Rent Control: The Good, the Bad, and the Ugly

Executive Real Estate Round Table
Franklin L. Burns School of Real Estate & Construction Management
Daniels College of Business | University of Denver

September 12, 2019

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THE WALL STREET JOURNAL.

The World’s Dumbest Housing Policy
First California makes homes unaffordable, then it imposes statewide rent control.

By The Editorial Board
Sept. 11, 2019 7:14 pm ET

Credit: Adobo
The World’s Dumbest Housing Policy

If every regulatory instinct Democrats in Sacramento have is wrong and counterproductive, maybe they should take Jerry Seinfeld’s advice to George Costanza and do the opposite. Consider a statewide rent cap that Democrats rushed through the legislature this week.

California already boasts the highest housing costs in the country, and even liberals have come around to acknowledging that not enough homes are built to meet demand. The state has added about half as many housing units as needed to accommodate population growth, and more than half of Californians spend 30% of their income on rent.

Blame a thousand regulatory burdens. Local governments limit what housing developers can build and where. They layer on permitting fees, and then there are the state’s high labor costs and expensive green-energy mandates and restrictions that opponents can exploit to block projects for years.

Last year state regulators mandated solar panels on new homes. Cities are increasingly prohibiting natural gas hookups as they try to block fossil fuels. The San Luis Obispo City Council voted last week to charge developers a $6,000 fee for every new housing unit that isn’t all electric.

The upshot is that an “affordable” housing unit in California costs $332,000 to build and nearly $600,000 in San Francisco, according to state budget figures. Developers can’t turn a profit on low- and middle-income homes despite abundant federal and state subsidies.

Democrats have ladled out billions of dollars for housing in this year’s budget, and voters in 2017 approved $3 billion in general obligation bonds for low-income housing. Gov. Gavin Newsom has also threatened to sue cities that don’t meet their state-mandated zoning quotas for affordable housing. And now Democrats want to constrain housing prices by fiat. Mr. Newsom and Democratic legislators are pushing a law to limit annual rent increases across the state to 5% plus inflation. Rent increases have been slowing, but nearly 50% of units in San Francisco and the East Bay would have been capped in 2015 and 40% in 2016.

After businesses complained that the rent cap would discourage new development, Democrats agreed to exempt units built in the last 15 years. But who can trust that progressives won’t broaden the cap in the future? Some liberal groups are already pushing a ballot initiative next November to let local governments expand rent control.

The rent cap could encourage landlords to increase rents up to the limit each year rather than respond to the market. Landowners might also decide it’s more profitable to convert buildings to condos, which would further limit the stock of rentals. The biggest harm so far has been to increase uncertainty for developers. Building permits in the first seven months this year have fallen 17% compared to 2018 despite an increase in state subsidies. The only other times permits have plunged by this much were during recessions.

California’s progressive regulatory complex is contributing to this housing slowdown by driving businesses and people from the state. More than 700,000 residents have left since 2010, and many more will head for the exits if progressives have their way and the cost of living in sunshine keeps rising.
What Exactly is Rent Control?
What Does a [Typical] Rent Control Policy Look Like?

1. Caps on Rent Increases on Existing Leases
   a. Oregon: 7% per year
   b. California: 5% per year plus inflation
   c. Rent Boards set “Maximum Base Rents” (by unit)

2. Renewals: Landlords **Must** Renew Leases Unless there is “Just Cause”

3. Vacancy Decontrol Policies
   a. Sometimes tied to previous tenant’s rent

4. Common Exemptions
   a. Newer Properties (Less than 15 – 20 Years old)
   b. Small Owners / Single Family Homes
California approves statewide rent control to ease housing crisis

By Conor Dougherty and Luis Ferré-Sadurní

Sept. 11, 2019

California lawmakers approved a statewide rent cap on Wednesday, covering millions of tenants, the biggest step yet in a surge of initiatives to address an affordable-housing crunch nationwide.

DENVER REMAINS AT TOP OF RECOVERY FOR HOME PRICES

Of the 100 largest metros in the United States, 75 now have home prices above the peak reached before last decade’s housing crash, according to the latest update to the Home Price Recovery Index from HSH.com.

And metro Denver continues to hold the top spot — something it has done in every quarter but one since the index launched in 2015.

