



WHITE PAPER



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Rent Control: Bad Economic and Failed Social Policy

I BACKGROUND

As communities across the country have removed old heavy-handed rent control policies, eleven California cities continue to maintain rent control ordinances (governing residential rental housing) and have adopted regulatory schemes that restrict the viable reasons for which a tenant may be evicted. (Aside from the eleven cities, many other California communities have adopted rent control for mobilehome parks. This paper, however, does not address those ordinances.)

This paper provides an examination of the issue, using data available to determine whether the policy goals intended for rent control have been or are being achieved by local government.

In California, there is an argument that the landmark property tax relief measure in the 1978 - Proposition 13 - gave rise to rent control. The argument goes that after the passage of Proposition 13 there would be a decline in property taxes. Landlords, it was presumed, would pass along those savings to renters in the form of reduced rents. When rent reductions did not universally materialize during an era of high inflation, consumer activists, looking for an opportunity to galvanize constituents, saw rent control as their issue. Their first attempt at enacting an ordinance failed. But the following year, Santa Monica's for Renters Rights (SMRR) was formed, and the group successfully enacted a tough ordinance that effectively froze rent hikes. The success of SMRR caught on and spread to other college towns – notably Berkeley, where rent control was also implemented.ⁱ

The early restrictive rent control measures were aimed at eliminating perceived windfall profits by landlords and, in turn, protecting the public welfare.

A. Public Policy Goal

The declared policy goal in support of rent control was purported to be protection of those individuals and families least able to afford basic housing – younger, elderly, single-parent households, less educated renters. For example, in San Francisco, the initial version of rent control was intended to serve a definite group: "senior citizens, persons on fixed incomes, and low- and moderate- income households."ⁱⁱⁱ

Not surprisingly, however, a wide array of studies have demonstrated not only that this policy failed, but that it has actually served to worsen the "affordable housing crisis" in the communities that have embraced rent control. In other words, not only has it failed to help those least able to pay rents, rent control has actually hurt them, making it harder to find affordable housing.



B. What is Rent Control?

Rent control is at its core “price control.” Study after study has demonstrated that price controls end up crippling the commodity that is controlled. There may be a short term reduction in the price, but over the long run, prices rise, and supplies dwindle. This is precisely what has happened in those areas where rent control has strangled the market place. The result has been, the emergence of high priced shadow markets, decreased supply of available rental housing, middle class renters hoarding price controlled units, and gentrification of areas directly affected by rent control.

The pure policy goal of rent control may, at one time, have been legitimate. The reality today, however, is people who were not intended to be the beneficiaries of rent control – middle and upper class professionals – hoard their apartments, forcing those who could really use the help into higher priced distant housing.

II ECONOMIC IMPACT

A. Housing Stock

It has been more than two decades since Santa Monica and Berkeley enacted their rent control ordinances. This time frame has created an ideal scenario for determining the long range effects of rent control. A 2003 study examined the housing trends in rent controlled jurisdictions by comparing rental housing in Berkeley and Santa Monica with the counties in which they are nested to afford a comparable demographic and economic comparison.

Table 1
PERCENT CHANGE IN TOTAL RENTER-OCCUPIED HOUSING UNITS

	Percent Change 1980-1990		Percent Change 1990-2000		Percent Change 1980-2000	
	Berkeley Alameda	Santa Monica LA	Berkeley Alameda	Santa Monica LA	Berkeley Alameda	Santa Monica LA
Total Units*	-12.10%	-4.90%	5.29%	-4.01%	-7.45	-8.71
	12.05%	10.07%	5.80%	5.51%	18.56	16.14

*includes mobile home, boat, RV, etc.

Table 1 above shows the change in renter occupied dwelling units between 1980 and 2000. The trend in the rent control cities of Berkeley and Santa Monica showed negative growth in the number of rental units compared to their respective counties, which demonstrated positive growth. Moreover, this decline occurred at a time when California was experiencing a massive economic boom. These statistics support the assumption that rent control is a disincentive to maintain and construct residential rental properties.ⁱⁱⁱ

B. Population

One of the primary policy arguments supporting rent control is protection of certain age groups, such as the elderly and younger populations. As available housing units decrease, however, (see previous section), it stands to reason certain people will be forced out of the rental market. During the twenty-year period (1980-2000), populations in Berkeley and Santa Monica were in decline. Yet at the same time, the counties in which the cities are nested experienced significant population growth. A breakdown of population growth by age group tells a compelling story about who is benefiting from rent control.



