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IN THEIR LOCAL-FEDERAL SETTING

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The traditional landlord-tenant relationship, originally weighted heavily in favor of the landlord, has been greatly modified ever since World War II. Courts and legislatures, partly in recognition of severe housing shortages, have created and extended the rights of residential tenants. Regulations that have emanated from the courts and legislatures have generally been in the form of habitability, rent control, anti-eviction, and anti-discrimination laws. They all were designed to improve the lot of tenants, in particular of certain classes of tenants. At the same time, these laws place additional burdens on landlords and investors in housing. Depending on a housing market's demand and supply conditions, landlords may respond to the increased costs, for example, by absorbing them and operating at a lower profit, by passing the costs on in the form of higher rent, by cutting back on repair and maintenance, by abandoning the building, or by any combination of these. Clearly, some of these alternatives can be detrimental to the welfare of low-income tenants. Moreover, the reaction of tenants, landlords and potential investors in apartment houses is likely to be influenced by whether the law is imposed by local or federal government.

This paper will examine major classes of property law that regulate the relations between landlords and tenants, with special reference to their welfare effects. Empirical results will be presented in relation to habitability and anti-speedy eviction laws. Furthermore, the implications of

the source of such laws, i.e., whether local or federal governments, will be probed.

Major Landlord-Tenant Laws

Habitability Laws

Before World War II, most of the American states retained the common law rule that landlords owed no duty to deliver and maintain habitable housing; they subscribed to the doctrine of caveat emptor. Moreover, the Lessee's covenant to pay rent was considered independent of the Lessor's covenant to provide habitable housing. After World War II many American cities enacted housing codes. Courts and legislators responded by providing a number of remedies allowing tenants to initiate code enforcement in the form of repair and deduct, rent withholding, and receivership laws.[1] They were supplemented by anti-retaliatory eviction laws.

The repair and deduct remedy is a self-help measure. It allows the tenant, upon his own initiative, to repair his defective premises and deduct the repair charges from his rent, after the landlord has been notified of the defect and has failed to act within a reasonable time. This remedy is limited to minor defects and represents for the landlord the least costly code enforcement mechanism.

Rent withholding can rely on an escrow method or rent abatement. In the first case, the tenant pays rent into a court-created escrow account. Rental income is withheld from the landlord until violations are corrected. An alternative is rent abatement, which permits a tenant to remain in possession of premises without paying rent, or paying a reduced amount until housing defects are remedied. The condition of the premises constitutes a defense either to an action of eviction or to an action for rent.

Receivership involves appointment by the court of a receiver who takes control of the building and who corrects hazardous defects, after a landlord failed to act within a reasonable period. If large scale repairs are needed which cannot be financed through rental payments, some statutes permit the receiver to seek additional loans by converting old first liens into new second liens imposing particularly heavy costs on the lender and ultimately on the landlord. Rent is deposited with the court-appointed receiver until the violation is corrected. As long as the tenant continues to pay rent into escrow, the landlord cannot evict for non-payment. Of the three remedies, receivership is the most potent for assuring habitable housing and at the same time the most costly to the landlord.

The three major remedies are often supplemented by laws that can reinforce them. Retaliatory eviction laws are designed to protect tenants from being penalized by landlords for complaining against housing code violations. Such laws usually freeze rents for ninety days after compliance.

Anti-Speedy Eviction Laws

In recent years, a number of states have taken steps to lessen the certainty and promptness with which landlords can enforce evictions -- statutory provisions by which a writ of restitution is enforced, and court-made laws which determine the right of self-help procedures available to landlords in evicting tenants.[2] The former determine the discretionary power of courts to delay enforcement of a writ of restitution, once it is issued by a court. Starting in 1927, Massachusetts awarded courts the power to give a discretionary stay of an eviction if the tenant would face substantial hardship in finding other housing; such legislation has spread throughout the Northeast.

Self-help provisions entitle a landlord to take possession of premises and to remove a tenant without resort to judicial remedies, whenever a contractual provision of the lease was broken. However, in recent years courts have given tenants more protection and have provided tort remedies particularly against the use of excessive force. Moreover, the Uniform Landlord and Tenant Act adopted by a handful of states also abridges the right of landlords to exercise self-help.

