

The Impact of Rent Control on the Private Rented Sector

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The Impact of Rent Controls on the Private Rented Sector: Executive Summary

Demand for private renting has grown substantially over the last 20 years, while rental supply has often lagged. This has boosted UK rental levels, particularly in major cities like London. With life returning to cities and an attendant recovery in tenant demand, rental levels have been rebounding sharply. Higher housing costs are also taking effect at the same time as a significant rise in inflation and the cost of living, placing pressure on households' finances. This has led to various City Mayors calling for powers to allow them to freeze rents, reigniting the debate about rent control in the UK.

However, whilst rent control may be socially desirable, in reality the costs may outweigh the benefits and, ultimately, such regulations could harm, rather than help, both the private rented sector (PRS) and its customers. This report sets out the main advantages and disadvantages of rent control, as summarised below:

Rent control benefits:

- Rent control enables people on lower incomes to access affordable accommodation
- Rent control prevents profiteering landlords from exploiting their tenants
- Rent control in some forms, can provide low risk, predictable income streams
- Rent control reduces tenant turnover

Unintended consequences of rent control:

- Rent control can reduce rental housing supply, and exclude more people in need of a home from the sector
- Rent control can favour tenants on higher incomes with stable employment at the expense of those on lower incomes and families
- Reduced incentives for property maintenance can reduce the quality of the rented housing stock
- Rent control can create a significant 'shadow' rental market
- Rent control can lead to reduced labour mobility

While motivated by the public and social good, the resultant consequences and side-effects of rent control can outweigh the initial benefits. As stated in a 2009 academic review, *"economic research quite consistently and predominantly frowns on rent control. [...] "the economics profession has reached a rare consensus: Rent control creates many more problems than it solves"*ⁱ. Meanwhile another famous quote says more succinctly *"rent control appears to be the most efficient technique presently known to destroy a city – except for bombing"*ⁱⁱ.

Rent control is gaining popular support as a solution for a problem, that of rising rents. However, the problem is, in itself, the consequence of a larger issue, namely a growing imbalance between the supply of and demand for housing. Introducing rent control to try to reduce the effects of the housing crisis is unlikely to solve the underlying problem: instead, policymakers should look to fix the housing crisis directly by increasing housing supply through simply encouraging and enabling a greater level of development across all tenures, both private and affordable. From a rental perspective, this should also include encouraging the establishment of a professional, large-scale Build to Rent sector.

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The Private Rented Sector (PRS): a changing landscape

The UK's housing landscape has changed significantly, with rising house prices making it harder for younger generations to climb onto the housing ladder. The private rented sector (PRS) has picked up a lot of the slack, growing from forming only 10% of overall household tenure in England at the start of the Millennium to 19% by 2022, and nearly 30% of households in Londonⁱⁱⁱ. Inevitably, this structural change has placed significant pressure on the burgeoning sector, particularly in London, leading to rising rental levels.

Figure 1: PRS rental growth vs. Average Earnings and CPI Inflation



Source: ONS, March 2023

As figure 1 suggests, rental levels in London have risen by c. 45% since 2007, falling behind average (UK) earnings growth, which has increased by 70%. Nevertheless, periods of above-average rates of growth in London often lead to renewed calls for rent controls in order to ensure that the Capital remains an inclusive and affordable place to live and work. More recently, significant rental growth in regional cities like Bristol have also placed rent control on local agendas elsewhere in the country.

However, while rent controls as a concept have gained in popular support, the reality is that such regulations are treating the symptoms but not the cause of the problem – in this case a fundamental imbalance between the demand for and supply of housing. While rent controls may appear to be a good “quick fix”, they may, in fact, do more harm than good in the long term.

What is rent control?

Rent control can come in a variety of different forms, but can broadly be split into three different types:

- **First Generation:** “Hard” rent controls, focussing on the entire sector which tend to enforce ceilings/ freezes, above which it is illegal to set rents. These were generally used in the early post-World War days of rent control where extreme situations called for extreme measures. However, such strict controls were only ever meant to be in place for short periods of time.
- **Second Generation:** These tend to allow rent controls in the form of restrictions to the level of rental increase, although they tend to allow rises to allow landlords to offset rises in costs etc.. They are binding for both existing and new tenancies.
- **Third Generation:** Seen as the most landlord-friendly version of rent controls. These generally allow rents on new tenancies to be set at open market rates but limit the size of the increase within existing tenancies.

