

An Analysis of Rent Control Ordinances in California



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EXECUTIVE SUMMARY

It wasn't long ago that state policymakers were worried about falling home prices and the impact the declines were having on the California economy. Today those worries have turned 180 degrees and policymakers are focused on opposite concerns—the rising costs of rental housing and the impact it may be having on low-income families.

This report makes the following findings:

- Beacon Economics did not find strong evidence that rent control helps to reduce the number of low-income households spending 30% or more of their income on rent.
- Rent control can have a negative impact on low-income households not living in rent-controlled units through higher growth in citywide median rents.
- Rent control ordinances are associated with lower growth rates in the supply of rental housing and with higher rental price growth in the broader market.
- Rents are too high because multi-family housing and the state's housing stock have failed to expand commensurately with the ever-growing population. The solution to this affordability problem is to expand the apartment stock in these cities, not introduce price ceilings.

The growth in housing prices in California has been impressive in recent years. In the City of San Jose, for example, asking rents have risen by 8% per year for the last three years. Some of these gains are being driven by a recovering economy, which is driving job growth and higher incomes. From 2011 to 2014, the share of renting households using over 30% of their income to cover the cost of housing fell modestly due to improved economic circumstances for many renters in the state. Still, the share of the population spending more than 30% of their income on housing in California remains the highest in the nation at just over 54%. This, combined with the still too-slow pace of new home construction, suggests the challenge of rising rents is likely to get worse before it gets better.

Policymakers are struggling to find appropriate responses to the growing problem. At the local level this has led to discussions about the controversial issue of rent control. Such ordinances are certainly well intentioned, but questions remain as to whether they are the most appropriate strategy to combat housing affordability issues among the renter population. Clearly such rules can directly reduce the rental burden of those fortunate enough to live in a stabilized unit. But the transfer of income from the owner of the property to the tenant also has the impact of reducing the overall supply of housing. This 'winners versus losers' phenomenon implies that the net impact is, at best, mixed. In Beacon Economics' analysis, we have reviewed the literature on the subject, which generally indicates mixed opinions over whether rent control laws generate positive impacts in the cities in which they are enacted or not.

Beacon Economics has undertaken an analysis of rent control ordinances in the State of California to better understand the effects these ordinances have on local housing markets. But we start by setting aside the standard rent/supply question often at the core of such debates. Worries about unaffordable housing clearly are aimed at lower income households so rent control policies need to be considered in the context of social assistance and not strictly in the framework of market supply and demand. Our study starts with a more specific question—does rent control specifically help low income families and residents.

Our findings support the view that they do not work as intended, and can actually do more harm than good to the overall rental housing market. In particular, rent control ordinances largely attack the symptoms (high cost of

living) of a much broader causal factor, rather than the source of high housing costs. That source is California's lack of new housing supply commensurate with new population growth – something that continues to drive housing costs higher in the state.

To explore these findings in more depth, Beacon Economics conducted a quantitative analysis using demographic and housing data from the 2000 U.S. Census and the 2013 American Community Survey to assess whether rent control ordinances:

- Provide significant benefits to low-income households
- Affect the rental housing supply
- Affect the median rent

The quantitative analysis found that:

- The presence of rent control was associated with a decrease in the number of middle-income households (those making between \$35,000 and \$75,000 annually) that spent 30% or more of their income on rent from 2000 to 2013.
- For low-income households, however, there was no statistically significant decrease found, which suggests that rent control policies do not directly benefit the intended recipients.
- The presence of rent control was associated with a decrease in the growth of renter occupied housing in a city from 2000 to 2012, indicating that these policies actually restrict the supply of rental housing, thereby increasing rents throughout the market rather than placing downward pressure on rental prices as intended.
- The presence of rent control was associated with an increase in the growth of median rent in a city from 2000 to 2013.

The findings in Beacon Economics' review of existing literature, as well as our own analysis of the available data, demonstrates that rent control policies are not an effective way to deal with unaffordable housing. What's more, rent control policies can have negative consequences for low-income households due to higher growth in rents for units not covered by such policies. In other words, rent control policies can protect some people at the expense of others since residents who do not live in rent-controlled properties face higher rents as well.

At best, the existing literature suggests that rent control laws do not accomplish their goals of increasing diversity, providing affordable housing for low-income residents, or reducing homelessness. At worst, rent control laws actually move cities further away from these goals by making low-income residents in cities with rent control laws worse off or leading them to move elsewhere. In San Jose, for example, 57.1% of low-income households did not live in rent-controlled housing (pre-1980 structures with three units or more) in 2013, which leaves them vulnerable to higher rent growth in housing that is exempt from rent control policies.

Ultimately, prices increase due to high demand, low supply, or a combination of the two. Addressing the larger problem of California's housing shortage—especially in markets with strong rent growth—is the more economically sound approach to dealing with unaffordable housing.

The following report is divided into three broad sections. The first section outlines the quantitative analysis Beacon Economics undertook to assess the impact of rent control policies on low-income households, rental housing supply, and median rents. The second section provides an overview of rent control ordinances in the state,

along with a review of relevant literature on the topic. In the final section, the City of San Jose, where the City Council has recently started to explore ways to reduce further rent growth beyond its current ordinance, is examined along with some of the potential effects of making these changes.

QUANTITATIVE ANALYSIS

Using the indications of previous studies as a starting point, Beacon Economics has conducted an analysis of the empirical effects of rent control ordinances in California cities. This analysis of rent control policies focuses on three key questions:

- Has the policy provided significant benefits to low-income households?
- How has the supply of renter occupied housing been affected?
- What has been the impact on rents?

