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THE INTERNATIONAL PROBLEM OF SKYROCKETING RENT: WHY INCREASED RENT CAN HURT THE ECONOMY

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ABSTRACT

Skyrocketing rent has become an International problem, London has the fifth most expensive high-end rental property in the world and comes second in Europe after Moscow according to ECA International, the world's leading provider of knowledge, information and technology for the management and assignment of employees around the world, rents for an unfurnished, three-bed apartment in a sought after area of the UK's capital now average around GBP 5000 per month. Singapore remains the third most expensive city in Asia to rent a high-end three-bedroom apartment. Hong Kong remains the most expensive location in the world, rents for an unfurnished three-bedroom apartment in a sought-after area of Hong Kong averages at GBP 7,350 per month, while the average two-bedroom apartment in Tokyo costs $4,352 per month. Rents for an unfurnished three-bedroom apartment in a sought-after area in New York City averages at $ 9,200 per month. Shanghai is the 9th globally, Dubai is 16th globally, Sydney has slipped from 12th to 20th place due to weakened Australian dollar, and a three bedroom apartment with a sea-view in Kuwait can cost between K.D. 1,300 to 1,500 per month. This paper attempts to shed some light on why rents are so high, whether or not rent control can help, and why high rents can hurt the economy.

Keywords: Rent, housing, immigration, economy, supply, demand, elasticity, landlords, buy-to-rent, investment, rent control.

INTRODUCTION

The issue everyone who is looking to rent a property agrees on is that the rent is too high, too inaccessible to allow for economic justice. Almost everyone agrees that improving affordability, quality, and access to housing is a pressing issue. The issue of high rent is not a new one, however, not much research or literature was dedicated to shed light on how to tackle what is today turning into a global problem. There is plenty of literature out there teaching people how to buy to invest in property and how to enter the property market and how to become a millionaire from the sales and rents of property, however, other than this commercial literature, not much attention has been given this growing phenomenon. In his book *The Ideology of Home Ownership: Homeowner Societies and the Role of Housing* (Ronald, 2008) Explores the rise of modern home-ownership as a cultural, socio-political and ideological phenomenon. Although Ronald touches on the issues of rising rent, his main focus is the housing consumption across a range of societies dominated by political and cultural commitment to home ownership which has been largely manipulated and ideologically charged. (Lind, 2010) In his book *Rent Regulation: A conceptual and Comparative Analysis* classifies and compares the rent control systems in a number of European countries and North American cities. It is also used to describe typical patterns of change from 'harder' to 'softer' rent controls. Lind's work concentrates only on the western world and only on rent control, not other problems related to high rent. In his book *Theory and Measurement of Rent* (Keiper, 2012) provides a historical development of rent theory and its relevance to contemporary problems, the book also contains an analysis of the real-property values on which the estimates of rent for 1956 are based. Separate estimates for the

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various classes of real property, broken down by states, are presented, and these are linked to earlier estimates in an analysis of national and state trends since 1922. Keiper's work is important in the sense that a historical overview of an economic problem is a useful way to tackle the current situation, however, with population, immigration and mortgage/loan rates changing so dramatically, his work can be seen as outdated.

This article is particularly important because it explores the present situation of rent, why rent is rising today and whether rent control can be effective in today's economy, the paper also touches on why this expansion in the rent industry is harming the economy.

Why are rents skyrocketing?

1. The Increasing Price of owning a House

One reason why rent is increasing is because the price of owning a house is also increasing. One would then ask why is the price of owning a house increasing, the answer to this question differs from one country to another; it can be that there is what economists call a house price bubble, it can be the low long-term interest rates, or individual income growth, or that in some places the demand for houses is larger than supply, government lending can also be a factor. It can also be all those factors combined.

House price growth has been rampant, especially in certain cities. Between 1975 and 1995, house prices in the United States increased an average of 0.5% per year, or 10% over the course of two decades. By contrast, from 1995 to 2004, national real prices grew 3.6% per year, a more than seven-fold increase in the annual rate of real appreciation, and totaling nearly 40% in one decade. In some individual cities, such as San Francisco and Boston, real home prices grew about 75% from 1995 to 2004, almost double the national average.

