How effective is the German “Mietpreisbremse”?

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Finance and Real Estate Markets

The European Real Estate Society, Industry Seminar Berlin, Friday, 31st March 2017
Motivation

Measuring and isolating the causal effect – improve (or skip) regulation

German literature
• Most offers with too high rents (Deschermeier et al. 2014/2016)
• Rents are still rising with Mietpreisbremse (Thomschke/Hein 2016)
• Mietpreisbremse does not work (Kholodilin/Mense/Michelsen 2016)
• Database of underlying rent surveys ("Mietspiegel") is insufficient (Sebastian/Lerbs 2015, Kauermann et al. 2016, Voigtländer 2016 et al.)

International literature
• Misallocation of housing under rent control (e.g. Glaeser/Luttmer 2003)
• Slow construction activity, depress investments for refurbishment and maintenance (e.g. Anderson 1998)
• Empirical evidence: Rent control bears small effects, however owners shift units away from rental status and reduce rents (Sims 2007)
High attraction of big cities

Demographics has changed rapidly in Germany

Source: Fotolia
Shortage of residential flats

A problem of the whole society
Huge shortage in the big cities

Construction needs vs. constructed units in the big seven cities

Berlin: Shortage of 20,000 housing units every year!
Rents are (still) continuously rising

Average Rents for new rented dwellings in apartment buildings (2005=100)

1th June 2015
Introduction of the Mietpreisbremse

Quelle: F&B
German rental brake („Mietpreisbremse“)

The political response of a societal problem

• Political Targets:
  • Limitation of rental price increases
  • Reduction of housing costs
  • Keeping and expanding affordable housing

• Rule: Rents for new contracts maximum 10 percent over local average rent („ortsübliche Vergleichsmiete“)

• Exceptions:
  • New constructed buildings
  • Considerably refurbished buildings

Bildquelle: Fotolia
German Landlord-Tenant Law:
High level of protection for sitting tenants
Till 2015: no restriction on the initial rent on a *new lease*

**Existing lease contracts**

- §557 BGB: *Index rent*

- §558 BGB: *Rent capping limit*: increase for a 3-year period must not exceed 20% (in declared tensed communities: 15%)

- §559 BGB: after improvements, *e.g.*, modernization, especially energy conservation measures, annual assessment is limited to 11% of the costs related to the modernization of the specific rental unit

**New lease contracts**

- No regulation before 1th June 2015
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Existing lease contracts

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New lease contracts

• §556 BGB: Mietpreisbremse: Rents for new contracts must not exceed local average rent (“ortsübliche Vergleichsmiete”) by more than 10%
What is a tensed market situation?

Länder governments define communities in tensed (“angespannt”) residential markets for (initially) 5 years in acts (“Verordnungen”)

The following issues must be fulfilled:
• Rents rising higher than nationwide average
• Average rent-to-income-ratio is higher than nationwide average
• Population rise and too low construction of new buildings
• Low vacancy rate while demand for homes is persistently high

Mietpreisbremse in force in ca. 310 communities
Rent surveys (Mietspiegel)…

… define local average rent ("ortsübliche Vergleichsmiete")

- However, municipalities and counties are not obliged to prepare a rent survey
  - Qualified rent surveys (n ~ 130)
  - Simple rent surveys (n ~ 600)
  - No rent surveys (n ~ 10.500)
- Qualified rent surveys ("qualifizierte Mietspiegel")
  - are recognizing scientific principles
  - are based on local rental contracts of the last 4 years
  - are updated every 2 years
- Qualified rent surveys differentiate across size, year of construction, interior equipment and location

… however, what is a “good / high standard” location?

- Source: Fotolia
### Case of Berlin: The rent survey (Mietspiegel)...

