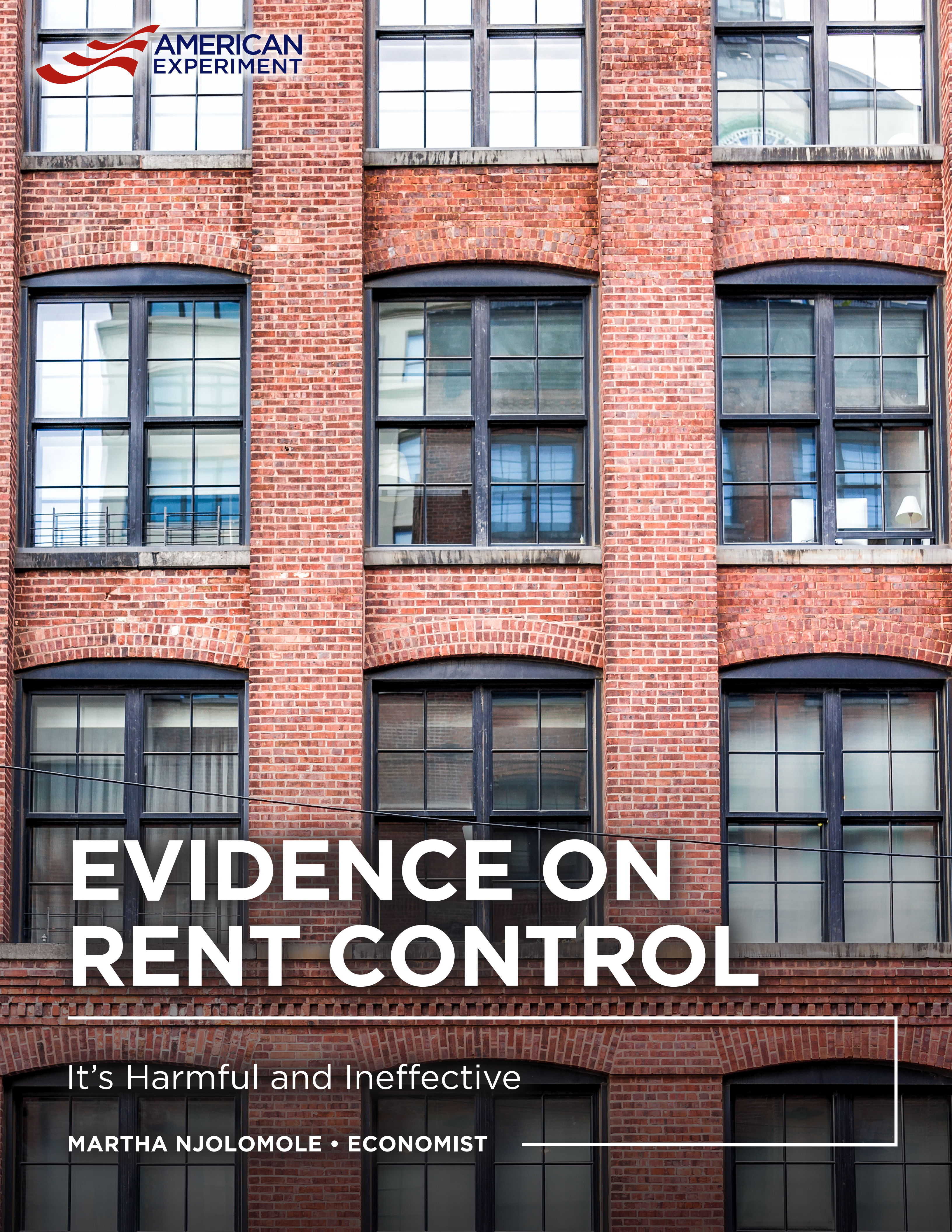

AMERICAN EXPERIMENT

EVIDENCE ON RENT CONTROL

It's Harmful and Ineffective

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Executive Summary

- Economists generally agree that rent control is a bad idea. In a 2012 survey on whether rent control measures have had a positive impact in the last three decades on the quality and quantity of housing supply in the cities that used them, 81 percent disagreed, and only 2 percent agreed. Research evidence is also clear that rent control is bad policy.
- Certainly, proposals being currently considered differ from the strict first generation rent control policies that froze rents and allowed no increase. Research shows, however, that even current moderate forms of rent control are equally disastrous.
- When San Francisco enacted an ordinance that capped rent hikes at 7 percent per year, total rental housing supply was reduced by 15 percent. Furthermore, landlords converted building into luxury condos and new construction forcing housing stock under rent control to decline by 25 percent. Rental prices went up by 5.1 percent citywide as excess demand flowed into the unregulated sector. Similar results have been observed in other cities that have had moderate forms of rent control like Cambridge, Brookline, Boston, Los Angeles, Berkeley, Santa Monica, Berlin, Ontario, and Stockholm.
- The Twin Cities will face similar, if not more disastrous results if rent control is enacted, especially considering that St. Paul's proposed ordinance would be one of the strictest in the nation.
- High and rising housing prices in the Twin Cities are a symptom of demand for housing outpacing supply. In recent years, housing construction has not kept up with population growth. Between 2010 and 2017, for instance, the Twin Cities added 83,091 households and only 63,604 new housing units — a shortfall of 19,487 units. Rent control will not solve this problem.
- To tackle the housing crisis, lawmakers should focus on removing impediments to housing construction, namely excessive fees and regulations.

Introduction

Rising housing costs are bringing up an old idea in the Twin Cities — rent control. This November, voters in both Minneapolis and St. Paul will decide whether to give local bureaucrats the power to limit the rates by which landlords can raise their rents. Advocates claim this will help low-income renters, especially people of color, escape gentrification and hold on to their housing.

Indeed, lack of affordable housing is an issue facing the Twin Cities. But years of research evidence, as well as experiences from other cities, show that rent control is a harmful and ineffective solution to the affordable housing crisis.

Evidence on Rent Control

Economists generally agree that rent control is a bad idea. In 1992, for example, when economists were polled on whether rent control reduces supply of housing, 93 percent agreed with the statement.[1] Similarly, when the University of Chicago[2] surveyed leading economists in 2012 on whether rent control measures "have had a positive impact over the past three decades on the amount and quality of broadly affordable rental housing in cities that have used them", 81 percent disagreed — with most of them disagreeing strongly — and only 2 percent agreed. Research evidence is also clear that rent control is bad policy.[3]

