

Can Rent Controls Help Reduce the High Cost of Housing in High Demand Cities?

Joshua Hall and Noah Trudeau

Government leaders often are unhappy with market prices, especially when rents are rising rapidly, as they have been in Boston, San Francisco, and Chicago. As lawmakers and city councils push for a solution, rent controls are popular with officials and voters alike. This is a familiar problem of supply and demand in economics. What do the laws of supply and demand reveal about the potential for success or failure of rent controls? Are high rents symptoms of problems or the cause?

San Francisco is a good example. It has a strong economy that produces a lot of value for owners, employees, and consumers. With a thriving economy amid desirable amenities and climate, San Francisco is a place where lots of people want to live—and it has a housing shortage.¹ San Antonio is another city that has a strong economy, amenities, and desirable climate, spurring demand for housing. Yet unlike San Francisco, San Antonio does not have a housing shortage. Why is this the case? One possibility is that San Francisco has rent controls while San Antonio does not.

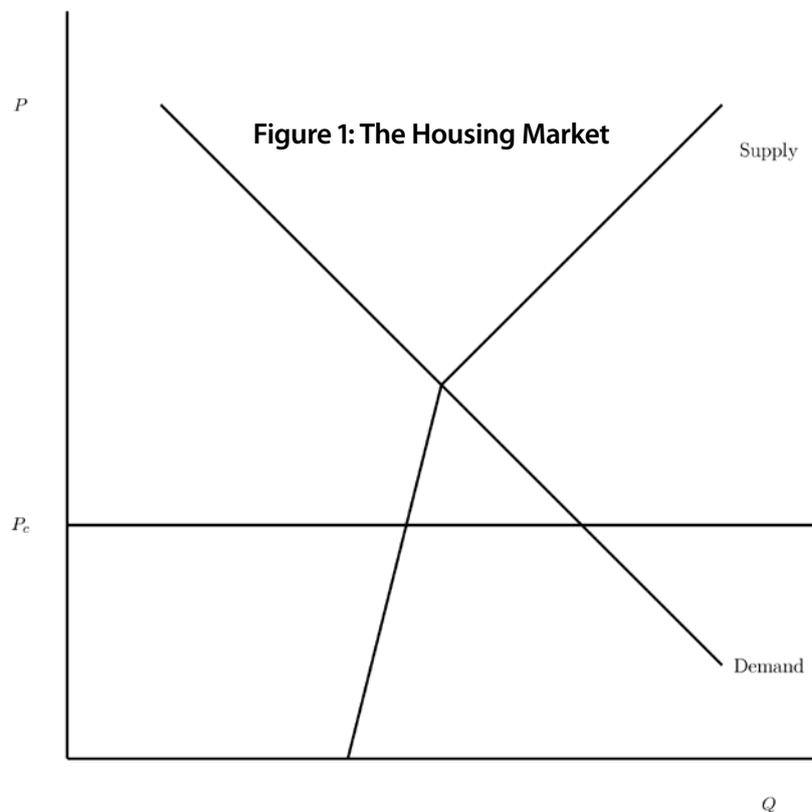
The Housing Market and Rent Controls

Housing markets are like many other markets, in that individuals are the demanders and firms are the suppliers. Unlike many consumer items, however, housing is a durable good. Once an apartment building or home is con-

structed, it remains potentially available for rental.

In ordinary consumer markets, the quantity supplied responds to price. This is true in housing, but with a twist. In the language of economics, housing supply is “inelastic,” or relatively unresponsive to prices below the cur-

rent price. If rents fall, landlords cannot easily reduce their supply of housing to the market. The apartments and rental houses are still there. Still, landlords could reduce the quantity a little by converting rental units to owner-occupied housing or even abandoning them if the rents fell too low. In Figure 1, this



The figure depicts the demand and supply for housing in a city with rent control (P=Price and Q=Quantity). The supply curve is more vertical below the intersection of supply and demand because the quantity does not change much with price since housing units are already built.

lack of responsiveness means that the supply curve is very steep below the equilibrium price.

Above the equilibrium price, more housing can be supplied in response to increases in demand. The increased quantity of housing can come through several channels. New construction, transformation from commercial to residential, rental of extra space in existing units (roommates), and subdivision of existing structures are all possible. Thus, even with a fixed supply of land, more housing can become available without tearing down and building new units. The result is that when demand for housing increases in a city, the quantity supplied can show strong increases. This market mechanism keeps rent increases modest, as current property owners supply more housing to make money from that increased demand. In the diagram, the supply curve has a kink at the current price but is otherwise like the supply for any other consumer good.

The Housing Market

Rent controls are a form of price ceiling implemented by governments to deal with increasing rents. In the United States, historically, rent controls were often passed in response to war time pressures and periods of high inflation.² For that reason, many U.S. cities had their first rent controls implemented during World War II or during the 1970s. San Francisco implemented its current rent control law in 1979.

In Figure 1, rent control shows up as a horizontal line at P_c . When rent controls are below the equilibrium price set in the market, they create a mismatch between the wishes of demanders of housing and the suppliers of housing. At the below-market prices created by rent control, more people want apartments at the rent-controlled price than can obtain them. The result is a shortage of housing *created by the rent control*. While some consumers get the security of stabilized rents, others have increased insecurity that comes from the shortage of units.



AP Photo/Rich Pedroncelli, File

Rent control supporters march past the Capitol in Sacramento, Calif., April 23, 2018. Californians who rent apartments, single-family homes, or condominiums built after 1995, have limited protections from rising costs under a state law that restricts rent control. At the November 2018 ballot, voters rejected Proposition 10, which would have opened the door to more rent control in cities and counties across the state.

