

## Berlin's Rent Controls Are Proving to Be a Disaster

Andreas Kluth, *Bloomberg*, 2 mars 2021

*A year ago, the leftist government of Germany's capital region imposed central planning on the city's housing market. That was a bad move.*



Berlin declares class war. Photographer: Steffi Loos/Getty Images Europe

If populism on the political right corrupts democracies, populism on the left ruins economies. For the latest evidence take a closer look at the housing market of the German capital, Berlin.

A year ago, a rent cap took effect in the city that was unprecedented in Germany. For all apartments built before 2014, rents were frozen at whatever they were on Jun. 18, 2019. Tenants in those units can also force landlords to lower rents defined as “excessive.”

This reform came courtesy of the city state's “red-green-red” governing coalition between the three left-leaning blocs in the German political spectrum: the Social Democrats, the Greens and the Left (which descends largely from the communist party of the former East Germany).

That heritage seemed to set the tone of the campaign that preceded the legislation. At times it descended into a competition between the coalition partners about who could play the most demagogic class warrior, rhetorically pitting pitchfork-wielding tenants against let-them-eat-cake landlords. It's probably no coincidence that there's even a separate grassroots effort for a ballot initiative to expropriate large property-owning companies.

The underlying problem was real: Rents in Berlin, a place that was once proud of being grungy and affordable, have soared in recent years as demand from new arrivals far outstripped supply.

The right answer to that shortage would be to increase supply — for instance, by cutting red tape in zoning and construction. By contrast, as I argued in 2019, Berlin's approach falls into the same logical trap as fixing any price. In a food shortage, for example, regulating the price of bread only trades one expression of scarcity (high prices) for another (empty shelves).

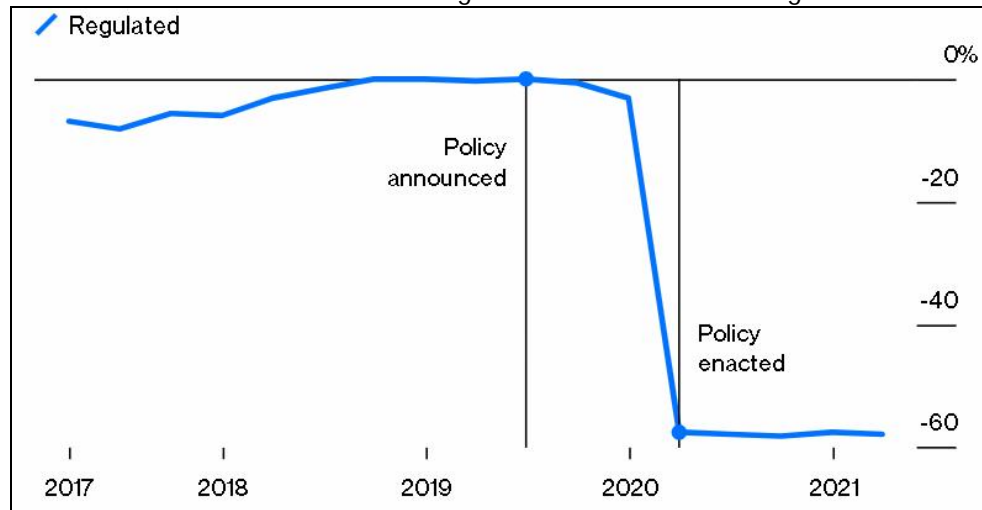
Now the empirical data is starting to come in, and four economists at Munich's Ifo Institute — Mathias Dolls, Clemens Fuest, Florian Neumeier and Daniel Stoehiker — have crunched the numbers. What do they say?

Unsurprisingly, the rent controls have split housing in Berlin into two distinct markets: the much larger one, consisting of all apartments built before 2014, which is now regulated; and the smaller unregulated one of relatively new buildings.

The following two charts show the relative trend of rents in these two segments when compared to the average growth in the 13 next-largest German cities. As expected, rents in Berlin's regulated market plummeted in relative terms. But since the excess demand of apartment hunters had to go somewhere, rents in the unregulated market simultaneously started rising faster than in the 13 other cities. Newly built apartments have therefore become even more unaffordable for most people.