Certainly, proposals being considered in the Twin Cities are different from strict first generation rent control policies that were heavily popularized by cities like New York and Washington D.C. after World War II. Evidence presented in this report, however, shows that even second generation or moderate rent control policies (also known as rent stabilization) — which allow landlords to raise rents at capped rates — also have disastrous consequences.

Places like San Francisco, Cambridge, Los Angeles, and other cities all around the globe have found that, much like earlier proposals, second generation rent control policies:

- Reduce the quantity and quality of housing supply
- Heavily subsidize housing for middle- and high-income renters
- Reduce the mobility of renters
- Lead to housing misallocation
- Reduce property values and erode the property tax base. ■

Note: There is a significant literature showing the negative impacts of the earlier strict version of rent control that was introduced during the war in places like New York. This report only focuses on regions that have had second generation or moderate rent control policies which are more comparable to what is currently being proposed in the Twin Cities.

Quantity and Quality of Housing Supply

From an economic standpoint, rent control can be thought of as a price ceiling — i.e., landlords have a limit which their rents cannot go over. Price ceilings are problematic since by limiting prices they also limit potential profits; thereby, discouraging the provision of goods and services while increasing demand. This leads to further scarcity, exacerbating the problem.

One way through which rent control reduces housing supply is by discouraging investments into the housing market for the development of new units.

Evidence

- Between 2010 and 2018, California cities with rent control measures in place faced a 2 percent decline in their growth of housing supply.[4]
- Between 1980 and 1990, Santa Monica and Berkeley lost an average 10 percent of their rental housing units, while cities that had no rent control experienced an increase in their rental housing units.[5]
- After rent control repeal in 1995, Cambridge, Massachusetts experienced a 20 percent rise in permits for new construction and unit improvements, and spending on housing construction and improvements doubled.[6]
- Between 2010 and 2013, Los Angeles experienced decline in the growth of housing supply which deprived the city of an additional 79,000 units of housing. Median gross rent was 3.8 percent higher than it would have been without rent control.[7]

Apart from discouraging investment in new construction, rent control also incentivizes landlords to shift to other types of real estate exempt from rent control. Landlords may convert their apartments into owner-occupied condominiums or luxury units. Landlords may also demolish old building and redevelop them into new, expensive housing. This reduces the housing stock available in the market for low-income renters.

