

Why California Tenants Need Rent Control

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Stephen Barton, Ph.D. fundaffordablehousing@gmail.com

Summary

Excessive rent increases have devastating effects. They have forced hundreds of thousands of families to choose either to pay more than half of their income for rent, forgoing other necessities of life, or to move far away from jobs, family and community ties. Too many cannot afford either choice and become homeless.

- All of these consequences generate high stress, with resulting harmful impacts on tenants' physical and mental health, on children's performance in school and on workers' performance on the job.
- The larger economy is harmed by the accompanying labor shortages and worsening traffic congestion and the reduction in income available to support local businesses after the rent is paid.
- The quality of life of the community is harmed by the increase in homelessness, the effects of childhood stress on the schools and the destruction of community ties.

Rent regulation is similar to public utility regulation. It prevents unnecessary rent increases but allows the rent increases that are actually necessary for real estate investors to obtain a fair return on their investment. The result is that rent control reduces displacement.

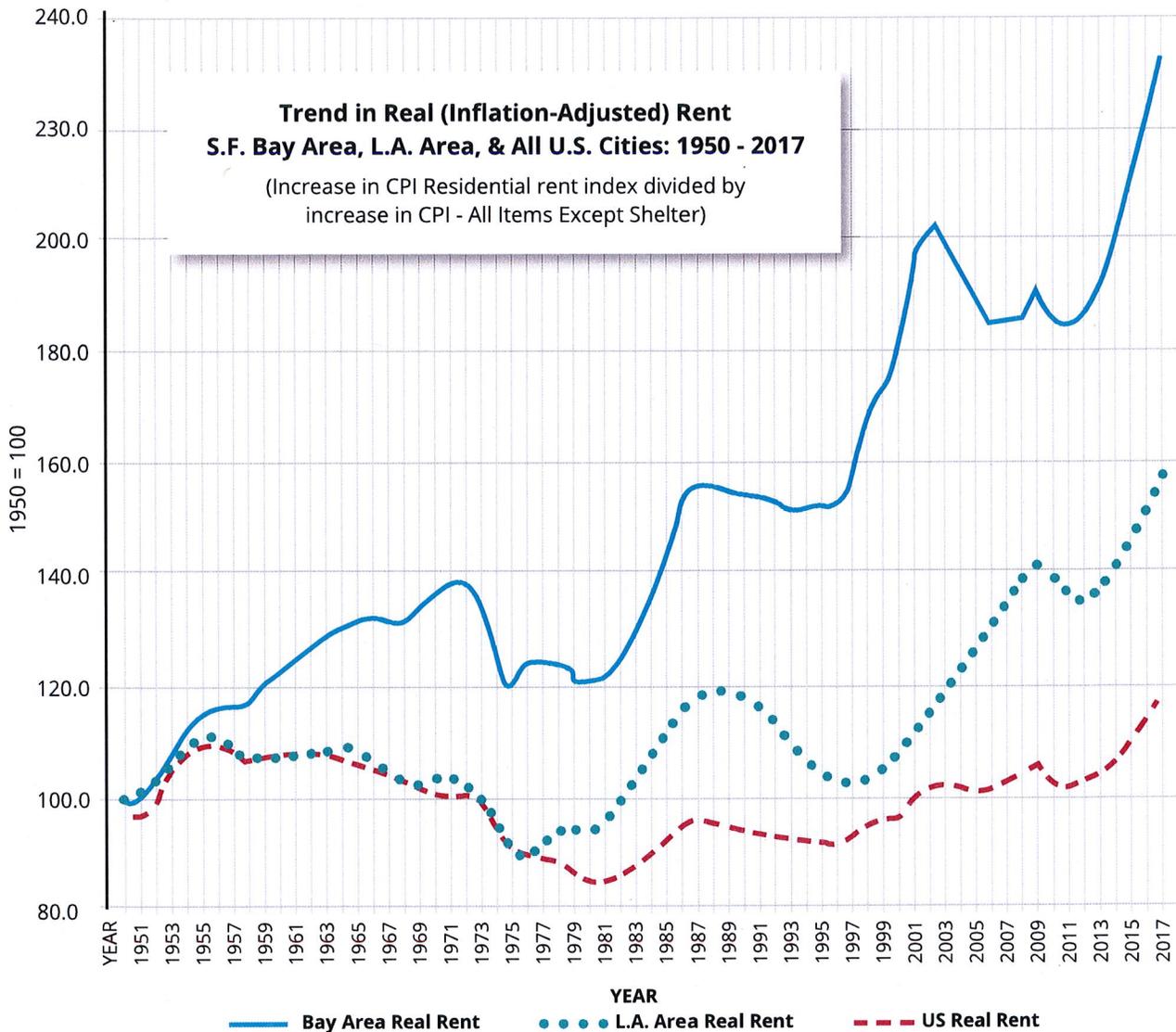
Rent control encourages new construction, increases proper maintenance and reduces the costs of government health and social service programs.

