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impacts *of* statewide rent control

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Rent control remains a polarizing topic between policy makers and the business, real estate, and economic development communities. As a result, policy makers need to review the purpose of the legislation, and further evaluate the long-term impacts these policies may cause.

This article will serve to review current economic literature on rent control around the country. In addition, it will compare the existing rent control legislation in California, the District of Columbia, New Jersey, New York, and Oregon, and provide a graphical overview of each.

THE SHIFT IN SUPPORT OF RENT CONTROL

Oregon's debate over rent control in 2019 inspired visceral reactions from those who both support and oppose the policy. The resurgence of the rent control discussion results from the widely-accepted belief that America's cities face an overall housing shortage, which has led to an affordability crisis. Large numbers of both renters and homeowners pay an increasingly high percentage of their incomes on housing. This affordability crisis has forced policy makers to seek answers through policy intervention, such as rent control.

A recent study performed by the economics division of the National Association of Home Builders suggests there is currently a net housing shortfall of approximately 1 million single-family homes and apartments across the U.S. This lack of supply drives up rental rates, and causes a ripple effect throughout the economy including reduced homeownership, deferred wealth generation among young people, and a higher percentage of young adults continuing to live with their parents relative to prior generations.

The challenge then becomes what policies, if any, should be enacted to mitigate these affordability issues. Most economists believe that rent control in practice is an ineffective and misguided tool, providing a band-aid to incumbent renters while making the underlying housing supply shortage even worse.

For example, the nation's poorest 20% of individuals do not make enough to afford minimum quality housing without subsidies. As Jenny Schuetz, a Fellow at the Brookings Institution's Metropolitan Policy Program, points out, housing unaffordability isn't a failure of housing markets, but a function of the low wages and unstable incomes generated by labor markets. This, combined with the fact we simply haven't built enough housing in the last 40 years within cities where people want to be, is what led to our current reality. The last thing we want to do now, is further restrict the supply of new housing, which is exactly what rent control will do.

TENANT RESPONSE TO RENT CONTROL

As Harvard University economist Edward Glaeser recently said, rent control is, "Not a good way of helping the downtrodden. It's a way that freezes a city and stops it from adjusting to changes, a way that freezes people in apartments and stops the motion that is inherent in cities."

Going further, the freezes that Professor Glaeser references above refer to rent controls' favoritism to people who already occupy rental housing units. Rent controlled apartments are always assigned to existing tenants in place. However, those seeking new housing, often younger families and minorities, will face higher housing cost due to scarcity of apartments, as there are few incentives for the existing tenants to vacate.

If an individual who already has housing is protected by rent control for a period of years, their decision to move requires a new living arrangement much better than their existing situation. They have the option to stay in their existing unit and remain protected by rent control. If they seek new housing that better meets their needs, they will generally need to pay significantly more than their current rents. For most tenants, the choice is easy, and they decide to stay where they're at, preventing new tenants from moving in.

The premium rent for a new apartment often leads to a mismatch between the apartment unit and the household's needs. Empty nesters forgo the option of giving up their multi-bedroom apartment because of its rent-controlled status. Households who find a new job in another part of the region will either suffer the longer commute or give up the opportunity. Tenants in these favored situations will give up the mobility that renting allows. And the young households who are living in their parents' home or in a less than satisfactory apartment remain powerless to compete for the apartments of the incumbent tenants.

INVESTOR RESPONSE TO RENT CONTROL

Real estate development is driven by investment by both institutions and high net worth investors, who seek risk-adjusted rates of return on their investments. When investor returns diminish, or if investors sense there's growing government policy intervention in a region, it's not uncommon for those investors to seek different markets and different real estate asset classes.

In October of 2019, the National Multifamily Housing Council ("NMHC") conducted a survey which found that market participants in cities and states with rent control (and even those jurisdictions which are considering rent control) expect to decrease their investment significantly moving forward. Of the survey respondents, 58% currently operate in markets that recently imposed rent control or are seriously considering doing so. Of that group, 34% have already cut back on investment or development, while an additional 49% are considering doing so moving forward.

Some of these challenges may be masked by the current conditions of low interest rate. We may see further reduction in investment for new housing in cities with rent control regulation once these rates begin to rise.

