

VIEWPOINT

The Opportunity Cost of Rent Control

CBRE RESEARCH
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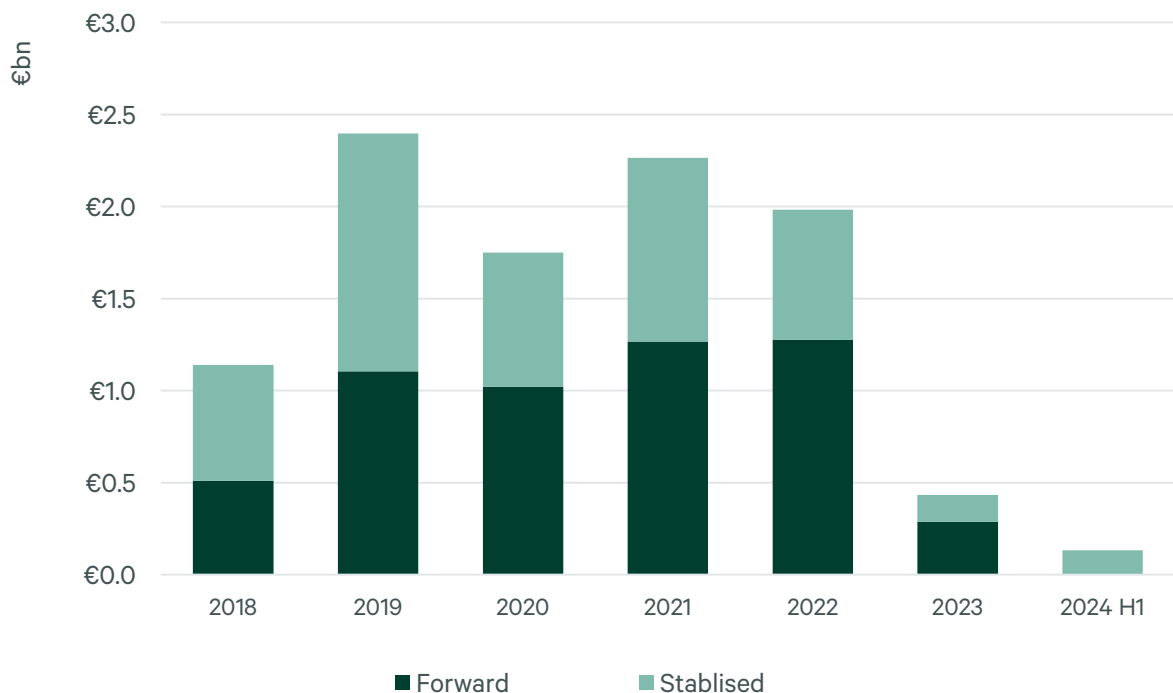
In the years 2018 to 2022, a total of €9.5 billion was invested into the residential sector in Ireland by institutional investors. The majority of this investment was made by investors based outside of Ireland, and indeed, many of the domestic institutional investors active during this period used internationally-sourced finance.

Of this €9.5 billion, more than €5 billion was deployed by investors acquiring assets in ‘forward structured’ transactions. The bulk of these acquisitions were for private rental sector apartments in Dublin and the Greater Dublin Area. With an average of just over €1 billion of capital deployment per annum, and assuming an average unit cost of €500,000, these transactions were accounting for the supply of 2,000 new apartment units per year and 10,000 units over the course of five years.

The majority of this investment was made through ‘forward commitments’, a transaction structure in which an investor agrees to purchase a development, typically at the early or mid-construction stage of development, with the transaction then concluding at the end construction.

Separately, a handful of large-scale transactions were structured as ‘forward funds’, whereby institutional investors funded the construction of apartment developments, taking ownership of the subject site in the first instance, and then funding the development on a phased basis, before taking full ownership of the development on completion of construction. The primary example of this was German investor Union Investment forward funding 435 rental units with developer Ballymore at 8th Lock in Rathbourne, west Dublin, in 2021.