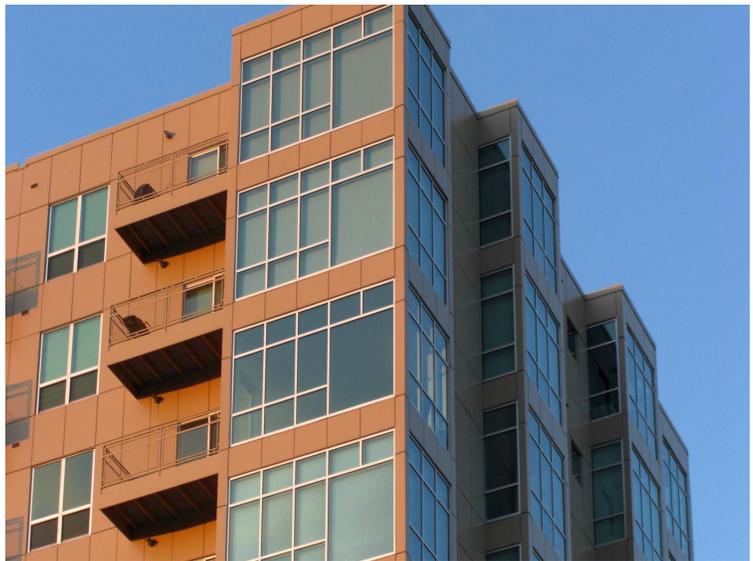
Rent control most certainly benefits households living in rent-controlled units, but are these households the intended beneficiaries of this public policy? And at what cost does this market distortion come? Intervening in markets always comes at a price—if policy actions did not come with trade-offs, there would be little controversy over proposed rules. This section of the report seeks to assess how beneficial rent control policies have been using actual data, as well as the trade-offs that accompany these policies as evidenced in the data.

METHODOLOGY

To answer these questions Beacon Economics generated estimates from three statistical models. Data from the 2000 Census and the 2013 three-year estimates from the American Community Survey (ACS) were utilized and represent one of the most comprehensive data sources available for housing and demographic analysis on a city-by-city basis. Other sources used include metropolitan area income from the U.S. Bureau of Economic Analysis (BEA), population estimates from the California Department of Finance (DOF), and median home prices from DataQuick.

To assess the effect of rent control in cities that have such policies in place, each model included a rent control variable, which was equal to 1 if the observation was a city with a rent control policy, and 0 if it was not. Each model was also weighted by a measure¹ of the city's population in 2013.

Some cities have implemented measures that are similar to rent control but are not as strong. The City of Fremont, for example, has a Residential Rent Increase Dispute Resolution Ordinance, which provides rental residents and owners with steps they can undertake to resolve rent increase disputes. This analysis also includes a second rent control variable equal to 1 for observations where a city has a type of measure that is short of rent control, and 0



¹Logarithmic population was used in order to normalize the population base for a least-squares approach.

if it does not. This allows us to control for any effects these secondary measures may have on the dependent variables in each model.

The first model estimates how rent control has affected households at different income levels, and specifically how rent control has affected the share of households spending more than 30% of their income on rent. Rent control is aimed at benefiting low-income households, and as such this analysis segments households into low- (less than \$35,000 annual income), middle- (between \$35,000 and \$74,999), and high- (\$75,000 or greater) income groups.

The dependent variable in the first model is the change in the share of households spending 30% or more of their income on rent from 2000 to 2013 for each income group. To control for overall macroeconomic conditions, the model includes the following: metropolitan area income in 2000 and 2013 from the U.S. BEA, countywide population growth from 2000 to 2013 from the California DOF, and growth in countywide median rents over the period from the ACS.

The second model addresses the supply-side effects of rent control policies and considers both overall rental housing units as well as rental households in the low-, middle-, and high-income groups specified above. The dependent variable in the equations for each of the income groups is the growth in the number of renter households from 2000 to 2013 by income group. Metropolitan area income in 2000 and 2013, as well as county population and metropolitan area median home price growth over the period, are included as controls for broader macroeconomic conditions. The growth in overall households in a city, for renters and owners, is also included to control for overall housing trends over the time period.

Growth in the number of renter occupied housing units was modeled, irrespective of the occupying household's income level, to capture the broader supply picture. The target/dependent variable in this equation was the growth in total rental units from 2000 to 2013 across all income groups. This model also included metropolitan area income and home prices, and county population growth to control for broader macroeconomic conditions.

The third model examines the impact of rent control policies on median rent growth in a city from 2000 to 2013. As with the above models, broader macroeconomic conditions were controlled for with metropolitan area income and home prices, as well as county population growth.

RESULTS

Beacon Economics has found that rent control policies do put downward pressure on the number of middle-income households paying 30% or more of their income on rent in cities with rent control policies in place. However these benefits come at a cost to the broader economy as rent control policies also appear to negatively affect the growth of the supply of rental housing and put upward pressure on median rent growth. Additionally, absent from the results is evidence that low-income households, arguably the primary intended beneficiaries of rent control policies, benefit from rent control in terms of reducing the number of low-income households spending 30% or more of their income on rent.