Evidence

- In San Francisco, "many buildings were converted to new construction or condos that are exempt from rent control" causing the number of renters living in rent-controlled units to decline by 25 percent. Furthermore, total rental housing supply was reduced by 15 percent and rent went up by 5.1 percent citywide as excess demand flowed into the uncontrolled sector. And since the high-end housing built in San Francisco attracted residents with higher incomes, rent control contributed to the gentrification of San Francisco, the exact opposite impact that the rent control policy intended.[8]

- In Cambridge, about 10 percent of housing was converted to condominiums between 1960 and 1970.[9]
- In Cambridge, Brookline, and Boston, the rental housing stock declined by 8, 12 and 2 percent respectively between 1980 and 1990 as landlords converted to condos and other types of housing that were exempt from rent control, while nearby cities experienced an increase in their rental housing stock.[10]

Rent control also encourages tenants in regulated apartments to overstay to maximize savings from cheap rent. This, however, means that fewer apartments are available on the market for new low-income renters, effectively reducing the housing stock and raising prices as renters compete over fewer available units. Moreover, this demand also spills over to the unregulated sector, raising prices.

Evidence

- In San Francisco, while tenants in rent-controlled apartments saved $2.9 billion between 1995 and 2012, current and future residents paid $2.9 billion more for housing because prices in non-controlled buildings had skyrocketed, cancelling those savings.

And when landlords cannot convert their units into higher end condos or redevelop their units due to capital or legal constraints, they cut back on maintenance expenses leading to deteriorating housing quality.

Evidence

- In Cambridge, rent controlled buildings were generally found to be deprived of essential repairs, were in worse condition compared to non-rent-controlled and commonly had maintenance problems like holes in the walls and floors, chipped or peeling paint issues and loose railings. ■

Subsidies for Middle and High-Income Renters

Contrary to popular opinion, residents in rent-controlled houses are not always the poorest. Evidence heavily indicates that middle- and higher-income renters heavily benefit from rent control measures.

Evidence

- In Stockholm Sweden, between 2011 and 2016, individuals in rent-controlled apartments were found to have incomes 30 percent higher than the metropolitan average.[11]
- In San Jose, 62.1 percent of renters in rent-controlled units in 2013 were middle- and higher-income earners. Additionally, low-income renters only made up just 27.7 percent of all renters in rent-controlled apartments in cities of Los Angeles, San Francisco, and Oakland.[12]
- In Cambridge, only 35 percent of the tenants in controlled units had incomes of $10,000 or less.[13]

Furthermore, because landlords are prevented from using price to choose whom to rent to, they may use other characteristics like race, income levels, or status of public assistance. This ends up hurting already disadvantaged individuals — whom rent control is intended to help.

In Cambridge, for example,

- Landlords preferred to rent their units to higher income tenants, not those receiving public subsidies.[14]
- There were fewer poor renters during rent control than after rent control was abolished. Sims (2007) estimated that only 26 percent of renters in the bottom quintile of the household income distribution were in rent controlled apartments. Additionally, while Hispanic and Black residents were 25% of the city's populations, they were only 12% of the residents in rent-controlled units.[15]
- Rent control ultimately led to the displacement of large, disadvantaged renter populations by a younger, higher income, better educated, singles population.[16]

In Santa Monica and Berkeley

- The proportion of "low-income households, college students, elderly persons, families with children, and disabled persons" declined, and was displaced by high-income renters, managerial and professional employees, and highly educated individuals at a higher rate compared to other cities.[17] ■

Property Values and the Tax Base

When rents are not allowed to grow as they would in a market, property values decline or grow at a slower rate — an effect that also spills over to non-rent-controlled neighborhoods. Maintenance and other quality issues also decrease the desirability of rent-controlled buildings and surrounding buildings thereby driving down rents and property values.

