

Rent Control As An Unconstitutional Taking And Too

Intrusive A Method

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Price controls in the past have usually passed constitutional review, and so, until, now have rent control ordinances. The day appears to be near, however, when certain types of rent control (so common in some states, e.g., California where about 1/3 of all rents are controlled) may run into serious legal difficulties, and for good reason. Rent control ordinances, whether strict as those of Berkeley and Santa Monica or more lenient as in Los Angeles, are designed to protect tenants from rent increases considered excessive. Protection is especially aimed towards low income tenants who might be forced to vacate if rents are raised. Although the form and severity of these ordinances vary widely, all have one common attribute -- they reduce the freedom of landlords to set rent levels.

Rent controls are imposed in periods of inflation, or in periods of great imbalance between the supply and demand of rental housing. The history of rent control goes back to the aftermath of World War I when, between 1920 and 1923, several cities and states adopted rent control or eviction control statues in response to the housing crises created by World War I. During World War II, all cities in the United States were authorized to stabilize rents. New York City has the distinction of having had rent control for longer than any other city in the United States. Rents there

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have been controlled since 1921, except for the period 1929-42; they were virtually frozen between 1943 and 1953. In recent years the emphasis has been on stabilizing rents.

The enactment of rent control in California can be traced back to the high inflation of the second half of the 1970s and the passage of Proposition 13. Proponents of Proposition 13 had promised tenants that part of the property tax savings of landlords would be passed on to tenants in the form of lower rents. When these promises were not kept, strong pressure on local government developed to enact rent control, with the consequence that today about 1/3 of all tenants in California are covered by such ordinances. Outside California, New York, Boston, Washington DC and about 200 other cities have rent control ordinances in addition to a number of counties.

The effectiveness of rent control in keeping down rent increases has at best been limited. Our recent study of Alameda, Los Angeles and Santa Clara counties showed that rents in cities with rent control did not rise more slowly between 1970 and 1980 than they did in cities without controls.¹ This finding is consistent with that of the Los Angeles Rental Housing Study of 1984 which concluded that by and large rent control has done little for tenants.² Specifically during the period 1978 and 1984 when rent control was in force in Los Angeles, rent increases averaged 10.9%, compared to 11.1% in surrounding cities with no rent controls. The difference was a modest \$7 per household per month.

¹Werner Z. Hirsch, Rental Housing Data Base (Sacramento: Department of Real Estate of the State of California, 1987) 36p.

²Rent Stabilization Division, The Los Angeles Rent Stabilization System (Los Angeles: Community Development Department of the City of Los Angeles, 1985)

Why are these controls not more effective? First of all, as with all government regulation, those adversely effected will try an end-run. Landlords appear to be able to devise a number of techniques by which they either get around these regulations or protect themselves against them. Moreover, my study of Berkeley where landlords must annually file their rent schedules with city government showed large landlords raising rents substantially above allowable limits despite the law.

Although the effectiveness of rent controls to rein in rent increases, is moot, their ability to produce undesirable side effects is much clearer. One such is on residential property values. For example, in order to determine the effect of rent control on the value of residential income property, we compared cities in Los Angeles County which have rent control with cities which do not. In an analysis of pairs of sale and resale data of residential income properties (the sales having taken place some months before the imposition of rent control and the resales after it) we found that rent control had resulted in a decline of somewhere between 7 and 12% a year in residential income property values.³

In addition to reducing property values, rent control also adversely affects the quality of housing. A recent national study found that cities with rent control have suffered a significantly greater decline in the quality of residential income property than have cities without controls.⁴ Adjusting for other factors that can lead to poor housing quality, the decline in cities with rent control was about 14% greater between 1974 and

³Werner Z. Hirsch, Rental Housing Data Base, *op cit.*, pp. 3-14.

⁴David L. Mengle, Rent Control and Housig Quality, Ph.D. dissertation (on deposit at the Library of the University of California, Los Angeles, 1983).

1977 than in cities without it.

Another negative effect likely to result from rent control pertains to the supply of rental housing. We see much evidence that rent control has a chilling effect on investors. They tend to shun controlled jurisdictions and prefer to build in uncontrolled ones. This fact apparently holds even when new construction is excluded from controls and rent control does not significantly reduce residential rents; it leaves investors with the impression of unwarranted government interference in their investment decisions.

Despite this growing body of negative economic findings, the courts until recently have not only sanctioned rent controls but made them easier to implement. For example, the U.S. Supreme Court has eliminated the requirement that control statutes be merely temporary emergency measures. Moreover, some state courts abandoned the legal requirement of a housing "emergency" to validate a rent control ordinance. For example, in 1976 the California Supreme Court in Birkenfeld v. City of Berkeley ruled that a crisis, or extreme exigent circumstances, are no longer required to justify rent control.⁵ According to the court, it was enough that "its operative provisions are reasonably related to the accomplishment of a legitimate governmental purpose."

There are, however, straws in the wind suggesting that the court's attitude toward rent control is ready to change. On the state level, the new Chief Justice of the California Supreme Court gave notice in his dissent in Alexandra Fisher v. City of Berkeley.⁶ He argued that there existed

⁵Birkenfeld v. City of Berkeley, 17 Cal. 3d at 165 (1976).

⁶Alexandra Fisher v. City of Berkeley, S.F. 24675 Super Ct. No. 536602-6 (1984)

"less intrusive" and "equally effective" methods of accomplishing the objectives of Berkeley's rent control ordinance, e.g. "to spread the financial burden among all city tax payers." It is likely that Chief Justice Lucas's view, that rent control should not be permitted except when less intrusive and equally effective methods to attain the stated purpose are unavailable, will find support among the four new members appointed to the court since this decision was rendered in December 1984. Consequently a more restrictive view of rent control is likely to emerge.