Different countries have taken different approaches to rent control over the last century but it is perhaps a clear indication of the unforeseen and negative side-effects of rent controls that the way these are implemented has evolved and, to an extent, have been loosened over time. Even where more restrictive forms of rent control are implemented,

there are often exemptions proposed, such as for new build housing, in an attempt to counter some of the more harmful side effects of the regulations.

Rent control pros and cons

The benefits of rent control are clear and socially desirable but there are also a number of more damaging side effects that potentially mean that even those people who are expected to benefit from such a regime could ultimately lose out in the long term.

Rent control benefits^{iv}:

- Rent control enables people on lower incomes to access affordable accommodation
- Rent control prevents profiteering landlords from exploiting their tenants (assuming that rent control is also backed by some form of increased security of tenure)
- Rent control that limits rent increases within existing tenancies (e.g. to inflation) but does not limit the rental level of new tenancies (second generation controls) is attractive to landlords as it provides low risk, predictable income streams
- Rent control within tenancies (especially when aligned with security of tenure) tends to encourage tenants to remain in their existing accommodation for longer. Reduced tenant turnover may prove attractive for landlords, reducing the risks around their income streams

All of these factors imply that rent control in some form or another is socially and economically beneficial. However, the reality is that rent control can have very negative side-effects, even in those countries where the policy is perceived to be working.

The main disadvantages and unintended consequences

Reduced supply

Rent control can reduce rental housing supply both in terms of new construction and the amount of existing rented housing by deterring investors from entering/ encouraging them to leave the sector. Reducing the profitability of any business inevitably impacts its attractiveness and a 2015 study^v asking landlords how they would respond to the introduction of rent stabilisation measures in London indicated that almost 60% would sell some of their properties as a result. Indeed, many countries, such as Sweden, the Netherlands and Germany, have abolished rent controls on new build housing in an attempt to reverse this trend. In addition, UK rental supply has continued to reduce as a result of legislative changes relating to Buy to Let investors^{vi}. This demonstrates that landlords are very sensitive to negatively-perceived regulatory changes. This shift towards divesting, or at least reducing new investment, would likely be magnified if rent controls were implemented.

- Britain's own example, where institutional investors left the sector en masse due to strict rent control and security of tenure regulations in the post-War years only to return recently – and tentatively - after the introduction of the Assured Shorthold Tenancy (AST) is a case in point.
- A 2018 study^{vii} into the San Francisco rental market, shows that rent controls led to a 15% fall in the supply of rented housing, subsequently causing a 5.1% rise in rents in that city.
- The Danish Ministry of Finance is quoted in a report^{viii} as saying “The controls on and subsidies for the housing sector have a paradoxical effect [...] rent control legislation means that rents for regulated dwellings are lower than the rent a private landlord would accept for it to be profitable to build new dwellings. The demand for inexpensive regulated dwellings thus is higher than the offerings of such”.
- Stockholm is a well-known example where rent control has led to a huge imbalance between the demand and supply of privately rented housing. Indeed, in 2015, it was estimated that it takes nearly nine years to gain access to a rent-controlled property in the city^{ix} (or significantly longer in the more desirable neighbourhoods), a number that has remained around that level since, with c. 500,000 people already waiting for such properties, while the supply of rented accommodation remains restrained.
- In New York the construction of new build housing has declined sharply since the introduction of rent controls in 1969 as rent control has reduced potential profits^x.
- In the Netherlands, the PRS has declined sharply in recent years and this is seen as a result of the combination of rent control and policies that have incentivised owner occupation and social renting at the expense of private landlords^{xi}.