Home prices in Denver-Aurora-Lakewood are 91% above the old high. Runners-up include Austin, Texas, with an 81.4% increase, and San Francisco, up 73.5%.
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Real Rent Growth
(Metro Denver, Trailing 12-month Rate)

Source: Vacancy and Rental Rate Survey (University of Denver & Apartment Association of Metro Denver)
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Key Stats

- Median Household Income (Denver): $76,643
- Median Home Price (Denver): $408,000
  - Home Price to Income Ratio (Denver): 5.3
  - Home Price to Income Ratio (US): 3.9
- Median Rent (Denver): $1,462
- Households Spending > 50% Income on Housing: 280,000

1 US Census
2 Denver Association of Realtors
3 Vacancy and Rental Rate Survey (DU)
4 Colorado Department of Local Affairs
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Slow wage growth
Home prices and rents in metro Denver have risen much faster than Colorado wages since 2011.

Percent growth
- Average yearly metro-area rent
- Average home price*
- Average weekly wage

Rent grew 9.39% more than wages
Housing grew 8.98% more than wages

*As indexed by Case Shiller

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What Do Economists Think About Rent Control?

Princeton's Alan Blinder’s "Murphy's Law of economic policy": "Economists have the least influence on policy where they know the most and are most agreed; they have the most influence on policy where they know the least and disagree most vehemently."

The analysis of rent control is among the best-understood issues in all of economics, and -- among economists, anyway -- one of the least controversial.

In 1992 a poll of the American Economic Association found 93 percent of its members agreeing that "a ceiling on rents reduces the quality and quantity of housing."
What Do Economists Think About Rent Control?

“Almost every freshman-level textbook contains a case study on rent control, using its known adverse side effects to illustrate the principles of supply and demand.

**Sky-high rents on uncontrolled apartments**, because desperate renters have nowhere to go -- and the **absence of new apartment construction**, despite those high rents, because landlords fear that controls will be extended? Predictable.

**Bitter relations between tenants and landlords**, with an arms race between ever-more ingenious strategies to force tenants out...constantly proliferating regulations designed to block those strategies? Predictable”
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History of Rent Control in Colorado

Rent-control bill moves

A bill preventing city and county governments from enacting rent-control ordinances passed the House by a 37-26 vote.

The measure, sponsored by Rep. James Chaplin, R-Broomfield, is aimed at a petition drive in Boulder. Residents there are asking the City Council to let voters decide on rent controls.

Chaplin, who is in the real estate business, said rent controls actually “destroy the availability of property.” He said such controls don’t work. The bill now goes to the Senate for action.

Anti-rent control bill OK’d

Local governments couldn’t pass rent control ordinances, under a bill given final approval Wednesday by the Colorado Senate.

Sponsored in the Senate by Ted Strickland, R-Westminster, H.B. 1604 was triggered by talk in Boulder of imposing rent controls on landlords.

The measure passed 23-10, mostly with Republicans in favor and Democrats opposed.

Opponent

Hazardous-waste bill alive

The Senate State Affairs Committee on
States with Rent Control

Source: National Multifamily Housing Council / New York Times
What Proponents Say About Rent Control
What Proponents Say About Rent Control

Guiding Principles

1. Housing is a Right
2. The Public’s Role in Creating Land Value
3. The Rent is Too Damn High

Why Rent Control?

1. Immediate Impact
2. Doesn’t “Cost” Anything*
3. Prevents Displacement*
4. Reduces Gentrification* / Preserves Economic Diversity
5. Doesn’t Reduce Construction*
6. Supreme Court Protects “Fair Returns on Investment”
What Opponents Say About Rent Control

Guiding Principles

1. High Prices Reflect (Cyclical) Supply and Demand Imbalances

2. Long-Term Solution to Affordability is More Supply
   a. Wider Variety
   b. Public-Private Partnerships
   c. Direct Assistance to Struggling Renters
What Opponents Say About Rent Control

Why Not Rent Control?

