

# Rent stabilisation: Principles and international experience

A report for the London Borough of Camden



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London faces a housing crisis. For a long time, people on low incomes have been struggling with the cost and quality of housing. But it's now so acute that, in my role as Leader of Camden Council, even senior people in multinationals raise with me regularly the issue of housing for their staff.



There is no single solution and tackling this crisis needs a diverse set of interventions. We're a local authority and don't control all the levers. However, we can stimulate debate. This is why I commissioned the London School of Economics, led by Professor Christine Whitehead OBE, to advise on what can be done in London to influence quality and price in the private rented sector without adversely affecting the supply.

A third of our residents in Camden live in privately rented homes, and it's not just young professionals and students, more and more families are moving into the sector. This means more people have no long-term security – something that becomes more important as their children settle in at local schools and they become part of the community. But the sums just don't add up. The average house price is £700,000, which would require a household income of £175,000 to get a mortgage. The average weekly rent for a two bedroom property is £440. The average family needs an annual income of £70,000 to afford a modest lifestyle and the high rents in the borough. The median income is £33,000.

We are acting to improve quality where we can. We want to enable landlords to run a successful business. We administer the London Landlord Accreditation Scheme on behalf of all 33 London boroughs and help landlords provide a quality service through training and support. We think the scheme could have even more benefits for Londoners by introducing rent certainty.

While rent stabilisation could never be the solution by itself, we hope this will spark debate and lead to action to prevent many areas of our city becoming unaffordable for a whole section of society.

**Councillor Sarah Hayward**  
**Leader of Camden Council**

# Executive summary



## Background: the aims of the project

This research was carried out on behalf of the London Borough of Camden. The council is concerned that local residents are increasingly being priced out of local accommodation and wishes to contribute to the national debate on how to organise a better private rented sector for both tenants and landlords.

Camden is atypical even for London, as roughly one third of its households rent privately, one third are in social rental and one third are owner-occupiers. Rents in the borough are very high and rising faster than in most of the rest of London. Security of tenure is very limited and standards often poor. Only 14% of private tenants receive housing benefit (compared to around 25% in the country as a whole), suggesting that the borough's lower-income tenants are concentrated in social housing.

It was in this context that Camden asked us to examine principles and international evidence around the benefits and costs of rent stabilisation for both landlords and tenants, and to recommend possible models.

Our methodology included a detailed literature review of theory and evidence; an analysis of rent stabilisation models used in several countries, looking particularly at the impact on tenants and landlords; a review of some current practice in London; interviews; and a roundtable discussion, bringing together stakeholder experience and views on our recommendations. The research team would like to thank those who so generously shared their time and knowledge with us throughout the project and especially at the roundtable.



## Findings: the literature

Economic principles suggest that traditional rent freezes (often called first generation rent controls) work badly, especially over the longer-term. They lead to immobility, poor quality housing in the sector and incentives for landlords to transfer to other tenures if possible. Almost all countries that have had such controls have either liberalised their systems completely (the UK) or limited their purview to rent increases within tenancies (often called rent stabilisation).

Rent stabilisation schemes vary in their detail but generally aim to provide greater certainty to both landlords and tenants within the period of the lease while taking account of market pressures at the beginning of the tenancy. The objective is not therefore to hold down returns but rather to reflect longer-term trends.

There are good reasons why landlords as well as tenants (and indeed in some cases rather more than tenants) might be happy to agree to a form of rent stabilisation linked with longer-term tenancies. Institutional investors in particular could benefit from a system where initial rents are set by the

market but increases within tenancies are index-linked, as this would provide low risk income that matches their liabilities. Tenant turnover, with its many associated costs, would also be reduced. On the tenants' side, those who want longer-term tenancies and predictable rents would find this type of contract attractive.

Incentives for other types of landlord can be very different. In the UK in particular, many smaller landlords aim to secure capital gains and therefore require certainty of vacant possession. They cannot spread risk across a portfolio of properties, making it harder for them to accept a long-term commitment. Finally, those dependent on mortgage finance must obey their lenders' terms and conditions, and most currently rule out longer-term lets.

The most obvious lesson from the literature is that regulatory systems must address a range of other factors in addition to rents. These include security of tenure and procedures for eviction and sale, as well as standards and transactions costs. What works in one country with one set of institutional arrangements may well make things worse in another.

## Findings from other countries

We examined the evidence from six other countries with widely differing regulatory frameworks, as well as more general European evidence. Three main messages emerged: most countries have stronger regulations about rent rises within tenancies than the UK; in many countries there have been increasing pressures on private renting especially since the financial crisis; and in these countries, whatever the basic level of regulation, there has often been political pressure to increase controls in the face of rising demand.

## Germany: the example of good practice?

Germany is currently seen, especially by foreign commentators, as the best exemplar of rent stabilisation. Nearly 50% of households rent privately. Most have to make significant investment in the dwelling through bathroom and kitchen furniture and equipment, making it more obviously their home but also increasing the costs of moving. Rent increases within the tenancy are linked to specified indices. Initial rents can be set up to 20% above comparable rents in the area (in some cases

up to 50%), giving comfort to the landlord in case of unexpected changes in costs not covered by the index. Security is indefinite but eviction procedures are relatively well defined. Importantly, general inflation has been very low and real house prices had been falling since the 1980s in many areas.

However, since 2008, and indeed earlier in some cities (notably Munich), the situation has changed. Landlords have faced unexpected costs, particularly because of stricter energy efficiency requirements. House prices have been rising rapidly with commensurate increases in owner-occupation. The atmosphere in terms of eviction has become more toxic. Most importantly it is becoming increasingly difficult to access private rented accommodation in cities with buoyant markets. As a result, political pressure is growing for stronger rent controls in major cities (an important factor in the latest elections). Concerns are also growing about how any increase in controls might make it harder for working households to find accommodation and could constrain investment.

## Denmark, France, the Netherlands, Ireland, USA

Denmark provides an example of one extreme with tenure specific properties and complex regulation, both national and local. Deregulation with respect to new investment has brought little response except from owner-occupiers letting for short periods.

There have been pressures to increase controls in a number of European countries – notably the Netherlands, where there will be no increases in regulated rents for at least the next two years, and France, where legislation has been passed (although not yet implemented) that would control both initial rents and rent increases in some cities.

In Ireland, where the sector remains small and deregulation had been almost complete, the introduction of some element of rent stabilisation at approximately market levels, together with longer-term tenancies and stronger controls on standards, appears to have produced a more stable market. Since its introduction, however, investment in the sector has come mainly from those unable to sell their owner-occupied homes.

Evidence from New York and San Francisco, two high-demand US cities, shows that those living in rent stabilised apartments generally remain for

considerably longer than those living in units whose rents are not controlled. Nonetheless, it tends to be well off households who benefit from the system, while those trying to enter the market face worse conditions than they otherwise would.

Overall, the international evidence suggests that while both tenants and landlords can benefit from rent stabilisation under particular conditions, the impact depends upon broader housing market conditions. These systems also tend to become less flexible over time and to favour established tenants over new entrants.

## Conclusions and recommendations

The benefits of a mandatory rent stabilisation scheme are that all tenants would in principle be treated equally; tenants would have greater security; and there would be greater predictability for both landlords and tenants. Where both sides are comfortable with these arrangements, transaction costs and risks should fall. However mandatory systems also impose costs and these could well outweigh these benefits. These include:

- tenants and landlords have diverse requirements, so a one-size-fits-all system would not benefit everyone and would be difficult to implement;
- in order to provide adequately for landlords, rent stabilisation will often result in higher initial rents and more regular rent increases for tenants;

- potential tenants may find it more difficult to find accommodation as landlords look for ‘good’ tenants;
- landlords state that they look for a stable regulatory environment. Many would perceive the discussion of rent stabilisation as the first step towards further regulation. Especially in high demand and pressured areas, anything that reduces supply is highly undesirable – as is now becoming strongly evidenced in Germany.

Our **recommendation** is therefore that Camden should positively enable longer-term tenancies with index-linked rent increases, voluntarily agreed by landlord and tenant, while at the same time improving transparency and contractual enforcement for both landlords and tenants across the sector. The German example as well as experience in other countries suggests that there are two main indices that could be used: either some measure of general inflation (such as CPI) or an index of local rents. The scheme would not necessarily have to specify which should be used, as long as landlord and tenant agreed. This voluntary approach could be an attractive part of the voluntary accreditation scheme for a sub-set of accredited landlords.



# 1. Background

## Reasons for the research

This research has been carried out on behalf of the London Borough of Camden. The council is concerned that local residents are increasingly being priced out of local accommodation and forced to leave the area — a process that will change the borough's demographic profile. They also wish to contribute to the national debate on how to provide suitable private rented housing to a wider range of tenants, how to ensure tenants get a better deal, and how to give good landlords the incentive to remain in the sector.

In this context, Camden has asked us to look at possible mechanisms for rent stabilisation and associated tenure arrangements, looking specifically at the principles behind stabilisation and evidence on how stabilisation approaches work in practice in other countries. This research was completed with a view to recommending a model that might protect tenants from extreme rent rises without disadvantaging landlords.

## Private renting in Camden: problems and issues

Camden is a central London borough and thus encompasses some of the most expensive residential property in the country; the median house price in the borough was £575,000 in 2013, and the lower-quartile figure was £387,500 (GLA 2014). It is also an area with a significant population of low income and vulnerable people. According to the 2011 Census, some 17% of households nationally live in private rented housing, and 25% in London — but the figure for Camden is 32%, an increase of 10% since 2001 and one of the highest in the country. Equally, Camden has over twice the national average proportion of households living in the social sector while slightly fewer than a third of Camden households are now owner-occupiers.

The borough has very high rents. Accurate data on private rents are notoriously hard to find, but the best information, collected by the Valuation Office to help determine Local Housing Allowance (LHA) caps, shows that median Camden rent in the year to 3Q2013 was £1,733 — up more than 8% in two years. The lower-quartile figure (£1,343) was not much less. Only Westminster and Kensington & Chelsea had higher rents. For comparison, the median rent for all of London was £1,300, and for England as a whole £595 (Valuation Office rent data).