How does one tell when rapid growth in house prices is caused by fundamental factors of supply and demand, and when it is an unsustainable bubble? Stiglitz [2] provided a general definition of asset bubbles in this journal: "if the reason that the price is high today is only because investors believe that the selling price is high tomorrow - when 'fundamental' factors do not seem to justify such a price - then a bubble exists. At least in the short run, the high price of the asset is merited, because it yields a return (capital gain plus dividend) equal to that on alternative assets." The "dividend" portion of the return from owning a house comes from the rent the owner saves by living in the house rent-free, and the capital gain from house price appreciation over time. A housing bubble could be driven by home buyers who are willing to pay inflated prices for houses today because they expect unrealistically high housing appreciation in the future[3].

So what is causing the growth of house prices if a bubble did not exist? Price growth is supported by basic economic factors such as low real, long-term interest rates, high income growth, and housing price levels that had fallen to unusually low levels during the mid-1990s. The growth in price-to-rent ratios – especially in cities where this ratio was already high – can be explained by the fact that house prices are more sensitive to real, long-term interest

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ates when interest rates are already low and even more sensitive in cities where house price growth is typically high[4].

A common measure used to assess housing valuations is the house price to-rent ratio, which is akin to a price-to-earnings multiple for stocks. This metric is intended to reflect the relative cost of owning versus renting. Intuitively, when house prices are too high relative to rents, potential home buyers will choose instead to rent, thus reducing the demand for houses and bringing house prices back into line with rents. A common argument is that when price-to-rent ratios remain high for a prolonged period, it must be that prices are being sustained by unrealistic expectations of future price gains rather than the fundamental rental value, and hence contain a “bubble.”[5]

Ten years ago, a mere 10% of Britons lived in privately rented accommodation. Today, 18% do. The prices they pay take up, on average, some 40% of their incomes. In the United States 52% of American are making a major monthly sacrifice to cover rent or mortgage, 15% of home owners are paying 35% of their income to rent or mortgage, while in New York home owners pay 77% of their income to rent or mortgage. This not only inhibits their consumption and their ability to save for retirement but also hampers individuals from saving for a down payment to buy a house. Therefore, the rental market is now acting like a barrier to buying rather than a stepping stone[6].

Glaeser, Gyourko and Saiz[7] found that house prices have increased a lot more in inelastic places where the supply of houses was limited, in contrast to cities where there was a larger supply of new house construction and supply was more elastic. In areas where there was an elastic supply, the prices of houses remained close to house production costs.

Landlords are benefiting from the worst U.S. rental-housing shortage in more than a decade as construction trails demand and more Americans opt to lease rather than buy. There’s an undersupply of single-family houses and apartments to rent for the first time since 2001, according to an analysis by Frank Nothaft, chief economist at mortgage buyer Freddie Mac. The shortage is giving the upper hand to institutional investors who spent more than $25 billion since 2012 buying single-family homes to rent. While the market for apartments has been in favor of landlords for five years, owners of houses are now able to increase rents and reduce turnover to boost profits.

“It’s that supply-demand equation that allows us to get aggressive about raising rents,” Stephen Schmitz, chief executive officer of American Residential Properties Inc., a landlord with more than 8,500 homes, said at an investor conference this month. “Three years ago, you would go to raise somebody’s rent and they could say, ‘I’ll go down the street and pay $100 less than I’m paying you now.’ But today they can’t because all those houses down the street are occupied.”[8] Levitin and Wachter[9] provide that government lending and affordable-housing policies are critical to inflating the prices of houses, and encouraging financial institutions to lend improvidently to low or moderate income consumers.

In Kuwait, where a welfare state exists, government lending has definitely escalated the increasingly high price of houses. Where every married male national is entitled to house loan with zero interest of K.D 70.000 ($ 245.000), a divorced or widowed woman national is entitled to K.D 45.000 ($ 160.000). The policy which has been in practice since the late 60s (the women loan much more recent) has caused an increase in house prices, however, the monopoly land owners have in the small state and the economic and political power they poses upon the monarchy, in addition to the low interest rate loans commercial banks are luring lenders to take, have made the prices of houses far beyond the reach of the low to standard income Kuwaiti families. The Kuwaiti government and parliament are now to sign the increase of the house loan to K.D 100.000 ($ 350.000) for the married men and K.D 70.000 ($245.000) for the divorced women in an attempt to help families afford homes, however, the reality is that a small house in Kuwait costs $400.000 while an average house costs half a million. An apartment which widowed or divorced women may consider and one that meets the criteria of the government lending agency, costs no less than $ 210.000, therefore, the increase in the housing loan is seen by many as only another opportunity for property investors and banks to gain more profit and to make Kuwaiti families' dream of owning a house more distant.[10]

