasing Rent Supplement payments if this is appropriate. Supplements are awarded on a conditional and temporary basis with regular review to allow the household to try and continue to source alternative accommodation within the prescribed limits. This protocol is in place for 13 weeks during which the alternative accommodation is sourced but where this does not materialise (and anyway is likely to be difficult in a supply constrained environment) the protocol can extend a further 13 weeks. It may be necessary to extend this protocol on a case by case basis to keep families at risk in their homes.

##### 4.5.2. State Expenditure in the Private Rented Sector

Significant expenditure is incurred by the State on providing accommodation for eligible low income households in the private rented sector. According to information received from the Department of the Environment, Community and Local Government (DECLG), housing authorities have indicated that their estimate of the total 2014 housing authority expenditure on homeless services will be in the region of €65 million. This

figure represents expenditure on all housing authority funded homeless services. Stripping out the elements of the €65 million which are not strictly related to homelessness accommodation, the figure is around €41 million, comprising €34.4 million for emergency accommodation €6.5 million is for homeless prevention, tenancy sustainment and resettlement supports. The €41 million includes expenditure on homeless hostels managed by the various voluntary service providers (such as Focus, Simon, Crosscare, St. Vincent de Paul, Peter McVerry Trust etc.), as well as the various temporary private emergency accommodation solutions funded by housing authorities such as B&Bs, hotels, hostels, and private landlord properties.

Separately, the Exchequer allocation for the funding of such housing authority expenditure ('Section 10 funding') in 2014 is €45 million, which must be accompanied by at least 10 per cent additional funding from the housing authorities. This would suggest that 'Section 10' funding will be €49.5 million this year. As this is in excess of the €34.4 million above, it is likely that housing authorities will have to utilise funding available to them from other sources. This will result in other services not being funded by the local authorities.

The HSE will expend in the region of €30m on homelessness services in 2014, although this is excluded from Table 4.6 as it relates to a range of services, including social services.

According to the Implementation Plan on the State's Response to Homelessness<sup>83</sup>, Dublin City Council is currently incurring significant unforeseen costs accommodating homeless families in private emergency accommodation, while the shortage of local authority housing and private rental properties in the Dublin region is exacerbating the situation. As of the 29<sup>th</sup> April 2014, a total of 184 households with child dependents were residing in 16 commercial hotels in Dublin. The full year estimate in 2014 for hotel use in Dublin is expected to be over €4 million (included in the €34.4m). There is a clear urgency for alternative housing solutions for these and other families becoming homeless in the Dublin region and across the State.

<sup>83</sup> <http://www.environ.ie/en/PublicationsDocuments/FileDownload.38053.en.pdf>

Thus taking into account the current expenditure on Rent Supplement and homelessness, the total costs to the State of accommodating people in the private rented sector as well as on homelessness will be around €387 million in 2014. This is significant and needs to be taken into account in the context of the cost of the options contained in this report.

**Table 4.4: State Expenditure in the Private Rented Sector\***

	<b>2014</b>
	<b>€m</b>
Rent Supplement	344.0
Homelessness (by Housing Authorities)	
-On Emergency Accommodation	34.4
- Homeless Prevention, Tenancy Sustainment and Resettlement Supports	6.5
Assistance with Rent Deposits	<u>2.1</u>
<b>Total Cost to Exchequer</b>	<b><u>387.0</u></b>

Source: DECLG, DSP.

\* Including all emergency accommodation in hotels, hostels and B&Bs.

#### 4.6 CONCLUSIONS

The private rented sector is involved in the provision of social housing support mainly through the Rent Supplement scheme, an income support scheme which is operated by the Department of Social Protection, through the RAS scheme operated by local authorities and through the leasing initiatives by housing authorities and approved housing bodies. A new Housing Assistance Payment scheme is currently being piloted by housing authorities and will cater for households with long-term housing needs.

A number of changes to Rent Supplement have taken place since 2009. The current minimum tenant contribution has increased over the past number of years, which is part of on-going strategy to realign the Rent Supplement minimum contribution with differential rents charged by Local Authorities. In addition, the maximum rent limits have been reduced in line with the decline in the overall market, but there have been some increases in the 2013 Review, reflecting the recent increase in rents in the country, and in particular Dublin.

Rent limits provide a benchmark for the Department's staff in their respective regions. Rent Supplement maximum rates are generally set at the 35<sup>th</sup> percentile of the available market rent to ensure that 35 per cent of the relevant market

is available for Rent Supplement tenants. A review of rent limits in other jurisdictions reveals broadly similar practices. In the United Kingdom, Housing Benefit is adjusted annually and is based on the Local Housing Allowance rate which is set at the 30<sup>th</sup> percentile of a representative sample of private sector rents or at the existing LHA rate plus 1 per cent. In the United States, the Housing Assistance Payment sets a payment standard between 90 and 110 per cent of the Fair Market Rents, which in turn are based on the 40<sup>th</sup> or 50<sup>th</sup> percentile of rents and are reviewed annually. In Australia, the Commonwealth Rent Assistance sets rent thresholds and maximum rates which are indexed to the CPI in March and September of each year.

An analysis of the current Rent Supplement rent limits relative to the 35<sup>th</sup> percentile using the PRTB rent data revealed that Rent Supplement tenants seeking accommodation in the market today are more challenged in sourcing accommodation in certain areas of Dublin. However, these trends are also likely to reflect the relative proportion of Rent Supplement tenants across the Dublin postcodes. Consultations undertaken suggest that some areas of Dublin are highly concentrated with Rent Supplement while other areas have a relatively low proportion. At a county level, rent limits are sufficient to meet the 35<sup>th</sup> percentile of market rents. Once again this analysis highlights how the key issues affecting the rental market at present are largely concentrated in Dublin.

A range of consultations with relevant stakeholders in relation to the administration of the Rent Supplement scheme revealed a range of issues for tenants and landlords. Most notably from the landlord point of view was the payment of rent in arrears and the direct payment to the tenant. Tenants' concerns largely related to the stress of sourcing adequate accommodation within the rent limits set. However, it is hoped that the introduction of the HAP will resolve the majority of concerns for persons who are long term dependent on Rent Supplement.

## 5. TAXATION OF THE PRIVATE RENTED SECTOR

### 5.1 CURRENT TAX TREATMENT OF LANDLORDS IN IRELAND

#### 5.1.1 Charge to Irish Tax on Rental Income

Rental income is generally chargeable to tax under Case V of Schedule D under the Taxes Consolidation Act (TCA) 1997, and is chargeable to tax as income tax where the rental income accrues to individuals, and corporation tax where it accrues to companies<sup>84</sup>.

Rental income is computed on the basis of the gross amounts of rents receivable and a surplus or deficiency is calculated separately for each rental source. The rental income chargeable to tax is the aggregate of the surpluses as reduced by the aggregate of the deficiencies. Rental losses occur when the deficiencies exceed the surpluses.

#### Individuals

In the case of individuals, any rental income surplus is generally chargeable under the following heads of charge:

- Income tax at rates of 20% /41%
- PRSI at rates of 4%
- USC at rates of 2%/ 4%/ 7% /10%.

For income tax purposes, the marginal rate of income tax, PRSI and USC on rental profits will be somewhere between 26% and 55%.

Table 5.1 below summarises the marginal rates<sup>85</sup> of income tax, PRSI and USC that apply on the basis of income levels of a singly assessed individual<sup>86</sup>. It should be noted that the rates of tax are progressive and all forms of income will be taken into account in arriving at the rate of tax applicable to income of an individual.<sup>87</sup> As can be

seen, the rate of overall tax (of which income tax is only part) is progressive and will increase substantially once an individual hits €32,800.<sup>88</sup>

Additionally, the rate of USC increases to 10% for an individual who has *relevant income*<sup>89</sup> exceeding €100,000 in a tax year. Relevant income includes all forms of trading income and rental income of an individual. As such, the highest or marginal rate of tax on rental income of individuals is 55%.

**Table 5.1: Effective Tax Rates for Individuals\***

Income	Income Tax Rate	USC <sup>90</sup> Rate	PRSI Rate	Total
€10,000	20%	2%	4%	26%
€20,000	20%	7%	4%	31%
€ 30,000	20%	7%	4%	31%
€40,000	41%	7%	4%	52%
€100,000	41%	7%	4%	52%
€ 150,000	41%	10%	4%	55%

\*(including PRSI and USC, based on different income levels).

The impact of the USC is however perhaps understated somewhat in some cases. As the USC is chargeable on 'gross income' **before** deduction for Section 23 relief, capital allowances on plant and machinery and certain tax incentive reliefs (capital allowances)<sup>91</sup>, its real effect is greater than it would be if it were a higher rate of income tax.

Tenants of non-resident landlords are obliged to deduct tax from payments of rent at a rate of 20% of the gross rent.<sup>92</sup> This is a payment of tax on account. This withholding obligation does not apply where an Irish-based resident is appointed

applying to 'relevant income' exceeding €100K per annum). Rental income falls under the definition of 'relevant income' for USC purposes.

<sup>88</sup> Higher income levels before entry to the top marginal income tax rate will apply where an individual is assessed under joint or separate assessment (with a spouse or civil partner).

<sup>89</sup> Relevant income will generally be all forms of income except employment income, deposit interest subject to DIRT and social welfare pensions, but will include rental income.

<sup>90</sup> For individuals over 70, or individuals holding full medical cards, where 'aggregate income does not exceed €60,000, the rate of USC is reduced by 3%.

<sup>91</sup> This contrasts with the position that applies where capital allowances are available to be claimed against trading income as in that case, the USC will be calculated on the income after deduction of capital allowances.

<sup>92</sup> Where the landlord is non-resident, the tenant has an obligation to retain tax at the standard rate of income tax (20%) from the gross rent payable and pay this over to Revenue – section 1041 Taxes Consolidation Act 1997. This obligation has the potential to place significant tax compliance burdens on tenants, who may not have access to advice.

<sup>84</sup> In the case of real estate investment trusts ("REITs"), a different taxation regime applies.

<sup>85</sup> This is the highest rate of tax to which the individual will be subject (the effective rate will generally be lower due to tax credits and lower USC charges although the higher the income level, the more likely it is that the effective rate of tax will be close to the marginal rate).

<sup>86</sup> Where an individual is assessed under joint or separate assessment (with a spouse), the higher rate of income tax (41%) will only arise at higher income levels.

<sup>87</sup> USC or the universal social charge can be chargeable at different rates depending on the source of the income. In particular, it is chargeable on 'relevant income' or 'relevant emoluments' at rates of 2% to 10% (the latter rate only

to act for tax compliance purposes on behalf of the non-resident.

### Companies

In the case of Irish resident companies<sup>93</sup>, they are generally liable to corporation tax on rental income at a rate of 25% (the 12.5% rate of corporation tax only applies to trading income).

Additionally, where the Irish resident company is a 'close company'<sup>94</sup>, an additional charge to tax is levied where there is any estate or investment income *undistributed* at the end of 18 months following the end of the accounting period in which it arose. This charge, a 'surcharge on investment income' is charged at a rate of 20% on the undistributed taxable income after allowance for mainstream corporation tax (i.e. an effective 15% on the gross income chargeable to corporation tax<sup>95</sup>).

The effective rate of corporation tax on rental income of Irish resident companies can therefore be up to 40%. By contrast, non-resident companies are chargeable to income tax (and not corporation tax) at a rate of 20 per cent. Tenants of non-resident landlords are obliged to deduct tax from payments of rent at a rate of 20% of the gross rent.<sup>96</sup> This is a payment of tax on account. This withholding obligation does not apply where a non-Irish-based agent is appointed to act for tax compliance purposes on behalf of the non-resident.

#### 5.1.2. Computation of Taxable Rental Income

In arriving at taxable rental income, taxation legislation prescribes that only certain expenditure can be deducted. Broadly speaking, deductible expenditure is allowable only to the extent that:

- it would be allowable if the receipt of rent were treated as the carrying on of a trade or

business during the currency of the lease or during the period in which the individual or company was entitled to the rent;

- it is not of a capital nature;
- it is incurred by the individual entitled to receipt of the rents.

Deductions in computing rental income are generally speaking limited to the following:

- Rents payable by the landlord in respect of the property (this would be a superior lease rent or a ground rent);
- Rates payable by the landlord to a local authority in respect of the property. This generally only applies in relation to a commercial property. In the case of residential property, commercial rates are generally not chargeable save where the property is used in connection with a rateable business. Property taxes including the household charge and the non-principal private residence (NPPR) charge, levied up to the end of the tax year 2013, are not allowable deductions from rental income for tax purposes. This is discussed separately below.
- The cost of PRTB registration fees.
- The cost of any service or goods which the landlord is, under the lease, required to provide, such as refuse collection, water charges, utilities, maintenance charges.
- Maintenance of the property such as cleaning and general servicing, exterior and interior painting and decorating (but only on or after the period from when the property is first let).
- Insurance of the premises against fire, public liability insurance etc.
- Fees payable to management companies in relation to the letting and collection of rents and legal fees for drawing up leases.
- Accountancy fees incurred for the purposes of preparing a rental account.
- Repairs to the property (but not capital expenditure generally consisting of improvements to the property).
- Interest on money borrowed to purchase, improve or repair the let property. There are certain restrictions outlined below in relation to the letting of private residential property<sup>97</sup>.
- Certain mortgage protection policy premiums.
- Expenditure on decoration and upkeep of the property between lettings.

<sup>93</sup> Section 23A Taxes Consolidation Act 1997 contains rules to determine tax residence of companies. Generally, companies which are 'managed and controlled' by their board of directors in Ireland will be Irish tax resident.

<sup>94</sup> This is determined under Part 13 Taxes Consolidation Act 1997. Generally, a close company is a company under the control of 5 or fewer participators (shareholders).

<sup>95</sup> For example, if the rental income was €100,000, mainstream corporation tax would be €25,000. The surcharge, where it applies would be levied at 20% of the income net of corporation tax (i.e. €75,000) and would be €15,000. Adding this to the corporation tax of €25,000 gives a charge of €40,000.

<sup>96</sup> Where the landlord is non-resident, the tenant has an obligation to retain tax at the standard rate of income tax (20%) from the gross rent payable and pay this over to Revenue – section 1041 Taxes Consolidation Act 1997.

<sup>97</sup> Notably the restriction limiting the deduction to 75% of the interest otherwise allowable.

Although capital expenditure is not deductible against rental income, capital allowances are available in relation to fixtures and fittings within the premises which constitute *plant and machinery*<sup>98</sup> for taxation purposes<sup>99</sup>. These will include, for example, loose furniture, kitchen appliances and other plant. Capital allowances are granted over a period of 8 years at an annual rate of 12.5% of the cost of same.

What generally speaking will not be deductible in computing taxable rental income will also include the following:

- Repayments of borrowings obtained in relation to the purchase, improvement or repair of the rented residential property<sup>100</sup>.
- Capital improvements to the fabric of the premises, to include improvements such as consolidating living units within the building (save to the extent that this is expenditure on plant and machinery items<sup>101</sup>) and upgrade of the premises to meet regulatory standards for rental properties<sup>102</sup>.
- Expenditure on upgrading of property, whether by repairs or otherwise, prior to the first letting of the property.

### 5.1.3. Deduction for Interest on Borrowings

Currently, tax legislation provides that interest on money borrowed to purchase, improve or repair let property is deductible in computing rental income chargeable to income tax or corporation tax.

The test under the legislation is generally to be assessed on the basis of whether the interest was incurred 'wholly or exclusively' in connection with the rental business.

In relation to interest accruing on or after 7 April 2009, the deduction for interest on loans employed on the purchase, improvement or repair of rented residential property is restricted to 75%

of the interest accruing. It is noteworthy that this restriction, introduced by Finance Act 2009, does not apply to loans employed on the purchase, improvement or repair of non-residential rental property, where the full amount of interest continues to be deductible in such cases.

The Exchequer saving in relation to the amendment introduced was estimated in the Summary of Budget Measures published at €95 million in a full tax year.<sup>103</sup>

Notwithstanding this level of saving, the cost of a full reversal of the measure is likely to be €112 million in a single tax year, based on Revenue Commissioner estimates made in 2012.

Table 5.3 outlines the increase in the overall tax burden for individual investors. The restriction of interest together with the increased rates of taxes since 2009 primarily have contributed to significant tax increases particularly for investors who borrowed to acquire rented residential premises.<sup>104</sup>

It should be noted that the restriction on interest deductibility has no impact on cash investors or certain types of fund investors (for example, REITs, pension funds, unit trust arrangements), in the latter case due to the tax exempt nature of those entities.

This measure restricting interest deductibility did not apply to investors borrowing to invest in the commercial property sector. For investors seeking investment opportunities, this is a factor where the investment is being sourced from borrowings.

The distinction between the commercial investor property sector and the residential investor sector, in terms of the ability to claim interest deductions, is almost unique when one looks at the sectors in other jurisdictions reviewed. Additionally, the

<sup>98</sup> Plant and machinery will include fixtures and fittings in the property and can include kitchen units, sanitary ware, heating systems, hot water systems, fire safety equipment, carpets, blinds, curtains, furniture.

<sup>99</sup> This is subject to the property being a house let as a furnished house and let on bona fide commercial terms in the open market – see s284(7) Taxes Consolidation Act 1997.

<sup>100</sup> Although deductions are available for interest on borrowings employed in the purchase, improvement or repair of rental properties, there is no relief for repayments of the loans themselves.

<sup>101</sup> See commentary above.

<sup>102</sup> See below for different incentive schemes providing relief/allowances for capital expenditure.

<sup>103</sup> See Summary of measures published on 7 April 2009. The basis for the introduction of the restriction was cited by the Minister for Finance as being, "We need to broaden our tax base so that everyone makes a contribution. We will remove unjustified reliefs and we will ensure that capital is taxed in a fair manner".

<sup>104</sup> This assessment of the increased tax burden for investors on the expiry of tax incentive reliefs since 2007 is not factored into this report. Readers are referred to the Tax Policy Report of the Department of Finance of December 2011 and the Goodbody/Indecon Report of February 2006. The 'guillotine' in relation to certain tax incentive reliefs, introduced in Finance Act 2012, to apply in many cases from the end of 2014 may have additional effect in this regard.

nature of the restriction is not in keeping with international comparisons.<sup>105</sup>

Additionally, from 2006 onwards, interest on money borrowed for the purchase, improvement or repair of rented residential property is not deductible unless it can be shown that the registration requirements of the PRTB have been satisfied in relation to all tenancies in the particular premises in charge for the period in question.<sup>106</sup> This was a measure to ensure compliance with the Residential Tenancies Act 2004 on the part of landlords in the residential sector.

In relation to interest deductibility, the following points might also be noted:

- Revenue has confirmed in its guidance notes<sup>107</sup> that interest on a loan or part of a loan used to pay stamp duty, legal fees and other expenses incurred in relation to the purchase, improvement or repair of a premise is not deductible.
- Additionally, it might be noted that the deductibility of interest only arises for the period from when a property is first let. Interest is not deductible in the period following the purchase of the property up to the time the property is first let. Interest relief, however, continues to be available in between lettings.

available as a deduction in calculating the chargeable gain for capital gains tax purposes.

The distinction between repairs and capital expenditure can be somewhat difficult to apply in practice but the following general points might be noted:

- Any work involved in converting existing parts of the premises through the breaking down of walls and increasing sizes of residential units will, generally speaking, be capital in nature.
- Any replacement of items in the premises with improved replacements will generally be capital. For example, replacement of single glazed windows with double glazing would be treated as capital expenditure and no allowances or relief are available for such expenditure.
- Improvement of heating facilities and plumbing will generally be viewed as capital in nature and again, absent being able to claim capital allowances as plant and machinery, such expenditure will not be deductible.

**Table 5.2: Differences in the Computation of Rental Income Chargeable to Tax: Residential Vs Non-Residential Property**

Type of Expenditure	Residential	Non-Residential
Rates/ Property taxes	No deduction	Deduction *
Interest on borrowings	limited to 75%	full 100%

\* Where not payable by the tenant

#### **Relief for Capital Expenditure**

Although deductions are permitted for repairs and restoration of assets in rented residential premises, capital expenditure does not (with the exception of expenditure on plant and machinery) give rise to a deduction against rental income for tax purposes. Any such capital expenditure is

<sup>105</sup> See paragraph 5.2 of this section.

<sup>106</sup> Section 11 Finance Act 2006.

<sup>107</sup> Chapter 4.8.6 (Par.7) of the Income Tax, Capital Gains Tax & Corporation Tax Manual.

### Box 13: Tax Treatment of Landlords In Other Jurisdictions

#### Germany

Under German Law rental income is defined as the making available of an asset to another person for a valuable consideration.

All rental income of individuals is taxable under German Law pursuant to Paragraph 21 EStG (Einkommenssteuergesetz), independent of the source from which it is generated. Rental income consists of the rent itself (“**net rent**”) plus the advance payment for service charges (“**gross rent**”).

Usually, rental income is liable to income tax unless the rented property forms part of the assets of the business. In this case, rental income is liable to business tax under paragraph 21 EStG.

Expenditures related to the purchase, the safeguarding and the maintenance of the rented property (“**income-related expenses**”) reduce the tax liability.

Income-related expenses are:

- Depreciation for deterioration;
- Service charges, e.g. charges for water, electricity or fuel (if not passed on to the tenant);
- Property tax;
- Depreciation for rented furniture;
- Finance charges, e.g. mortgage fees, interests;
- Costs for repair and maintenance;
- Legal fees related with the tenancy agreement;
- Accountancy fees;
- Costs for fire insurance, legal cost insurance and third party liability insurance; and
- Administration costs (including travel costs).

The rental income after the deduction of all applicable income-related expenses is subject to taxation. A positive balance leads to a payment of taxes, whereas a negative balance leads to a tax saving which can be set off against other taxable income from other sources.

Rental income not exceeding €520.00 per year from the temporary rent of a room in the family home or a small holiday apartment is tax free and need not to be declared to the Revenue. However, if such rental income not exceeding €520.00 is declared to the Revenue, income-related expenses cannot reduce the tax liability.

#### Tenancy agreements with relatives

Furthermore, tenancy agreements with relatives are strictly controlled. In general, to obtain tax deductions under such agreements, they must be made and executed on an arms lengths basis. If the Revenue does not accept the tenancy agreement, rental income is neither taxable nor reduces the tax burden.

In the situation where a house/apartment is rented (to a relative) for other than valuable consideration, tax deductions are not available. However, where rented at a discount, a tax deduction is permitted if the rent paid by the relative is 66 percent of the rent customarily in place. A rent of at least 66 percent allows for the full application of income-related costs. If the rent is less than 66 percent, say 60 percent, only 60 percent of the income-related expenses can be declared.

#### Income tax rates

In most cases, rental income is taxed under income tax. The income tax rates depend on the income of a person. The average income tax rate lies between 2.6 and 35.1 percent. The maximum income tax rate is 42 percent.

#### Business tax rates

Where the rented property belongs to a business, i.e. the rented property is owned by a body corporate or partnership, the rental income is treated as business income. The business tax is a community tax under German Law and therefore varies depending on the particular assessment rate. Partnerships are granted a tax allowance of €24,500, corporations are not.

### **United Kingdom**

The way rental income is taxed differs depending on the situation. In the following the main rules are explained.

#### **How tax is calculated**

Income tax must be paid on any profit from renting out property. The profit is the sum left once the aggregate amount of rental income is added together and then reduced by any allowable expenses or allowances such as repair and maintenance costs, legal service costs, insurance costs, improvement costs or depreciation.

Taxes must be paid on the profit made from renting out the property, after deductions for 'allowable expenses'<sup>108</sup>.

Allowable expenses are costs incurred on the day-to-day running of residential property, i.e.:

- letting agents' fees;
- legal fees for lets of a year or less, or for renewing a lease for less than 50 years;
- accountants' fees in preparing the rent account;
- buildings and contents insurance;
- interest on property loans;
- maintenance and repairs to the property (but not improvements);
- utility bills, such as gas, water and electricity;
- rent, ground rent, service charges;
- Council Tax;
- services paid for, such as cleaning or gardening; and
- other direct costs of letting the property, like phone calls, stationery and advertising.

Allowable expenses do not include capital expenditure, i.e. costs incurred for buying a property or renovating it beyond repairs related to wear and tear. Depreciation cannot be deducted for residential property. However, special tax allowances for rental business property may be claimed to take account of depreciation.<sup>109</sup>

#### **Taxable income**

The taxable income is primarily the rent received, but also any separate sums receivable from the tenant for the use of furniture, as well as charges for services normally provided by a landlord, such as cleaning of communal areas, provision of hot water and heating and arranging repairs to the property.

If the person has several properties, all rental receipts and expenses can be lumped together, so expenses on one property can be deducted from receipts on another.

The only caveat to this is that overseas properties are treated separately to UK properties, so for instance one is not allowed to lump together a UK holiday let and a Spanish property.

#### **Applicable tax rate**

The rental profits are taxed at the same rates as income received from business or employment – 20%, 40% or 45%, depending on which tax band the income falls into.

#### **Trading income**

If services are provided that are not normally offered by a landlord such as cleaning of rooms when let, a regular laundry service or regular meals, this income will usually be treated separately as trading income rather than rental income. In this case, the tax allowances for self-employed persons can be applied.

If joint owners share the income from the same property, each receives up to £2,125 tax free, even if there are more than two of them, e.g. three joint owners could claim in aggregate £6,375.

#### **Rent a Room Relief**

A rent-a-room relief can be claimed even in the case where the rental is treated as trading income, providing furnished accommodation is let in a privately-used home. To qualify one must let furnished residential

<sup>108</sup> <https://www.gov.uk/renting-out-a-property/paying-tax>

<sup>109</sup> <http://www.hmrc.gov.uk/manuals/pimmanual/pim3005.htm>

accommodation in one's only or main home. The relief does not apply to rooms rented as an office or for other business purposes.

If the gross income is below the rent-a-room limit of £4,250 (or £2,125) the profit is automatically exempt from tax under the rent-a-room scheme. However, one can decide to opt out and elect to be taxed in the normal way. A loss on the rent-a-room accommodation cannot be set against other rental income outside the rent-a-room scheme.

Even in the case of a lodger, where a tenant sublets a room, the tenant has to pay taxes on the rental income. In these cases a rent-a-room relief brings great advantages. For example, a tenant charges his lodger £450 a month rent to share the house; the annual rent of £5,400 is more than the rent-a-room allowance (£4,250). Under the rent-a-room scheme, over a year £4,250 of the rent will be tax-free, leaving £1,150 profit to be taxed. The tax payable would be £230 (£1,150 x 20%).