About a quarter of Camden households receive housing benefit<sup>1</sup>. The great majority of these were in social housing; only 16% of all housing benefit claimant households (4,433) lived in the private rented sector, and of all private tenants only about 14% claimed housing benefit. This is much lower than the national figure, where more than 25% of households in private rentals claim housing benefit (English Housing Survey Table FT3231). Given the high rents in the area this low claimant rate reflects the relatively very high incomes of those renting in the Camden market.

In April 2011 housing benefit was replaced for new claimants by LHA. This is currently capped at £258 per week for a one-bed apartment and £413 per week for a four-bed unit. The cap on LHA has made it more difficult for Camden households in housing need to find accommodation in the private rented sector. Council figures show that in 2009/10, 84% of Housing Options and Advice (HOAS) placements were in the borough; since April 2011 this has fallen by over half to 35% (LB Camden 2013b).

<sup>1</sup>According to Council figures there were a total of 23,793 households claiming housing benefit in Camden, or 24% of the total of 97,534 households enumerated in the 2011 Census.

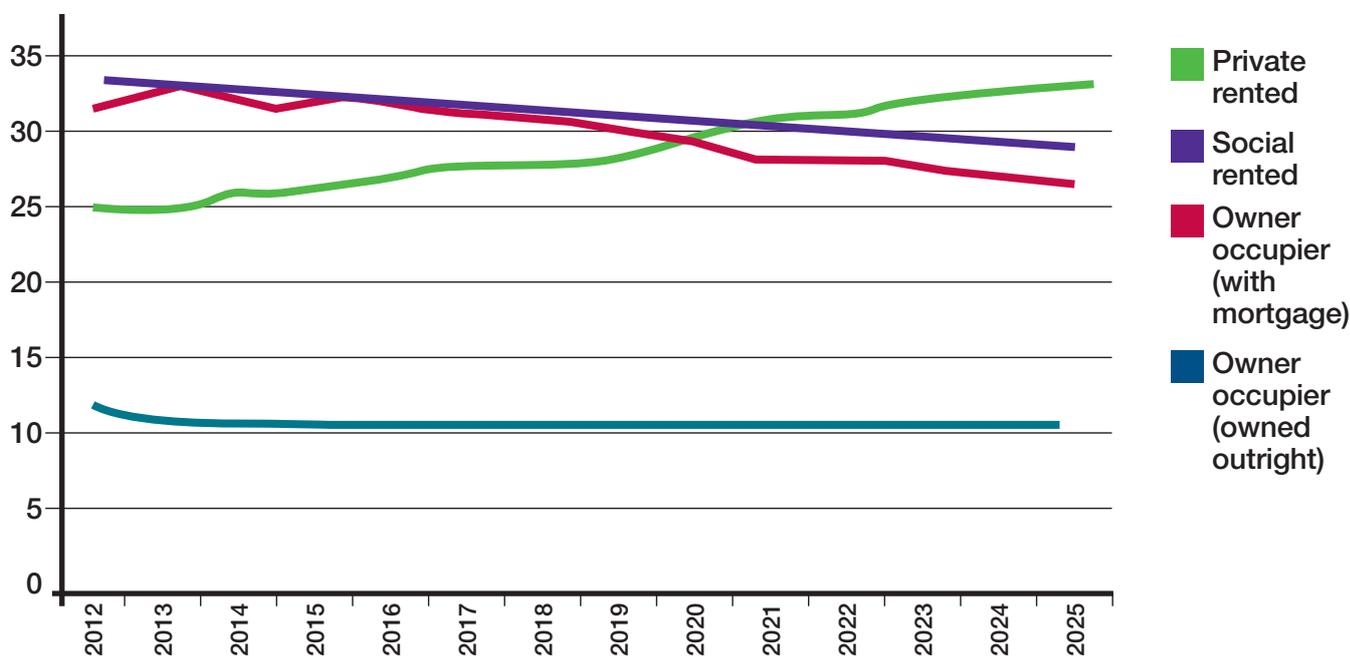
Evidently Camden is atypical of the country and indeed London in terms of the size of the social sector where many poorer households are housed; in terms of the size of the private rented sector which is comparable to both social renting and owner-occupation; and also in terms of the relatively small proportion of lower income tenants accommodated in the private rented sector.

Camden manages the increasingly important voluntary London Landlord Accreditation Scheme on behalf of the 33 London boroughs. The scheme complies with the London Rental Standard and some 12,000 landlords and 1,000 agents are now members. This group aims to provide good quality homes to their tenants while at the same time achieving an adequate risk-adjusted rate of return on their investment.

## The political context

Camden is one of the country's most unequal boroughs, housing both the very wealthy in the market sector and the very poor mainly in the social sector. The local authority is Labour-controlled. 'Maintaining the social mix of Camden is an explicit aim of the Council,' according to the Camden Equality Taskforce (2013). The council's private rented sector strategy, entitled A private rented sector that works for everyone. Year one: A call for change (LB Camden 2013), reinforces this. In it Councillor Sarah Hayward, leader of the council, says 'we have to take action to preserve what we all love so much about the borough — its unique social mix'. This report points out that 'increasingly working families are using private renting as a long-term solution due to a lack of affordable housing in London, raising their children in private rented homes' (p. 2). The strategy identifies three major areas for improvement: property standards, strengthening the voice of tenants, and increasing supply. Two of its eight specific goals are 'more security and better rights and conditions for private tenants' and 'a greater number of affordable private rentals'.

**Figure 1: Household projections by tenure: London families with dependent children**



Source: Whitehead et al (2012)

The private rented sector is also gaining political importance because of its increasing role in meeting long-term housing need for a growing number of families with children. In this context, figure 1 gives a graphic projection of how the private rented sector might, if past trends continue, become the most important provider of housing for Londoners with children over the next few years.

## 2. Research question and methodology

### Our research question was:

What does international evidence show about how it might be possible to ensure predictable rents, rent increases and security of tenure for Camden private tenants without disadvantaging landlords?

### Our sub-questions were:

- What do economic principles say about rent control and rent stabilisation?
- What models of rent control and rent stabilisation have been employed internationally, and what effects (positive and negative) have they had for landlords and tenants?
- What risks do rent stabilisation models entail?

Driving these questions are three distinct objectives which, in many cases, may be at odds with one another: providing adequate secure accommodation for lower income households already living in the private rented sector; enabling similar households not already living in the borough to find suitable accommodation in Camden; and not disadvantaging landlords to the point where supply to lower income households is reduced.

In this context it should be recognised that at the moment only about 4,500 private tenants in the borough receive housing benefit. The level of the rent cap, which ranges from £258 to £413 per week, implies that households on well above average incomes are eligible and included in this number. Thus, even now, relatively few households on limited incomes are able to live in the private rented sector in Camden.

### Methods

#### We used a mixed-methods approach for this research:

- a. First, we conducted a literature review of theory and evidence on the effects of different forms of rent stabilisation;
- b. Second, we analysed some of the models used in other countries, showing how various forms of rent stabilisation affect tenants and potential tenants as well as landlord returns and risks in different circumstances;
- c. Third, we researched rental contracts currently available in London and carried out interviews with major landlords, the Greater London Authority and the Homes and Communities Agency;
- d. Fourth, we hosted a roundtable discussion at the London School of Economics with stakeholders from Camden, elsewhere in London, and central government.



# 3. The economics of rent regulation



## Economic principles

The main economic reason for introducing regulation is that the market in question is operating badly – i.e., there is market failure arising from market power; lack of information and asymmetry in that information; external costs or benefits from the provision of the good; dynamic problems in ensuring adequate investment; and/or issues around risk and uncertainty. The housing market is susceptible to many of these problems, particularly because of the contractual relationship between landlord and tenant and because it is difficult to adjust supply rapidly in the face of changing demand.

Regulation may also be introduced for reasons of equity and distribution. In particular because housing is both costly and a necessity of life, regulation may be introduced to make housing more secure and affordable. In these circumstances there will often be a tension between helping tenants and protecting returns to landlords, and an emphasis on the former can result in lower investment and increasing pressure on rents. In this environment it is often necessary to introduce other subsidies or forms of provision such as social housing where market returns are not required.

In some circumstances – e.g., if information to both landlord and tenant is improved, contracts are made more transparent and easy to enforce, risks are reduced and/or constraints on investment overcome – both landlord and tenant may gain from the intervention. In such cases supply will increase and rents may be lower (or there may be additional demand for the better product). In other circumstances, the effect of regulation is to

control rents below market levels and/or to provide greater security of tenure or other benefits to tenants, which reduce returns or increase risks to landlords. In this case the results will be a reduction in supply; pressure to avoid or evade the regulation; immobility and under-occupation of poor quality, ill-maintained properties; and higher rents and worse housing for those excluded from the market.

Clearly, good regulation should benefit both landlords and tenants, providing a more secure investment for landlords and investors and offering greater security and better quality housing to tenants. This is the ideal. Bad regulation, on the other hand – even if it is imposed with good intentions and may provide short term benefits – results in disincentives to supply rented accommodation, insider/outsider issues for tenants, and ultimately worse conditions for everyone.

The main rationale for regulating rents, tenure security and evictions in the private rented sector has usually been the failure of supply to adjust as rapidly as demand. When for one reason or another demand increases, rents rise often well above the longer-term costs of provision. In these circumstances landlords make excess profits and there is political pressure to even the playing field so that tenants are not being disadvantaged. In addition, there are usually major issues of asymmetry and power inherent in a contract where neither side has full information. These problems become more extreme in times of scarcity or when the distribution of income is uneven. The argument then tends to be that since landlords are making excess profits, limiting rents will not adversely affect supply.

The literature is full of very strongly held opinions about how and why private renting works or does not work in different housing markets – and especially about the extent to which this is determined by regulation in general and rent control in particular. Many commentators, especially market-oriented economists, citing evidence of post-war decline in private renting and of poor conditions in what remains, argue that regulation has been almost wholly bad, not only for landlords but for tenants. Others, usually more governance-oriented, point to countries where large, well operating private rented sectors provide for the full range of housing requirements - and suggest that they work better as a result of strong and stable regulation.

