STATES OF JERSEY

RENT CONTROL: REMOVAL OF EXEMPTIONS (P.139/2010) – COMMENTS

Presented to the States on 28th October 2010
by the Minister for Housing

STATES GREFFE

COMMENTS

Introduction

The Dwelling-Houses (Rent Control) (Jersey) Law 1946 protects sitting tenants from excessive rises in their rents as follows –

(a) The standard tenancy agreement prevents rental increases from exceeding changes in the Retail Price Index.

(b) Where the standard tenancy agreement is not in place, a tenant may have reference to the Rent Control Tribunal to ensure their rent is "reasonable".

If P.139/2010 is approved, it will mean that sitting tenants will lose the guarantee that their rent will not rise above inflation. When overall rental prices have outstripped the Retail Price Index, this is a considerable loss. Instead, tenants will have to go to a Tribunal who will set a "reasonable" rent with reference to market rents, which have seen above-inflation increases in recent years. This will be time-consuming and costly, without any expected reduction in rents. Furthermore, all the excellent protections of the standard tenancy agreement will be lost.

Accordingly, while the proposition is right to be concerned about rental values and waiting lists, its solution is unlikely to assist. As such, the States are asked to reject the proposition.

The powers of the Tribunal

When considering any contract to which the Law applies, the Tribunal may –

> *"…approve the rent payable under the contract or reduce or increase it to such sum as the tribunal may, in all the circumstances think **reasonable**…"*.

It is broadly taken, following judgements of the Court, that the normal method of assessing the reasonableness of any rent would be to establish a market rent and to deduct a figure in respect of scarcity, if any.

As the proposition itself says, the issue today is not one of "scarcity", but of market prices having risen higher than inflation or earnings. As the Tribunal would make a decision with reference to market rents, it is difficult to see what frequent sittings of the Tribunal will achieve – other than more time and costs.

The standard tenancy agreement also offers a range of other protections, including a cap on the size of the deposit, non-payment clauses if the premises are unfit, clauses that prevent premiums for utilities being charged, and notice periods of up to 6 months for longer-standing tenants. If the standard tenancy agreement is removed from the Law as proposed, these statutory protections will disappear.

- Where a landlord breaches the standard tenancy agreement, by for example, seeking to raise the rent above the Retail Price Index, then the tenant has no obligation to pay – rather, they should do nothing other than pay the rent as properly due under the terms of the contract. It follows that a tenant has no need to have recourse to the Tribunal because they are protected by the terms of the agreement.

- Alternatively, where a landlord inserts some additional clause into the standard agreement, for example, as the proposition suggests, to say the Dwelling-Houses (Rent Control) (Jersey) Law 1946 "shall not apply to the premises" then the tenant may refer the rent to the Rent Control Tribunal on the basis that the exemption no longer applies as the rental agreement is not the standard one, and indeed, on the basis that it is not possible to avoid the Law simply by inserting such an evading provision into the agreement.

The full weight of the Dwelling-Houses (Rent Control) (Jersey) Law 1946 therefore sits behind the standard agreement and the inflationary cap contained within.

House Prices and Rents have outstripped inflation and earnings in recent years, as illustrated –

% Growth	**House Prices**	**Private Sector Rents**	**Earnings**	**Retail Price Index**
2002 – 2010	53%	40%	34%	31%

This is consistent with the existence of the standard tenancy agreement which protects sitting tenants *only*, rather than controlling overall changes in rents. Should all tenants have access to the Rent Control Tribunal, there is no firm reason to believe the above indicators would be any different as the Tribunal looks to market rents, which have risen by 40%.

The economic arguments

The advice of the Economic Advisor is attached at the Appendix. It suggests that rent controls reduce the supply and quality of rental accommodation.

The proposition suggests that low interest rates have motivated more people to invest in property to obtain a return. This is logical and consistent with the anecdotal evidence, which points to increasing numbers of landlords marketing property – which in turn is leading to rental values *slowing* in 2010.

On the other hand, had genuine rent controls been in place over the last 2 years, less people would have invested in property, meaning less properties would now be being marketed, while demand for properties would have remained the same. This is a recipe for higher rents, and illustrates the dangers of rent control.

As to whether landlords are making excess profits, asset prices have risen faster than rents in recent years, meaning that yields for property-owners are reducing, not increasing. Going forward, there is some expectation that this rents will continue to slow, and house prices will remain static, because of the economic climate, tightened lending criteria, and levels of supply.

The States Waiting List and social housing

The Waiting List for States Housing has grown as financial distress has increased in the present economic climate.