IMMIGRATION

As immigrants, both past and present, are attracted to large urban cities and these cities experience higher future rent growth, it seems that this is not a story of immigrants causing rents to grow faster; instead, this is merely a story about where immigrants choose to locate. Past immigrants located in cities that provided them the best economic opportunities. These cities were large, urban areas rich with cultural amenities, thriving economies, and increasing populations. As a result, housing prices were higher. Then, new immigrants follow suit[11].

Saiz[12] who analyzed the impact of immigration in Miami and its effect on Miami housing market, found that rental prices in Miami increased by 8 – 11% more than comparable housing markets during this time; thus, Saiz concluded that immigrants cause a short-run increase in rental prices. This result provides the first evidence in support of a simple housing demand theory; when the immigrants landed in Miami, these migrants induced a one-time shock to housing demand. As a result of the demand shock, rental prices increased.

In addition to Saiz's research[13] studying the effects of immigration on the rental housing market, Ottaviano and Peri[14] also analyzed the US housing market. Gonzalez and Ortega in Spain[15], Accetturo et al.[16] in Italy, and Degen and Fischer[17] in Switzerland. The work completed by the researchers above, regardless of the country of analysis, has found a strong and positive connection between higher immigration and higher rents. In the U.S., 1% of legal immigrants caused an increase between 1.1% - 1.6% for both rents and housing values. In Spain immigration caused rents to rise 3.4%, in Switzerland it was 2.7%. The UAE, specifically Dubai was found with the highest rent in the Middle East, while Kuwait came second on the Middle Eastern level[18], in both these states immigrations rose dramatically. The Kuwaiti Minister of social affairs announced that immigrants in Kuwait equal two thirds of the whole Kuwaiti population[19], while in the UAE the population of immigrants is 5.5 million, while UAE nationals have not yet reached 1 million (900 thousand)[20]. Countries with high immigration rates should expect to see rising rental demand – new arrivals don't buy, and those planning to stay for only a few years are more likely to rent here and buy in their home country than the other way around. The same goes for all our foreign students: they are mostly renters, not wannabe homeowners.

Buy – to – Rent Investment

Another reason why rent is skyrocketing is the increase in the buy – to – rent phenomenon. A combination of rising rents and sharp increases in house prices has made buy-to-let highly profitable in recent years. The LSL[21] study suggested landlords had seen a gross average return of 12.7% in the past year. This typically, was £8,233 in rent and £13,066 in capital gain, before taking tax, mortgage repayments and maintenance costs into account. Landlords have also seen the cost of buy-to-let mortgages fall as well as choice flourish in the past year[22].

The overriding motive for private landlords is to receive a financial return, with returns in residential property outperforming other forms of investment in recent times. Yet landlords have different motives for investing. The biggest group of Buy – to – Let investors are small-scale and amateur, investing for retirement. These are most likely to expect to continue letting property over the medium- to long-term. The private sector landlords have consistently held the highest level of unfitness in terms of poor property conditions. In recent years better quality property has increased in the market, however, this improvement in property conditions appears to happen more with new stock entering the market than by the active modification by landlords. Some Buy – to – Let investors are happy to hold on to poor-quality stock and obtain high rental yield, though have little interest in long-term capital growth. These landlords have been called 'rent maximisers.

The lending industry and some academics view Buy – to – Let mortgages as a positive contribution to how investors operate. Some state that gearing (the relationship between invested equity and debt) is low in the private rental sector, and see much potential for investors to improve their returns if they borrowed further. For the lending industry, Buy – to – Let borrowers are currently proving to be a safer bet than others, as Buy – to – Let borrowers have lower levels of arrears[23].

There are compelling reasons for supporting a thriving private rented sector, not least in providing choice for tenants and greater competition in the lettings market, which was for many years dominated by local authority provision. In economic terms, a strong supply of good-quality and affordable rented accommodation is essential to support the mobility of workers, particularly those in the early stages of their career, with a degree of flexibility that owner-occupation and social housing cannot. However, it would be a mistake to assume that

[21] The UKs leading provider of residential property services.

