

Rent control: will the ALUR law be sufficient?

By Sabine Le Bayon, Pierre Madec and Christine Rifflart

On 10 September 2013, Parliament began discussing the [bill on “Access to housing and urban renovation \[“Accès au Logement et un Urbanisme Rénové” – ALUR\]](#). This legislation will result in stepped-up state intervention in the private rental market and complements the government decree that took effect in summer 2012 on rent control in high-pressure areas. This was an initial step in the government’s effort to curb the increase in housing costs being faced by renters. [1]

The government’s willingness to regulate the excesses of the private rental market is expected to have a rapid impact on households moving into a new home. For sitting tenants, the process is likely to take longer. In a city like Paris, we can expect that, if the highest rents decline to the ceiling set by law, average rents will fall by 4 to 6%. If through a ripple effect this then affects all rents, the deflationary impact would be greater. On the other hand, the risk of an upward drift for lower rents cannot be discarded, even if the government argues otherwise. Ultimately, the impact of the law will depend in large part on the zoning defined by the rent monitoring “observatories” that are currently being set up.

The regulatory decree: a visible, but minimal, impact

The latest [annual report](#) of the rent observatory for the Paris region [the Observatoire des loyers de l’agglomération parisienne – “OLAP”] [2] sheds some initial light on the decree’s impact on rent control. To recap, the decree holds rents upon re-letting to a maximum of the pace of the legal benchmark (the “IRL”), unless substantial work has been performed (in which case, the increase is unrestricted).

Between 1 January 2012 and 1 January 2013, 51% of Paris residences offered for re-letting saw their rent increase faster than the IRL, despite the absence of substantial work. This share was lower than in 2011 (58.3%) and 2010 (59.4%), but remains close to the level observed between 2005 and 2009 (50%), prior to the existence of the decree.

The impact derived from monthly data seems a bit more conclusive. Thus, over the period from August to December 2012 when the decree was implemented, the share of rentals offered for re-letting that rose faster than the IRL cap fell by 25% on average over a year, against only 8% for the months from January to July 2012 compared to the same period in 2011.

The decree therefore does seem to have had an effect, by helping to reduce the share of rents that increased faster than the IRL cap by about 18%. However, given that if there had been full compliance with the decree no rentals would have risen more than the IRL, the impact has still been inadequate. Several factors already identified in a [working document](#) may explain this: the non-existence of benchmark rents, a lack of information about both owners and tenants, a lack of recourse, etc. One year on, it would seem that these shortcomings had a negative impact on the measure's implementation.

A law on a larger scale

The major innovation of the ALUR law concerns the regulation of the level of rent in high-pressure areas, whereas previous decrees focused on *changes* in rents. Henceforth, a range of permissible rent levels will be set by law, and the decree will then regulate the maximum permitted changes [3]. To do this, every year the government sets by a prefectural decree a median benchmark rent per sq.m, per geographic area (neighbourhood, district, etc.) and per type of accommodation (one-bedroom flat, two-bedroom, etc.). So:

- For new lets or re-lettings, the rent cannot exceed the cap

of 20% over the median benchmark rent, called the upwards adjusted median benchmark rent, except by documenting an exceptional additional rent (for special services, etc.). After that, any increase may not exceed the IRL, in accordance with the regulatory decree for high-pressure areas (except if there is major work);

- Upon renewal of the lease, the rent may be adjusted upwards or downwards depending on the upwards adjusted or downwards adjusted median benchmark rent [4]. Thus, a tenant (or a lessor) may bring an action to decrease (or respectively, to increase) the rent if the latter is higher (or lower) than the median rent as adjusted upwards (or downwards). In case of an increase in the rent, a mechanism for staggering this increase over time is set up. If there is a disagreement between tenant and landlord, an amicable settlement process may be initiated prior to referral to a judge within a strictly determined timeframe. Within this range, the increase is limited to the IRL;

- During a lease, the annual rent review is currently performed as now, on the basis of the IRL;

- Furnished rentals will now be covered by rent control: the prefect will set a higher benchmark rate and any change will be limited to the IRL.

The introduction of these median benchmark rents represents three major advances. On the one hand, they will be calculated from the information gathered by the rental observatories about the entire rental housing stock, and not simply from vacant housing available for rental, *i.e.* what is called the “market” rent. This so-called market rent is almost 10% above the average of all rents, which itself is above the median rent. This calculation method will therefore inevitably lead to lower rents (both market and average).

Similarly, choosing the median rather than the average as the

benchmark rent should make for greater stability in the measure. In the event that all rents more than 20% above the median (*i.e.* above the upwards adjusted benchmark rent) are reduced and all other rents remain unchanged, the median remains the same. In the case of an adjustment of all rents, the median would fall, but in a lesser proportion than the average, which by definition is more sensitive to changes in extreme values.