Rent Control

Rent control has been a topic of interest ever since the end of World War II, when New York City passed such an ordinance. In the middle 1970s, with real estate prices and rents rising rapidly, a number of cities, counties and states have passed legislation to control rent increases.[3] These laws differ among jurisdictions mainly as to whether new construction, single dwelling units, luxury apartments and voluntarily vacated units are exempted from control, the size of rent increases permitted, and eviction rights. For example, the 1979 Los Angeles City Ordinance has the following features —

- Apartments built after March, 1979 are exempt from controls. So are luxury units, which for one-bedroom apartments are defined as those renting for more than $420 a month.

- Rents can be raised to any level on units that tenants voluntarily vacate or from which they are legally evicted.

- Landlords can unilaterally decide to make capital improvements and pass those costs on to renters over a five-year period. They can also evict tenants in order to perform certain major improvements inside apartments, and then charge the new tenants any rent they wish.

- Seeking to avoid a large and expensive bureaucracy of rent-control administrators, the ordinance left enforcement of the law entirely to tenants through civil action.

- A "just-cause" eviction clause limits landlords' ability to oust renters.

- Annual rent increases cannot exceed 7%.

- Landlords who have financial problems because of the high price for which they purchased the property are denied the case-by-case relief that is authorized for landlords with actual operating problems.

Just-Cause Eviction Laws

In the United States a few local and state governments have begun to experiment with just-cause eviction statutes to assure tenants of continued tenancy. Under such laws, tenants can only be evicted for just cause, which is explicitly stipulated in the legislation. For example, such statutes in New Jersey delineate a limited number of legal grounds which constitute the sole basis for eviction:

    a. Failure to pay rent;

    b. Disorderly conduct;

    c. Willful damage or injury to the premises;

    d. Breach of expressed covenants;

    e. Continued violation of landlord's rules and regulations;

    f. Landlord wishes to retire permanently; or

    g. Landlord wishes to board up or demolish the premises because he has been cited for substandard housing violations and it is economically unfeasible for him to eliminate the violations.

A just-cause eviction law applying solely to senior citizens was passed by the California Assembly in the 1973-74 legislative session, but

died in the Senate. It listed six grounds, similar to the New Jersey ones,

for evicting a tenant sixty years of age or older who has been in continuous

possession of a dwelling for five years.

On the local level, universal just-cause eviction ordinances have

also been enacted, usually very similar to the New Jersey one, in conjunc-

tion with a rent control law which permits rent increases whenever a voluntary

vacancy occurs. Under such a rent control law, it is essential that tenants

be protected against capricious eviction.

Anti-Child Discrimination Laws

The federal government as well as the states have passed laws that

prohibit housing discrimination based on race, religion and country of

origin. However, some legislation bars housing discrimination against

children.[4] The first such law was passed as early as 1898 by the state of

New Jersey, though such laws gained prevalence during the 1970s.

Land use control has been delegated by most states to local governments,

who have dealt with anti-child discrimination to promote public health,

safety, welfare and morals. The cities of San Francisco, Los Angeles and

Berkeley in California, for example, have passed ordinances prohibiting

discrimination against families with minor children in the rental or leasing

of residential property. Units with a certain minimum floor area and build-

ings serving exclusively persons 62 years of age and older are exempted

from the requirements of the ordinance. Penalties for violation are

specified and the ordinance is subject both to annual review and to automatic

expiration. Anti-child discrimination ordinances also exist in Everett,

Washington and Howard County, Maryland.

By early 1979, six states had statutes that prohibited discrimination in housing against families because of the presence of children: Arizona, Delaware, Illinois, Massachusetts, New Jersey, New York. The states of Montana and New Hampshire as well as the District of Columbia prohibit discrimination on the basis of age. In California state law prohibits "arbitrary" discrimination. However the courts upheld the right of landlords to discriminate against male children over five years of age.

Welfare Analysis of Landlord-Tenant Relations Laws

Habitability, anti-speedy eviction, rent control, just-cause eviction and anti-child discrimination laws all have in common a possible effect on the utility functions of tenants and the cost functions of landlords and investors in apartment houses. The presence of a landlord-tenant law and its enforcement can be considered one of the many characteristics of the complex commodity we call rental housing. Within a hedonic housing price framework, a dwelling is of higher quality and has greater value, the more desirable characteristics are imbedded in the dwelling and the more pronounced and pervasive they are. Landlords who comply with a landlord-tenant law provide therefore, larger quantities of housing services, i.e., a higher housing quality. Consequently, we would be little surprised if rent for a properly defined housing quantity was merely $100 in a location without a given landlord-tenant law and $104 in a location that had such a law.

