The High Cost of Rent Control

That rent control is an ineffective and often counterproductive housing policy is no longer open to serious question. The profound economic and social consequences of government intervention in the nation's housing markets have been documented in study after study, over the past twenty-five years. In response to this hard-earned experience, states and local jurisdictions from Massachusetts to California have banned or greatly constrained rent control. Nevertheless, several communities around the country continue to impose rent controls, usually with the stated goal of preserving affordable housing for low- and middle-income families. Rent control does not advance this important goal. To the contrary, in many communities rent control has actually reduced both the quality and quantity of available housing.

Role of Rents in a Market Economy

Too often, those who advocate rent regulation have ignored the basic laws of economics that govern the housing markets -- treating privately-owned, operated and developed rental housing as if it was a "public utility." In so doing, they harm not only housing providers, but also, in the long run, the consumers they intend to serve.
Rents serve two functions essential to the efficient operation of housing markets: they compensate providers of existing housing units and developers of new units for the cost of providing shelter to consumers; and they provide the economic incentives needed to attract new investment in rental housing, as well as to maintain existing housing stock. In this respect, housing is no different from other commodities, such as food and clothing -- the amount producers supply is directly related to the prevailing market price.

This second function is particularly important in evaluating the economic implications of rent control. In an unregulated market, a housing shortage -- the reason usually cited for imposing rent control -- will be addressed in a two-step process. In the short-term, rents on the margin will rise as consumers compete for available units. Over time, these higher rents will encourage new investment in rental housing -- through new construction, rehabilitation, and conversion of buildings from nonresidential to residential use -- until the shortage of housing has been eliminated. Without the increased rents required to attract new investment, new housing construction would be sharply limited and there would be no long-term solution to the housing shortage. Conversely, a fall in rents sends the message to the market that there is no room for new investments.

When a community artificially restrains rents by adopting rent control, it sends the market what may be a false message. It tells builders not to make new investments and it tells current providers to reduce their investments in existing housing. Under such circumstances, rent control has the perverse consequence of reducing, rather than expanding, the supply of housing in time of shortage. Three additional factors must be considered in the economic implications of rent control. First, the longer rent control remains in place, the more substantial the gap between controlled rents and true market rents is likely to be. Second, the costs of rent controls are not confined to the political boundaries of those communities that adopt them, but often impose significant costs throughout regional housing markets. Third, while the distortions induced by rent control depend on their stringency, any application of rent control leads to inequities and inefficiencies in the housing market.

Harm Caused by Rent Control

Economists are virtually unanimous in their condemnation of rent control. In a survey of economists of the American Economic Association, fully 93 percent agreed that "a ceiling on rents reduces the quality and quantity of housing available."(1) Economists generally point to six principal objections to rent control: Inhibition of New Construction By forcing rents below the market price, rent control reduces the profitability of rental housing, directing investment capital out of the rental market and into other more profitable markets. Construction declines and existing rental housing is converted to other uses.

Studies have shown, for example, that the total number of rental units in Cambridge and Brookline, Massachusetts, fell by 8 percent and 12 percent respectively in the 1980s, following imposition of stringent rent controls. Rental inventories in most nearby communities rose during that period.(2) Similarly, in California the total supply of rental units dropped 14 percent in Berkeley and 8 percent in Santa Monica between 1978 and 1990, even though the rental supply rose in most nearby cities.(3) And in the United Kingdom, which has imposed rent control since the Second World War, the share of all housing provided through privately owned rental units dropped from 53 percent in 1950 to less than 8 percent in 1986, reflecting the flight of investment from the regulated market.

Deterioration of Existing Housing

By reducing the return on investments in rental housing, rent control also can lead to a drop in the quality and quantity of existing rental stock. This may take the form of condominium and cooperative conversions or, in some cases, abandonment of unprofitable property. It can also lead to a deterioration of the quality of housing stock as providers faced with declining revenues may be forced to substantially reduce maintenance and repair of existing housing. A study by the Rand Corporation of Los Angeles' rent control law found that 63 percent of the benefit to consumers of lowered rents was offset by a loss in available housing due to deterioration and other forms of disinvestment. Studies of rent control in New York and Boston similarly found marked differences between rent-controlled and other units in housing quality and the level of expenditures on maintenance and repair.