## Forms of rent regulation

Rent regulations are specific rules governing the rent that a landlord is allowed to charge for the disposition of a property. There are two main forms, which may be used together or separately. The first is to control rent levels across the board - for both new and existing tenancies - by imposing a legal maximum (rent ceiling) on the rent in a particular housing market, which is below the market's equilibrium rent. The second is the control of rent increases.

In this context Arnott (1995, 2003) identifies 'three generations of rent control'. The first generation is the control of rent levels; the second controls rents after initial lettings and the third controls rent increases within each letting.

**'First generation'** rent control – control of rent levels

Arnott's 'first generation' or 'hard' rent control restricts the level of rents across either the whole of the private rented sector or a separable and defined element of it. 'Rent freezes' lead to a significant fall in real rents if rents cannot be adjusted upward to offset inflation and increasing housing costs (Arnott, 1995, 2003). They also generate incentives for landlords to leave the sector, especially if there are related but uncontrolled sectors such as owner-occupation and lodgings to which the properties can be transferred. Further they reduce the incentive to invest in repair and improvement. On the other hand, they give tenants an incentive to stay even when their housing needs change, and give both landlords and potential tenants an incentive to avoid and evade the law.

From the 1960s onwards, particularly after the energy crisis of 1973, the ensuing rapid inflation and the introduction of housing allowances, more flexible second generation rent control – or 'soft' rent control - was introduced across much of Europe. Even so, whenever rent control or stabilisation is discussed much of the debate assumes that it would be 'hard' controls that would be introduced (see for instance much of the commentary on Ed Miliband's recent proposals).

**'Second generation'** rent control – control of rent increases both within and between tenancies

The objective of second generation rent control is to allow some mitigation of cost increases for landlords and thus reduce their incentives to under-maintain their properties, while retaining some limits on the size of rent increases. These limits apply both to rent increases within a tenancy and to increases applied when renting to a new tenant. There have been many variants of second generation controls in terms of their restrictiveness. Some countries have allowed landlords to cover some or all increases in costs, which might include taxes, operating expenses and financing charges. Others have indexed rents more or less to inflation. Even in the most restrictive systems, landlords have usually been allowed to amortise the costs of substantial improvements to the dwelling (Turner and Malpezzi, 2003). While this form of rent control limits the extent to which real rents fall over time, it may still generate significant incentives for landlords to disinvest, especially in an inflationary environment.

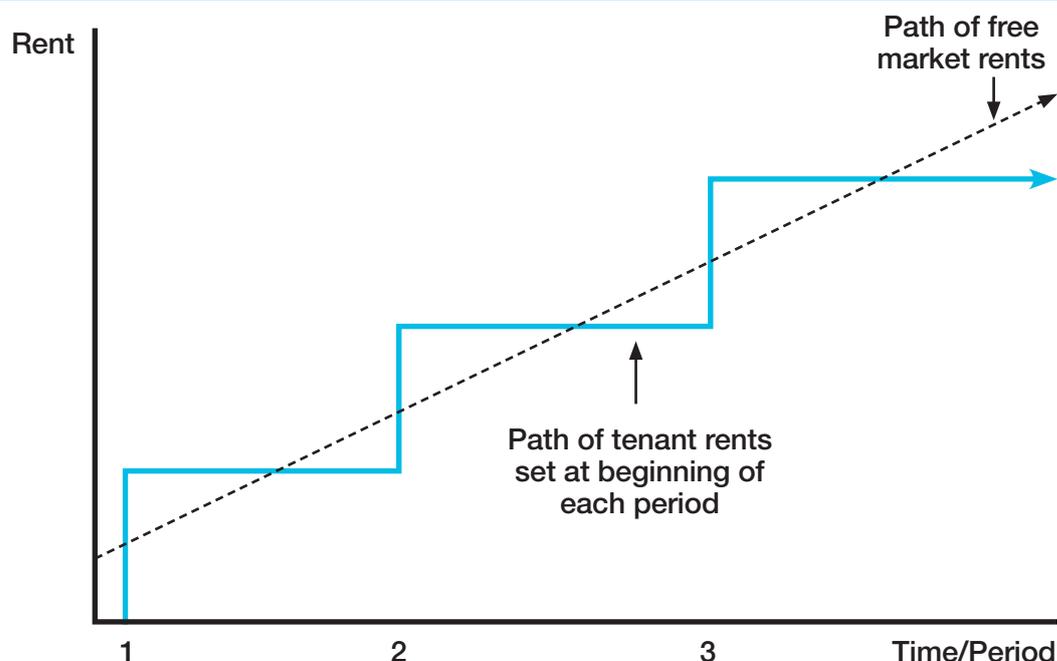
**'Third generation'** rent control – control of rent increases within tenancies

Third generation rent control is seen as the most market friendly. Rent increases are regulated within an individual tenancy but are either unlimited between tenancies or regulated under a more generous regime. In its pure form, third generation rent control implies market rent on a new lease but controls over increases within the tenancy; Arnott (2003) calls this 'tenancy rent control'. In principle this allows adjustment to market returns while protecting the tenant from unexpected rent increases and giving the landlord some security that cost increases are offset. It can be seen as a way of smoothing rent changes while maintaining a long-term rate of return which is competitive with other investments.

Figure 2 describes one form of third generation rent control which is consistent with full adjustment of supply to underlying market conditions. Here the path of market rents reflects long-run costs of provision. Because rents within the tenancy are determined administratively, initial rents will be set above long-run market levels and fall over the time of administrative determination. If predictions are correct about underlying market pressures and the administrative rules are transparent, this form of regulation can ensure the long-run equilibrium level of supply and the required rate of return over time – even for open-ended tenancies.

**Figure 2: The growth of rents under third generation rent controls**

Tenancy starts in period 1 and rents are reset each 'period' of, say, three years duration, at a time when market rents are rising strongly.

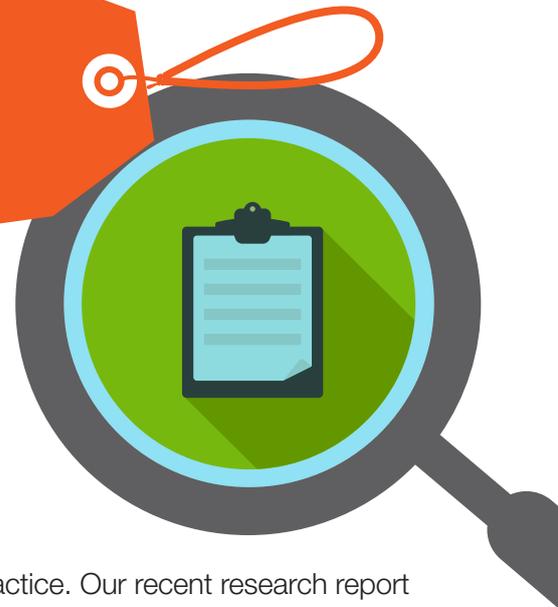


Source: Ball (2010) Fig. 4.

The impact of higher initial rents varies according to how long a tenant actually remains in a tenancy. Assuming market rents are rising faster than the index, tenants who stay longer than the average will end up paying 'too little' in rent and those who stay for a shorter period than average will pay 'too much'. A major benefit for many landlords is that controlled rents and rent increases reduce turnover and thus their transaction costs because of a reduced maintenance requirement and fewer vacancies. This 'turnover minimising' can bring not only consistent returns to landlords (Turner and Malpezzi, 2003) but also greater rent stability to tenants. There are however costs for landlords who want the option of selling with vacant possession.



## 4. Evidence from the literature



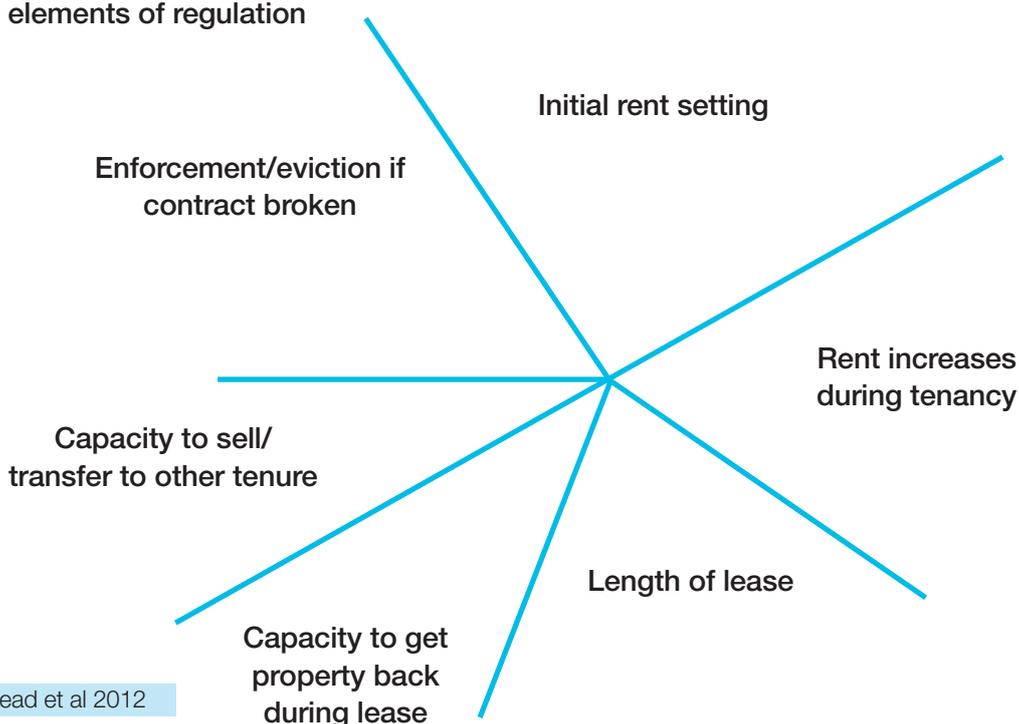
### On regulation

Historically there is a vast literature on rent regulation in both theory and practice. Our recent research report (Whitehead et al 2012) reviewed much of that literature on regulation and its impact on landlords and tenants. It also compared 11 European countries with respect to the forms of regulation in place and their apparent impact on the scale of private rental provision.