### France

Under French Law furnished and unfurnished properties are treated differently for tax purposes. Unfurnished property is regarded as non-commercial property. Furnished property is treated as commercial. If a person is renting both, then each will be taxed on a separate basis. A second distinction is the turnover. Small landlords are given some choices as to the basis on which to be taxed.

#### Taxation of rental income from furnished lettings

There are two different income tax regimes for the taxation of profits from furnished accommodation. As said, small landlords can choose the regime under which they wish to be taxed. The two tax regimes are micro-enterprise and régime réel. Additionally, there exist different charges for social charges/social security contributions.

##### (a) *Micro-enterprise*

Small landlords of furnished accommodation can qualify to be taxed as a micro-enterprise under a taxation system called Bénéfices Industriels et Commerciaux ("**BIC**"). A person is eligible for the Micro-BIC tax status if the gross revenues do not exceed a fixed amount each year. The tax liability is calculated after deduction of a fixed percentage allowance against the annual turnover.

The level of the fixed allowance and turnover limit depends on the type of furnished accommodation provided. Owners of rural gîtes, meuble de tourisme and chambres d'hôtes benefit from a fixed percentage cost allowance of 71 percent, with a turnover limit of €82,200. Technically, to be called a gîte, the owner must live nearby in order to provide help, assistance, and a warm welcome to guests. Gîtes are generally old farm workers' cottages or converted outbuildings and barns within proximity of the owners' principal residence. Furthermore, in order to qualify for the 71 percent allowance, the owner must be affiliated to the "Gîtes de France".

For all other furnished accommodation a tax allowance of 50 percent can be claimed against earnings and the maximum turnover limit is €32,900 per year.

The actual rate of taxation will be that applicable under the normal rules for personal income tax.

##### (b) *Regime Réel*

Under the régime réel, the tax liability is determined after the deduction of the eligible costs against the gross rental income. Eligible costs include general management costs, the costs of property insurance, local property taxes, the costs of a managing agent, guardian, caretaker, gardener and the costs of insurance against the risk of non-payment of rent by the tenant. In addition, also deductible are the interest costs associated with the purchase, repair or improvement of a rented property purchased with the view to it being let. Depreciation is deductible as well, but cannot be used to create a deficit or to increase a deficit if one can be created from other sources. That said, if the costs for depreciation cannot be used in the beginning, they can be carried forward for use in later years.

It should also be noted that costs of repair and maintenance of a property are deductible. Works to increase the size of a property or to add additional units are not deductible.

The actual rate of taxation will be that applicable under the normal rules for personal income tax.

### Social Charges

The social charges and the social security contributions to which a landlord is liable depend on whether the business is registered or not.

If a business is not registered the landlord will be liable for social charges, called *prélèvements sociaux*, at a rate of 15.5 percent on the net rental income. This charge is deductible against income tax at a rate of 5.1 percent.

If the business is registered, the social charges and social contributions depend on the business tax status.

As a micro-enterprise<sup>110</sup> one pays social security contributions of 45 percent on the rental income after a deduction of a fixed cost allowance of 50 percent. This cost allowance is increased to 71 percent in the case of *chambres d'hôtes* (lodgings)<sup>111</sup> and rural *gîte* (rural lodgings) owners. They pay 45 percent on 29 percent of their rental income.

As an auto-entrepreneur<sup>112</sup> one pays a fixed percentage social security contribution. The rate depends on the nature of accommodation and services offered. The normal rate for furnished accommodation is 24.8 percent on the gross rental income. This figure is reduced to 14.2 percent for *chambres d'hôtes* and rural *gîtes* owners, because they offer a number of services, e.g. cleaning, reception, which makes them quasi-hoteliers.

Any person taxed under the regime *réel* pays social security contributions of 45 percent on the actual net profits.

### Value Added Tax

VAT will only be charged where breakfast, daily cleaning, reception service and/ or linen service are provided to the tenant.

### **Taxation of rental income from unfurnished lettings**

Rental income from unfurnished lettings is taxed under a system called *revenus fonciers*.<sup>113</sup> Two income tax regimes apply for *revenus fonciers*: *micro-foncier* and *regime réel*. In addition, all landlords are liable for the social charges.

#### *(c) Micro-foncier*

Where the rental income from unfurnished property does not exceed €15,000 a year, then a person is entitled, but not obliged, to be taxed under the system of *micro-foncier*. The income figure is doubled if the rental property is owned and run by a couple. Under this system the tax authority automatically applies an allowance of 30 percent against the gross rental income. Therefore, no calculation and deduction is needed as the allowance will be applied automatically.

If the eligible costs are less than 30 percent of the gross income, then a person would benefit from this approach.

It should be noted that losses cannot be carried forward under this system as is possible under the *regime réel*.

#### *(d) Regime réel*

If the costs are higher than 30 percent of the gross rental income, one can choose to be taxed under this system. If the rental income exceeds €15,000 per year, one is obliged to use this system.

Under the *regime réel* the tax liability is determined after deducting the actual eligible costs against the gross rental income. The eligible costs include general management cost, the costs of property insurance, local property taxes, the costs of a managing agent, guardian, caretaker, gardener and the costs for an insurance against of the non-payment of rent by the tenant.<sup>114</sup> Furthermore, interest costs associated with the repair or improvement of a rented property, as well as on a mortgage for a property purchased with view to being rented, are deductible.

<sup>110</sup> The European Union defines micro-enterprises as those that meet two of the following three criteria and have not failed to do so for at least 10 years: fewer than 10 employees, balance sheet total below EUR 2 million and/or turnover below EUR 2 million.

<sup>111</sup> Means: room in a Bed & Breakfast.

<sup>112</sup> Means: sole trader.

<sup>113</sup> Means: property income.

<sup>114</sup> See article 31 – Code général des impôts, CGI.

### Social charges

Additionally a landlord is liable for the social charges at a rate of 15.5 percent on the net rental income. This charge is deductible against income tax at a rate of 5.1 percent.

### **The Netherlands**

Taxable income generally is split into three “boxes”, and each box is assessed separately. Spouses and other legally recognised partners are assessed separately, although they can choose their own allocations for certain income and deductions.

Property is taxed under box three, irrespective of the actual income received. Income from property owned but not lived in as a main residence is taxed here. Note that the value of the asset rather than the actual income is taxed. It is an imputed nominal return equal to a 4 percent tax on 30 percent of the value of the asset, i.e. a flat tax of 1.2 percent per year. An amount of €21,139 of the value of the assets is exempted.

The amount of money invested in approved “green investments” is exempted up to €56,420. Moreover, a tax credit is applied for these investments in the amount of 0.7 percent per year.

There are special provisions for depreciation of an “immovable property”. A distinction is made between immovable property held for investment purposes and buildings used in a trade or business.

Investment property cannot be depreciated to an amount lower than the property’s official fair market value for tax purposes, which is known as WOZ-waarde. In other words, a property will not be subject to depreciation unless the carrying amount of the building and the land on which it is located is higher than its value for tax purposes. This value is determined by the municipal tax authorities annually. As this value is based on the assumption that the property is free of a lease, the value for tax purposes of commercial real estate may be lower than fair market value.

Maintenance costs continue to qualify for tax relief and any maintenance-related value increase does not lead to a compulsory upward revaluation of the property. Moreover, a property is not required to be re-valued where its value increases due to market developments.

### **Belgium**

Individuals who receive income from Belgium pay income tax. Taxes due on rental income derived from letting property in Belgium are generally calculated over the “Revenu Cadastral” value of the property, regardless of the actual amount of rent received.<sup>115</sup>

A cadaster, using a cadastral survey or cadastral map, is a comprehensive register of the real estate or real property's “metes-and-bounds” of a country. A cadaster commonly includes details of the ownership, the tenure, the precise location, the dimensions and area, the cultivations if rural, and the value of individual parcels of land.

In order to calculate the cadastral income one needs to know the regional tax rate plus the provincial and district additions. Unfortunately, there is no harmonisation at a national level of the percentage of the cadastral income that will be charged.

The cadaster office determines the cadastral income by an estimation of the annual net rental income on the basis of rents applicable in 1975. Either the cadaster office or the notary informs the owner of property about the specific cadastral income.

The cadastral income reflects the average amount of money that would be charged as a monthly rent. To compensate the fact that the cadastral income is calculated on a 1975 basis, the cadastral income is increased. The increase itself depends on the use of the property.

For a built-on plot the cadastral income is increased by 60 percent, for an unbuilt-on plot by 90 percent.<sup>116</sup> A rented

<sup>115</sup> Revenu cadastral means: cadastral income.

apartment that is only used for private purposes is taxed with a cadastral income increased by 40 percent.<sup>117</sup>

If a property is rented to a private person who uses it for private and commercial purposes, the minimum tax rate is the cadastral income increased by 40 percent. The same applies if property is rented to a corporation.<sup>118</sup>

In other words, real estate income includes rental income from both real estate that is used for professional activity and for private purposes. A tax on immovable property is levied on all real estate property. The rate of this tax ranges from 1.25 percent to 2.5 percent depending on the region where the property is located. The tax is levied on the deemed rental income of the property.<sup>119</sup>

There has been a request for a preliminary ruling of Hof van Beroep te Antwerpen (Antwerp Court of Appeal), submitted on 10 September 2013, dealing with the question of whether the cadastral income taxation system is contrary to Article 56 of the EU treaty.<sup>120</sup>

Taxable income is based on the 'cadastral income', which is the property's deemed income. This is an annual indexed value determined by the tax authorities, but in practice the 1975 index is used, so that cadastral income values tend to be lower than actual rental incomes.

The cadastral value minus deductible expenses (which includes depreciation, repairs, maintenance, renovations, interest payments, as well as property and inheritance tax payments) is taxable.

#### **Luxembourg**

Under Luxembourg tax law, rental income that is taxable includes either the income from the actual rental of a building or the rental value of a building occupied by an owner-occupier.

However, only the net rental income derived from the property is taxable.

#### **Determination of the net rental income derived from the actual rent**

The net income equals the gross rental income less deductible expenses. Deductible expenses for rental income include the maintenance costs for the building, interest and charges related to the financing of the property, property taxes, insurance premiums and the depreciation of the building.

Property is depreciable, with the exception of land. If no split is made in the deed of sale between the price for the land and the price for the building, it is assumed that 20 percent represents the value of the land. The depreciation is determined using the straight-line method. The acquisition costs, expenses for the registration duties, the notary's and architect's fees form the basis for the depreciation. The rates vary between 2 percent and 6 percent per year and are based on the useful life of the assets.

There exists a lump-sum allowance for certain expenses being lesser than 35 percent of the gross rental income and not exceeding €2,700 per year.

#### **Determination of the net rental income derived from the owner-occupier**

An imputed rental income is calculated on the basis of the real estate assessed unitary value as determined and communicated by the Luxembourg tax authorities. The taxable imputed rental income ranges from 4 percent to 6 percent of the assessed unitary value.

The rental value of the occupier's principal dwelling can only be reduced by interest paid on a loan financing the acquisition of the property or the construction of an extension to the property, subject to a certain maximum amount. Ceilings are fixed at €1,500 per year per family member for the first year and the five following ones. This amount falls to €1,125 for the next five years of occupation, then to €750 for the following years.

<sup>116</sup> Frank/Walter: Handbuch Immobilienrecht in Europa, Rn 500 ff

<sup>117</sup> Frank/Walter: Handbuch Immobilienrecht in Europa, Rn 500 ff.

<sup>118</sup> Frank/Walter: Handbuch Immobilienrecht in Europa, Rn 500 ff.

<sup>119</sup> [www.minfin.fgov.be](http://www.minfin.fgov.be)

<sup>120</sup> C-489/13.

Where the unitary value of the building is very low, the imputed rental income is usually negative and creates a loss which can be offset against other taxable income

#### **Sweden**

Under Swedish tax law rental income is considered to be capital income. Individuals are liable to capital income tax of 30 percent on all investments including real estate.

Tax is assessed on annual rentals and other income received from the property after deduction of related expenses. For private property, the related expenses are deemed to equal a standard amount of SEK 21,000<sup>121</sup> or 20 percent of the annual rental income. If property is rented from an employer to an employee, the standard deduction is not available.

Non-private property is treated as business property. Income from business property is subject to tax under the provisions applicable to business income. Rental income from property that is not deemed to be a private dwelling is considered as business income on the basis of net income. The taxable income is calculated according to the accruals concept. Actual costs for maintenance such as repairs, insurance costs, real property tax and interest costs are deductible. Furthermore, depreciation on buildings is tax deductible according to particular percentage tables. The corporate tax rate is 22 percent.<sup>122</sup>

If an employee earns rental income from business property, then income from the rental business is taxed on top of the employee's taxable income, thus at a marginal tax rate of 50 percent to 58 percent.

#### **Switzerland**

In general, the taxable rental income under Swiss tax law is the actual income,<sup>123</sup> unless the property is rented to relatives or friends at a discount or if they are allowed to live there for free. In that case, the owner is liable for the amount of the rental market value.

If the rental income is less than 50 percent of the rental market value, it is assumed that the tenancy agreement has been concluded for tax avoidance reasons. In this case 70 percent of the rental market value will be the basis of the taxable rental income. This method appears to be similar to the German one.

Furnished holiday apartments are taxable at a rate of 80 percent of the gross income.

Rental income is taxed under income tax as all income falls under income tax. The Swiss income tax is levied on the gross income.

Income tax is levied three times in Switzerland, by the federation (i.e. the central State), by the canton and by the community. The cantonal and community tax rates vary as they are determined by each canton and community independently.

For example, the income tax rate in canton Thurgau ranges from 13.9 percent<sup>124</sup> up to 19.1 percent.<sup>125</sup>

#### **United States**

Under US Tax law all income is liable to taxes, unless the law considers income as specifically not liable to tax.<sup>126</sup> Rental income is liable to taxes and is taxed under the income tax code. Sources of income are not distinguished. Furthermore all taxes are declared by self-assessment.

Federal Income Tax and State Income Tax are levied separately and have to be declared in separate tax returns. The federal income tax rate depends on income and marital status. The State income tax rate varies between 0.36

<sup>121</sup> 21,000 SEK = 2,325 EUR (1 SEK = 0.110720 EUR; 1 EUR = 9.03181 SEK),  
Mid-market rates: 2014-05-20 11:27 UTC.

<sup>122</sup> <http://www.tradingeconomics.com/sweden/corporate-tax-rate>.

<sup>123</sup> BGE 71 I 131; LGVE 1984 II Nr. 6.

<sup>124</sup> Bottighofen is the community with the lowest income tax rate in the canton Thurgau.

<sup>125</sup> Hauptwil is one the communities in the canton Thurgau with the highest income tax rate.

<sup>126</sup> Internal Revenue Code, sec. 61 IRC.

percent and 11 percent, depending on the State. In seven States, State income tax does not have to be paid. These are Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming.

The taxable rental income is the net income after deduction of eligible costs such as mortgage fees, property tax, management fees, utility bills, insurance costs, repair and maintenance costs, legal service fees, advertising materials associated with the property, improvement costs and depreciation.

### Conclusion

A review of other jurisdictions has revealed differences in practice between the jurisdictions. It would seem there are certain practices that are worthy of further consideration in the main report but not in the current report. Such practices and rules would in some cases require an overhaul of the Irish tax rules on rental income.

Most jurisdictions do however treat the rental sector as a business without making significant distinctions between the residential and investment sectors. See Table 5.4.

The UK rules bear closest resemblance to the Irish rules, which is unsurprising as many of our legislative provisions concerning the computation of income are very closely aligned with the UK.

## 5.2 TAX ISSUES FOR LANDLORDS IN PRACTICE

In relation to the tax regime applicable to the private residential rental sector, there have been a number of legislative amendments over the past number of years which have impacted adversely on the tax position for landlords and tenants within the sector. These are outlined and discussed below.

This section also details the possible impact of tax changes over the past seven years. To some extent, the impact of the tax changes has not fed through to higher rents due largely to the property crash which had a deflationary effect on rental rates. However, in a market where supply is more limited, upward pressures on rents are likely to arise at least partly from fiscal interventions within the sector.

Consideration of the tax issues outlined below is useful to enable the addressing of whether such tax measures impact on the following:

- The level of rents sought in the residential investment sector;
- The possible exit of existing investors from the sector;
- The impact on supply into the sector.

### 75% Limit on Interest Relief

This restriction introduced as and from 7 April 2009 has been highlighted above.

The restriction is in contrast to lettings in the commercial investment sector which enjoy full interest relief to the extent it arises on borrowings taken out the purchase, improve or repairing the premises.

As highlighted elsewhere in this section, the restriction on interest relief is not reflective of other international jurisdictions.

The interest restriction has a number of potential effects:

- Existing investors in the sector, particularly those who acquired properties in the period from 2004 to 2007 are likely to have suffered significant increases in taxation on rents<sup>127</sup>. This presents a risk to the maintenance of stock within the sector in light of risks of bank defaults and sales within the sector.<sup>128</sup>
- The restriction on interest relief for investors places a greater burden on cash buyers and institutional investors to increase supply within the sector. Whilst increased institutional involvement will no doubt assist the professionalisation of the sector, those forms of investor will not solve supply issues on their own.
- The restriction may encourage investors using borrowings to focus on the commercial investment sector. As such, increased bank lending may be applied by investors into the commercial investment sector.<sup>129</sup>

<sup>127</sup> See Table 5.3.

<sup>128</sup> The RED C Survey found that 70 per cent of landlords had an outstanding debt on their property and close to one third intend to sell their properties as soon as they can.

<sup>129</sup> Based on the Red C Poll, 70% of landlords currently have debt on their properties – this increases to 81% for investors who invested in the last 6 to 10 years.

### **Lack of Tax Relief for Capital Expenditure on Rental Properties**

Section 23 type relief<sup>130</sup> has largely been phased out and this has reduced significantly the incentive to invest in rented residential property situated in locations which might not be considered attractive.

The removal of this relief and other tax incentive reliefs has been a firm policy decision based on a number of reports commissioned by the Department of Finance.

Additionally, the Countrywide Refurbishment Scheme<sup>131</sup>, which was targeted at incentivising the carrying out of capital expenditure to upgrade rental stock, is now eliminated. The withdrawal of the refurbishment relief that applied on a countrywide basis is in this regard somewhat regressive as far as landlords are concerned and this is perhaps particularly exacerbated by the fact that the Home Renovation Incentive Scheme Introduced in Finance (No. 2) Act 2013 only extends to principal private residences and does not extend to capital work carried out on rented residential accommodation<sup>132</sup>.

Having regard to the Housing Standards<sup>133</sup> that now apply to rented residential accommodation, the lack of tax relief for capital expenditure to bring properties up to the requirements of the Housing Standards is proving an effective bar to such work being undertaken.

It is posited that older rental premises which do not meet the standards are more likely to fall out of the rented residential sector due to the fact that such properties are generally owned by older landlords who have neither the means nor the desire to invest heavily in such properties,

<sup>130</sup> Section 23 of the Finance Act 1981 and extended by subsequent legislative amendments. It applied in respect of certain expenditure incurred on the purchase, construction or refurbishment of properties located in certain tax incentive areas, where the properties were used as rented residential accommodation.

<sup>131</sup> The Countrywide Refurbishment Scheme was introduced by the Finance Act, 2001. The scheme provided for tax relief in the form of a deduction from a lessor's rental income of expenditure incurred on the refurbishment of a rented residential property

<sup>132</sup> Depending on the nature of the capital work, plant and machinery capital allowances might be available to the landlord – these can be claimed over 8 years.

<sup>133</sup> Housing (Standards for Rented Houses) Regulations 2009 (SI534/2008) (“Housing Standards”) came into effect on 1 February 2009

particularly when such investment does not attract tax relief against the investment.

It is to be noted that in some international jurisdictions reviewed, the principle of tax relief for depreciation on premises is accepted, thereby providing a measure of relief for capital depreciation against the charge to tax on rental income. This does not appear to be universal practice and it would be more usual for such tax reliefs to be targeted at a particular objective.

### **Capital repayments on borrowings**

One issue which has been highlighted by landlords in the consultations is the fact that there is no tax relief against rental income for capital repayments on bank borrowings. It should be noted that such tax relief is not available in the commercial rental sector and generally speaking is not available in the international jurisdictions reviewed during this assignment.

### **Increases in the Tax Burden for Individuals**

Table 5.3 below summarises the effective tax position arising from the increased tax rates and the introduction of the local property tax.<sup>134</sup> The table sets out a comparative tax position between the year 2007 and 2014 taking into account three buy to let investors who each purchased a property in Dublin on a variable mortgage in 2000, 2004 and 2007, based on identical rents and a range of assumptions in regard to typical operating costs. The tax position is evaluated based on five cases: three for self-employed persons and two for employees.

The final rows for each class of worker evaluated provide the increase in tax charges compared with 2007. Thus for a self-employed landlord who purchased with a mortgage in 2000 and is earning less than €100,000, his tax charges between 2007 and 2014 increased by 28 per cent. In such an instance the effective increase in rent that would be required to achieve parity with the after-tax position that pertained in 2007 is estimated to be in the region of 20 per cent. The corresponding increase required for an employee paying tax at the lower rate, who would have experienced a 76 per cent increase in the tax charge, is estimated at 16 per cent.

<sup>134</sup> Up to 31 December 2012 the charge on property consisted of an NPPR charge and the annual household charge of €100. In the year 2013, the NPPR and 50% of the Local Property Tax was payable. As and from 1 January 2014, Local Property Tax only is payable.

The conclusion in this regard is that legislative amendments may have necessarily played some part in the increase in rents which has been experienced to date. In a market in which rental supply is tighter, pressures for increased rents arise not just from the wish to have greater profits but also to address cost increases and changes in the fiscal regime.<sup>135</sup>

***Deductibility of property taxes***

In other jurisdictions which have been reviewed, property taxes on rented residential properties are generally deductible when calculating rental income for a landlord.<sup>136</sup>

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<sup>135</sup> However, rents reflect supply and demand in the market and what tenants are willing to pay, which may leave limited scope to increase the rent above this level.

<sup>136</sup> Reply to PQ 4171/13 stated that the Thornhill Group had recommended that owners and not occupiers be liable for property taxes in the residential investment sector. The Group also recommended that the LPT charge be deductible similar to commercial rates for tax purposes. This is being examined as part of the *Construction 2020* Strategy.

**Table 5.3: Effective Tax Position for Landlords: 2007 Vs. 2014**

Date of House Purchase	Jan-00	Jan-04	Jan-07
Overall Cashflow (excl Tax) = (Local Property Tax) (Reduction from 2007 to 2014)	495.0	495.0	495.0
% reduction in cashflow	-65%	-10%	-4%
<b>Increase in Tax 2007 Vs. 2014</b>			
A. Self-employed - <€100K	-1,121	-1,407	-1,444
% increase since 2007	28%	68%	n/a
B. Self-employed >€100K	-1,370	-1,584	-1,528
% increase since 2007	+34%	+76%	n/a
C. Self-employed - Lower Rate	-876	-947	-861
% increase since 2007	+41%	+85%	n/a
D. Employee - Higher Rate	-1,549	-1,631	-1,444
% increase since 2007	+44%	+89%	n/a
E. Employee - Lower Rate	-1,303	-1,171	-861
% increase since 2007	+76%	+131%	n/a
<b>Effective Increase in Rent to Achieve Parity</b>			
A. Self-employed - <€100K	20%	24%	24%
B. Self-employed >€100K	25%	28%	27%
C. Self-employed - Lower Rate	12%	13%	12%
D. Employee - Higher Rate	26%	27%	24%
E. Employee - Lower Rate	16%	15%	12%

Notes:

1. The difference in the overall cashflow is the Local Property Tax as it is assumed that all other costs remain the same for each investor in 2007 and 2014. The percentage reduction from 2007 to 2014 thus represents the annual change in the cashflow for each landlord.
2. The implied increase in rents required to offset the increase in taxation is derived by applying the effective rate of tax for the particular individual to the increase in tax (plus LPT) to derive the required increase in gross income required to sustain the increase in tax. This is then expressed as a percentage of the total rental income of €16,500.

**Table 5.4: Tax Deductions Allowable for the Private Rented sector Internationally**

Deductions	Ireland	Germany	Belgium	The Netherlands (Note: Certain property tax scheme)	Luxembourg	Sweden	Switzerland Not Specified	France	UK	USA
Letting fees	Yes	Yes	No	No	No	No	The federal state and every province has different tax laws.	Yes	Yes	No
Maintenance	Yes	Yes	Yes	Yes	Yes	Yes	ditto	Yes	Yes	Yes
Capital Expenditures	No	Yes	No	No	Yes	No	ditto	Yes	No	Yes
Depreciation	No	Yes	Yes	Yes	Yes	Yes	ditto	Yes	No	Yes
Repairs	Yes	Yes	Yes	No	No	Yes	ditto	Yes	Yes	Yes
Interest	Yes (75%)	Yes (100%)	Yes (100%)	No	Yes (100%)	Yes (100%)	ditto	Yes (100%)	Yes (100%)	Yes (100%)
Property Tax	No	Yes	Yes	No	Yes	Yes	ditto	Exemption (15 years)	Yes	Yes

## 5.3 TAX ISSUES FOR TENANTS

### 5.3.1. Relief for rent paid

Prior to Finance Act 2000, a limited form of tenants' tax relief existed for certain tenants. The relief was originally introduced into the Taxes Consolidation Act 1997 by Section 142A Income Tax Act 1967.

The relief operated by allowing tenants paying rent to claim a deduction against tax of an amount equal to the standard rate of tax multiplied by the level of rent paid up to certain limits. The limits for tenants under 55 were relatively low although the limits for married couples were double those of individuals. For individuals aged 55 or over or widowed individuals, higher limits applied.

The relief for tenants not having a tax liability was zero in that the relief was capped by the amount of income tax paid by the individual. Although the Commission Report of 2000 recommended that the relief be reconstituted into the form of refundable tax credits, which would allow benefit to be taken by individuals not within the tax system, this recommendation was never followed.

In Finance Act 2000 and subsequent Finance Acts, the limits in relation to the relief were increased, although the actual relief continued to be capped based on the tax liability of the individual claimant.

This relief was essentially introduced in order to bring certain landlords operating in the black economy into the spotlight from a Revenue perspective, in that the Landlord's details had to be included in relation to any claim made to Revenue.