Figure 1: Irish Residential Investment Volumes – Forward vs Stabilised



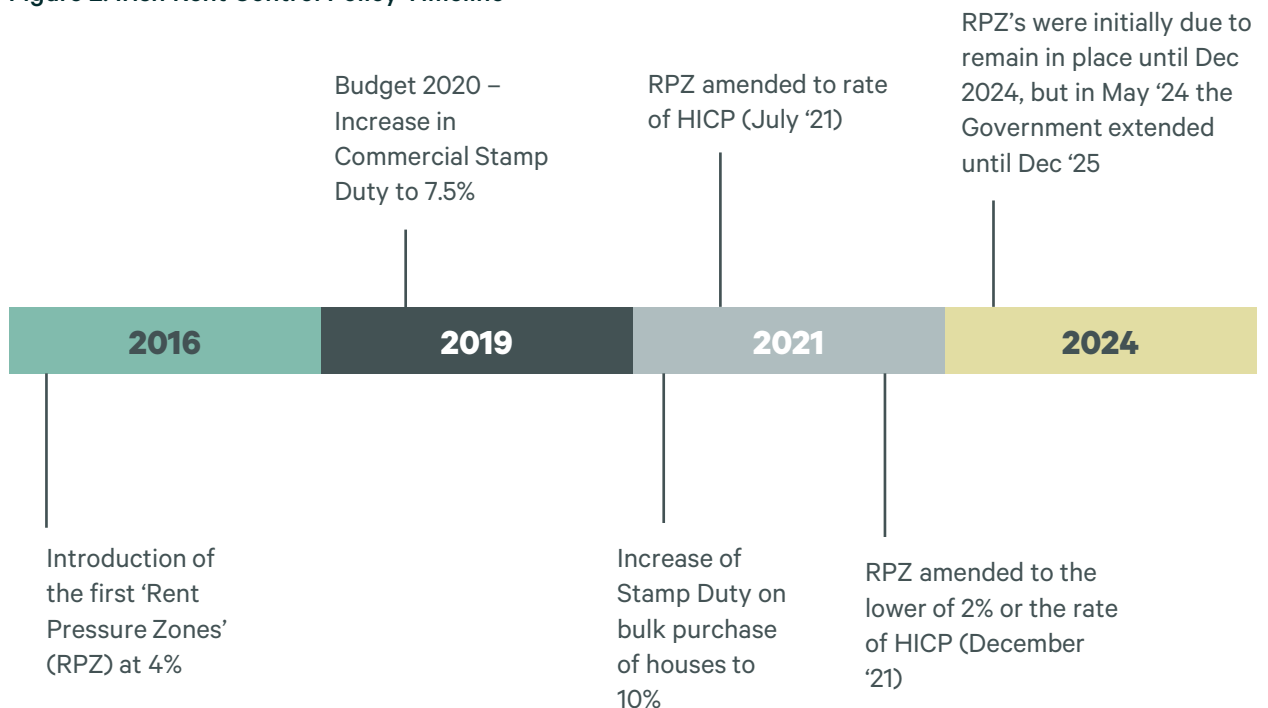
Source: CBRE Research

The extent of the investor interest in these types of transactions meant that domestic developers were able to move forward with planning and commencing the construction of large-scale, modern, sustainable, and amenity-supported apartment developments throughout this period. The higher probability of a bulk exit sale reduced development risk significantly, while the bulk sale mechanism also allowed developers to complete the disposal efficiently and to move on to their next development project much more quickly. This resulted in a significant increase in the construction of private rental apartments that are still carrying through to completion today. However, since the start of 2023, just one forward structured residential investment transaction has been originated in the Irish market, and that transaction was largely a carryover from the previous year. Essentially, no new transactions of this type have been originated in the Irish market since 2022.

There are a number of reasons for this, including the sharp increase in the cost of capital and construction costs that occurred from 2022 onwards. However, the key underlying reason that has discouraged investment is centred around Irish rent control policy, which was adjusted again in December 2021, limiting annual rent increases to the lower of 2% per annum or the rate of HICP. Equally as punitive and discouraging to investment is the fact that this rent control applies to the next letting of a property even at the end of the previous tenancy (unless the property is left vacant for 24 months). With these measures in place, and considering the higher cost of capital, underwriting these investments to meet standard return requirements becomes unviable.