1. Exacerbates the Affordable Housing Crisis Through Rental Housing Shortage
2. Drives Up Prices on Uncontrolled / Vacant Units
3. Makes it Difficult for Property Owners to Maintain their Buildings
   a. 29% of Rent-Controlled Housing in US is Deteriorated v. 8% of Uncontrolled Units (Niebanck)
4. Leads to Additional Regulation ("Bitter Relations")
5. Reduces Property Values ⇒ Property Tax Revenues
6. Accelerates Gentrification
7. Disproportionally Hurts Young and Future Renters
Empirical Evidence: The Stanford Study

The Effects of Rent Control Expansion on Tenants, Landlords, and Inequality: Evidence from San Francisco

Rebecca Diamond†, Tim McQuade‡, & Franklin Qian§

March 4, 2019

Abstract

Using a 1994 law change, we exploit quasi-experimental variation in the assignment of rent control in San Francisco to study its impacts on tenants and landlords. Leveraging new data tracking individuals’ migration, we find rent control limits renters’ mobility by 20% and lowers displacement from San Francisco. Landlords treated by rent control reduce rental housing supplies by 15% by selling to owner-occupants and redeveloping buildings. Thus, while rent control prevents displacement of incumbent renters in the short run, the lost rental housing supply likely drove up market rents in the long run, ultimately undermining the goals of the law.
Empirical Evidence: The MIT Study

HOUSING MARKET SPILLOVERS:
EVIDENCE FROM THE END OF RENT CONTROL IN CAMBRIDGE MASSACHUSETTS

David H. Autor
Christopher J. Palmer
Parag A. Pathak

ABSTRACT

Understanding potential spillovers from the attributes and actions of neighborhood residents onto the value of surrounding properties and neighborhoods is central to both the theory of urban economics and the development of efficient housing policy. This paper measures the capitalization of housing market spillovers by studying the sudden and largely unanticipated 1995 elimination of stringent rent controls in Cambridge, Massachusetts that had previously muted landlords' investment incentives and altered the assignment of residents to locations. Pooling administrative data on the assessed values of each residential property and the prices and characteristics of all residential transactions between 1988 and 2005, we find that rent control's removal produced large, positive, and robust spillovers onto the price of never-controlled housing from nearby decontrolled units. Elimination of rent control added about $1.8 billion to the value of Cambridge's housing stock between 1994 and 2004, equal to nearly a quarter of total Cambridge residential price appreciation in this period. Positive spillovers to never-controlled properties account for more half of the induced price appreciation. Residential investments can explain only a small fraction of the total.
Market Consequences of Rent Control

Sources: Rent control law cools investment in apartments

Investment in multifamily housing projects fell substantially in Oregon following passage of the new statewide rent control law by the 2019 Legislature in February.

According to a June 18 article in the rental industry trade journal CoStar, investments in market rate apartment buildings in Oregon totaled $200 million in March, April and May of this year — a 38% drop from the $325 million invested during the same period last year.

Most of the decline came from out-of-state investments, according to the article.
Market Consequences of Rent Control

CRAIN’S NEW YORK BUSINESS

September 06, 2019 01:53 PM | UPDATED 3 HOURS AGO

De Blasio admits rent laws have 'consequences'

The comments came in response to reports by Crain's that private equity giant Blackstone had halted upgrades on rent-regulated apartments in Manhattan's sprawling Stuyvesant Town complex and by The Real Deal that the firm was deliberately leaving many of the units vacant. Blackstone's actions follow legislation passed in Albany earlier this year that limited property owners' ability to recover investment costs from rent-regulated tenants—legislation the mayor endorsed.
Market Consequences of Rent Control

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New York Landlords in a Financial Bind From New Rent Law

Curb on market-rate conversions pressures the value of rent-stabilized apartment

The new laws could cause the values of rent-stabilized apartment buildings to drop 20% to 45%, depending on their current rent rolls, several brokers and investors said. That would leave many properties worth less than their mortgages and put building owners at risk of default.

“It’s all over,” said Lazer Sternhell, a real-estate investor and broker of rent-regulated properties in New York. “You can’t raise the rents. You can’t deregulate.”

Source: Wall Street Journal (06/24/19)
Market Consequences of Rent Control

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New York Landlords in a Financial Bind From New Rent Law

Curb on market-rate conversions pressures the value of rent-stabilized apartment

Asking prices for the sale of regulated buildings are already falling. In one example, a brokerage had previously pitched a partially vacant, 22-unit building in the East Village on the premise that a buyer could eventually double the monthly income from $26,300 to $52,600.

After the rent law passed, the company notified potential investors that they were lowering income expectations and cutting the asking price by 17%, the first of what could be many cuts.

“Every spreadsheet in New York just changed,” said Steven Vegh, a real-estate broker who sells buildings to investors.