The relief has been abolished in respect of rent paid on new tenancies on or after 8 December 2010. In respect of existing tenancies, the relief is being tapered off before finally expiring at the end of the tax year 2017.

This relief provided a measure of benefit to tenants on premises and its removal has increased the effective cost of paying rental income of private rented accommodation for tenants.<sup>137</sup> From a social assistance perspective, it is notable that this relief did not provide any benefit to

<sup>137</sup> The relief did not apply in relation to tenancies where the landlord was a housing authority for the purposes of the Housing Act 1966.

tenants not within the tax net as the relief was given against the income tax liability of the individual claimant or claimants.

### 5.3.2. Rationale for elimination of relief

The Commission on Taxation 2009 recommended the abolition of this relief. The rationale for the elimination of the relief appears to have been to achieve parity with the owner occupier sector in that mortgage interest relief has also effectively been eliminated and will finally taper off at the end of 2017. Additionally, Budget 2011, which was handed down in December 2010, highlighted that the elimination of the relief over a full year would give rise to savings of €97 million.

In consultations with the Department of Finance, they have indicated that from a tax policy perspective, any fiscal measures introduced to address the current issues in the private rental sector should not seek to discriminate against the owner occupier sector. In this regard, having regard to the elimination of mortgage interest relief, the roll-back of the elimination of this relief would offend this policy.

### 5.3.3. Rationale for Freezing rent relief for rent paid by certain tenants

As outlined above, the original rationale for the introduction of this relief was to identify landlord's operating in the "black market".

In general, the rental sector is considerably more compliant than it was at the time of introduction of the relief and the original rationale for introducing the relief may not be so significant today.

However, in light of the fact that tenants, particularly lower paid tenants, in the private rental sector are competing for accommodation with higher paid individuals, as well as with owner occupiers where properties are exiting the rental sector, there may be a financial rationale for considering a limited freezing of the removal of the relief until supply comes on stream.

In recommending any freezing of the removal of the relief, we are conscious of the need to avoid any distortion with the owner occupier market<sup>138</sup> and any measures which will serve to increase market rents. In this regard, we consider there is a

<sup>138</sup> Mortgage interest relief is due to expire in 2017 although there are no tapering provisions in that legislation.

case for the limited reintroduction of the relief on the following basis:

- That the freezing of relief would be restricted to individuals with earnings below a certain threshold, to be based on a percentage of the average industrial wage.
- The freeze should only apply for a limited period of time until supply within the residential sector increases. A period of 3 years is suggested in this regard with the relief being removed in 2017 as planned.
- The freeze in relief will be at 2013 limits<sup>139</sup>, which were 50% of the limits that applied up to the tax year 2010 and would indicate that if rent relief were to be reintroduced completely, that the cost of same would be approximately €17 million per annum. By applying income limits at a low level, this figure should be significantly lower. The *Employment Earning Inequality in Ireland* report<sup>140</sup> divided the population into quintiles from poorest to richest based on median pay. Assuming the same distribution applies to tenants in the private rented sector and assuming low income individuals are accounted for in the first three quintiles set out, then 60% of individuals renting would qualify for the relief, suggesting a cost of circa. €10.2 million per annum.

This cost would increase by the same amount annually over the 3 years until the abolition of the relief. As many individuals eligible for the relief may not be in a tax payable situation, it would be suggested that the relief could be claimed against any USC or income tax paid by the individual. This relief would be claimed following the end of the tax year although administrative arrangements might be possible to be organised, with the approval of Revenue.

#### 5.4 CAPITAL TAX FOR PRIVATE RENTAL SECTOR

The Commission appointed to consider the future of the Private Rental Sector in 2000 stated in their conclusions as follows:

<sup>139</sup> Per the table contained in Section 473 TCA 1997, as introduced in Finance Act 2011. This specifies that the appropriate relief for a widowed/surviving civil partner or married person under 55 was €400, and €800 for persons aged over 55. For other individuals, the relief would be capped at €200 per annum for single individuals under 55 and at €400 per annum for single individuals aged 55 years or over.

<sup>140</sup> <http://www.publicpolicy.ie/wp-content/uploads/employment-earnings-inequality-in-ireland.pdf>

“The commission’s recommendations were framed in the context of the agreed objective that a more professional approach to the provision of management of rented accommodation would be desirable. The majority considered that this could best be achieved by treating for tax purposes the business of providing accommodation for renting in the same way as any other business, where appropriate, and provided that it is a legitimate business being actively managed”.

The private rental sector has since the first Bacon Report of 1998 been the subject of certain tax amendments which have led to business models diverging from the commercial rental sector. Separately, from a capital tax perspective, the private rental sector is not generally viewed in the same manner as an active business. The origins of this lie in historic distinctions being drawn between earned and unearned income and also from the scheme under which tax was assessed, particularly since the Income Tax Act 1918.

The comments below outline distinctions between the treatment of the private rental sector and active businesses, and also with the commercial rental sector where appropriate.

#### Capital Gains Tax

Capital Gains Tax is levied on any gain arising from the disposal of property by individuals or corporates. The gain is generally the difference between the price paid on the property, any enhancement expenditure incurred on the property and the disposal price or value of the property at the date of disposal. Tax, where it arises, is chargeable at a rate of 33% for individuals and corporates.

Certain reliefs apply in relation to Capital Gains Tax, such as retirement relief, and this is generally available on the disposal of an interest in a business or shares in certain qualifying family companies. Retirement relief permits the person making the disposal, who has achieved the age of 55 years, to dispose of the qualifying assets and obtain the full relief of the certain limits.

Qualifying assets will not include assets held as investments and as such, rental properties will not be included for the purposes of retirement relief.

In relation to the private rental sector, a relief was introduced in Finance Act 2012<sup>141</sup> to provide an incentive for investment in land and buildings in Ireland (although the relief was extended to properties acquired in other EEA jurisdictions to comply with EU law and EEA bilateral agreements). The relief provides that for any properties acquired on or before 31 December 2014<sup>142</sup> where the property is held for seven years prior to a disposal of the property. Where the conditions are met, any gain arising on the disposal of the property can be taken either tax free on a disposal seven years from the date of purchase or, where disposed of later, relief will be available to the extent of the gain multiplied by seven years as numerator and the entire period of ownership as the denominator.

The above relief provides significant benefit to individuals investing in land and property in the State and extends to individuals operating in the Private Rental Sector.

#### **Capital Acquisitions Tax**

Capital Acquisitions Tax is the collective tax term for gift tax and inheritance tax. Gift tax is generally payable by a beneficiary taking a benefit from a disponer to the extent that the gift or benefit exceeds the particular tax free threshold as between the individual beneficiary and the disponer. The rate of tax applicable on any excess is 33%.

Inheritance tax is applied in a similar manner but generally only arises on death. The rate of tax is similar and there is no distinction on rates or tax free thresholds between gift tax and inheritance tax.

Within the Capital Acquisitions Tax regime, there are targeted reliefs and exemptions include agricultural and property relief, relevant business property relief and dwelling house relief.

The reliefs allow for either an effective 90% reduction in asset values qualifying for the relief for tax purposes or a full exemption in some cases.

The reliefs mentioned do not apply to taxable benefits consisting of residential investment property. However, such reliefs equally do not apply to commercial investment property. As such,

<sup>141</sup> Taxable rate Section 604A TCA 1997 was introduced by Finance Act 2012.

<sup>142</sup> The final date was previously 31 December 2013 but this was extended by the Finance Act 2013.

there is no distortion in the capital tax regime concerning capital acquisitions tax between the commercial rental sector and the residential rental sector.<sup>143</sup>

#### **Stamp Duty**

At the present time, stamp duty is levied at a rate of 1% on residential property and 2% on non-residential property. There is no distinction drawn between properties held by investors in rented accommodation and owner occupiers. The rate of stamp duty applicable does not form a barrier to entry into the private rental sector.

In the Commission on taxation report of 2009, one of the recommendations was an exemption from stamp duty for purchasers of residential property by owner occupiers. The report specifically stated that any such exemption should not apply to investors in residential property. The current rates of stamp duty on residential property of 1% applied both to owner occupiers and investor purchasers.

Many of the comments on this section highlight the differences in the tax regime between the commercial property sector and the residential investment sector, with most being unfavourable to the latter. In relation to stamp duty, the residential investment sector fares better in relation to properties having a value of less than €1 million, as a rate of 1% applies.

With regard to equalising the position in relation to stamp duty between the commercial investment and the residential investment sectors, there would appear to be no good reason why there should be a difference in rates. An increase in the rate of stamp duty on the purchase of residential investment property to 2% might additionally assist with offsetting any cost in granting increased interest relief for investors in residential property in certain cases.

Based on sales in 2014 to date being 28,000 and approximately 6,000 of those sales being of residential investment properties, it is considered that the benefit of an increase in the stamp duty

<sup>143</sup> It should be noted however that commercial property which is used for an active business, and which is owned outside a company carrying on a business can qualify for certain tax reliefs under the Capital Acquisitions Tax code and the Capital Gains Tax code. However, this is generally where the property has been used for the business for a period of time and is being transferred at the same time and to the same person as the underlying interest in the active business.

rate for residential investment purchasers would be in the region of €15 million

## 5.5 RISK ISSUES RE TAX INCENTIVES

Measures were introduced in Finance Act 2011 to restrict the use of property reliefs through a ring-fencing approach, and targeted a yield of €60 million in its first year. In a report carried out by the Tax Policy Unit of the Department of Finance in December 2011<sup>144</sup>, it was concluded that the proposals would have amounted to an effective termination of reliefs given the limited rental yield associated with the properties that give rise to the reliefs. It was determined in the report that despite the potential gain to the State from a termination of reliefs, long term and immediate costs would occur including possibly in terms of reputational effects which might impact on fiscal and other economic instruments of the State.

Arising from this report in December 2011, amendments were introduced in Finance Act 2012 which sought to apply a guillotine to certain capital allowances incentives to apply at the end of 2014 or, if later, the expiry of the tax life of the relevant capital allowances.

Over the years, a proliferation of tax incentive schemes had developed, some of which gave capital allowances and some which gave what was referred to as Section 23 Relief. The latter applied generally in relation to investment properties in certain areas targeted for investment.

In 2005, the Department of Finance commissioned Indecon Economic Consultant and Goodbody Economic Consultants to undertake a detailed review of the various property-based reliefs. A conclusion of the study was that the schemes had generally served their purpose and that there was absolutely no case for further government incentives and absolutely no case for future government incentives. The view expressed in the report was that continuing to approve new projects would contribute to oversupply and represent a clear waste of scarce public resources.<sup>145</sup> Following the report, Budget 2006 closed down virtually all of the tax incentive schemes in use<sup>146</sup> and provided for transitional

arrangements in relation to certain pipeline projects.

In considering options for the purposes of this report, the authors are conscious of the need to avoid any incentives being granted which would run counter to the 2005 report. However, and following current tax policy, the following points might be noted:

- Tax incentives for these purposes would not include measures seeking to remove any distortion or differences in the fiscal treatment as between the commercial investment sector and the residential investment sector.
- Any measures being considered would, to the extent that they provide any incentives, be time limited.

## 5.6 CONCLUSIONS.

It is clear that the tax regime for landlords investing in the residential investment sector is in the main less favourable than for investors in commercial investment property.

The main disadvantages arise in relation to investors in residential investment property who are seeking to utilise borrowings to assist with the purchase of such properties. These individuals or companies are subject to interest deductions of 75%, as against 100% for the commercial rental sector. This is the main disadvantage as between the two sectors although the lack of deduction for local property taxes also represents a less favourable position for residential landlords.<sup>147</sup>

The fiscal changes in the period between 2007 and 2014 have increased substantially the tax burden on residential landlords, particularly those with borrowings taken out in relation to the purchase of investment properties. The restriction on deductions and increased tax [including USC and local property taxes] charges could justify increases in gross rents of approximately 20% to 24%, depending on the personal circumstances of a landlord (Table 5.3). Whilst the market rent will be dictated by a number of factors, it is clear that the increased fiscal costs may explain some of the operate pressure on private rental sector rent levels.

<sup>144</sup> *Economic Impact Assessment Of Potential Changes To Legacy Property Reliefs.*

<http://www.finance.gov.ie/sites/default/files/Property-Based-Reliefs-Impact-Assessment.pdf>

<sup>145</sup> See page 11 of the December 2011 report.

<sup>146</sup> See page 12 of the report of December 2011 for a list of the relevant schemes.

<sup>147</sup> *Report of the Inter-Departmental Group on the Design of a Local Property Tax.*

<http://www.environ.ie/en/PublicationsDocuments/FileDownload.ad.31669.en.Pdf>

Separately, the fiscal amendments, particularly the restriction of interest deductions, have the potential to create a barrier to entry into the private rental sector for individuals and companies wishing to finance the purchase through borrowings. Although banks generally speaking have not been the source of investment into the private rental sector recently<sup>148</sup>, increased supply into the private rental sector will depend on new investors coming into the market. Without levelling the investment outcomes for individuals leveraging such purchases with investment in the commercial property sector, there is a potential barrier to entry for investment into the private rental sector.

Whilst the lack of interest deductibility is not an issue for REITs or cash buyers, international evidence would indicate that such buyers will only represent a relatively small percentage of the market.<sup>149</sup>

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<sup>148</sup> According to the IBF approximately 4% of mortgage drawdowns in 2013 were for Residential Investment Letting

<sup>149</sup> The introduction of REITS in Germany in 2007 have not played a major role on the real estate market, particularly in relation to the tenant market. Only 4 REITS and 2 Pre-REITS have been founded since 2007.

## 6. THE BUSINESS OF A LANDLORD

### 6.1 THE BUSINESS OF A LANDLORD

The aim of the landlord/investor is to maximise his return for a given level of risk, i.e. investing in the property in anticipation of a capital gain while securing a tenant who will pay a sufficient rent to cover the outgoings. The main source of returns historically has been related to capital growth with many small scale landlords often prepared to forego an adequate return on rental in the hope of capital appreciation in the medium-term. This is recognised by many as being a feature of the Irish rental market in the Celtic Tiger era as landlords made their investments on the basis of future price growth. The unprecedented decline in house prices during the 2007-2013 period combined with the imposition of austerity measures, cuts in disposable incomes and additional charges has impacted negatively on the business of residential letting.

Table 6.1 sets out the current costs associated with being a landlord in Ireland. The examples are based on three buy to let investors who each purchased property in Dublin in 2000, 2004 and 2007. Their mortgage repayments are based on a 90% loan to value (LTV) and the term is 25 years in each case. There are three mortgage rate scenarios: Standard Variable, Tracker (ECB + 0.75 basis points) and Tracker with an interest only mortgage.

The typical annual operating costs faced by a landlord, excluding mortgage costs and taxation, are identical in each case and are estimated at €3,765, based on assumptions about the level of investment in maintenance and repairs. However, when mortgage repayments are included the total annual operating costs, before tax, range from around €13,390 for the 2000 investor on a tracker mortgage to €31,355 for the 2007 investor after he switches to interest and principal repayments. When set against the estimated annual rental income of €16,500, in seven of the nine examples set out, the income is not sufficient to cover the total operating costs. The situation is further compounded by taxation, which was addressed in the previous section.

The table also shows the gross and net yields before taxation. In terms of the gross yield, the annual rental income as a proportion of the sales

prices, the figures range from 3.8% for the 2007 investor to 7.9% for the 2000 investor. When annual operating costs are included, the net yields decline dramatically, ranging from -4.2% for the 2007 investor to 0.9% for the 2000 investor. The situation is particularly pronounced for those investors who purchased in the boom years, although the net yields are also poor for the 2000 investor. In such scenarios, it is clear that the prospect of capital growth was possibly the main factor which motivated investors in the buy to let sector over the past decade. The problem appears to be, with the benefit of hindsight, that neither high yields nor high capital growth have materialised for investors who bought buy to let properties in the past decade.

### 6.2 ARREARS IN THE BUY- TO- LET SECTOR

The mortgage arrears problem is one of the biggest remaining challenges from the financial crisis. Much work has been done to develop a policy response for homeowners in arrears, including the development of a Code of Conduct on Mortgage Arrears by the Central Bank in February 2009 which was subsequently updated in 2011 and again in July 2013. Each is intended to provide workable solutions by facilitating early and constructive engagement between lenders and borrowers in regard to principal residential dwellings. However there are no corresponding resolution strategies in place for buy to-let (BTL) mortgages, although there have been a number of recommendations by the Joint Committee on Finance, Public Expenditure and Reform<sup>150</sup> which are set out later.

While the BTL arrears issue is a different issue to that which arises for owner occupiers, where the family home is at stake, it is clearly having a negative impact on tenants. Many tenants are, through no fault of their own, caught up in disputes between receivers and landlords. Such disputes can often result in the tenant being asked to vacate the property without giving the appropriate notice. There is also the likelihood that landlords who are in arrears will not have the financial resources to undertake urgent repairs or maintain their property. This raise the question as to who is responsible for same when a receiver is appointed to a private rented property and is receiving rent from the tenant?

<sup>150</sup> <http://www.oireachtas.ie/parliament/media/committees/finance/Finance-Committee-Report-on-Mortgage-rrears-Resolution-Process.pdf> (July 2014).

Table 6.1: Annual Costs of Being a Landlord

	2000			2004			2007		
	Variable Rate	Tracker Rate	Tracker & Interest Only for 10 years	Variable Rate	Tracker Rate	Tracker & Interest Only for 10 years	Variable Rate	Tracker Rate	Tracker & Interest Only for 10 years
	<b>EXAMPLE 1</b>			<b>EXAMPLE 2</b>			<b>EXAMPLE 3</b>		
Date of House Purchase	Jan-00	Jan-00	Jan-00	Jan-04	Jan-04	Jan-04	Jan-07	Jan-07	Jan-07
Rent @ July 2014 PRTB Index - Dublin House	1,500			1,500			1,500		
Annual Rental Income (11 months)	16,500			16,500			16,500		
<b>Gross Yield % (based on rental income only)</b>	7.9%	7.9%	7.9%	5.3%	5.3%	5.3%	3.8%	3.8%	3.8%
<b>Net Yield % (net income before tax)</b>	0.1%	0.9%	0.3%	-1.6%	-0.2%	-2.0%	-3.7%	-1.5%	-4.2%
<u>Annual Expenses</u>									
Mortgage	12,469	9,625	13,673	18,362	13,451	19,895*	25,677	18,140	27,590*
Insurance	500	500	500	500	500	500	500	500	500
Maintenance (4% of rental income)	660	660	660	660	660	660	660	660	660
Repairs (8% of rental income)	1,320	1,320	1,320	1,320	1,320	1,320	1,320	1,320	1,320
Advertising/Legal	50	50	50	50	50	50	50	50	50
BER Certificate	150	150	150	150	150	150	150	150	150
Local Property Tax	495	495	495	495	495	495	495	495	495
PRTB Registration	90	90	90	90	90	90	90	90	90
Professional Fees (Accountants)	500	500	500	500	500	500	500	500	500
<b>Sub-Total</b>	<b>16,234</b>	<b>13,390</b>	<b>17,438</b>	<b>22,127</b>	<b>17,216</b>	<b>23,660</b>	<b>29,442</b>	<b>21,905</b>	<b>31,355</b>
<b>Net Profit/ (Loss) before tax</b>	266	3,110	(938)	(5,627)	(716)	(7,160)	(12,942)	(5,405)	(14,855)

\* Assuming switched to principal and interest repayment

The scale of the BTL crisis is quantified by the Central Bank on a quarterly basis. The most recent information shows that there were 39,669 BTL loan accounts in arrears at the end of June 2014 out of a total of around 144,000 BTL mortgage accounts. This figure represents 27.5% of the total BTL mortgage loan accounts<sup>151</sup>, up from 26.9% one year previously and 23.1% in June 2012, the first time the data was published. This indicates that the BTL arrears problem is escalating with an additional almost 5,000 BTL loan accounts in arrears in less than two years. In terms of value, while the outstanding value of BTL mortgage loans has reduced over that time from €31.25 billion to €29.16 billion, the value of arrears cases has increased from €9.82 billion to €10.70 billion.

The total arrears of 39,669 represents 13 per cent of the total estimated stock of 305,377 units (Census 2011) rented from private landlords. With 144,187 BTL mortgage accounts, this would imply that 104,518 are not in arrears and 161,190 or almost 53 per cent have no mortgage (see Table 7.6).

A further disaggregation of the BTL arrears cases indicates that 22% of the total BTL mortgage loan accounts are in arrears for more than 90 days. This proportion is up from 20.4% in June 2013 and represents a significant increase since the data was first made available in June 2012 (16.6%). The number of BTL mortgage accounts which are 90 days or less in arrears has followed a similar trend, having fallen to 7,920 cases in June 2014 (5.7% of the total BTL loan accounts) from a peak of 10,000 cases in March 2013 (6.7%).

The corresponding values indicate that the almost 40,000 BTL mortgages in arrears represented 37% by value of the total BTL mortgage accounts outstanding, while those cases which are more than 90 days in arrears accounted for just over 30% of the total by value.

The escalation of the number of arrears cases to around 40,000 would appear to indicate that little progress is being made by financial institutions. Industry sources suggest that there are currently 4,000 receiverships in place on buy to let properties. However with around 14,500 BTL mortgage accounts in arrears for almost two years (over 720 days) there have been very few cases of

repossessions, with an average of 549 per quarter in the year to June 2014.

Although limited to date, the prospects for repossessions over the coming years are difficult to predict. Typically previous recessions in other countries led to a rise in repossessions – in the UK in the late 1980s recession, for example, repossessions trebled each year for five years after the property crash in 1990 relative to their low point in 1989 (15,800 repossessions)<sup>152</sup>. In an Irish context, however, the improved macroeconomic situation and recovery in house prices and employment should benefit buy to let investors who are in arrears. But there is a risk that their prospects could substantially change should mortgage interest rates begin to rise anytime soon. It is telling that close to one third of respondents in the RED C survey said that they intend to sell as soon as they can. In terms of the 179,000 landlords registered with the PRTB this would correspond to 52,000 landlords or properties, assuming each sold one property. This level of properties would only come to the market when lenders consider it a good time to sell. The timing of disposal could adversely impact on house prices.

The Central Bank has examined more granular data<sup>153</sup> on the BTL mortgage accounts in arrears looking at a number of characteristics which presents further information on BTL mortgages, as follows:

- A distribution of the 21,261 BTL mortgages which are over 360 days in arrears shows that many originated between 2003 and 2008, with 2006 accounting for the largest proportion in this group.
- Based on the geographical location of BTL borrowers who are over 360 days in arrears, the Border and Midlands regions have high shares compared to other regions in this group at greater than 15% of all BTL arrears over 360 days in arrears, while the Mid-West had the lowest share at under 11%. The West region accounted for around 13% while the Dublin region had a low share, although it had the largest mortgage population. This geographic distribution does not necessarily reflect the distribution of properties by

<sup>151</sup> The corresponding figure for principal dwelling mortgages was 126,055 mortgage arrears cases, 16.5% of the total number of principal dwelling mortgage loan accounts outstanding.

<sup>152</sup> <https://www.gov.uk/government/statistical-data-sets/live-tables-on-repossession-activity>

<sup>153</sup> <http://www.centralbank.ie/polstats/stats/Documents/Frost%20Paper.pdf>

location as investors may have raised mortgages on properties in counties outside of where the loan was raised.

- In terms of loan-to-value (LTV) ratios, the Central Bank research reported that LTVs were higher across all regions for BTL loans compared to principal dwelling loans<sup>154</sup>. Dublin BTL loan accounts had the highest LTV ratios across all arrears categories while for those accounts 90 days or less in arrears, the current LTV ratio is 111, indicating that a number of these BTL loans are in negative equity.
- A substantial proportion of around 70% of BTL cases in arrears over 90 days or more were on tracker mortgages compared with 28% on standard variable rates.

More recent research by the Central Bank<sup>155</sup> showed that interest-only mortgages were mainly issued to BTL investors on tracker mortgages between 2005 and 2008 at high LTV ratios, and were predominantly issued to Dublin BTL borrowers for the purchase of apartments. Interest-only mortgages were offered to BTL investors for an initial period of ten years. The corresponding LTV were found to be much higher for interest-only mortgages while 82% of these loans were found to be in negative equity.

The authors concluded that with a significant number of BTL mortgages due to revert to principal and interest repayments in the next twenty four months, there would be concerns about the ability of this group to service their much higher repayments, following the switch back to principal and interest mortgages. When these borrowers switch, there is the risk of a further increase in BTL arrears amongst this group. Moreover, for those BTL investors opting to exit the sector, there is likely to be a shortfall if the property is sold. With a significant number of these BTL borrowers expected to be at retirement age when their loans are due to switch to principal and interest, their ability to meet the higher repayments is likely to be severely curtailed.

All of these issues raise concerns about the future level of arrears in the BTL sector and the implications for the supply of rented housing.

Against this background the capacity of rents to meet the much higher principal and interest repayments is an issue which either requires a quick resolution of the BTL arrears or higher rents. The Central Bank research concluded that following the switch to principal and interest repayments in Q1 2014, the median estimated repayment would range from €1,290 in the Border region to €2,050 in Dublin compared with average monthly rents of €400 in Leitrim and €1,230 in Dublin, according to Daft.ie.

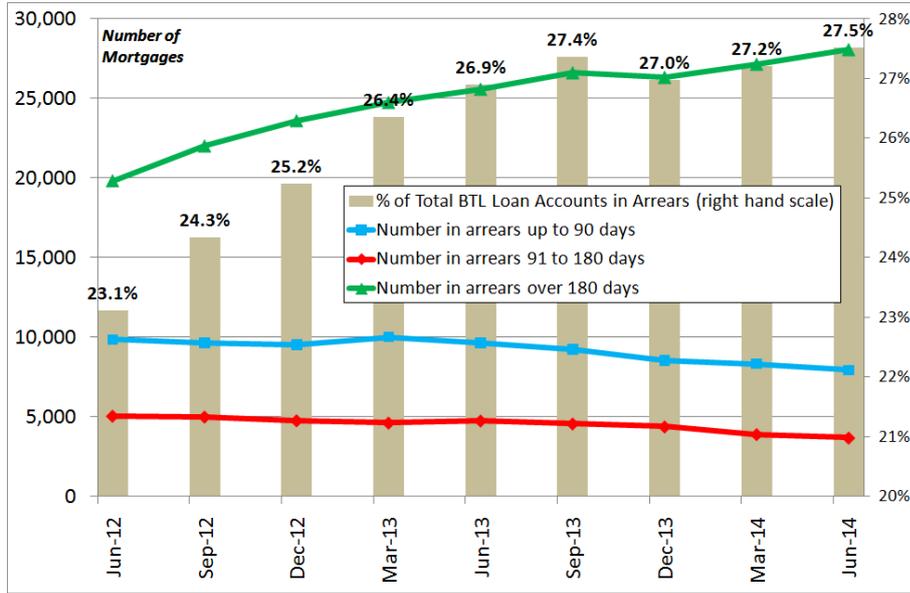
According to the survey of landlords, respondents on average have been landlords for close to 9 years while two-thirds have been landlords for over five years, indicating they purchased their properties before 2009. The analysis presented in Table 6.3 considers the same three Buy to Let cases, previously examined, who purchased property in Dublin in 2000, 2004 and 2007. The LTVs are assumed to be 90% and the term is 25 years in each case. There are three mortgage rate scenarios: Standard Variable, Tracker (ECB + 1%) and Tracker with an interest only mortgage. In the case of the 2000 investor, the current rent is sufficient to cover the mortgage repayments while for the 2004 investor coming off a tracker with an interest only mortgage, the rent needs to be closer to €1,700 per month, before other costs are taken into account. For the corresponding 2007 investor, the rent would need to be €2,300 per month to cover his mortgage repayments only.

