

The background of the slide is a golden-yellow gradient with faint, stylized financial charts. These include a bar chart at the top left, a 3D pie chart on the bottom left, and a large 3D bar chart on the right side. A line graph with numerical markers (0, 30, 60, 90, 120, 150) is also visible, running diagonally across the center. The overall aesthetic is professional and data-oriented.

The new German rent price cap and its impact on rent price formation and investment incentives

Presenter:

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Gliederung

- I. The new rent price cap**
- II. Investment incentives**
- III. Critique of the rent price brake**
- IV. Simulation of the rent price brake**
- V. Conclusion**

I. The new rent price cap

The new rent price cap and its exemptions

- newly signed leases in areas with “tight housing markets”“: respective local reference rent + 10 per cent
- Exemptions:
 - Ongoing leases are: rents must not be reduced.
 - the so-called “Vormiete” (§ 556e Abs. 1 BGB): the rent level already achieved in the previous lease can be maintained
 - new rental dwellings (§ 556f BGB)
 - the first lease agreement after a “comprehensive modernization” of a dwelling (§ 556f BGB)

II. Investment incentives

Non-comprehensive modernizations

- According to § 556f BGB no exception to the rental price brake is provided for “non-comprehensive” modernizations.
- But non-comprehensive modernizations are covered by the grandfathering of Vormiete if the corresponding modernization apportionment was already payable by the previous tenant.
- If this is not the case, § 556e para 2 BGB is applicable:
Individual LRR (before modernization)
+ 10 per cent
+ a modernization-related apportionment according to the rules of § 559 BGB

Comprehensive modernizations

- A modernization is comprehensive is, if it has such an extent that an equality with new buildings appears to be justified. ..., if the amount investment is at least about one-third of the expenses required for a comparable newly constructed dwelling.
- After a comprehensive modernization in an ongoing tenancy, the landlord can increase the rent under the provisions of § 559 BGB (11 per cent modernization apportionment).
- If there is a change of tenant, the landlord can take what the market will yield.
- But not in case of a further change of tenant: Then rental price brake and Vormiete apply.

Effects on modernization incentives

- Modernization incentives are not significantly impaired by the rent price brake.
- They have even been enhanced:
 - The apportionment of the modernization costs by 11 per cent to the annual rent is a very attractive investment especially in tight housing markets in the current interest rate environment.
 - The economic attractiveness of modernization investments has been substantially increased by the rental price brake, both in ongoing and terminated leases
 - The reason for this is the relatively less favorable treatment in pricing legislation of the technical investment alternatives “ongoing letting in unmodernized state” or “re-letting in unmodernized state” (see the example).
 - Thus, there will be even more modernization pressure in tight housing markets.
- The MietNovG thus misses its aim of “curtailing rent increases on tight housing markets”.

Example Comparison of alternatives

Comparison of alternatives without Mietpreisbremse			
	1) Hold	2) Sell	3) Modernize and hold
Sales price or lost DCF €, resp.	- 750.000	+ 750.000	- 900.000
Modernization costs €			- 500.000
DCF €	+ 900.000	- 900.000	+ 1.500.000
NPV €	+ 150.000	- 150.000	+ 100.000

Example Comparison of alternatives

Comparison of alternatives with Mietpreisbremse			
	1) Hold	2) Sell	3) Modernize and hold
Sales price or lost DCF €, resp.	- 750.000	+ 750.000	- 800.000
Modernizations costs €			- 500.000
DCF €	+ 800.000	- 800.000	+ 1.500.000
NPV €	+ 50.000	- 50.000	+ 200.000

Intermediate conclusion

- Recommendation to reduce the modernization apportionment.
- Even better would be an inflation indexation of the levy rate
- Proposal: Inflation rate + 5-6 percentage points

Incentives for new residential developments

- No effects on the investment incentives for new construction, since the new dwellings are totally excluded.
- Complete market splitting
- Possibly loss of confidence, feeling of insecurity

III. Critique of the rent price brake

Counterproductive effects

- Slowdown of the adjustment dynamics of the local reference rent (“modified rents”, see § 558 para 2 BGB); the system is otherwise self-referential and not adaptive
- Limitation of windfall gains
- Rental price brake affects the spatial allocation function of rents: With the rental price brake more dwellings are missing than without!

IV. Simulation of the rental price brake

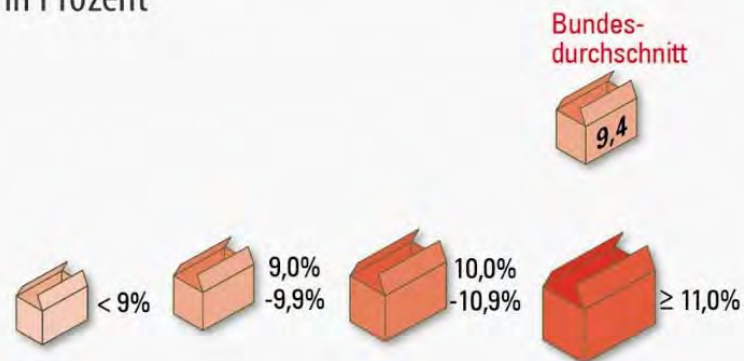
The model

- model estimates the adjustment path of the local reference rent in terms of average annual growth rates
- different scenarios in terms of fluctuation and rental price brake level
- minimum requirement:
 - LRR growth rate = inflation rate
 - with a turnover rate of 7.5 per cent
 - Accordingly, the rental price brake has to be adjusted.