Effect: No help for low-income households

The first model estimated how the presence of rent control policies is correlated with the change in the share of households spending 30% or more of their income on rent through the use of a rent control variable, after accounting for broader economic trends. The model results displayed in Table 1 for middle-income households show a coefficient of -5.01 for the rent control variable, which indicates that the presence of rent control in a city is

associated with a 5.01 percentage point reduction, on average, in the change in share of middle-income households spending 30% or more of their income on rent between 2000 to 2013. In other words, the share of middle income households spending at least 30% of their income on rent was 5 percentage points lower, on average, than similar households living in cities with no rent control ordinances in place. This result was statistically significant at the 5% level.

To put the above results into perspective, the City of Los Angeles, for which there is a rent control policy in place, will be used to demonstrate the implications. In 2013 there were 250,175 middle-income renter households spending 30% or more of their income on rent in Los Angeles, which represented 49% of all middle-income renter households in the city, up from just 13% in 2000. The coefficient of -5.01 implies that, without rent control, the share of middle-income renter households paying 30% or more of their income on rent would be 54%, an increase of 12,534 households. Given this, there are 12,534 middle-income households in Los Angeles that have benefited from rent control during the 2000 to 2013 period in terms of reducing the number of households spending 30% or more of their income on rent.

Table 1: Change in share of renter households paying 30% of income or more on rent from 2000 to 2013

	Control 1: Cities with Rent Control	Control 2: Cities short of Rent Control	Log of MSA income 2000	Log of MSA income 2013	Countywide median rent growth	Countywide population growth
Low Income (Less than \$35,000)	-1.434 (2.197)	-1.388 (2.741)	-1.628 (14.105)	-7.414 (15.343)	0.154* (0.085)	0.064 (0.075)
Middle Income (Between \$35,000 and \$75,000)	-5.018** (2.482)	-1.539 (3.097)	17.477 (15.936)	-8.629 (17.334)	0.523*** (0.096)	-0.239*** (0.085)
High Income (Greater than \$75,000)	0.108 (0.088)	0.053 (0.115)	0.616 (1.116)	-0.747 (1.136)	0.001 (0.006)	-0.003 (0.005)

Standard errors in parentheses

*** = 1% significance, ** = 5%, * = 10%

The coefficient on the rent control variable for low-income households was -1.43, however this result was statistically insignificant with a p-value of 0.515. This means that there is a 51.5% chance of observing the same reduction in the share of low-income households spending 30 or more on rent from 2000 to 2013, assuming that rent control policies had no effect on the change in shares. In other words, this result is statistically indistinguishable from no effect on low-income households. The result for high-income households was 0.10 with a p-value of 0.224. While this result was more significant than the coefficient for low-income households, it is still on the outer boundary of what is considered statistically significant by most conventional standards.

It is worth noting that the coefficient on the second rent control variable, which was equal to 1 for cities with measures short of rent control and 0 for cities without such measures, was not statistically significant. This suggests that measures short of rent control, such as rent dispute ordinances, do not play a role in decreasing the share of households spending 30% or more of their income on rent at any income level.

Effect: Decrease in supply of rental housing

The results of the second model, which examined the effect of rent control on the supply of rental housing, can be found in Table 2. The coefficient on the rent control variable was -10.12, indicating that the presence of a rent control policy in a city is associated with a 10.12 percentage-point reduction in the growth of rental housing from 2000 to 2013. This result was statistically significant just below the 10% level with a p-value of 0.108.

The City of Los Angeles can be used again to demonstrate the implications of this result. The number of renter occupied units was 842,894 in 2013, a 7.6% increase over the number of units in 2000. If we apply the coefficient of -10.12 on the rent control variable we find that the amount of renter occupied housing would have increased by 17.7% over this time period in the absence of rent control, which would have put the total number of occupied rental units at 922,030 in 2013. This implies that from 2000 to 2013 growth in the number of renter occupied units in the City of Los Angeles was deprived of an additional 79,136 units due to the presence of rent control.

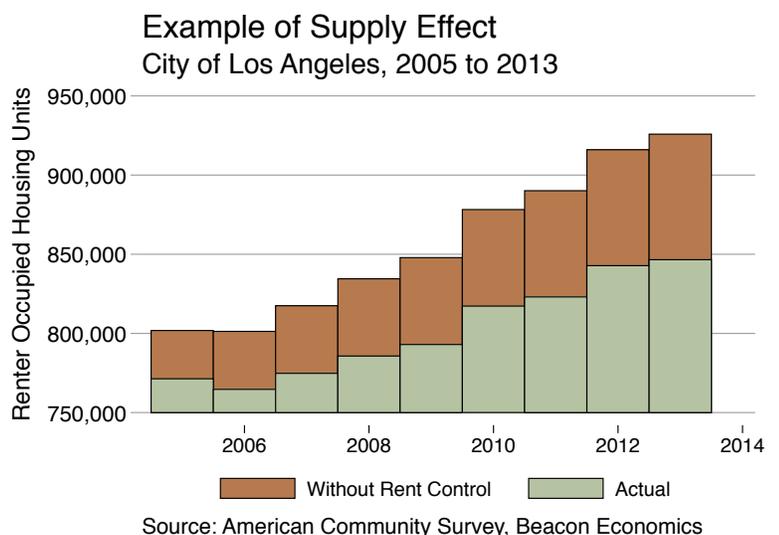
Table 2: Growth in Renter Occupied Housing Units From 2000 to 2013

Control 1: Cities with Rent Control	Control 2: Cities short of Rent Control	Log of MSA income 2000	Log of MSA income 2013	Countywide median home price growth	Countywide population growth
-10.121* /n (6.250)	-7.223 (7.791)	-40.950 (39.791)	42.520 (44.848)	-0.168** (0.083)	1.026*** (0.218)

Standard errors in parentheses
 *** = 1% significance, ** = 5%, * = 10%
 /n p-value was 0.108

One hypothesis for this reduction is the idea that investors might fear that new rental units will eventually be covered under future rent control ordinances, given that there is already a policy in place. Although the Costa-Hawkins Rental Housing Act currently exempts rental units built after 1995 from rent control, future local ordinances and actions by the State Legislature could subject newer units to future rent controls. This hypothesis is supported by the current results as well as other studies included in the subsequent literature review.