The analysis shows that following a switch to principal and interest repayments after ten years, the repayments for the investors who are on tracker and interest only mortgages range from €1,658 for the 2004 investor to €2,299 for the 2007 investor. While the assumption is that the property is purchased in Dublin, where the rent may not cover the higher figure, the rents on properties purchased outside Dublin are unlikely to cover the equivalent mortgage repayments on those properties. Moreover, the 2007 investor on a tracker and interest only mortgage is in negative equity (Table 6.3). Such landlords are also more likely to experience financial difficulty with day to day expenses such as equipment failure, repairs and with business hazards such as voids and rent arrears.

<sup>154</sup> The Central Bank uses median current and median original loan to value ratios.

<sup>155</sup> <http://www.centralbank.ie/publications/Documents/EconomicLetter%20-%20Vol%202014,%20No.%205.pdf>

Figure 6.1 Buy to Let Mortgages in Arrears



Source: Central Bank of Ireland

Table 6.2: Buy to Let Arrears

	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
<b>Total BTL Mortgage Accounts</b>	150,187	150,544	150,124	149,395	148,529	147,610	145,528	144,686	144,187
Balance outstanding (€bn.)	31.25	31.05	31.16	30.92	30.63	30.34	29.67	29.37	29.16
<b>Total Mortgage Arrears cases</b>	34,719	36,635	37,878	39,371	39,948	40,396	39,250	39,361	39,669
<i>of which</i>									
- In arrears up to 90 days	9,840	9,617	9,512	10,002	9,622	9,218	8,544	8,313	7,920
- In arrears 91 to 180 days	5,039	4,986	4,752	4,609	4,739	4,552	4,366	3,887	3,666
- In arrears over 180 days	19,840	22,032	23,614	24,760	25,587	26,626	26,340	27,161	28,083
<b>Total over 90 days</b>	<b>24,879</b>	<b>27,018</b>	<b>28,366</b>	<b>29,369</b>	<b>30,326</b>	<b>31,178</b>	<b>30,706</b>	<b>31,048</b>	<b>31,749</b>
<b>% of Total BTL Mortgage Loan Accounts</b>									
- Up to 90 days in arrears	6.6%	6.4%	6.3%	6.7%	6.5%	6.2%	5.9%	5.7%	5.5%
- More than 90 days in arrears	<u>16.6%</u>	<u>17.9%</u>	<u>18.9%</u>	<u>19.7%</u>	<u>20.4%</u>	<u>21.1%</u>	<u>21.1%</u>	<u>21.5%</u>	<u>22.0%</u>
Total	23.1%	24.3%	25.2%	26.4%	26.9%	27.4%	27.0%	27.2%	27.5%
<b>Value of BTL Mortgage Loans outstanding (€bn.)</b>									
- up to 90 days in arrears	2.36	2.22	2.22	2.22	2.31	2.12	1.96	1.85	1.76
- more than 90 days in arrears	<u>7.46</u>	<u>7.93</u>	<u>8.38</u>	<u>7.93</u>	<u>8.58</u>	<u>8.86</u>	<u>8.65</u>	<u>8.77</u>	<u>8.94</u>
Total Value	9.82	10.15	10.60	10.15	10.89	10.98	10.61	10.61	10.70
Value of Total Mortgage Arrears outstanding as % of Total BTL Mortgages	31.4%	32.7%	34.0%	32.8%	35.6%	36.2%	35.8%	36.1%	36.7%
Value outstanding > 90 days as % of Total BTL Mortgages	23.9%	25.5%	26.9%	25.7%	28.0%	29.2%	29.2%	29.9%	30.7%
<b>Total Repossessions</b>	378	414	454	479	502	516	502	568	611

Source: Central Bank of Ireland

While the introduction of rent controls in such a scenario would further limit the capacity of BTL investors to meet the full principal and interest repayments, leading to further arrears and adverse consequences for supply, equally the prospect of further rent increases in an already supply constrained market would have adverse consequences for tenants, which in some cases may be very high and thus put added pressure on affordability

### 6.3 PROFESSIONALISING THE RENTED SECTOR

As previously pointed out the Irish rented sector comprises mostly individual landlords who have one or two rented dwellings. They generally have other income from full-time employment and many would not see themselves as ‘professionals’ in the residential letting business or in it for the long term. The preceding analysis illustrated the high costs associated with maintaining residential investment properties for individual investors with mortgages.

An emerging new phenomenon on the Irish property landscape has been the emergence of Real Estate Investment Trusts (REITs). These are mutual funds for commercial and residential real estate which raise money on the Irish Stock Exchange. Since legislation was passed to allow for the establishment of REITs in the Irish market, three companies have raised a total of around €865 million, one of which is focused solely on the private residential rented market. Over 1,000 residential units have been acquired to date in the Irish market and there are considerable plans to increase this number further.

REITs are a welcome development in the Irish rented sector and represent one solution to mobilising capital investment relatively quickly. The Irish based REIT, IRES REIT, for example, is already a leading provider of residential accommodation across Canada, and brings with it a proven track record of performance and experience of professional property management. REITs also have many benefits for tenants. They generally have higher standards of estate management, maintenance and regulatory compliance than private landlords. They provide related services to the tenant and are likely to avoid disputes at all costs as their commercial remit requires them to maximise their rental income without any interruption. As long term players in the market, there may be the potential

to offer longer leases to tenants who wish to be long term renters.

One issue of concern in the Irish market may be the lack of large scale concentrations of rented housing in urban locations which may limit the opportunity to buy high volumes of units in such locations. For this reason REITs should be encouraged to undertake development and refurbishment in order to increase the supply of rented property. However, consultations with REITs indicated that there are issues with respect to the planning laws which adversely impact on the development viability of the construction of large apartment blocks.

In regard to the buy to let arrears crisis, REITs may be in a position to provide a solution by investigating the acquisition of unsustainable buy to let property portfolios from banks. Such a move would assist the banks but would also ensure that the existing stock is protected by retaining these units in the rented sector in the long term.

The issue of rent controls or any form of rent stabilisation may, if introduced, adversely affect the attractiveness of the investment opportunity generated for REITs. The introduction of rent regulation may lead to expectations that rental income would be lower than it might otherwise be in a non-regulated market. Property values would fall with the result that buy- to- let disposals by banks would incur increased writedowns, which would in turn increase the amount of recapitalisation required by such banks. The impact of rent regulation would most likely discourage investment from REITS which are prepared to commit to the rented sector over the long term and make some contribution to addressing the current supply shortage in the sector.<sup>156</sup>

<sup>156</sup> The forthcoming report on the Future of the Private Rented Sector will examine the role of REITs in terms of addressing other countries where REITs have been established.

Table 6.3: Status of Mortgage Repayments for Buy-To-Let Investors who Purchased a Property in Dublin in 2000, 2004 and 2007 and Taxable Rental Income

Mortgage Interest Rate	2000			2004			2007		
	Variable	Tracker	Tracker & Interest only (10 years)	Variable	Tracker	Tracker & Interest only (10 years)	Variable	Tracker	Tracker & Interest only (10 years)
	<b>EXAMPLE 1</b>			<b>EXAMPLE 2</b>			<b>EXAMPLE 3</b>		
Date of House Purchase	Jan-00	Jan-00	Jan-00	Jan-04	Jan-04	Jan-04	Jan-07	Jan-07	Jan-07
Months (25 Years)	300	300	300	300	300	300	300	300	300
Loan amount (90%)	189,000	189,000	189,000	279,000	279,000	279,000	387,000	387,000	387,000
House Price at time of purchase	210,000	210,000	210,000	310,000	310,000	310,000	430,000	430,000	430,000
Capital outstanding @ July 2014	103,640	95,670	135,902	194,748	181,800	268,892	310,099	292,324	387,000
Current value @ July 2014	350,000	350,000	350,000	350,000	350,000	350,000	350,000	350,000	350,000
Equity (July 2014)	246,360	254,330	214,098	155,252	168,200	81,108	39,901	57,676	-37,000
Monthly Mortgage Repayments (July 2014)	1,039	802	1,139	1,530	1,121	1,658	2,140	1,512	290
- Interest	389	72	103	730	137	203	1,161	220	290
- Capital	650	730	1,037	800	984	1,455	978	1,291	0
Switching to Principal and Interest Repayment in Principal and Interest repayment after 10 years			<b>2010</b>			<b>2014</b>			<b>2017</b> 2,299*
Rent @ July 2014 PRTB Index - Dublin House	1,500			1,500			1,500		
Annual Rental Income (11 months)	16,500			16,500			16,500		
Percentage Gross Yield (House)	7.9%			5.3%			3.8%		
Percentage Net Yield (House)	0.1%	0.9%	-0.3%	-1.6%	-0.2%	-2.0%	-3.7%	-1.5%	-4.2%
<b>Taxable Rental Income</b>									
<b>Net Profit (Loss)</b> (from Table 6.1)	266	3,110	(938)	(5,627)	(716)	(7,160)	(12,942)	(5,405)	-(14,855)
<b>Add</b>									
Interest Relief Restriction (25% of interest)	1,168	217	308	2,190	411	608	3,484	661	871
Capital Repayments on Loan	7,797	8,757	12,440	9,601	11,806	17,462	11,741	15,498	24,107*
Local Property Tax	495	495	495	495	495	495	495	495	495
<b>Total Taxable Rental Income</b>	<b>9,726</b>	<b>12,579</b>	<b>12,306</b>	<b>6,660</b>	<b>11,996</b>	<b>11,405</b>	<b>2,778</b>	<b>11,248</b>	<b>10,618</b>

## 6.4 CONCLUSIONS

It is clear that the prospect of capital growth in the medium-term was possibly the main factor which motivated investors in the buy to let sector over the past decade. But the property crash post 2007 combined with the imposition of austerity measures, cuts in disposable incomes and additional charges have impacted negatively on the business of residential letting. The problem appears to be, with the benefit of hindsight, that neither high yields nor high capital growth have materialised for investors who bought buy to let properties in the past decade.

The mortgage arrears problem is one of the biggest remaining challenges from the financial crisis. However there are no resolution strategies in place for buy to let (BTL) mortgages, although there have been a number of recommendations by the Joint Committee on Finance, Public Expenditure and Reform.

There needs to be a quick resolution of the buy to let arrears problem if a sustainable rented market is to be restored. With 27.2 per cent or close to 40,000 of the total BTL mortgage loan accounts in arrears, a little over one-fifth are in arrears for more than 90 days. The escalation of the number of arrears cases would appear to indicate that little progress is being made by financial institutions. Many tenants are, through no fault of their own, caught up in disputes between receivers and landlords. This raises the question as to who is responsible for same when a receiver is appointed to a private rented property and is receiving rent from the tenant?

Interest-only mortgages were mainly issued to BTL investors on tracker mortgages between 2005 and 2008 at high LTV ratios. As a result there are increasing concerns about the ability of those investors to service their much higher repayments following the switch to principal and interest mortgages. This is likely to raise the risk of a further increase in BTL arrears amongst this group. Moreover this problem is likely to be exacerbated by the fact that anyone who purchased a property after 2004 on a tracker and interest only mortgage is also likely to be in negative equity. There is the further concern that their prospects could substantially weaken further should mortgage interest rates begin to rise anytime soon.

While the introduction of rent controls in such a scenario would further limit the capacity of BTL investors to meet their full principal and interest repayments, leading to further arrears and adverse consequences for supply, equally the prospect of further rent increases in an already supply constrained market would have adverse consequences for tenants.

REITs are a welcome development in the Irish rented sector. They generally have higher standards of estate management, maintenance and regulatory compliance than private landlords. Large scale investment in residential rented property, also allows these standards to be achieved at a lower cost than in a more fragmented rented market. REITs provide related services to the tenant and are likely to avoid disputes at all costs as their commercial remit requires them to maximise their rental income. The introduction of rent controls or any form of rent stabilisation may adversely affect the attractiveness of the rented sector for REITs.

## 7. APPROACHES TO RENT REGULATION IN IRELAND

### 7.1 INTRODUCTION

The review of rent regulation in other jurisdictions set out the complexity of rent regulation systems and suggests that there are considerable variations in how rent regulations are administered. The Terms of Reference requires an examination of the potential for some form of rent regulation in the Irish private rented sector to address the recent escalation in rents in urban areas, notably Dublin. The underlying assumption is that the level of supply of rented accommodation will not increase in the short-term<sup>157</sup> and some 'quick-win' solutions are required in the interim. This section examines a range of rent regulation models which could be adopted in an Irish context should a political decision be made in favour of rent regulation. Section 8 will examine other options to address the issue of rent stability.

The range of options examined for Ireland is based on rent stability regulations in other jurisdictions. As previously set out, some models relate increases in rent or initial rent levels to some defined index (second generation rent controls) rather than leaving rents to be determined freely by the market. Alternatively, the most recent form of rent control to be established involves rents being regulated *within* a tenancy but decontrolled *between* tenancies.

### 7.2 OPTIONS FOR RENT REGULATION

The potential options evaluated assume a number of the different models used in other jurisdictions are applied in Ireland. Six options in total have been selected which are summarised in Table 7.1 and described in more detail below.

#### 7.2.1. Description of the Options

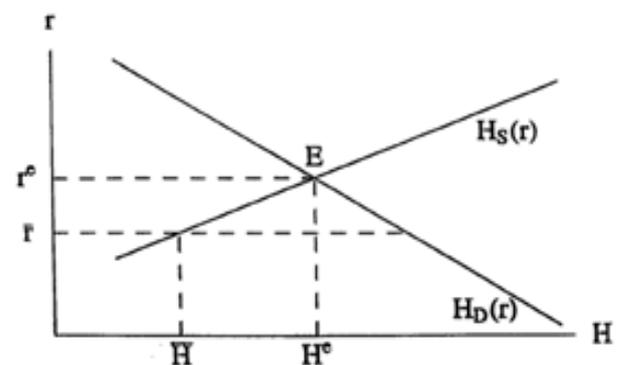
##### Option 1: Full Rent Control

The first type of rent regulation was full rent control which generally involved a rent freeze and set a rent ceiling below the market clearing rent either on a temporary basis or indefinitely. The rent level would be frozen for the entire market or for specifically defined segments of the market (e.g. older properties). There are few examples of

this type of rent control in place today, but this option is included in an Irish context, only to show it in comparison to the other options evaluated.

Using economic principles, Figure 7.1 illustrates the impact on demand and supply for rented accommodation when a rent ceiling is introduced. The demand for rental housing is given by the downward sloping demand curve,  $H_D(r)$ , with supply illustrated by  $H_S(r)$ . These curves show the quantity demanded and supplied at different rent levels. The equilibrium rent, where supply matches demand, is given by  $r^e$ , associated with a quantity of rental properties  $H^e$ . A rent ceiling is set at a level below that set by the market. As a result the rent paid by consumers falls to the level determined by the ceiling. This can lead to an increase in the demand for rental accommodation. However, the fall in the level of rents acts as a disincentive to landlords who respond by reducing the supply of rental units. As a result a rent ceiling can contribute to excess demand for rental units. In such a scenario existing tenants will retain their accommodation while some new households will not be accommodated. Rent ceilings can also have implications for the owner occupancy market as they can increase the incentive to convert units from rental to owner occupancy.

Figure: 7.1 Illustration of Rent Controls using Supply and Demand Curves<sup>158</sup>



<sup>157</sup> The forthcoming study on the Future of the Private Rented Sector will address supply side issues.

<sup>158</sup> Arnott, R. (1997). Rent Control. *The New Palgrave Dictionary of Economics and the Law*.

**Table 7.1: Rent Regulation Options**

OPTION	MODEL	INITIAL RENT	RENT INCREASE	TENANCY DURATION
1	Full Rent Control	Set at a level based on historic date to be determined	N/A	N/A
2	Indexed to CPI	Determined by free market	Indexed to CPI	N/A
3	Indexed to CPI within a Tenancy	Determined by free market initially, reverts to prevailing market rent at end of tenancy plus 10% due to supply constraints	Indexed to CPI	4 years
4	Frontloading	Determined by free market initially, plus frontloading of 10% at beginning of tenancy. At end of tenancy rent reverts to prevailing market rent plus frontloading of 10% plus a further 10% due to supply constraints	Indexed to CPI	4 years
5	Variant of German system for 4 years only	Capped at 5% above the average market rent at beginning of tenancy;	In line with the increase in average market rent under this scenario	4 years
6	Operating cost recovery	Determined by free market	In line with the increase in landlords' operating costs	N/A

The imposition of a rent control ceiling can also impact on the incentive for landlords to maintain and invest in their existing properties as it now takes longer to get any return on the investment. Housing and labour market mobility can be reduced. Excess demand can also result in higher advance payments to landlords of non-refundable deposits. It can also result in a mismatch between household types and housing units as well as the possibility of increased discrimination.

**Option 2: Indexed to CPI**

Reflecting the development of more flexible forms of rent control during the 1970s, the second option involves a rent certainty model whereby rents are pegged to some relevant index such as the consumer price index (CPI). This allows rents to move in line with inflation and allows landlords to at least recover some costs. However in a situation whereby rents are rising by more than the rate of inflation, such a cap on rents in line with inflation can discourage investment in the sector.

**Option 3: Indexed to CPI within a Tenancy**

The third option involves rent increases being regulated within an individual tenancy but unregulated between tenancies. In this option, the prevailing market rent applies on commencement of a new lease with rents rising by the CPI within the tenancy. At the end of the first four years, the

prevailing market rent is increased by 10 per cent due to supply constraints which would be expected as a result of the rent regulation. While the rent regulation remains in place, this 10 per cent increase is assumed to apply on commencement of each new tenancy. Thus based on a four year tenancy, the tenant has some certainty around what the increases in rent are likely to be. The landlord is allowed to recover any cost increases within the tenancy which are in line with the rate of inflation.

There would be little benefit for tenancies of shorter duration as the prevailing market rent would always prevail on commencement of a new tenancy. Thus, for example, individuals signing fixed one year leases would pay the prevailing market rent.

**Option 4: Frontloading**

A slight variation on the previous option is the Frontloading option which implies that the introduction of rent regulations within a tenancy would give rise to higher initial rents than prevail in the market. This frontloading takes place, particularly in an escalating rent scenario, as landlords seek to be compensated for the potential loss of income that would arise while rents are pegged to the CPI during the tenancy. Under this option, the 10 per cent increase in rents on termination of the first and subsequent

tenancies would also apply due to anticipated supply constraints, while the regulation remains in place.

**Option 5: Variant of the German System**

The fifth option is a variant of the German system. As already noted for Germany, the current system is such that the tenant and landlord agree the initial rent between them in a new lease agreement; rent increases every twelve months are set by reference to the average market rent in the locality, based on the official “*Mietspiegel*” (Tables Reflecting Local Rents), tables compiled by the local authorities.

New proposals are being considered which would see rents for new leases being capped in cities/areas where the housing market is under pressure at a maximum of 10 per cent above the average local rents. This proposal is for a five year period only.

In an Irish context the equivalent option examined seeks to replicate a similar cap on the level of rent increase relative to the increase in rents that currently prevails in the Dublin market of 10 per cent. Thus the variant of the German proposal under consideration here is to cap initial rents for new tenancies at 5 per cent above the average in the market. Thereafter, rents increase every year in line with the increase in average market rents under this scenario for the duration of each tenancy, assumed to be four years

**Option 6: Operating Cost Recovery**

This final option examined is based on models which allow some operating cost recovery for landlords in the determination of rents. In the review of other jurisdictions, this model ranges from allowing landlords recover a portion or all of their operating expenses to one which allows landlords to fully recover all operating expenses plus a reasonable profit. The latter applies in New York where the assessment of what constitutes operating expenses and a reasonable profit is made by the agency responsible for the State’s major housing and community renewal agencies.

In developing such an index in an Irish context, three sub-components of the CPI were used. The corresponding weights were derived from the analysis in Section 6 of the costs faced by landlords who purchased properties in the period since 2000. While this index has a significant mortgage interest component, the RED C survey reported that 70 per cent of landlords had an outstanding

debt on their property. The overall CPI is used to reflect the balance, after taking account of the three sub-indices.

**Table 7.2: Sub-Indices used for the Operating Costs faced by Landlords**

Sub-Index from CPI	Weighting %
Mortgage interest	38.0
Insurance connected with a dwelling	2.5
Maintenance and repair of dwelling	10.0
Remainder: CSO All Items	49.5
<b>Total</b>	<b>100.0</b>

**7.2.2. Approach to Evaluation of Options**

There are two approaches which could be taken to evaluating the above options:

- 1) Examine their impacts against the trajectory of rents in the free market by looking back retrospectively to ascertain what would have transpired for rents had some form of rent regulation been introduced at some time in the past.
- 2) Examine their future impacts against the projected trajectory of rents in the free market by examining the impact on rents under each rent regulation option, based on assumptions for the key variables, notably, free market rents and the consumer price index.

The first approach is the most favoured as it allows the use of historic data to test the various options. Examining the potential impact in the future is a subjective exercise, which would require projections for the trend in unregulated market rents overtime, a trend which is likely to be influenced by the demand and supply for rented accommodation but also trends in the owner occupied market and the growth in employment and incomes for example.

**When last were private sector rents increasing by current rates?**

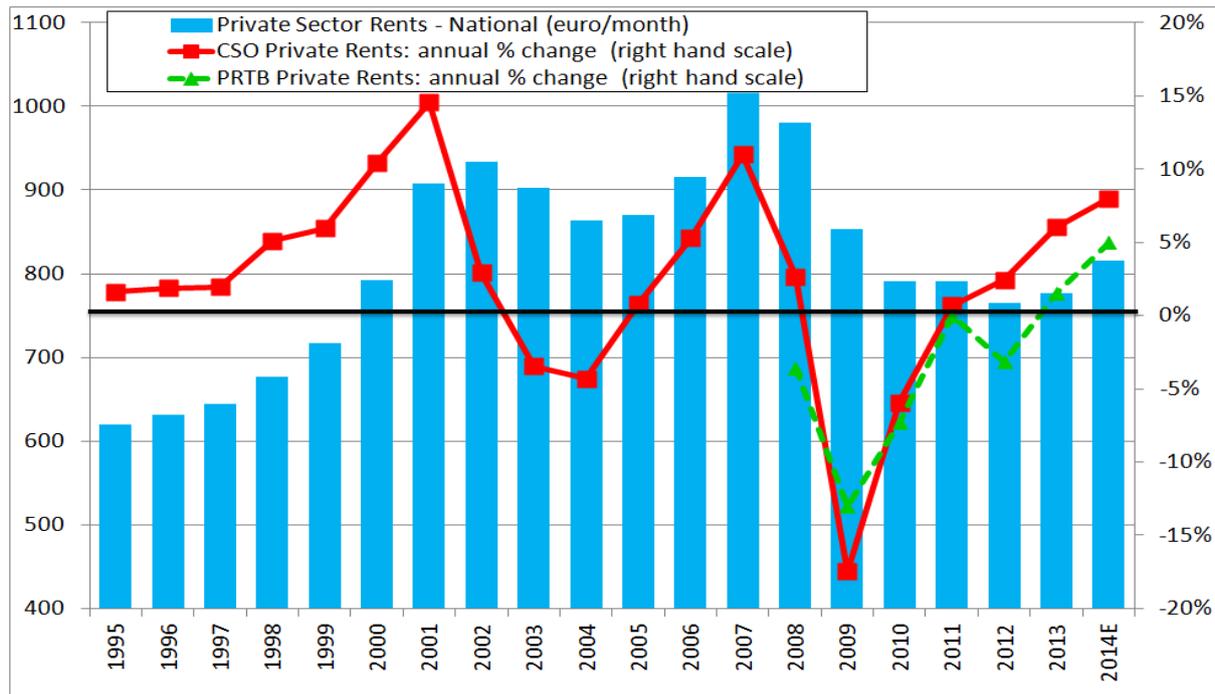
Looking back in time to ascertain when some form of rent regulation might have been introduced, the trend in private sector rents is examined over the period 1995-2014E (Figure 8.3). Nominal rents increased by 2 per cent per annum on average over the period 1995-2013. The late 1990s experienced an acceleration in the rate of increase in average rents, which reached 6 per cent in 1999, 10.5 per cent in 2000 and 14.6 per cent in 2001. In

real terms these increases were equivalent to 4.2 per cent in 1999, 4.6 per cent and 9.2 per cent respectively. This period would have followed the most rapid period of house price inflation in the late 1990s while the wider economy was experiencing solid growth and employment and incomes were rising strongly. The period 2005-2007 was also associated with an acceleration in nominal rents, although in real terms, the rate of increase peaked at 5.8 per cent in 2007. In

contrast, both the PRTB and the CSO rent index show that market rents fell during the crisis and are currently at levels substantially below where they were in 2007.

For the purposes of testing the impact of rent regulation, it is assumed that the escalation in rents in the late 1990s would have led to the introduction of rent regulation in 2000.

**Figure: 7.2 Trend in Average Private Rents across the State, 1995-2014E**



Source: CSO, PRTB.