From 1980 to 1990, the combined 15 to 34 year old age group experienced a nearly 33 percent decrease in Berkeley and close to 45 percent decrease in Santa Monica. The same combined age group saw increases in both counties. The 35 to 64 age group was one of the only groups with population gains in both rent controlled cities. Meanwhile, in the rent control cities, the 64+ age group showed little or no growth, yet the two counties had large percent gains. The following decade 1990-2000, saw similar patterns of population growth in the cities and their respective counties.^{iv}

What these statistics reveal is that those people most able to help themselves (35-64) are benefiting from rent control, while the individuals the policy is meant to protect are benefiting the least. Rent control pushes certain age groups out of the rental housing market. Michael St. John, a Berkeley sociologist, determined that “rent control has actually accelerated gentrification in Berkeley and Santa Monica. Poor and working class people have been forced out of those communities faster than in surrounding municipalities.”^v

C. Economic Impacts

When fewer rental units are available, landlords are more selective when screening tenants. Using permissible selection criteria such as employment and income, a small number of units that become available tend to be awarded to people with higher incomes and predictable employment.

**Table 2
PERCENT CHANGE IN RENTAL HOUSEHOLDS
WITH ANNUAL INCOMES LESS THAN \$20,000**

Income Group	Percent Change 1980-1990		Percent Change 1990-2000		Percent Change 1980-2000	
	Berkeley Alameda	Santa Monica LA	Berkeley Alameda	Santa Monica LA	Berkeley Alameda	Santa Monica LA
Less than \$10,000	-49.64%	-54.11%	-30.95%	-22.07%	-65.23%	-64.24%
\$10,000-\$19,999	47.99%	48.07%	24.78%	8.47%	60.88%	52.47%
	-36.39%	-50.58%	-21.34%	-24.49%	-49.96%	-62.68%
	33.23%	32.22%	25.60%	7.12%	50.32%	37.05%

Table 2 above illustrates that cities practicing rent control continued to lose low-income households at a higher rate than the comparison counties. It provides support for the assumption that rent control does not maintain economic diversity. While the declines may only be modest in some cases, when the overall economic picture is taken into consideration (specifically the economic boom from the dot com explosion in the Bay Area), it is important to note that both cities lost low-income rental households at a greater rate than their respective counties.

D. Shadow Markets

Rent control splits the rental housing market into two segments – the regulated segment and the shadow market – those units that are not regulated. When prices in the regulated segment are kept artificially low, prices in the shadow market increase. And with the regulated segment of the market inaccessible to all but a chosen few, demand is increasingly filled by the shadow market at a higher price.

Standard Supply and Demand Economic Theory predicts that any price controls, including rent control, will produce an excess of demand over supply, thereby promoting the emergence of so-called shadow markets. Shadow markets are alternative markets that serve as a safety net for excess demand above supply. In terms of rent control, “a ceiling on rents will reduce the quality and quantity of housing.”^{vi}



Prices in the shadow market, where prices are not regulated, are forced higher than the normal market because the shadow market absorbs the excess demand in the restricted market.^{vii} The shadow market phenomenon helps explain the perversity of rent control.

“In cities without rent control, available units are almost evenly distributed above and below the census median. In rent controlled cities, most available units are priced well above the median. This is because tenants in rent controlled areas tend to hoard their apartments, forcing everyone else to shop in the shadow market. Thus rent control is the cause of a widely perceived ‘housing crisis’ in rent controlled cities.”^{viii}

E. Housing shortages

Given the disincentive to produce new housing in rent controlled jurisdictions and the inclination to hoard units held below market rates, some unfortunate consequences occur: longer commutes, crowded living conditions, scarcity of available housing, and even homelessness. Prospective tenants are pushed into the next community where the shadow market exists to take up the slack for the excess demand.

III LEGAL ISSUES

Below are examples of leading cases on various issues impacted by rent control.

