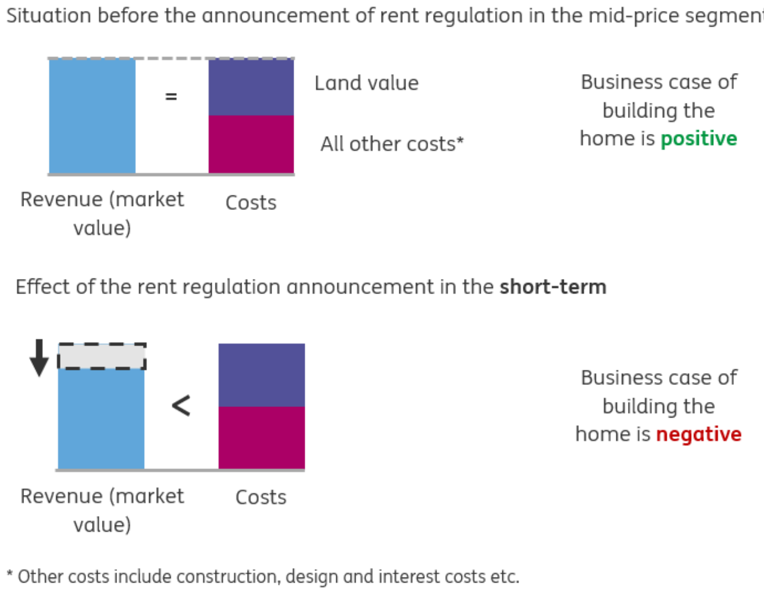
Rent regulation in the Dutch housing market: help or hindrance?

The announcement of new rent regulations in the Netherlands has prompted rising uncertainty among developers, landlords and households. Negative effects will likely subside over time, but the short-term outlook appears much more clouded given the expected delays in construction and persistent housing shortage

Proposed rent regulation hinders new construction

Government plans to regulate middle-segment rent prices as of 2024 are currently underway in the Netherlands, aiming to limit the maximum per month to approximately €1,100 using a points system. While questions have been raised over the potential for such measures to slow down housing production, any impact will likely be subdued in the long run. Lower rental income ultimately puts downward pressure on land prices, thereby helping to restore the return on housing construction. Rent regulation does not, however, aid in solving the structural housing shortage. Instead, it reduces the total rental supply and increases aggregated demand for housing. The short-term benefits (i.e., private sector tenants benefiting from lower rents) are unlikely to be sufficient to offset such negative side effects.

Revenues and costs of building a residential rental home



Source: ING Research

Short term outlook for building production

These measures will inevitably delay the implementation of ongoing housing construction projects in the short term. As a result of the announced regulation, the expected rental income will be lower than previously thought for these projects.

In response, investors will pay a lower price for these rental properties while the cost to the developer remains constant in the short term. This has a negative impact on the business case for these projects for developers with two major consequences:

- **Delays**: project promoters will try to rebalance the business case of ongoing projects, e.g., by renegotiating the land price and examining which project adjustments help to reduce costs (building smaller dwellings, for instance). This will take extra time and will slow down the implementation of projects.
- **Fewer projects:** developers will cancel some projects or postpone them indefinitely if they fail to rebalance the business case through renegotiation.

Impact of rent regulation varies by project

The extent to which the announced rent regulation causes delays varies between housing construction projects. Three characteristics play an important role:

The impact on rental income

The financial shortfall increases with the share of homes affected by the regulation and the difference in size between the maximum rent and previously assumed rent. The higher these shares, the higher the probability of delay.

Land prices

The scope for absorbing financial shortfalls is smaller for developers who have acquired relatively expensive land. This is the case for land purchases that took place just before the announcement of rent regulation and the tipping point of the housing market, or for developers who have bought land at a relatively high price for various reasons. In these scenarios, rent regulation will soon lead to a financial deficit, and the risk of a project being delayed increases.

Room for negotiation

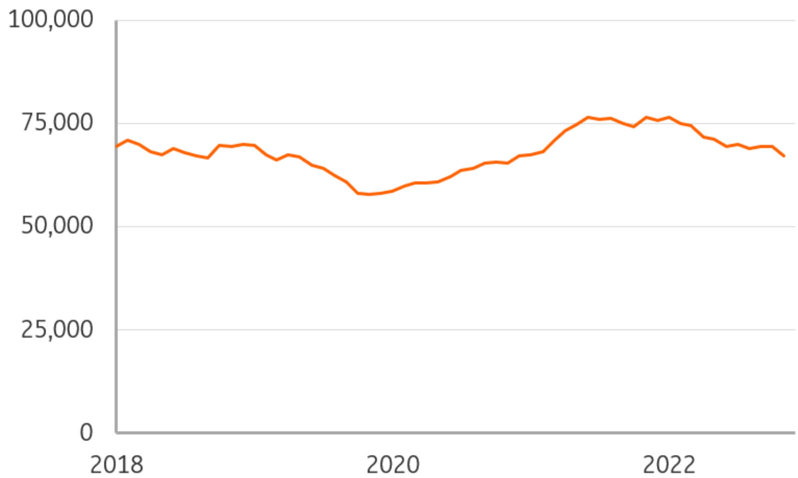
If the developer has not yet bought the land, there may still be room to renegotiate pricing. However, the opportunity to do so will be limited in some cases, including those where the landowner would incur higher costs for the foundational groundwork. In order to avoid a larger financial deficit on the project, there would therefore be less willingness to sell at a lower price.

