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EFFECTS OF RENT CONTROL ON REAL ESTATE
IN MALAYSIA

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ABSTRACT

Rent control legislation in many countries was enacted as a means to provide adequate legal shelter for tenants of rent controlled premises from being evicted or charged exorbitant rent by their landlords. In Malaysia today, majority of the controlled premises are traditional double storey or three storey terrace shophouses completed before 1948 that are mainly located in the older parts of major towns and cities. This paper will highlight salient points as regard to rent control legislation in Malaysia pertaining to the implementation of such legislation, determination of fair rent and cessation of controlled premises. The effects of rent control on property management, redevelopment and market values of controlled premises are also discussed and rationalised.

1.0 INTRODUCTION

Rent control legislation in many countries was enacted with the objective of protecting the rights of occupation of tenants and members of their families. It is a means of providing adequate legal shelter for tenants of rent controlled premises from being wilfully evicted or charged exorbitant rent by their landlords. This is to ensure the continued presence of the tenants most of whom are involved the business sector of the nation's economy after the second world war.

The history of rent control legislation in Malaysia are as follows :

1. Rent and Charged Land (Restriction) Enactment 1940
2. Control of Rent Ordinance 1947
3. Control of Rent Ordinance 1948
4. Control of Rent Ordinance 1956
5. Control of Rent Act 1966 (currently in force in Peninsula Malaysia)

2.0 RENT CONTROLLED PREMISES

Premises by definition under the Act means

.. any dwelling house, flat, factory, warehouse, office counting house, shop, school and any other building in which persons are employed or work and any part of any premises let or sublet separately and includes any land, outbuildings and appurtenances occupied therewith.

Controlled premises according to the Act are all buildings completed on or before 31 January, 1948 within local authority areas with the exception of the following :

- a) property of the Government of the Federation or of any state;
- b) property belonging to, vested in or acquired on behalf of any municipality;
- c) furnished premises let at rental which includes board; and
- d) premises which cease to be controlled under section 24 i.e.
 - i) a tenancy for a fixed period which has been determined either by effluxion of time or by any other means whatsoever; or
 - ii) where the tenant surrenders his tenancy voluntarily or is required by law so to do.upon the issuance and service of the certificate of decontrol given out by the Rent Tribunal.

3.0 PROTECTION ACCORDED UNDER RENT CONTROL ACT, 1966

With the coming into force of the Rent Control Act, 1966, the following protection was accorded namely ;

3.1 Tenancy

Tenancy is define by the Act as :

any lease, demise letting or holding of premises, whether in writing or otherwise by virtue whereof the relationship of landlord and tenant is created, howsoever such relationship may be described but does not include the letting or hiring of furnished rooms with board.

Once a tenancy is created in a controlled premise, the Act provides protection to the tenant in the form of secured occupation until such time when a certificate of decontrol is issued by the Rent Tribunal.

It is therefore no easy task to terminate a tenancy, or to evict tenants occupying controlled premises.

Part IV of the Act provides avenues for the recovery of possession of controlled premises. To recover possession of controlled premises is an uphill task in which the onus of proof is mainly on the landlord to prove default on the part of the tenant. The courts would normally be sympathetic towards the tenant and possession is seldom given unless the landlord has good evidence against the tenant.

In the case of recovery of possession for the purpose of development under section 18 or 19 of the Act again the onus of proof is on the landlord to satisfy the Rent Tribunal the conditions set out by the Act. Tenants have been known to challenge the order made by the Tribunal and more often it involved lengthy litigation and expensive legal costs.

3.2 Fair Rent

Another protection provided by the Act to the tenant of rent controlled premises is the determination of fair rent.

Section 5 lays down the provision for the determination of fair rent which are as follows :-

- a) by agreement in writing between the landlord and tenant; or
- b) in the absence of such agreement, by a decision of a Rent Officer provided that such decision is accepted by both parties; or
- c) if such decision is not accepted by either party, by an order of the Rent Tribunal.

