
CAN RENT CONTROL AND RENT STABILIZATION SOLVE PORTLAND'S HOUSING AFFORDABILITY PROBLEM?

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If you've picked up a local paper recently, you are aware that calls for rent control are increasing, and the issue has gone from fringe to mainstream. Stories covering rent control usually start with an emotional anecdote that leads to the ultimate conclusion that controlling rent is the only way to stop greedy landlords. Opponents strike back with dismissive comments signaling that their counterparts don't understand basic rules of supply and demand. The debate has certainly been lively, but not always constructive.

The point that these knee-jerk reactions miss is that—in its modern form—rent control is a series of complicated regulations that yield complicated results. It is nuanced and context-specific, and any evaluation of its merits should be treated as such. What follows is such an assessment: an objective review of the primary issues that have arisen as a result of rent control, an exploration of how policies have adapted to overcome these challenges and how successful they have been, and a look at how such policies might apply in Portland.

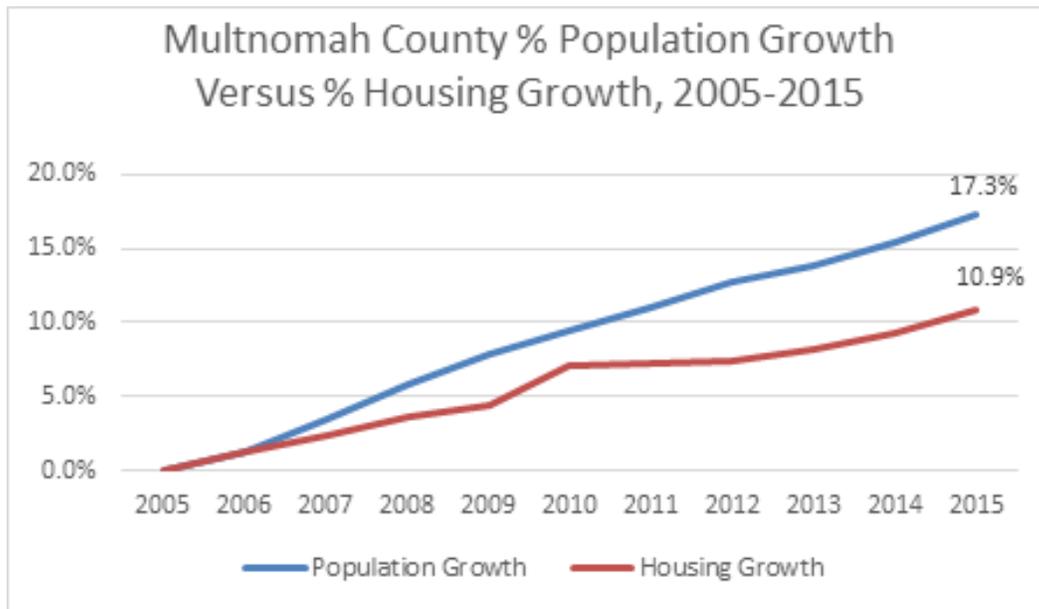
But first, let's establish why we are having this conversation at all.

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THE HOUSING CRISIS AND RENT CONTROL

Calls for rent control have emerged from a very real housing affordability crisis in Portland, and understanding the current crisis is central to understanding how rent control might function in Portland. Between 2000 and 2015, Portland grew by 100,000 residents, a nearly 20 percent increase in population over just 15 years. This rapid expansion is primarily the product of in-migration. For the last three years, Oregon has earned the title of number one destination for movers, according to the United National Movers study. And, according to Metro's forecasting, the trend is likely to continue. Specifically, Metro expects the Portland region to add 400,000 people by 2035.

During this same period of in-migration, the Great Recession hit, and new housing starts slowed to a trickle. Despite the many cranes in the sky, Portland has yet to catch up on the backlog of needed new units. The graph below tells how this story has played out in Multnomah County by illustrating the gap that has grown between population and housing since 2005.