Finally, the obligation to include in the lease both the median rent and the upwards adjusted median benchmark rent, the last rent charged and, where relevant, the amount and nature of any work performed since the last contract was signed, provides for greater transparency and a stricter regulatory framework, which should result in greater compliance with the measure.

What changes should be expected?

In 2012, out of the 390,000 residences put up for rent in Paris, 94,000 have a rent higher than the upwards adjusted median rent (3.7 euros / sq.m more on average) and 32,000 have a rent that is more than 30% below the median benchmark rent (2.4 euros / sq.m less on average). Since only rents above the upwards adjusted median rent are to be corrected, the reduction in the average rent would be 4% to 6%, depending on the area and type of housing. This reduction, although not insignificant, would at best permit a return to the rent levels recorded in 2010, before the steep inflation seen in 2011 and 2012 (+7.5% between 2010 and 2012). This adjustment in rents could nevertheless take time. Owners and tenants could easily exercise their rights at the time of a re-letting [5], but revaluations at the time of a lease renewal may take longer to realize. Despite access to information and a regulatory environment that is more favourable to the tenant, the risk of a conflict with the landlord and heightened competition in the rental market in areas where the law applies may still deter some tenants from asserting their

rights.

The issue is much more complex for the 32,000 residences with rents below the downwards adjusted benchmark rent. While the quality of some of this housing can justify the difference (insalubrious, location, etc.), it is also clear that the main factor behind the weakness of some rents is the tendency of tenants to be sedentary. Thus, according to the OLAP rent observatory in Paris, the average rent for housing occupied for over 10 years by the same tenant is 20% lower than the average rent for all lets. The question thus arises of revaluing these rents. Indeed, during a new let or a lease renewal the law allows owners to reassess up to the level of the downwards adjusted median rent – which is also in contradiction with the decree [6]. Once this level has been reached, future changes shall not exceed the IRL.

Eventually, then, some units with similar characteristics will therefore be on the market at very disparate rents, thus penalizing landlords with sedentary tenants. In contrast, tenants who have lived in their homes for a long time might well see significant revaluations in their rent (over 10%). The housing cost burden [7] on these households could thus rise, pushing those facing excessive budget constraints to migrate to areas experiencing less pressure.

Nevertheless, the possibility of revaluing the rent to the level of the market rent in case of an obvious undervaluation is already provided under existing law, *i.e.* the Act of 6 July 1989 (Article 17c), at the time the lease is renewed. In 2012, in Paris, 3.2% of owners made use of this article. With the new law, while readjustments should be more numerous, the inflationary impact should be weaker as the benchmark (the downwards adjusted median rent) is well below the market rent.

From this point on the issue of zoning is central: the more refined the breakdown, the more the benchmark rents will correspond to the actual characteristics of the local market.

In the event of a larger division of the territory, the median benchmark rents may be too high for the less expensive neighbourhoods and too low for the more expensive ones. Meanwhile, low rents will not be re-valued much in the expensive neighbourhoods, and even less so in the others. This could lead to more “inter-neighbourhood” convergence in rents – regardless of local conditions – and less “within-neighbourhood” convergence, which would have adverse consequences for both landlord and tenant.

The impact on rents of the law currently under discussion could be all the greater given that property prices began to fall in France in 2012 and the current sluggish economy is already slowing rent hikes. But it should not be forgotten that only the construction of housing in high-pressure areas (including via densification [8]) will solve the structural problems of the market. Rent control measures are merely a temporary measure to limit the increase in the housing cost burden, but they are not by themselves sufficient.

[1] For more information, see the blog [“Rent control: what is the expected impact?”](#)

[2] The territory covered by this report is composed of Paris and what are called the “petite couronne” and the “grande couronne” (its near and far suburbs).

[3] As the rent control decree does not cover the same field as the law (38 urban areas versus 28), some areas will be subject to the control only of changes, and not of levels.

[4] While the bill is unclear on the calculation of the downwards adjusted benchmark rent, an amendment adopted in July by the Commission of the Assembly proposed that this should be at least 30% lower than the median benchmark rent. Another amendment clarifies that in case of an upward adjustment, the new rent shall not exceed the downwards

adjusted median rent.

[5] In 2012, only 18% of residences on the private rental market were subject to re-letting.

[6] During the renewal of a lease or a re-letting, the rent control decree permits the owner to re-value their rent by half the gap between the last rent and the market rent.

[7] This is the share of household income spent on housing.