And since landlords usually use gains from appreciation to reinvest in their buildings, eroding property values limits capital expenditures, which could in turn lower property quality, lowering property values further. Declining property values also affect property tax collections.

Evidence

- Between 1995 and 2004, property values increased by $2 billion for both controlled and uncontrolled buildings in Cambridge after rent control was repealed.[18]
- Between 1980 and 1990, Cambridge lost an estimated 20 percent of its property tax revenues due to loss in taxable assessed property values.[19]

Mobility

By incentivizing people to overstay, rent control reduces mobility. When people move less, it means there are fewer vacant houses circulating in the market which raises prices for new renters. Moreover, reduced mobility reduces people's ability to scale up economically

When people don't move, they are less likely to accept better job opportunities outside their local labor markets,[20] hampering their chances of moving up the income ladder. Moving is one of the ways people find better economic opportunities. Less mobility, in essence, means stagnation and less dynamism in the economy.

Evidence

- In San Francisco, rent control residents were found to be about 20 percent more likely to stay at their original address and in San Francisco than were non-rent-controlled residents.[21].
- In New York, "about 23 percent of households in stabilized units have lived in their unit for 20 years or more, compared with only 7 percent of households living in market-rate units", as of 2011.[22]

Housing Misallocation

By encouraging tenants to overstay, rent control contributes to housing misallocation whereby people end up living in houses that are too big or too small. Consider a family with three children that lives in a rent-controlled apartment paying hundreds of dollars below the market rent. Chances are once these kids move out, the parents are less likely to move although they do not need the extra space. When this happens, there is an inefficient allocation of space since housing units are either underutilized or overutilized.

Evidence

In 1990, after 10 to 20 years of rent control, Brookline and Cambridge had the lowest number of tenants per building compared to other Metropolitan Boston Communities, signaling underutilization.[23]

Students in rent-controlled apartments in Berkeley have fewer roommates than those in non-rent-controlled units suggesting underutilization.[24]

Experiences from Outside of the U.S.

Rent control's negative impacts are not exclusive to the United States. Numerous other examples exist outside the U.S. to provide us with caution.

Evidence

In Ontario rent control increased rents on exempt buildings — i.e., those built after 1975; reduced new construction; accelerated the deterioration of rental housing units; encouraged landlords to convert buildings to new and expensive units; reduced rental housing supply; and reduced tax revenues.[25]

In numerous German cities, including Berlin, rent control policies that were enacted in 2015 resulted in the neglect of rental units, increased rents in unregulated markets and encouraged landlords to demolish old buildings and turn them into new, more profitable buildings.[26]

In Sweden, rent control policies have resulted in massive housing shortages and long queues in cities with rent control.[27] ■

How the St. Paul Rent Control Proposal Compares

Generally, most rent control ordinances in the nation can be considered moderate since they allow for rent increases and contain numerous provisions to mitigate the negative effects of rent control.

Currently, the Minneapolis ballot question has no specific proposal and voters will only be giving power to the city council to enact rent control measures in the future. St. Paul residents on the other hand will be voting on a proposal that will cap rent hikes at 3 percent over a 12-month period.

The proposal, while it can be considered moderate in the sense that it allows landlords to raise rents, it contains no other provisions that would put it on par with most other current rent control ordinances. In fact, if enacted, it will be one of the strictest rent control ordinances for the following reasons:

1. It does not include vacancy decontrol, i.e., landlords cannot raise rents to market rates between tenants.
2. It does not exempt new construction; most rent control ordinances exempt new construction.
3. It does not consider inflation

"The ability to raise rents to market levels between tenants can mitigate the losses that landlords incur due to rent control."

The ability to raise rents to market levels between tenants — vacancy decontrol — can mitigate the losses that landlords incur due to rent control. This can, in turn, weaken the economic impacts of rent control. By depriving landlords of a mechanism through which they can recoup some of their lost profits, the St. Paul ordinance will augment the distortionary effects of rent control on housing investments. In the same way, not exempting new housing would excessively deter the construction of new housing by lowering the profitability of new development.