Source: U.S. Census

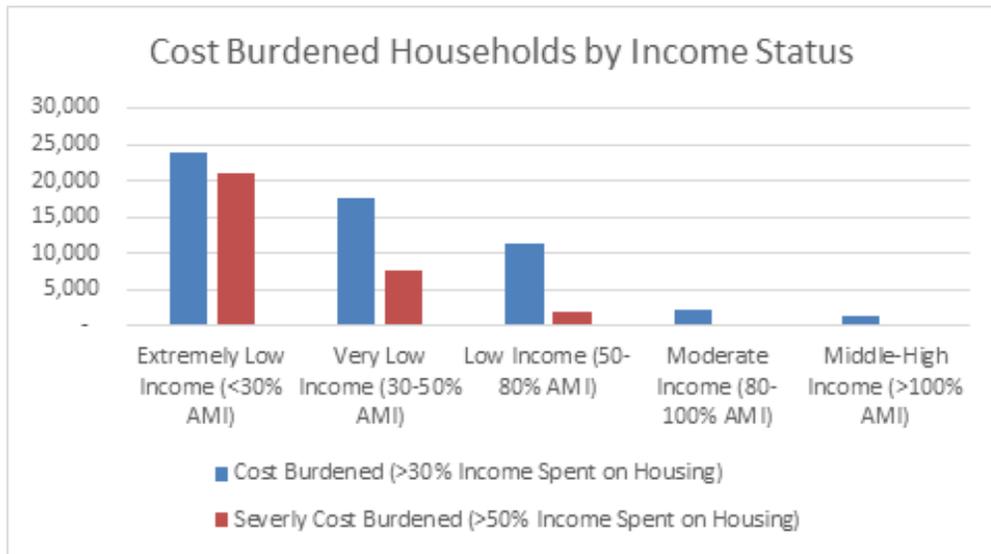
Portland's homeownership rate is 53 percent, which lags behind the national average for homeownership, but is comparable to other metro areas of similar size. This means that a lot of people are renters, and subject to the whims of the rental market. With the added population and few new units to competitively drive down prices, vacancy rates have declined over time, and rents have skyrocketed. According to AxioMetrics, annual rent growth in Portland in 2015 was more than 14 percent, making it the number one metropolitan area for rent growth for several months running. Since the 2008 recession, AxioMetrics estimates effective rent growth to be over 35 percent.

Rent growth would not be such a big deal if it were paired with corresponding wage growth. On the one hand, Portland has added many jobs, and average wages have steadily increased as high-earning jobs have been added to the market. On the other hand, wage growth has not been evenly distributed—middle-income earners in particular have experienced little job growth and little wage growth.

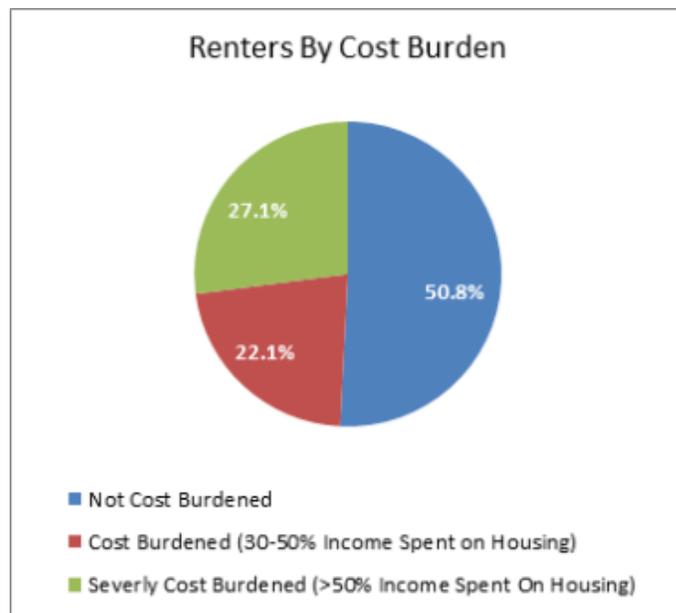


The result has been that rental rates are unaffordable for a large portion of the population. According to HUD Comprehensive Housing Affordability Strategy data, just under 50 percent of Portland renters were cost burdened in 2012, meaning that half of the renting population spent more than 30 percent of income on housing. Unsurprisingly, this burden falls largely on low-income households.

Anecdotally, and from a variety of sources including homeless providers and media reports, evictions seem to be up, and many have charged that this is increasing the homeless population. Empirically, these anecdotes are not supported with data—at least not yet. There is no reliable comprehensive data on evictions, although the Community Alliance of Tenants reports an increase of callers reporting eviction to their hotline. According to A Home For Everyone, point in time homeless counts between 2013 and 2015 are unchanged in the aggregate.



Source: HUD Comprehensive Housing Affordability Strategy



Source: HUD Comprehensive Housing Affordability Strategy

It is against this background that rent control is being discussed actively. Stated plainly, the problem is that rents are increasing rapidly and wages are not following suit, whatever the outside causes may be. It is argued that rent control is designed to stop rents from rising, thereby attacking one side of this equation.

