The Case for Preserving Costa-Hawkins: Who Really Benefits from Rent Control?

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A Scattershot Approach

The State of California is currently facing a severe housing shortage, and the lack of rental housing supply is fueling competition for existing units and increasing rents to levels that are squeezing many households, especially low income renters. Following decades of underbuilding and recent strong economic growth through the current business cycle, market conditions are very tight in most apartment markets in California, making it very difficult for many households to find affordable rental housing. As of 2016, nearly 54% of renter households in California spent more than 30% of annual income on rent, a critical cost threshold that is designated as a "cost burden."[1] Moreover, the current vacancy rate for the most affordable, "workforce" segment of the California apartment market is extremely low at just 2.3% as of July 2018, according to Yardi Matrix.[2] In comparison, the vacancy rate in the high-end, "discretionary" segment of the apartment market was double the workforce segment at 4.6%, during the same time period.[3] Given the extreme shortage of available units, low income households often have no other option but to exceed the cost burden threshold.

Although advocates often seek to promote rent control as a mechanism to help these households, evidence from markets with rent control in California and around the country show quite the opposite. Rent control compounds the affordability crisis by significantly reducing the supply of available rental units, as outlined in the previous paper in this series, *The Case for Preserving Costa-Hawkins: Three Ways Rent Control Reduces the Supply of Rental Housing*.[4] In particular, by reducing the potential for operating income, rent control incentivizes property owners to convert existing apartment buildings to other uses. Moreover, rent control creates an inefficient allocation of housing, such that more units are needed to serve the same population over time, and restrict the financial viability of new apartment construction, making it very difficult for new supply to keep pace with the growth in housing demand.

Beyond the negative supply effects, rent control is commonly intended to assist low income renter households by flattening rent increases and making it easier for these households to stay in their existing units. However, there are no mechanisms whatsoever to ensure that low income households actually receive these benefits. Instead, rent control is applied based only on the age of the building, and does not require any means testing for household incomes. As such, households of all income groups can and do reside in rent-controlled units. In practice, however, low income households often do not have the resources to spend searching for these highly coveted units.

As highlighted below, numerous case studies focused on markets with existing or past rent control demonstrate that a significant portion of the benefits from rent control accrues to households in higher income brackets. This occurs largely because households with more education and greater financial resources have significant advantages in terms of finding and securing units in rent-controlled buildings. In effect, rent control increases competition and exacerbates the housing shortage for low income households, while the cost-saving benefits accrue haphazardly to those who: 1) happen to be in the right place at the right time; 2) have the wherewithal to find available units; and 3) have sufficient lifestyle flexibility and job opportunities to make it possible to stay in the same unit over an extended period of time.

Critically, this scattershot approach does not consider who is most in need. Repealing the Costa-Hawkins Rental Housing Act (Costa-Hawkins) would not change this fundamental flaw inherent in the concept of controlling rents and does not address the root cause of the problem – the inadequate supply of rental housing. Quite the opposite, if Costa-Hawkins were repealed and local jurisdictions across California were to further expand rent control with stricter measures, such as vacancy control, low income households would likely be squeezed even further by additional reductions in supply, while relatively high income households would disproportionately reap the cost-saving benefits of living in apartments with below-market rents.

More Competition for Low Income Households

As detailed in the previous paper in this series, rent control shrinks the supply of rental units on the market, and thereby increases competition for available housing units. Indeed, not only do low income households often compete with one another for both rent-controlled units and relatively low cost market units, but these households also face considerable competition from wealthier households who are often in a much better position to track down and secure rent-controlled units.

Finding housing can be a complicated and time consuming process that varies widely by income and location. However, relatively high income households have several major advantages over low and middle income households when it comes to finding a rent-controlled apartment. First, households with relatively high incomes and higher levels of education are much more likely to have regular access to reliable internet and transportation. In San Francisco, 42% of extremely low-income households, defined as households with annual incomes less than 30% of the area median income (AMI), found their current residence through family or friends, according to the 2018 San Francisco Housing Needs and Trends Report.[5] In comparison, only 10% of high-income households, defined as households with incomes of more than 200% of AMI, relied on family or friends to find housing. Instead, high-income households were three times more likely than the lowest income group to find their residence through the internet or in newspapers.[6] Second, relatively high income renters typically have stronger credit and the ability to pay for application fees on multiple units (or even large deposits) – factors that are particularly helpful when searching for housing in a tight housing market. Perhaps most importantly, higher income households often have the resources to pay for their current residence, or for temporary accommodation, while they spend the time to find a new place to live. This luxury to dedicate substantially more time and money to the housing search process, represents a considerable advantage that makes it much easier for households with greater financial resources to patiently search for a highly coveted unit in a rent-controlled building. Given the large disadvantage when it comes to the apartment search process, it is not surprising that low income households are less likely to receive the benefits of below-market rents through rent control over time.[7]

In addition to the direct effect on the ability to access rent-controlled units, the overall reduction in rental housing supply resulting from rent control (highlighted previously) can also increase competition in the broader market for relatively low cost market-rate units. As a result, the challenges of finding housing in a tight housing market can keep low income households stuck in their current homes even as their needs change over time, or may force households to move farther away from employment opportunities in order to find lower cost housing.