#### Rents Plummet in Berlin's Regulated Apartments...

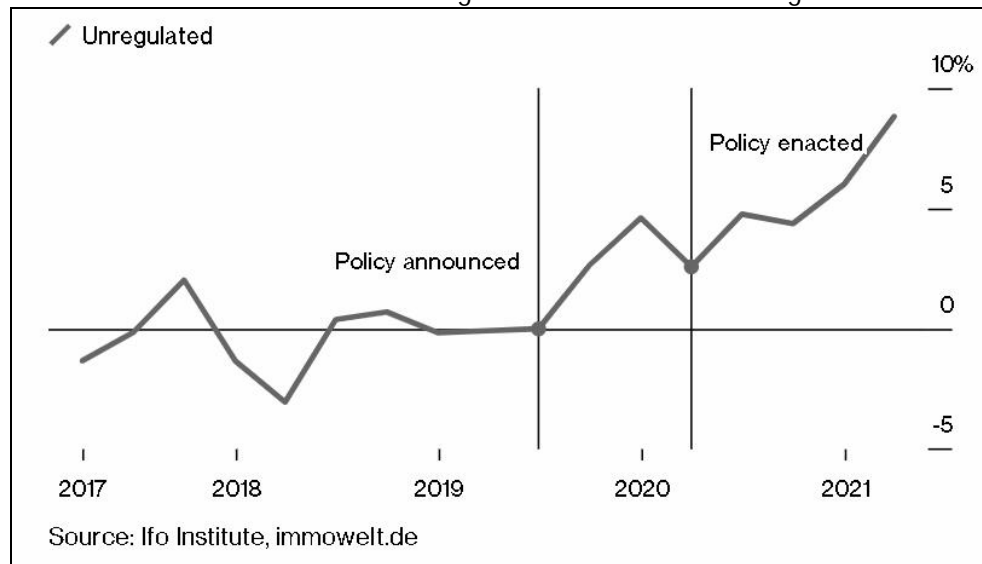
Growth in Berlin rents relative to growth in the 13 next-largest German cities



Source: Ifo Institute, immowelt.de

#### ...But Rise Even Faster in the Unregulated Ones

Growth in Berlin rents relative to growth in the 13 next-largest German cities



Source: Ifo Institute, immowelt.de

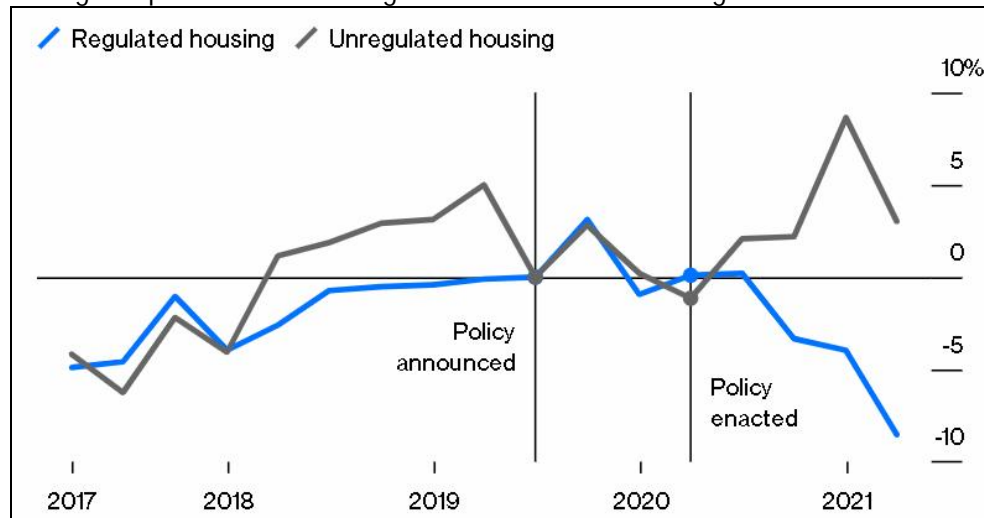
Source: Ifo Institute, immowelt.de

The next chart shows what happened to home prices in the two segments. Price changes in the regulated market dropped relative to those in the 13 other cities. That's because real estate loses value if its future cash flows to landlords are capped. There was also an acceleration of apartments going up for sale, as landlords tried to cash out of their now less profitable investments.

Price increases in the unregulated market, meanwhile, outpaced those in the other cities, as expected. But the trend isn't as clear in this segment, because investors worry that rent controls could be extended to younger buildings in future.