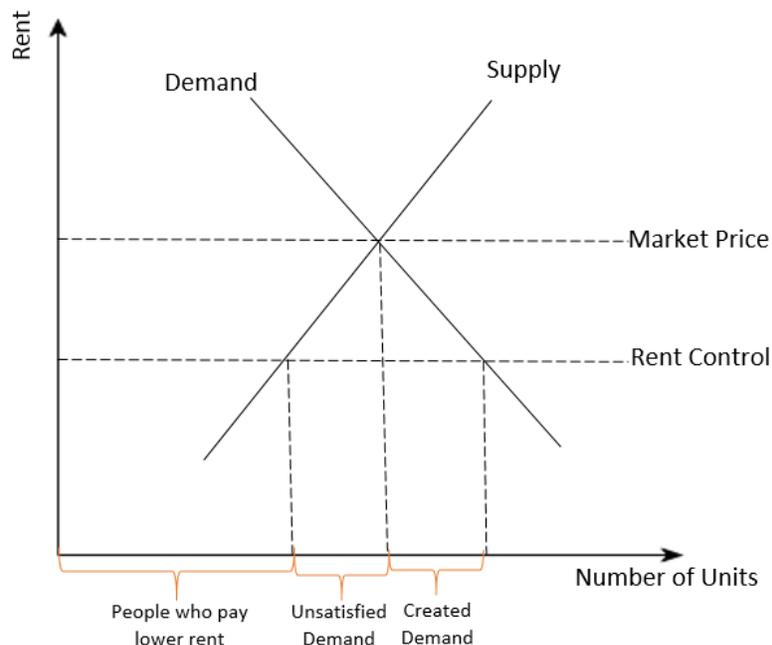
A pre-emptive statewide ban on rent control has been in effect since 1985. Importantly, the state ban includes a provision for localities to impose a temporary rent control in the event that a “natural or man-made disaster that materially eliminates a significant portion of the rental housing supply.” Many feel that

Portland is at that point given the figures laid out above. In October of 2015, The Portland City Council declared a housing emergency, leading many to wonder why temporary rent control hasn't already gone into effect. At the state level, calls to remove the ban have also become increasingly frequent, with House Speaker Tina Kotek recently pledging to introduce legislation in the 2017 session that would both repeal the ban, and place restrictions on rental rate increases.

RENT CONTROL VERSUS RENT STABILIZATION

There is a misunderstanding among many as to what constitutes rent control. In its purest form, rent control is a freeze on rents. Economists often refer to this type of rent control as “hard”, “pure”, or sometimes “first generation” rent control. It is this hard form of rent control that is—almost unequivocally—bad. On this point, a well-known survey from 1990 revealed that over 90 percent of economists agree that rent control decreases the quantity and quality of rental housing in the controlled area.

Here's why. When rent control is imposed, a price ceiling is created that artificially lowers the price that landlords can charge for rent. The amount of housing supplied will drop in reaction as property owners see smaller incomes from renting out units. The price ceiling will also increase the amount of housing demanded for the lower priced units. The result is a shortage of units where the quantity demanded exceeds the quantity supplied. Those who are able to obtain a unit will benefit from a lower rental rate, but this benefit will be offset to some degree by a deterioration of units as landlords have less incentive to invest money in maintenance, and have a decreased ability to move easily from one unit to another in the tight market. In addition, those who are unable to find housing because of the shortage will be worse off under such a system of rent control.



In modeling hard rent control, it is easy to see how this would function. More importantly, empirical analyses of rent control also bear out these consequences. Studies agree that in areas with hard rent control, the following happens:

1. Developers stop building housing, as their ability to recuperate costs is reduced.
2. Existing landlords convert their housing stock from rental (e.g., apartments) to ownership (e.g., condominiums) or to commercial uses. #1 and #2 together lead to a housing shortage.
3. Housing stock deteriorates as landlords have less money and less incentive to reinvest in their properties.

Interestingly, the legislative text in Oregon's ban repeats these findings: "The Legislative Assembly also finds that the imposition of general restrictions on housing rents will disrupt an orderly housing market, increase deferred maintenance of existing housing stock, lead to abandonment of existing rental units and create a property tax shift from rental-owned to owner-occupied housing." While these impacts are by no means the only issues with rent control, they are among the most frequently cited.

Hard rent controls were first introduced in the United States during World War II to control for inflation. The controls were eventually lifted, except in New York City, which has continued a complicated and bifurcated system of rent control—some of which is still hard rent control—to this day. Then in the 1970s, a new generation of rent control was imposed in parts of Massachusetts, New Jersey, Connecticut, New York State, and Washington DC. In reaction to the problems with hard rent control, these policies included provisions for rent increases, as well as a bundle of regulations on maintenance, conversion of units, and tenant protections. These policies are referred to as "second generation" or "soft" rent controls, or simply "rent stabilization."

Have these policies significantly curbed the negative impacts of rent control? Under what conditions and in what context? The next sections will examine each of the main objections to rent control, consider the empirical evidence, and extrapolate the issues to our Portland context.

RENT CONTROL IMPACT 1: BUILDERS STOP BUILDING

Developers make decisions on whether to build based on a wide variety of different reasons and market forces. Still, the impact of hard rent control cannot be understated. Developers rely on increases over time to keep costs and income in balance, and without the ability to increase income, the financial equation often won't pencil out. When it does, it is usually because the developer has padded his or her pro forma with heavy rents to hedge against the inability to increase in the future. Further, developers are willing to take on the risk of downturns because

windfall profits can be made in a good market. Without this upside, the risk-reward equation changes significantly.