Much like the first model, the coefficient on the second rent control variable, which was equal to 1 for cities with measures short of rent control, and 0 for cities without them, was not statistically significant. This suggests that these policies have no discernible positive impacts on the supply of rental housing.



Compared with other groups, the effect on household formation appears to be concentrated among low-income households. The results of the equations on growth in renter households by income group are presented in Table 4. The coefficient on the rent control variable was -7.51 and statistically significant at the 10% level. This indicates that the presence of a rent control policy in a city was associated with a 7.51 percentage point decrease in the growth of low-income renter households from 2000 to 2013. The coefficient for the rent control variables in the middle- and high-income equations was not statistically significant. This suggests that rent control ordinances did not diminish household formation for middle-income and high-income households, but did result in less household formation growth for low-income renters.

Table 3: Growth in Renter Households by Income From 2000 to 2013

	Control 1: Cities with Rent Control	Control 2: Cities short of Rent Control	Log of Household growth	Log of MSA income 2000	Total MSA income 2013	Countywide median home price growth	Countywide population growth
Low Income	-7.51* (4.124)	-6.844 (5.150)	1.048*** (0.088)	45.373* (26.451)	-32.622 (29.745)	-0.084 (0.056)	0.001 (0.158)
Middle Income	-9.472 (6.870)	-10.842 (8.580)	0.840*** (0.147)	-69.264 (44.068)	36.359 (49.555)	-0.072 (0.093)	0.621*** (0.263)
High Income	-19.580 (15.689)	0.703 (19.593)	2.223*** (0.335)	-634.51*** (100.634)	501.549*** (113.166)	-0.999*** (0.212)	0.145 (0.600)

Standard errors in parentheses
 *** = 1% significance, ** = 5%, * = 10%

Effect: Increase in price of rental housing

Basic economic theory tells us that when supply is reduced prices rise, and the results from the third model support this idea. In this model, the effect of rent control policies on the growth of median rents in a city was examined and the results are presented in Table 4. The coefficient on the rent control variable was 6.55, meaning that compared with cities that do not have rent control ordinances, the presence of a rent control policy in a city is associated with a 6.55 percentage point increase in the growth of median rents from 2000 to 2013. This result was statistically significant at the 1% level. The implications are that rent control ordinances make rental units more expensive in the overall market rather than less. While some households benefit from the cap on rent growth in their specific units, these caps are associated with higher rents in the market overall. This is converse to the stated goal of rent control, which is to address housing affordability for renters, particularly for low-income households.



According to the ACS, the median gross rent in the City of Los Angeles was \$1,172 in 2013, up 74.4% from 2000. Applying the coefficient on the rent control variable from the rent growth model results in a growth rate of 67.9% in the case where no rent control policy was in effect, putting the rent in 2013 hypothetically at \$1,128, 3.8% lower than the observed median gross rent in 2013. So in addition to fewer rental units being constructed, rent control is also associated with making rentals more expensive in cities with rent control policies. The coefficient on the second rent control variable for cities with ordinances short of rent control, like the previous two models, was not statistically significant.

Table 4: Growth in Median Gross Rent from 2000 to 2013

Control 1: Cities with Rent Control	Control 2: Cities short of Rent Control	Countywide median rent growth	Log of MSA income 2000	Log of MSA income 2013	Countywide median home price growth	Countywide population growth
6.553*** (2.515)	-3.210 (3.153)	0.79*** (0.125)	-22.693 (16.534)	10.613 (18.115)	-0.056 (0.042)	-0.305*** (0.088)

Standard errors in parentheses

*** = 1% significance, ** = 5%, * = 10%

In sum, the results of this quantitative analysis indicate that rent control policies do not help low-income households, the intended beneficiaries. There was no statistical evidence indicating that rent control policies, on average, reduced the number of low-income households spending 30% or more of their income on rent. Rent control policies were also associated with higher rent growth in the overall market, which impacts low-income households disproportionately.

THE MOTIVATIONS BEHIND RENT CONTROL LAWS

California's high cost of housing is one of the reasons some residents have left the state in search of places that have lower costs of living but that also offer gainful employment opportunities.² The stock of available rentals in several major metropolitan areas of California is extremely low. According to real estate research firm REIS, the apartment vacancy rate in San Francisco and Oakland stood at just 3.9% and 2.5%, respectively, in the third quarter of 2015. The apartment vacancy rate in Los Angeles and San Diego stood at just 3.2% and 2.4%, respectively. However, this is not a phenomenon that is isolated to California's "core" markets. In fact, at 3.9%, San Luis Obispo County maintained the highest apartment vacancy rate. Every other market in the state—from the Central Valley to Bakersfield to Shasta County—maintain vacancy rates that are below 4%.