**Assessing the performance of rent regulation**

Using the first approach however, it is important to acknowledge that any assessment of the performance of rent regulation in isolation from the overall intricacies of the wider housing market is tenuous. Recent research on rent regulation by the European Commission<sup>159</sup> acknowledged that the rented sector sits in a broader framework of the housing market where rental regulations would interact with a range of other instruments. The Commission advised policymakers considering setting controls on both rent levels and rent increases:

*“to bear in mind their broader implications for housing market stability and consider them within*

*the context of existing incentives for home ownership such as taxation incentives (deductibility of interest rates, property taxation vs. other assets, etc.) or macro-prudential measures (LTV caps, amortization rules for mortgages, etc.).”*

The following points are thus noted in advance of examining the various options:

- In the analysis which follows there is a simple comparison between the ‘free’ market rents which actually transpired over the period since 2000 and the regulated rents which are assumed to materialise under each option. The likelihood is that the introduction of rent regulation would make the ‘free’ market rent redundant, as rents would be determined by the specific regulation put in place. These regulated rents are independent of the ‘free’

<sup>159</sup> Cuerpo, C., Kalantaryan, S., Pontuch, P., Rental Market Regulation in the European Union, European Commission, European Economy, Economic Papers 515, April 2014.

market which transpired over the period and thus may be higher or lower.

- The likelihood is that the immediate announcement of rent regulation would give rise to the expectation amongst landlords that regulated rents would be lower than what they would otherwise be. The reality is, as will be shown below, that this may not always be the case.
- The regulated rents derived under each option would represent the maximum rents permissible while the market conditions may be such that the actual regulated market rent, in terms of what tenants are willing to pay, could be below this maximum level. The reality is that, given the macroeconomic conditions post 2007, rents under all options may well have been closer to what actually transpired in the free market, when rents declined by 22.7 per cent.
- The analysis which follows assumes that any form of rent regulation is likely to result in landlords exiting the sector and/or in a reduction in new supply. To allow this, some options make assumptions as to the rate of increase in rents on tenancy decontrol.
- The period under consideration captures the unprecedented boom in the housing market and the catastrophic bust which followed post 2007. The level of new housing supply increased from around 50,000 in 2000 to over 93,000 at the peak (2007). With 25 per cent of all residential mortgages going to investors in the period 2005-2008<sup>160</sup>, the outturn for housing supply in a rent regulated market could have been very different.
- It is also conceivable that a lower housing supply outturn would have a significant impact on government revenues while the reduction in stock would require increased Exchequer resources for those unable to meet their needs in the rented (or owner occupied) market.

Given the unprecedented boom in demand for housing, albeit mostly for owner occupation in the period 2000-2007, the introduction of rent

regulation could have led to a range of consequences. While discouraging investor demand and resulting in an excess demand for rented accommodation, rent regulation may have further exacerbated the demand for housing for home ownership as tenants may have moved into owner occupation in the absence of finding rented accommodation. However, the housing affordability issues in the market up to 2007 may have seen those unable to provide their own needs in the rented or owner occupied sector turning to the State for assistance, in the absence of any moderation in property price inflation.

### 7.3 RENT REGULATION SCENARIOS

The rent regulation scenarios are tested using data for the Dublin market<sup>161</sup>. The next chart (Figure 7.4) shows the trajectory for regulated rents which would have transpired in Dublin under each of the six options. The rent which actually transpired in the unregulated or free market is shown for comparison. Nominal rents are derived using PRTB Dublin rents from 2008 with rents for the period pre 2008 derived using the percentage changes in the CSO private rents index<sup>162</sup>.

#### 7.3.1. Full Rent Control

Under full rent control, with rents capped at their 2000 level, average rents remain below what transpired in the free/unregulated market. However, the literature suggests that the introduction of a rent cap would have had a number of undesirable consequences post 2000. In every jurisdiction where it was introduced, it led to a reduction in the supply of rental units due to an increase in demand for the 'lower' priced units.

#### 7.3.2. Rent Certainty linked to CPI

Looking back retrospectively at what would have happened to rents if they had been linked to the consumer price index (CPI) from 2000, Figure 7.3 shows that rents would have been higher in every year, relative to the free market, except in 2001 and 2002. Average rents in 2014 would be higher nationally (+€245/month) and in Dublin

<sup>161</sup> Appendix 2 contains the corresponding charts for rents in the national market.

<sup>162</sup> Given that the CSO private rents index is based on a sample of residential property letting agents in Dublin, in the regional cities (Cork, Limerick, Waterford and Galway) and in a selection of towns, it is more consistent with an 'urban' based rents index. However in the absence of any other data, it is used to extrapolate rents before 2007 nationally and in Dublin as the PRTB provides average rents nationally and in Dublin from Q3 2007 onwards.

<sup>160</sup>The Irish Banking Federation has only been measuring the breakdown of loans issued for the purchase of residential property since 2005.

(+€194/month) than those being experienced in the market at present. These levels would be equivalent to peak rents in 2008.

This option allows annual rent increases to keep pace with inflation but in the event that landlords' costs were increasing in excess of the rate of inflation, these would not be passed on to tenants. Variants of this option were in place in Ontario where rent increases were allowed to keep pace with inflation but only for inflation rates below 4.45 per cent and in some years, inflation exceeded this percentage<sup>163</sup> <sup>164</sup>. However, with inflation currently in Ireland running considerably below this level, at around 1 per cent, and given the ECB target of under 2 per cent for the foreseeable future, this may generate poor returns for landlords faced with higher operating costs, especially those who are heavily indebted.

### 7.3.3. Rent Certainty with a Tenancy

The third option assesses the impact assuming rent increases are regulated within an individual tenancy but are unregulated between tenancies. The main assumptions are reiterated below:

- ✓ Rent increases within a four year tenancy are indexed to the CPI.
- ✓ At the break in the first and subsequent tenancies, rents for new leases are assumed to be 10% higher than the prevailing market rent to take account of the potential impact on supply.

Under this option, rents are allowed to increase in line with inflation during a tenancy, providing some level of rent certainty for the tenant. Under this option there are benefits for the tenant in the early years as Figure 7.3 shows that rents are marginally lower in Dublin, relative to the unregulated market, in years 2 to 4 (2001-2003) of the first four year tenancy, albeit the tenancy commences at the prevailing market rent.

Over the period 2001-2003 the CPI increased by 13.6 per cent while nominal rents in the unregulated market increased by 13.8 per cent or just 0.3 per cent in real terms. In 2004 (Year 5), however, the rent would revert to the prevailing

market rent at the beginning of a new tenancy, which is assumed to be 10 per cent higher than the rent in the previous year (Year 4). In the second 4 year tenancy, the tenant benefits as rents indexed to CPI increase by 11.7 per cent in the period 2004-2007 relative to rents in the unregulated market which increase by 17.8 per cent or 5.5 per cent in real terms. In 2008 on commencement of a new tenancy, the rent would revert to a market rent which is 10 per cent higher than the rent in the previous year but as with Option 2, the chart shows that rents indexed to CPI within the tenancy post 2008 would be substantially higher than in the unregulated market. In the event that the market sustained these rents, the tenant would be worse off. A feature of the indexed tenancy agreement generally is that it may provide a better return to landlords through lower tenant churn and lower maintenance costs.

The European Commission<sup>165</sup> concluded that when rents are regulated within a tenancy, "tensions between landlords and tenants could be exacerbated as landlords would have incentives to increase the rotation of contracts (for example by encouraging eviction processes, by a biased tenant selection or through a reduction in the maintenance investment) while the latter would opt for long duration tenancies as their fixed costs of moving increase over time."

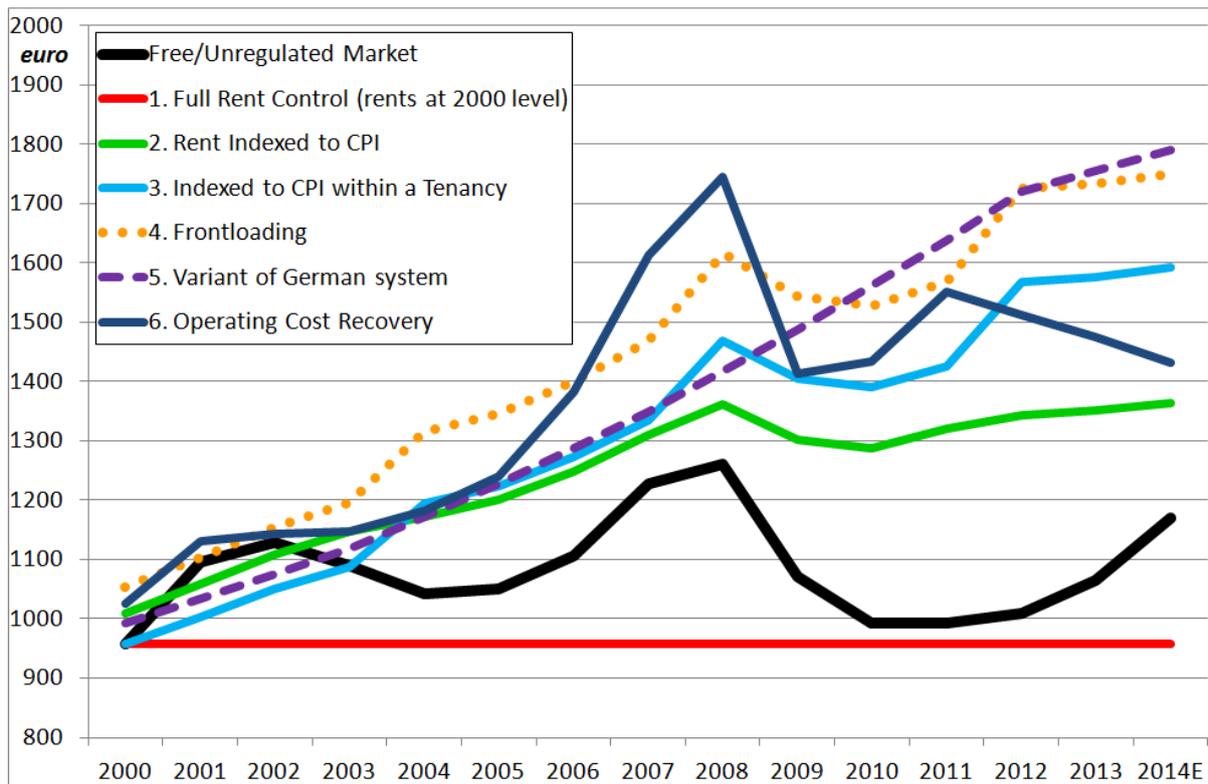
Conversely, landlords may see this option initially as limiting their potential returns compared with the free market. This may encourage some landlords to exit the sector. Others may seek compensation at the beginning of a tenancy by increasing the initial rent above the market level, an outcome which is examined in the fourth option below.

<sup>163</sup> Smith, L.B., Vacancy Decontrol in Canada, Professor Emeritus, Department of Economics, University of Toronto and President of High Value Consultants Limited.

<sup>164</sup> Using a similar cap in an Irish context, there would have been four years in the period 2000-2014E when the inflation rate was in excess of this level.

<sup>165</sup> Cuerdo, C., Kalantaryan, S., Pontuch, P., Rental Market Regulation in the European Union, European Commission, European Economy, Economic Papers 515, April 2014.

Figure: 7.3 Rent Regulation Scenarios in the Dublin Market, 2000-2014E



#### 7.3.4. Frontloading

The fourth option is a variation of Option 3 which assumes that the announcement of a rent regulation leads landlords to increase initial rents above the market rent and at the break point on commencement of a new tenancy as a compensation for the lower regulated rents within tenancies.<sup>166</sup> This frontloading, set at 10 per cent, assumes that the market will bear this level of rent increase which is more likely to be the case in a supply constrained market. The tenant is clearly worse off compared with Option 3.

The evidence from other jurisdictions is that there is limited potential to stop landlords frontloading rent increases, particularly in a supply constrained environment. Indeed in Ontario, for example, a similar rent regulation was found to generate a two-tiered system whereby long term tenants would pay less rent than new tenants. Rents on a vacated unit were found to be higher than they

would have been in the absence of rent controls. As a result new tenants paid substantially higher rents than sitting tenants.

A further variation of options 3 and 4 would involve longer leases whereby the tenant could remain in the property for longer and would end up paying less in rent than those who stay for shorter periods. With the average lease lasting 18 months in Ireland, this option could result in tenants staying longer in a tenancy thus reducing tenant turnover. Moreover lower tenant turnover would also discourage labour mobility, with adverse consequences for the efficiency of the labour market. With tenants moving less often, there tends to be a misallocation of house types as tenants may stay in properties that are bigger than they actually need. Landlords, on the other hand, will actively seek to rent to short term tenants who are more likely to remain in their property for a shorter period of time and so provide the opportunity to revert to the prevailing market rent.

#### 7.3.5. Variant of the German Proposal

The introduction of a variant of the German rent regulation proposal in Ireland over the period

<sup>166</sup> Le Bayon, S., P. Madec, and C. Riffart, (2012) "Rent control: What is the expected impact?" *ofce* August 2<sup>nd</sup>. Their view is that the rent control measures introduced in France will only be positive for tenants if there is not a negative impact on rental supply and if landlords do not seek to offset future rent control by raising the rent at the time of the first letting.

2000-2013 assumes that initial rents for new tenancies are capped at 5 per cent above the average in the market. Thereafter, rents increase every year in line with the increase in average market rents under this scenario for the duration of each tenancy, assumed to be four years. The regulation is assumed to remain in place over the entire period 2000-2014.

Thus for example, according to the RED C survey of tenants, 25 per cent of tenants in Dublin had received a rent increase in the last twelve months. For the purpose of this option it is assumed that the same proportions are applicable in the year 2000 and so 75 per cent of tenancies would receive a rent increase of 5 per cent in the first year under this system while 25 per cent would not be subject to a rent increase, since they would be within the 12 month rent review period. In such a situation, the overall market would increase by 3.8 per cent. The following year rents for the 25 per cent would increase by 5 per cent and rents for the 75 per cent would increase by the market average from the previous year which would be 3.8 per cent, resulting in an average rent increase for the overall market of 4.1%. In the intervening years of each four year tenancy, the rents increase in line with the average in the market. The rent reverts to the market rent plus 5 per cent for 75 per cent of tenants in 2004, at the end of their 4 year tenancy; while it reverts to the market rent plus 5 per cent for the remaining 25 per cent of tenants in 2005. Thereafter rents would again adjust for the remainder of the tenancy in line with the average in the market under this scenario, assuming the regulation remains in place over the entire period.

Figure 7.3 illustrates the trajectory for rents under Option 5. Under this option rents increase by 90 per cent in the period 2000-2014 or by 4.7 per cent on average per annum. This is clearly an unrealistic option and generates the highest rents relative to all options by 2014.

However, mindful of the fact that the purpose of this analysis is to come up with 'quick-win' solutions, this regulation would most likely only be introduced for a short period until such time as supply comes on stream. We have previously noted that the equivalent proposal in Germany is being proposed for a five year period only. Thus this option could be introduced for an initial four year period, in line with the duration of a tenancy or for two terms, depending on the impact in the market. Thereafter, the market could be

deregulated with rents determined in the free market. What would happen to rents in a deregulated market is impossible to establish and would depend on demand and supply as well as the macroeconomic environment at the time rents are deregulated. For example, rents on foot of deregulation could follow the trend which actually transpired in the free market post 2008, resulting in rents falling as a result of the economic crash.

The likelihood is that this form of rent regulation in the early years would return a respectable yield of around 5 per cent to buy to let investors, which may encourage investors into the sector or at least discourage exits from the sector. Tenants, on the other hand, would see average rents at the end of the first four years in line with average rents under Option 2 by 2004, when rents are indexed to CPI. At the end of the second four years, assuming the regulation remains in place, average rents are in line with Option 3 by 2008. Thereafter, with rents increasing by 5 per cent per annum, average rents at the end of the third tenancy are the second highest by 2013 after the frontloading option. This is clearly an unsustainable scenario for tenants.

However unless there is a supply response under this option the likelihood is that there would be excess demand for rented property in the early years. This may give rise to landlords favouring more secure tenants in stable employment as opposed to vulnerable low income tenants. This option may also see landlords actively seeking to rent to short term tenants in the early years order to revert to the market rent increasing at 5 per cent. This regulation, as with any rent regulation option, may hit hardest the very group that the regulation is being brought in to protect in the first place. There is the further likelihood that black market transactions would be a feature under this system.

If a decision was made to proceed with a variant of the German model, the reference rents used would need to be definitive for the purposes of regulation and would most likely be the PRTB Rent Index.

### 7.3.6. Operating Cost Recovery

The final option examined sees rents changing to allow landlords to recover their operating costs. As set out in Table 7.2, a composite index is developed based on three sub-components of the CPI. The largest weighting is given to the sub-component, mortgage interest (38%), reflecting

the proportion of operating costs accounted for by mortgage interest and given that 70 per cent of landlords in the RED C survey had an outstanding debt on their property.

Based on the composite index, operating costs faced by landlords are estimated to have increased by 2.7 per cent per annum over the entire period compared with 2.2 per cent per annum for the CPI index. The increases are well above average in 2000 and 2001, reflecting peak mortgage rates of around 6 per cent, and in later years in 2005-2008, reflecting the escalation in house prices. As a result using the percentage changes in the operating cost index to determine the maximum allowable increase in rents would have given rise to a significant increase in rents in the period 2004-2008, as shown in Figure 7.3. Post 2008, average rents under this option fall sharply up to 2014 (-18%).

## 7.4 POTENTIAL IMPACT OF RENT REGULATION OPTIONS

### 7.4.1. Potential Impact on Rents

In a further analysis of the impact on rents under each of the options, the change in regulated rents relative to what actually transpired in the free market rent is examined for Dublin only. Assuming a four year tenancy, Table 7.3 shows the impact on rents under each option at the beginning of each tenancy and during each tenancy as over the entire period to 2013<sup>167</sup>.

The main points evident from the Table are as follows:

- Overall the annual average percentage change in actual rents over the full period was 0.8 per cent. The corresponding percentage changes are higher in all other Options. However it makes more sense to look at the increase in regulated rents in each four year tenancy: under options 3 and 4 average rents increase by 4.3 per cent per annum in the first four years (2000-2003), 3.8 per cent in the second four years (2004-2007) and fall by 1 per cent per annum in the third four year tenancy (2008-2011). As rents return to the prevailing market rent at the end of each tenancy and assuming there is a reduction in supply, there is

a 10 per cent increase in each tenancy decontrol period.

- Average regulated rents in the short term (2000-2003) increase under all options by less than in the unregulated or free market, albeit marginally, with Option 6 increasing by the least amount (3.8%).
- Average regulated rents in the period 2004-2007 increase under all options by less than in the unregulated market with the exception of option 6 which increases by 10.9%.
- Average regulated rents in the period 2008-2011 fall under all options, with the exception of the German Model (rents increase by 5 per cent per annum), reflecting the fall in rents in the unregulated market and the reduction in the CPI over this period.
- In 2012-2014 average rents in the unregulated market in Dublin recovered by 7.7%, while options 2, 3 and 4 only increase in line with the average CPI in that period (0.7%). Regulated rents under Option 5 increased by 5 per cent per annum while rents under Option 6 continues to experience a decline (-2.7% per annum).
- Rents under Option 6 experience the most volatility. The increase in regulated rents is below the unregulated market in the first four year period and is significantly above it in the second four year period, while regulated rents fall by less than the unregulated market in the third four year period. Moreover this option experiences an average annual rate of increase over the entire period at 2.8 per cent.

An alternative way of examining the impact on rents is to consider the change vis à vis the unregulated or free market. The next Table examines the outturn for regulated rents under each option in the Dublin market relative to the rents which transpired in the free market. The shaded figures represent the years in which regulated rents under the particular option are higher than the free market rent. Regulated rents under options 2, 4 and 6 are almost always higher than the free market while rents under option 3 and 5 are higher than the free market from 2004 onwards.

<sup>167</sup> 2014 is excluded as only an estimate has been used to date in evaluating the options.

**Table 7.3: Rent Regulation Options in the Dublin Market: Impact on Rents, 2000-2014E**
**ANNUAL AVERAGE PERCENTAGE CHANGES IN MONTHLY RENT**

DUBLIN	2000-2003	2004	2004-2007	2008	2008-2011	2012	2012-2014	2000-2013
Unregulated/Free Market	4.4%	-4.3%	5.6%	2.7%	-7.7%	1.7%	7.7%	0.8%
2. Rent Indexed to CPI	4.3%	2.2%	3.8%	4.0%	-1.0%	1.7%	0.7%	2.3%
3. Indexed to CPI within a Tenancy	4.3%	10.0%	3.8%	10.0%	-1.0%	10.0%	0.7%	3.9%
4. Frontloading	4.3%	10.0%	3.8%	10.0%	-1.0%	10.0%	0.7%	3.9%
5. Variant of German system	4.1%	4.8%	4.8%	5.0%	5.0%	5.0%	5.0%	4.7%
6. Operating Cost Recovery	3.8%	3.1%	10.9%	8.2%	-3.9%	-2.5%	-2.7%	2.8%

**Table 7.4: Rent Regulation Options in the Dublin Market: Impact on Rents, 2000-2014E**

DUBLIN MARKET	2000	2001	2002	2003	2004	2005	2006	2007
1. Full Rent Control (rents at 2000 level)	0.0%	-12.7%	-15.2%	-12.2%	-8.2%	-8.9%	-13.5%	-22.1%
2. Rent Indexed to CPI	5.6%	-3.4%	-1.8%	5.3%	12.4%	14.2%	12.8%	6.6%
3. Indexed to CPI within a Tenancy	0.0%	-8.5%	-6.9%	-0.3%	14.6%	16.5%	15.0%	8.7%
4. Frontloading	10.0%	0.7%	2.4%	9.7%	26.1%	28.1%	26.5%	19.6%
5. Variant of German system	3.8%	-5.8%	-4.7%	2.7%	12.4%	16.9%	16.4%	9.9%
6. Operating Cost Recovery	7.1%	3.2%	1.4%	5.3%	13.3%	18.0%	25.0%	31.4%

DUBLIN MARKET	2008	2009	2010	2011	2012	2013	2014E
1. Full Rent Control (rents at 2000 level)	-24.1%	-10.6%	-3.5%	-3.5%	-5.1%	-10.1%	-18.2%
2. Rent Indexed to CPI	8.0%	21.5%	29.8%	33.2%	33.2%	26.9%	16.5%
3. Indexed to CPI within a Tenancy	16.5%	31.1%	40.1%	43.7%	55.5%	48.1%	36.0%
4. Frontloading	28.1%	44.2%	54.1%	58.1%	71.0%	62.9%	49.6%
5. Variant of German system	12.4%	38.9%	57.4%	65.2%	70.5%	69.7%	61.9%
6. Operating Cost Recovery	38.5%	32.0%	44.6%	56.4%	50.0%	38.6%	22.4%

**7.4.2. Potential Impact on Tenants**

In theory, the literature suggests that rent regulations should lead to a decrease in regulated rents, increasing the attractiveness for tenants and thus boosting demand. Tenants are protected against sharp increases in rents and tenure security should be enhanced. The anticipated reduced rents, however, are likely to result in a reduced supply of rental accommodation due to the impact on landlords' profitability and on rental yields. The size of the rental stock should be lower as a result, a development which would keep upward pressure on rents, notwithstanding the regulation in place. According to the European Commission these impacts are uncertain and cannot be considered in isolation to the broader housing market, as rent regulations will have broader consequences for housing market

dynamics and household finances, interacting as they do with taxation incentives and macro-prudential policies<sup>168</sup>.

The impact for the tenant is estimated using the present value in 2014 of the average monthly rent paid each year over the period 2000-2014. This allows the cost to the tenant and the income to the landlord to be estimated using a discount rate. The choice of real discount rate is important, since it represents the value of money over time for those renting accommodation. In theory one could argue that it should represent the marginal cost of consumer borrowing. We have chosen to use the Test Discount Rate (TDR) recommended for use in cost benefit analyses and cost effectiveness

<sup>168</sup> Cuerdo, C., Kalantaryan, S., Pontuch, P., Rental Market Regulation in the European Union, European Commission, European Economy, Economic Papers 515, April 2014.

analyses for public sector projects<sup>169</sup>, which is 5% net of inflation. Assuming a 2% per annum long term inflation rate, this is equivalent to a 7% nominal interest rate, which appears reasonable. Alternative higher (7%) and lower (3%) rates have been tested to identify where it makes a difference to the results, and while these generate different present values, they do not change the ranking of the options.

Excluding the full rent control option which is unlikely, the chart shows none of the options generate a lower present value than in the unregulated or free market. Option 2 is very close to the free market option with the other options, 3, 5, 6 and 4, in that order, generating higher present values than the free market, leaving the tenant worse off under these options, particularly under option 4. Conversely the best option for the landlord would be option 4, where the maximum income is generated; the worst options being the free market, where the least income is generated (excluding the full rent control option).

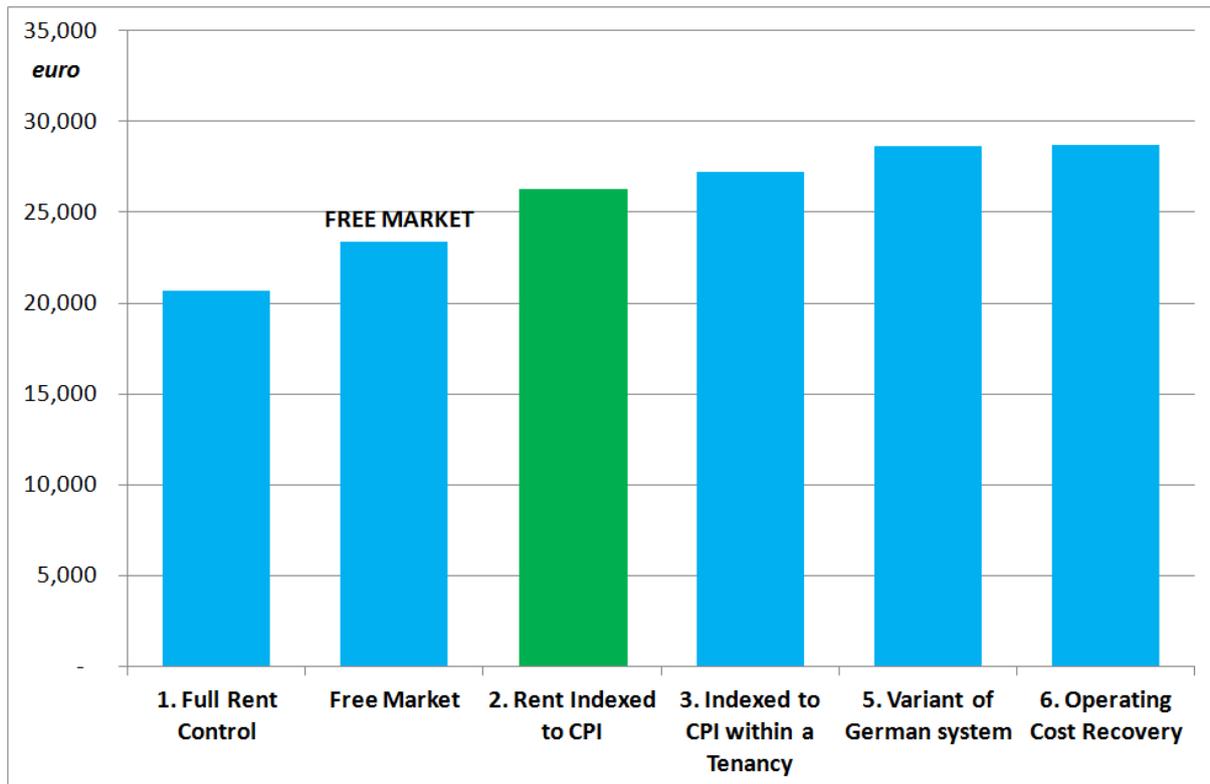
Table 7.5 also shows that the ranking of the various options remains unchanged in the national market, using the present value of rents in 2014 and the same discount rate (5%).