One of the most important findings from the research was that the complexity of regulatory systems makes it inappropriate simply to look at the nature of controls over rents. Figure 3 clarifies the most important elements which interact with one another to help determine outcomes. These can be summarised as:

- i. the way in which initial rents and rent changes during the tenancy are determined (which is the core element addressed in the literature on regulatory constraint);
- ii. the extent of security of tenure available to tenants and the impact this has on landlords' property rights. Security relates not just to length of lease, but also encompasses how easily tenants can extend their tenure, how easily landlords can gain vacant possession, and the right of the landlord to sell the property, whether tenanted or vacant; and
- iii. the mechanisms by which these regulations are enforced and their effectiveness.

**Figure 3: The elements of regulation**



Source: Whitehead et al 2012

The second major finding was that the proportion of private renting had declined in most of the 11 case study countries. Only in England has there been a really significant increase in proportional terms – starting not at the time of deregulation but from the mid-1990s when Buy to Let was introduced and particularly after the turn of the century when affordability and access to owner-occupation worsened. In a small number of countries the size of the sector has remained fairly stable – slightly increasing in Germany, Sweden and somewhat declining in Switzerland and France.

Third, looking to the current position on regulation, three countries – England, Finland and Norway – now have low levels of regulation while seven have medium regulation (Table 1). Within the latter group, three countries (Germany, Sweden and Switzerland) have regimes that have remained relatively stable over the period 1980 to 2010. France and the Republic of Ireland have seen increases in regulation, while Spain and Denmark have introduced less regulated systems. Only the Netherlands still has a strong regulatory regime, and even there rents on more expensive properties are now deregulated. Traditional rent control – nominal caps on rent levels – is hardly found today. Those countries that do combine strong rent regulation with sizable private rented sectors usually have systems that permit rents to adjust to near-market levels even though they are formally ‘controlled’. They also tend to have small social sectors and constraints on entry into owner-occupation.

**Table 1: Overview of regulation in the 2000s (latest available information)**

Country	Initial rent	Rent increases	Length of lease	Termination of lease	Selling property	Enforcement problems	General perception of regulatory framework
Denmark	Low	Medium	High	Medium	High	Medium	Significant
England	Low	Low	Low	Medium	Medium	Medium	Limited
Finland	Low	Low	High	Low	Low	Medium	Limited
France	Low	Medium	Medium	Medium	Low	High	Significant
Germany	Medium	Medium	High	Medium	Medium	Medium	Significant
Netherlands	High	High	High	Medium	Medium	Medium	Strong
Norway	Low	Medium	Medium	Low	Medium	High	Limited
Republic of Ireland	Low	Low	Medium	Medium	Low	Medium	Significant
Spain	Low	Medium	Medium	Medium	Medium	High	Significant
Sweden	Medium	Medium	High	Medium	Medium	Medium	Significant
Switzerland	Low	Medium	High	Medium	Low	Low	Significant

Source: Whitehead et al 2012

Another of our reports (Scanlon & Kochan [eds] 2011) looked at the broader lessons that the UK could learn from abroad, including the USA as well as Europe. This demonstrated that there is a wide range of approaches to regulation of the private rented sector; that regulation can be associated with well operating private rental markets (although there are also plenty of examples of bad regulation which worsened conditions for many households accommodated in the sector or excluded from it by regulation); that the majority of investors in all countries are individuals – but how long they remain in the sector varies greatly — with some investing for generations; and that the size of the sector depends fundamentally on other opportunities for both investors and households as much as on conditions in the sector itself.

## On institutional investors

Another important possible impact of rent stabilisation is how institutions might respond to its introduction. In our report for 'Homes for Scotland' (Whitehead & Scanlon 2013), we reviewed the literature and looked at the barriers to investment in private renting, and in particular, explored what institutional investors are looking for when they decide whether or not to invest.

### Four main messages relevant to the rent stabilisation issue came out of the interviews:

- **first**, institutional investors are looking for 'utility'-type, long-term investments – i.e., ones with near-certain, index-linked, low-risk returns (which implicitly must remove the risks of unexpected inflation or additional costs) that match their liabilities. This is why some representatives of the finance industry have said that in principle rent stabilisation could be a positive inducement to investment;
- **second**, their boards need to be convinced that the private rented sector will not generate reputational risks – they do not wish to be associated with bad landlords and bad management. This is one reason why accreditation schemes and professional management are seen as so important;
- **third**, they hate uncertainty – and any proposals for change in the regulatory regime create uncertainty (which is one reason why so many have expressed concern that the Miliband proposals will have negative effects);
- **fourth**, the other investors looking to be involved in private renting are housing associations, who might draw on money from sovereign wealth funds or institutional investors as well as debt finance. These landlords already have experience with longer-term leases with index-linked rent increases.

## Other landlords

It is important to remember that the vast majority of the private rented sector is owned by individuals and that therefore any regulatory system must take their interests into account. Some small landlords are hardly or not at all motivated by financial considerations, whereas others operate on a wholly commercial basis as small businesses. In general the evidence in the UK is that individual landlords are less interested in long-term income returns than in capital gains. This group is generally thought to be antipathetic to regulation, although it is clear that there are large numbers still prepared to let to housing benefit receiving tenants where rents are implicitly controlled through the caps on benefits.

## Summary

### Thus the literature suggests:

- (i) the general trend internationally has been towards deregulation, particularly with respect to initial rent determination. Equally, while there are examples of control of rent increases when tenants change, in the majority of countries it is only within-tenancy rent increases that are now regulated;
- (ii) the determination of rents is only part of any regulatory regime. In particular where there is any type of rent control or stabilisation there also tends to be long or indefinite leases or mandatory lease renewal, regulations to limit evictions to circumstances where the tenant has broken the agreement, and often restrictions on the ways in which landlords can dispose of their property;
- (iii) in most countries security of tenure is indefinite (in part because short-term arrangements are not seen as part of the sector);
- (iv) countries with large private rented sectors tend to have quite stable regulatory regimes - but they also often have constraints on transfer to other tenures;
- (v) only in the highly deregulated UK and Irish markets has there been rapid growth in the private rented sector. In both cases there are many other factors – especially in terms of what is happening in other sectors of the housing market – that have helped generate the expansion;

(vi) the vast majority of landlords in all countries are individuals rather than institutional investors. The former are more likely to value capital gains, while the latter generally seek predictable rental income streams;

(vii) the biggest concerns about regulation are that:

- controls over rents at the start of a lease may not allow landlords to make a business return;
- rigid rent adjustment systems may not accommodate unexpected changes in the value of the rental stream or in costs;
- tenure security and enforcement procedures may make it difficult and costly for landlords to obtain vacant possession when the tenant does not keep to the contract; and
- governments may continue to make changes in the regime as a result of political pressures.

All of these would apply to the introduction of rent stabilisation and would need to be addressed if any approach were to work effectively.



## 5. International evidence from specific regulatory regimes

This section sets out current regulations around rent levels, increases, and security of tenure in five European countries and two US cities. Table 2 provides summary statistics about the size of the private rented sector in each.

**Table 2: The proportion of households who rent privately**

Country/city	% of households in PRS (latest)
England	18
Camden	32
Germany	49
Netherlands	10
Ireland	9
Denmark	14
France	21
San Francisco	59*
New York	64*

\*rented dwellings as percentage of all dwellings

### Sources:

**England:** English Housing Survey, 2012;

**Camden:** 2011 Census;

**European countries:** Whitehead et al 2012 Figure 11;

**US cities:** 2010 US Census

## Germany

Germany stands out for the size of its rental sector — nearly 50% of households rent their homes, rising to almost 90% in Berlin. The bulk of rented housing is in private ownership, and most ‘social’ housing is actually privately owned but rented to low income households for a limited period as a condition of subsidy. Many middle income families in Germany consider their rented housing to be a permanent home, as the strong security of tenure and opportunities to customise accommodation

provide many of the features of owner-occupation in other countries.

## Rent regulations

In Germany rents on private rented housing can be freely set on initial letting, although charging rents ‘substantially higher’ than the average for similar properties (in practice more than 20% in most areas [Kemp & Kofner 2010]) is a criminal offence.

Rent rises within a tenancy are controlled. There are various ways of determining the permitted increase. The lease contract may specify an annual rent increase (Staffelmiete) or state that rents rise in line with a cost of living index, but these options are little used. In practice most rents go up by the average in the local area. There are three ways of determining this: first, by the mirror-rent tables (Mietenspiegel); second, by consulting a local expert; or third, by referring to rents for three comparable units in the same area.

The Mietenspiegel system was set up in 1982 as a way to provide objective empirical data about local rent levels. Mietenspiegel tables are produced in some 300 municipalities, and are updated every two years. They are based on data provided by tenants’ and landlords’ associations or, in bigger cities, on specially commissioned surveys. Data are gathered about dwelling characteristics and rent levels for rents agreed in the preceding four years. Some cities provide relatively simple tables relating rents to dwelling size and date of construction (see for example Cologne’s Mietenspiegel at <http://www.koeln.de/immobilien/mietenspiegel.html>). Others produce what are known as ‘qualified Mietenspiegel’; these are based on hedonic regression analysis and include a much greater range of variables<sup>2</sup>.

<sup>2</sup>See for example information about the most recent Mietenspiegel survey in Munich here: <http://www.muenchen.de/rathaus/Stadtverwaltung/Sozialreferat/Wohnungsamt/Mietenspiegel.html>

Rents can be raised at most once every 15 months, and by a maximum of 20% over three years unless the dwelling has been modernised or benefited from energy efficiency investment. In this case the landlord can charge 11% of the investment cost every year. Because this is one of the few ways landlords can achieve significant rent increases, it has led to a high level of energy efficiency investment in the German rented stock.

## Security of tenure

German leases are indefinite - the tenant generally has the right to remain in the dwelling until he or she dies. Fixed term contracts are only permissible in certain limited circumstances. On the death of a tenant the contract passes to the tenant's heir(s); the landlord is permitted to give notice and cancel the lease if the heir did not already live in the dwelling. On sale of dwellings the lease also binds the new landlord.

There are a few specific reasons for which the landlord is permitted to evict a tenant: if the tenant has rent arrears of three months or more; if they are causing a nuisance; or if the landlord wants to use the property for themselves or a relative to live in. The landlord's notice period in such cases depends on the duration of the tenancy, and is up to nine months. The tenant on the other hand can leave with three months' notice. Tenancies can be transferred to another tenant with the landlord's permission.