- Rent control encourages new construction by channeling higher income workers into the market for new construction rather than allowing them to displace sitting tenants from existing housing. Bay Area cities and Los Angeles, with rent control, have built proportionally more multifamily housing than their unregulated neighbors.
- Rent control combined with good cause for eviction encourages maintenance by empowering tenants to report code violations without fear of retaliation. Many buildings occupied by low-income tenants are substandard even though the rents are far higher than is actually necessary to profitably operate and maintain them. This is because the tenants lack bargaining power in tight, unregulated markets.
- Rent control will reduce the need for health, mental health and other human services and for temporary and long-term housing assistance, all of which are very expensive to provide, and will result in a net fiscal benefit to State and local government.

We can't wait until increased supply "catches up" and "trickles down". That will take at least another thirty years or more by any realistic estimate of construction capacity and cost. Excessive rent increases are creating extreme hardship now. Only rent control can provide some immediate relief.

1. The Problem: Rising Real Rents

From the end of World War II to 2011 rents in the U.S. as a whole were relatively stable when inflation is taken into account. Since 2011 rapidly rents are creating crises in cities around the U.S. In California the situation is much worse. Rents in the San Francisco Bay Area and the Los Angeles Area have increased much faster and over a longer period. According to the U.S. Census Bureau, the median contract rent in the L.A. area is 50% higher and the median in the Bay Area is nearly double that in the rest of the U.S.



2. Displacement Prevention is a Major Positive Effect of Rent Control

Rent control does not simply make tenants less likely to move, it prevents forced moves. **Forced moves are particularly harmful** because they disrupt work, family and community ties. As Professor Matthew Desmond found while researching his recent book *Evicted: Poverty and Profit in the American City*, when tenants are forced to choose between spending nearly all of their income in rent or moving away from

their jobs, relatives and communities to find housing they can afford, it generates enormous stress that can be devastating to their physical and mental health. Professor Gary Evans has demonstrated that poverty-generated stress, including forced moves, has harmful effects on the mental functioning of children that continue on into adulthood. Recent medical research has demonstrated that traumatic stress in early pregnancy is transmitted to the fetus and harmful effects result throughout the child's life.

Beyond the effects on the individual, excessive rents drain money from the community that would otherwise be spent at local businesses; force out workers who provide important services such as childcare, in-home supportive services; and disrupt the community ties that help provide people with a sense of security in their neighborhoods and daily lives.

Matthew Desmond & Rachel Kimbro, "Eviction's Fallout: Housing, Hardship and Health", http://scholar.harvard.edu/files/mdesmond/files/desmondkimbro.evictions.fallout.sf2015_2.pdf, *Social Forces*, 2015.

Gary W. Evans & Michelle A. Schamberg, "Childhood poverty, chronic stress, and adult working memory", *Proceedings of the National Academy of Sciences*, April 21, 2009. 106 (16) 6545-6549; <https://doi.org/10.1073/pnas.0811910106>

Israel Rosenfield and Edward Ziff, "Epigenetics: the Evolution Revolution", *New York Review of Books*, June 7, 2018, 36 – 38. <http://www.nybooks.com/articles/2018/06/07/epigenetics-the-evolution-revolution/>

3. Rent Control Encourages New Construction and Maintenance

Most U.S. tenants live in older housing, where the owner can profitably operate and maintain the building at a lower rent because the construction costs have been paid off. Market-rate new construction responds to the needs and preferences of tenants with incomes high enough to pay the development costs in addition to the costs of operation once the housing is built.

Standard economic theory suggests that **rent control in coastal California cities will increase new construction**. This is because when higher-income tenants moving into an area with an expanding job market simply push current tenants out of the older buildings, this reduces the market for new construction. The displaced lower-income tenants cannot pay enough rent to support new construction. In contrast, **when rent control protects lower-income tenants from displacement, new high-income tenants create an expanded market for new construction**.

This effect is contingent on reasonable provisions for new construction to profitably recapture its development costs, something that would be a constitutionally requirement for any rent control ordinance. **Up to now, all rent control ordinances in California have included an exemption for new construction**. Given that some "new construction" is coming up on forty years old, it should be possible to provide a rolling exemption that provides sufficient incentive while ensuring that tenants are protected after a reasonable period.

