

Legal Measures to Stimulate Growth in the Spanish Rental Housing Market

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Abstract

Spain is, at present, among the countries in the European Union with the least rental housing in proportion to privately-owned. Only 11% compared to the European average of 40%. The origin of the disharmony in the rental housing market was the existence of legislation which overprotected the tenant and other factors, economic and financial, which also contributed to it.

The successive governments of Spain have been conscious of that situation, foreseeable two decades ago, and implemented measures with a tendency to incentivise and potentiate housing rental but considering the present results either there has been no effect or they have been insufficient. For instance, they passed a new Spanish Urban Rental Law which did not make much of a change to the rights of the tenant, they reformed the regulation of eviction for rental non-payment and other measures. Recently new measures were implemented but we are still waiting the results. Finally the current government has announced some new reforms.

The problem is that there still exists a necessity for housing due to the rise in the Spanish population, but the high property prices and the difficulties getting credit from banks has made access to home ownership difficult, if not impossible, for low income families, the youth etc. Facing this option, the alternative of rental housing seems hardly viable for low income families due to the fact that the rental housing market in Spain is tiny for the previously mentioned reasons, as well as the scarcity of the supply in rental housing and the high rents.

I. - Spanish Housing Market Antecedents and Current Situation

The Spanish Civil Code of 1889 regulated housing rental with a conception of the contract that gave primacy to freedom of contract between the contracting parties and hence left the contents of the contract (the rights and obligations of landlord and tenant) dependent on the supply and demand of the free market. At the beginning of the previous century, when the economy stopped being based on agriculture and industrialisation began, a mass exodus occurred from the countryside to the city. The working and middle class, due to their necessity for housing, found themselves in a weakened position in the face of the power held by the landlords. In concordance with freedom of contract, the landlord could impose the contractual conditions and the tenant had to accept them as a consequence of their weakened position. In order to alleviate this situation, in 1946 and 1964 specific housing rental laws were passed, independent of the Civil Code, with one clear objective: to protect the legal position of the tenant via two fundamentals: 1) The concession to the tenant of the right to indefinitely extend the rental agreement. 2) The severe limitation of the landlord's possibilities of raising the rent. In other words, withdrawing the rental housing market from the supply and demand of the free market as a result of the fact that the rights and obligations of the contracting parties were pre-established by the law.

This legislation did not change until the introduction of a new law in 1994 whose characteristics I shall deal with later on. The consequence was that during those years the Spanish rental market progressively lost its attraction for landlords and investors. The majority of landlords were progressively put off and preferred to leave their properties vacant, rather than renting, while they were waiting to resell at a better price. This has determined that, in Spain, companies that invest in rental housing practically do not exist, and as a result there are no professional or rental-market specialised businesses.

But, if the origin of the disharmony in the rental housing market was the existence of legislation which overprotects the tenant, there are other factors which have also contributed to it. In Spain, policies have been developed and circumstances have coincided which have fomented a tendency of Spanish families towards home ownership and to avoid renting. These factors and circumstances can be summarised as follows.

1) During the 60's and 70's, policies were developed for the subsidisation of house ownership in favour of low income families. These were known as Officially Protected Housing (Viviendas de Protección Oficial, VPO). This policy has continued with its ups and downs to this day. On the other hand, no similar policy of subsidies for the housing rental was implemented until last year (the new Housing Plan of 2009-2011 of the Ministry of Housing).

2) In 1977, a significant political and economic agreement, named the The Moncloa Pacts (Los Pactos de la Moncloa), was signed. As a consequence of said pacts, in 1981 the Spanish Mortgage Market Law (La Ley de Mercado Hipotecario) was promulgated, which regulated the financial instruments necessary to make mortgages an attractive prospect for banks and the result of which was a notable enlargement and extension of the mortgage market destined for property development and housing purchase. In the 80's, the Spanish economic upturn began, as did the tendency of Spanish families toward home ownership. During the 90's, the housing market and the purchase of property with mortgages would continue to grow, then favoured by the lowering of interest rates. At that time it cost the same to pay the monthly repayments on a mortgage as the monthly rent for a house. Why would anyone rent given these circumstances?