The fair rent per month agreed or determined however shall not in any case exceed the following :-

- a) one-twelfth of the annual value of the controlled premises; or
- b) the amount of the rent per month of the controlled premises immediately before the commencement of the Act together with an increase of 100% thereof.

In determining fair rent, the following factors are also taken into consideration i.e. :-

- a) the location of the controlled premises;
- b) the age and character of the controlled premises;
- c) the state of repair of the controlled premises;
- d) the type of use, whether the controlled premises is use for business or domestic;
- e) any improvements made to the controlled premises by the tenant with the written consent of the landlord.

The procedure in determining fair rent are provided in detail in section 7 which are as follows :-

Step 1: Landlord and tenant will negotiate for a fair rent and if they agree to a figure within the limit provided, then it shall be reduced to writing and will thereafter constitute the fair rent.

Step2: Where there is no agreement within one month of the commencement of the negotiations, either party may request the Rent Officer to determine the fair rent. The Rent Officer merely recommends what the fair rent should be. If both parties accept the decision of the Rent Officer within one month of his decision, the amount so determined shall be the fair rent.

Step 3: Where the decision of the Rent Officer is not accepted by the parties within one month or if a Rent Officer for whatever reason is unable to decide within one month what the fair rent ought to be, the Rent Officer will issue to both parties a Certificate of Dispute.

Step 4: Upon receipt of the Certificate of Dispute, either party may apply to the Rent Tribunal to determine the fair rent and the amount so determined will be the fair rent (unless set aside on appeal).

Step 5: If any party do not agree with the decision of the Rent Tribunal may within 21 days from the date of decision make an appeal to the Appeal Board. Any decision made by the Appeal Board shall be final and cannot be questioned in any court.

The procedures mentioned above can be translated into a flow chart below :-

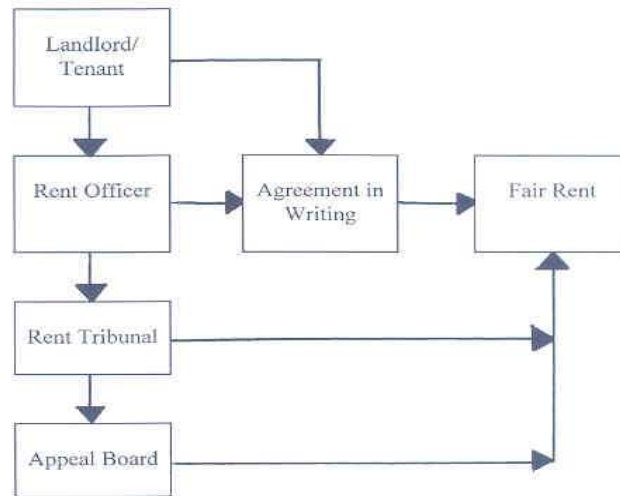


Chart 1.0 : Procedure In Determining Fair Rent

4.0 EFFECTS OF RENT CONTROL ON REAL ESTATE

Discussion on the effects of rent control on real estate, the writer will briefly cover on the aspects of property management, redevelopment and market value.

4.1 Type of Property Affected By Rent Control

In Malaysia today, majority of the controlled premises are traditional double storey or three storey terrace shophouses completed before 1948 that are mainly located in the older parts of all major towns and cities in Malaysia most being the state capitals or district administrative centres.

They normally used to be the central business district of the town which have gradually shifted through the process of time and urban growth. The very fact that they are controlled premises has resulted in the shift of the central business district to an area with newer and more modern buildings which are not under rent control with rental being open market and competitive thereby giving good investment returns to the landlords.

4.2 Property Management Of Rent Controlled Premises

Management of controlled premises are mainly left to hands of the tenants due to extremely low rent received by the landlord when compared to the current rental values of buildings not subjected to rent control. The very poor investment returns from a controlled premises led to the landlords being uninterested to manage and maintain their properties.

More often than not it is left to the tenant to maintain the buildings to a level fit for their own consumption. This situation has resulted in rent controlled buildings being improperly manage with inadequate maintenance budget due to the tenants themselves having to pay for the maintenance cost.