The fact that social housing rents, as the proposition explains, are lower than private rents – by at least 20%, and in some cases to a far greater extent – naturally makes social housing more attractive to those in financial need, and the artificially low social housing rent levels provide a hidden subsidy to better-off social housing tenants. As a person receives the same Income Support linked to a "fair rent" whether they are in private or social housing, naturally, they look to the best value accommodation. This explains the imbalance of rising waiting lists and an apparent surplus in marketed private rental properties.

The proposition suggests that applying rent control to all tenancies would enable tenants to have their rent controlled and thus remove any motivation to apply for social housing. For this to be realistic, private sector rents would have to be artificially suppressed to social housing levels. At once, it is unlikely that the Tribunal could do this, or that it would be desirable in the longer term.

One view on this is that social rents should be at the proper market level so as to remove that hidden subsidy and to limit the number of people who apply for social housing to those who most need it. However, any move to do so needs to be treated with caution, particularly in respect of those requiring Income Support and the additional benefit that they would need to meet higher rents. A rents policy for the social housing sector will be developed in collaboration with the Social Security Department as part of the overall arrangements for the transformation of the Housing Department into an 'arm's length' organisation.

Article 2(e) of the Law exempts any part of the Law from applying to any property where the States is either lessor or lessee. However, the amendment, if successful, would cause the Law to apply to Housing Trusts, who are presently exempt on the basis that they use the standard tenancy agreement which protects tenants from above-inflation rent rises and other behaviour which is considered inappropriate. All Housing Trusts are already also limited in respect of rent increases as their rents cannot exceed the fair rent level established by the Minister for Housing for the States' own social housing stock. This is, in itself, a means of rent control, and as such, it would seem somewhat unnecessary to extend the jurisdiction of the Rent Control Tribunal to the Housing Trusts. This is especially the case when additional regulation of the Housing Trusts is being pursued.

Financial and manpower implications

Clearly, to support a Tribunal takes time and costs money.

Presently, there is no Rent Control Officer as the Tribunal has not sat for many years. However, should this proposition be successful, between 0.5 – 1 member of staff would be needed to manage a heavier burden – costing between £21,000 – £42,000 per annum, depending on case numbers – plus the expenses of convening the Tribunal.

Conclusions

A desire to make housing more affordable and to reduce waiting lists is understandable. However, this proposition will achieve neither. Instead, a much more in-depth analysis of the issues and the legal instruments is needed, including –

- A continuing focus on ensuring sufficient housing supply is created to meet controlled demand.

- Innovative schemes to support affordable housing for those most in need, and a social housing stock that is fairly priced, larger and of a high standard, backed by a targeted benefit regime.

- Further analysis of the effects and means of rent control, including a comparison with other jurisdictions.

States of Jersey

Economics Unit
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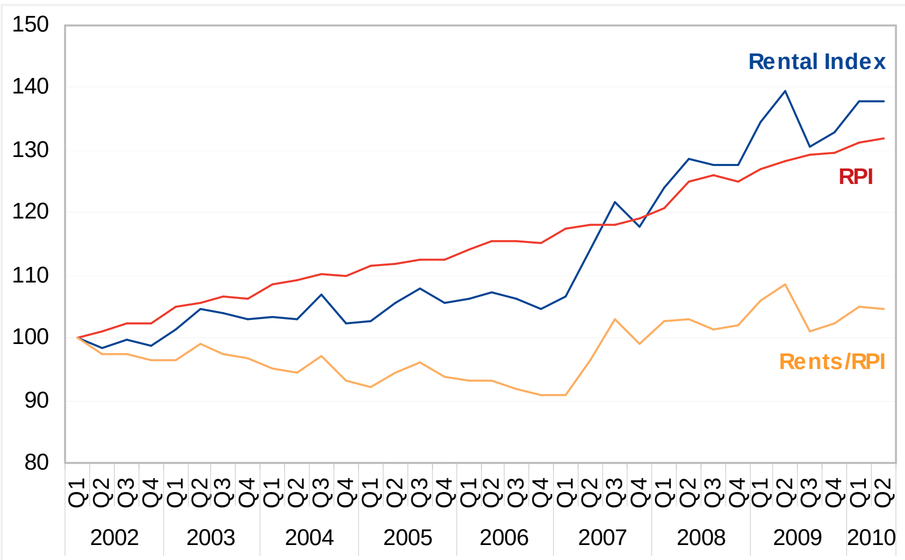
Rent Control: An Economic Assessment

1. Background

The Private Sector Rental Index (PSRI) in Jersey measures the annual increase in rents on newly rented properties in Jersey. Figure 1 illustrates how the PSRI has changed since 2002 (the first year PSRI data is available) relative to the Retail Price Index (RPI). While RPI has increased by 32%, the PRSI has increased by 38%, so rents have increased slightly more than overall inflation over this period. Average earnings increased by 34% over the same period.