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the growing numbers of people entering private rented accommodation are all doing so for lifestyle reasons. There are many in the sector who would rather own their own home. Data drawn from the 2010 British Social Attitudes survey shows that 86% of the public would most prefer to buy a home, and even 68% of renters would prefer to buy[24].

However, high house prices have been a barrier to first-time buyers. Because of, the growing reliance on private lettings, it is too expensive for an increasing number of people to afford. This problem is growing as the private rented sector expands. Private landlords clearly contribute a very significant proportion of the demand for sales. House price growth has been mentioned as an incentive behind landlords' investment in private rented accommodation, but given the staggering sums invested by them it might be asked how much of that price growth was in fact driven by landlords in the first place. To put things in perspective, buy-to-let accounted for 13% of the total outstanding mortgages in the UK in early 2013, according to the Council of Mortgage Lenders. Oxford Economics argued some years ago that the increase in buy-to-let and second homes was 'undoubtedly contributing to the overvaluation of housing'[25]. A study by the National Housing and Planning Advice Unit found that gross buy-to-let lending may have increased the average UK house price by up to seven per cent by the end of 2007[26].

Can rent control help solve the problem of high rent?

Rent controls prohibit prices from rising above politically-determined levels. However, under a price ceiling, fewer housing units are supplied than demanded, resulting in a shortage. The reason why under a price ceiling fewer properties would be available for rent on the market is that under capped rents landlords will not be able to cover mortgage payments, leading them to end the tenancy and sell the property[27]. This could leave those families who have no choice but to rent privately with even fewer options.

Another dimension of the resulting inefficiency of rent control is that units will be in excess demand and hence it is not necessarily the highest-benefit users who get in. Tenants may apply for or remain settled in apartments that do not well suit their needs simply because the apartment carries a low price. In other words, many of those who do not get in have higher willingness-to-pay than many of those who do get in. Price is not functioning to help assure that resources flow to highest valued uses[28].

Economists have also argued against rent control as it can result in the following disadvantages: in markets where demand outstrips supply, landlords may discriminate on a tenant's characteristics rather than price. This could see people with lower incomes pushed even further to the bottom of the market (or into a black market with fewer protections) as prospective tenants with higher incomes are viewed as more reliable. Also, when rents are capped and no longer cover the landlords mortgage, landlords may attempt to maintain their margins by cutting down on repairs letting properties fall into disrepair and worsening landlord-tenant relations by offering poor living conditions and poor quality properties. Some landlords will try to game the system like in New Jersey, where rent caps exist, landlords have been subdividing their apartments, landlords will benefit while ordinary renters are forced into even more cramped living conditions[29].

Germany, France and Spain use what is sometimes called second generation rent control to calm rents without directly setting prices: rents are determined by the market at the outset; renters have longer term contracts and, as long as renters are in these contracts, their rent can only be increased by an inflationary index, such as RPI or CPI, however, this is not rent control but an incentive to calm the high rise of rents[30].

Many economists are against the old-style rent cap which involves setting overall maximum rent levels, giving tenants indefinite contracts, and limiting the rent increases that could be charged to tenants once they were in a contract, mainly their objection comes from all the disadvantages (above) rent caps can entail, but also because capping rent is a historical old method originally introduced in the UK in 1915 as an emergency wartime measure to deal with housing shortages caused by the absence of any building workforce. Economists argue that we needn't look for historical outdated and highly flawed measures when we can find new solutions for the issue of high rent.

Ross Clark in the Times suggests providing owner - occupiers a decisive boost in their losing battle against investors (buyers – to – let) to help house prices in areas of high demand fall back towards historical norms. How can that be done? Clark suggests putting covenants on new homes, limiting them to being bought by owner-occupiers, or by "reorganising stamp duty so that owner-occupiers pay nothing and investors pay double."[31]

Because one of the facts leading to increased rent is the high demand against the smaller supply of property, height restrictions on buildings and the extremely long development process play a big factor in continually constraining new supply. So as demand keeps rising, prices are just pushed up and up. This increases the burden on families through increased rents and the taxpayer through housing benefit payments too. It also makes it more difficult for people to live or move to the areas where they work.