In order to curb this negative impact, rent stabilization policies take several approaches. The most important among these is that rent stabilization policies (and, actually, some hard rent control policies too) exempt new units from rent control entirely. Most advocates believe that this provision alone should end the debate entirely as to whether rent control impacts new supply. Unfortunately, the evidence says otherwise. The problem is that once a policy goes into place, there is little to prevent the passage of new regulations that would bring new units under rent control. Debt financiers, in particular, do not like such regulatory risk. There are many markets without this risk, so builders will tend to just build elsewhere.

In New Jersey, state law guarantees no rent control for at least 30 years, and contracts are made with developers to provide further assurance of the same. One comprehensive study of 76 New Jersey cities over 30 years found that rent control had negligible impact on new supply. This suggests that additional assurance may help to curb negative impacts on new supply; however, as the study did not look at other states, the evidence here is not conclusive.

Further, some economists have theorized that the marked impact that rent stabilization has on supply is not just a function of regulatory risk, but a question of demand. Generally, developers build not (just) based on projected increases in population, but under the assumption that their new product will be able to lure tenants from existing buildings. In cities with declining populations and high vacancies, it's the only reason new housing is built at all. In a rent stabilized economy, the market advantage of a new complex is minimized as it cannot compete on price. However, in a rapidly growing location like Portland, with an affluent immigration that is anticipated to continue, this calculation should have less of an impact.

Exempting new housing from rent control is not the only policy designed to mitigate the impact on builders: rent stabilization policies usually include a suite of regulations designed to ensure developers a better rate of return and give some assurance that even if new projects become rent controlled, the impact will be small. A central tenet of rent stabilization policies is that rent is not held constant. Rent increases can be tied to inflation, or, more commonly, a governing body is appointed that decides on year-over-year increases in rent based on a market assessment, inflation, municipal needs, and providing landlords with a "reasonable" rate of return. This varies widely between municipalities: in Los Angeles, for example, rent increases are between 3 percent and 8 percent each year, whereas in Berkeley, rents are capped at 65 percent of inflation, allowing for only tiny increases each year. Many policies also have cost pass-through provisions which allow landlords to apply for rent increases in order to cover costs of on-site capital improvements. Too, jurisdictions with rent stabilization often allow landlords to apply for hardship provisions that will allow for rent increases if cash flow problems arise. Vacancy

decontrol is another common policy, wherein rents may increase to market rate when a tenant vacates.

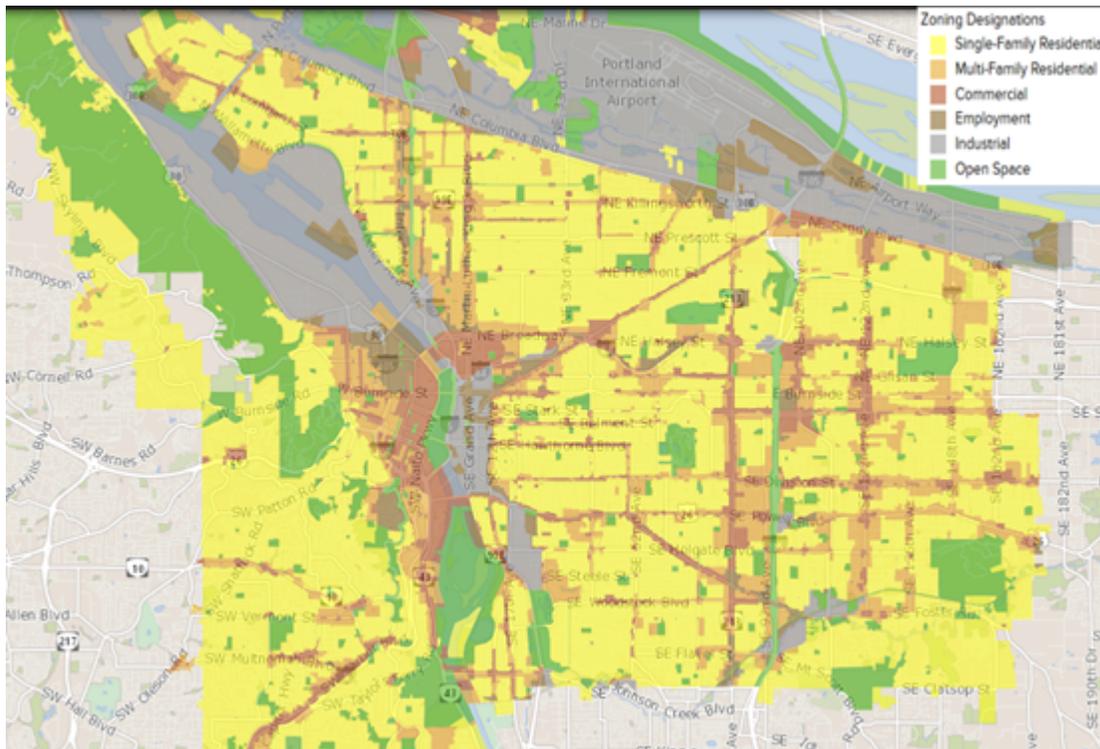
Most of the above does little to provide certainty for the developer: what the governing body considers a reasonable rate of return is unlikely to match what a developer thinks is “reasonable”, not to mention that the process is liable to become highly politicized, and not necessarily in favor of development. The headache of going through a rent control board in order to be able to make a “fair return” is less-than-enticing.

