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Research Report

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# The Rent Control Issue in California

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July 1977

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## THE RENT CONTROL ISSUE IN CALIFORNIA

### Introduction

In recent years, and particularly in recent months, the cry for rent control has been heard in California. This study describes the recent history of the rent control issue in the state and analyzes the arguments for and against rent control. The rent control problem centers on the perceived widening gap between the ability of tenants to pay and the increased rentals required to operate and maintain rental units. This problem re-creates a conflict typical of our economic system--income redistribution from the "haves" to the "have-nots" versus the allocation of scarce economic resources through the price system.

By the mid-1950's, New York was the only American city that had continuously maintained rent control following the lifting of rent, price, and wage controls in the years immediately following World War II. In the early 1970's, there were attempts by the Nixon Administration to stabilize prices (including rents), as well as numerous state and local rent control ordinances--the so-called "Second Generation Rent Controls." Alaska, Connecticut, Maine, Maryland, New York State, and New York City now have legislative authority to impose rent controls. At the present time, several communities in Massachusetts; Miami Beach, Florida; Washington, D.C.; and more than 130 communities in New Jersey have taken advantage of similar authority and have instituted such controls. Other communities in Massachusetts and parts of Maryland were controlled temporarily. In California, following the model of successful cases of rent control implementation in other parts of the country, groups in Los Angeles, San Francisco, Santa Barbara, San Diego, and Orange County are currently lobbying for, or have recently promoted,

local rent control, either through city councils or through the initiative process.

Organized on the other side of the rent control issue is the California Housing Council, formed in late 1975 and composed primarily of those with vested interests in the profitable maintenance and construction of rental housing, especially apartments. The Council promotes state preemption of rent control, coordinates opposition to local rent control efforts, and develops affirmative housing programs, especially for the elderly and low-income families.

To date, pro-rent-control forces in California have concentrated on two goals: the adoption of rent control in the city of Berkeley and the defeat of any attempt by the state legislature to assume sole authority for imposing rent controls throughout California. Naturally, anti-rent-control forces, such as the California Housing Council, have opposed these two objectives.

#### The Rent Control Issue in Berkeley and the State Legislature

During the summer of 1969, when Berkeley experienced unrest on the rental housing issue, the Berkeley Tenants Union was formed and announced a program of massive rent strikes. In response, the Berkeley City Council created a nine-member Rental Housing Committee to investigate the increase in rents vis-à-vis taxes and other costs, to hear problems and complaints from both tenants and owners concerning rents and/or leases, and to recommend possible solutions. The committee's final report, issued after the 16-month work session ended March 16, 1971, recommended several remedial measures, not including rent control. As a result, the Berkeley City Council, on February 8, 1972, declined to place the issue of rent control on the ballot.

A minority report submitted by a Rental Housing Committee member recommended rent control, delineating provisions that later became a rent control petition. The petition became an initiative in the June 6, 1972, Berkeley election. With 27,915 voting in favor and 25,301 opposing, Berkeley voters passed Charter Amendment I. This amendment added Article XVII to the city's charter, providing for the establishment of a Rent Control Board, maximum rent, maximum rent adjustments, and so forth.

On August 2, 1972, the state legislature ratified the charter amendment to add Article XVII, and it became effective on that date. On January 23, 1973, five Rent Control Commissioners were elected by Berkeley voters in a special election. However, the Rent Control Board was prevented from operating by an injunction from the Alameda County Superior Court in an action brought by a group of Berkeley landlords.

On May 14, 1973, the court declared Article XVII unconstitutional and void for the following reasons:<sup>1</sup>

- The eviction provisions of Article XVII were preempted by state law;
- No true citywide emergency existed and, hence, no proper basis existed for the imposition of rent controls under the police power; and
- Article XVII denied due process to the landowners involved.

On June 16, 1976, the California State Supreme Court affirmed the 1973 decision of the Alameda County court. Nevertheless, Chief Justice Wright, expressing the unanimous view of the court in his opinion, disagreed with some aspects of the Alameda County court decision:<sup>2</sup>

- The existence of an emergency is not necessary for rent control;

- The facts established in the Alameda County court did not preclude the city of Berkeley from legislating on the subject of residential rent control;
- State law does not preempt the field of placing maximum limits on residential rents; and
- An enactment for the purpose of rent control could properly take the form of an initiative amendment to the city charter.

However, the charter amendment was found to be unconstitutional because:

- The Rent Control Board could adjust maximum rents following an adjustment procedure that would make unreasonable delays inevitable; and
- The eviction provisions of Article XVII were preempted by state law, as the county court also had decided.