- The (2015) introduction of strict rental caps in Paris is believed to have led to a sharp reduction of c. one-third of investors in the sector^{xii}. These caps were then scrapped in 2017, having had the unintended consequence of significantly increasing rents in neighbouring areas that did not impose the caps^{xiii}, although they are now being reintroduced.
- Berlin's recent rent cap led to a fall in advertised rental supply of more than half, with landlords instead choosing to occupy their own homes or keep them empty^{xiv}
- A recent study into rent controls in the US^{xv} shows that between 2010 and 2018, rent controlled Californian cities saw growth in supply fall by 2%. Los Angeles is cited as a particular example where housing supply was almost 80,000 lower than it would otherwise have been.
- Introduced in September 2020, rent control in Catalonia resulted in rental supply dropping by 12% by February 2021. Rent control laws (2021) led to building permits for multi-family housing falling by 80% over a three-month period in St Paul, Minnesota, compared with the previous year.
- A study on the impact of rent caps in Berlin (2022) found a "considerable decline in the number of advertised rental units."

Benefits the groups least in need of affordable housing

Rent control can favour tenants on higher incomes with stable employment at the expense of those on lower incomes and families. Inevitably, when the price of any good or service is capped, it inherently becomes more attractive and accessible and thus increases the demand for it. Rising demand in the face of inelastic (and potentially falling) supply means that it becomes increasingly difficult for people to access that good or service. In the case of housing, this can lead to the situation where landlords, faced with a large number of applicants, will "cherry pick" the least risky tenants, namely those who have higher disposable incomes and who are in more stable and less complicated situations. Equally, situations may arise where tenants are encouraged to offer "key money" or similar incentives to secure rent controlled accommodation or properties end up being sub-let on the black market, again generally favouring wealthier tenants at the expense of those on lower incomes.

- A recent European Property Federation report into the Danish rental market indicates that "in reality, private rent control benefits the privileged^{xvi}"
- Stockholm is renowned for having a large black market where high "down payments" for first-hand contracts are the norm and where second-hand rental contracts charge rates that are much higher and for a much shorter let than they would be for a first-hand rental contract^{xvii}.
- A study by Faust & Karreskog^{xviii} highlights that people with "greater social capital" are often able to better access these kind of tenancies and then tend to retain them, for example within their own families, potentially for decades. This has led to greater segregation within cities.
- Cities in the USA (New York, Santa Monica) tend to experience the situation where tenants in rent-controlled housing have higher incomes than the properties' owners and often pay a higher cost for those apartments than the actual controlled price^{xix}, putting them out of reach of those on poorer incomes.
- Even the controls introduced in certain German cities in 2015 have shown signs of this: the "Mietpreisbremse" (rental price brake) has already been roundly criticised and it has been suggested that, as well as violating Germany's constitution, it is already leading to landlords favouring tenants on higher incomes over those on lower incomes^{xx}, exactly the opposite to the intentions behind the introduction of the legislation.
- A USA report on rent control suggests that "Rent control appears to help affordability in the short run for current tenants, but in the long run decreases affordability, fuels gentrification, and creates negative externalities on the surrounding neighbourhood^{xxi}"
- A 2021 paper ran a model of the subsequently implemented Berlin rent cap which found it ineffective in helping low-income households and only benefiting higher income individuals.^{xxii}
- A paper by Donner & Kopsch^{xxiii} shows that tenants in rent-controlled apartments in Stockholm had incomes that were 30% above average. Other analysis has suggested these kinds of trends have also been echoed in other major cities from San Jose to Los Angeles and San Francisco.

Poorer quality of supply

By affecting the rent that can be charged on a property, landlords are often forced to reduce costs in order to maintain a profit margin, notably by reducing the amount of money that is spent on maintenance or property upgrades. This therefore reduces the quality of the rented housing stock.

- This has, for example, been demonstrated in a number of studies of the rental market in the USA^{xxiv}.
- The OECD has also commented that “one of the main lessons to be drawn from the experiences of Denmark and many other European countries is that rent controls, most often without proper regard for incentives to maintenance, have serious long-term effects on the quality of the relevant housing stock”^{xxv}
- This was the case in Vienna, with landlords limiting maintenance and repair spend as they cannot recoup this through higher rents.
- In Sweden, landlords can only increase rents if the property is also renovated. However, this has had the impact of both delaying maintenance work for as long as possible, disadvantaging existing tenants, before then renovating the property to an extremely high standard in order to access an elevated rent, which lower income households are likely unable to afford^{xxvi}.