Vacancy decontrol, while equally uncertain, has a larger upside for private landlords as rents can jump to market rates when tenants vacate. In 1997, California State passed a law requiring that all municipal rent control ordinances include a vacancy decontrol provision. Prior to the passage of this bill, Santa Monica, Berkeley, West Hollywood and East Palo Alto had vacancy control, providing an excellent opportunity to study the impacts of vacancy decontrol. Empirical evidence from the four areas suggests that vacancy decontrol had a positive impact on the amount of new housing being produced.

Yet vacancy decontrol may have unintended consequences. Firstly, as the same four-municipality study shows, aggregate rents go up in the area, lessening the impact of rent control. Whether this is good or bad depends on one’s perspective. Vacancy decontrol also provides an incentive for landlords to evict, although that particular issue has not been studied. Some have also posited that vacancy decontrol increases real estate speculation, which drives up land values and ultimately home prices. Here, too, empirical evidence is limited.

In sum, rent stabilization policies appear to have less impact on new supply of housing--albeit not dramatically—than hard rent control. Still, Portland’s need for additional housing is dire, which makes any small impact on new supply concerning.

One additional important local context to consider is the impact of Portland’s urban growth boundary (UGB). If, as many contend, the urban growth boundary constrains the supply of housing by limiting the availability of land, and rent control further limits new supply, then it stands to reason that layering regulations will deteriorate the supply of new housing further. Equally troubling is the limitation placed on housing density due to exclusionary zoning practices, particularly in the central core where demand is strongest. The map below shows the extent of single family zoning in yellow within Portland.



Source: Portlandmaps.com

While no other jurisdictions with rent stabilization have a UGB, some places do have other policies designed to control growth. The California Bay Area, for example, has exclusionary zoning policies, large lot requirements, height restrictions in what should be dense parts of town, and impact fees that are high enough to act as a growth deterrent. Analyzing rent stabilization in the Bay area is notoriously difficult due to countless regulations, unparalleled market demand, and relentless NIMBYism. Nevertheless, studies of the area that attempt to control for these variables are not favorable. San Francisco's housing production is just over 50 percent of what it needs to be to meet population demand.

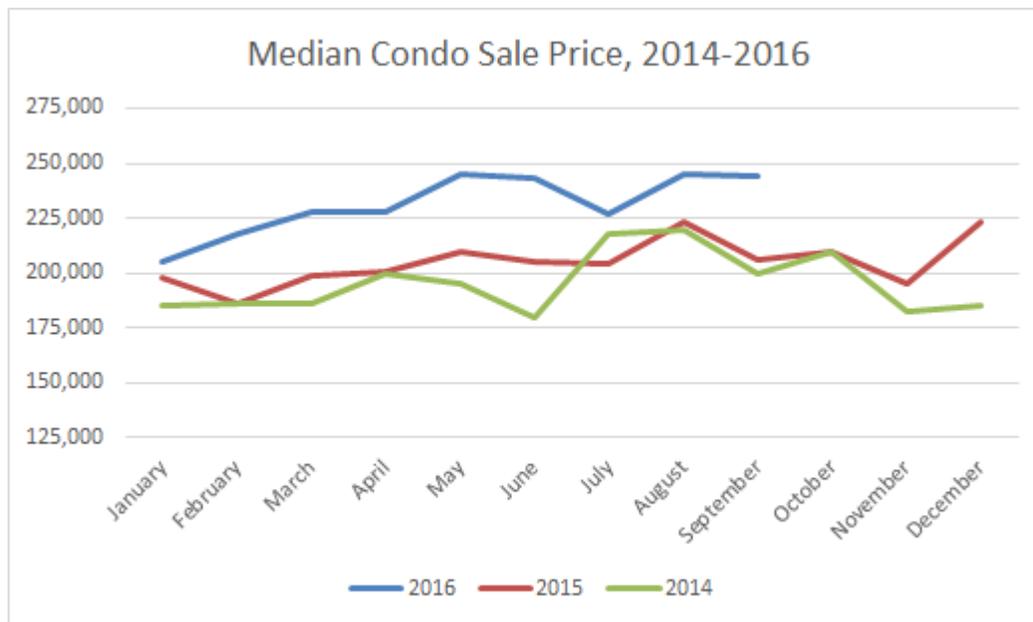
Many uneasy comparisons have been made between Portland and San Francisco: rocketing rents, tight housing market, high in-migration, and supply limitation. It is important to note that Metro contends that its models show that within the UGB, and under current zoning, there is room for 400,000 more units to be built, 118,000 of which would be single family homes. Limiting the urban area also equates to smaller travel costs, which are a major affordability factor.