LANDLORD RESPONSE TO RENT CONTROL

Rent control often triggers a harmful response from landlords who become unable to increase rents at a rate necessary to keep up with adequate building maintenance and inflation. With their income fixed, landlords will neglect routine upgrades to the building and property, or even begin converting the building to a property use not governed by rent control, such as the conversion to condominiums.   Another tool landlords may use is to preemptively begin raising rents before the building reaches the age required to be controlled by rent control. That is, the rent control ceiling becomes a floor for future rent increases. Landlords experiencing a recessionary market, such as with the current Coronavirus outbreak, may decide to offer one-time rent concessions to attract tenants, rather than permanent reductions in their statutory rent.

When adequate standards of maintenance are not met, building quality, as well as overall tenant quality of life may fall below acceptable standards. The decline in maintenance may also damage city finances, as reduced investment will lead to lower building assessed values, which ultimately means less property tax revenue generated for the jurisdiction implementing rent control, thereby driving up tax burdens on non-rent controlled buildings.

Most states with rent control have established minimum building sizes to be subject to the rent restrictions. As a result, developers considering a housing project may choose to build fewer units then they otherwise would have to avoid building the unit threshold subject to rent control. By reducing the scope of their projects, this reaction will reduce housing supply further, causing rents to continue to rise.

Other negative impacts include the increasing payment of "key money," or what effectively becomes a bribe paid by a prospective tenant to property managers to secure a unit in a rent-controlled building. Finally, it's not always clear that the existing tenants in an apartment are beneficiaries of the legislation. In sublease situations, a sublessor may charge their roommate or sublet tenant a higher than proportional rent for the space. In no market with rent control are sublet rents regulated.

Of course, not everyone sees rent control as a burdensome action against landlords. In a recent interview with Bisnow, New York State Senator Brian Kavanagh said he believes that The Housing Stability and Tenant Protection Act of 2019 (the "Act") – which ushered in many new rules on housing – created a balance among the many interests at stake in a way the reflects the public interest. When asked about landlords reactions to the Act, Senator Kavanagh had this to say, "My premise is not that all landlords are bad people, or even that most landlords are bad people, [but] I do think that landlords respond to economic incentives, and we've adjusted those incentives so that you'll have a healthier market [and] better outcomes."

	Age of Units Covered by Rent Control	Size of Building Covered by Rent Control (i.e., exemption for duplexes, etc.)	Number of Jurisdictions in the state that are included (i.e., statewide or local option)	Rent Increase Limits	Vacancy control or decontrol
California	15 years or more	2 or more units	Various municipalities	5% statewide, plus local rate of inflation, or 10% of the lowest rent charged at any time during the 12-monts prior to the increase (whichever is less).	Vacancy decontrol
District of Columbia	Units built prior to 1975	All housing accommodations (apartment building or apartment complex) in the District of Columbia. Title II of the act, which provides for rent stabilization, applies to rental units (single apartment or house).	All housing accommodations (apartment building or apartment complex) in the District of Columbia. Title II of the act, which provides for rent stabilization, applies to rental units (single apartment or house).	2% plus CPI, not to exceed 10%	Vacancy decontrol
New Jersey	Varies by municipality	Varies by municipality	Local option, individual municipalities may adopt rent control	Varies by municipality	Varies by municipality.
New York	Rent Control - Units built prior to February 1, 1971. Rent Stabilized - Units built before January 1, 1974.	Rent Control - Tenants continuously occupying rent-controlled units since before July 1, 1971. Rent Stabilized - Generally, 6 or more units.	Statewide	7.5%	Rent Control - Vacancy decontrol Rent Stabilized - Vacancy control.
Oregon	15 years or more	5 or more units.	Statewide	7% + CPI	Vacancy control

NEW RENT CONTROL LEGISLATION

Rent control in the United States is limited to only four states – California, New York, New Jersey, and Oregon, and the cities of Washington, DC and Tacoma Park, Maryland. This section will review new initiatives in rent control that have taken place in recent years.