The tradeoff between additional costs and benefits, and therefore the welfare effects, of landlord-tenant laws can be analyzed within a demand and supply system presented in Figure I. On the horizontal axis are quantity of housing service units, i.e., housing quality, and on the vertical

axis are price and cost of a housing service unit. Demanders, i.e., tenants, may be more or less affected by the law than suppliers, i.e., landlords, who incur increased marginal costs in the face of a landlord-tenant law. In short, enactment of a landlord-tenant law can lead to an upward shift of both the demand function, supply function, or both. In Figure I only the supply function shifts. The welfare question relates to which function encounters a larger vertical upward shift and, if such shifts occur, whether the difference between the two shifts is statistically significant. We can argue that the particular law benefitted tenants, only if, as a result of a landlord-tenant law, the demand function shifts upward and this shift is significantly larger statistically than the corresponding supply function shift. A more powerful test of welfare effects would involve comparisons of consumer and producer surpluses in the absence and presence of laws, given more restricted assumptions.

The empirical testing of hypotheses about welfare facts of various landlord-tenant laws can proceed in two steps — first, hedonic rent functions are estimated and second, a demand and supply system is estimated using shadow housing prices and quantities derived in step 1.

The estimation of hedonic rent equations as well as the derivation of price and quantity indices have been discussed elsewhere.[5] Briefly, in the hedonic price approach, monthly gross rent is regressed against five quantity variables and four classes of quality variables. The former are number of rooms, age of building, number of bathrooms, presence of air-conditioning and availability of rented parking. The four classes of quality characteristics are quality inside the dwelling, neighborhood quality in terms of physical characteristics of the area, neighborhood quality in terms of public services provided in the area, and the quality of public

space inside the building. Data come from <u>SMSA Annual Housing Survey</u>,
1974 and 1975, U.S. Department of Housing and Urban Development of the U.S.
Bureau of Census.

The functional form of the demand function can be expressed as:

$$P_I = g(Q_I, Y_I, T_I, B_I, L_I) \tag{1}$$

where

P_I = price of housing service unit of region I

Q_I = quantity of housing service units in region I

Y_I = income variable of region I

T_I = taste variable of region I

B_I = price of non-housing commodities variable of region I

L_I = law variables of region I.

The functional form of the supply function can be expressed as:

$$P_I = h(Q_I, K_I, L_I) \tag{2}$$

where

K_I = vector of cost of production variables in region I.

We will present an econometric analysis of two landlord-tenant relations
laws -- habitability laws and laws that deny landlords certainty and promptness
of eviction. The data come from the Annual Housing Survey and pertain to
tenants with annual family incomes in 1974 of $9,000 or less.

The rental housing demand and supply equations for low-income rentals
with habitability laws and eviction laws as right-hand variables for 61
data points in 29 metropolitan areas are presented in Table I. Specifically,
three law variables -- two for eviction and one for habitability laws --
are introduced into the equations in the form of dummy variables:

PEREVICT - identifies states with statutory enforcement of writs of

                restitution with short versus long periods between judgment

                and ultimate eviction: favoring tenant = 1 and favoring landlords = 0

Figure I

Effects of Habitability Laws

Logged Price of Rental Housing Service Units
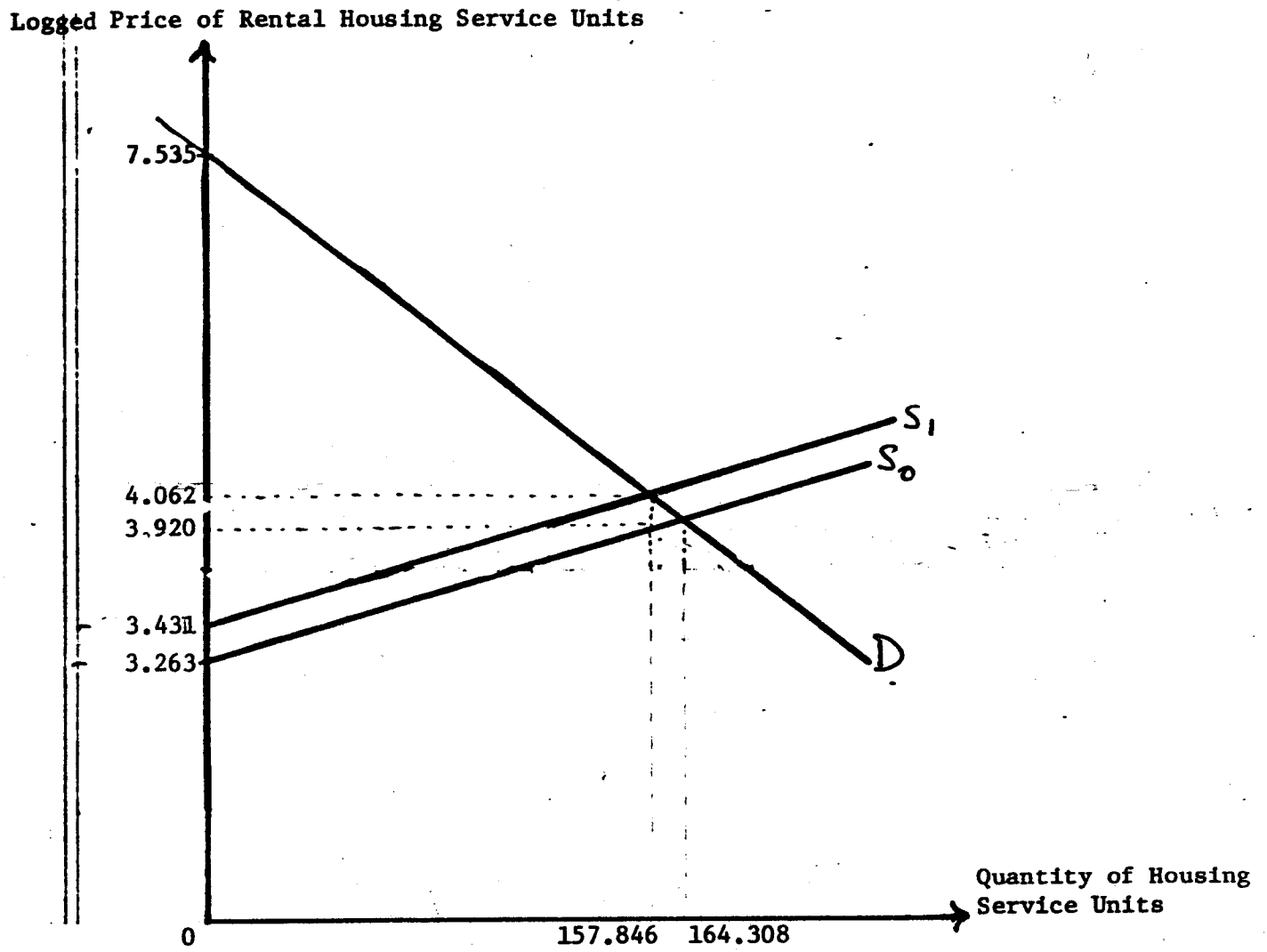
SELFHELP — identifies states with self-help laws: with such laws, i.e., favoring landlords = 0 and without such laws, i.e., favoring tenants = 1

HABITAB — identifies states with habitability laws: with such laws, i.e., favoring tenants = 1 and without such laws, i.e., favoring landlords = 0.

When either of the three law variables assumes a value of 1, i.e., the legal environment favors tenants, it imposes costs on landlords. All three laws in the supply function are therefore expected to be positively correlated with the price of housing services. They are also expected to be positively correlated with price in the demand function.

As an income variable, we use the median income of renters in 1974-75, FAMINCO; as a taste variable, we introduce per household expenditures on furniture, furnishings and appliances in 1974-75, PHFURSAL; and as a variable reflecting the price of non-housing commodities, we price a bundle of major goods, POTHER.[6] A positive correlation between price and these independent variables is expected.

In connection with the supply function, the vector of cost of production variables (K) is represented by

PERPTAX — per capita property tax in $000's in 1974-75.

BOECKH — building cost of brick/concrete apartment buildings in July/ August 1974

LAND — per square foot land value of dwellings in 1974.[7]

We expect production cost as well as law variables to be positively correlated with price.

Turning to the empirical results of the regression analysis in inverse semilogarithmic form (Table I), we find that the demand function performs well. All variables but two have the correct sign. The exceptions are, first, the taste variable, PHFURSAL, which, however, is not statistically significant. Second, the eviction law, PEREVICT, has the wrong sign but is insignificant as well. Three of the variables, i.e., QUAN, POTHER, and FAMINCO, as well as the constant   , are found to be statistically significant at at least the 90% confidence level (one-tailed test). All three law variables are found not to be statistically significant.