Although rent control is often intended to benefit low income households, the reality is that rent control actually makes it more difficult for low income households to find rental housing by reducing the number of available rental units and increasing competition among households of all income groups for a limited number of highly prized discounted units.

Who Really Benefits from Rent Control?

Households of all income types reside in rent-controlled units because there are no means testing to target households based on either income or net worth. As such, while the goal is often to support low income households, middle and higher income households frequently live in these units. Although rent control does decrease housing costs for some low income households, the savings from living in these units tends to accrue disproportionately to: 1) households who happen to be in the right place at the right time; and 2) households in higher income brackets with greater ability to secure and remain in rent-controlled apartments, for whom housing assistance is least needed.

In addition to the challenges of competing to secure a rent-controlled unit, the savings from living in a rent-controlled unit generally accrue slowly over an extended period of time. As a result, benefits are greatest for households with sufficient lifestyle flexibility and career opportunities to allow for long-term residency. In contrast, recent residents moving to a new community and households who move frequently are largely excluded from these costs savings.

In practice, however, many renter households do not have the luxury to stay in one home over the long term without the need to move in search of work, or to accommodate other changing housing or family needs. In fact, more than 30% of renter households in California, or 1.8 million households as of 2016, moved into their unit during the prior two years, while 73% moved within the prior six years, according to the Census.[8] Moreover, low income households typically move much more frequently than higher income households. As of 2016, more than 18% of the California population living at or below the poverty line had moved to a new residence in the prior year, compared with less than 12% of the population living at or above 150% of the poverty level.[9] Given the challenges of both renting and remaining in a rent-controlled unit, rent control is a highly ineffective and inefficient method to provide rental assistance for low income households.

Numerous case studies on communities with current or past rent control measures reach similar conclusions. A 2006 Brigham Young University study on rent control in the Boston metropolitan area found that rent control programs that existed in several communities in the region from the late-1980s through the early-1990s were not particularly effective at transferring the benefits to low income or minority households.[10] Specifically, "only 26% of rent controlled apartments were occupied by renters in the bottom quartile of the household income distribution, while 30% of units were occupied by tenants in the top half of this distribution."[11] Moreover, Hispanic and African-American minority groups, which accounted for one-quarter of the population in the cities with rent control, only represented 12% of the population living in rent controlled units.[12] As a result, much of the benefit from rent control accrued to wealthier households. Further research on the Cambridge, MA market also found that, "rent-controlled apartments were concentrated among highly educated professionals, while the poor, the elderly, and students were generally excluded."[13]

Research on rent control in New York City led to similar conclusions that rent control was an inefficient mechanism to target benefits for low income households and resulted in a random redistribution of wealth. Specifically, researchers found that the strict rent control program in New York City did a poor job at providing equitable benefits to similar families, and that the tenant benefits were, "higher for wealthier and older families and lower for larger families and minority families."[14]

Further supporting this concept, a 1988 study from the University of Toronto examined the effects of the Residential Premises Rent Review Act, which implemented rent control in Ontario starting in 1975.[15] The research highlighted the fact that only 34% of benefits from the rent control program went to low-income households and concluded that rent controls, "appear to be an extremely inefficient and inequitable method of income redistribution."[16] These results are not at all surprising, considering the fact that rent control is applied blindly, based only on the age and size of the property, with no means testing and no consideration for which households are most likely to benefit from living in rent-controlled buildings.

Conclusion

While the scarcity of available housing and the challenges of rising rents represent major hurdles in many markets in California, rent control is at best a poor mechanism to help low income households afford their monthly rent. Whereas individual households struggling with the challenges of housing costs generally need targeted assistance designed to facilitate both access and affordability, rent control is entirely need-blind, and therefore largely fails to ensure that the benefits of lower rents help those most in need. Instead, rent control exacerbates the problem of housing scarcity, creates greater competition and, ultimately, makes it harder for households with limited resources to secure affordable housing.

Repealing Costa-Hawkins and expanding the scope for rent control would do nothing to more effectively target rent relief to the households most in need. To the contrary, many of the households who would benefit from the cost savings are likely to be those who least need the assistance – relatively high income earners who already live in existing apartments and those who have the resources to find rent-controlled apartments. There is no doubt that California is facing a housing crisis following decades of underbuilding, and many California households are struggling with the challenges of declining rental affordability. What these households need today are thoughtful and well-crafted programs designed to support the development of more rental housing and to effectively target benefits to those in need of assistance, not a scattershot approach that is likely to exacerbate the problem for many of the state's most vulnerable households.

End Notes

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