Reduced Property Tax Revenues

Rent control also reduces the market value of controlled rental property, both in absolute terms and relative to the increase in property values in unregulated markets. The tax implications of this reduction can be significant, as taxable assessed rental property values decline relative to unregulated property. A study of rent control in New York City calculated the loss in taxable assessed property values attributable to rent control at approximately $4 billion in the late 1980s. These distorted assessments cost the city an estimated $370 million annually in property tax revenues. The city of Berkeley, California, also estimates a significant loss in its tax revenue because of rent control.

Substantial Administrative Costs

The administrative costs of rent control can be substantial, often outweighing any short-term benefits of rent regulation. Rent controls require the creation of elaborate bureaucratic systems. Rental property must be registered; detailed information on the rental property must be collected; and elaborate systems for determining rents and hearing complaints and appeals must be established. The associated costs in dollars and time fall not only on providers, but also on consumers and municipal authorities. For example, in Santa Monica, the Rent Control Board in 1996 had a budget of more than $4 million a year to control rents on only 28,000 apartments.

Reduced Consumer Mobility

The primary beneficiaries of rent control are those consumers lucky enough to find themselves in a rent-controlled unit. But even these consumers pay a price. Consumer "mobility" is substantially reduced by the reluctance of many consumers to part with the rent control subsidy. A recent study in New York City found that rent control tripled the expected duration of residence. Consumers who would otherwise move to smaller or larger homes or closer to their jobs do not do so because they do not want to lose the subsidy. This loss of mobility can be particularly costly to families whose job opportunities are geographically or otherwise limited and who may have to travel long distances to reach those jobs available to them. And for the community at large -- including nearby communities that have not themselves imposed rent control -- reduced consumer mobility can mean increased traffic congestion and demand for city services, among other costs. Because of these spillover effects, rent control is an issue for state and regional policy as well as for local governance.

Consumer Entry Costs

The short-term benefits of rent control also are limited by often significant entry costs that must be paid by those in search of rental housing. In many rent-controlled communities, prospective consumers must pay substantial finder's fees to obtain a rental unit, due to the scarcity of available housing. And in some communities, a "gray-market" in rental housing has developed in which units are passed among friends or family members, or new consumers may be required to pay "key money" or to make other payments to current consumers or providers to obtain housing. Poor families, single consumers, and young people entering the market are especially hard-hit by these costs.

Social Implications of Rent Control

In addition to the substantial economic costs associated with rent control, the decision whether to regulate rents raises difficult questions of social policy: The Substantial Costs of Rent Control Fall Most Heavily on the Poor
The costs of rent control fall disproportionately on the poor. As described earlier, these costs include (a) an often-substantial drop in the quality of existing rental housing, and (b) substantially reduced access to new housing. Poor families suffer a marked decline in existing housing as the quality of existing housing falls in response to reduced maintenance expenditures. The middle class can move out; for many reasons, poorer families lack this option.

Poor families also are at substantial disadvantages when it comes to finding new housing. In a tight market, there may be more people looking for housing than available rental units, thereby giving housing providers substantial discretion in choosing among competing potential consumers. In an unregulated market, this consumer selection process will be governed by the level of rents. However, by restricting rent levels rent control causes housing providers to turn to other factors, such as income and credit history, to choose among competing consumers. These factors tend to bias the selection process against low income families, particularly female- headed, single-parent households.