The supply function also performs well. All variables, except SELFHELP, have the right signs. However, SELFHELP is not statistically significant. Four variables, i.e., QUAN, PERPTAX, BOECKH, and one of the law variables (HABITAB), are found to be statistically significant at the 95% confidence levels (one-tailed test). The constant also is statistically significant at the 95% confidence level.

From the semilog supply function in Table I, we can see that a change from a law favoring landlords to one favoring tenants would lead to a 18.3% and 0.9% increase in the supply price of the initial equilibrium quantity of housing service units landlords supply,[8] in the case of, respectively, a habitability law and a statutory enforcement of a writ of restitution. On the other hand, a self-help law appears to lead to a 0.7% decrease of supply price. However, only the presence of habitability laws has a statistically significant effect.

With the aid of the demand and supply functions thus estimated, it is now possible to reach conclusions about the extent to which specific landlord-tenant laws, i.e., HABITAB, SELFHELP and PEREVICT laws, appear to

Table I

Demand and Supply Functions

Inverse Semilog

	DEMAND		SUPPLY	
	Coefficient	t-statist.	Coefficient	t-statist.
CONSTANT	7.53	5.66*	3.26	6.69*
QUAN	−0.022	−2.23*	0.004	2.15*
PEREVICT	−0.03	−0.38	0.018	0.45
SELFHELP	0.03	0.46	−0.014	−0.38
HABITAB	0.03	0.23	0.19	3.34*
FAMINCO	0.11	3.05*		
PHFURSAL	−0.04	−0.35		
POTHER	2.49	1.71**		
PERPTAX			0.83	4.30*
BOECKH			0.43	2.06*
LAND			0.04	0.94

*Significant at 0.05 one-tailed test level.

**Significant at 0.10 one-tailed test level.

affect the welfare of demanders and the costs of suppliers of rental housing. Specifically, we will compare the net regression coefficients that relate the price of housing service units to the presence of habitability and anti-speedy eviction laws in the demand and supply functions. We find that the presence of habitability laws raises the constant term of the supply equation an average of 0.168 units of the log of the price index which, as stated before, means an 18.3% increase in the supply price of the original quantity. The demand curve shifts up 0.027 units on average. Alternatively, the demand price of the original quantity increases by 2.7%.[9] Disregarding, for the moment, that the shift of the demand curve is not statistically significant, the supply price of the initial quantity increases by at least 15.6% more than the demand price. The lack of significance for the demand shift should point to an even greater difference.[10] The final equilibrium result is that, on average, the price of housing service units increases by 15.3% while the quantity decreases by 4.1% due to the presence of habitability laws. The presence of either of the two laws reducing eviction certainty and promptness appears to have no effect on either the demand or supply function of indigent tenants.

Thus, this econometric study for 1974-75 indicates that, since in the presence of habitability laws, supply function shifts were significantly larger than demand function shifts, these laws, rather than increasing the welfare of indigent tenants, have resulted in its deterioration. Eviction laws, on the other hand, had no significant effects.

Similarly, in connection with rent control, anti-child discrimination and just-cause eviction laws, it is not difficult to deduce that all three have a chilling effect on investors and landlords who in turn tend to reduce the supply of rental housing in the intermediate- and long-run.

Implications of Local and Federal Laws

We now turn to some of the implications that relate to the level of government that regulates landlord-tenant relations.

1. If certain local or state habitability laws reduce the well-being of indigent tenants, they would seek to vote with their feet and move to jurisdictions without such laws. They would do so, however, only if expected welfare gains exceeded transaction costs associated with moving. Such moves would not occur at all when nationwide laws are imposed by the federal government.

2. A major reason why laws regulating landlord-tenant relations have apparently failed to enhance the welfare of indigent tenants is that they are merely regulatory in nature and do not provide poor tenants with increased purchasing power. Landlords cannot afford to comply with costly regulations unless they were enjoying substantial profits before, unless the regulations increase their operating efficiency, or both. Both these conditions have a low probability. Therefore, for a landlord-tenant law to benefit indigent tenants, it must be accompanied by income transfers to those targeted for improved housing. An example would be a rent subsidy.