At the same time, the pace of construction in California is not strong enough to make much of a dent in the multi-family residential marketplace. Multi-family residential permitting suggests that construction is up significantly in California in 2015—44% higher in the first six months of 2015 than in the first six months of 2014, and comparatively higher than in the United States as a whole (32.7%)—but apartment rents in major cities remain very high. In San Francisco, the average monthly cost of rent stood at roughly \$2,517 in the third quarter of 2015 according to REIS. The comparatively affordable rent in the Oakland area stood at nearly \$1,701. In Los Angeles, apartment rents stood at \$1,587, and in San Diego, \$1,532.

²<http://www.latimes.com/business/la-fi-california-migration-20150101-story.html>

In California’s major cities, renting is generally considered the “affordable” option for most families, with existing home prices pricing most individuals—particularly young people—out of the market. However, both rents and home prices in general are making some of California’s major cities unaffordable, forcing workers to relocate or face long commutes.

This has been the reality for residents of cities in the San Francisco Bay Area and much of Southern California for decades. In response, many municipalities in the state have implemented rent control laws to limit rent appreciation, with the objective of maintaining affordable housing for low-income households, protecting community diversity, and reducing evictions. And, while Beacon Economics readily agrees that housing costs are a significant challenge facing the state, the question remains as to what is driving costs so high as well as the most effective way to respond to that challenge.

RENT CONTROL LAWS IN CALIFORNIA

The cities of Santa Monica (April 1979) and Berkeley (June 1980) were some of the first in California to establish citywide rental control laws. These laws applied to most rental units, including apartments, single-family homes, and condominiums. The rental ceilings were set so that rents increased roughly in line with, or somewhat below, the increase in cost of living each year. In the years since, several other major California cities have implemented rental ceilings to help curb rent price growth. These cities and their rental ceilings are listed below.

Despite the very good intentions behind rent control laws, they attack the symptom of the underlying malady and do little to address the root cause of the state’s affordability challenge: the inherent undersupply of housing, which leads to high rents in California’s cities. Simply put, rents are too high because multi-family housing and the state’s housing stock have failed to expand commensurately with the ever-growing population. The solution to this affordability problem is to expand the apartment stock in these cities, not introduce price ceilings.

California Apartment Vacancy Rates, Q3-15

Metropolitan Area	Vacancy Rate
Hanford-Corcoran	3.9
San Francisco (MD)	3.9
San Luis Obispo	3.9
San Jose	3.3
Los Angeles (MD)	3.2
Santa Barbara	3
Yuba	2.8
Orange County (MD)	2.8
Ventura	2.7
Inland Empire	2.6
Oakland (MD)	2.5
San Diego	2.4
Sacramento	2.4
Visalia	2.3
Modesto	2.3
Vallejo-Fairfield	2.2
Redding	1.9
Stockton	1.9
Fresno	1.8
Bakersfield	1.8
Santa Cruz-Watsonville	1.8
Santa Rosa	1.5
Chico	1.5
Carmel/Monterey	1.5
Merced	1.4

Source: REIS

Rent Control Law in California Cities

City	Allowable Increase
Berkeley	65% of Yearly San Francisco-area CPI Increase (effectively 2%)
Los Angeles	3% or Los Angeles-area Yearly CPI Increase, up to 8% (whichever is higher)
Los Gatos	5%
Oakland	1.7%
Palm Springs	75% of Yearly Los Angeles-area CPI Increase
San Francisco	60% of Yearly San Francisco-area CPI Increase
San Jose	8% (21% if rents have not increased in more than two years)
Santa Monica	75% of the Yearly Los Angeles-area CPI Increase
West Hollywood	75% of Yearly Los Angeles-area CPI Increase

Source: California Apartment Association (Updated 06/05/2015)

NEGATIVE SIDE EFFECTS OF RENT CONTROL LAWS

Rent control laws come with problems of their own. Economists sometimes refer to “negative externalities,” which are the unintended consequences of a particular public policy. The evidence suggests that local rent control ordinances are accompanied by such externalities. What’s more, rent control ordinances in particular can exacerbate problems they are intended to address.

- First, price ceilings encourage individuals who would otherwise move elsewhere to stay in their apartments. The data suggests that this is particularly true of higher-income households who have a propensity to move less frequently.

In cities like Santa Monica or San Francisco, where rents are very high, this means that wealthier individuals, who might otherwise move to more expensive housing, stay in their lower-cost apartments. This restricts the available supply of local affordable housing.

- Second, price ceilings discourage the diversification they are meant to encourage. By causing rent-controlled units to turn over less frequently, the supply of available units can actually contract in cities with such ordinances.

Cities like Santa Monica or San Francisco maintain artificially low rents on otherwise expensive properties, while market-rate rentals in those cities not only remain unaffordable to most, they actually rise in cost because growth in the supply of housing has been discouraged following the implementation of rent control laws.

- Finally, limiting how much landlords can increase rent may create a disincentive to properly maintain the property, since landlords will not be able to recover the cost of that investment through higher revenues. This can affect the quality of life for tenants, and affect the surrounding neighborhood by decreasing the value of adjacent properties.

REVIEW OF RENT CONTROL LITERATURE

Researchers have been analyzing rent control impacts for decades. The existing literature provides a good assessment of the impacts that can be expected from both an economic and social perspective. Ultimately, the literature shows that there are, at best, mixed opinions over whether rent control laws generate a positive impact on their cities.