## How does it work?

German tenants and landlords expect properties to be rented for the long-term, and to be in every sense the tenant's home. They are rented 'bare' - that is, they are unfurnished and usually do not even contain kitchens; the tenant is expected to purchase and install their own. This clearly affects the tenant's incentives to remain in the same property.

German households move relatively infrequently. A 2007 survey showed that only about 10% of German households had moved in the preceding two years, compared to about 15% of Britons and 22% of Americans (Andre 2010). 'Because rent increases during a tenancy are more strictly regulated than rents for new contracts, rents for tenants who have occupied the property for a long period of time tend to be significantly below market rents' (Whitehead et al 2012, p. 143). (It should be

noted that this is also the case in markets with no indexation – rents for existing tenancies in England have on average been rising by less than 1% in England and under 2% in London).

One reason why the regulatory system has worked so well in Germany has been that house prices have been falling in real terms and often in monetary terms for the last two decades. The general pressure has thus been more on reducing rents. However since 2007 in particular this position has changed in some major cities. Prices and owner-occupation rates have been rising, and rental markets are beginning to silt up in areas of housing pressure, with queues for rented properties resulting in people having to bid for dozens of units (including providing significant documentation). There is considerable evidence that new investment is not keeping pace with demand.

Lately, there has been strong political pressure for tightened rent regulation in some cities where rents have been rising rapidly (Fitzsimons 2014). As already noted, rises are already capped at 20% over three years, but in April 2013 the law was changed to permit cities to implement a local cap of 15% over three years. This was implemented in Bavaria in May 2013 and was an important element in coalition discussions prior to the 2013 election. It is expected to be implemented in Berlin, Hamburg and other cities where rents have been rising rapidly.

A study of the German property market by the IW Institute in Cologne, published in the autumn of 2013, warned that caps may end up aggravating the supply and demand imbalance by curbing investor appetite for real estate, and slowing the construction of new apartment buildings. The message echoed that of the German Central Bank, which cautioned against trying to contain this development with rent controls.

## The Netherlands

The Netherlands has the largest proportion of social housing in Europe, making up about one third of the housing stock, and many middle income families live in the sector. Private rental, by contrast, now accounts for only 10%, and its share has been falling steadily. Much of this stock is owned by long standing privately owned companies that are looking for regular income. More recently, some of these owners are aiming to realise value for their 'pension fund' by selling into owner-occupation.

## Rent regulation

Social and private rental housing are subject to the same regulations with respect to rents and tenure security. In the bulk of the market, rents are set not by the market but on the basis of a 'points' system. Points are allocated for characteristics such as the size, condition and facilities of the home<sup>3</sup>, as well as the characteristics of the local environment (transport, shops, schools etc.) - but not for the desirability and price of the location. The number of points determines the maximum rent that can be charged. After signing a lease, the tenant has six months in which they can challenge the rent level before the Rent Commission.

At the top end of the market (in both social and private rented housing) - that is, for dwellings with over 142 points, which in 2014 gives a maximum rent of over €700/month regardless of size - rents are decontrolled. The cut-off point for decontrol is revised annually in January. This regime was put in place in 1990 for new construction and in 1994 for existing dwellings, with the goal of gradually freeing rents as the proportion of decontrolled properties grew. The 'free' rented sector reached 5% by 2004, and the aim was that 25% would be deregulated in the following five years, but the target was dropped by the new government in 2007. Currently about 30% of private rented dwellings have decontrolled rents (Whitehead et al 2012).

Regulated rents can only be increased by a percentage announced annually in a government decree. Since 2008 this has been in line with inflation. Rents on properties with points equal to a maximum rent above that level (over €700/month) can be set at market levels (Fitzsimons 2013). Interestingly, in many parts of the country, rents that could be raised above the controlled limit are not actually increased because the market rent is actually lower than the amount indicated by the points.

<sup>3</sup>The main determinant is size — one point is given for each square metre of internal space. Other factors include for example having its own boiler (3 points, or 5 for a condensing boiler), floor insulation 2 points, bath 6 points, etc. See Fitzsimons 2013 pp 23-26.



## Security of tenure

Leases are generally indefinite and binding on the new landlord if the property is sold. Tenants can be evicted only if the tenant has not fulfilled his or her obligations, or if the landlord wants to use the property themselves. The period of notice is between three and six months, depending on how long the tenant has lived in the property.

## How does it work?

There are a great many rented dwellings with more than 142 points, for which the landlords charge less than the €700/month – even though they could charge as much as they like. It is the actual rent charged, rather than the number of points, which determines whether the letting remains in the regulated sector. This anomaly comes about for two reasons: first, because some local markets in the Netherlands simply will not support higher rents; second, because housing associations are the dominant landlords. Their stock of 'social' housing competes directly with private rented housing. Much of it is of high quality and there is little or no stigma associated with living in social housing in the Netherlands. These housing associations see it as part of their social mission to keep rents low; they are also wealthy and do not need to maximise returns. This means that for the sorts of properties renting at or somewhat above the cut-off point, private landlords find it difficult to compete with housing associations as the latter charge much

lower rents<sup>4</sup>. This is one reason that institutional landlords in particular have been divesting from the sector.

On the other hand there are other areas where market rents are much higher and there are still shortages. In this context, it has long been recognised that the outcomes of the points system do not necessarily correspond with market outcomes. Particularly in high demand, high cost areas, this system produces large gaps between the regulated rents for units with 142 points or less and free, market rents. This has led to the emergence of black markets in some areas, where side payments are made and tenants paying the regulated rent may be able to sub-let the dwellings for large profits.

To address these issues, in 2011 the system was modified in order to give extra points to dwellings in 10 high cost areas, allowing landlords to charge higher rents on new lettings. In these areas, dwellings worth less than €2,900/m<sup>2</sup> (according to the national property valuation system) are allocated 15 extra points, while those worth more than €2,900/m<sup>2</sup> were allocated an additional 25 points. This has taken significant numbers of units out of regulation when a vacancy occurs.

Another recent change has been to allow landlords to impose higher rent increases in 2013 and 2014 on households with higher incomes – for those earning more than €43,000 per annum rents may be increased by 6.5%. These higher rent increases were initially coupled with a temporary tax on all landlords owning more than 10 dwellings with regulated rents, but the two policies have now been separated.

Finally, the Dutch government has now agreed that the €700 limit will be maintained for three years with the intention of incentivising the transfer of properties to the deregulated sector.

<sup>4</sup>In 2010 housing associations owned 1.06m dwellings with over 142 points, but on only 87,600 was the rent more than the cut-off (Fitzsimons 2013 p. 96).

## Ireland

Ireland has been identified (maybe erroneously) as the source for the Miliband proposals on rent regulation and security of tenure. In reality Ireland

is regarded as a country that has deregulated but organised the market with the aim of generating higher quality rental housing rather than lower rents.

## Rent regulation

Rent controls were abolished in 1982 in Ireland, and since then rents have remained largely unregulated. The 2004 Residential Tenancies Act however did stipulate that rents within a tenancy could only be changed once a year, and could not be greater than the open market rate (Department of the Environment, Heritage and Local Government, undated). Rents may be reviewed either up or down only once a year unless there has been a substantial change to the property. Tenants must be given 28 days' notice of new rents, and may ask for a review if they feel they exceed the market rate for the property. Disputes can be referred to the Private Residential Tenancies Board (PRTB).

Some 30% of private rented sector tenants receive rent supplement (the equivalent of housing benefit). There are caps on this benefit, which depend on area and household size (the maximum is €1,000/month in Dublin for a family with three children). As in the UK these caps act as an informal version of rent control at the lower end of the market.

## Security of tenure

Security of tenure was strengthened by the Residential Tenancies Act 2004. Landlords are permitted to terminate a tenancy without giving a reason during a six-month probationary period, but after that (and up to four years), the landlord can only end the tenancy for certain specified reasons (non-payment of rent, overcrowding, intended sale etc.). After four years a new tenancy commences and the process starts again. Notice periods for both landlords and tenants increase in line with the tenancy's duration (Norris 2011).

There have also been significant moves in recent years to improve the minimum standards of private rented housing. Regulations introduced in 2009 aim to improve cooking, heating and laundry provisions, set minimum space and storage provisions to facilitate family living, require landlords to maintain the exteriors of dwellings and will completely phase out the traditional 'bedsit' (with shared facilities) by 2013 (Hayden et al. 2010).

## How does it work?

The introduction of higher standards and increased security were generally welcomed and are thought to have improved conditions. However it remains a relatively small part of the housing system, generally accommodating more mobile households but also a significant proportion of lower income households who cannot obtain social housing.

Ireland is now experiencing a housing crisis that affects all tenures. Rents have been increasing rapidly, especially in Dublin, and there is political discussion about the reintroduction of some form of rent stabilisation (or what Threshold, the Irish housing charity, calls 'rent certainty').

## Denmark

In Denmark about 14% of dwellings are rented privately, down from 35% in 1970. Rent regulation applies in one form or another to nearly 90% of the sector. The only units that are exempt are those built after 1991 and penthouses on top of existing buildings.

### Rent regulation

Regulations limit both the initial level of rents on new leases and rent rises. There are two main systems: the running-cost system, or omkostningsbestemt husleje, applies in most areas; this is known in Denmark as 'strong' rent control (Andersen 2014). Under the running-cost system, permitted rents are based on the cost of operating the property, an allowance for exterior maintenance, plus a fixed yield. This yield varies with the age of the building and is based on its 1973 value. Each municipality can decide whether the running-cost system should apply to multi-unit properties in its area; if not, then the second system (the 'value of the rented property', or det lejedes værdi) will apply (Whitehead et al 2012).

The 'value of the rented property' rules apply to small buildings everywhere and to all buildings in municipalities that do not use the 'running-cost system'. The 'value of the rented property' rules are a type of mirror-rent system. Under this system, rents must reflect the average rents for similar dwellings in the same area. The two systems produce different rent levels, with the latter producing higher rents than the former, but both are well below notional market rents - according to the Danish Property Federation, in 2008 controlled

rents in central Copenhagen were about 28% below freely agreed rents on post-1991 properties (Whitehead et al 2012 p. 106). The gap between controlled and notional free-market rents is greatest in Copenhagen and other large cities.