Fluctuation rates

Umzugsquote in den Bundesländern 2014

in Prozent



Quelle: www.techem.de

Fluctuation rates

- Berlin currently below 10 per cent, falling tendency
- GdW 2012: 9,2 per cent (2005: 10,3)
- GdW West 2012: 8,6 per cent (2005: 9.7)
- GdW East 2012: 10,0 per cent (2005: 11.2)
- GdW Bavaria 2012: 6,5 per cent
- GdW Hamburg 2012: 7,8 per cent
with a vacancy rate of 0,8 per cent
- Fluctuation is lower at co-operatives and higher at small private landlords

Model assumptions

- In the beginning all tenants pay the same rent.
- One period: validity of a rental table (2 years)
- All rents are raised or newly concluded, respectively, solely with respect to the rental table.
- All rents (rents in ongoing tenancies as well as newly agreed rents) are raised in the period in which a legal increasing possibility has arisen and they are raised to the legally permissible maximum value.
- Empirical representativeness of the rental table in terms of the ratio of rents in ongoing tenancies and newly agreed rents.
- The model simulates a single quality segment of the housing market. It is however representative of all quality segments and the overall development of the local reference rent at the housing market.

Model equations

Variables:

VM: Local reference rent (€ per m² and month)

BM: Rent in ongoing tenancy (€ per m² and month)

NM: Newly agreed rent (€ per m² and month)

FR: Fluctuation rate (per cent)

MB: Rental price brake (per cent)

Model equations:

$$NM_t = VM_t * (1 + MB/100)$$

$$VM_t = (FR * 2/100 * NVM_{t-1}) + (1 - FR * 2/100) * BM_{t-1}$$

$$BM_t = VM_t$$

LRR development

Annual growth rate of
LRR: 0,51 per cent

Year	VM Local ref. rent	BM Rents in ongoing tenancies	NM Rents for newly agreed leases
1	6,00	6,00	6,60
3	6,06	6,06	6,67
5	6,12	6,12	6,73
7	6,18	6,18	6,80
9	6,24	6,24	6,87
11	6,31	6,31	6,94
13	6,37	6,37	7,01
15	6,43	6,43	7,08
17	6,50	6,50	7,15
19	6,56	6,56	7,22
21	6,63	6,63	7,29

Table 3: Development of the local reference rent with 5 per cent fluctuation and a 10 per cent rental price brake

Effects of the rent price brake



Fluctuation %		5,0	6,5	7,5	10,0	15,0
VM % YA	Rent cap 10 %	0,51	0,67	0,77	1,04	1,59
VM % YA	Rent cap 15 %	0,77	1,01	1,18	1,59	2,46
VM % YA	Rent cap 20 %	1,04	1,37	1,59	2,17	3,38
VM % Ya	Rent cap 25 %	1,31	1,73	2,02	2,76	4,36
VM % Ya	Rent cap 30 %	1,59	2,11	2,46	3,38	5,39

Effects of the rent price brake

- Intermediate conclusion: At 2 per cent inflation, rental price brake should be fixed at level of 20, or still better 25 per cent above the LRR.
- The rental price brake should depend on the rate of inflation.
- According to this formula:
Rent price brake = Inflation rate * 10 + 5 percentage points
- Then the local reference rent can grow roughly at the same rate as the Consumer Price Index.

Inflation %	0,0	0,5	1,0	1,5	2,0	2,5	3,0	3,5	4,0	4,5
Rent cap %	5	10	15	20	25	30	35	40	45	50

Consideration of violations

- Possibility of violations of the rental price brake
 - in a certain percentage share of newly concluded leases the LRR is exceeded by more than 10 per cent.
 - the inflated rents are fully represented in the rental table.

Exceedance of LRR in case of violation in %	33	50	33	75	50
Share of infringement cases in all new leases in %	50	50	33	33	75
Change of LRR yoy in % with Mietpreisbremse 10 per cent	1,72	2,46	1,39	2,59	3,38
Change of LRR yoy in % with Mietpreisbremse 20 per cent	2,15	2,92	1,96	3,21	3,62

Fluctuation rate: 7,5 %

IV. Conclusion

Conclusion

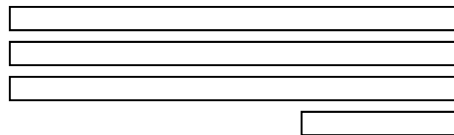
- The rental price brake will effectively limit the windfall profits in tight housing markets.
- But it will also exacerbate the housing shortage due to the impairment of the allocation function of rental prices.
- The modernization incentives are significantly improved (for the time being).
- Recommendations:
 - readjustment the system: higher rental price brake combined with a lower modernization apportionment rate.
 - Both, should be made dependent on the rate of inflation in an appropriate manner.
 - Additional measures needed to ensure the effectiveness of the price regulations.

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