Indeed, evidence shows that while vacancy control kept rents much lower in the cities of Santa Monica, Berkeley, East Palo Alto, and West Hollywood compared to surrounding cities, the provision also magnified the negative impacts of rent control on housing supply. One study found that between 1980 and 1990, these four cities had fewer rental housing units than border cities, two of which had rent control with a vacancy decontrol provision.[28] This is because landlords in cities with vacancy control converted to owner-occupied units at higher rates than landlords in border cities. Additionally fewer new rental units were being created in cities with vacancy control.

Another study has also shown that housing supply grew faster in Berkeley, Oakland, San Francisco, and San Jose after the repeal of strict rent control policies through the passing of the Costa-Hawkins Rental Housing Act. This is a 1995 California state law that repealed vacancy control and required all California Cities to exempt new buildings, single family homes and condos from rent control.[29]

"It is highly likely that these magnified effects of rent control will be concentrated on low-income housing."

Moreover, given the structure of the Minneapolis market — which is representative of the St. Paul market — it is highly likely that these magnified effects of rent control will be concentrated on low-income housing. As an analysis by the Center for Urban Affairs (CURA)[30] notes, in recent years prices for units that serve low-income residents have grown at higher rates than rents for high-end units. This would make the proposed 3 percent cap more binding in the low-income rental market. If current trends persist, landlords will likely gravitate towards catering to the higher end of the rental market, where rents will not be as significantly impacted by rent control and reduce their investments at the lower end of the market.

And besides the proposal having one of the country's lowest caps, it does not factor in inflation rates, something which would prove costly in times of high inflation. Certainly, inflation rates have been low the past few years, but that changed during the COVID-19 pandemic period and high inflation rates will likely persist. According to the Bureau of Labor Statistics, for example, the Twin Cities Metro experienced an inflation rate of 6.5 percent between July 2020 and July 2021. A 3 percent cap on rent hikes during times of high inflation — like now — would significantly increase the cost of undertaking investment in housing and reduce landlord profits.

Notwithstanding, rent control is a proven disastrous policy and no number of modifications would change that. But the current St. Paul proposal would only amplify the negative consequences that other cities with rent control have faced. ■

Rent Control Treats Symptoms

Historically, rent control measures have mainly shown up in areas facing rising housing costs due to shortage of supply.

In 1593, for example, Jews living in Rome — who at the time were forbidden from owning property and could only rent in the ghetto — were banished from all but three of the Papal states. They flocked to the ghettos of Rome and Ancona, causing rents to rise disproportionately in those ghettos compared to other regions. This resulted in Pope Clement freezing rents to protect Jews from their Christian landlords.

Likewise, when Lisbon enacted rent control 1755, it was only after a great earthquake had destroyed one-third of the city, which slashed the city's housing stock leading to high prices.