RENT CONTROL IMPACT 2: RENTAL UNITS CONVERT

As the benefits of owning an apartment complex are reduced or eliminated, owners will find other uses for their buildings by converting to ownership status, or retrofitting to an entirely different use like commercial.

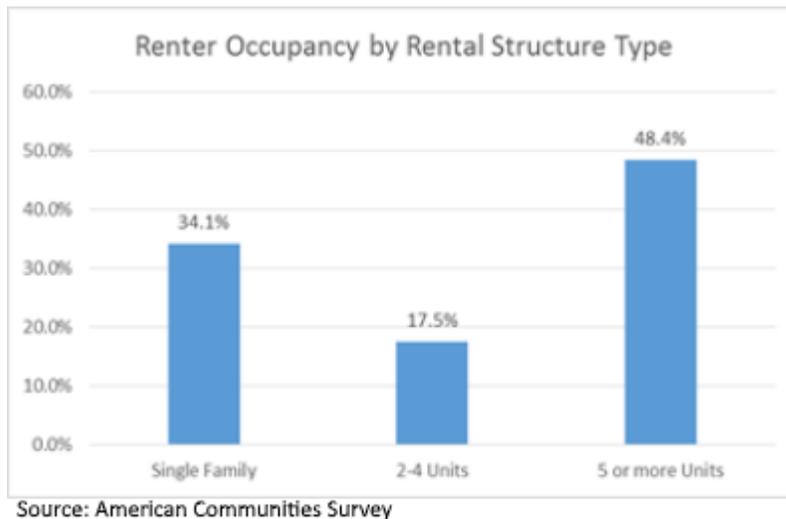
The policies described in the last section that “loosen” rent control to allow for a larger return can also work to dissuade landlords from converting units. More to the point, most jurisdictions with rent stabilization also apply restrictions designed to prevent this conversion process. Most commonly, anti-condominium conversion laws are put in place. These types of policies might require landlords seeking to convert apartments to obtain sign-off by all tenants, approval of the rent control board, and give heavy monetary relocation assistance for displaced tenants. The laws certainly have a chilling effect on conversions, but they also are notoriously flawed with loopholes. In California, strong condominium conversion laws are counteracted by the Ellis Act, which guarantee the right of landlords to “go out of business.” Thus, landlords will evict tenants, go out of business, and re-incorporate under a condominium or commercial scheme.

Traditionally, Portland has not been a very strong condominium market, and very few new condominium buildings have been built since the recession. At present, condominiums are selling at a quicker rate, and at increasingly higher sale prices (see graph below). This healthy market provides an incentive for conversion of apartments to condominiums in the event that rent control makes apartments less attractive.



Another component of many rent stabilization policies is an exemption of single family homes or smaller complexes under a certain size. In California, for example, state law mandates that single family homes be exempt, and the District of Columbia exempts any buildings with five units or less. Relatedly, condominium conversion laws usually only apply to buildings over a certain amount of units. In San Francisco, for example, condominium conversion laws only apply to complexes with 5 or more units.

In Portland, the exemption of smaller units bears particular scrutiny, as the majority of renters live in single family and “middle” housing of less than 5 units. As the adjacent chart describes, over one-third of renters reside in single family residences. And, Metro forecasts that—despite the many high-rises currently popping up around town—single family housing will still continue to dominate the region. A national study from the Joint Center for Housing Studies of Harvard University noted that from 2005-2015, “conversions of single-family homes from owner-occupancy and other uses accounted for the lion’s share of growth” within the rental sector, but that “growth in the number of single-family rentals appears to have slowed as house prices have rebounded, reducing the financial incentive that lured investors of all sizes into this market.” In Portland, an area that recently ranked first in the country for most rapidly inflating housing prices according to the S&P/Case-Schiller Home Price Indices, this statement is particularly alarming. There is already plenty of incentive to turn housing stock from rental to ownership; a price ceiling on rents could easily tip the scale.