This situation has resulted in the aggravation of physical deterioration in rent controlled premises not withstanding the fact that most of the buildings are already more than 50 years old.

Poor property management of rent controlled premises may contribute to the creation of urban slump in most of the towns it occupies if not all.

Another phenomenon arising from the rent controlled legislation is the tenants reaping high profits from sub-letting part of the premises normally at open market rates. This leads to overcrowding and unsanitary living conditions which are also characteristics of urban slump or urban decay.

4.3 Redevelopment of Controlled Premises

Even though rent control legislation in Malaysia allow for the recovery of possession of controlled premises for the purpose of development as provided under section 18 or 19 of the Act, the task faced by the landlords is slow and tedious.

To recover possession of rent controlled premises, the landlords have to satisfy three conditions i.e.

- i) a plan for such development which have been approved by the local authority.
- ii) evidence that funds are available for the purpose of putting into effect such development.

- iii) a written undertaking by the landlord that work for the purpose of putting into effect such development will commence within three months of the date of possession of the premises shall have been obtained.

Among the problem faced by the landlords in the process of recovering possession can be as follows :-

a) Time

The time taken to obtain an order from the Rent Tribunal may take at least three years. In the mean time, building/planning approval lapse after one year and need to be renewed each year.

Further problems may persist when tenants objects to the small compensation allowed by the Act and always seek postponements of Tribunal hearings in order to frustrate the landlord in the hope that the landlord will abort his proposal.

The Act provides for compensation payable to tenant affected an amount not less than a total of two years rental but not more than a total of four years rental.

b) High Cost Of Eviction

In order to overcome the problem mentioned in (a) above, landlords sometimes resort to private arrangements by paying a lump sum compensation to tenant sometime known as "tea money" so as to extinguish the tenant's objection.

It is uncommon to eviction to hear eviction cost to in excess of RM100,000/- for a double storey rent controlled shophouse. If an order can be obtained, the eviction may amount to a mere RM9,600/- (i.e. four years rental at RM200/- per month).

c) Difficulty In Obtaining Planning Approval

Being mostly located in the older parts of town centres and most of such land parcels are of small and odd sizes, the landlords often face difficulties of satisfying modern planning requirements such as setbacks, building lines, provision of backlanes and parking bays etc.

All the problems mentioned above does not render rent controlled premises incapable of redevelopment, it is pertinent to note that the problems contribute to the increase of redevelopment cost particularly in the cost of holding the property and high cost of eviction.

Based on site observation, the number of controlled premises being decontrol are slowly increasing and redevelopment are taking pace which will take the area out from the path of being an urban slump. This is clearly evidence in the older part of the City of Kuala Lumpur and other State capitals undergoing rapid redevelopment exercise.

4.4 Market Values of Controlled Premises

When discussing market values of rent controlled premises, it is important to also discuss the submarkets that are found in the property market of controlled premises.

According to Mani Usilappan in his paper entitled "Valuation of Rent Controlled Premises" there exist three submarkets for rent controlled properties namely :-

4.4.1 Controlled Premises With Vacant Possession

These type of property are often transacted for purpose of redevelopment or sometimes for existing business use. These properties are very often owner occupied and never let at all or the vendor could have obtained vacant possession by virtue of section 24 before selling it.

Market values of these type of properties are normally the highest in the rent controlled property market because they reflect the redevelopment or existing use value without any encumbrances attached. The purchaser is therefore free to deal with the property in anyway he pleases subject to the approval of the local authority.

4.4.2 Controlled Premises Without Vacant Possession

These are properties that are transacted while the property is still subjected to an existing rent controlled tenancy. However these properties are bought either with a view of future redevelopment by the purchaser or with a view of obtaining vacant possession.

The market value of these type of properties are the lowest due to the difficulties and restriction as discussed in para 4.1 and 4.2. However there are transactions involving these type of properties but small in volume.