A. Ellis Act

California’s Ellis Act law establishes the process for withdrawing residential rental property from the rental housing market. In the leading case on this issue, the Santa Monica Rent Control Board attempted to deny the plaintiff/landlord’s eviction notices based on their intent to withdraw residential rental units. The court held invalid the City Charter sections that prohibit residential landlords from evicting tenants in order to go out of the rental residential housing business. *City of Santa Monica v. Yarmark*, (1988) 203 Cal.App.3d 153, 249 Cal.Rptr.732.

B. Rent Control – Antitrust

According to the United States Supreme Court, the rent ceilings imposed by an ordinance and maintained by the Rent Stabilization Board have been unilaterally imposed by government upon landlords to the exclusion of private control. The rent controls established by Berkeley’s Ordinance lack the element of concerted action needed before they can be characterized as a per se violation of the Sherman Act; we cannot say that the Ordinance is facially inconsistent with the federal antitrust laws. As such the Berkeley rent control ordinance did not conflict with the Sherman Act and, therefore, was not preempted by the federal antitrust laws. *Fisher v. City of Berkeley*, (1986) 475 U.S. 260, 106 S.Ct. 1045

C. Rent Control – Eviction

The authority of a city to pass rent control by initiative measure was upheld. State law does not preempt the field of placing maximum limits on residential rents. A local ordinance may also limit the grounds and conditions for eviction, but may not conflict with the summary nature of state law eviction procedures. *Birkenfeld v. City of Berkeley*, (1976) 17 Cal.3d 129, 170 Cal.Rptr. 465



D. Acceptance of Rent Payment

A tenancy may be created by consent and acceptance of rent, despite the absence of a lease. In this case, the original tenant's guest became a tenant, protected by the rent control ordinance, when the owner negotiated a rent increase with the "new" tenant and accepted his rent payments after the original tenant left. *Cobb v. City and County of San Francisco (Passalaqua)* (2002), 98 Cal.App.4th 345, 119 Cal.Rptr.2d 741.

E. Failure to Repaint

The court upheld a reduction in rent under the West Hollywood rent control ordinance for the owner's failure to repaint at least once every four years, even where a tenant takes the apartment "as is." (*Berman v. City of West Hollywood Rent Stabilization Dept.*, (1988) 197 Cal.App.3d 837, 243 Cal.Rptr. 144.)

F. Rent Adjustments

A rental property owner has the right to petition for individual rent adjustments to achieve a fair return on previously unregistered apartment buildings under the Berkeley rent control ordinance. *Searle v. City of Berkeley Rent Stabilization Board*, (1988) 197 Cal.App.3d 1251, 243 Cal.Rptr. 449.

G. Roommate

"Roommate" of a former tenant, whose occupancy was approved and expressly authorized by the owner, is entitled to the protection of the just cause eviction provisions of Berkeley's rent control ordinance. *DeZerega v. Meggs*, (2000) 83 Cal.App.4th 28, modified 83 Cal.App.4th 935c, 99 Cal.Rptr.2d 366.

H. Taking – Rent Control

Santa Monica's rent control law does not provide a basis for an owner to maintain an action for governmental "taking" without just compensation. Under rent control, adjustment of future rents was generally sufficient to compensate for prior rent ceilings that were set so low as to be confiscatory, and such adjustments preclude a "takings" claim. *Kavanau v. Santa Monica Rent Control Board*, (1997) 16 Cal.4th 761, 66 Cal.Rptr.2d 672.

I. Standing to Sue

The United States Supreme Court upheld the Tri-County Apartment Association's standing to challenge the rent control ordinance, but found that the "takings" argument regarding the statute's effect was premature, and held that the ordinance "on its face" did not violate the constitution. *Pennell v. City of San Jose*, (1988) 485 U.S. 1, 108 S.Ct. 849.

J. Surviving Tenant

The son of an original tenant who occupied the premises for more than one year prior to the original tenant's death is a "surviving tenant" entitled to eviction protection in *West Hollywood*. *Pick v. Cohen*, (2000) 83 Cal.App.4th Supp 6, 100 Cal.Rptr. 2d 839.



K. Tenancy-In-Common

The tenancy-in-common method of ownership does not violate the Ellis Act. Under such ownership, the building is no longer a rental, but is an owner-occupied building. The Rent Board had unsuccessfully argued that the owners' partnership agreement created a landlord/tenant relationship. *Santa Monica Rent Control Board v. Bluvshstein*, (1991) 230 Cal.App.3d 308, 281 Cal.Rptr. 298.