RENT CONTROL IMPACT 3: HOUSING STOCK DETERIORATES

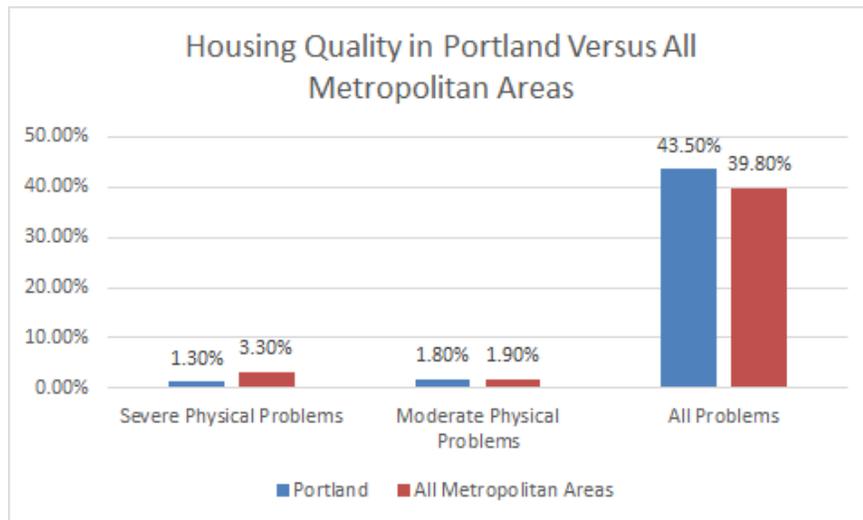
Under a rent freeze, there is little incentive for a landlord to improve housing stock since there is no monetary benefit for the landlord in the form of rent increases. Further, as inflation pushes maintenance costs up, but rents stay the same, eventually the landlord’s operational costs will exceed rents, inducing corner-cutting on regular maintenance to avoid further losses. In extreme cases, a deterioration of units could lead to abandonment.

In a rent stabilization situation, better returns will be realized—theoretically—and therefore the disincentive should be lessened. Once again, any of the policies that soften the impact of rent control and allow for higher returns will impact housing stock deterioration. Vacancy decontrol is particularly geared towards the maintenance issue, with the rationale being that a landlord will at least update units and increase maintenance when a new market-rate tenant can be attracted. In

addition, municipalities generally use a carrot and stick approach to incentivize/force appropriate maintenance of rental units. As a carrot, most jurisdictions allow landlords to apply for pass-through of maintenance expenses. The associated stick is stepped-up code enforcement to ensure buildings are complying with building, health and sanitary codes. Too, there is often a boosting of tenant protections against retaliation and no-cause evictions to reduce tenants’ fear of reporting overdue maintenance issues.

The literature on the impacts of rent stabilization policies on housing maintenance is generally not favorable, however. Empirical studies on the issue have generally revealed a statistically significant deterioration in quality of rental stock, although it should be noted that such studies generally rely on housing data rather than information on direct maintenance expenses. A study published in the *Journal of Urban Economics* considered the impact of ending rent control in Cambridge, Boston and Brookline, Massachusetts, which had policies in place from the early 1970s until 1995. The results reveal a significant difference between housing quality, particularly items of physical damage, during and after rent control.

The bureaucratic process of the rent board is a significant factor here. A long and arduous application and decision process will significantly discourage landlords from going through the maintenance pass-through process. Cambridge, for example, reported a median adjudication time of 171 days in 1988-1999 for fair operating cost increase cases. In theoretical models economists have demonstrated that if the incentive and disincentive are large enough, no impact would be expected on maintenance issues.



Source: National Housing Survey

The current quality of rental housing in Portland is best catalogued by the National Housing Survey. This survey, undertaken by the Census, measures housing quality in metropolitan areas across the country. In Portland, only

1.3 percent of housing units qualify as having severe physical problems, and only 1.8 percent are categorized as having moderate physical problems. This is both lower than, and comparable to, other metropolitan areas. Of greater concern, 43.5 percent of survey respondents reported “any problem”, which is higher than the national average of 39.8 percent. Anecdotally, tenant advocacy organizations believe this is a bigger problem than reported, and the City of Portland has prioritized housing code compliance to address what it perceives as an important issue. Still, the point here is that Portland’s housing does not appear to be significantly deteriorated. If it were, the maintenance issue caused by rent control would pose a significantly larger threat.

THE ALTERNATIVE TO RENT STABILIZATION

Rent stabilization policies mitigate some of the negative impacts of hard rent control, but not all of them. In particular, possible impacts on new and existing supply are problematic given the clear need for additional units. The alternative to rent control is to build more subsidized units—for which there is simply not enough allocated money—or to wait for supply to catch up to demand, and for natural effects of housing “filtering” to produce more affordable units. Filtering is the process that occurs as housing stock originally built for higher income individuals ages and deteriorates. Higher income households with the means to move on do so, and the now-older stock is rented to people with more modest incomes. The majority of so-called affordable housing stock in the United States has gone through this filtering process.