**Table 7.5: Rent Regulation Options: NPV of Monthly Rents over the period 2000-2014 in 2014**

	National Market	Dublin Market
1. Full Rent Control	16,061	20,651
Free Market	18,065	23,352
2. Rent Indexed to CPI	20,417	26,252
3. Indexed to CPI within a Tenancy	21,162	27,210
5. Variant of German system	22,283	28,652
6. Operating Cost Recovery	22,299	28,672
4. Frontloading	23,278	29,932

<sup>169</sup> <http://www.per.gov.ie/project-discount-inflation-rates/>

**Figure: 7.4 Rent Regulation Options in the Dublin Market: NPV of Monthly Rents over the period 2000-2014 in 2014**



### 7.4.3. Potential Impact on Supply

The various rent regulation options will have impacts on existing and new supply. In principle, the highest ranked options which favour the tenant should have the most negative impact on supply while options 4, 6 and 5, which favours the landlord, in that they deliver the highest rental income in NPV terms, should have the least negative impact on supply.

The impact of rent regulation on supply is uncertain as in any dynamic housing market there will be a range of diverse factors which impact on housing demand and supply. What is known about the existing rented stock is that there are 40,000 BTL mortgages in arrears out of the total estimated stock of 305,377 units (Census 2011) rented from private landlords. According to the Central Bank there are 144,686 BTL mortgage accounts which implies that 160,691 or almost 53 per cent have no mortgage.

**Table 7.6: Buy To Let Properties: Mortgaged And Owned Outright**

	Number of Properties	%
Total as per Census 2011	305,377	100.0
Total BTL Mortgage Accounts	144,686	47.4
<i>of which</i>		
- In arrears	39,361	12.9
- Not in arrears	105,325	34.5
ImPLY owned outright	160,691	52.6

Source: CSO, Central Bank.

In the RED C landlord survey 29 per cent of all respondents and 36 per cent of those who had become landlords more recently stated that they intended to sell as soon as possible. Based on the 179,000 landlords registered with the PRTB, the 29 per cent would correspond to around 52,000 properties, assuming they each sold one property. This figure represents those planning to exit in the current unregulated rental market. The introduction of some type of rent regulation would imply that more would be likely to exit the sector.

**Potentially between 52,000 and 89,000 properties could exit the sector**

When the present value of rents for tenants (Option 1) is below the corresponding value which arises in the free market, there is the risk that those landlords in arrears may exit the market. There is a further group, who have mortgages but are not in arrears, a proportion of whom may exit the market, and a further proportion of those without a mortgage, who may also choose to sell their properties as soon as prices recover.

Based on a Red C survey the current profile of landlords is set out in Table 7.7. The table shows the number of landlords with mortgages that are currently experiencing a shortfall in rent to meet mortgage repayments is 88,736. If rent regulations further curtail landlords’ ability to repay mortgages, it is likely that some or all of these landlords could potentially exit the sector. Thus assuming each landlord has one property, this suggests, that an additional 36,700 properties (a total of c. 89,000) could potentially exit the sector.

**Table 7.7: Profile of Landlords with Mortgages**

Landlords	(%) of Landlords	(%) with Mortgage	(%) Shortfall in Rent
< 5Yrs	34%	63%	75%
6-10 Yrs	46%	81%	74%
10 Yrs +	20%	56%	53%
No of Landlords	179,000	125,085	88,736

However, there is the potential for this figure to be higher, based on the analysis presented in Section 6. The latter showed, based on the costs faced by the nine buy to let investors who purchased properties in 2000, 2004 and 2007, that their net incomes in the first year under each of the rent regulation options would be negative with one exception<sup>170</sup>. Net yields would thus be negative, a factor which may also lead to landlords exiting the sector.

This level of properties coming onto the market could lead to a slowdown in property price inflation and a shift in tenure, as 73 per cent of properties which came to the market in the first half of 2014 went to owner occupiers. For the

purposes of assessing the impact of the rent regulation options on supply it is assumed that the existing rented stock would reduce by somewhere between 52,000 in Options 4, 5 and 6, the worst options for tenants, and 89,000 in Option 2, the worst option for landlords. Based on information received from Sherry Fitzgerald Estate Agents, it is estimated that around 32,000 investor properties were sold in the period since 2010, while some 12,500 investors entered the market, resulting in a net loss of 19,500 properties in the period. Also 33 per cent of properties for sale at present are investors seeking to exit the market while 19 per cent of all sales in the first half of 2014 were to investors. Thus some of the rented properties would remain in the rented sector.

**Regulations can discourage new supply**

In addition to the existing stock, the introduction of rent regulations was found to limit new investment in the sector in some jurisdictions. These concerns were raised by a number of stakeholders as part of the consultation process and were based on the premise that short term regulations are likely to remain in place in the long term or at least are more difficult politically to be removed. While many jurisdictions have removed rent regulations from new properties, many consultees voiced concerns that once regulations were introduced they could in time be applied to new properties and become more onerous for landlords.

The introduction of rent regulations would also affect the efforts to attract new investment into the Irish rented sector, for example as rent regulations would reduce property values and would impact on the pricing equation for foreign investors and their banks. This could lead to a further recapitalisation being required by banks by increasing the writedowns they would have to take on their BTL portfolios.

The potential decline in the stock of rented property will have particularly negative impacts for new tenants. As such, in a supply constrained environment rent regulations will not provide any benefits for the current 2,500 individuals who are in emergency homeless accommodation. Moreover in a supply constrained market, landlords have more flexibility in their choice of tenant and can more easily discriminate amongst groups. This has given rise to black market activity in some jurisdictions.

<sup>170</sup> The 2000 buy- to-let investor on a tracker mortgage would have a positive net income in each option in the first year.

There is also the potential for relatively poor choice of rental housing in a rent regulated environment. As has been set out previously unless landlords are compensated for additional investment in their properties they are unlikely to maintain the property to the same standards as in the private market. This in turn could lead to tenants seeking affordable accommodation to opt for lower standard accommodation and other tenants undertaking black market transactions to obtain a desirable unit. This was the case in the Flanders region of Belgium where, following a contraction of the private rental sector, the proportion of vulnerable households which depended on the sector increased. In some cases this resulted in the agreed rent for a property not being in line with the quality of the rented premises since the demand for cheaper housing exceeds the supply (Winters and Vermeir, 2013).

#### 7.4.4. Potential Impact on Rent Supplement

As previously set out in Section 4, Rent Supplement limits vary across the country and

across household types. The total cost will depend on the number of recipients which is currently 74,900, on changes in the tenant contribution and household type. The distribution of Rent Supplement across the country is such that 35 per cent of recipients are in Dublin where rents are escalating well above the average. The number of recipients is currently declining due to the introduction of RAS and HAP but also due to the improving macroeconomic environment. There are thus a range of factors which will influence the cost of Rent Supplement and for this reason in order to establish the impact of the rent regulation options, only the short term impacts on the cost of Rent Supplement are estimated. It is also assumed that Rent Supplement moves in line with the market and thus the percentage change in rents in the first year under each option is assumed to be equivalent to the percentage change in the total Rent Supplement cost. The impacts on Rent Supplement are set out in Table 7.7.

**Table 7.8: Rent Regulation Options: Impact on Rent Supplement Cost in Year 1**

	Impact on Dublin Rents in Year 1	Impact on Rents in Rest of Country in Year 1	Overall Average Change in Rents in Year 1	Short Term Impact on Rent Supplement Cost
				<b>€m.</b>
Total Current Cost of Rent Supplement				<b>344</b>
Impact of Options on Rent Supplement cost:				
Free Market	10.0%	2.0%	4.8%	16.5
1. Full Rent Control (rents at 2000 level)	-18.2%	-0.8%	-6.9%	-23.7
2. Rent Indexed to CPI	1.0%	1.0%	1.0%	3.4
3. Indexed to CPI within a Tenancy	1.0%	1.0%	1.0%	3.4
4. Frontloading	11.0%	11.0%	11.0%	37.8
5. Variant of German system	3.8%	4.3%	4.1%	14.1
6. Operating Cost Recovery	-2.9%	-2.9%	-2.9%	-10.0

In the absence of any rent regulation, it is estimated that a policy decision to increase Rent Supplement in line with market rents would see the cost increase by 10 per cent in Dublin and 2 per cent across the rest of the country<sup>171</sup>, resulting

in a 4.8 per cent increase overall. This is equivalent to €16.5m. The highest impact on the cost of Rent Supplement arises with the frontloading option as rents increase by the CPI plus 10 per cent in the first year, which represent an increase in Rent

<sup>171</sup> The PRTB index for Q1 2014 showed rents year on year increasing by 8.4 per cent in Dublin and 0.8 per cent outside Dublin. Average rents in 2014 are assumed to increase by 10 per cent in Dublin and 2 per cent outside Dublin (4.8 per cent

overall) in 2014 for the purpose of ascertaining the impact on Rent Supplement. These figures compare with an increase of 9.2 per cent in the first seven months of 2014, according to the CSO Private Rents index, which is considered closer to an urban based rental index.

Supplement of €37.8m. The lowest impact arises for options 2 and 3, with a cost of €3.4m reflecting the current historically low rate of inflation of 1 per cent. There would be reductions in the cost of Rent Supplement with options 1 and 6. The reduction is significant with option 1 as controlling rents at their 2000 levels would generate a reduction in overall rents of 6.9 per cent relative to their 2014 levels. The corresponding reduction in Rent Supplement is estimated at €23.7m. This is an unrealistic option given the current upward pressure on rents, especially in Dublin. With Option 6, following a review of the latest components of the operating cost index using the CSO indices, operating costs have declined by 2.9 per cent in the seven months to July 2014. Assuming an annual decline of the same magnitude would generate a saving in Rent Supplement of €10 million.

*affordable housing opportunities for young and low-income households and the prevention of homelessness situations require more targeted policies, which would be welfare-enhancing while not taking a toll on rental market efficiency.”*

#### 7.4.5. Summary of Rent Regulation Options

The six rent regulation options evaluated in an Irish context are summarised in the next table.

Based on the above analysis, the overriding concern in the Irish market, which is currently a market under pressure in certain locations, is that any form of rent regulation could potentially reduce the supply and quality of rented accommodation and thus distort the market further, in the absence of any incentives to stimulate supply. This would see the impact falling disproportionately hardest on the very people that the rent regulations are trying to assist.

The intended purpose of good rent regulation should be to benefit both tenants and landlords equally. Tenants require security of tenure, good quality accommodation and some degree of rent certainty, while landlords require a good return on their investment, which implies covering their operating costs and making a reasonable profit, if they are to remain committed to the sector. However the European Commission<sup>172</sup> pointed out that other more targeted policies may be more appropriate:

*“The drawbacks of rent controls in terms of unintended consequences for housing market stability and negative effects on labour mobility would advise against their use for redistribution purposes. Social concerns such as the provision of*

<sup>172</sup> Cuerdo, C., Kalantaryan, S., Pontuch, P., Rental Market Regulation in the European Union, European Commission, European Economy, Economic Papers 515, April 2014.

Table 7.9: Rent Regulation Options: Summary

RENT REGULATION OPTION	PROS	CONS	COST FOR TENANT (PV of Monthly Rent for Dublin Tenant 2000-2014 in 2014 )	IMPACT ON NEW SUPPLY (in absence of any incentives to encourage supply)
UNREGULATED/ FREE MARKET	<ul style="list-style-type: none"> <li>▪ Rents determined by demand and supply</li> <li>▪ New supply would not be adversely impacted</li> </ul>	<ul style="list-style-type: none"> <li>▪ Current market failure not addressed</li> </ul>	€23,352	Positive
1. Full Rent Control	<ul style="list-style-type: none"> <li>▪ Rent ceiling at or below market clearing rent</li> </ul>	<ul style="list-style-type: none"> <li>▪ Fall in rents leads to a reduction in rental units</li> <li>▪ Reduces level of new investment</li> <li>▪ Reduces investment in stock and hence quality</li> <li>▪ Distorts housing market by incentivising owner occupancy</li> <li>▪ Reduces housing and labour mobility</li> <li>▪ Pressure on Exchequer to accommodate those unable to find accommodation in the private market</li> </ul> <p><b>Legislature Involvement</b></p> <ul style="list-style-type: none"> <li>▪ Rent Control Legislation required to be passed with the effect of retrospectively reducing rents in market.</li> <li>▪ Potential delay in passing legislation may spook market – emergency legislation procedures could be used to counter this issue</li> <li>▪ Risk of constitutional challenge – prior to signing the legislation, the President can refer the statute to the Supreme Court for a review of its constitutionality but if not, it can be challenged by affected parties.</li> <li>▪ Precedent would</li> </ul>	€20,651	Negative

		indicate that if the measures are short term in nature and seek to balance.		
2. Rent Indexed to CPI	<ul style="list-style-type: none"> <li>▪ Rent certainty for tenants</li> <li>▪ Allows landlords' costs to keep pace with inflation</li> </ul>	<ul style="list-style-type: none"> <li>▪ Generated the highest annual rate of rent increase in the short-term</li> <li>▪ Rents higher in every year relative to the free market in 2000-2014</li> <li>▪ Lower inflation target in immediate future would generate poor returns for landlords</li> <li>▪ Rents in 2014 would be back to their peak levels in 2008</li> <li>▪ Landlords costs may increase in excess of the rate of inflation</li> <li>▪ Reduces quality of existing stock</li> <li>▪ Lead to some landlords exiting the sector</li> <li>▪ Reduces new entrants</li> </ul>	€26,252	Negative
3. Indexed to CPI within a Tenancy	<ul style="list-style-type: none"> <li>▪ Rent certainty within a tenancy for tenants</li> <li>▪ Encourages tenants to take longer leases than the current 18 months</li> <li>▪ Lower maintenance costs for landlords</li> </ul>	<ul style="list-style-type: none"> <li>▪ Lower tenant turnover</li> <li>▪ Biased tenant selection by landlords</li> <li>▪ Lead to some landlords exiting the sector</li> <li>▪ Reduces new entrants</li> </ul>	€27,210	Negative
4. Frontloading	<ul style="list-style-type: none"> <li>▪ Rent certainty within a tenancy for tenants</li> </ul>	<ul style="list-style-type: none"> <li>▪ Higher initial rents</li> <li>▪ Rents are always higher than the free market</li> <li>▪ Two-tier system as long term renters can pay less than new renters</li> <li>▪ Lower tenant turnover</li> <li>▪ Discourages labour mobility</li> <li>▪ Lead to an inefficient labour market</li> <li>▪ Misallocation of house types</li> <li>▪ Landlords seek to rent to short term tenants</li> <li>▪ Lead to some landlords exiting the sector</li> <li>▪ Reduces new entrants</li> </ul>	€29,932	Negative

5. Variant of German system	<ul style="list-style-type: none"> <li>▪ Initial rents capped at 5% above the market rent</li> <li>▪ Average rents record the highest rate of increase under this system assuming it is in place indefinitely; however more likely to be a short-term solution, assuming supply constraints are addressed;</li> </ul>	<ul style="list-style-type: none"> <li>▪ Landlords can discriminate against tenants favouring tenants who have more secure and stable employment</li> <li>▪ May discourage renting to vulnerable low income tenants or those on Rent Supplement/HAP</li> <li>▪ Lead to some landlords exiting the sector</li> <li>▪ Reduces new entrants</li> </ul>	€28,652	Negative
6. Operating Cost Recovery	<ul style="list-style-type: none"> <li>▪ Positive measure for landlords</li> </ul>	<ul style="list-style-type: none"> <li>▪ Landlords are faced with different operating costs</li> <li>▪ Does not provide rent certainty</li> <li>▪ Market rents are highest under this option</li> <li>▪ May not fully cover all operating costs as an average index only</li> <li>▪ Does not allow for any profit</li> </ul>	€28,672	Positive

## 7.5 LEGAL BASIS FOR RENT REGULATION IN IRELAND

### 7.5.1. Outline

First Generation rent controls were introduced in Ireland during World War I and continued to operate until after World War II. In 1946 the Rent Restrictions Act was implemented which extended the provisions already in place and in 1960 the Rent Restrictions Act saw substantial changes to the regulation of rents. The 1960 Act provided permanent control over units covered by the previous acts and generally provided rent control on unfurnished dwellings and decontrolled a number of dwellings subject to certain criteria.

However in 1981, following a constitutional challenge *Blake and Others V Attorney General and Madigan V Attorney General*, the Supreme Court found that the Parts II and Parts IV of the Rent restrictions Act 1960-1967 were unconstitutional. In their ruling the Court stated that the regulations amounted to an “*unjust attack*” on landlords’ property rights. In particular the court complained that the legislation provided for no compensation for landlords subject to rent

control, and the almost permanently alienated the property from the landlord. Following this ruling, the Housing (Private Rented Dwellings) Acts of 1982-1983 sought to phase out the formerly rent-controlled sector.

While the Court found Part II and Part IV of the Act unconstitutional, subsequent cases did find that the Article 43.2.1 of the Constitution also requires that private *rights ought to be regulated by the principles of social justice* and the exercise of right may be delimited by the State to reconcile it with the exigencies of the common good<sup>173</sup>.

### 7.5.2. Potential Future Application

As such, in considering the introduction of any measures seeking to apply rent regulations, the risk of constitutional challenge must be considered in formulating legislation.

Whilst the question of whether measures are constitutional or not is a question within the preserve of the Supreme Court, greater risk of challenge will exist where any legislation is crafted

<sup>173</sup> Report of the Commission on the Private Rented Residential Sector. July 2000

to substantially impact on property owners over tenants. However, if such measures are temporary in nature and are reasonable having regard to social justice requirements, then whilst challenges cannot be ruled out, there is less likelihood of this being successful. It is therefore a question of balance.

The question of constitutionality can also be the subject of a reference by the President prior to signing legislation into law.

It is usual for government to ‘proof’ legislation for constitutionality through the office of the Attorney General. As such, whilst the table below summarises the risks, any legislation specifically will have to be reviewed having regard to its particular terms, specifically in relation to:

- Nature of regulation option;
- Application – Dublin only, main cities or nationwide;

- Period of application of measures;

If measures are to be the subject of legislation, the following issues also arise:

- **Timing:** Delays in the Oireachtas process may create significant uncertainty in the market and could lead to exits unless the process is dealt with speedily. (IBRC Act 2013 was passed overnight so there is precedent for the process to be accelerated).
- **Regulatory Authority:** Under the old forms of Rent Regulation, the courts were the regulating authority. As the PRTB is now the regulatory authority it would be necessary to assess the suitability of the PRTB to fulfil the regulation role for all of the options.

**Table 7.10: Legal and Timing Issues for Rent Regulation Options**

RENT REGULATION OPTION	LEGISLATIVE ROUTE/ ISSUES	CONSTITUTIONAL RISK	TIMING SENSITIVITY	REGULATORY AUTHORITY
FREE MARKET	<ul style="list-style-type: none"> <li>▪ N/a</li> </ul>	<ul style="list-style-type: none"> <li>▪ N/a</li> </ul>	N/a	<ul style="list-style-type: none"> <li>▪ PRTB under RTA 2004 with further reference to Courts</li> </ul>
1. Full Rent Control	<ul style="list-style-type: none"> <li>▪ New Rent Control Legislation would be required to fix rents at the 2000 level</li> <li>▪ Former rent control legislation only applied to properties rented at the effective date and limited increases prospectively – if the new legislation is to apply to all properties this will effectively amount to a forced rent reduction</li> <li>▪ Time limitation would need to be considered</li> <li>▪ Legislation would need to include specific calculation tools of 200 rent levels.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Risk of successful challenge extremely high as effective expropriation of property rights rather than limitation of rents going forward</li> <li>▪ Level of impact for landlords likely to create groundswell of support for challenge</li> </ul>	<ul style="list-style-type: none"> <li>▪ Emergency legislation could presumably be an option.</li> <li>▪ Constitutional issues may increase process if referred by President to Supreme Court. Significant potential impact on market</li> </ul>	<ul style="list-style-type: none"> <li>▪ Courts</li> </ul>
2. Rent Indexed to CPI	<ul style="list-style-type: none"> <li>▪ Could be addressed by amendments to RTA 2004 (under current proposed Residential Tenancies legislation)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Risk of challenge low</li> </ul>	As above	<ul style="list-style-type: none"> <li>▪ PRTB with further reference to the Courts</li> </ul>

	<ul style="list-style-type: none"> <li>▪ Benchmark from which increases apply would need to be set</li> </ul>			
3. Indexed to CPI within a Tenancy	<ul style="list-style-type: none"> <li>▪ Could be addressed by amendments to RTA 2004 (under current proposed Residential Tenancies legislation</li> <li>▪ Question of security of tenure would have to be addressed to be effective</li> </ul>	<ul style="list-style-type: none"> <li>▪ Risk of challenge low subject to terms of security of tenure provisions</li> </ul>	As above	<ul style="list-style-type: none"> <li>▪ PRTB with further reference to the Courts</li> </ul>
4. Frontloading	<ul style="list-style-type: none"> <li>▪ Could be addressed by amendments to RTA 2004 (under current proposed Residential Tenancies legislation</li> <li>▪ Question of security of tenure would have to be addressed to be effective</li> </ul>	<ul style="list-style-type: none"> <li>▪ Risk of challenge low subject to terms of security of tenure provisions</li> </ul>	As above	<ul style="list-style-type: none"> <li>▪ PRTB with further reference to the Courts</li> </ul>
5. Variant of German system	<ul style="list-style-type: none"> <li>▪ Could be addressed by amendments to RTA 2004 (under current proposed Residential Tenancies legislation</li> <li>▪ Question of security of tenure would have to be addressed to be effective</li> <li>▪ Localised approach would also have to be factored in to legislation</li> </ul>	<ul style="list-style-type: none"> <li>▪ Risk of challenge low subject to terms of security of tenure provisions</li> </ul>	As above	<ul style="list-style-type: none"> <li>▪ PRTB with further reference to the Courts</li> </ul>
6. Operating Cost Recovery	<ul style="list-style-type: none"> <li>▪ Could be addressed by amendments to RTA 2004 (under current proposed Residential Tenancies legislation</li> </ul>	<ul style="list-style-type: none"> <li>▪ Risk of challenge negligible</li> </ul>	As above	<ul style="list-style-type: none"> <li>▪ PRTB with further reference to the Courts</li> </ul>

## 7.6 CONCLUSIONS

Rent regulation can take many forms, can be very complex and can result in a number of consequences for private rented housing markets. Aside from full rent control and the introduction of a rent ceiling, rent regulation typically involves some form of rent stabilisation, whereby increases in rent or initial rent levels are related to some defined index rather than leaving rents to be determined freely by the market. Any assessment of the performance of rent regulation should bear in mind the broader implications for housing market stability as the regulation would interact with a range of other instruments.

Six options are evaluated in an Irish context based on an assumption that the escalation in rents in the late 1990s led to the introduction of rent regulation in 2000. The regulated rents derived under each option represent the maximum rents landlords would charge. However the market and macroeconomic conditions may be such that the actual regulated market rent may, in terms of what tenants are willing to pay, be below this maximum level.

The immediate announcement of rent regulation would give rise to the expectation amongst landlords that regulated rents would be lower than what they would otherwise be. The analysis suggests that this may not always be the case.

Average regulated rents in the short term (2000-2003) increase under all six options by less than the unregulated or free market rent, albeit marginally, with option 6 (operating cost recovery) increasing by the least amount (3.8%). However, the medium and long term consequences of capping rents under either option may eventually give rise to higher rents in the market when the market becomes deregulated, due to the potential negative impact on supply. The latter assumes there are no corresponding measures to protect the existing stock and encourage new supply during the regulated period.

Overall the annual average percentage change in actual rents over the full period was 0.8 per cent. The corresponding percentage changes are higher in all other Options. However it makes more sense to look at the increase in regulated rents in each four year tenancy: under options 3 and 4 average rents increase by 4.3 per cent per annum in the first four years (2000-2003), 3.8 per cent in the second four years (2004-2007) and fall by 1 per cent per annum in the third four year tenancy (2008-2011). As rents return to the prevailing market rent at the end of each tenancy and assuming there is a reduction in supply, there is a 10 per cent increase in each tenancy decontrol period.

In an assessment of regulated rents versus the free market, regulated rents under options 2, 4 and 6 are almost always higher than the free market while rents under option 3 and 5 are higher than the free market from 2004 onwards.

The literature suggests that rent regulations should lead to a decrease in regulated rents, increasing the attractiveness for tenants and thus boosting demand. Tenants are protected against sharp increases in rents and tenure security should be enhanced. The reduced rents, however, result in a reduced supply of rental accommodation due to the impact on landlords' profitability and on rental yields. The size of the rental stock should be lower as a result, a development which would keep upward pressure on rents, notwithstanding the regulation in place.

None of the options generate a better outcome for the tenant (in present value terms) compared with the unregulated or free market. Option 2 is very close to the free market option with the other options, 3, 5, 6 and 4, in that order, generating higher present values than the free market, leaving the tenant worse off under these options,

particularly under option 4. Conversely the best option for the landlord would be option 4, where the maximum income is generated; the worst options being the free market, where the least income is generated (excluding the full rent control option).