Source: Wall Street Journal (06/24/19)
Market Consequences of Rent Control

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Going down
With tighter rent regulations, sales of multifamily buildings are expected to decline.

New York City rental-apartment sales

Source: Wall Street Journal (06/24/19)
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Affordable Housing: National Trends

<table>
<thead>
<tr>
<th>SHORTAGE IN RENTAL HOUSING</th>
<th>6.3M</th>
<th>3.2M</th>
<th>3.1M</th>
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<tbody>
<tr>
<td>Growing rental demand, limited new construction, and rising development costs have caused rents to rise.</td>
<td>New renter households earning under $75K</td>
<td>Change in rental housing units affordable to them</td>
<td>Shortage of rental housing units</td>
</tr>
<tr>
<td>The supply of rental housing units affordable to households earning less than $75,000 did not keep up with demand from 2000 to 2016.</td>
<td>Source: National Multifamily Housing Council</td>
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Affordable Housing: National Trends

RISING DEVELOPMENT COSTS

Development costs are rising, and rents must rise to cover the increased costs.

The cost to develop a new apartment building has risen more than twice as fast as inflation since 2000, increasing the rent that must be charged to support new development.

- Real hard costs (materials and labor) increased by 57%.
- Land costs increased 100%.

Source: National Multifamily Housing Council
STAGNANT INCOMES

At the same time, renter incomes have stagnated.

The real median renter income declined by 5.5% from 2000 to 2016, leaving the median renter with $175 less per month.

Renter income declined by 5.5% from 2000 to 2016.

The median renter household income was $175 less per month.

Source: National Multifamily Housing Council
Affordable Housing: National Trends

Real Median Gross Rent and Affordable Monthly Rent for the Median Renter

Source: National Multifamily Housing Council
Affordable Housing: National Trends

**Affordability Challenges Spread**

Stagnant incomes paired with rising rents have led to growing affordability challenges.

- 20.2 million renter households — 46% of all renters — struggled to afford rent in 2016. Middle-income renters experienced the largest increase in cost-burdened households* since 2000.

- 46% of all renters struggled to afford rent.

- 129% increase of middle-income burdened renters.

Source: National Multifamily Housing Council

*Cost-burdened households are defined as those who spend more than 30% of their income on housing.
Affordable Housing: National Trends

Source: National Multifamily Housing Council
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Source: Vacancy and Rental Rate Survey (University of Denver & Apartment Association of Metro Denver)
Real Rent Growth v. Construction
(Metro Denver, Trailing 12-month Rate)

Source: Vacancy and Rental Rate Survey (University of Denver & Apartment Association of Metro Denver)
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New Supply and Occupancy

Units Built

2,000
4,000
6,000
8,000
10,000
12,000
14,000
16,000

Occupancy

84.00%
86.00%
88.00%
90.00%
92.00%
94.00%
96.00%
98.00%


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PHASE II — EXPANSION
Declining vacancy
New construction

Long-Term Occupancy Average

PHASE III — HYPERSUPPLY
Increasing vacancy
New construction

PHASE I — RECOVERY
Declining vacancy
No new construction

PHASE IV — RECESSION
Increasing vacancy
More completions


Professor Glenn Mueller, PhD
Franklin L. Burns School of Real Estate and Construction Management

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When Do Rents Grow in Denver?

38-Year Relationship Between Occupancy (Vertical Axis) and Rent Growth (Horizontal Axis)

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Housing gap
The Denver area has been adding households at a higher rate than housing units for a decade.

Added yearly to the metro area
- Household
- Housing units

Added 21,575 more households than housing units

Sources: State Demography Office; Factors Impacting Housing Affordability report
The Denver Post

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Alternative Solutions

Source: National Multifamily Housing Council

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Alternative Solutions

Lower Development Costs

- Land Cost Reduction
  - Public Land
  - By-Right Development
- Soft Cost Reduction
  - Accelerated Approvals
  - Fee Waivers
  - By-Right Development
- Hard Cost Reduction
  - Reduced Parking
  - Flexible Design Standards

Lower Ongoing Expenses

- Financing Reduction
  - Public Capital Funding
- Operating Cost Reduction
  - Tax Abatements
  - Public Operating Funding

Greater Potential Revenue

- Revenue from Additional Units
  - Density Bonus
  - Reduced Parking
  - Flexible Design Standards
  - Public Funding
- Rental Revenue

Source: National Multifamily Housing Council