<table>
<thead>
<tr>
<th>Wohnfläche</th>
<th>Wohnung</th>
<th>Ausstattung</th>
<th>Wohnfertig</th>
<th>Altbau</th>
<th>Neubau</th>
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<td>6.48</td>
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<td>90 m² und mehr</td>
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<td>5.98</td>
<td>6.72</td>
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</table>

**Source: Berliner Mietspiegel 2015**
Concept of location categories (Wohnlagen)

Map of Berlin

- Differentiation on a macro-level is far too rough!
- Also micro-levels must be considered

Sources: Cologne Institute for Economic Research, Mietspiegel Berlin 2015
Data for advertised dwellings from Immobilienscout24

120,000 observations from Jan. 2015 to June 2016

- Type of dwelling
- Floor / Level
- Size
- Rent
- No. of Rooms
- Year of construction
- Date of last modernization
- Type of heating
- Garage / Parking space
- Condition of the dwelling
- Quality of the equipment
- Housing animals
- …

Source: www.immobilienscout24.de
Rents overshoot in high standard locations

Share of rents with more than 10 % over average rents (Diff.: Location)

Source: Deschermeier/Seipeltt/Voigtländer (forthcoming)
Small flats more often with too high rents

Share of rents with more than 10% over average rents (Diff.: Size)

Source: Deschermeier/Seipelt/Voigtländer (forthcoming)
New buildings are more often in line with the law

Share of rents with more than 10 % over average rents (Diff.: Age)

Source: Deschermeier/Seipeltt/Voigtländer (forthcoming)
Difference in Difference Approach

Isolating the causal effect of the regulation on rents

Source: Deschermeier/Seipel/Voigtländer (forthcoming); Cf. Cameron/Trivedi (2005) and Thomschke/Hein (2016)
Results: Rent offers fall with 2.7 per cent

\[
\log(p_{it}) = \alpha + \delta_0 D + \delta_1 T + \beta (D \cdot T) + \gamma^T X_{it} + \epsilon_{it}
\]

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<th>Variables</th>
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<td>(-0.027^{***})</td>
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<tr>
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<td>Geographic control variables</td>
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<td>Time Dummies</td>
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<td>(R^2)</td>
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<td>(N)</td>
<td>116,966</td>
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Source: Deschermeier/Seipelt/Voigtländer (forthcoming)
High “excess” rents for central, new & premium flats

\[ \text{Spread}_i = \alpha + \beta^T X_i + \epsilon_i. \]

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<th>Log(Distance.main railway stat.)</th>
<th>Log(Distance.regional railway stat.)</th>
<th>Log(Distance.local transport)</th>
<th>Log(Distanz.coldspot)</th>
<th>Log(Distanz.recreation)</th>
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<td>location: high standard</td>
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Source: Deschermeier/Seipel/S/Voigtländer (forthcoming); *** \( p < 0.001 \)
Discussion

Mietpreisbremse is “bad” for tenants (too)

- Instrument shows only little effect on rents, in most cases rents lie above rent survey
- Political target failed: not more affordable housing created
- Lower supply for rented housing
  - Investments and refurbishments decline
  - Higher incentives for owner-occupation
- → devastating impacts on German rental market

Source: Fotolia
Discussion

No checks, no complaints, no legal action...

• Renters are poorly informed about their rent contract and their legal rights

• No legal action

• Landlords can not-respect and avoid the rule

• -> Suggested Reform: Duty to give notice on rent the previous tenant paid

Source: n-tv.de, 6.11.2016
Discussion

Tenants suffer from “lock-in-effect”

• Rents of sitting tenants are much lower compared to tenants in new leases
• Consequence: Renters avoid moving and expand their tenure length
• Distortion in the real estate marketplace

Source: Fotaliia
Discussion

Necessary improvements

- Information obligation of the landlord with respect to the previous rent
- Implementation of back pays and penalties
- Incorporate fully modernized houses
- Apply rent control all over the country
- Improve (qualified) rent surveys
  - Oblige municipalities to prepare
  - Use more data and better methods
  - Expand referenced contracts from four to eight years

Source: Fotaliia
Rent regulation (on new lease contracts) does not fix problems…
… it creates new problems!

“One of the great mistakes is to judge policies and programs by their intentions rather than their results.”

Milton Friedman

Source: www.studentsforliberty.org
How effective is the German "Mietpreisbremse"?
Minister Maas noticed our study, but did not follow our suggestion…

Quelle: twitter