On June 16, 1976, the same date as the California State Supreme Court decision, the state assembly passed a bill to prohibit rent controls by local governments, such as the city of Berkeley. The state senate passed a similar bill on August 30, but Governor Brown vetoed the bill on September 30, 1976, thereby motivating Berkeley pro-rent-control forces to attempt a charter amendment by voter initiative in compliance with the decision of the California Supreme Court.

On February 2, 1977, the Berkeley Housing Coalition filed a rent control initiative petition, which appeared to avoid the unconstitutional aspects of the earlier (1972) amendment. Presented as Measure B on the April 19, 1977, ballot, the rent control proposition failed, 21,970 to 13,111. The election results represented a victory for the California Housing Council, for Citizens Against Rent Control, and for the Coalition for Fair Housing, a group of Berkeley property

owners and realty agencies that opposed the rent control initiative. The election represented a defeat, of course, for the Berkeley Housing Coalition, which promoted rent control.

Currently, the California Housing Council is sponsoring Assembly Bill 933, which would give the state legislature sole authority for imposition of rent controls throughout California. This bill would achieve the same objective as the bill vetoed by Governor Brown in 1976. In the meantime, local rent control groups continue to work for the implementation of rent control in their communities.

#### The Case for Rent Control

Proponents of rent control contend that renters benefit from such measures in the short run, because the stock of existing rental housing can neither be physically removed to a non-rent-controlled area nor, in most cases, put to alternative use. Supporters contend that, to low-income families, rent control provides an opportunity to rent moderately priced housing, while, to moderate- and high-income families, it provides extra income for downpayments on owner-occupied homes, vacations, and so forth.

One argument often used to discourage rent control is that "what happened in New York City will happen in our community." However, rent control supporters point out that other large American cities, where there has been no rent control, have housing problems equal to, or greater than, those of New York. The interaction of several factors--including rent control--over a 30-year period produced the deterioration, abandonment, and destruction of the rental housing stock in New York City, particularly in the South Bronx. The implication is that rent

control alone does not lead to housing problems. In addition, rent control proponents reason that most rent control plans recently proposed are flexible, unlike New York City's rent control program.

Other arguments for rent control are also presented to voters prior to rent control referenda. For example:

- The benefits far exceed the cost of rent control; and
- The poor, minorities, students, the disabled, and the aged cannot afford housing without rent control.

Some rent control supporters believe that local communities should protect residents from rent increases. Others contend that rent control forces landlords to provide decent maintenance; only then should landlords be allowed to continue getting high rents. Some proponents argue that rent control ends arbitrary control of rents and housing by absentee landlords, real estate speculators, and banks, because elected representatives, responsible to all residents, adjust rents upward or downward to reflect actual housing market conditions. This argument implies that the price system in which supply and demand normally interact to determine rents is prevented from operating by the economic power of landlords.

Advocates also claim that rent control discourages high-profit, rent-quick, inadequate apartment construction, thus helping to preserve older homes and a community's unique environmental character. They believe controls help ensure that new housing construction serves those most in need--low-income families, minorities, students, the disabled, and the aged. Thus, proponents feel that

rent control does not hurt homeowners and small landlords, but instead eliminates the exploitation of tenants by unscrupulous large landlords and guarantees decent rental housing at fair prices.

Advocates also contend that since most rent control amendments allow for regulated increases rather than absolute freezes on rent levels, few disincentives to landlords or developers should arise. Stiff rent hikes may leave tenants helpless, since relocating can be expensive and obtaining information on other units takes time and effort. With rent control, proponents believe, tenants avoid such costs.

#### The Case Against Rent Control--The Misallocation Argument

The case against rent controls is primarily one of misallocation of scarce economic resources--in this case, rental housing. Opponents of rent control believe that when the price system is prevented from functioning freely, distortions and disincentives arise in the rental housing market.

According to this argument, a freely fluctuating price system provides the economic incentive for an expansion of the supply of rental housing when shortages exist. When rental housing is in short supply, rental rates increase, thus making rentals more profitable for landlords. The increased profitability encourages landlords to expand the supply of rentals. Eventually, excess profits decline until there is no incentive to increase supply, and a state of market equilibrium is reached. While such equilibrium between supply and demand seldom occurs in a dynamic economic environment, it is a useful concept for analyzing market adjustments in the context of a price system. However, without the signals provided by the price system, supply may not increase, and society experiences a misallocation of resources--

having less rental housing, for example, and more of some other goods or services than desired. It is possible for a rent control system to result in somewhat lower rents for renters and somewhat lower profits for landlords, so that maintenance of existing stock continues and new construction is not completely discouraged. According to opponents, however, such a system may require a costly bureaucracy to perform a function that the price system performs without charge.