Some Unintended Consequence of Rent Controls

While rent controls can make housing more affordable for those fortunate enough to obtain rent-controlled units, they distort markets and ultimately can make it more difficult for many to find affordable places. Under so-called “first generation” rent controls, developers often did not want to build new rentals because they might be subject to rent control. As a result, cities with rent control often found that developers were unwilling to build new apartments even during periods of housing shortages. In a well-documented survey of landlords, many said they would not build new units if a rent control law were passed.³

More recent rent controls, like San Francisco’s, explicitly exclude new construction from the rent control law to minimize this issue. Still, other issues remain. When prices can’t account for changes in a market, people make other adjustments. Economist Art Carden points out that one major unintended consequence is that a shortage allows

landlords to be choosy about picking tenants.⁴ This can allow landlords to be discriminatory. When there is a long list of people who would like to rent a place, profits aren’t hurt by landlords discriminating over race, sexual orientation, marital status, or religion.

Landlords also find ways to overcome controls by adding fees to their rentals. One example is the key fee. While an apartment may be \$1500 a month, the key is an additional \$700 a month. It has also been shown that apartment quality declines in rent-controlled areas as landlords skimp on maintenance in order to maintain positive returns on investment.⁵

Individuals are willing to do a lot to get a rent-controlled apartment. In 2011, a woman married her 87-year-old boyfriend one month before he died in order to get the right to his \$400 rent-controlled New York apartment.⁶ People also hold on to apartments—even, in some cases, if they’re not using the apartment—because the rent doesn’t increase. This restricts supply and further exacerbates the shortage of housing.

Recent Evidence

While economists almost unanimously agree that rent controls do not promote overall housing affordability, there is still active research in this field of economics to better understand all the trade-offs. One study from Massachusetts uses data from the American Housing Survey to show that rent controls made new housing less likely to be rentals. Thus, even though the controls didn't prevent construction of new housing, they did make rental supply lower. The same paper also found evidence of deterioration in the quality of rentals due to rent controls.⁷ A separate study estimated that eliminating rent controls from Cambridge (Mass.) led to a \$1.8 billion increase in the housing stock from 1994 to 2004.⁸ A more recent paper finds that rent control does indeed limit the mobility of renters.⁹

Does Rent Control Work?

In reality, does rent control work? If the question is whether dollar rent amounts are less under rent control, then absolutely they are. Rent control causes rent to be less for *rent-controlled units* than if there were no intervention. If that were the only goal of rent control policies, then they succeed astoundingly. Politicians typically don't use that sort of language in pushing for rent control.

Instead, rent control is posed as a way to promote equality, benefit renters, and reduce the cost of living in high-demand cities. In the process, rent control is said to prevent “gentrification,” the takeover of poorer urban neighborhoods by wealthier new owners. If these are the goals for instituting rent controls, then they fail. Potential suppliers of rental property make decisions that restrict rental supply and instead supply high price units for purchase. This increases income disparity in cities and actually promotes gentrification.

Consumers who are able to get a rent-controlled apartment benefit, but at the cost of the many others who are unable to rent because of the shortage. City economies are hurt by the restriction

of the rental market and the decrease in mobility that is caused by rent controls. While the elimination of controls won't entirely solve the housing supply problems that lead to high prices, rent controls do not help make housing more affordable for most residents.

Teaching Suggestions

1. *The Worst Room*

“The Worst Room” is a blog devoted to apartment listings in New York City.¹⁰ It can be found at: www.worstroom.com/. These are actual listings for rental spaces in New York and other high-demand cities. We ask our students to visit the page and ask them some of the following questions: Why are rents so high in these cities? Do you notice any differences across neighborhoods of New York? Why do you think there are differences? To what extent do you think these listings are the consequence of rent controls?

2. *The New York Times*

The New York Times has an entire topic section on “Rent Stabilization and Rent Control” (www.nytimes.com/topic/subject/rent-stabilization-and-rent-control). As an activity, we assign our students to read through the articles to find examples where the narrative is consistent with the economics of rent controls and where it seems at odds with it. For example, there are stories of five-person families staying in one-bedroom apartments rather than moving to bigger places because of rent control. Similarly, there are stories regarding Mayor Ed Koch keeping his rent-controlled apartment while living in the mayor's mansion. 🌐

Notes

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8. David H. Autor, Christopher J. Palmer, and Parag A. Pathak, “Housing Market Spillovers: Evidence from the End of Rent Control in Cambridge, Massachusetts,” *Journal of Political Economy* 122, no. 3 (2014): 661–717.
9. Rebecca Diamond, Tim McQuade, and Franklin Qian, “The Effects of Rent Control Expansion on Tenants, Landlords, and Inequality: Evidence from San Francisco,” NBER Working Paper (2018).
10. The Worst Room, www.worstroom.com/

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For a simplified look at the rent controls in San Francisco see: Schwartz, Elaine. “Does Rent Control Really Control Rent?” *Econlife* (April 11, 2018). <https://econlife.com/2018/04/san-francisco-rent-control/>.

JOSHUA HALL is Professor of Economics and Chair of the Economics Department in the John Chambers College of Business & Economics at West Virginia University. He earned his PhD in Economics at West Virginia University in 2007 and, prior to returning to WVU in 2013, was the Elbert H. Neese, Jr., Professor of Economics at Beloit College. **NOAH TRUDEAU** is a second year PhD student in economics in the John Chambers College of Business & Economics at West Virginia University. His research interests include public economics, law and economics, and applied microeconomics. His recent research involves the investigation of the effects of occupational licensing on industries and consumers.