How long does it take for supply to drive down prices? A 2014 study by economist Stuart Rosenthal in the *American Economic Review* suggests that national filtering rates for rental housing are between 1.8 and 2.5 percent per year. The lower of the two rates represents housing filtering in areas with high housing inflation, and the higher of the two rates (2.5 percent) represents the average filtering rate in areas with very low housing inflation. In Portland, where housing is inflating rapidly, Rosenthal’s model would predict a 1.8 percent filtering rate per year. Over the short term, this figure is disappointing. Over a ten year span, the model predicts a 15 percent reduction in rent, which is much more encouraging. The below table shows the impact of Rosenthal’s model on an average 2 bedroom 2 bathroom unit in the Portland-Vancouver MSA, as measured by Multifamily NW. Come year ten, housing would be priced at an effective \$180 per month less than when stock was new. While year two decreases (\$20) may be unimpressive, in year ten, \$180 represents a significant impact on a family’s budget.

Theoretical Impacts of Filtering on a 2BR/2BA in Portland MSA			
Year	Rent: 2 BR/2BA	Rent Decrease Due to Filtering	Percentage Decrease
Year 1	\$ 1,207.00	-	-
Year 2	\$ 1,185.27	\$ (21.73)	1.80%
Year 3	\$ 1,163.94	\$ (43.06)	3.57%
Year 4	\$ 1,142.99	\$ (64.01)	5.30%
Year 5	\$ 1,122.41	\$ (84.59)	7.01%
Year 6	\$ 1,102.21	\$ (104.79)	8.68%
Year 7	\$ 1,082.37	\$ (124.63)	10.33%
Year 8	\$ 1,062.89	\$ (144.11)	11.94%
Year 9	\$ 1,043.76	\$ (163.24)	13.52%
Year 10	\$ 1,024.97	\$ (182.03)	15.08%

Rosenthal's model does little to account, however, for Portland's current situation, where rapid in-migration combined with an already tight housing market has meant that wealthier newcomers are snatching even some of the less desirable housing stock. Neither, of course, does it address the urban growth boundary and what impact that may be having on supply limitations and natural filtering. It also does not account for the housing boom that Portland is currently experiencing, which might, conversely, offset the former impacts.

Still, if we take Rosenthal's estimates at face value, the question then becomes: do we have ten years to wait for rents to decrease? Housing advocates would answer a resounding no, as likely would anyone who has tried to apartment hunt in the Portland market within the last year. If the answer is no, then relief in the form of rent stabilization might be warranted. However, to the extent that rent control limits supply by slowing construction and increasing conversion to ownership or commercial, placing ceilings on rents will exacerbate the situation in the long run.

CONCLUSION

This report is by no means exhaustive of all the possible issues, unintended consequences and benefits that could result from rent stabilization. It has endeavored to take on the most common critiques of rent control, see what the data reveals when regulatory policies to assuage these consequences are applied, and to infer how the Portland market might react. Reverse engineering these critiques, some recommendations for crafting a rent stabilization policy in Portland might include the following.

1. New apartments should be exempted from rent control. This is the best way to limit the impact of rent control on new supply, which is direly needed. As

noted above, exempting new builds from rent control will not eliminate the risk for developers, and some impact on supply is still to be expected. To further curb this negative impact, Portland might consider giving a guarantee to developers in the manner that New Jersey has done.

2. Exempting single family and middle housing from rent control should be carefully considered. On the one hand, more than half of renters live in single family or small multifamily units, and surely deserve the same protections as their counterparts in large apartment complexes. On the other hand, the conversion of single family (34 percent of the rental market) and, to a less extent, middle housing, is a very real concern in the Portland market.
3. Provisions should be made that would allow landlords to apply for cost pass-throughs for maintenance expenditures and hardship. This will not eliminate the issue of unit deterioration and maintenance deferrals, but it will at least mitigate some of the most egregious consequences.
4. Vacancy decontrol is a popular rent stabilization tool and a powerful way to allow landlords to recoup costs, but has a number of negative consequences that should be further explored, as noted above.
5. Any rent control policies will need to be met with an adequate government structure to deal with the impacts of rent control, and a recognition that this structure will not come without a price tag. In particular, if unit maintenance is to be upheld at appropriate levels, code enforcement will need to be significantly increased. Portland has already struggled with increasing enforcement to levels that tenant advocates are comfortable with. Adjudication boards will also need to be strengthened to readily deal with landlord-tenant disputes. And, an adequate staff must be maintained to review any pass-throughs allowed by the law. A bureaucracy that is too slow and immobile to address the needs of a nimble rent stabilization policy will have immobilizing effects similar to hard rent control.

While evidence on the impacts of rent stabilization is weaker in some areas than others, overall it appears that risks of rent stabilization outweigh the benefits. Yet, much of that cost-benefit analysis will depend on an area's priorities, principles, and choices about who the winners and losers in society should be. If Portland decides to adopt rent stabilization, a carefully crafted, nuanced, and context-specific policy is needed to mediate as many of the negative consequences of rent control as possible. ■