

## **Fair Alternatives to Rent Control: A Different Way of Looking at Rental Housing Economics**

by Ilse Cordoni

Let's begin with a brief history of San Francisco's Rent Control Ordinance passed in June of 1979. 1978 and 1979 were years of high inflation; tax laws favored investors in residential income property and speculation was rampant. Buildings changed hands repeatedly at ever higher prices as investors "traded up."

Tenants were at the mercy of inflation and speculation in a real estate market in which speculators would buy, increase rents and then a short time later sell at a higher price. It was this admittedly out-of-control economy that fostered the original "temporary" Rent Stabilization Ordinance. Due to inflationary pressures, rent increases were not just limited to buildings being bought and sold; the actual ordinance appeared to have been precipitated when one of San Francisco's largest landlords gave simultaneous large across-the-board rental increases to all of his many tenants.

It's important to note that the original 1979 ordinance was not passed in order to subsidize the needy; it was passed in an economy in which a tenant might find his rent increased by large amounts repeatedly and often by a succession of owners as the buildings traded from investor to investor.

Consider this: the first iteration of the ordinance mandated that annual increases be no more than seven percent! Although the extreme "progressive" faction now embodied by the likes of the Tenants Union and Tenderloin Housing Clinic declared at the time that it was their intention to transfer equity to tenants, initially San Francisco rental housing providers seemed to find the ordinance reasonable (especially those of us who lived with our tenants in four or fewer units, and until 1994 were exempt), even when the maximum increase when lowered to four percent. As inflation waned, the allowable increases still covered expenses and profits (and until 1986, tax laws also benefited owners who were taking a big loss on their properties).

However, throughout the 1980s, rent control became increasingly politicized and the "tenant bloc" (65% of S.F. voters are tenants) became a faction without whose stamp of approval, no Supervisor could get elected. Economically, the gap between rent controlled rents and "new" rents continued to widen as owners realized that their only chance to survive was to charge the highest possible rent when renting a vacant apartment. As it did, so did the perception – widely promoted by "progressives" – that rent control was needed for *all* tenants. (We all knew by then that there was nothing "temporary" about the ordinance.) Rather than being a protection for tenants against unreasonable increases, the ordinance had become an entitlement and, ultimately, as we have all experienced, the very transfer of equity sought by the radical tenant activists.

### **A Political Solution to a Political Problem**

Rent control protects long-term tenants without respect to need, drives up rents for new tenants without consideration of their economic circumstances and over time makes the

city affordable only to the most well-heeled. It is equally random with rental property owners; some of us have long-term tenants whose income exceeds our own; others have buildings filled with market-rate tenants; still others have long-term tenants who are truly in need of rent subsidies.

The current San Francisco rent control ordinance serves neither tenants nor owners well. It serves a few long-term tenants while driving up rents for owners who are lucky enough to have voluntarily vacated units.

I don't believe the general voting public has any idea of how rent control works against rental housing providers – particularly those of us with small buildings. Rather than considering the economic reality of diminishing incentives, well-intentioned voters have drunk the Kool-Aid of “progressive” candidates and voted repeatedly in a manner they've been assured was beneficial to tenants. As we all know, this has caused a vicious cycle in which property owners divest their properties in favor of more reasonable investments and rental units are removed from the market in favor of other types of ownership such as TICs and condo conversions.

Rent control is clearly a political solution to a political problem – how to get elected; not an economic solution to an economic problem – how to provide a market in which there is a fair exchange of money between a housing provider and a housing recipient.

Assume for a moment that politics were taken out of the picture (a huge assumption!) What is the problem and what is a reasonable solution? The problem is that new rents are artificially high, old ones are artificially low and there is no relationship between who is asked to pay the high rents and who gets the benefit of the low rents except time in residency – not need or ability to pay, value of the space rented or services provided by the housing provider.

Most economists and rental property owners agree that if rent control, as it currently exists, were discontinued, most rental asking prices would stabilize downward. At the same time, all rents would go up to market rates. Overall, the increase of rents that have been artificially would be counterbalanced by the decrease of those driven artificially high by rent control.

If there is a real problem with regard to affordability of rental housing in San Francisco and if politics is not the motivation, what's the solution? If a majority of voters believe there should be protections in place to help tenants unable to afford market-rate rents, and that it's a problem that needs to be addressed, then is it not a social issue that should be addressed by the public at large rather than by an individual property owner who has inherited a low-rent tenant?

The will of the voters has been to favor tenants at the expense of housing providers, the result of the politicization of the voting populace and the perception fostered by vote-hungry political candidates that property owners are rich and empowered while tenants are poor and disenfranchised. In fact, as well all know, San Francisco tenants are

currently more empowered than owners. The perception of most voters is NOT the reality of the economics.

If there is a public will to assist tenants unable to pay market rents, why should this burden be assumed by individual property owners in a random fashion? Shouldn't it be considered a public service, the cost of all which is to borne by all San Franciscans and the benefit of which is to be received by those who qualify on a rational and humane basis?

### **The Economic Answer**

The economic answer is a rent subsidy program into which everyone pays and from which those renters who qualify based on a defined objective standard of need receive rental subsidies paid to their housing provider to equalize their rents to market rates. Such a subsidy could be funded in a number of ways. I don't know how exactly one would calculate the costs to be shared by all citizens of our good city or the most appropriate or efficient way to fund it – possibly a sales tax increase or a “residency” tax. Shared by all residents, such a tax would likely not be huge for any one individual. After all, we rental housing providers alone are already funding it, building by building!

This solution would allow tenants at any economic level to move freely as need or desire dictates (rather than to be entrapped in a lifetime low-rent situation), disincen Ellis Act evictions, and reduce or remove the need for large “buy-outs” of tenants, all the while preserving rental housing as a viable business option. Reasonable tenant protective provisions of the current ordinance, such as payment of moving costs, could be retained to ensure that tenants are treated fairly when being displaced for owner occupancy or for another reasonable purpose (such as major rehabilitation of a building or unit). The “tax” and accompanying increase of rents to market would be phased in over a number of years to provide time to create an equitable system to administer the concept.

If market rates were charged by all property owners while the truly economically disadvantaged received rental benefits, San Francisco's rental housing business could become profitable again – as all small businesses must be in order to survive. Our tenants – both those in need and those with means – would be well served; our rental housing stock would be preserved both economically and physically.

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