[8] On this subject, see the article by [Xavier Timbeau, "Comment construire \(au moins\) un million de logements en région parisienne" \[How to build \(at least\) one million residences in the Paris region\]](#), *Revue de l'OFCE* no. 128.

Rent control: What is the expected impact?

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[The decree on rent control](#), which was published in the *Journal officiel* on 21 July, takes effect on 1 August 2012 for one year. The measure was announced in January 2012 during François Hollande's presidential campaign. It has now been adopted, while awaiting the major reform of landlord-tenant rental relations that is scheduled for 2013.

Difficulties in finding housing and deteriorating living conditions for an increasing share of the population point to growing inequality in housing. This inequality is undermining social cohesion, which is already being hit by the economic

crisis. For many people, homeownership is becoming a problematic proposition due to the rising cost of buying, while applications for the allocation of social housing remain on hold for lack of space, and the private rental market is becoming increasingly expensive in large cities because of the soaring price of property. Rent control in these cities is serving as an emergency measure to slow the price increases. This poses a challenge of keeping investors in the private rental market, which is already characterized by a shortage in housing supply and very low rental returns (1.3% in Paris after capital depreciation).

The decree aims to significantly lower market rents [2], which are being driven up by rents at the time of re-letting, *i.e.* during a change of tenant. Unlike rent during the lease period or upon renewal of a lease, which are indexed to the IRL rental benchmark, until 31 July 2012 rents for new tenants were set freely. In 2010, this applied to nearly 50% of re-lettings in the Paris area (60% in Paris). Now, in the absence of major renovations, these will be subject to control. Only rents for new housing that is being let for the first time or renovated properties (where the renovation represents more than one year's rent) will remain uncontrolled (Table 1).

Table 1. The method of setting rent under current law

Legal framework set by	Renewal of lease	Re-letting	First letting and new housing
Act of 6 July 1989 as modified	<ul style="list-style-type: none"> - Indexed to the IRL - In case of obvious under valuation, re-evaluation over 3 years or 6 years if the difference is greater than 10% - In case of renovations, increase agreed in advance between the landlord and tenant 	Uncontrôle	Uncontrôle
Decree for the Paris region	<ul style="list-style-type: none"> - Indexed to the IRL - In case of obvious under-or renovation for an amount at least greater than 1 year's rent, authorized increase of half the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.) 	Uncontrôle	Uncontrôle
Decree of 21 July 2012 (applicable in the relevant municipalities)	<ul style="list-style-type: none"> - Indexed to the IRL - In case of obvious under-valuation or of renovation for an amount at least greater than 1 year's rent in the private or common areas, authorized increase of either half of the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.) 	<ul style="list-style-type: none"> - Indexed to the IRL - In case of an obvious under-valuation or of renovation for an amount between 6 month's rent and 1 years' rent in the private or common areas, authorized increase either of half of the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.) - Uncontrolled if renovation of at least 1 year's rent 	Uncontrôle

By using the [data from the Observatoire des Loyers de l'Agglomération Parisienne](#), along with the hypotheses set out in the [OFCE Note \(no. 23 of 26 July 2012\)](#), "Rent control: what is the expected impact?", we evaluated the impact this decree would have had if it had been implemented on 1 January 2007 and made permanent until 2010. According to our calculations, this decree would have resulted not only in sharply slowing increases in rents for re-lettings during the first year it was applied (+1.3% in the Paris area, against 6.4% observed), but also in stabilizing or even reducing rents at the time of the next re-letting, *i.e.* in our example, three years later (in 2010, 0% in Paris and -0.6% in the Paris region). Finally, in 2010, rents would have been 12.4% lower in Paris and 10.7% lower in the Paris region than they would have been in the absence of the measure. This means that in Paris, rents would have been about €20.1 per sq.m instead of the rate of €22.6 per sq.m actually observed (Table 2). For an average size dwelling (46 sq.m) re-let in Paris, the monthly rent would thus have been €924 instead of €1,039, a savings for the tenant of €115 per month. For the Paris region as a whole, using the same assumptions, the rent upon re-letting would have fallen on average to €15.9 per sq.m, instead of the

actual €17.8 per sq.m. For an average rental area upon re-letting of 50 sq.m, the gain would be €95 per month!

Over the longer term, the decree would make it possible to reduce the gap between sitting tenants in place for more than 10 years and new tenants (a gap of 30% in 2010 in the Paris region and 38% in Paris itself), and to improve market fluidity.

Currently, what possibility is there of moving if the mere fact that a couple has children increases the price per sq.m by over 15% in the Paris region? Similarly, the financial incentive to move for a couple living in a four-room 80 sq.m dwelling whose children have left home is zero, because the rent for a 60 sq.m unit with 3 rooms would cost just as much. This premium on being sedentary increases the pressure on the rental market and encourages households to stay in properties that are not suited to their needs, and even hampers labour market mobility.