Rental Market Impacts of Rent Control

According to economic theory, a price ceiling should lead to a substantial increase in demand for rentals, as consumers seek out rentals that are fixed at below market rate. In addition, the prices of rentals that are exempted from rent control should rise, as consumers fill up rent-controlled units, making rent control-exempt units more scarce. Empirical studies demonstrate that very impact.

A 1993 study by St. John & Associates examined the impact of rent control on the rental stock in the Cities of Berkeley and Santa Monica a decade after rent control policies were enacted.³ The study used U.S. Census data from 1980 and 1990 to compare rental stock in the two focus cities against stock in similarly sized California cities. The analysis found that while none of the comparison cities lost housing stock during the 10-year window, Berkeley's rental stock fell 14% while Santa Monica's rental stock fell 8%. Rent control laws in these cities created a tight and shrinking rental market as demand outpaced supply.

A 1999 study in the *Journal of Housing Research* claims that this effect might perpetuate itself over time, even in the face of laws that prohibit new construction from being subject to rent control laws.⁴ Using data from the American Housing Survey from 1984 to 1996, the study showed that rent controls not only increase the price of housing that is not under rent control laws, but also new construction that is exempted from rent controls may appreciate in price very quickly because rent controls discourage growth in new rental construction. Investors fear that rent controls may eventually apply to new units, and thus the investors are discouraged from supporting new construction. A tight supply of rentals becomes exacerbated in the present due to concerns about rent control policy that may be enacted in the future.



³St. John & Associates. "Rent Control in Perspective: Impacts on Citizens and Housing in Berkeley and Santa Monica Twelve Years Later." Aug. 1993.

⁴Dirk Early and Jon Phelps (1999) Rent Regulations' Pricing Effect in the Uncontrolled Sector: An Empirical Investigation. *Journal of Housing Research*: 1999, Vol. 10, No. 2, pp. 267-285.

Even though the values of rentals exempted from rent control laws rise in response to the laws, the total value of rental stock shows weak growth in cities where such laws are enacted. This is because the value of rentals with price ceilings tends to stagnate over time, as landlords have no incentive to renovate or otherwise improve their units. Price ceilings put a cap on earnings from rental units, and thus renovations will likely reduce profits from those units. A 1993 study uses data from New York City to establish a link between suppression of rent below market levels and deterioration of housing quality.⁵ In effect, by establishing rent controls as a means of supporting low income residents, cities not only restrict the supply of rentals these individuals can choose from, they also effectively increase the number of subpar units, which can have negative consequences for the whole neighborhood.

Taking this a step further, a 2012 study by researchers at the National Bureau of Economic Research finds that this effect is reversible if cities put an end to rent control laws.⁶ The study examined the impact of the largely unexpected elimination of rent control in Cambridge, Massachusetts in 1995 by comparing assessed valuations of rentals in 1994 and 2004. The analysis found that eliminating rent control increased the value of rentals that were previously subject to the law by 18% to 25%. Eliminating rent control also increased the value of rentals that were never subject to the law by 12% — a spillover effect of the value appreciation for previously rent-controlled units. Eliminating rent control laws provides an impetus for investors to ramp up construction and for landlords of previously rent-controlled units to renovate and improve their properties.



Social Impacts of Rent Control

Academic literature raises serious doubts about whether rent control laws accomplish their intended effects of providing affordable housing for lower-income residents, encouraging diversity in the community, and reducing homelessness. Indeed, a number of major studies suggest that rent control laws have the opposite effect. A 2002 study by Edward Glaeser examined the effects of rent control laws on reducing segregation in cities in the New York area.⁷

Using data from the New York Housing and Vacancy Survey, the study found that rent control laws helped some poorer and older tenants live in Manhattan, an otherwise unaffordable borough, but rent control laws in some New

⁵Choon-Geol Moon and Janet G. Stotsky (1993) The Effect of Rent Control on Housing Quality Change: A Longitudinal Analysis. *Journal of Political Economy*: Dec. 1993, Vol. 101, No. 6, pp. 1114-1148.

⁶David H. Autor, Christopher J. Palmer, and Parag A. Pathak (2012) "Housing Market Spillovers: Evidence from the End of Rent Control in Cambridge Massachusetts." NBER Working Paper Series: Jun. 2012, No. 18125.

⁷Edward L. Glaeser (2002) Does Rent Control Reduce Segregation? Harvard Institute of Economic Research: Nov. 2002, Discussion Paper No. 1985.

Jersey cities actually made lower-income residents more isolated. Lower-income residents who live in more expensive areas tend to be older, long-term residents who are less likely to have children and less likely to be helped from integration (through work or school opportunities) and other benefits.

The 1993 study by St. John & Associates mentioned above claimed that economically advantaged consumers in Berkeley and Santa Monica succeeded more consistently than economically disadvantaged consumers in securing rent-controlled units. As rent control laws draw down the stock of rentals and drive up prices of exempted units, the controlled units become even more unattainable for lower-income residents. What is left is an exclusionary, homogenous community that has been “gentrified” through rent control laws.