Figure 1



Private sector rental prices are driven by the interaction between supply and demand for rental housing. If prices are increasing it suggests that the demand for rental housing outstrips supply, so potential tenants are willing to pay more to secure themselves housing, and landlords are able to ask for higher rents.

2. Rent Control

Rent control appears an attractive policy on the surface because it seems like it will reduce the price of rental housing, in turn making housing more affordable for those on lower incomes. However, once one recognises that changes in prices affect the incentives facing landlords and potential tenants and have knock-on effects on supply and demand, rent control can look less attractive. In particular, economic theory, supported by evidence from actual experience, suggests that rent controls –

- Reduce the availability of rental housing
- Reduce the quality of rental housing
- Cause misallocations of housing
- Are difficult to administer
- Do not achieve the distributional goals they are advocated as the solution for.

It is useful to distinguish between different types of rent control; in particular, there are three 'generations' of rent controls. 'First-generation' rent controls place restrictions on the level of rents across the whole rental sector. 'Second-generation' price controls allow for some restricted increase in rents to allow for factors such as investment and inflation. 'Third-generation' price controls (or 'tenancy rent controls') place restrictions on the change in rents *within* tenancy agreements, but not between them. First- and second-generation rent controls are largely discredited, as the evidence suggests that they have the negative effects listed above. The evidence on the effect of third-generation rent controls is more ambiguous, and as a consequence they have more support and are in use in a number of jurisdictions, including Jersey. However, even in this weaker form, most economists believe that rent controls do more harm than good.[1]

Reduces the availability of rental housing

Rent controls set a limit on the absolute level of prices or the rate at which they are allowed to increase. In turn, this raises demand for housing relative to the market equilibrium (since the price is artificially low), and reduces the supply of housing (since landlords' would be less willing to rent), creating an excess demand for rental housing. In addition, third-generation rent control creates an incentive for tenants to stay in the same property, which reduces the turnover in the rental market.

[1] For a survey, see Jenkins (2009) *Rent Control: Do Economists Agree?* (Econ Journal Watch, Vol. 6).

Reduces the quality of rental housing

Rent control destroys landlords' incentives to maintain the housing stock. There is little incentive for landlords to invest in their properties to maintain and improve them if it will make no difference to the level of rent they will receive. Further, since price can no longer be used to allocate housing to those who are most willing to pay for it, another system of rationing is required. At best, the mechanism will be some form of waiting list or queuing system. However, it is quite plausible that the allocation mechanism becomes the willingness to tolerate bad housing conditions. In other words, since landlords will no longer get a higher price in return for maintaining their properties, they will neglect to do so, and the allocation of housing will then be made based on those who are willing to tolerate a poor standard of housing.

Causes misallocations of housing

Restrictions on price reduce its ability to bring supply and demand into balance; therefore other mechanisms must be used. There is no reason to believe that these mechanisms impose costs on potential tenants, and as a result, there is no reason to believe that properties will be occupied by those that value them the most. For example, if there is excess demand, landlords might choose tenants based on tenant characteristics. This has no cost to the tenant, and therefore the allocation of tenants to properties will not reflect the value placed on the properties.

There is also evidence that rent controls, particularly second- and third-generation controls, create an incentive for tenants to remain in a property for longer than they would otherwise, and an incentive for landlords to select short-term tenants.

Rent control is difficult to administer

As mentioned above, restrictions on price reduce the ability of the price mechanism to bring supply and demand into balance; therefore other mechanisms must be used. This may be queues or quality deterioration, but it also creates a significant incentive for a 'black market' in rental housing. This could manifest in a number of ways, including side-payments, bribes, over-the-odds payments for non-regulated items – for example items of furniture. If a rent control system is to work and be considered fair, these transactions would need to be policed, which is difficult and potentially costly.

Rent control does not achieve the distributional goals that it is often advocated as the solution for

There is some evidence that the effectiveness of second- and third-generation rent controls is hampered by the ability of landlords to set the initial price. To the extent that tenants are willing to pay a higher initial price in return for controlled increases, rent control simply alters the timing of payments rather than reducing them.

Even when they are effective at reducing prices, the evidence suggests that any benefits from rent controls are poorly targeted. Tenants as a whole don't benefit – some tenants lose out, while others gain – and there is little evidence that those that gain are the poorest or most vulnerable.

3. Conclusion

The economic literature on rent controls is fairly conclusive. Rent controls create substantial inefficiencies in housing markets without any redeeming contributions in terms of redistribution or fairness objectives.

If the objective is to support those on low incomes in obtaining affordable housing, then this objective would be better achieved using other policy levers such as the tax and benefit system. If the objective is to reduce the price of rental housing, then there are only 2 options: (a) increase the stock of rental housing, or (b) reduce the demand for rental housing.