Rent increases are controlled under both systems, and are also regulated for post-1991 dwellings whose initial rents are freely set. Leases may specify either periodic rent increases or state that rents will rise with an inflation index; rents can also be raised if landlords can prove that their costs have risen, or if they have carried out improvements to the property.

Landlords can bring their properties out of the purview of cost-based (stronger) rent regulations into the mirror-rent system by investing in improvements to vacant dwellings. Skifter Andersen calculated that as of 2008, about 28% of properties under strict rent control had been transferred this way to the less stringent regime (Skifter Andersen 2014).

### Tenure security

The standard lease is an open-ended contract that can only be terminated if there are rent arrears or the landlord wants to live in the property. The tenure of dwellings in Denmark is fixed when they are built. Rental dwellings cannot generally be sold to owner-occupiers<sup>5</sup> and only limited term rental contracts are permitted for dwellings that were originally built for owner-occupation. Tenants are permitted to sub-let and to trade tenancies.

## How does it work?

The regulation of private rents keeps them below market levels and results in excess demand. This allows landlords to select among potential tenants, and they tend to prefer stable households with good employment rather than vulnerable low income tenants, who then must be housed in the social sector. Because units cannot be transferred out of the sector, the landlord has no other legal means of obtaining income from the property other than to sell to another landlord (or to the tenants as a cooperative). Incentives to maintain the properties are limited while tenants have little reason to move even if they are under-occupying.

<sup>5</sup>Multi-unit rental buildings must be sold in their entirety rather than broken up and sold as individual units. Landlords who intend to sell are required to offer sitting tenants the option to buy the entire building as a cooperative, and this has been popular especially in Copenhagen.

## France

The relative size of the private rented sector has remained fairly constant since the early 1980s when it accounted for 23% of the stock. In 2006 the latest statistics show private renting at 21% - somewhat larger than the social rented sector at 17%. Housing in both rented tenures is concentrated in Paris and major metropolitan areas.

### Rent regulation

The Mermaz-Malandain law passed in 1989 remains the primary arbiter of rent control in France. It fundamentally regulates rent increases during the period of the lease, but leaves the landlord free to set the rental level when signing a new lease. However, about 5% of the privately rented stock is subject to strict rent control under the terms of the rental law of 1948.

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. The annual adjustment of rents is regulated. From 2006, this adjustment was governed by the National Institute for Statistics and Economic Studies (Institut National de la Statistique et des Études Économiques, INSEE) Rent Reference Index (Indice de Référence des Loyers, IRL), which was calculated on the basis of the index of the cost of daily living, the index of maintenance and renovation costs and the index of construction costs. Since 2008, annual rent adjustments have however been based on the cost of living index alone.

### Tenure security

The standard length of a contract in the 'free' market sector is three years for furnished dwellings and one year for unfurnished dwellings. Security of tenure is strong within a tenancy. Landlords are allowed to terminate a tenancy agreement at the end of the lease if they wish to occupy the property themselves or house a close relative or a family member, sell the property, carry out major refurbishment of the property, or if the tenant has consistently failed to meet their obligations in the past. If the landlord wishes to sell the property, the sitting tenant has the first right of refusal. Absolute

security of tenure applies only for the duration of the tenancy agreement (DCLG 2010).

### How does it work?

The relative size of the private rented sector in France has stayed fairly stable since the 1980s. This may partly be a consequence of the various tax incentives that have been available for individual rental landlords. Except for those still governed by the 1948 regulations, the average quality of private rental properties has greatly improved over time because of the availability of loans, subsidies and tax incentives that have encouraged private sector landlords to refurbish and renovate their rental properties.

Rents in the private sector are significantly higher than social rented sector rents. In 2009, the average annual rent for a free market dwelling was €6,300, while that within the social sector was €4,000 (Dol and Haffner 2010). There has been increasing concern at the rapid increases in rents in Paris and a number of other major French cities, which led to calls for the reintroduction of some form of rent control.

In 2012 the government limited rent increases on new lets in 38 high pressure areas to the rise in the legal benchmark (IRL), unless substantial work had been performed (in which case the increase was unrestricted). In 2013 this was followed by the *Accès au Logement et à un Urbanisme Rénové* (ALUR) law. Its major innovation was to regulate the level of rent in a few high pressure areas, whereas previous decrees focused on changes in rents. Under ALUR, a range of permissible rent levels will be set by law, and maximum permitted rent increases will be governed by decree. In the designated high pressure areas, rents on new leases are limited to 20% per square metre above the median rent in the neighbourhood, which will be assessed annually by a 'local rent observatory.' Existing rental contracts that overstep that limit will be brought down when they are renewed. The law also caps agents' fees, bans limiting access to lists of rentals to those who pay fees, and cuts the number of documents prospective tenants are required to produce.

The other main element of the ALUR law is a rent guarantee, paid for by both landlords and tenants, which will recompense landlords for unpaid rent. If a tenant defaults, landlords will no longer have to chase them through the courts, but simply apply to

the fund for reimbursement. This fund will pay the landlord up front; then investigate the claim. If the tenant defaulted due to unemployment, illness or low income, they will receive rent relief; if they were negligent or taking advantage, they will be sued.

There are many criticisms, particularly of the open-ended nature of the guarantee system and the costs of implementation (Vorms, 2013). The change in government and minister has put the introduction of both elements of the ALUR law in doubt.

## The USA

The USA has a highly decentralised housing policy system in which the federal government has a relatively small role (James, 2014). States and individual municipalities can establish their own policies, and take widely divergent approaches. In 35 states rent control is explicitly prohibited, and in several others it is permitted but not found in practice. But in four states (California, Maryland, New Jersey and New York) some local governments do regulate rents - and these include some of the country's biggest cities. The nature and degree of rent regulation varies by city.

In general in the USA dwellings can be transferred between tenures (from private rental to owner-occupation, for example) with little restriction. However in cities that have regulated rents there are often laws governing procedures for changing rental apartment buildings to condominiums (so-called 'condo conversions').

### New York City

New York City operates two rent regulation programmes: rent control (older and more restrictive) and rent stabilisation. Rent control affects pre-1947 buildings. Under New York State law, rent control can only be applied in municipalities that continue to have a 'rental housing emergency'; local governments must abolish it if the overall city vacancy rate rises above 5%. Importantly, rent control only applies if the tenant (or in some cases their spouse) has been living in the unit continuously since 1971. The number of rent controlled apartments is therefore declining as these tenants die or move out; as of 2011 there were only 38,374 rent controlled units in New York City (out of a total of 2.2 million), and the number will have fallen further since then.

Rent stabilisation applies to apartments in buildings with six or more units that were built between February 1, 1947 and January 1, 1974, and to tenants living in pre-1947 buildings but who moved in after 1971. Receipt of certain fiscal incentives for the construction or renovation of rental apartments is also conditional on the application of rent stabilisation for a limited period, so there is a small inflow of new rent-stabilised buildings. Tenants in rent-stabilised apartments have the right to renew their leases for a term of either one or two years. Permissible annual rent rises are set by the Rent Guidelines Board, taking into account both landlord costs and overall housing supply. For the year ending 30 September 2014, rents on one-year lease renewals can be raised by a maximum of 4%, and by 7.75% for two-year renewals.

Landlords can raise the rent by up to 20% when renting a rent-stabilised apartment to a new tenant on a two-year lease; higher rent increases are possible if the landlord carries out improvement works, as they can add 1/60 of the cost of improvement to the monthly rent (in larger buildings; a more generous 1/40 in smaller ones).

Since 1993 it has been possible for landlords to take higher priced units out of the rent regulation system under so-called 'luxury decontrol'. There are two ways: first, any apartment that becomes vacant for which the market rent is more than \$2,500/month, and which can legally be rented for that amount (that is, previous rent of at least \$2,083/month plus 20% vacancy increase) can be removed from the rent regulation system. Second, landlords can petition to remove occupied units from the system if they rent for over \$2,500/month and the tenants have a household income of \$200,000 or more for two consecutive years. Using these two provisions about 13,500 units leave the rent regulation system per year - a total of more than 100,000 since 1994 (New York City Rent Guidelines Board 2013). New tenants of units that have come out of rent stabilisation have little security of tenure, as the protections against eviction under rent stabilisation do not apply to them and they are not entitled to mandatory lease renewal. These vacancy decontrol provisions are controversial, with regular attempts to repeal them.

Most New York rental units are in multi-unit buildings in single ownership. Landlords are not permitted to sell these buildings into owner-occupation (as either cooperatives or condominiums) without permission from the state

attorney general with existing tenants who do not wish to purchase as owner-occupiers remaining on their existing terms.

## How does it work?

Table 3 shows that in 2011, some 47% of New York rental housing was subject to either rent control or rent stabilisation. This represents a decline from 1981, when 63% of rented dwellings had regulated rents (Furman Center 2011).

**Table 3: Regulation of New York City rental housing stock, 2011**

Regulatory regime	Number	% of rental units
Rent-stabilised	986,840	45.4
Market rate	849,800	39.1
Rent-controlled	38,374	1.8
Other*	297,620	13.7
<b>Total</b>	<b>2,172,634</b>	<b>100</b>

\*Mostly what would be termed 'social housing' in the UK, including public housing, Mitchell-Lama, HUD-regulated, Article 4, etc.

Source: Furman Center 2011

Table 4 compares market and stabilised rents in New York's five boroughs in 2011. City-wide, the median rent for stabilised apartments was 75% of the market rent, but there was wide variation among the boroughs. In Queens and Staten Island, lower priced areas of the city, the difference between market and stabilised rents was 15% or less, while on Manhattan median stabilised rents were less than half of market rents. It should be borne in mind, however, that apartments with stabilised rents are generally smaller and older than those with market rents.