Can this measure encourage mobility and restore household purchasing power? In the short term, it will certainly benefit the most mobile households by limiting the increase in the share of their budget spent on housing [3]. But these are the households facing the least constraints on income, that is to say, those with high incomes or a relatively low share of income spent on housing. It will also benefit households that are forced to move or those who are running up against the limits on their finances. For all these households, the increase in the share of income on housing will be lower than it would have been without the decree. In contrast, for low-income households whose share is already high [4], the decree won't change anything, because they can ill afford the additional cost of re-letting.

Table 2. Simulated change in rents upon re-letting in the Paris region using the hypothesis that the decree took effect on 01 Jan 2007

	Rents noted letting on 31/12/2006	Rents after re-letting on 01/01/2007	Change in 2007	Rents on 31/12/2009 after indexing to IRL and before re-letting	Rents on 01/01/2010 after letting	Change in 2010	Gap between observed and simulated rents upon re-letting in 2010
PARIS		19 €/m ²	2.2 %	20.1 €/m ²	20.1 €/m ²	0 %	-12.4 %
Actual	18.6 €/m ²	(20.1 €/m ²)	(+ 8.3 %)	(20,9 €/m ²)	(22,6 €/m ²)	(+8,3 %)	
PARIS REGION		15.4	1.3%	16 €/m ²	15.9 €/m ²	-0.6 %	-10.7 %
Actual	15.2 €/m ²	(16.2 €/m ²)	(+ 6.4)	(16.9 €/m ²)	(17.8 €/m ²)	(+5.7 %)	

What are the risks?

While there are real benefits to be expected, these would still need to be made viable by the application of this decree, or at least by the next Act. Besides the difficulty of implementing the decree (absence both of reliable mechanisms to monitor rents in the areas concerned and of a legal framework to allow tenants to assert their new rights), the impact of this measure will be positive for tenants only if the rental supply does not shrink (by maintaining current investors in the market and continued new investment) and if landlords do not seek to offset future rent control by raising the rent at the time of the first let.

Likewise, the realization of improvements in line with the Grenelle 2 environmental consultation or simply maintenance work could wind up being abandoned due to the lengthening of the amortization period for landlords compared with the previous situation. Conversely, some owners might be encouraged to carry out major renovations (in excess of one year's rent) and "to upgrade the dwelling" in order to be able to freely determine the rent. This would give the landlord a margin of safety to offset any subsequent shortfall. These increases, if they occurred, would penalize less creditworthy tenants and would promote the process of gentrification already at work in the areas under greatest pressure. We could then see increasing differences between the market for

“rundown housing” and that for renovated housing.

This decree should in the short term limit the extent of disparities in the areas under greatest pressure, at no cost to the government. But it will not solve the problem for the poorest households of the share of income going to housing: to do this, it is necessary to increase the stock of social housing, to improve its fluidity and to significantly upgrade housing subsidies [5], which would require a major financial effort. The fundamental problem remains the lack of supply, particularly in urban areas, where by definition the available land is scarce and expensive, with higher rents simply passing on the price of property. However, to ease housing prices, more land needs to be available, with a greater density where possible, transport needs to be developed to facilitate the greater distance travelled between residential areas and workplaces, and so on. These are the levers that need to be used if we are to improve the housing conditions of less well-off households.

[1] The decree applies in municipalities where the rent increases seen over the period 2002-2010 were more than double the increase in the IRL benchmark (*i.e.* 3.2% per year) and the market rent per sq.m exceeds the national average outside the Paris region (€11.1 /sq.m) by 5%. This includes nearly 1,400 communes in 38 cities (27 in metropolitan France and 11 in overseas departments).

[2] There are two types of rent: the average rent is the rent of all rental housing, whether vacant or occupied; and the market rent is the rent of all dwellings available on the rental market, *i.e.* new rental accommodation and re-lettings. This is very close to the rent for re-lettings, as residences for first-time lets represent only a small portion of the

available supply.

[3] This share has increased for 15 years for households in the private rental sector, and particularly the less well-off.

[4] In 2010, more than half of private sector tenants spent an income share on housing (net of housing benefit) of over 26.9%, but above all, the share was 33.6% for the poorest 25% of households.

[5] According to the IGAS report "Evaluation of personal housing assistance", in 2010, 86.3% of rents in the private rental sector were greater than the maximum rent taken into account for calculating housing benefit. Any increase in rent is thus borne entirely by the tenant.