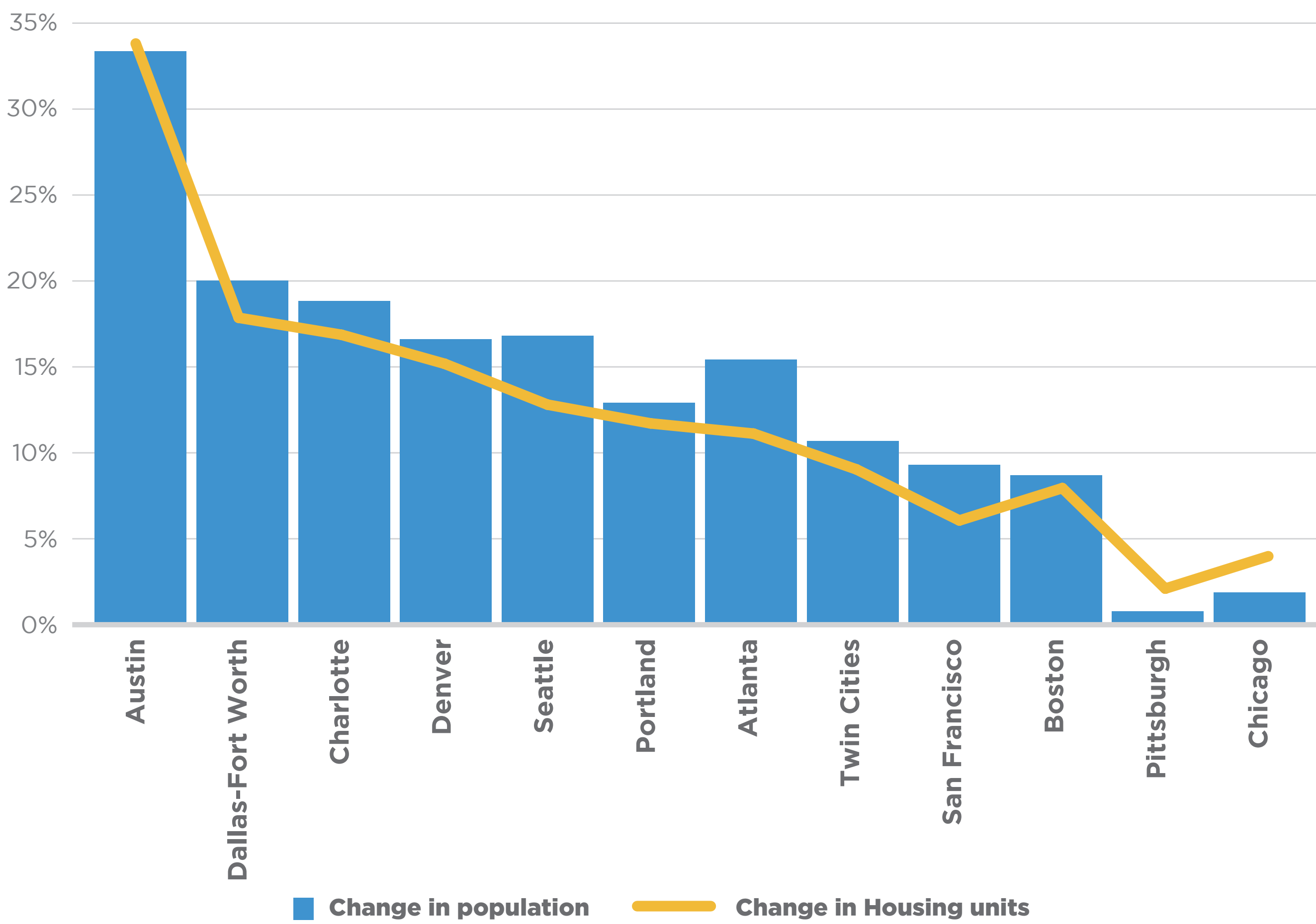
And like most European countries that adopted rent control during the interwar period, Washington D.C and New York — the earliest cities to adopt rent control in the U.S. — were pushed by housing shortages that had come about due to the events surrounding World War I.[31]

So, to say the least, the Twin Cities region is not facing a novel problem. The cost of housing is high and rising because there is not enough supply to satisfy demand. The few units available are being bid up quickly due to excessive demand, causing prices to go up.

Evidence from the Metropolitan council shows that while housing supply has grown, it has lagged population growth. Between 2010 and 2017, for instance, the Twin Cities added 83,091 households (a growth rate of 7.4 percent) and only 63,604 new housing units (a growth rate of 5.4 percent) — a shortfall of 19,487 units.[32] And compared to other regions, the Twin Cities region has had the 4th highest housing growth shortfall among 12 peer metros between 2010 and 2020.[33] Accordingly, rent control will only treat the symptom, not the root cause of high housing prices. ■

FIGURE 1

Change in Population Vs. Change in Housing Units (2010-2020)