However, we have now seen two cuts to base interest rates by the ECB in the last four months, and clearly the market is firmly on a path to a materially lower cost of capital over the next 18 months. It is at this point we need to assess Irish rent control policy. Allowing some flexibility, particularly to rent caps at newly constructed apartment development, could help to unlock a portion of supply that is currently locked out of the market.

Figure 2: Irish Rent Control Policy Timeline



Source: CBRE Research

Through our work at CBRE, we regularly speak with the largest institutional investors in Europe and North America on their investments in Ireland. Over the last two years, our periodic discussions with decision makers controlling potentially billions worth of investment into the Irish residential market have centred on rent control, and its impact on the viability of investing into Irish apartment development. Our conversations with these investors follow a similar theme and trajectory. Ireland’s economic, employment, and demographic growth make it an incredibly attractive place to invest. The fundamentals are positive, but unfortunately, investment into the residential sector is largely unviable with the rent control policy that is currently in place.

Of course, tenant protections in some form can be required in a market that faces the challenges that Dublin and much of Ireland do. But fundamentally locking out up to €1 billion of capital per annum that could support the development of thousands of apartments in a market that is so fundamentally undersupplied is not something we can afford to do.

Irish Institutional Property research has consistently highlighted the gap that exists in funding residential development in Ireland. To reach the initial National Planning Framework objective of 50,000 new dwelling completions per annum, approximately €15.1bn of funding is required.

The State allocated €4bn per year under Housing for All through several different initiatives on both the supply side and demand side. Of course, the level of government capital has been scaled up somewhat since then, but regardless, if we are to reach 50,000 to 60,000 new dwelling completions per annum, then clearly a significant funding gap exists. To have any hope of reaching these targets, then a holistic approach to housing development with both public and private capital playing a role is required.

Figure 3: Residential Development Finance Requirements



Source: IIP

Scottish Rent Control

Scotland is a recent example of a country implementing rent control measures. The Cost of Living (Tenant Protection) (Scotland) Bill, which included a rent freeze and moratorium on evictions, was put in place from September 2022. From April 2023, the rent freeze was lifted, and a 3% annual rent increase was allowable, but with an exemption put in place for private landlords who could raise rents by up to 6% in order to cover certain costs. In September 2023, the Scottish Government confirmed that this rent cap and eviction moratorium would come to an end in March 2024.

Research from Propertymark (a Scottish estate agent membership body) stated that "landlords in Scotland were increasing rents between tenancies to cover their costs and anticipated costs due to a fear of ongoing rent control legislation". They also highlighted that in the long term, these rent control measures would lead to billions of pounds worth of investment being lost.

The Scottish parliament is currently reviewing a national Housing Bill that was published in March of this year. Reports suggest that the rent control policy within the Bill is being reviewed to ensure it is less restrictive than initially outlined.

Dutch Exemption for Newly Constructed Developments

Another jurisdiction where rent control policy is worth analysing is the Netherlands. New rent controls introduced under the Affordable Rent Act in July of this year increased the number of rent-controlled properties to 96% of the country's entire rental market, the highest proportion of rent-controlled homes in Europe per the OECD.

The Act introduced a law that saw properties graded to determine the maximum rent a landlord can charge. The grading is based on the official value, number and size of rooms, design, energy efficiency and outdoor space. This year, rent for social housing can increase by a maximum of 5.8% while housing graded at over '143 points' can experience annual rent increases of at most 5.5%.

Notably, however, there are some exemptions to this regulation for developers who begin construction of new rental properties before 2028. In these cases, landlords will be allowed to charge a surcharge on the maximum rent cap for a period of 20 years.

This is something worth noting in an Irish context. If the goal is to maintain a fair market for renters but also to continue to promote supply from all private sources, then perhaps a similar methodology is worth exploring in our market, giving an exemption to newly constructed development in order to reignite private rental apartment supply.

Contacts

Colin Richardson

Director
Head of Research &
Consultancy
colin.richardson@cbre.com

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