Most studies have found that rent control has no effect on new construction, but we know that proportionately more new apartments are built in cities with rent control than in the cities without it. The three largest Bay Area cities with rent control (San Francisco, San Jose and Oakland) have only 27% of the housing but according to the U.S. Census Bureau since the year 2000 they built 43% of the new multifamily rental units in buildings with five or more units. Similarly, the City of Los Angeles, with 42% of the housing in Los Angeles County, has built 62% of new multifamily rentals since 2000. There are, of course,

multiple factors at work. Cities with a greater proportion of tenants are both more likely to pass rent control ordinances and less likely to oppose construction of multi-family rental housing.

Low income families in coastal California often live in substandard housing while paying rents that would get them into new apartments with exercise rooms and swimming pools in other parts of the U.S. That's because in our tight markets they have no bargaining power and will often be ignored or even evicted just for complaining. With rent control and "just cause" eviction protections, tenants can get repairs made when they are needed.

Edgar O. Olsen, "What Do Economists Know About the Effect of Rent Control on Housing Maintenance?" *Journal of Real Estate Finance and Economics*, 1:3 (1988) 295 – 307

4. Rent Control Will Have Positive Fiscal Impacts

The standard analysis by the Legislative Analyst's Office will find that most legislation that reduces inequality has a "negative" fiscal impact, while things that increase inequality have a "positive" fiscal impact. People with high incomes pay more in income and capital gains taxes than lower-income people, so allowing rapidly rising rents to increase the incomes of real estate investors at the expense of low-income people has a "positive" fiscal impact by bringing in more tax revenue. Similarly, gentrification and pushing low-income people out of a community can raise property values and thus raise property tax revenue. This analysis ignores the costs that rising inequality inflicts on the community and the benefits of greater equality in creating a higher quality of life and reduced suffering. It also ignores the fiscal benefits of rent control, which will significantly reduce the level of health, mental health and other human services and for housing subsidies required to meet essential human needs.

Over the years, California court decisions have, on constitutional grounds, moderated the allowable strength of rent controls. Rent controls are required to allow rents to increase sufficiently to cover increases in operating and maintenance costs and to provide an inflationary adjustment to maintain the buying power of the landlord's cash flow. This ensures that the value of the property will continue to increase over time, although it may not increase as fast as it would without regulation. Furthermore, since California residential rental properties are only reassessed when they are sold, a very slow process, any effects would take many years to manifest themselves, while the benefits from reduced displacement and homelessness would be immediate.

Studies of what is now forty years of rent control in various cities in New Jersey report that there is no evidence of negative fiscal impacts.

Joshua D. Ambrosius, et al. "Forty years of rent control: Reexamining New Jersey's moderate local policies after the great recession", *Cities*, 49 (2015) 121-133.

5. New Construction Cannot Restore Affordability in Less Than 30 Years, if Ever

There are several major reasons why the rental housing market is not adequately competitive. One cause is **restrictive land use regulations that limit increases in supply**. The single largest governmental barrier to increased supply of rental housing is single-family zoning, and since that is backed by the voting power of the American middle class, it is not going away. It protects homeowners' property values but the supply restriction has significant costs for tenants and first-time homebuyers.

There are **major barriers are inherent in the development process.**

- In-fill construction in urban areas at high density is more complex and expensive than building low-rise apartments on vacant lands.
- The capacity for new construction has limits. Higher density requires more highly skilled construction workers. In the Bay Area so much multi-family housing is under construction that there are shortages of building contractors with the necessary capacity and construction costs have increased rapidly.
- New construction is self-limiting. New housing is typically aimed at higher-income tenants who can pay enough rent to profitably repay the high cost of new construction as well as ongoing operating costs. Once enough expensive apartments are built to meet the demand at the high end of the rental market, construction will slow even though tremendous demand remains at the middle and low end of the market.

There are **major time lags in construction.**

- A study by the LAO indicated that in order to keep housing prices level during the thirty-year period from 1980 to 2010, California would have needed to produce nearly twice as much housing as it actually did. In order to catch up, California would need to double its production for the next thirty years.
- A study by the UCLA Anderson Center found that it would take a 20% increase in housing supply to reduce housing prices by 10%, which is the increase of only the last few years.