3) As an additional incentive to housing purchase, for more than 30 years in Spain the buying of homes has enjoyed a highly important tax relief on the buyer's Income Tax (El Impuesto sobre la Renta de las Personas Físicas). Whereas renting property had no tax advantage until recently, as I shall indicate later.

With all these legal, economic and financial antecedents, its no wonder that the Spanish have been nursing such a culture prone to house buying. The result has been that Spain is at present among of countries in the European Union with the least rental housing in proportion to privately-owned. Only 11% compared to the European average of 40%. For a full description of the Spanish property panorama it is necessary to add that during this first decade of this millennium there was a boom in housing construction. The growth in housing construction and the mortgage market from 2004 to 2008 has caused the building of eight hundred thousand homes per annum; more that Germany, France, Great Britain and Italy put together. This enormous supply has been principally absorbed by Spanish people buying a

second home as an investment or a holiday home as well as by foreigners. In these recent years, Spain has been chosen by many Northern Europeans as a place to spend their breaks or to live during their retirement in their own property. As the demand was unceasing so the property value uncontrollably rose.

When in 2008 the global credit crunch arrived, Spain was affected in a particular way, coinciding with the bursting of the housing bubble, all of which caused a fall in the housing demand and a spectacular halt in the construction and purchase of property. The problem is that there still exists a necessity for housing due to the rise in the Spanish population, but the high property prices and the difficulties getting credit from banks has made access to home ownership hard, if not impossible, for low income families, the youth etc. Facing this option, the alternative of rental housing seems hardly viable for low income families due to the fact that the rental housing market in Spain is tiny for the previously mentioned reasons, as well as the scarcity of the supply in rental housing and the high rents.

The successive governments of Spain have been conscious of this entire panorama, foreseeable two decades ago, and implemented measures with a tendency to incentivise and potentiate housing rental but considering the present results either there has been no effect or they have been insufficient.

II. - Measures adopted by Spanish Law to Incentivise the Rental Market

I shall show each measure separately.

1. Rental Legislation Reform

The first measure to be taken was the abolition of the old Spanish Urban Rental Law (Ley de Arrendamientos Urbanos) which strongly protected the tenant and promulgates a new one which did not make much of change to the rights of the tenant. In 1994 new law got passed, which is now in force, and also still continues to protect the rights of the tenant, although not as much as the previous law. The content of the contract comes legally established and therefore continues **partly** to remove rental supply and demand from the free market. In effect, to favour stability of habitual tenants, they have the right to remain in the property for

a minimum of five years irrespective of the fact that the established duration in the contract might be less. That is to say that if it is agreed that the contract last a year, the tenant has the right to extend the contract at will up to 5 years. The landlord has to put up with the tenant's staying for five years and can not throw the tenant out. As far as the rent is concerned, the landlord, during this five year period, can only raise the rent annually and in accordance with inflation, that is to say the landlord can not freely raise the rent each year. After said five years the landlord will then unrestrictedly be able to evict the tenant or agree to a new contract with a new free rent.

From my point of view, I have doubts whether it would be better to liberalise the rental housing market. It would be convenient to have similar knowledge of the legal situation of rental agreements in other countries. The doubt is if a free market would attract more investment in rental housing thus augmenting the supply and finally cause a lowering in the price of rents. Also, one might consider if it is convenient to reduce from five to three years the duration of occupancy.

But, independent of what is previously mentioned, what have the problems in the landlord-tenant relationship been? The problems in Spain originate in the judicial difficulties that the landlord has when evicting the tenant in the case of rental non-payment, but also when recovering unpaid rent and getting recompense for damages that have been caused, although when a tenant does not pay, the landlord's priority is that the tenant vacates the property. Let us now examine the reforms to the rules of eviction.

2. Reform to the Rules of Eviction for Rental Non-Payment

The regulation of Eviction for Rental Non-Payment is found in the Spanish Civil Procedure Law (Ley de Enjuicamiento Civil), 2000, and although it is recent, it has continued the tendency of the Spanish lawmaker to favour the position of the tenant. The law establishes that the tenant can avoid eviction and render useless the commenced trial, and avoid legal fees accrued to the landlord. Thus allowing the possibility to pay and continue in the property even though the trial has begun¹. The landlords can avoid this if by demanding payment before a judge and the tenant does not pay within 4 months. In conclusion, the tenant is allowed 4 month duration to leave and also without paying as in the majority of the cases the

tenant will be insolvent. The lack of recovery the rental payments after eviction are causing landlords to ask for excessive deposits when the contract is drawn up.