The impact of rent regulation on supply is uncertain as in any dynamic housing market there will be a range of diverse factors which impact on housing demand and supply. However an analysis of the supply impacts under each option shows that potentially between 52,000 and 89,000 rented properties, in a worst case scenario, could exit the sector due to the impact on net yields for landlords. Rents tend to be higher the greater the contraction in supply, due to black market transactions.

It is estimated that a policy decision to increase Rent Supplement in line with market rents would see the cost increase by €16.5m. With the introduction of rent regulation, the cost of Rent Supplement under the frontloading option would increase by €37.8m. The lowest impact arises for options 2 and 3, with a cost of €3.4m reflecting the current historically low rate of inflation of 1 per cent. However the overriding concern in a market currently under pressure in certain locations, is that any form of rent regulation could potentially reduce the supply and quality of rented accommodation and thus distort the market further, in the absence of any incentives to stimulate supply.

Given where the Irish housing market is at present, the introduction of rent regulations in Ireland is likely to exacerbate the current problems being experienced in the market. A whole series of negative impacts are likely, including a reduction in new supply of rented property as well as an exodus of existing landlords from the sector. New foreign investment, which is currently being encouraged to address the supply shortage, is likely to be discouraged. A supply constrained market can also result in landlords being selective about their choice of tenant, thus generating black market activity. This issue may already be a feature of the market. Moreover, the introduction of rent regulations would see the impact falling disproportionately hard on the very people that the rent regulations are trying to assist

## 8. STRATEGIES FOR THE SECTOR

### 8.1 CONTEXT FOR STRATEGIES

This report has examined the issue of rent stability, identified the different approaches to the regulation of rent increases in other jurisdictions, reviewed the treatment of Rent Supplement and assessed the taxation treatment of the sector as well as the business of a landlord. Section 7 of this report considered a range of options for Rent Regulation, identifying the pros and cons for each in an Irish context. This section now sets out some additional policy options to achieve greater rent stability and certainty in an Irish context. It is important to reiterate that this study is the first of two studies on the private rented sector, the second of which will cover a range of other issues including regulation and policy options to encourage the general supply of affordable private rented accommodation for different segments of the market.

Following a range of consultations and an extensive analysis of the aforementioned issues, it is evident that, the key emerging policy challenge is to create a sufficient supply of high quality rented accommodation for renters at an affordable price, with the appropriate level of regulation for the providers and increased security of tenure for current and prospective tenants. However the underlying assumption in this report is that housing supply will not increase in the short term. Thus what are needed are some quick fix solutions to address the escalation in rents in Dublin, particularly for low income households. Moreover an adequate private rental housing stock needs to be balanced with an equally strong social housing sector to ensure that the private rented sector is not relied upon to house marginal groups.

To begin with the following main points which have arisen from the research are summarised below:

- Increasingly the private rented sector is providing housing for a wide range of households, many of whom previously would have had their accommodation needs met by the owner occupied or social housing sectors.
- Rising rents in urban areas are generating significant difficulties for vulnerable households, a number of whom are being

squeezed out of their homes. This is giving rise to an increasing homelessness problem which is reaching crisis levels.

- The escalation in rents is a Dublin phenomenon. Rising demand from a range of sectors and a lack of supply are the key factors driving up rents.
- As such, increasing supply is likely to ultimately result in rent stability. There is an immediate housing requirement across the urban areas, but particularly in Dublin. An increase in newly constructed units is not going to be immediate so the measures below are suggested with a view to protecting, and improving supply and standards within, the existing housing stock.
- Fiscal changes between 2008 and 2014 have increased significantly the tax burden on landlords. This increased burden has outweighed increases in the commercial letting sector and in the business sector generally and is likely to be responsible to some extent for rent increases in the sector.
- The demand from owner occupiers is displacing investment in the residential letting sector. Data from Sherry FitzGerald suggest that 33 per cent of properties which have come to the market in 2014 to date are from investors but the majority are being bought up by owner occupiers. Owner occupiers are competing for stock in the market and the demand is also encouraging exits of landlords from the sector.
- The lack of finance is an issue across the board in regard to both public capital for the provision and refurbishment of social housing as well as the availability of mortgage finance in the private buy to let sector.
- The equalisation of the tax treatment of residential rental investment and commercial investment will impose some costs on the Exchequer; however it may be possible to balance some of these costs by equalising, for example, the treatment of stamp duty as set out in Section 5.

For the purposes of this report, the various options are set out under the following headings:

- ✓ Rent Stabilisation and Affordability
- ✓ Protecting the Existing Private Rented Stock
- ✓ Promoting Investment and Supply

The options are ranked in regard to those a) that can take effect immediately to assist the sector and discriminate in favour of vulnerable tenants who are being hardest hit by the current crisis; and

b) others which are likely to be for the medium and longer terms.

## 8.2 RENT STABILISATION AND AFFORDABILITY

The impact of rent regulations has been widely documented in economic literature with economists generally agreeing that the theoretical justification for rent regulation is relatively weak. Based on the review of rent regulations in other jurisdictions (Section 3) and the rent stability options analysed in the previous section, the potential negative impacts of rent regulation have been highlighted. The primary reason is that they act as a disincentive to supply and discourage the entry of small and large scale investors, in the absence of any parallel measures to increase supply. Thus the level of investment in rented property would be lower in a regulated environment than in an unregulated one. Moreover the regulation of rents can lead to landlords exiting the sector, thus reducing the existing stock. Perversely the impacts could fall disproportionately hardest on the very people that the rent control system is trying to assist.

For these and other negative reasons outlined in Section 3, rent regulation is not considered a good idea in the Irish private rented sector. There are a number of other measures which are focused on

- ✓ Providing better information to ensure the sector is more informed,
- ✓ Improving the situation with respect to the review of rents and the determination of Rent Supplement limits,
- ✓ Enforcing what legislation is in place under the Residential Tenancies Act 2004,
- ✓ Protecting the existing stock,
- ✓ Increasing the supply of rental properties, and
- ✓ Providing targeted tax incentives.

### Option 1: Review of Rents

Under existing legislation, Part 3 of the Residential Tenancies Act 2004 states that rents may not be greater than the open market rate and may be reviewed (upward or downward) once a year only unless there has been a substantial change [not defined in the legislation] in the nature of the accommodation that warrants a review. Tenants are to be given 28 days notice of new rents. The 'market rent' is defined as the rent which a willing tenant not already in occupation would give and a willing landlord would take for the dwelling, in each case on the basis of vacant possession, having regard to the other terms of the tenancy

and the letting values of dwellings of a similar type, size and character to the dwelling and situated in a comparable area to that which it is situated (Part 3, Section 24).

The main options dealing with the review of rents are as follows:

- a) Notice of a rent increase should be extended to three months with the tenant's acceptance/rejection of the increase advised one month in advance of the rent adjustment. The tenant may seek a review at any stage in the 3 month period.
- b) The landlord should provide details of a minimum of three comparable properties in the area to justify rent increases, where possible, or alternatively evidence should be sufficient and appropriate to the property in question.
- c) Tenants should be afforded the option to provide similar data if they wish to do so in their negotiations and in a dispute situation.
- d) Due weight should be given to the PRTB rent data in dispute resolutions in the absence of other information. Thus the PRTB Rent Index will be the primary source of market rent increases but the determination in a dispute will be based on evidence and subjective factors in the case.
- e) The current provisions in the Residential Tenancies Act 2004 in regard to rent being reviewed no more than once in twelve months should be publicised.

The 3 months notice period will allow the tenant more time to assess the market and determine if they are happy with the level of rent increase. More time will allow the tenant to assemble more information and data if they wish to see a review of the proposed increase.

The rationale for recommending a minimum sample of three comparable properties is based on a similar obligation on landlords in Germany. This requirement will also seek to ensure that landlords do not attempt to increase rents based purely on trends in the market but also on the quality of the accommodation which they offer. Currently the PRTB data only provide location and number of rooms. Given that new lettings will be determined by the free market, there may be the potential for landlords to seek short term tenancies.

The provision of three comparable properties may not always be possible, particularly in rural areas. Similarly the PRTB database may not have

adequate coverage in these locations. In these instances, any other evidence presented and subjective factors should determine the outcome of any dispute.

The expectation is that these measures will dampen rent increases as inevitably some landlords may seek to capitalise on the general trend in the local market without taking the quality of accommodation into account. Moreover the use of the PRTB Rent Index as the primary source of market rent increases should dampen rent increases as other sources, notably Daft.ie are based on asking prices, which in Dublin are on average around €200 above PRTB registered rents.

### **Option 2: Provision of Market Information.**

The PRTB should:

- a) Increase the data gathered from the PRTB registration process to allow greater profiling of rents in the sector.
- b) Increase the information available on market rents through publication of a quarterly report, supplemented with an online mapping tool, detailing average market rents each quarter across property types and locations and ensure that they are easily accessible for landlords and tenants.
- c) Increase awareness of the PRTB, rents, rights and obligations via a mailshot to landlords and tenants.

The more detailed data provided by the PRTB might include information on BER ratings, facilities and the age of the property. In terms of the PRTB publication there would be an opportunity to provide detailed regional and local data and other relevant information around other issues, e.g. affordability. While more detailed information is provided within the PRTB website, this is not published widely.

The provision of more information is expected to ensure that tenants are more informed as currently many do not appear to be informed. It appears that while the Residential Tenancies Act 2004 has been in place for the past ten years, tenants are not overly aware of their rights.

The RED C survey of tenants reported that 32 per cent of tenants had not heard of the PRTB. Young adults aged 18-24 and older persons over 55 years of age were less familiar with the PRTB than other age groups. Furthermore, 40 per cent did not know if their property was registered while around two-thirds had received no information from the

PRTB. In terms of renters' rights, 33 per cent of tenants agreed with the statement that they are not fully aware of their rights as a tenant.

These findings would suggest that more needs to be done to make tenants aware of their rights and obligations. Armed with the appropriate information, tenants will be better placed to argue their case and should it end up in a dispute, the likelihood is that more rent disputes would be ruled in favour of the tenant. It is expected that these measures would serve to dampen rent increases.

### **Option 3: Introduce a Rent Certainty Lease Product**

One option to address the issue of rent stabilisation would be to introduce a Rent Certainty lease which landlords and tenants may voluntarily be willing to sign up to under certain conditions. While there is currently no impediment to creating long term leases under the Residential Tenancies Act 2004, this information may not be well publicised. Some tenants want longer term tenancies, are keen to remain long term renters, and want to know the rents they will be paying over the duration of their tenancies. Some landlords may be content to forego market rents in return for less tenant turnover, less void periods and a rent linked to some published index (e.g. CPI inflation or earnings). In this context, there may be a market for a specific long term lease product, where the lease would extend in excess of the existing four year term and the rent would be indexed on an annual basis during the lease term. The key requirement of such a lease would be the voluntary nature of the scheme as landlords and tenants would have to agree to sign up for it.

This product is already in place in Germany (which has a range of lease options). It would be similar to the rent indexed within a tenancy (option 4) rent regulation option evaluated in Section 7, which was based on a four year tenancy.

It is not expected that an incentive would be required to increase take-up but information on the lease should be publicised. The potential take-up is difficult to estimate. But the RED C survey reported that only 18 per cent of tenants have lived at their current property for more than four years. However 65 per cent of tenants surveyed are renting for more than four years, but not in the same property. This suggests that there may be a significant group who may be willing to remain in the same property for more than four years if the

terms and conditions can be agreed voluntarily with the landlord and tenant.

The disadvantage of such a lease product is that it may reduce turnover within the private rented sector. For this reason, it would be essential that new supply is brought on stream. Otherwise there is a risk that the rents for the units that become available would be higher in a supply constrained environment than they would be in a more stable housing market. Without incentives to encourage new supply, the onus would be put back on Government to address the housing shortage which in turn reduces their capacity to deliver other services.

This option can be summarised as follows:

A rent certainty lease product should be introduced which would benefit both landlords and tenants and would involve

- ✓ A voluntary agreement between the landlord and the tenant
- ✓ A lease which would extend to in excess of four years, and
- ✓ The indexation of rent on an annual basis during the lease which would revert to market rent at the end of the lease.

The terms of such a lease would be drawn up by the PRTB who would publish information regarding the conditions of the lease, which should include the possibility of a break clause after four years.

#### **Option 4: Rent Supplement limits**

The changes to Rent Supplement were set out in Section 4 and noted that the maximum rent limits have been reduced in line with the decline in the overall market since 2009. There have been some increases in the 2013 Review, reflecting the recent increase in rents in the country, and in particular Dublin. The review explained how Rent Supplement maximum rates are generally set at the 35<sup>th</sup> percentile of the available market rent to ensure that 35 per cent of the relevant market is available for Rent Supplement tenants. A review of rent limits in other jurisdictions reveals broadly similar practices.

The options to support Rent Supplement recipients are as follows:

- a) There should be no indexation of Rent Supplements as it may not reflect the market.
- b) Rent Supplement limits should be reviewed in line with market rents based on market share.
- c) Current rent limits may not be appropriate in certain rented markets, most notably Dublin,

and should be adjusted in the short term, until supply issues can be addressed.

- d) Rent limits should be reviewed every 12 months.
- e) The existing Interim Tenancy Sustainment Protocol (ITSP) should be extended for an additional 26 weeks to allow reviews on a case by case basis.

The indexation of Rent Supplement can lead to rents which fall behind the market and do not move in line with market share and thus would exacerbate the current issues in the market.

However rent limits should be reviewed in line with market rents based on market share. As mentioned in Section 3, the rent limits are published for certain categories of tenants but consultations suggest that categories outside of these (i.e. larger families) are dealt with on a case by case basis.

The increase in rent limits, assuming they move in line with the market, will, by implication, increase the average market rent. However, this does not imply that rents will increase in the non Rent Supplement market *per se*. Market rents will be determined by supply and demand.

It is estimated that a policy decision to increase Rent Supplement in line with market rents would see the cost increase by 10 per cent in Dublin and 2 per cent across the rest of the country<sup>174</sup>, resulting in a 4.8 per cent increase overall. This would be equivalent to an increase of €16.5m on the current Rent Supplement cost of €344m.

The review of Rent Supplement every twelve months will align the review of rent limits with the review of market rents in the Residential Tenancies Act 2004. The review may move rent limits downwards or upwards, which would imply either a saving or a cost for the Exchequer.

The ITSP has only been in place since 16<sup>th</sup> June 2014 which is not enough time to establish the full cost of this measure. However it consists of a quick fix short-term temporary solution for the Dublin market where the problem is most acute. Given that the protocol is consistent with Article 38 of

<sup>174</sup> The PRTB index for Q1 2014 showed rents year on year increasing by 8.4 per cent in Dublin and 0.8 per cent outside Dublin. Average rents in 2014 are assumed to increase by 10 per cent in Dublin and 2 per cent outside Dublin (4.8 per cent overall) in 2014 for the purpose of ascertaining the impact on Rent Supplement.

the Social Welfare Regulations 2007<sup>175</sup>, which allows payments to be made in exceptional cases to Rent supplement claimants across all household types, it should be extended for the full twelve month period and should remain focused on family households in Dublin.

**Option 5: Incentivise Landlords to accept Rent Supplement/HAP tenants for a minimum of 5 years in exchange for 100 per cent interest relief on borrowings**

Section 5.5 highlighted the context for the abolition of tax incentives going back to the 2005 Department of Finance review of the various property based reliefs. The study concluded that the schemes had generally served their purpose and that there was absolutely no case for future government incentives. The view expressed in the report was that continuing to approve new projects would contribute to oversupply and represent a clear waste of scarce public resources.<sup>176</sup> Budget 2006 subsequently closed down virtually all of the tax incentive schemes in use<sup>177</sup> and provided for transitional arrangements in relation to certain pipeline projects.

It is important to acknowledge, notwithstanding the above conclusion in the 2005 report, that the market circumstances are very different eight years on. The measure propose here would be time limited and would remain in place until the core issue of supply is addressed. There would be an associated cost for the Exchequer which is estimated below.

It is not recommended that there be an increase in interest relief on borrowing generally for landlords in the short to medium term but landlords letting to Rent Supplement/HAP tenants should receive 100 per cent interest relief where the following conditions are met:

- ✓ The units are let to tenants in receipt of Rent Supplement/HAP;
- ✓ The rent is set at the maximum rent assistance limit and no top-ups are taken;
- ✓ The tenancy complies with the requirements of the Residential Tenancies Act 2004 (registration, rent reviews, Part 4 protections).

The restoration of 100 per cent interest relief, which would apply for the period in which the property is let under the above conditions and should be kept under review. It has the potential of discriminating in favour of the social sector and against other tenants. However, the latter may be viewed as being in a more favourable economic position to withstand the disadvantage.

The total cost of reinstating this measure for all landlords is estimated at €112m by the Department of Finance. Based on 35 per cent of the market representing Rent Supplement tenants, this would be equivalent to €39.2m. However not all landlords have borrowings. The RED C survey reported that 70 per cent of landlords had an outstanding debt on their property. Thus assuming the same proportion for Rent Supplement/HAP landlords, the cost of this measure would be of the order of €27.5m in a full year.

**Option 6: Freeze the removal of Tenants' Tax Relief for Low Income Tenants at 2013 level to 2017.**

The relief for tenants operated by allowing tenants paying rent to claim a deduction against tax of an amount equal to the standard rate of tax multiplied by the level of rent paid up to certain limits. This relief was essentially a relief introduced in order to bring certain landlords operating in the black economy into the spotlight from a Revenue perspective in that the landlord's details had to be included in relation to any claim made to Revenue. The relief has been abolished in respect of rent paid on new tenancies on or after 8 December 2010. In respect of existing tenancies, the relief is being tapered off before finally expiring at the end of the tax year 2017.

Section 5.3 set out the rationale for the elimination of the relief for tenants which was to achieve parity with the owner occupier sector as mortgage interest relief had been eliminated and will be phased out by December 2017. It also noted that in general, the rental sector is considerably more compliant than it was at the time of introduction of the relief and the original rationale for introducing the relief may not be so significant today.

However, in light of the fact that tenants, particularly lower paid tenants, in the private rental sector are competing for accommodation with higher paid individuals as well as owner occupiers where properties are exiting the rental sector, there is a clear financial rationale for

<sup>175</sup> S.I. No. 412/2007 - Social Welfare (Consolidated Supplementary Welfare Allowance) Regulations 2007.

<sup>176</sup> See page 11 of the December 2011 report.

<sup>177</sup> See page 12 of the report of December 2011 for a list of the relevant schemes.

considering a limited freezing of the removal of the relief until supply comes on stream.

In recommending any freezing of the removal of the relief, we are conscious of the need to avoid any distortion with the owner occupier market<sup>178</sup> and any measures which will serve to increase market rents. In this regard, consideration should be given to the limited reintroduction of the relief on the following basis:

- That the freezing of relief would be restricted to individuals with earnings below a certain threshold to be set based on a percentage of the average industrial wage.
- The freeze should only apply for a limited period of time until supply within the residential sector increases. A period of 3 years is suggested in this regard with the relief being removed in 2017 as planned.
- The freeze in relief will be at 2013 limits<sup>179</sup>, which were 50% of the limits that applied up to the tax year 2010 and would indicate that if rent relief were to be reintroduced completely, that the cost of same would be approximately €17 million per annum. By applying income limits at a low level, this figure should be significantly lower. The Employment Earning Inequality in Ireland<sup>180</sup> divided the population into quintiles from poorest to richest based on median pay. Assuming the same distribution applies to tenants in the private rented sector and assuming low income individuals are accounted for in the first three quintiles set out, then 60% of individuals renting would qualify for the relief, suggesting a cost of circa. €10.2m.

### 8.3 PROTECTING THE EXISTING STOCK

The crisis in the private rented sector is such that measures should not be introduced which would jeopardise the existing stock and lead to an exit of landlords from the sector. The biggest challenge in regard to the existing stock is the level of buy to let

mortgage arrears while for landlords coming to the end of their interest only mortgages, there are concerns about the capacity of the rent to cover their higher interest and capital repayment mortgages.

Thus what is required is a quick resolution to the BTL arrears issue before it escalates further. While we are informed that standard forbearance techniques are being employed by lenders, there needs to be a code of conduct on BTL mortgage arrears similar to that for arrears for principal dwellings which would set out the rules of engagement between the lender and the landlord and tenant. Such a code should fully adhere to the requirement of the Residential Tenancies Act 2004. BTL mortgages which are unsustainable should be prioritised as a matter of urgency if there is to be a sustainable and fully functioning rented sector in the medium-term.

Threshold, in its submission to the Joint Oireachtas Committee on Finance, Public Expenditure and Reform<sup>181</sup>, on matters relating to mortgage arrears called for a code of conduct on buy to let mortgage arrears which would ensure that the requirements of landlord and tenant law become an explicit consideration in the receivership and repossession processes and safeguard the private rented sector from volatility arising from a higher scale of repossessions and receiverships.

Moreover in situations where lenders appoint receivers to BTL properties, the Minister for Finance has agreed to change legislation to make receivers take on the responsibilities of the landlord to uphold the requirements of the Residential Tenancies Act 2004. In this regard the tenant should not be asked to vacate the property outside of the legal notice of termination and the tenant should not be subject to rent increases to cover other charges other than those associated with changes in the market rent and which are in line with the terms of the Residential Tenancies Act 2004. The Joint Committee on Public Expenditure and Reform<sup>182</sup> highlighted the difficulties with the selling of a property due to mortgage difficulties of the landlord and recommended that tenants should not have their

<sup>178</sup> Mortgage interest relief is due to expire in 2017 although there are no tapering provisions in that legislation.

<sup>179</sup> Per the table contained in Section 473 TCA 1997, as introduced in Finance Act 2011. This specifies that the appropriate relief for a widowed/surviving civil partner or married person under 55 was €400 and €800 for persons aged over 55. For other individuals, the relief would be capped at €200 per annum for single individuals and €400 per annum for single individuals aged 55 years or over.

<sup>180</sup> <http://www.publicpolicy.ie/wp-content/uploads/Employment-Earnings-Inequality-in-Ireland.pdf>

<sup>181</sup> Buy to Let Mortgage Arrears: Measures Needed to Protect Homes of Tenants and Stability of Private Rented Sector, Threshold Submission to Joint Oireachtas Committee on Finance, Public Expenditure and Reform.

<sup>182</sup> <http://www.oireachtas.ie/parliament/media/committees/finance/Finance-Committee-Report-on-Mortgage-rrears-Resolution-Process.pdf> (July 2014).

leases ended, their rent increased or any other detrimental changes imposed when a receiver takes over a property.

**Option 7: A Code of Conduct for buy to let mortgage arrears should be developed.**

- a) A code of conduct for buy to let mortgage arrears should be established which will safeguard the security of tenants. It should set out:
- The rules of engagement between the lender and the landlord and tenant, and
  - Fully adhere to the requirements of the Residential Tenancies Act 2004.
- a) BTL mortgages which are unsustainable should be prioritised as a matter of urgency if there is to be a sustainable and fully functioning rented sector in the medium-term.

**Option 8: Introduce Capital Gains Tax Relief for Landlords letting to Rent Supplement tenants.**

Consideration should be given to introducing changes to the regime for principal private residence relief (PPRR). An option would be to provide that any period in which a property is let to Rent Supplement/HAP tenants would be included as part of the period in which PPRR is available, provided this is for a period of 5 years during the ownership period, all of which is to be in the future. This would be subject to the following conditions being met:

- The units are let to tenants in receipt of Rent Supplement/HAP.
- The rent is set at the maximum rent assistance limit and no top-ups are taken.
- The tenancy complies with the requirements of the Residential Tenancies Act 2004 (registration, rent reviews, Part 4 protections).

The cost of this measure is difficult to quantify but will only be realised on a sale. It is intended to assist in permitting such tenants compete with other tenants in the tight market. This measure will not discriminate between owner occupiers who already enjoy this relief.

**8.4 PROMOTING INVESTMENT AND SUPPLY**

While the second study will fully address measures to promote investment and supply, there are some short term measures which can be introduced with immediate effect which would improve the efficiency of the existing housing stock.

**Option 9: Improve awareness in regard to the Rent a Room scheme.**

Rent a room relief has been in place for a number of years. According to the Revenue Commissioners there are 4,073 claimants of relief based on a review of Forms 11 and 12. This figure is likely to be understated. The total cost is estimated at €5.9m. It only applies to home owners who occupy a property as a sole or main residence and who let one or more rooms in their houses. The relief operates to exempt any income of up to €10,000 per annum. This form of relief can encourage the take-up of free space in dwellings by single tenants rather than having single tenants taking complete units.

The low take up may reflect a lack of awareness of the scheme. Thus the following should be considered:

- The scheme should be publicised via an advertising campaign by either the Department of the Environment, Community and Local Government or by the Housing Agency.
- The income exemption should remain €10,000 per annum.

This measure would incentivise use of space in existing properties in the short term until the supply side is addressed.

Persons renting under the rent a room scheme would not be subject to the requirements of the Residential Tenancies Act 2004 as they are classified as ‘licensees’ instead of tenants.

**Option 10: Extend the Living City Initiative to Investors**

The Living City Initiative is a targeted pilot tax incentive which aims to:

- Encourage people back to the centre of Irish cities to live in historic buildings; and
- Encourage the regeneration of the retail heartland of central business districts.

This scheme was introduced in the Finance Act 2013 on a pilot basis in five main cities. The Initiative provides tax incentives for works performed to refurbish residential and retail buildings either to bring them up to a habitable standard or even to make improvements to buildings which are currently inhabited. The incentives are targeted at owner/occupiers rather than investors. The participating local authorities have been asked to identify areas in the main cities which might fall within the scope of the scheme.

It is understood that an application for EU State Aid approval was submitted on 27<sup>th</sup> March 2014 and the outcome of this application is awaited. The areas to be designated will not be announced until approval has been received.

It is recommended that this scheme should be extended to investors to encourage people to rent in city centres. There are many locations in cities which tenants would willingly reside in, being close to their place of employment and amenities and which would increase footfall for existing businesses. Moreover such an initiative would support sustainable development encouraging residential occupancy in areas which heretofore have been neglected.

Under the initiative as it is currently set out, residents will be able to claim tax relief for the cost of the refurbishment works in the relevant properties. This relief can be claimed at the rate of 10% per year for 10 years against their income, but only for the years in which the house is the principal private residence of the person. If the property is sold within the 10 year period, entitlement to the relief stops and the new owner will not be entitled to claim any relief.

