Rent reform and market value

Architect **Denis Camilleri** explains how the old rent laws and the current scenario affect the market value of property.

The Rent Laws Act X of 2009 came into force on June 19, 2009. This Act has righted Act 31 of 1995, as now all pre-1995 leases over a period will revert to their open market rental levels. This was not the case for the 1995 Act, whereby previous leases to this date were still regulated by the outdated tied rental regulations. This signifies that uplift will occur over a transition period for existing leases to the open market rental of the previously tied rental market. This tied rental market noting the 2005 Housing Census can still comprise 15 per cent of the total occupied residences, standing at 139,178. Further, all rental agreements have now to be undertaken via a written contract, whereby previously even a verbal contract sufficed.

The 2009 Act is further more exhaustive than any previous Acts, as it relates not only to main residences but embraces the whole tied rental market, mainly, summer residences, garages, clubs and commercial premises.

With regards to main residences, a restricted security of tenure is still included whereby a tenant's spouse not legally separated may linger on indefinitely, together with any natural or legal child of the tenant who has been living

defined as the tenant who has had a valid lease since June 1, 2008, whilst a beneficiary is defined as that heir related by consanguinity or affinity up to the grade of cousin. As from January 1, 2010 sub-letting by a sitting tenant is not allowed unless specifically stated in contract. For sub-letting that occurred prior to June 1, 1995, this lease shall terminate by June 1, 2018.

These old commercial leases are to be increased by 15 per cent per annum as from January 1, 2010 up to December 31, 2013. As from January 1, 2014 a property market index is to be introduced, acting as a guide to assist the parties to establish the fair market rental value. In the event that this index is not introduced by then, the commercial leases are to increase annually by five per cent as from January 1, 2014. These new conditions relating to specified periodic rental increases will not apply if these had already been stipulated in the original lease agreement, with the prevailing conditions applying.

Again as noted above for the residential sector, the 2009 Amendments have not presently attracted the full open market value potential. Revaluations as undertaken have revealed that for commercial premises which:

a) presently fall below the current open

The 2009 Act is further more exhaustive than any previous Acts, as it relates not only to main residences but embraces the whole tied rental market, mainly, summer residences, garages, clubs and commercial premises.

with tenant as on June 1, 2008 and continued up to the death of the tenant, this date also referring to any person living with the tenant. In some particular instances, a three or five year lease extension on demise is also possible.

The minimum rental amount is imposed at €185 per annum, unless agreed otherwise. The rent shall then be increased on a three-yearly basis according to the index of inflation. On noting this restricted security of tenure still in existence, it appears that premises may take a further period – possibly varying between 20 and 35 years – prior to revering to open market conditions. An amendment occurring to the repairs and maintenance undertaking, now imposes external ordinary maintenance to be within the tenant's remit. If the landlord undertakes any structural repairs, then the rental amount may be increased by six per cent of the costs incurred instead of the previous 10 per cent, although a capping in value had previously existed in that the rental amount could not be more than doubled.

Considering a basic leased residence in a poor or fairly good residential area, its present open market value on vacant possession is estimated at €11,250 (50sqm @ €225/sqm) for a basic poor area and €29,250 (90sqm @ €350/sqm) for a fairly good area. The return on capital to be expected from a housing investment is not expected to obtain a much better return than from other comparable safe opportunities, such as Government Bonds or long-term index linked Treasury Bills, but it is even not expected to do worse. By reference to this, a real return of four per cent from capital-value rents has long been settled upon.

Noting the above minimum rental amount of €185 per annum, the rate of return for the basic premises works out at 1.64 per cent and 0.625 per cent for a fairly good premises, well below the expected four per cent return. At this expected rate of return, fair rental values work out at €450 per annum and €1,170 per annum respectively.

On the other hand, if due to the 2009 amendments, both premises are considered to revert to their original owners in 25 years, the present open market values of these premises works out at €7,500 and €15,000 respectively. As the vacant open market value as noted above is given at €11,250 and €30,000 respectively, the 2009 Amendments have not presently attracted the full open market value potential. On the other hand, the €7,500 and €15,000 market values post-2009 rental amendments attracts a 100 per cent increase in market value for properties predating this amendment.

Summer residences and garages not connected to leased premises or not considered a commercial tenement, as from 1st June 1, 2010, unless there is an agreement between the landlord and the tenant, may be terminated. As this signifies that the property owner has the right not to renew the lease in question and re-acquire possession of such property, these premises may now be valued at their full present open market value.

Clubs, whether political, social, sports, musical or philanthropic, are to retain their security of tenure. The minimum rental value is to be raised to €300 per annum, noted at being a pittance. In this case, capital appreciation of these premises is not considered to have been affected.

For leases contracted prior to June 1, 1995, the 2009 Act outlines a 20 year period for protecting the existing tenure. This transition period is taken up to May 31, 2028, when all commercial premises shall revert to open market conditions. In the event that the sitting tenant dies during this period, the lease is transferred to an eligible beneficiary. The sitting tenant is

a) presently fall below the current open market rental value, this has attracted an increment of 50 per cent on capital value;
b) presently has weak escalation clauses, this has attracted an increment of 33 per cent on capital value;
c) presently rental levels are at a pittance, this has attracted an increment of 333 per cent on capital value.

The good news of the 2009 Amendments is that capital values except for clubs are to increase. This implies an improvement to the country's economic indicators. In the housing sector due to the imposition of a low ceiling rental level, affordability should not be jeopardised and if any household is to fall below the poverty line, Government should have structures in place to revert the situation.

The same cannot be said for the business community. Those companies using properties attracting very low rental levels will require over the transition period to make their business systems more efficient to make up for the loss in income from increased rental outflows. Government on the other hand can witness an increase in its revenue from succession dues and other property tax sources.

These amendments, with safeguarding of owners now in place, should further act as a stimulant to bring more of the vacant properties onto the market. In the 2005 Housing Census, this is quoted as standing at 27.6 per cent of the 192,314 units available. Of these vacant units however, 10,113 were listed as holiday dwellings or forming part of the second home market. It is then stated that 21.3 per cent of vacant premises require only minor repairs, 5,274 units were still in shell form, with only a small percentage in a dilapidated condition. The liberalisation of the rental market for new lease agreements should surely act to incentive the reuse of the vacant property market. This will further reduce the negative effect on our surroundings and built environment.