Academic estimates suggest that these planning restrictions have raised rental and housing costs by as much as 35-40% above what they would be in a more liberal regime, therefore, removing constraints to allow more property development can assist in calming the prices of rents[32].

How high rent hurts the economy

Director of the Economic Growth Program at the New America Foundation in Washington, D.C. Michael Lind argues that the economy is threatened when there are too many "takers" and not enough "makers." The "takers" who threaten the dynamism and fairness of industrial capitalism the most in the 21st century are not the welfare - dependent poor - but the rent-extracting, unproductive rich. Profits should be distinguished from rents. "Profits" from the sale of goods or services in a free market are different from "rents" extracted from the public by monopolists in various kinds. Unlike profits, rents tend to be based on recurrent fees rather than sales to ever-changing consumers. While productive capitalists — "industrialists," to use the old-fashioned term — need to be active and entrepreneurial in order to keep ahead of the competition, "rentiers" (the term for people whose income comes from rents, rather than profits) can enjoy a perpetual stream of income even if they are completely passive.

The argument the "rent" is but wealth accumulated through passive means without any sign productivity or being socially useful is not a new one, Adam Smith in his book *An Inquiry into the Nature and Causes of the Wealth of Nations* describes rentiers as opportunistic driven by exploitation and monopoly:

"As soon as the land of any county has all become private property, the landlords like all other men who love to reap where they never sowed, and demand a rent even for its natural produce. The wood of the forest, the grass of the field, and all the natural fruits of the earth… "[33]

Rents come in as many kinds as there are rentier interests. Land or apartment or rental-house rents flow to landlords. Royalty payments for energy or mineral extraction flow to landowners. Interest payments on loans flow to bankers and other lenders. Tolls are rents paid to the owners of necessary transportation and communications infrastructure. However, none of these rents are productive or socially beneficial. The classic productive capitalist wants to found a company to provide a new, socially useful good or service and make profits by sales. In contrast, the classic parasitic rentier enjoys a perpetual stream of income without any contribution to the community. With jobs becoming more scarce and job seekers moving into (or staying within) increasingly unaffordable major cities, the landlords are depositing this windfall without lifting a finger or remodeling a bathroom[34].

We tend to view all money-making enterprises as if they were equally productive and socially useful simply because they make somebody money somewhere. And we seldom distinguish between wealth accumulated through passive means like rent collection and active efforts at doing something productive. If we want a technology-driven, highly productive economy, we should encourage profit-making productive enterprises while cracking down on rent-extracting monopolies, whether they are natural products of geography and geology (real estate and energy and energy and mineral deposits) or artificial[35] (chartered banks, professional licensing associations, labor unions, patents and copyrights). This is a valid distinction between "makers" and "takers."

CONCLUSION

This paper argues that the international problem of skyrocketing rent is hurting the economy. Rent is rising for multiple reasons; the first is the high prices of owning a house which is pushed up by low, long term interest rates, income growth, prices bubbles, low inelastic house supply and government lending. The second reason why rent is rising is immigration; people tend to migrate to bigger cities in search for better job prospects and higher quality of life, research shows that where the rate of immigration increases rent follows due to rise in demand for renting property, immigrants prefer to rent rather than buy as their stay in bigger cities tends to be temporary and for work reasons. Investors or rent maximizes have also played a role in pushing rent up, the trade of buying to rent becoming more profitable as the cost of mortgages fall and the demand for private renting heightens. Tenants worldwide are calling for rent control, although this outdated policy isn't without downturns, such as: an increasing fall in property supply, poorer living conditions, subdivided flats creating even smaller living spaces and tenant discrimination where low income tenants are more likely to suffer than high income tenants. That said, many believe that low supply of property which continues to push rents up can be turned around if more properties were built as restrictions to expand development are removed, and if buyers – to – occupy are given an advantage over buyers – to – let buy increasing stamp duty on the latter.

Rentiers continue to squeeze high rents from tenants even when the rented property is not being maintained or improved by the landlord. Skyrocketing rent hurts the economy in the sense that such high rents which are consuming 35% to 45% of tenants' incomes are yielded by private landlords who don't actually contribute to society in terms of productivity, development, or innovation but merely accumulate more wealth without any redistribution.

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