According to information on the initiative, where the size of some houses is regarded as being too big for the average family, the approach to be adopted is to divide larger houses into smaller units. There will be minimum sizes placed on these units to ensure that an acceptable living space is provided. In such instances, these properties would be suitable for rented accommodation.

This incentive is limited to cities, being the areas where letting supply is limited, and the extension to landlords should allow for both increased investment in the sector and should also assist in improvement of quality and standards.

Thus it is envisaged that this measure would

- Focus on the same five cities as the LCI for owner occupiers, and where rising rents are most prevalent.
- Focus on the existing rental stock in those five cities and also enable more stock to be converted into rental use.
- Allow for the conversion into dwellings from other uses.
- Be time limited to a five year qualifying period.

- A claw back period of 10 years might apply where the property is sold or taken out of private rental use.

Based on the pilot scheme in Limerick city and Waterford city, an analysis by Indecon<sup>183</sup> suggested that a third of potentially eligible buildings would be refurbished by owner occupiers under the Scheme, provided a number of amendments were made to the scheme. These included changes to the timing of the tax relief so that the relief would be given in the year in which the expenditure was made, rather than spread over a number of years as proposed in the scheme. In the absence of such a change, it was suggested that there would be very low levels of take up, with only 10 per cent of eligible buildings availing of the incentive. This was equivalent to only about 10 residential buildings (and 1 retail) per year in each pilot area under the Scheme, although it was suggested that the take up in Dublin City could potentially be higher. The annual Exchequer cost over 5 years was estimated at €3 million in the pilot areas. Extending the initiative to the three other cities would suggest a total cost in the region of €7.5m. Based on the number of pre 1919 rented units and vacant residential stock and assuming the take up is twice that in the owner occupied sector, the total cost of extending the scheme to landlords is estimated at around €17m.

#### **Option 11: Reduce commercial rates for residential units above commercial premises**

A related measure, intended to ensure an efficient use of vacant stock, is the recommendation in *Construction 2020*<sup>184</sup> to consider removing incentives that existing arrangements for commercial rates may offer to owners to keep or render properties empty.

As set out in *Construction 2020*, an occupied commercial property is subject to commercial rates, and a habitable unoccupied property is subject to 50% of commercial rates. However, an uninhabitable unoccupied property is not liable for rates at all, which may incentivise a developer or owner to render a property uninhabitable - for example by removing a stairs or lift - rather than developing it.

<sup>183</sup> Ex-ante Evaluation of the Living City Initiative for Urban Regeneration, Indecon International Economic Consultants, October 2013.

<sup>184</sup> Recommendation 22. <http://www.merriestreet.ie/wp-content/uploads/2014/05/Construction-Strategy-14-May-20141.pdf>

Consideration should also be given to extending this consideration to residential units over a commercial property. This would see the owner paying lower rates if the unit is habitable or higher rates if the unit is uninhabitable. However, due to a lack of data on vacant properties above commercial units, it is not possible to cost this option.

**Option 12: Reduce VAT on New Housing Construction from 13.5% to 9% for a limited period of 2 years**

The current debate around development viability concerns the lack of an appropriate rate of return to developers in delivering residential development projects. While this has to do with the cost of construction excluding the VAT payable by the end user, one solution would be to reduce the rate of VAT on new housing construction (as opposed to sale) from the current 13.5% to 9% for a limited period of time to generate lower house prices and thus encourage new residential development. EU rules may need to be considered in regard to this issue.

The expectation would be that the lower VAT rate of 9% would generate a higher level of housebuilding as the lower house price would increase demand. However it is difficult to ascertain what the supply side impact would be. There is also the risk that the lower VAT rate might not be passed on by the housebuilder, thus increasing his profit margin. However, if the lower VAT rate was to apply for only a limited period, say two years, the impact is more likely to be that house prices would be lower than they would otherwise be, thus boosting demand. In this instance the response is likely to be an increased level of housebuilding.

The cost of the lower VAT rate has been estimated initially based on 2013 transactions for new properties and the corresponding prices, according to the Property Price Register. The analysis estimates the proceeds from VAT at almost €80 million, based on the total of 3,674 new dwellings transacted in 2013. Assuming a lower VAT rate of 9% the loss of revenue would be €26 million. Based on an estimated 5,000 transactions in 2014 the corresponding VAT revenue would be €122 million based on a VAT rate of 13.5%. Thus, assuming the same volume of transactions, the lower VAT rate of 9% would result in a loss of €40 million of tax revenue. Assuming a further 6,500 new dwellings were transacted in 2015 and 8,500 in 2016; the lower VAT rate would reduce VAT

revenues by around €58 million and €81 million respectively in each year.

The core benefit is the positive signal the measure sends to house builders and house buyers. The impact in terms of encouraging a higher level of housebuilding than would otherwise materialise is difficult to predict. But based on the total VAT revenue in the period 2014-2016, the loss of revenue is equivalent to 7,139 units or 2,380 units per year. Any additional units provided over and above the 20,000 transactions projected for the period 2014-2016 would generate additional VAT plus there would be the additional income generated in terms of development levies and employment taxes by the increase in the construction workforce. There would also be further indirect and induced impacts through multiplier effects which would result in other economic benefits across the economy as a whole.

**8.5 MEDIUM TO LONGER TERM STRATEGIES**

A number of strategies are recommended for the longer term.

**Option 13: Restore full Interest Relief on Borrowings to 100% and amend the tax legislations to link the availability to compliance with a number of the provisions of the Residential Tenancies Act 2004.**

In 2009, amendments were introduced under which the deduction for interest on loans taken out to purchase, improve or repair residential letting premises (but not commercial letting premises) was limited to 75% of such interest. Consideration should be given to reinstating full interest relief for the overall sector (to achieve equity with the commercial letting sector).

The tax legislation should be amended to link the availability of interest relief on borrowings not only to registration of the letting with the PRTB, as it currently does, but also to compliance with certain of the provisions of the Residential Tenancies Act 2004. Points to note are:

- This legislation limits rent reviews to once in a 12 month period and then incorporates appeal provisions. This measure supports rental stability.
- The legislation requires strict terms in relation to Part 4 tenancies and periods of notice and termination.
- This change would have to be accompanied by legislative changes to allow the PRTB to notify

Revenue of situations where there has been a lack of compliance.

- This change might be accompanied also by a reinstatement of the interest relief to 100 per cent of interest on borrowings to incentivise compliance.

Any such measures will need to be communicated clearly. The amendments may reinforce the existing rent stability measures in the absence of formal rent control measures.

This measure would require the PRTB to work closely with Revenue regarding compliance.

#### **Option 14: Funding Strategy for the Voluntary Housing Sector**

Although not strictly a rent stability issue, there needs to be a clear funding strategy put in place for the non-profit housing sector by exploring all options using CALF to ensure it can play its role in addressing the shortage of social housing supply. This will be expanded on in the second study which will deal with supply side issues.

#### **Option 15: Implement the supply side measures in Construction 2020 immediately to ensure a more balanced housing sector.**

Related to the previous issue and again more in terms of housing supply, the relevant measures in *Construction Strategy 2020* should be implemented as soon as possible.

## **8.6 SUMMARY OF OPTIONS**

Table 8.1 sets out the options, their pros and cons and their expected cost to the Exchequer, where these can be determined. The approach is to implement those which have a minor or no associated cost immediately and follow with those which have a cost, prioritising the rent supplement measures in this group.

Table 8.1: Summary of Rent Stability Options

RENT STABILITY OPTION	PROS	CONS	IMPACT ON RENT STABILITY	COST TO EXCHEQUER €M
<b>SHORT TERM OPTIONS</b>				
<b>1. PROVISION OF MARKET INFORMATION</b>				
a) Increase data gathered from PRTB registration process	<ul style="list-style-type: none"> <li>Greater awareness of rents and quality of accommodation (BER ratings, age of building) may allow tenants to successfully challenge rent increases.</li> </ul>	<ul style="list-style-type: none"> <li>Increased awareness may lead to more rent review disputes by tenants</li> </ul>	Low	Nil
b) Quarterly rental publication plus online mapping tool.	<ul style="list-style-type: none"> <li>Greater awareness of rents may allow tenants to successfully challenge rent increases if they are excessive.</li> </ul>	<ul style="list-style-type: none"> <li>Increased awareness may lead to more rent review disputes by tenants.</li> </ul>	Medium	Nil
c) Increase awareness of PRTB, rents, rights and obligations.	<ul style="list-style-type: none"> <li>Greater awareness of rights may allow tenants to successfully challenge rent increases.</li> <li>A more educated tenant which may result in more disputes ruling in favour of the tenant</li> </ul>	<ul style="list-style-type: none"> <li>Increased awareness may lead to more rent review disputes by tenants.</li> </ul>	Medium	Nil
<b>2. REVIEW OF RENTS</b>				
a) Extend notice period for rent increase to 3 months	<ul style="list-style-type: none"> <li>Allow the tenant more time to assess the market</li> <li>Allow the tenant more time to collate information and data if they wish to seek a review.</li> </ul>	<ul style="list-style-type: none"> <li>No impact on the level of rent sought</li> <li>Potential destabilising effect on security of tenure of facing notice of a rent review after 9 months rather than 11 months</li> </ul>	Low	Nil
b) Landlord should provide details of three comparable properties to justify rent increase where possible	<ul style="list-style-type: none"> <li>Seeks to ensure that landlords do not attempt to increase rent based purely on trends in the market</li> <li>Allows consideration of the quality of accommodation on offer</li> <li>Useful in rural areas, where there is likely to be a lack of suitable information available from the PRTB</li> </ul>	<ul style="list-style-type: none"> <li>No impact on the level of rent sought</li> <li>May not be possible in certain locations</li> </ul>	Low	Nil
c) Due weight to PRTB data in disputes	<ul style="list-style-type: none"> <li>May dampen rent increases as other sources, notably, asking rents are higher than the average market rent</li> </ul>	<ul style="list-style-type: none"> <li>No impact on the level of rent sought</li> </ul>	Low	Nil
<b>3. RENT SUPPLEMENT</b>				
a) Review Rent Supplement limits in line with market rents based on market share.	<ul style="list-style-type: none"> <li>Aim to provide a market share of properties.</li> <li>Reduces risk of homelessness.</li> </ul>	<ul style="list-style-type: none"> <li>RS generally seen as a pricing floor by landlords.</li> <li>Will increase the overall average market rent.</li> </ul>	Medium	€16.5m

b)	Review Rent Supplement rent limits every 12 months	<ul style="list-style-type: none"> <li>▪ Aim to ensure rents move in line with the market.</li> <li>▪ Consistent with the Residential Tenancies Act 2004</li> </ul>	<ul style="list-style-type: none"> <li>▪ RS generally seen as a pricing floor by landlords.</li> </ul>	Low	Impact on Exchequer will depend on review of rents (upwards or downwards)
c)	Extend the Interim Tenancy Sustainment Protocol (ITSP)	<ul style="list-style-type: none"> <li>▪ Increases security of tenure for tenants</li> <li>▪ Will reduce homelessness</li> <li>▪ Aligned with Section 38 of the DSP Social Welfare Regulations 2007</li> </ul>	<ul style="list-style-type: none"> <li>▪ No impact on the level of rent sought</li> </ul>	Low	Only in place since June 2014
<b>4. TAX INCENTIVES FOR RENT SUPPLEMENT/HAP TENANCIES</b>					
a)	CGT relief for landlords where letting for minimum of 5 years to Rent Supplement/HAP tenants – Relief will be for time of letting to tenant – not absolute exemption	<ul style="list-style-type: none"> <li>▪ Provides incentive to let to HAP tenants</li> </ul>	<ul style="list-style-type: none"> <li>▪ Might not have perceived benefit for landlords who bought since 2004 due to property price deflation</li> </ul>	Medium	Cost depends on a number of factors but is deferred.**
b)	100% Interest Relief on borrowings for landlords letting for minimum of 5 years to Rent Supplement/HAP tenants	<ul style="list-style-type: none"> <li>▪ Provides incentive to let to HAP tenants</li> </ul>	<ul style="list-style-type: none"> <li>▪ Unavailable to landlords who have no borrowings</li> <li>▪ May distort market in favour of HAP tenants</li> </ul>	Medium	€27.5m
<b>5. INCREASE SUPPLY OF RENTAL PROPERTIES</b>					
a)	Extension of Living City Initiative to Landlords	<ul style="list-style-type: none"> <li>▪ Areas covered by relief are perhaps very suitable for provision of rental residential accommodation</li> <li>▪ Extension of relief to investors into sector may allow for access to existing disused stock that is not compliant with housing regulations.</li> <li>▪ Focus is on cities where there is a shortage of supply.</li> <li>▪ Allows conversion of non-residential dwellings into residential uses</li> </ul>	<ul style="list-style-type: none"> <li>▪ EU State aid approval required – this is ongoing for existing scheme</li> </ul>	Low	€17M annually net cost
b)	Rent a Room relief	<ul style="list-style-type: none"> <li>▪ Revenue has indicated that there may be 4,073 claimants of relief based on review of Forms 11 and 12. Information likely to be incomplete</li> </ul>	<ul style="list-style-type: none"> <li>▪ Tenants not subject to Residential Tenancies Act 2004</li> <li>▪ Tax free threshold has the potential to</li> </ul>	High	NIL

	<ul style="list-style-type: none"> <li>▪ Potential short term immediate supply response.</li> <li>▪ Incentivise use of space in existing properties in the short term until the supply side is addressed.</li> <li>▪ No reduction in limits proposed but more information required to be publicised.</li> </ul>	limit the rate of increase in rents.		
c) Reduce commercial rates for residential units above commercial premises	<ul style="list-style-type: none"> <li>▪ Encourages use of overhead premises for residential purposes</li> <li>▪ Focus would be on cities where there is a shortage of supply.</li> </ul>	<ul style="list-style-type: none"> <li>▪ State Aid issues</li> </ul>	High	Cost would depend on the exemption or rebate. If the exemption route is applied – with the residential portion not being subject to commercial rates – then LPT might provide some compensation.
d) Reduce VAT on new housing construction as opposed to sale from 13.5% to 9% for a 2 year period.	<ul style="list-style-type: none"> <li>▪ Time limitation to provide incentive to increase supply.</li> <li>▪ This form of incentive has shown to be successful in hospitality sector.</li> </ul>	<ul style="list-style-type: none"> <li>▪ EU rules to be considered – may not be possible.</li> <li>▪ Supply side measure like this may be undermined by lack of bank funding for investors/ lack of investor appetite</li> </ul>	Medium	Cost – €40m to €60m in a full year depending on new house completions.
<b>6. PROTECTING EXISTING STOCK</b>				
a) Code of Conduct on BTL mortgage arrears:	<ul style="list-style-type: none"> <li>▪ Set out the rules of engagement between the lender and the landlord and tenant.</li> <li>▪ Fully adhere to the requirement of the Residential Tenancies Act 2004.</li> <li>▪ Ensure that the requirements of landlord and tenant law become an explicit consideration in the receivership and repossession processes.</li> <li>▪ Safeguard the private rented sector from volatility arising from a</li> </ul>	<ul style="list-style-type: none"> <li>▪ Legislative implications of recommendations</li> </ul>	Low	NIL

	higher scale of repossessions and receiverships.			
<b>7. VOLUNTARY RENT CERTAINTY LEASE</b>				
a) Introduce Rent Certainty Lease	<ul style="list-style-type: none"> <li>▪ Rent certainty</li> <li>▪ Voluntary arrangement between tenant and landlord</li> <li>▪ Less voids for landlord</li> <li>▪ Assists long term renters</li> </ul>	<ul style="list-style-type: none"> <li>▪ Information needs to be publicised.</li> <li>▪ May reduce mobility in the sector.</li> <li>▪ May require supply incentives.</li> </ul>	High	NIL
<b>8. OTHERS</b>				
a) Freeze removal of tenant's Tax Relief for low income tenants at 2013 levels to 2017	<ul style="list-style-type: none"> <li>▪ Provides small measure of relief to low income tenants who are suffering rent increases</li> </ul>	<ul style="list-style-type: none"> <li>▪ May have little real impact on affordability as worth €200 to €400 per annum – higher for individuals over 55.</li> </ul>	Low	€10.2m
<b>9. MEDIUM – LONG TERM OPTIONS</b>				
a) Restore full Interest Relief on borrowings to 100%	<ul style="list-style-type: none"> <li>▪ This is to incentivise investors into the market by non-cash buyers/ funds</li> <li>▪ To equalise the tax treatment with the commercial sector</li> </ul>	<ul style="list-style-type: none"> <li>▪ Cost and current budgetary constraints are the main downsides</li> <li>▪ May encourage property price appreciation.</li> </ul>	Medium	€112M per annum per comments from DOF, based on Revenue study of 2012.
d) Implement supply side measures in Construction 2020	<ul style="list-style-type: none"> <li>▪ Should promote new supply</li> </ul>		Medium	N/A
e) Clear funding strategy for the non-profit housing sector	<ul style="list-style-type: none"> <li>▪ Should promote new supply</li> </ul>		Low	N/A

\*\* Difficult to quantify but estimated at €26,000 per unit on the basis of a unit purchased in 2002 for €210,000 and sold in 2020 for €500,000.

## APPENDIX 1: RENT SUPPLEMENT LIMITS

Table A.1: Current Rent Supplement Rent Limits as of June 2013

County	Single person sharing	Couple sharing	Single person	Couple no children	Couple with 1 child or one-parent with 1 child	Couple with 2 children or one-parent with 2 children	Couple with 3 children or one-parent with 3 children
Carlow	€230	€250	€375	€433	€520	€560	€590
Cavan	€160	€190	€325	€350	€400	€415	€433
Clare	€190	€210	€320	€350	€400	€450	€500
Cork	€250	€270	€485	€575	€700	€725	€750
Donegal	€175	€200	€300	€325	€350	€400	€450
Dublin- Fingal	€300	€350	€520	€700	€850	€900	€950
Dublin - other	€350	€400	€520	€750	€950	€975	€1000
Galway	€280	€300	€475	€540	€700	€725	€750
Kerry	€190	€220	€365	€390	€500	€520	€540
Kildare	€250	€300	€433	€500	€650	€700	€750
Kilkenny	€200	€230	€390	€430	€540	€565	€590
Laois	€200	€230	€340	€350	€450	€480	€520
Leitrim	€175	€195	€300	€325	€350	€375	€400
Limerick	€200	€240	€375	€400	€500	€550	€600
Longford	€160	€175	€290	€300	€325	€340	€350
Louth	€215	€250	€390	€400	€550	€575	€600
Mayo	€195	€215	€375	€390	€433	€465	€500
Meath	€200	€260	€390	€420	€550	€600	€650
Monaghan	€180	€190	€300	€350	€400	€433	€450
Offaly	€200	€220	€360	€400	€450	€475	€500
Roscommon	€200	€220	€300	€325	€400	€410	€425
Sligo	€195	€220	€400	€425	€520	€540	€550
Tipperary	€195	€220	€370	€400	€485	€500	€525
Waterford	€220	€240	€375	€390	€475	€500	€525
Westmeath	€190	€210	€390	€400	€500	€520	€530
Wexford	€250	€270	€375	€390	€500	€540	€575
Wicklow	€240	€290	€425	€450	€600	€610	€625
Wicklow (Bray Area)*	€275	€300	€520	€680	€850	€925	€1,000
North Kildare Area**	€270	€290	€500	€575	€750	€800	€850

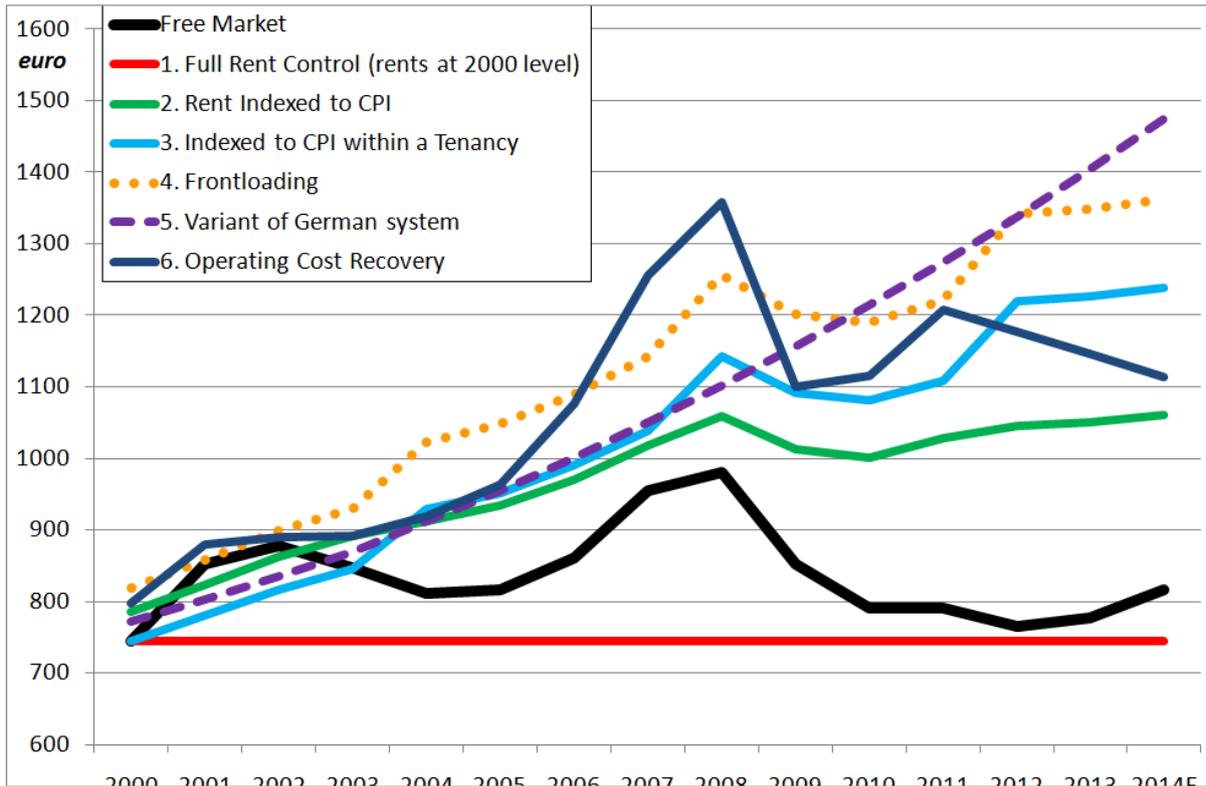
Source: Department of Social Protection

\* These limits apply to the towns of Bray, Delgany and Greystones only. All other areas in Wicklow are subject to the Wicklow limits. \*\* These limits apply to the towns of Kilcock, Maynooth, Leixlip and Celbridge only. All other areas and towns in Kildare are subject to the Kildare limits.

## APPENDIX 2: RENT REGULATION SCENARIOS IN THE NATIONAL MARKET

The following chart shows the impact of the rent regulation option examined in the national market. The trends are very similar to the trends discussed for Dublin in Section 7, albeit absolute rents are lower.

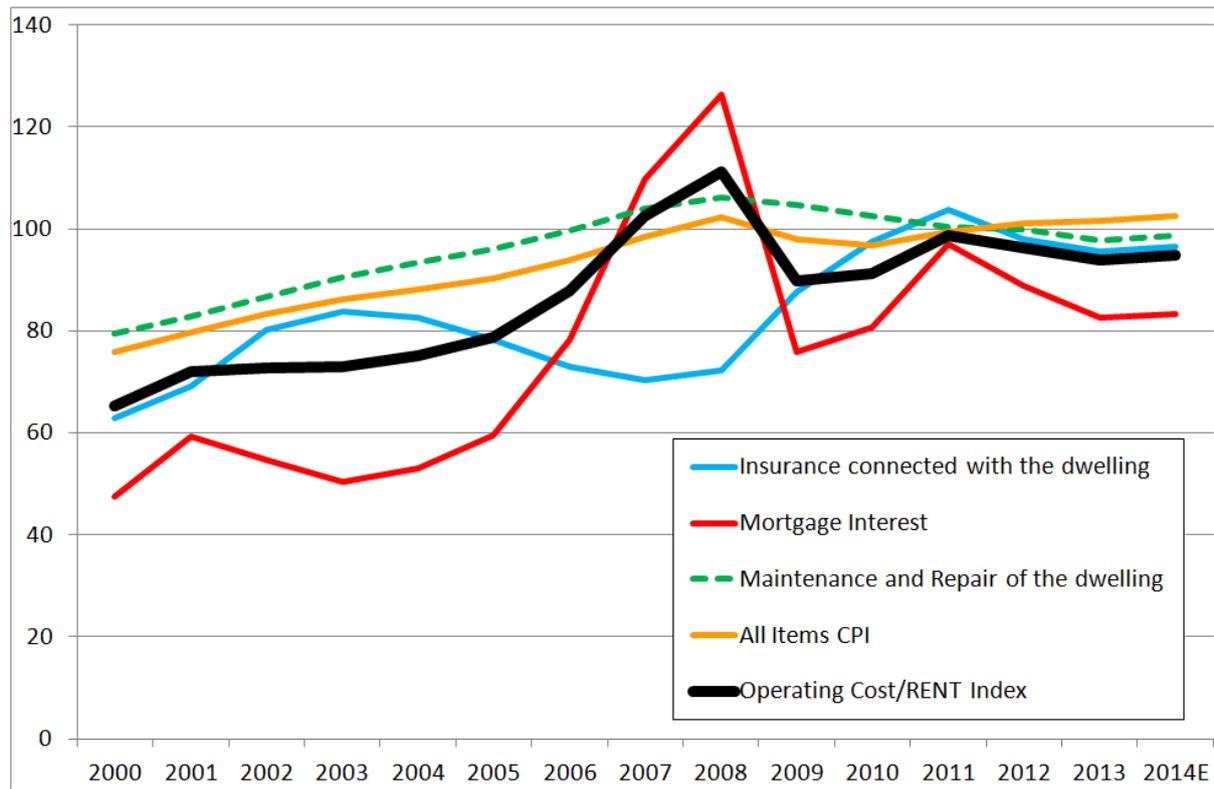
**Figure A.2: Rent Regulation Scenarios in the National Market, 2000-2014E**



## APPENDIX 3: COMPOSITE RENT INDEX FOR THE OPERATING COST RECOVERY RENT INDEX

The following chart shows the trend in each component of the operating cost Index over the period 2000-2014 against the overall composite rent index, which is used to determine rents.

**Figure A.3: Composite Operating Cost Index for Landlords, 2000-2014E**



Source: CSO



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