Higher Income Households Benefit Most from Rent Controls

Rent control is most often justified as an anti-poverty strategy. Yet, there is strong evidence that higher income households -- not the poor -- are the principal beneficiaries of most rent control laws. For example, a study of rent control in New York City found that rent-controlled households with incomes greater than $75,000 received nearly twice the average subsidy of rent-controlled households with incomes below $10,000. Another study concluded that rent control had the greatest effect on rents in Manhattan, the borough with the highest average income. Similarly, a study of rent control in Berkeley and Santa Monica found that the beneficiaries of controls in those communities are "predominately white, well-educated, young professionally employed and affluent," and that rent control had substantially increased the disposable income of these tenants while "exacerbating" the problems of low-income families.(13) And in Cambridge, Massachusetts, residents of rent-controlled housing had higher incomes and higher status occupations on average than other residents of the city, including homeowners.

Rent Control Promotes Housing Discrimination

By eliminating rents as the basis of choosing among a pool of potential consumers, rent control opens the door to discrimination based on other factors. As noted earlier, rent control forces housing providers to look to income and credit history in choosing among competing consumers, factors which sharply bias the selection process against poor and young consumers. In some cases, consumer selection decisions also may be based on a potential consumer's race, sex, family size or other improper or unlawful factors. This may occur notwithstanding the rigorous enforcement of Fair Housing laws. The reduction in housing caused by rent control also can slow the process of racial and economic integration of many communities, by limiting the opportunities of certain classes of consumers to reside in rent-controlled communities. In fact, in many middle-class communities rent control has raised a relatively impenetrable barrier to economic and racial integration.

Rent Controls Unfairly Tax Rental Housing Providers and Other Real Estate Providers

Rent controls are designed to supplement consumer income at the expense of rental property providers -- by holding below market levels the permissible rate of return on rental property investment. There is substantial evidence that such transfers are highly inefficient. For example, one study concluded that housing consumers gained in benefits only 52 percent of what housing providers lost. This is due, in part, to the tendency of consumers in rent-controlled units to "hoard" housing and to be over-housed, a tendency that further exacerbates the underlying housing shortage.

But more importantly, such income transfers pose fundamental questions of fairness. Why should the uniquely public burden of providing subsidized housing to the poor and middle class be borne solely by providers of rental housing? Given both the inefficiency and unfairness of the rent control "tax," we should rely on broader, more equitable means of subsidizing poor families. The fairness issue, as well as many of the other arguments against rent control, apply to commercial real estate as well. Controls on rents of retail, office, or industrial space deter construction, diminish the quality of existing structures, and unfairly transfer income from the property owner to the business occupying the rental space.

Effective Alternatives to Rent Control Exist

The answer to the problem of scarce housing and rising rents is increased housing supply -- not rent control-induced disinvestment. One way of stimulating the supply of affordable housing is through direct financial assistance to needy renters, whose increased purchasing power will lead to expansion of the quantity and quality of housing in the local market. This "demand-side" strategy is already in place through proven Federal and state programs. In addition, targeted programs to subsidize the construction or rehabilitation of affordable housing can be an effective complement to direct renter assistance. More generally, removal of inappropriate regulatory barriers to housing construction promotes housing affordability for both renters and homeowners.

Conclusion

Economists have long considered rent control a failed housing policy. As Dr. Anthony Downs, a leading economist and nationally-recognized expert on housing policy, concluded in a recent report on rent controls, other than during wartime, the economic and social costs of rent control "almost always outweigh any perceived short-term benefits they provide."(16) He also found that rent controls are both "unfair to owners of rental units and damaging to some of the very low income renters they are supposed to protect." Given this fact, reliance on rent control as a solution to the problem of housing affordability cannot be justified.

The National Multifamily Housing Council (NMHC) is a national association representing the interests of the larger and most prominent apartment firms in the U.S. NMHC's members are the principal officers of firms engaged in all aspects of the apartment industry, including owners, developers, managers and financiers. NMHC provides leadership for the apartment industry on legislative and regulatory matters, advances research, produces best practices resources and promotes the desirability of apartment living.

"In many cases rent control appears to be the most efficient technique presently known to destroy a city—except for bombing it."