#### Rent-Controlled Apartments Have Also Become Worth Less

Change in prices relative to growth in the 13 next-largest German cities



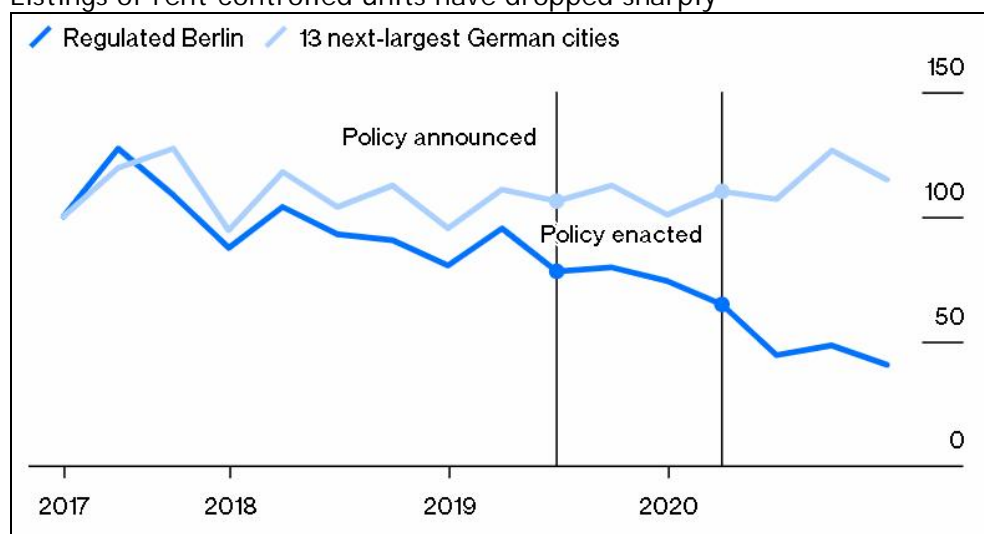
Source: Ifo Institute, immowelt.de

The most devastating charts are the next two. The first shows trends in listings of units for rent on [immowelt.de](https://www.immowelt.de), a German website. In the regulated market, the supply of apartments basically froze. Unsurprisingly, those tenants fortunate enough to already live in a rent-controlled flat are staying put. And whenever somebody does move out – when moving to another city, for example – the landlord tends to sell the unit rather than re-let it.

At the same time, listings in the unregulated market increased only marginally faster than in other cities. Tenants in those apartments are also discouraged from moving – after all, where to? – and anyway the supply of fresh housing is still constrained by construction schedules.

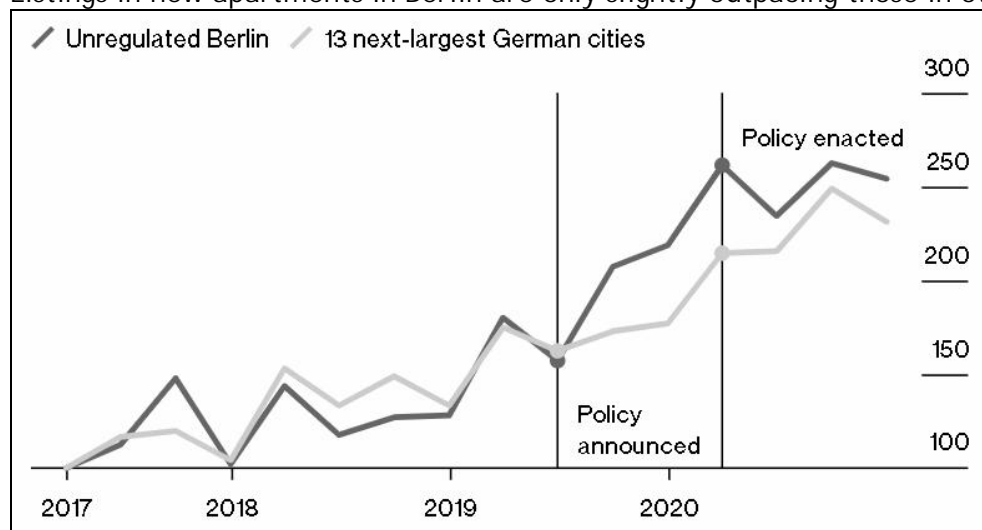
#### There Are Almost No Regulated Apartments Available Anymore...

Listings of rent-controlled units have dropped sharply



Source: Ifo Institute, immowelt.de. Note: Q1 2017 = 100

...Whereas the Extra Supply of Unregulated Units Can't Pick Up the Slack  
Listings in new apartments in Berlin are only slightly outpacing those in other cities



Source: Ifo Institute, immowelt.de. Note: Q1 2017 = 100

These data confirm what economists had warned about — and what's been observed in other cities that dabbled in rent controls, such as San Francisco or Cambridge, Massachusetts. The caps represent a windfall to one group of tenants: those, whether rich or poor, who are already ensconced in regulated apartments. Simultaneously, they hurt all other groups — especially young people and those coming from other cities — by all but shutting them out of the market.

To complicate Berlin's situation further, Germany's constitutional court is expected in the coming months to decide whether these rent controls are even legal. If the judges nix the legislation, lots of tenants in the formerly regulated sector could get hit by huge and even retroactive increases in their rents. That would create yet more chaos.

The biggest question is whether this episode of left-wing populism has damaged confidence in Berlin's real-estate market permanently. If investors fear that local property rights will be put at risk in every election, they might stop building houses in the city at all.