A review of local landlord-tenant relations laws reveals that all of them have been merely regulatory. Yet, the federal housing allowance program is a combination of habitability law and rent subsidy to tenants meeting specified income requirements.[11] Specifically, tenants who meet certain income requirements and agree to live in housing defined as habitable, receive rent subsidies. A program that combines assurance of habitable housing and rent subsidy is virtually impossible for local government to initiate. If a local government were to pursue such a policy, it would

soon be overrun by indigent immigrants from areas where such income transfers did not exist. The compassionate and benevolent jurisdiction would either have to ration the supply of habitable low-cost housing, go bankrupt, or both. In many respects the argument against local rent subsidies resembles that made in the field of public finance against local governments levying income taxes, i.e., tax avoidance behavior would result in taxpayers emigrating from high income tax jurisdictions.

3. Local rent control ordinances that also cover middle- and upper-income classes run into similar problems because they tend to drive such tenant groups out of controlled jurisdictions. Since rent control tends to force landlords to reduce repair and maintenance, and yet middle- and upper-income tenants insist on quality housing and are prepared to pay for it, these groups will tend to vote with their feet. They will seek housing in jurisdictions that offer well-maintained housing. As a result, controlled jurisdictions will deprive themselves of this important asset -- a group of people who provide tax receipts in excess of service costs. Moreover, the loss of the more affluent citizens is generally regarded as contributing to the decline of a community's quality of life and image.

Altogether, under federalism the opportunities to help indigent tenants enhance their welfare by means of local laws appear quite limited. If we decide to regulate relations between landlords and tenants, federal laws will often have to be sought to provide a remedy.

FOOTNOTES

[1]See Werner Z. Hirsch, et. al., "Regression Analysis of the Effects of Habitability Laws Upon Rent," California Law Review, 63 (September 1975), pp. 1098-1143.

[2]See Werner Z. Hirsch, Welfare Aspects of Laws that Determine the Celerity and Certainty of Eviction, UCLA Law-Economics Workshop, April 12, 1979.

[3]See Kenneth K. Baar, "Rent Control in the 1970s," Hastings Law Journal, 28 (January 1977), p. 631.

[4]For a detailed discussion of anti-child discrimination laws, see Rita A. Calvan and P. Schnidman, Children and Families — The Latest Victims of Exclusionary Land Use Practices, Washington, D.C. (mimeographed).

[5]See Werner Z. Hirsch, Law and Economics: An Introductory Analysis, (New York: Academic Press, 1979), pp. 59-64.

[6]Median income of renters in 1974-75 data come from the SMSA Annual Housing Survey. Per household furniture, furnishings and appliance expenditures in thousands of dollars in 1974 and 1975 data come from the Survey of Buying Power, sales and marketing management in 1975 and 1976. Price of non-housing commodities data come from Three Standards of Living For An Urban Family of Four Persons, Bureau of Labor Statistics, Bull. 1570-5, 1967.

[7]Per capita property Tax in SMSA in thousands of dollars, 1974 and 1975 data come from Local Government Finances in Metropolitan Areas and Large Counties, U.S. Bureau of the Census in 1974-1975 and 1975-1976. Per square foot land value of dwellings in SMSA in 1974 data comes from Data for States and Selected Areas and Characteristics of FHA Operations Under

Section 203. The construction costs index comes from <u>Boeckh Building Costs</u>

<u>Index Numbers</u>, American Appraisal Company, May-June 1974.

[8]This percentage shift of the supply curve at the initial equilibrium

quantity is determined as follows: Let α = (mean value of HABITAB) x

(coefficient of HABITAB), so that α will be an average shift of the supply

curve due to the presence of a habitability law. In order to give an inter-

pretation to this shift, the following transformation is used:

$$e^{\alpha} - 1 = \frac{(PRICE)_1 - (PRICE)_0}{(PRICE)_0}$$

= percentage change in supply price at the initial quantity.

[9]Note that, for small shifts, the relative and absolute shifts are

approximately equal. See R. Halvorsen and R. Palmquist, "The Interpretation of

Dummy Variables in Semilogarithmic Equations," <u>American Economic Review</u>, 70,

3, (June 1980), 474-5.

[10]An F-test was conducted to test the hypothesis that the coefficients

of HABITAB were equal in the demand and supply equations. This hypothesis

was rejected at the 5% level of confidence. See F.M. Fisher, "Tests of

Equality Between Sets of Coefficients in Two Linear Regressions: An

Expository Note," <u>Econometrica</u>, 38 (March 1970), 361-66.

[11]Housing and Urban Development Act of 1970, Sections 501 and 504.