New York boroughs are, of course, much larger in area and population than London boroughs. A comparable neighbourhood would be the Upper East Side of Manhattan, which has a population of 217,020 - about the same size as Camden's (2011 Census 220,338). Like Camden, this is one of the most expensive parts of the metropolitan area. The median rent-stabilised rent on the Upper East Side is 56% of the market rent (Table 4). Compared to those elsewhere in the country, New York City tenants must pay a higher proportion of their incomes in rent. The general rule of thumb in the USA is that rent payments should not exceed 30% of household income, although most New York City renters (57%) pay more

than this. Data from 2011 for the Upper East Side show that 47% of tenants in market-rent apartments were 'rent burdened' (pay more than 30% of their income in rent); interestingly, the figure for those in rent-stabilised apartments was even higher, at 59% (Furman Center 2011).

There are no income criteria for tenancies in rent-stabilised apartments. An analysis by the Furman Center at New York University looked at the incomes of households living in market-rate and rent-stabilised apartments. In most areas, households living in rent-stabilised units on average had much lower incomes than those in market-rate units - but they were not low in an absolute sense. 'Indeed, the median income of stabilized rental households in Manhattan below 96th Street (Core Manhattan) is higher than the median income of market-rate tenants in all but eight neighbourhoods outside of the core of Manhattan' (Furman Center 2011 p. 3).

**Table 4: Market and stabilised rents in New York boroughs, 2011**

Borough	Median rent per month		Rent stabilised as % of market
	Market	Rent-stabilised	
Bronx	\$1340	\$1066	80
Brooklyn	\$1350	\$1121	83
Manhattan	\$2625	\$1295	49
Upper East Side	\$2850	\$1585	56
Queens	\$1410	\$1230	87
Staten Island	\$1300	\$1110	85
Core Manhattan	\$2725	\$1480	54
New York City outside core Manhattan	\$1385	\$1132	82
<b>NYC overall</b>	<b>\$1550</b>	<b>\$1160</b>	<b>75</b>

Source: Furman Center 2011

Tenants in rent-stabilised units tended to stay much longer than those paying market rent (on average 12 years versus six years). The difference was most marked in the highest cost area; in Core Manhattan some 35% of households in rent-stabilised units had lived there more than 20 years (Furman Center 2011).

Rent stabilisation is a long standing source of political controversy in New York, with small landlords opposing it (a recent case challenging its constitutionality [Harmon v Kimmel] made it as far as the Supreme Court) and tenants' associations vociferously defending the principle. However the profile of those living in rent-stabilised apartments suggests that a significant proportion do not fall into the category of 'low income' household. Many who were on low incomes when their tenancies began would subsequently have seen their incomes rise, and the issue of who benefits from rent regulation is a live one in New York.

## San Francisco

San Francisco introduced rent control in 1979. Most rented dwellings are subject to the law, which applies to dwellings in multi-unit properties that were built before the 1979 law was passed. It also applies to tenancies that began before 1996 in single-family homes; those that began later are not covered. The exception for 'single-family homes' applies not only to houses but also to condominiums (apartments in individual ownership) - if a multi-unit building is in single ownership then the apartments are rent-controlled, but if the units are individually owned (as is typical in the UK) then rent control does not apply.

There is no restriction on the initial rent on a new lease, but landlords can only raise the rent by a set amount each year, as determined by the San Francisco Rent Board; this amount is meant to be 60% of CPI inflation in the local area. Permitted rent increases have been consistently low; for the year to 28 February 2015 the allowed increase is 1%, and in the preceding 20 years the permitted increase exceeded 2.5% only three times.

Landlords can also request permission to increase rents to reflect increased costs or capital improvements. In the case of capital improvements, the rent increase applies only until the investment is paid off (San Francisco Tenants Union 2014). Rent control can also be used as a punitive measure to enforce house standards: if an otherwise non-rent-controlled unit has housing code violations that are uncorrected for 60 days or more, the unit becomes subject to rent control.

Under the Ellis Act, a California state law passed in 1986, landlords are permitted to evict all the tenants from a building in order to remove it from the rental market. Under state law landlords must pay each evicted tenant compensation ranging from \$5,000 to

\$16,000; the San Francisco Board of Supervisors (city government) in April 2014 increased this for Ellis Act evictions in San Francisco, requiring landlords to pay evicted tenants the difference between their existing rents and market rents for similar units for a two-year period.

The resulting vacant properties are normally sold into owner-occupation; if the units are re-rented then for the first five years the rent cannot exceed the rent that the evicted tenant was paying, and the evicted tenant must be given first refusal.

## How does it work?

There are many parallels between the situation of San Francisco and that of Camden - both are relatively small, highly desirable and tightly constrained parts of prosperous metropolitan areas. Most San Francisco households rent, and rent levels and the rights and responsibilities of tenants and landlords are long-running local political issues, with vocal and well-funded advocacy groups on both sides. It is simply not possible for San Francisco to accommodate all those who want to live there, especially since it has now become the location of choice for well educated, well paid Silicon Valley employees who reverse commute. This has generated strong pressures to incentivise low-income/low-rent tenants to leave, and there have recently been protests against the 'Google bus' as a force resulting in gentrification.

At the same time, prices for owner-occupied housing are high, and landlords who do sell can potentially make large profits. The post-crisis upturn in the San Francisco housing market has seen a parallel rise in Ellis Act evictions, as landlords sell to developers.





## 6. Analysis

### The problem

Almost one third of all households living in Camden are private tenants – a comparable figure to those in social housing. Within this total only 14% of private tenants claim housing benefit, which is available to households with incomes well above the national average. Even allowing for non-claimants this suggests that poorer working households living in the borough are mainly accommodated in the social sector.

Private rents have been rising more rapidly in Camden than in London as a whole and far more rapidly than in the rest of the country. The Assured Shorthold Tenancy system enables landlords both to increase rents and to terminate the tenancy at the end of the lease (which is normally for between six months and a year). This contrasts with many other European countries where tenancies are longer-term or even indefinite, and rents within tenancies (and sometimes between tenancies) are regulated in one way or another.

In a number of countries there has also been pressure over the last few years – as demand for private renting has grown faster than supply with consequent shortages and rises in rents – to introduce or strengthen rent regulation. Legislation to this end has been proposed or passed in some parts of Germany and in France concentrating on major metropolitan areas where pressures are particularly strong. In the Netherlands there are proposals for a rent freeze on controlled rents.

It is in this context that we were asked to examine international experience as a basis for evaluating the potential for some form of rent stabilisation – i.e. relating rent increases or even initial rent levels to some defined ‘index’ rather than leaving rents entirely to market pressures.

Economic principles suggest that traditional rent freezes work badly, especially into the longer-term – generating immobility, poor quality housing in the sector and incentives to landlords to transfer to

other tenures if possible. Almost all countries that introduced this type of control have either liberalised their systems completely (the UK) or limited controls to within-tenancy rent increases (often called rent stabilisation).

There are good reasons why landlords as well as tenants (and indeed in some cases rather than tenants) might be happy to agree to a form of rent stabilisation linked with longer-term tenancies. Institutional investors are looking for returns to match their liabilities which themselves are often explicitly or implicitly linked to inflation or wage rises. Rents set by the market which are certain to rise in line with a defined index would provide low risk matching income. Further, tenant turnover is expensive both in terms of lost rent and the repairs, maintenance and replacement of equipment that have to be undertaken before re-letting. What such investors do look for are well behaved tenants and very clear, cheap procedures for eviction when a tenant breaks the contract. Many tenants do want longer-term tenancies and predictable rents and therefore would find this type of contract desirable. However, based on the evidence from the few examples available so far in London, many instead want the freedom to move if their circumstances change, and may therefore not be prepared to opt for additional security if any costs are involved.

Incentives for other types of landlord can be very different. In the UK, many Buy to Let investors enter the market not just for rental income but also for potential capital gains – they consequently put more emphasis on being able to sell with vacant possession. Equally, smaller landlords cannot spread risk across a portfolio of properties and other investments, making it harder for them to accept a long-term commitment. Finally, those dependent on mortgage finance must obey their lenders’ terms and conditions, which currently rule out longer-term lets.

In other countries those who invest in privately rented properties may face strong constraints on their capacity to leave the market – not only because of longer-term tenancies but also because properties cannot be transferred out of the sector. This is true in Denmark for units built before 1991; in New York for lower rented properties built before 1974 and in San Francisco before 1979. In these circumstances the incentive may well be to run down the properties if they cannot be transferred into the market rented or owner-occupied sectors.

What is very clear from the overview is that any regulatory system requires many other elements be addressed in addition to rents - notably the extent of security of tenure and the procedures for eviction and sale, as well as control on standards and means of accessing rental housing (e.g., agents' fees; limitation on side payments; rights to sub-let).

Table 5 summarises rent regulation, tenure security and restrictions on disposal of the dwelling for the seven locations studied, together with the position in England. It shows that there are very few cases where rents on initial lettings are controlled. In all cases these are instances where the units cannot be transferred to owner-occupation (except under certain conditions). The building also usually has to be sold as a single unit. In addition, there are instances where 'mirror' rents are required or tenants can appeal against the rent set so that rents cannot be completely out of line with rents of comparable properties in the area.

Controls on rents between lettings only exist where there are also controls on the rent at the beginning of the lease, and normally take the same form. In many cases there are also exemptions based either on the date of construction (aimed at bringing additional investment into the sector) or on the rent level – excluding properties with higher rents on the basis that these are let to those on higher incomes (although there are obvious issues with respect to larger units and therefore larger families).

Leases across our sample, and indeed across regulated sectors elsewhere in Europe, tend to be indefinite - that is, tenants can stay as long as they like unless they break the rules. In some cases where leases are fixed-term the tenant has a right to first refusal of a new lease.