If, as is likely in most cases of rent control, rents are fixed at levels below the market clearing rate where supply equals demand, excess demand develops at the controlled rent level for the temporarily fixed, available supply of rental housing. Prospective renters will be willing to pay more than controlled rent levels in order to obtain rental housing. Therefore, according to opponents, even though rent control laws may prohibit certain nonprice (that is, nonrent) methods of rationing the available supply of rental housing, nonprice rationing or allocation inevitably will result.

Examples of nonprice rationing methods include bribes or payoffs to landlords, queuing (first come, first served), or direct public allocation of housing with possible payoffs to, and lobbying of, elected and bureaucratic officials. Alternatively, landlords might require long-term leases, rent only to small family units, and insist on first and last months' rent. Those against rent control claim that it presents greater opportunities for discrimination based on appearance, race, religion, and other nonprice characteristics because, in a rent-controlled environment, an owner who discriminates on nonprice grounds does not risk losing rental revenue.

It is also claimed that rent control tends to increase market search costs, because potential renters must determine the types of allocating schemes employed. The mobility of tenants renting controlled units would be limited, since duplicate housing at a new location would probably cost more. The demand for housing in a community with rent control may increase, as tenants in nearby communities seek lower-priced rentals in that community. As a result, the housing shortage may intensify and students, the aged, and lower-income individuals--or families generally--may have an even more difficult time finding suitable housing.

Opponents of rent control contend that, to the extent that tenants enjoy a subsidy under rent control, the costs of subsidization must be borne by others, including real estate investors, governmental agencies, and taxpayers in general. Landlords of existing rental housing affected by rent controls may experience declining profits, as costs rise faster than rent control ceilings. Lacking the economic incentive to service, maintain, or upgrade rental housing units, landlords might permit deterioration of housing units and also reduce services to tenants.

Reduced profits result in the destruction of capital values: buildings yield lower returns when sold, and the final loss on the buildings is suffered by the last owner when the property loses its value and is abandoned. Tax revenues may also be lost, as described in the next section of this study. Mortgage lenders are reluctant to make new loans on rent-controlled properties, since there is an increased risk of default on such loans. Investors are also aware of the risks involved and may be less willing to approach lenders for loans on such properties. As a result, areas without rent controls may become more attractive to prospective

investors in new rental housing, and economic growth would occur there.

If the rental units are of a sufficiently high standard, the landlords may be able to sell them as cooperatives or condominiums to prospective owner-occupants, thereby circumventing the rent controls altogether and further reducing the stock of rental housing available to low-income groups. Finally, because owner-occupied housing is a close substitute for rental housing, rental shortages may result in increased demand in the owner-occupied housing sector. Non-rent-controlled housing, therefore, would probably increase initially in price and then later in supply, given the time lags involved in construction.

#### Other Arguments Against Rent Control

The case against rent control includes other but related arguments, in addition to the misallocation issue. It is claimed that with rent control, new apartment construction is curtailed and that the value of existing apartment houses may decline, because the profit to be made from new and existing apartment houses may decrease. Since most county assessors are bound by law to appraise property at its fair market value, and since the need for revenue in local communities is likely to increase, tax rates in local communities are likely to rise and/or non-controlled properties are likely to be reappraised upward. The ultimate result of reduced assessments on apartment buildings combined with potential apartment-owner tax delinquencies, abandonment, and destruction of properties may be a heavier tax burden for all property owners.

In addition to reduced tax revenues from rental housing, opponents also cite the direct costs of a rent control program. The direct cost of administering rent

control involves fees for landlords (including families relying on room rentals) and increased property taxes for all property owners (including single-family homeowners). The indirect costs to landlords involve the need to be aware of, and delays in, bureaucratic procedures to obtain, for example, rent increases or eviction. In addition, opponents claim that rent control permits the entrenchment and perpetuation of a new bureaucracy.

Opponents of rent control also state that the burden of attempting to cure the social ills arising out of low-income and inadequate housing should not fall on the shoulders of landlords and homeowners alone. It is argued that income redistribution is not always best accomplished by rent control, that landlords do not necessarily have significantly higher incomes than tenants, and that landlords do not necessarily "exploit" their tenants. Some argue that any housing shortage resulting from rent controls could lead to violations of the state's fair housing objectives, as stated in the Rumford Act.

#### Summary

Emerging in Berkeley in 1969 when student unrest was at its peak, the rent control issue is still being hotly debated in many California communities. The arguments for and against rent control are economic, social, political, legal, and environmental in nature--combined with varying degrees of dispassionate economic analysis, partisan politics, and raw emotion. Voters in California communities must decide whether the price system alone is to be allowed to determine rents, or whether nonprice rationing and income redistribution by means of rent control will be instituted.

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#### Footnotes

<sup>1</sup>See Birkenfeld v. City of Berkeley (1973).

<sup>2</sup>See Birkenfeld v. City of Berkeley (1976).

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