Uncertainty over rent regulation slows housing construction output

Some of the current uncertainty surrounding the planned regulation is hindering housing construction, thus making it increasingly difficult for residential investors to calculate the financial business case of projects in a reliable way. To ensure that delays are limited in the short term, it's important that decisions surrounding rental regulation are finalised quickly and efficiently – all the more because of the multiple downside risks currently being faced by the construction sector. Additional obstacles include rising interest rates (and associated demand shortfalls), higher construction costs and issues with nitrogen supply, as shown in the chart below.

Number of building permits is falling

Development of the issuance of building permits for new homes*

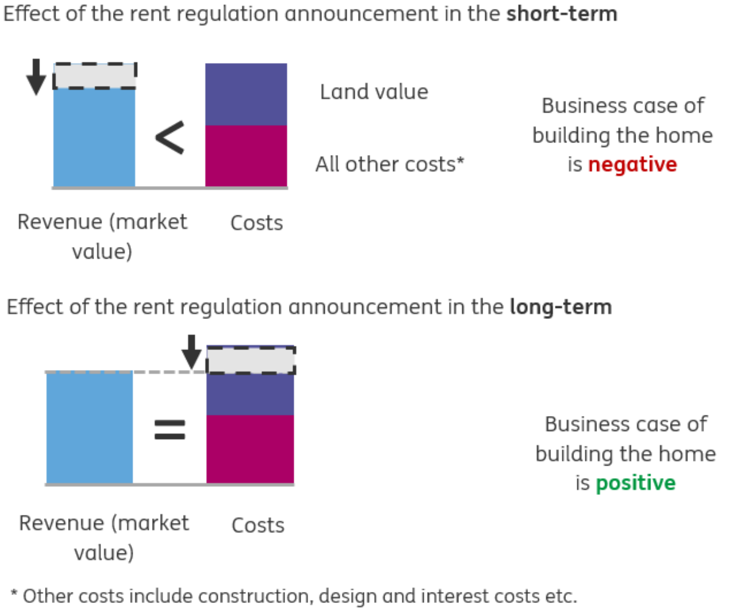


*Annual moving average per month up to and including November 2022.

Source: ING Research, National Statistics

We have seen the number of building permits decline in recent times, which is a prelude to lower house building output. As uncertainties surrounding mid-rent regulation persist, investors will remain more reluctant to purchase rental housing. This will increase the negative impact on new building production.

In the long run, lower land prices compensate for the revenue loss from rent regulation



Source: ING Research

Long term impact of mid-rent regulation on new construction set to fade

While the regulation of medium-term rents will curb housing construction output in the short term, the effects will fade in the long term for the following reasons:

- Once the details of the regulation are finalised, more certainty will be felt among developers. As a result, the measure will be taken into account in the early stages of project design in order to make the business case. They may, for instance, build smaller dwellings or opt for less luxurious finishes in order to reduce costs. On the other hand, if the scale of new housing proves less profitable than anticipated, attention may turn to the construction of larger, more luxurious dwellings which lie outside the scope of regulations imposed on the middle segment.
- Lower rent revenues put downward pressure on the price of land, as its value is derived from house prices (and not the other way around). While rent regulation works quickly through the market value of rental properties, adjusting land prices takes more time. Landowners are expected to hold onto original prices, which complicates negotiations with developers and investors in the short term. In order to prevent investors in rental housing from dropping out, however, lower prices are likely to be accepted eventually. This will, in turn, help to restore the profitability and interest in new rental housing.

Rent regulation not a structural solution to the housing shortage

Apart from the delaying effect of rent regulation on housing construction in the short term, the measure has other negative side effects on the housing market. In the long term, rent regulation does not help to solve the housing shortage because it leads to:

- **Fewer rental properties:** private landlords will often opt to sell properties after rental contracts expire. This reduces supply in the private rental sector and increases that of owner-occupied homes. The chance of finding a home therefore rises for households looking to buy at the expense of those looking for rental homes in the private market (i.e., those whose income is too high for social rental housing but cannot or do not want to buy).
- **Additional demand for homes:** rent regulation makes renting less expensive, which ultimately increases the overall demand for rental housing. Younger people, for example, may be incentivised to move out of their parent's homes sooner. If supply remains the same, this will exacerbate the pre-existing shortage in the housing market, with the number of households unable to find suitable properties likely to rise as a result.

As a result, it's likely that the planned regulation could add fuel to the fire of the ongoing housing shortage. It could also trigger further rent rises in the unregulated segment and cause affordability levels in this area to deteriorate. There is a slight advantage opposite to these negative effects: a small number of free-sector tenants will benefit from lower rents, thus increasing the affordability of the private rental sector for this select group.

Exploring alternative solutions

So if rental regulation does not help to tackle the housing shortage, what else might? Stimulating new-build production plays a major role in reducing the housing shortage, including various policy approaches such as land value capture. This increases the benefits of new construction for landlords and their residents and encourages property owners to allow more housing construction. A Dutch report we published last year delves into the details of this and other solutions for expanding the (free) rental sector and making it more affordable.

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