CALIFORNIA

California implemented statewide rent control that became effective January 1, 2020. Assembly Bill 1482, or the "Tenant Protection Act of 2019," (the "Bill") now caps rent increases for qualifying units at 5% plus the increase in the regional Consumer Price Index, or 10% of the lowest rent charged at any time during the 12-months prior to the increase, whichever is less. California Governor Gavin Newsom has said that with the Bill, California will boast the "nation's strongest statewide renter protections."

Rent may only be increased twice over any 12-month period, and must remain within the rent cap of 5%; the Bill will not overrule the more restrictive city and county rent controls that may exist within a jurisdiction. The Bill prohibits an owner of residential real property from terminating a tenancy without "just cause," which may include "at fault" just cause such as a default on rental payments, or "no fault" just causes such as the property owner's intent to occupy the real property themselves or one of their family members.

The Bill applies to rental units in an apartment building, but does not apply to single family homes, condominiums, or units which have been issued a certificate of occupancy within the previous 15 years.

Analysts at CoStar speculate that at the state level, the new rent control law may have a minimal impact on the current housing crisis in California. Based on rent growth this economic cycle, annual rent increases (minus inflation) for properties more than 15 years old in California, averaged about 2.7%; this is well below the new rent cap of 5%, suggesting that the statewide law may not be a binding constraint on rents.

WASHINGTON, DC

The Rental Housing Act of 1985, as amended (the "Act"), is the law governing rent control within the District of Columbia ("DC"). Under the Act, an apartment building or apartment complex is defined as a "housing accommodation," and a single apartment or house is called a "rental unit"; the Act applies to all rental housing accommodations in Washington, DC.

Under the Act, any increase in rent must meet specific conditions, including but not limited to the following:

1. The new rent charged may not be more than the prior rent plus an allowable increase (described below).

2. The increase in rent charged cannot be more than the increase allowed under any single section of the Act.

3. The last increase in rent must have been at least 12 months prior (except for vacant units).

4. The increase must not violate the terms of the lease.

5. The housing accommodation must be properly registered with the Rental Accommodations Registration.

6. The housing provider (property owner) must provide a 30-day notice of any increase in rent.

For tenants who are not elderly or disabled, the most their rent can automatically increase is the annual CPI plus 2%, but not to exceed 10%. However, there is an exception to the rental increase, which comes into play upon vacancy of a unit. The housing provider may raise rent charged upon a vacancy to 10% more than was charged for the rental unit before it was vacated, or to the rent level of a substantially identical unit in the same building, but no more than 30% than was charged for the vacated unit.

Certain exemptions from rent control include units that are federally or locally subsidized, units built after 1975, units owned by a person who owns no more than four rental units in DC, and units which were vacant after the Act took effect.

NEW JERSEY

Although the state of New Jersey does not have a law controlling or governing rent increases statewide, any municipality within the State may adopt ordinances controlling rent increases.

For example, in the City of Newark, New Jersey, no landlord may request an increase greater than the percentage increase in the CPI, from the CPI 15 months prior to the month of the proposed rent increase, and in no case shall the allowable rent increase exceed 4%.

The State of New Jersey finds itself uniquely positioned in that recent, more stringent rent control laws in New York has spurred significant investment in the Garden State by investors fleeing other rent-controlled markets. How New Jersey handles this influx of investment moving forward remains to be seen.

NEW YORK

New York City has two parallel rent controls in the form of both rent stabilization (by far the most commonly applied) as well as rent control. To qualify for rent control, a tenant must have been continuously living in an apartment since July 1, 1971, or be a qualifying family member who succeeded to such tenancy.

When a rent-controlled unit becomes vacant, it either becomes rent stabilized, or when in a building with less than six units, the apartment is removed from regulation altogether. As a result, rent controlled units in New York City have gone from around two million units in the 1950's, to now only 22,000 units. The maximum rent increases for rent-controlled tenants is now set at the average of the last five Rent Guidelines Board annual rent increases for one-year rent-stabilized renewals, or at 7.5%, whichever is less.

While only around 1% of units in New York City are now controlled by rent control, close to 50% of the city's units are rent stabilized (or approximately 1 million units). Rent stabilization generally applies to apartments in buildings with six or more units that were built between 1947 and 1974. Once a tenant is in a rent stabilized unit, the landlord can only raise rent by a percentage determined by the New York City Rent Guidelines Board.