Rent control laws tend to drive low-income residents away from an area by making rental properties unaffordable, so it is no surprise that the academic literature is split as to whether these laws reduce the problem of homelessness in cities. A 1997 study by William Gissy claimed that rent control laws have a slightly negative effect on a city’s homeless rate.⁸ The study noted that cities with rent control had higher rates of homelessness overall, but that the higher rate was due to the high cost of housing in those cities. The study followed a 1995 analysis by Paul Grimes and George Chressanthis that claimed rent control laws had a noticeable effect on increasing homelessness. Using U.S. Census data, the study attributed a 0.03% increase in shelter counts and a 0.008% increase in homeless street counts to rent control laws. An extensive 2009 literature review by Blair Jenkins concluded that many studies show rent control has no significant impact on homelessness.⁹

Ultimately, the academic literature suggests that rent control laws, at best, do not accomplish their goals of providing affordable housing for low-income residents, increasing diversity, or reducing homelessness. At worst, rent control laws actually move cities further away from these goals, making low-income residents in cities with rent control laws worse off or leading them to move elsewhere. This may explain why states such as Massachusetts have dissolved rent control laws and why states such as California have placed firm restrictions on rent control for new properties.

CASE STUDY: SAN JOSE

The San Jose City Council has recently taken steps to adjust the City’s current rent control ordinance in the wake of rapidly rising rents, driven in large part by the booming technology industry in Silicon Valley. However, not all residents receive the high wages that are so prevalent in the tech industry, and as a result have been faced with rents that, in many cases, are unaffordable. The City Council approved a plan to explore reducing the current cap on rent growth and increase tenant protections.

It is important to note that housing affordability is not unique to San Jose. It is a problem that spans the state and the overall situation in San Jose is not as bad as in some other regions of California. This is because even though average rents are rising, so are average incomes. According to the ACS, the median gross rent in San Jose was 29.7% of household income in 2014, near the bottom of the list among California metropolitan areas. San Jose was even below the Inland Empire region of Southern California, which is usually touted as having an affordability advantage compared to neighboring coastal regions. The median gross rent as a percentage of income in the Inland

⁸William G. Gissy (1997) Rent Controls and Homeless Rates. *International Advances in Economic Research*: Feb. 1997, Vol. 3, No. 1, pp. 113-121.

⁹Blair Jenkins (2009) Rent Control: Do Economists Agree? *Econ Journal Watch*: Jan. 2009, Vol. 6, No. 1, pp. 73-112.

Empire came in near the top of the list at 35.6%. So even though the level of rent is lower in the Inland Empire, incomes are lower as well.

The current San Jose ordinance sets the amount rent can increase for covered properties at 8% per year, or no more than 21% if there has been no increase in rent for more than 24 months. Apartment properties that were built and occupied before September 7th, 1979 are covered under the ordinance. Duplexes are exempt. Estimates place the number of covered units at 43,000.¹⁰

Housing affordability is a tremendous challenge in San Jose for households on the lower end of the income spectrum. After all, San Jose is one of the most expensive housing markets in the United States on an absolute basis. The median price for an existing home in the City was \$761,000 in the second quarter of 2015, substantially higher than the statewide median price of \$395,000.

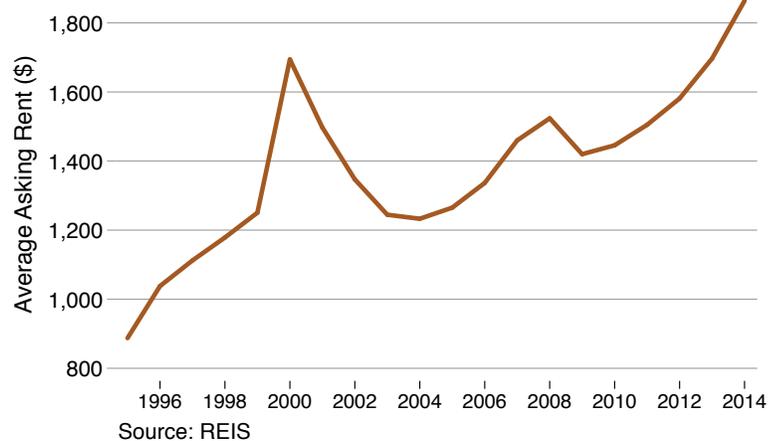
The high price of home ownership keeps most households in the rental segment of the housing market, and rents are still quite high relative to other parts of the state. The average rent for an apartment in the City was \$1,926 in the second quarter of 2015. In contrast, the average apartment rent was \$1,671 in the East Bay, and \$1,241 further north in the Vallejo metropolitan area.

And while tightening the current cap on rent growth may be well intentioned, in the aggregate there is potential for unintended, negative outcomes, particularly among low-income households. The City Council has not set its sights on any particular adjustment to the current ordinance, but one option that has been considered is to reduce the 8% annual growth cap to 4%. This will certainly help tenants who are able to secure housing in rent-controlled units, but a large percentage of these tenants aren't the intended beneficiaries of the policy. Additionally, adopting a more restrictive cap on rent growth could backfire as the broader housing market is negatively impacted.

An argument can be made that the intended beneficiaries of rent control policies are low-income households. However, these aren't necessarily the households that will benefit the most from stronger rent control policies. In the previous section we discussed how the presence of a rent control policy in a city was associated with reducing the change in share of middle-income households (between \$35,000 and \$75,000) spending 30% or more of their income on rent from 2000 to 2013. However, for low-income households (below \$35,000) there was no statistically significant effect found.

One reason for this is because low-income households generally have more turnover than middle- and high-income households, which limits the benefits of rent control as low-income households are faced with higher rent

San Jose Average Apartment Rent
1995 to 2014



¹⁰Ramona Giwargis, "San Jose Council Approves plan to strengthen rent control", http://www.mercurynews.com/bay-area-news/ci_28741872/san-jose-council-approves-plan-strengthen-rent-control

once they move to a new unit. In large cities, those with a population of 200,000 or more, the share of low-income households in 2013 with less than five years of tenure in their current residence (37.8%) was larger than middle- (32.5%) and high-income households (29.7%).¹¹

Additionally, low-income households in cities with rent control policies tend to be less concentrated in older housing than in cities without rent control. In large cities with rent control ordinances, middle- and high-income households made up 57.3%, on average, of the units covered by rent control in 2013. In contrast, these same groups occupy less than 40% of age-equivalent housing in cities without rent control ordinances in effect.