4.4.3 The Tenant Purchaser

These are instances whereby the controlled premises are bought over by the sitting tenant. The reason for purchase are mainly to secure permanent occupation of the premises which upon transfer will become owner occupied which thereon can be decontrol under section 24.

The market value of properties in this submarket is normally in between the market value of controlled premises with vacant possession and without vacant possession. The price agreed upon will depend upon the bargaining strength of the landlord(vendor) and tenant(purchaser). If the tenant is not desperate to buy, the price agreed may be nearer to the value of non vacant possession. On the other hand if the tenant is desperate to buy, then he may bid higher and may even offer as much as the vacant possession value.

For the purpose of this paper, a study on the market values of rent controlled premises based on transaction data available in the royal town of Klang which is the royal town of the Sultan of Selangor about 30 kilometers west of the city of Kuala Lumpur was conducted. It was found that the transaction prices for the three submarkets are as follows :-

i) Controlled Premises With Vacant Possession

Latest transaction prices for a double storey shophouse with vacant possession ranges between RM600,000 to RM630,00 or RM4,000 to RM4200 per square meter on gross basis.

ii) Controlled Premises Without Vacant Possession

Whilst transaction prices for a double storey shophouse without vacant possession ranges between RM450,000 to RM480,000 or RM3,000 to RM3200 per square meter gross.

iii) The Tenant Purchaser

Data was not available for this submarket

From the available data, it was found that the difference in market value of rent controlled premises with vacant possession and without vacant possession is between 20% to 25% which amounts to a difference of between RM120,000 to RM150,000.

The figure of RM120,000 to RM150,000 if translated into cost are actually cost of tenant eviction and holding cost for the period to obtain a certificate of decontrol.

To rationalise the above transaction prices, the following model can be used :-

Model 1

Value with Vacant Possession		RM600,000
less		
i. Compensation under section 18		
RM2,400 x 4 yrs	RM9,600	
Legal fees and other cost	RM15,400	
		RM 25,000
		RM575,000
P.V. RM1 for 3 years @ 10%		<u>0.7513</u>
Market Value without Vacant Possession		<u>RM431,997</u>
	say	RM430,000

Assumptions used in the above model is that the order for recovery of possession can be obtained after three years and the cost of borrowing cost is at 10% per annum

Model 2

Value with Vacant Possession		RM600,000
less		
Compensation under private agreement (Tea money)	RM100,000	
Legal fees and other cost	<u>RM 5,000</u>	
		<u>RM105,000</u>
		RM495,000
P.V. RM1 for 1 year @ 10%		<u>0.9091</u>
Market Value without Vacant Possession		<u>RM450,004</u>
	say	RM450,000

Assumptions used in the above model is that the order for recovery of possession can be obtained within one year due to the willingness of the tenant to surrender his tenancy and the cost of borrowing cost is at 10% per annum

Based on the above models used to rationalised the difference between the market value of controlled premises with vacant possession and without vacant possession, it can be concluded that Model 2 gives a more realistic results which is more in line with the general market behaviour and best explain the effects of rent control on market values of controlled premises without vacant possession.

5.0 CONCLUSION

Having discuss the effects of rent control on real estate we can therefore summarised as follows :-

1. There has been a gradual shift in the area of central business district in major towns due to the presence of rent controlled premises.
2. Poor property management due to neglect of maintenance by landlords of rent controlled premises may contribute to the creation of urban slump or urban decay.
3. The difficulty faced by landlords to redevelop controlled premises due to the slow and lengthy proceedings to obtain an order for recovery of possession, high cost of eviction and difficulty in obtaining planning approval has led to increase redevelopment cost which can be a deterrent to landlords to redevelop their property. This situation may further enhance the process of urban slump.
4. Based on the study conducted, it is evidenced that rent control had a reducing effect on market value particularly those that are without vacant possession. The study also indicate a difference of 20% to 25% between the market value of controlled premises with vacant possession and without vacant possession due to the cost of tenant eviction and holding cost of property to obtain the order for recovery of possession from the Rent Tribunal.

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