**Table 5: Current rent and tenure regulations – a summary**

Location	Rents				Lease form	Restrictions on evictions	Restrictions on sale / disposal to another tenure
	Rents on first letting of property controlled	Rents for new letting controlled	Exceptions	Increases controlled within tenancy			
Denmark	Yes	Yes	Post-1991 construction	Yes	Indefinite	Strong	Yes for multi-unit buildings
England	No	No	Existing pre-1971 tenancies	No	AST	None at end of term	No
France	No	No	Law may introduce rent caps in some areas	Yes	One to three years	Strong within tenancy	No
Germany	No <sup>6</sup>	No	But must not charge significantly above market (20% or more in some localities)	Yes	Indefinite	Strong	No
Ireland	No	No		No	Four years	None in first six months, then strong	No
Netherlands	Yes	Yes	Units renting for over €700/month (25% of sector)	Yes	Indefinite	Strong	
USA: New York City	Yes	Yes	Post-1974 buildings and smaller properties; 'luxury' dwellings (rent over \$2500/month)	Yes	One or two years with right to renew	Strong	Yes
USA: San Francisco	No	No	Post-1979 buildings, single-family homes and condos	Yes	One or two years; with right to renew	Strong	Yes

<sup>6</sup>Some perceive this as yes rather than no because of the mirror aspect – but this is consciously to allow rents higher than market to allow for future risks. However the issue has only become really important in high pressure areas.

Finally, there is the issue of enforcement of contracts. There are many instances of avoidance and evasion especially in areas of housing pressure. On the other hand there are instances, notably in some areas of the Netherlands, where it is clear that control does not bite because of low demand. In all countries landlords complain of the costs associated with legal eviction – but these clearly are factored into their preparedness to remain in the sector.

In most countries the size of the sector has declined in the face of restrictions as well as changes in opportunities in other tenures for both potential tenants and landlords. The major exceptions until recently have been Germany and Switzerland, both with very limited social sectors – although this is also changing.

### Germany: the example of good practice?

The German system has over the last few decades until at least 2008 matched this set of conditions fairly closely. Security is indefinite. Initial rents can be set up to 20% above comparable rents in the area (in some cases up to 50%) giving comfort to the landlord in case of unexpected changes in costs not covered by the index. Rent increases are defined within the tenancy. Nearly 50% of households rent privately - so most are mainstream households. Most also have to make significant investment in the dwelling, making it more obviously their home but also increasing the cost of moving out. Equipment is normally provided by the tenants. Eviction procedures are well defined – although landlords complain about the difficulties of achieving eviction. Probably most importantly, real house prices had been falling since the 1980s and inflation had been very low so there have been few surprises in terms of costs. It should however be noted that the majority of landlords in Germany are not institutions but individuals who usually keep their properties for long periods, even generations – in part because of the lack of capital gains.

Since around 2008, and even earlier in some cities (notably Munich), the situation has changed considerably. Landlords have faced unexpected costs, particularly because of requirements to improve energy efficiency. House prices have been rising rapidly in some cities with commensurate increases in owner-occupation. The atmosphere in terms of eviction etc. has become more toxic. Most importantly it has become extremely difficult to find privately rented accommodation, resulting in potential tenants having to submit many applications at considerable cost – particularly in Munich but also in Hamburg and latterly Berlin where up to 90% of households have traditionally rented. Landlords are increasingly choosy. Most fundamentally Germany has relatively lower levels of new building than even the UK. This has resulted, on the one hand, in calls for stronger rent controls in major cities, which have been endorsed in the latest elections, and, on the other, in increasing concerns about the difficulties faced by middle income working households seeking accommodation and of ensuring investment in pressure areas.

## 7. Conclusion and recommendation



Most countries have stronger regulatory frameworks than in the UK - but it is also the case that only in the UK has there been large-scale growth in the private rented sector, although liberalisation has mainly enabled rather than been the direct reason for expansion.

Equally in most countries, controls on rents on initial lettings and new tenancies have generally been associated with a declining sector and lower investment. Some form of 'mirror' rent system works better in areas where demand is relatively stable, but requires very considerable flexibility in areas of housing pressure. In those areas where supply is inadequate, queues, avoidance, evasion and the exclusion of more vulnerable households becomes the norm.

Rent stabilisation within the lease appears to work better, but can be upset by unexpected changes in costs that do not trigger increases. How well it works depends on the length of lease and the stability of the economic environment. There are certainly groups of landlords, especially among institutional landlords and housing associations, which provide market-rent housing, for whom a carefully designed rent stabilisation scheme would be acceptable and indeed desirable, for financiers, landlords and tenants alike. However it is far easier to operate such a system in a stable environment where housing market pressure is limited and where tenants have a significant stake in maintaining their tenancy and property standards.

In more pressured areas, the outcome of controls that generate below-market rents (whether only for existing tenants or for new tenancies) inherently generates insider/outsider issues. New York

provides perhaps the best example of what is likely to occur. Those who live in rent-stabilised properties (where rents are held below market rents) do indeed stay for much longer than those in market rented properties. But they also tend to have higher than average incomes, so the profile of those benefiting from the system is quite different from that which perhaps the policy makers wished to achieve.

More generally, already established tenants who pay their own rent can undoubtedly benefit from a well operated/well enforced stabilisation scheme. Under the current system, those whose rents are covered in full by housing benefit would receive no benefit from restrictions on rents, as long as the market rent is below the LHA for the area. However those households who themselves make up the difference between the LHA cap and the rent for their dwelling would benefit from a greater degree of certainty. Those who cannot readily find accommodation are however likely to be forced to live in other areas or in more expensive/more crowded/poorer conditions. Rent stabilisation is thus no substitute for an affordable rents policy.

The only way that this can be avoided is to ensure either that in the longer-term landlords receive their required expected return – implying either subsidies or above-market rents at the time the contract is agreed in pressure areas (as in Germany) to offset the risks of future changes either in the regulatory framework or in costs/returns. The more uncertain the environment, the higher that return needs to be.

The benefits of a mandatory rent stabilisation scheme are that all tenants would in principle be treated equally; it would be associated with greater

security and would provide greater predictability for both landlords and tenants. Where both are comfortable with the arrangements transactions costs and risks should fall.

However there are also very considerable costs which we suggest would outweigh these benefits. These include:

- First, both tenants and landlords have diverse needs and this suggests that a one-size-fits-all system would not work;
- Rent stabilisation, if it is to provide adequately for the landlord, will often result in higher initial rents for the tenant – because the landlord builds in the costs of fixing the rent and its increase for some period during which economic circumstances are uncertain;
- Equally those who are potential rather than established tenants may find it more difficult to find accommodation as landlords look for ‘good’ tenants, identified by accepted signals;
- Landlords consistently repeat that what they want is a stable regulatory environment, and their behaviour confirms it. This is why the same advisors who support the German system (although this is now changing) say it cannot be introduced in the UK. The evidence in this context is that, overall, Berliners have faced considerably higher rent increases than Londoners, in part because established tenants all face annual rent rises in Berlin while many landlords in Britain do not raise rents on a regular basis – as is evidenced by the rent index being developed by the Office for National Statistics (2014);
- This is also seen in the immediate response to any discussion of rent stabilisation because it tends to be seen as a first step towards further regulation. Especially in high demand and pressured areas anything that reduces supply is highly undesirable – as is now strongly evidenced in Germany.

For all the difficulties discussed above, there is growing public and political pressure for increased controls in many European countries, particularly in high demand urban areas. The benefits to established tenants (and therefore voters) of such controls can be high (and can be extended to some new tenants if the landlord has few options

but to rent). But the disincentives for landlords to enter or remain in the sector in the face of rents held increasingly below market levels also increase. Thus the costs to ‘outsiders’ – i.e., those looking for accommodation – also increase – and the longer the system is in place, more problems result for potential new entrants.

In the UK context any mandatory system of rent stabilisation would be a matter for national government. The current coalition has repeatedly stated that it will not introduce a change in legislation, and Ed Miliband’s recent announcement that he favoured the introduction of some form of rent control attracted widespread criticism. However primary legislation is not the only way to tackle the problem. Local authorities do have the power to devise and promote voluntary schemes in their own local areas, which can be tailored to local circumstances.

A single authority working alone is likely to face very real difficulties because of the possibility that landlords would go elsewhere. A voluntary scheme that operates across London or even more broadly has a far better chance of success than a strictly local initiative. Camden is in a particularly good position to take the lead because of its role in the voluntary accreditation scheme.

Finally, we should point out that in discussing rent stabilisation, this report addresses only one aspect of what is a complex and interdependent system. A genuine reform of the private rented sector would need to examine the roles played by market actors other than landlords and tenants. Two in particular - estate agents and mortgage lenders - seem to operate in ways that mitigate against more stable, long-term tenancies. The commission and fee system employed by most residential letting agents creates an incentive for them to let dwellings on sequential short-term leases, as this generates higher fees. And most Buy to Let mortgage lenders require borrowers, as part of their mortgage contract, to let the property on Assured Shorthold Tenancies of no more than 12 months’ duration. This is beginning to change, with Nationwide for example now allowing longer leases.

Rent stabilisation systems are attractive to tenants not only because they provide certain constraints on the amount of rent that can be charged, but also - and perhaps more importantly - because

they provide a degree of certainty and transparency about future rent increases that is lacking in the UK system at the moment. Even those tenants who are entirely happy with their accommodation and their landlord cannot be sure what rent they will pay in five, two, or even one year's time. A lease system that set out clearly when and how rents would rise would increase transparency and certainty.

Many landlords are anyway happy to provide good quality service and most do not actually increase rents to anything like comparable new letting levels while the tenant remains in place. The central issues here are around enforcing minimum standards across the board and rewarding good landlords and good tenants.

Any non-voluntary system would involve trade-offs. The beneficiaries would mainly be existing tenants. If the introduction of regulation were seen to limit returns to landlords - and to increase the risk of further regulatory changes - there would be a tendency to reduce the supply of private rented housing and an incentive for landlords to let to 'easier' tenants.

Our **recommendation** is therefore that Camden should positively enable longer-term tenancies with index-linked rent increases, voluntarily agreed by landlord and tenant, while at the same time improving transparency and contractual enforcement for both landlords and tenants across the sector.

The German example as well as experience in other countries suggests that there are two main indices that could be used: either some measure of general inflation (such as CPI) or an index of local rents. The scheme would not necessarily have to specify which should be used, as long as landlord and tenant agreed.

This voluntary approach could be an attractive part of the voluntary accreditation scheme for a sub-set of accredited landlords.

Its attraction to institutional funders and others looking to remain in the sector into the longer-term means that the benefits of rent certainty and longer-term tenancies are not restricted to Camden or even London.

Camden is in a good position to influence the national debate on these and other matters that seek to improve the sector for all stakeholders.

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