Three years after establishing the rules for eviction, the government then modified them againⁱⁱ, but has continued the tendency to favour the tenant. The new provisions, also of a procedural nature, further complicate the procedure from a formal point of view, which creates more insecurity. What can be considered as important is the possibility of accelerating the trial is regulated and eviction is accomplished more rapidly if the landlord concedes a partial reduction in the money owedⁱⁱⁱ. As far as the aforementioned 4 month period in which the landlord must start the trial proceedings in order to avoid the tenant's continued stay in the property, this has now been reduced to 2 months.

This last reform has had little or no effect on the situation because the eviction procedures last 8 or 9 months from the filing of the law suit to the eviction. The large volume of cases passing through the Spanish Courts contributes to this situation, determining a slow justice system. This explains why the current government announced last year a new reform of the eviction procedure, introducing what the media have called express eviction (**el desahucio exprés**)^{iv}, with objective of accomplishing eviction in the duration of one month from the eviction order. Until now this reform has not been implemented. In my judgement, the procedure should be simplified and stop be put to the halt of evictions once the order has been given. For this to occur, it should be sufficient enough that there has previously been an extrajudicial claim of payment which has not been fulfilled with a short period, let's say a month.

3. Spanish Real Estate Investment Trusts as Financial Instrument for the Stimulus of the Rental Housing Market

Another intent to stimulate rental housing has been the Spanish version of Real Estate Investment Trusts. In 1992, the Institutions for Collective Housing Investment (*Instituciones de Inversión Colectiva Inmobiliaria*, IICI) were created in Spain with the main objective of serving as a financial instrument to stimulate the rental housing market^v. With this approach, Spanish legislation only conceded a privileged tax position to ICIIs whose portfolio is composed of housing, as opposed to other countries where this is generally conceded to all

REITs. As has been said, the diverse factors that have favoured the tendency toward house ownership and the legal system for rental agreements, which does not favour investment in this market, have contributed to the fact that in Spain the IICIs have neither taken off nor have increased growth in the rental market. Due to this, the IICIs have registered singularly low financial figures in comparison to other countries in terms of numbers of REITs and above all in volume of holdings^{vi}.

Regarding the composition of the Spanish IICI holdings, they register a higher percentage of investment in housing in comparison with other countries. Specifically, 21.8% of the total holdings of the Spanish IICI is invested in first homes compared to for example to REITs from the US which invest 15.03% in housing or 5.15% invested by the Italian *Fondi Immobiliari* or 9% invested by the French *Sociétés Civiles de Placements Immobilières*. However, this policy has not accomplished growth in the Spanish IICIs. Besides, the released data has shown that in none of the countries the IICIs play an important roll in the residential market and on the contrary the highest investment percentages are destined for office, industrial and shopping center construction. In other words, if the REITs do not play an important roll in the rental housing market in any countries, why should it be any different in Spain?

Nowadays, we can state that IICIs in Spain have failed, those that are left are in a deep financial trouble. This explains why at present a new Spanish version of the REIT is being drawn up in the Chamber of Deputies (Congreso de los Diputados), the lower chamber of Spanish Parliament, which it is designing what will be called Housing Market Investment Trust (Sociedades Cotizadas de Inversion en el Mercado Inmobiliario, SOCIMI). It seems that these trusts have already renounced giving an important roll to rental housing as their tax benefits extend to all kinds of rental property, not just housing.

4- The Publicly Held Rental Company (Sociedad Publica de Alquiler)

In 2005, the Publicly Held Rental Company (Sociedad Publica de Alquiler, SAP) was created as a dependency of the Ministry of Housing. It is a National Company created with public money proceeding from another publicly held Company (the SEPES, another dependent of the Ministry of Housing). This entity acts as an intermediary between the owner and the

tenant during the signing and duration of the rental agreement. Whereby the trust punctually pays the landlord the monthly rent as agreed, via an insurance policy organised by the trust. Any problem which the tenant might have for the duration of the agreement will be managed by the SPA, avoiding any unnecessary disturbance or conflict between the parties. The landlord is guaranteed the receipt of the agreed rent and the restitution of the property in good conditions throughout the 5 year duration of the agreement.