If California can overcome the serious constraints resulting from regulatory barriers, lower profitability outside the luxury market, and limited capacity within the construction industry then the state might make real progress over the next twenty to thirty years. Even then, it takes a long time for new rental housing, which is built for the high end of the market, to “filter down” to moderate and low-income tenants after the construction costs are paid off.

There are **major time lags in the “filtering down” process.** Most tenants live in older housing that can be profitable at much lower rents, since construction costs are no longer an issue. Gardeners have a saying that the best time to plant a tree is twenty years ago. The best time to have a boom in rental housing construction is twenty years before the economic growth that creates major increases in demand for rental housing at all incomes, so that a good stock of older housing will be available when it is needed. Obviously that’s not the way the housing market works.

Legislative Analyst’s Office, “California’s High Housing Costs: Causes and Consequences”, March 17, 2015, <http://www.lao.ca.gov/reports/2015/finance/housing-costs/housing-costs.pdf>

Jerry Nickelsburg, “Affordable Housing to Get a Bump” UCLA Anderson School, September 2017

6. The Role of Land Rent

Our rental housing market is broken. In a fully competitive market, landlords compete for tenants, charging the lowest rent at which they can profitably operate and maintain the rental unit. In our broken market, tenants compete for a place to live, landlords can charge whatever the traffic will bear, and lower income families lose their homes to people with higher incomes.

Economists often mistakenly treat rental housing as a simple consumer good. In fact, rental housing involves two separable aspects, the building and the land or location. Each of these result from different

economic processes and require different modes of economic analysis. As Adam Smith pointed out in *The Wealth of Nations* (1776), widely regarded as the founding work of market economics, the rent that a tenant pays can be divided into two aspects. The “building rent” is the amount actually necessary to pay for the operation and maintenance of a home and to provide a normal profit to the landlord on their invested capital. The “land rent” is an extra payment for access to a desirable location. As the real estate industry saying goes, the three most important determinants of real estate values are “location, location, and location”. For tenants in coastal California a **substantial part of the rent is really just an admission charge for the privilege of living here.**

It is widely understood that taxation of land rent has no harmful effects on the production of goods or services because the actions of the landlord determine the building rent but not the land rent. The public makes locations desirable through government, which provides essential services and infrastructure, and through private action, which has generated a diverse and creative culture and a growing economy. Taxation of land rent simply recaptures value created by the public. (In modern economic terminology, land or location rent is one type of “economic rent”, which is broadly defined as business income over and above the level actually necessary to induce production of a good or service.) Lee Friedman and others have shown that the same logic is applicable to regulation of economic rent through rent controls. Constitutional requirements ensure that rent controls in California limit only increases in economic rent and not necessary increases in building rent, so rent controls will have no harmful consequences for the maintenance and supply of housing.

The cost of rental housing in California should be publicly regulated, just as we regulate the cost of water, gas and electricity through public utility regulation. Utilities are in a position to take advantage of limited competition unless they are regulated. We have a broken rental housing market where adequate competitiveness cannot be restored in less than a generation. Real estate investors are taking advantage of this broken market to exact an enormous transfer of wealth from people who do not own real estate to people who do. This disrupts the lives of individuals, families and communities. As a result, when housing costs are taken into account, California has the highest poverty rate in the nation. Rent controls can reduce these unnecessary costs and improve our quality of life.

Lee S. Friedman, *Microeconomics of Public Policy Analysis*, Chapter 13, “The Control of Prices to Achieve Equity in Specific Markets”, 507 – 549, Princeton Univ. Pr., 2002

Andrejs Skaburskis & Michael B. Teitz, “The Economics of Rent Regulation”, pp. 41 – 60 in W. Dennis Keating, Michael B. Teitz & Andrejs Skaburskis. *Rent Control: Regulation and the Rental Housing Market*, Center for Urban Policy Research, New Brunswick, 1998

Stephen Barton, “Land Rent and Housing Policy: A Case Study of the San Francisco Bay Area Rental Housing Market”, *American Journal of Economics and Sociology*, 70:4 (2011) 845 – 873.

About the Author

Dr. Stephen Barton has a Ph.D. in City & Regional Planning from the University of California, Berkeley and is the author of numerous academic articles and book chapters on housing policy and economics. His research and writing received a National Planning Award from the American Planning Association and a Research Award from the Community Associations Institute. Prior to retirement, he was Director of the Housing Department of the City of Berkeley, receiving an Affordable Housing Leadership award from the Non-Profit Housing Association of Northern California, and was Deputy Director of the Berkeley Rent Stabilization Program. Dr. Barton can be reached at fundaffordablehousing@gmail.com.