On the federal level, in Hall v. City of Santa Barbara an even stronger signal was given by the 9th Circuit Court in August 1986.⁷ In a unanimous vote, a three judge panel expressed concern that the Santa Barbara Mobile Home Park Rent Control Ordinance "eviscerates" the property rights of park owners. The court worried that the Santa Barbara ordinance "oversteps the boundaries of mere regulation and shades into permanent occupation of the property for which compensation is due".⁸ Since no compensation is paid, rent control would constitute a taking without compensation and therefore be unconstitutional.

What concerned the court most profoundly was that "the ordinance directs the landlord to give tenants a lease.... lasting indefinitely. Moreover, the landlord's residual rights in the property are largely at the mercy of his tenants: he loses practically all right to decide who occupies the property and on what terms. If a tenant moves, the tenant alone decides who will be his successor by electing the buyer for his rental unit: the landlord has no say as to who will live on the property, now or in the

⁷William C. Hall v. City of Santa Barbara, No. 85-5838 Ninth Circuit (April 22, 1986).

⁸Ibid.

future." Even more disturbing for the court was that, "... the tenant is able to derive an economic benefit from the statutory leasehold by capturing the rent control premium when he sells his mobile home."⁹ Therefore, the appeals court has sent the case back to the district court with instructions to determine whether Santa Barbara's Mobile Home Park Rent Control Ordinance has led to an increase in mobile home prices. If such an increase occurred, the ordinance would give "windfall to current park tenants at the expense of current mobile park owners,"¹⁰ resulting in a taking without compensation, which would make the ordinance unconstitutional.

We have undertaken an econometric study in order to determine the relation between the imposition of rent control on mobile home parks and the prices of mobile homes. Toward this end we analyzed 1981-1986 sales prices for 312 coaches in parks of 54 California jurisdictions, fourteen of which had a rent control ordinance. (The percentage of the 312 coaches sold in jurisdictions with rent control amounts to 39, which compares to a 34 percent estimate of pads under rent control in California in 1985.) Since the supply of mobile homes is quite inelastic at any point in time, our model is basically demand determined in the short run:

$$P = f(U, V, W, C),$$

where:

P = sales price of a coach

U = flow of housing services from coach

V = price per constant quality unit of pad services

W = price per constant quality unit of alternative housing

⁹Ibid.

¹⁰Ibid.

C = cost of transporting and installing coach.

Since all coaches were already located in parks, we were able to drop C. We attempted to control for differences in coach characteristics, park characteristics and the price of housing substitutes. To test for the effects of rent control, we included a 0-1 dummy variable in the regression equations; it took the value of 1 if a coach was located in a jurisdiction which had rent control on parks, and 0 otherwise. We estimated 2 regression equations, one in which all right-hand variables are linear, and a second with three of the six right hand variables in logarithmic form.

The two equations each explain about 60 percent of the relative size of price changes with R^2 values of .58 in the linear specification and .61 in the log-linear specification. We found when holding constant other variables affecting coach prices that the sales prices of coaches in rent controlled jurisdictions were on average about 15-16% higher than those in non-controlled jurisdictions.

Thus, our empirical study answers in a general way the question asked by the 9th Circuit Court: Rent control on mobile house parks is associated with an increase in mobile home prices. The increase is apparently quite substantial.

In view of these recent developments and findings, there is a high probability that the courts are getting ready to make a U-turn in their attitudes towards the constitutionality of certain types of rent control. Economists have been virtually unanimous for the longest time, in finding rent control, on balance, to be socially undesirable. Not only have they concluded that these controls lead to inefficient resource use, but that they hurt many of the tenant groups whom they were designed to help. It now seems that the moment is near when the courts and economists will march

together to oppose rent control. This can have good results, if it leads society to fashion more promising policies for assisting tenants who need and deserve help.

If the courts should make the U-turn and strike down some rent-control statutes on the ground that there are better alternatives to achieve the same goals, tenants need not be left unprotected. One approach which would meet Justice Lucas' admonition for "less intrusive" and "equally effective" methods would take the form of rent subsidies. The federal government, for example, has successfully experimented with rent supplement programs under Sections 501 and 504 of the Housing and Urban Development Act of 1970. These housing allowance programs involve an income transfer from federal tax payers to deserving indigent tenants whose landlords must provide housing that cannot be substandard.

Unlike rent control, this alternative does not single out landlords to subsidize their tenants, a burden they regard unfair and seek to evade. Rather than reducing housing supply and housing quality, as does rent control, subsidy programs would contribute to growth in the number of rental units of acceptable quality, an altogether desirable outcome.

If the courts should hold mobilehome ~~the~~ rent control ordinances of the type found in Santa Barbara an unconstitutional taking, at least one remedy suggests itself. It would not require the abolishing of all rent control, but insist that it provide for generous vacancy decontrol. Such a provision would not give the tenant "an economic interest in the land that he can use, sell or give away at his pleasure".¹¹ Therefore there would not then occur a taking without compensation.

¹¹Ibid.

In conclusion, it appears that the courts are approaching a turning point in their view of rent control. Some have begun to join economists in recognizing the pitfalls of such controls. By holding some of them to constitute an unconstitutional taking and finding others too intrusive a method compared to their achievement levels, they are likely to prod government officials to explore other, more socially desirable courses.