The result is that, after 4 years, the SPA has created 9,561 rental agreements in all of Spain, a number which falls far short of the expected figure. On the contrary, it has accumulated losses of 7.2 million euros^{vii}, which obliged the SEPES to pay 4 million euros in 2008 in order to alleviate this economic situation. Some might say that the SPA should be closed. The Minister of Housing recently stated that in 2010 there will be a revision of the results of the SPA and its future will be decided.

5- Fiscal Measures for the Stimulus of Rental Housing

Whilst in Spain housing buyers, as long as it is the home, have had tax benefits for 30 years, rental tax benefits did not arrive until 2006. These tax benefits presently exist in direct tax, because we do not take into account indirect tax as rental housing has always been exempt from VAT. And so, there are two direct taxes in which these tax benefits are conceded:

a) Income Tax (Impuesto sobre la renta de las personas físicas, IRPF) has tax benefits for the landlord and tenant. The landlord can reduce the net return to be declared (income minus expenses) by 50%, as long as the property is the official domicile of the tenant. Also, if the tenant is between 18 and 35 and has a low income, the reduction that the landlord can receive may reach 100%, in other words total exemption. In the tenant's income tax return a percentage of the annual quantity that satisfies the rental payment can be removed from the tax paid, as long as it is the official domicile. As is logical, this removal is subject to certain conditions related to the income level of the tenant.

b) In the Spanish Corporation Tax (Impuesto de Sociedades), in this case since 1992, there has existed a special tax system for companies whose principal activity is housing rental. The system awards a tax reduction of between 85 and 90%.

Epilogue

In closing, I would like to highlight that the problem in the property market that is preoccupying the authorities and academics is the stock of unsold housing, which according to estimations will rise to a million by the end of 2009, which has accumulated as a consequence of the credit crunch. Nothing better occurs to me than to redirect them to the rental housing market. The problem is that the promoter of property in Spain have got used to creating housing for purchase, but if they wish to subsist they will have to reconfigure their business toward focusing on rental housing.

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ⁱ Article 22.4 of the Spanish Civil Procedure Law (La Ley de Enjuicamiento Civil, LEC) informs the tenants that they can pay before the trial.

ⁱⁱ Final Disposition 3a of the law 23/2003 which modifies LEC.

ⁱⁱⁱ Article 437.3 LEC.

^{iv} The Spanish newspaper El País, 15th October 2008 (web: http://www.elpais.com/articulo/espana/CGPJ/avala/desahucio/expres/elpepuesp/20081015elpepunac_8/Tes#EnlaceComentarios)

^v The regulation of the the Institutions for Collective Housing Investment was done by the law 19/1992 which in its Preliminary Recitals highlighted this objective to stimulate the supply of rental housing.

^{vi} The capitalisation figures, that is to say the value of the holdings of the Spanish IICIs, when compared with those of other countries, could not be more hopeless. In Spain in September 2007, there existed 9 property investment funds and 8 property investment trusts. The holdings of the former are worth 7,779,780,000 Euros (we do not have data about the latter). Excepting the difference in size with Spain, in the US in July 2008 (source: National Association of REIT) there were 108 REITs with total holdings worth 306,867,593,000 dollars. Taking into account closer countries, Italy has 109 property funds whose holdings are worth

19,000,000,000 euros. In the last year alone they have created 15 new funds (data from December 2007, source: Associazione del Risparmio Gestito). In France, property savings are channeled through the sociétés civiles de placement immobilière (SCPI), of which there are 126, and the sociétés d'investissement immobilières cotées (SIIC), of which there are 48. The former have holdings worth 17,230,000,000 euros and the latter 46,220,000,000 euros (data from December 2007, source: Institut de l'Épargne Immobilière et Foncière).

^{vii} The Spanish newspaper El Mundo, 21st June 2008, p. 45.