SOURCE: METRO COUNCIL

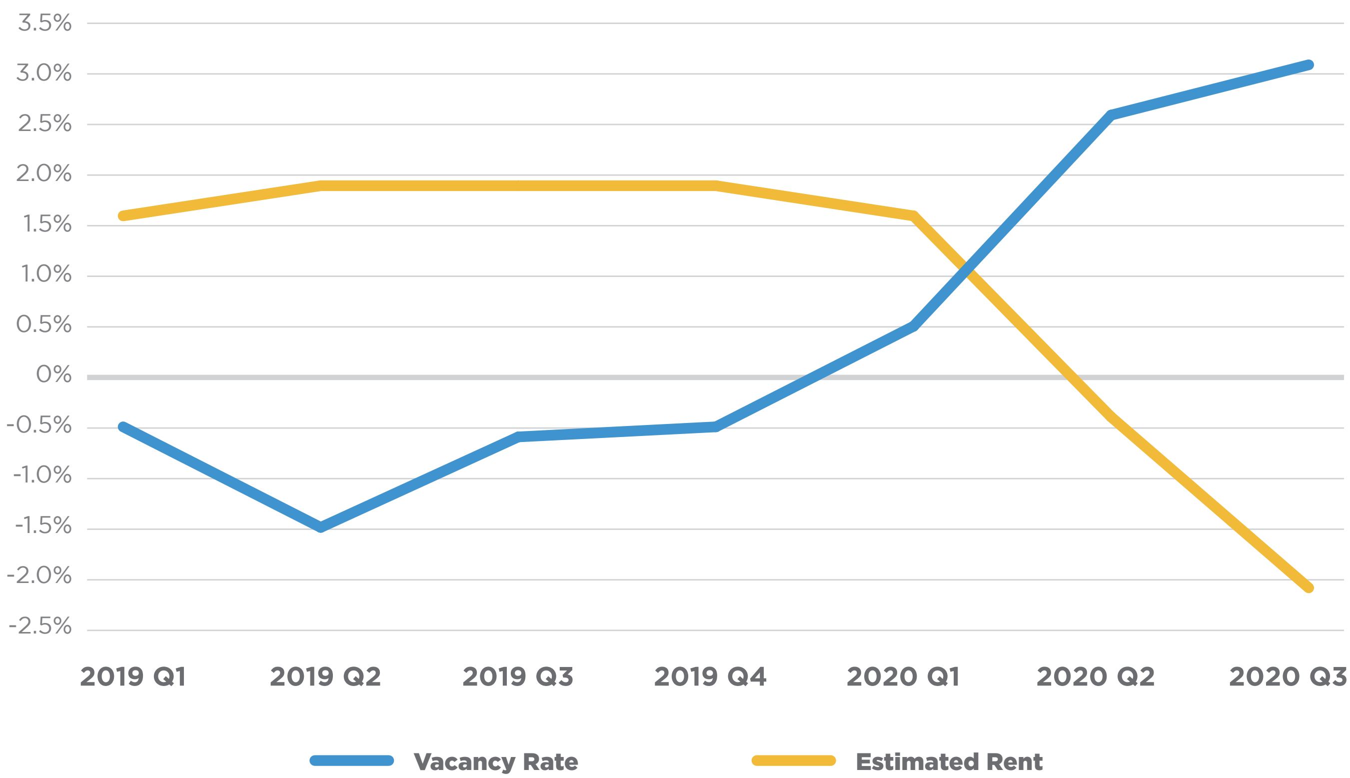
Lawmakers Should Focus on Increasing Housing Supply

Research heavily indicates that adding new housing — even at market rates — pushes vacancy rates up thereby driving prices down as renters have more units to compete over. [34] This phenomenon is something that we witnessed during the pandemic when high and rising vacancy rates lowered rents in many cities. In San Francisco, for example, rents were down by as much as 45 percent for one bedroom apatments between March 2020 and 2021.[35] In the Twin Cities, the vacancy rate in Q3 2020 was up by 3.1 percent compared to Q3 of 2019, causing rents to decline by 2.1 percent. While rents have started to rise back up, the negative relationship between vacancy rates and rent prices, as shown in figure 2 below, is an illustration that increasing housing supply pushes prices down or at the very least prevents prices from rising excessively.

Hence, given the evidence, policymakers should focus on increasing housing supply, in order to address the affordable housing crisis. They can do this by removing impediments to housing supply, namely burdensome permitting requirements, land use regulations, zoning rules, environmental building codes as well as excessive fees. Excessive fees and regulations delay construction projects and add tens of thousands of dollars to the cost of housing development in the Twin Cities — costs which are ultimately passed down to consumers.[36] ■

FIGURE 2

Year Over Year % Change in Vacancy Rate Vs. Year Over Year % Change in Estimated Rent



SOURCE: METRO COUNCIL

Conclusion

Evidence shows that rent control reduces the quality and quantity of housing supply; subsidizes housing for middle- and high-income individuals; reduces property values and erodes the tax base; reduces mobility; and encourages housing misallocation. To address the housing crisis, Minnesota lawmakers should focus on increasing housing supply by removing impediments to new construction such as excessive fees and regulations.

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