IV COSTA-HAWKINS – VACANCY DECONTROL

In 1995, the California Legislature passed and the Governor signed AB 1164 –the Costa-Hawkins Rental Housing Act.^{ix} This law cleared the way for owners in rent control communities to establish initial rental rates when there was a change in occupancy at a dwelling unit – a policy known as vacancy decontrol.

While cities and counties continue to maintain the ability to implement local rent control laws, state law preempts local law where the subject matter is already established in the Costa-Hawkins Rental Housing Act. There are four central tenets at the heart of Costa-Hawkins:

- Housing constructed after 1995 is exempt from local rent controls;
- New housing that was already exempt from a local rent control law in place before February 1, 1995, remains exempt;
- Single family homes and other units like condominiums that are separate from the title to any other dwelling units are exempt from local rent controls, and
- Rental property owners must have the ability to establish their own rental rates when dwelling units change tenancy.

The intent of Costa-Hawkins was to provide a “moderate” approach to the otherwise “extreme” rent control ordinances that were in place during the 1980’s in Berkeley, Santa Monica, Cotati, East Palo Alto, and West Hollywood.

The law contains several other provisions including protections for tenants from arbitrary eviction and controls on changes in terms of a tenancy, thereby allowing local governments to limit rents when the tenant remains in place.

V CONCLUSION

There is general agreement among economists that rent control is justifiable for short periods during and after unexpected (catastrophic) crises.^x The policy, however, becomes less viable as the crisis that legitimized its adoption in the first place wanes. Rent control in the United States (and other metropolitan areas throughout the world) was the panacea when housing was in short supply during World War I and II, and building materials were allocated for weaponry. Recent research has tried to more closely assess the arguments for and against rent regulation under less extreme circumstances.

Frequently, the equity and efficiency objectives that can be attained through rent regulation can be attained more efficiently either through voluntary contracting or through some other viable intervention.^{xi}



“Ongoing unnecessary rent regulation represents a political victory of tenants over landlords and of incumbent tenants over outsiders. The efficiency losses are sizeable. Although there is sometimes a case for redistribution from landlords to tenants, it is not clear that rent control is a good transfer mechanism. Certainly, regulations do not systematically favor poor tenants. Legislation preventing peacetime rent regulation is a radical measure that is well worth considering. At the very least, countries with strict rent control systems should consider erecting institutions that curb the influence of privileged insiders over rent levels.”^{xii}

It is time, therefore, for California’s local governments to recognize that rent control is a failed policy of social integration and public welfare protection. Serious, thoughtful statistically supportable debate must be conducted to weigh the merits of continuing or expanding rent control policies. City after city has moderated, toned down, and even eliminated rent control, “not because it was accomplishing its purportedly central goal of keeping housing affordable to low-income populations, but because the price controls were ruining housing markets and raising rents for tenants as a whole, most especially for the poor.”^{xiii}

ENDNOTES

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- i Harold Meyerson, LA Weekly, Best of 1999, www.laweekly.com/bestofla/bestofla99/essays/essay208.php3
 - ii Peter Byrne, The Case for Ending Rent Control, SF Weekly, August 09, 2000
 - iii Rent Control Issues and Impacts, Sacramento Regional Research Institute, 2003
 - iv Ibid at page 12
 - v Michael St. John and Associates, “Rent Control in Perspective: Impacts on Citizens and Housing in Berkeley and Santa Monica Twelve Years Later.” (Berkeley: St. Michaels and Associates, 1993)
 - vi J.R. Kearl, Clayne L. Pope, Gordon C. Whiting and Larry T. Wimmer, “A Confusion of Economists,” American Economic Review, 69, May 1979, 28-37
 - vii William Tucker, “How Rent Control Drives Out Affordable Housing,” Cato Policy Analysis, May 1997, p.____
 - viii Ibid at p. _____
 - ix California Civil Code § 1954.50 et. seq.
 - x Tore Ellingsen and Peter Englund, rent Regulation: An Introduction, Swedish Economic Policy Review 10 (2003) p. _____
 - xi Ibid
 - xii Ibid
 - xiii Peter Byrne, The Case for Ending Rent Control, SF Weekly, August 09, 2000