Reduced labour mobility

Although rent control can lead to reduced tenant turnover, this also inherently means reduced labour mobility^{xxvii}, as tenants will be reluctant to relinquish a good rent-controlled apartment, potentially disadvantageous given the increased need for flexibility in today’s labour market. Ironically, rent control can also lead to the perverse situation where tenants cannot afford to move as they may not be able to afford the rent elsewhere in the city, often leading to the misallocation of housing^{xxviii}. If tenants are unwilling or unable to leave their rent-controlled building to follow job opportunities, this could also potentially increase unemployment in that location. This has been shown by a report on the US market^{xxix}, suggesting that San Francisco tenants would stay more than 20% longer in rent controlled apartments, while, in New York, almost 25% of tenants in stabilised units have lived there for more than 20 years, versus c. 7% in units without rent controls. This can also “trap” households on lower incomes in one particular location, potentially meaning they will miss out on better job opportunities elsewhere.

Higher rents in non-rent-controlled areas

Evidence^{xxx} suggests that controlling rents in one market raises rents, and therefore worsens affordability, elsewhere.

- In New York, analysis has suggested that removing rent control would reduce rents in uncontrolled properties by as much as 25%^{xxxi}.
- A 2022 study on the near-term impacts of the Berlin rent cap’s found that rents surged in Berlin’s satellite city Potsdam and further neighbouring municipalities, indicating a substitution effect.^{xxxii}
- The US study by Njolomole^{xxxiii} demonstrated that, in Los Angeles, in addition to reducing potential rental supply, rents in the city were almost 4% higher than they would otherwise have been.

Rent control: a potentially disruptive influence

Rent control is designed to be a socially beneficial tool that attempts to ensure that all people in society, and notably those lower down the income scale, can continue to afford to live in suitable accommodation wherever they choose, whilst clamping down on the negative behaviours of rogue, profiteering landlords. This is undeniably an important goal. Unfortunately, the reality of the situation is often that rent control can exacerbate the affordability problem by reducing available supply, whilst increasing demand. This has been known to lead to flourishing black markets, ultimately harming the very people that such regulations are often intended to protect. The attendant deterioration of the housing stock is also likely to hit those on low incomes and families the hardest as they are then less likely to be able to access better-quality accommodation.

Where rent control has been seen to be working there tend to be generous fiscal incentives in place for landlords that help to offset the impact of the regulations to some degree and enable landlords to maintain a level of profitability from their investments. This is an important consideration to be taken account of for any public body considering introducing rent control policies.

Experience tends to suggest that the rent control regimes that appear to have had a less damaging impact on the functioning of the private market have generally been those that are the most flexible: for example, those that implement “Third Generation” rent controls appear to be less of a deterrent to landlords and have fewer harmful side effects and so cause less disruption to the market.

Rent control is also only part of the story – this type of regulation tends to go hand in hand with security of tenure. While this can be highly beneficial for both landlord and tenant, providing cash flow predictability and reducing costs, it can also, if too strict, disrupt the PRS. Indeed, it was this combination of anti-landlord rent control and security of tenure regulation that previously helped to drive UK institutional investors from the market. It has only been over the last decade that this has started to reverse.

Fundamentally, however, while rent control may be seen as a solution for a problem, that of rising rents, it is the underlying cause of that problem that needs to be tackled, namely a growing imbalance between the supply of and demand for housing. Introducing rent control to try to reduce the effects of the housing crisis is simply trying to fix the results rather than the underlying problem: instead, policymakers should look to help to solve the underlying problem of the housing crisis directly by increasing housing supply through simply encouraging and enabling a greater level of development across all tenures, and specifically from a rental perspective by encouraging the establishment of a more professional, large-scale build to rent sector.

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