In San Jose, this is certainly the case. Middle- and high-income households make up 62.1% of households in rent-controlled properties in 2013. What’s more, most low-income households in San Jose don’t live in rent-controlled properties. In 2013, 57.1% of low-income households did not live in rent control covered housing (pre-1980 structures of three units or more). This is unique among large cities with rent control ordinances in effect. In Los Angeles, San Francisco, and Oakland, only 27.7% of low-income households, on average, lived in comparable housing units.

In the quantitative analysis in the previous section, we discussed that the presence of a rent control ordinance in a city was associated with an increase in growth in that city’s median rent, and a decrease in the growth of renter occupied housing. As previously noted, one hypothesis for this is that investors are less likely to invest in new housing due to their uncertainty about future rent control ordinances that would limit their returns. This can inhibit supply growth, which in turn would put upward pressure on rent for properties not covered by a rent control ordinance.

These dynamics suggest that further reducing the cap on rent growth will provide few benefits to low-income households in San Jose. If the City Council were to increase the “intensity” of rent control by reducing the rent growth cap for example, the results found in the quantitative analysis could be exacerbated. The presence of a rent control policy in a city was found to be associated with a decrease in the growth of renter occupied housing, as well as an increase in the growth of citywide median rents.

As previously mentioned, less than half of low-income households in San Jose live in rent-controlled housing, and an increase in the “intensity” of the city’s rent control policy could mean that these households would be faced with rent growth above and beyond what would have otherwise taken place. So while the tightening of rent control

Households with less than 5 years in pre-1980 structures (3+ units)

Income Group	San Jose	Large Rent control cities	Other Large cities
Low Income	34.6%	37.8%	58.7%
Middle Income	38.9%	32.5%	31.2%
High Income	26.4%	29.7%	10.2%

Source: American Community Survey

Households in pre-1980 structures (3 unit +) by income Group

Income Group	San Jose	Large Rent control cities	Other Large cities
Low Income	43.1%	42.7%	60.3%
Middle Income	36.8%	31.9%	29.9%
High Income	20.1%	25.4%	9.8%

Source: American Community Survey

¹¹Based on analysis of the 2013 American Community Survey 1-year Public Use Microdata Sample.

policies in San Jose may be well intentioned, it could lead to undesirable outcomes in the broader housing market and could negatively affect the very households the policy was intended to help.

CONCLUSION

Beacon Economics has undertaken an analysis of rent control ordinances in the State of California in order to provide a better understanding of the effects these ordinances can have on local housing markets and on low-income households in particular. Academic literature on the subject was thoroughly reviewed and Beacon Economics conducted its own quantitative analysis of ordinances in the state using demographic and housing data from the 2000 U.S. Census and the 2013 American Community Survey.

The results found in the quantitative analysis are in line with findings in the existing literature indicating that rent control ordinances are associated with lower growth rates in the supply of rental housing and with higher rental price growth in the broader market. Additionally, Beacon Economics did not find strong evidence that rent control helps to reduce the number of low-income households spending 30% or more of their income on rent. On the contrary, the findings suggest that rent control can have a negative impact on low-income households not living in rent-controlled units through higher growth in citywide median rents.

The San Jose City Council's recent exploration into changing the City's current rent control ordinance and reducing the cap on rent growth has raised questions about the efficacy of such a policy prescription. In light of the findings contained in the quantitative analysis of this report, it appears that the strategy may not generate the intended effect. The majority of low-income households in San Jose do not live in rent-controlled properties, leaving them vulnerable to adverse effects that tightening the existing policy may have on the broader market, such as restricting supply or pushing up rents in units not covered by the ordinance.

Ultimately, the State of California, and especially regions like San Jose with high rent growth, needs more housing. For both renter and owner occupied housing, affordability remains an issue. The state is constantly under-building new residential units, which has exacerbated affordability issues for the past 30 years. Home building has simply not kept pace with population growth. Now that the cyclical effects of the Great Recession have waned, home prices are rising again, meaning homes are affordable for a smaller share of the population. Given the limited supply, however, this group still represents a large enough pool of buyers to maintain significant upward pressure on the state's housing market.

California is one of the nation's most popular states to live in, which keeps demand strong; but the supply of housing continues to come up short. Attacking the underlying cause of California's affordability challenges, rather than the symptoms of the problem, is likely the best way to manage housing affordability in the state and provide benefits to low-income households. Streamlining the permitting, zoning, and environmental processes for new residential construction at the local, regional, and state levels may prove to be the best strategy for addressing unaffordable housing in California. Strong demand and low supply drives up prices—that is basic economics. Intervening in the market to manipulate prices rarely yields the most effective results and, in the case of rent control, the data certainly supports this view.

ABOUT BEACON ECONOMICS

Beacon Economics, LLC is a leading provider of economic research, forecasting, industry analysis, and data services. By delivering independent, rigorous analysis we give our clients the knowledge they need to make the right strategic decisions about investment, growth, revenue, and policy. Learn more at www.BeaconEcon.com.

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