As part of the Housing and Stability and Tenant Protection Act of 2019, rent regulations have been made permanent, and will no longer expire every four to eight years within New York City. In addition, this new legislation has made it even more difficult for landlords to bring rent stabilized units up to market rate rents through the appeal of certain vacancy decontrols such as high rent vacancy decontrol (which previously allowed a landlord to deregulate their unit if the rent exceeded $2,700 and the previous tenant left).

After signing the new rent control bill into law, New York Governor Andrew Cuomo proclaimed, "I'm confident the measure passed today is the strongest possible set of reforms that the Legislature was able to pass and are a major step forward for tenants across New York." Governor Cuomo may be right in his assessment, but the ripple effects are yet to be seen.

OREGON

In March of 2019, Oregon Governor Kate Brown signed Senate Bill 608 ("SB 608") into law, becoming the first state in the nation to pass statewide rent control. Following about her decision, Brown stated, "Every Oregonian should have access to housing choices that allow them and their families to thrive. Today I signed the country's first statewide rent control bill, providing immediate relief to Oregonians struggling to keep up with rising rents."

SB 608 limits annual increases in rent to 7% plus the Consumer Price Index (CPI), maintains the existing law that no rent increases are allowed in the first year of a month-to-month tenancy, and requires that landlords give 90-day notice of rent increases thereafter. The seemingly innocuous threshold of 7% plus CPI made voting for rent control relatively easy for state legislators. Because of the relatively high limit on rent increases, the Oregon business community decided to focus their efforts on fighting the carbon reduction legislation, instead of statewide rent control. SB 608 exempts new construction (i.e. certificate of occupancy was issued less than 15 years ago), new tenancy, and subsidized housing.

Although the long-term effects of SB 608 remain to be seen, there are many provisions within the legislation that appear problematic.

SB 608 ignores, or fails to recognize that certain landlords previously held rent below market rents without the need for regulation. By capping the allowed rent rate increases, this will discourage "value-add" investing, whereby an owner buys a Class B or Class C property, makes substantial improvements, and re-rents the apartment at Class A or Class B rents. The reduced investment will lead to a long-term deterioration in housing quality. Given the complexity of the new rules, small landlords have been selling their properties and putting property management in the hands of third-party property specialists, recognizing the need to preserve their rights to charge market rents.

Many economists believe that rents will rise faster in 2020 and 2021 than previous years, however, this is expected to be more due to the lack of supply than a result of the rent control legislation. For some properties, the "CPI + 7%" cap might be tested. It's also possible that the cap will be increased by future legislatures.

The 15-year certificate of occupancy requirement, which determines what buildings are covered by the legislation creates a long-term threat to the real estate market. This provision was written into the legislation to shield proponents from the charge of harming new construction. Of course, a better-written legislation would have said, "2004 or more recent." Historically, that was how New York's rent control legislation was written, which is how the "pre-war, post-war" distinction came about.

For Oregon, this means the number of units covered by SB 608 will grow over time, and eventually all units will be covered by the legislation. The unstated goal of the advocates of rent control is to turn rental housing into a public utility.

CONCLUSION

With the new legislation in California, New York and Oregon, the past two years have seen the greatest legislative activity in rent control since the inflation of the 1970's. Yet over 75% of the US population lives in states without rent control. In those states, landlords and tenants negotiate each year over apartment rents and the landlord-tenant relationship is voluntary. Landlords invest and maintain quality levels in order to achieve the highest rent possible. Yet the competition among landlords means that tenants retain bargaining power and quality levels are maintained.

The states that have chosen to put rent control legislation are changing the voluntary relationship between landlords and tenants into a statutory one. Limits on rent increases will reduce incentives for developers to build new housing units, even if the legislation explicitly exempts new units. Maintenance of housing units will suffer as property owners will need to see any compensating increase in rent for their investment. Small landlords will likely exit the market as professional property managers will be better equipped to navigate the new legal environment. And ultimately, the tenant benefits that accrue to primary tenants is unlikely to be equitably distributed, as young and minority households are less likely to have an existing apartment tenancy.

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