ECONOMICS AND RENT REGULATION: A CALL FOR A NEW PERSPECTIVE

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INTRODUCTION

During periods of rapidly escalating rents, housing activists often urge the adoption or extension of measures to regulate rents and to strengthen security of tenure. Their proposals, generally lumped under the heading of rent control, are soon met by an outpouring of economic analyses purporting to demonstrate that rent controls are at best misguided and, more likely, a program for unmitigated disaster. Among the most important claims is that rent regulation inevitably leads to undermaintenance, reduction of rental housing construction, housing abandonment, and misallocation of housing resources.[1] These arguments are so universally shared by members of the economics profession that they are often used by textbook writers to educate introductory students to the "evils" of government interference with competitively determined market prices.[2]

Economic literature is rich with arguments and counterarguments regarding other areas of government interference in market pricing such as minimum wages, agricultural price supports, fixed exchange rates, and tariffs. Yet there is virtual unanimity among economists that rent controls are "bad" and have no place in housing policy.[3]

This paper explores the logic of the conventional economic analysis of rent regulation and discusses some of its deficiencies. It argues that the basic

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1. See President's Comm'n on Housing, The Report of the President's Commission on Housing 91–92 (1982) [hereinafter President's Comm'n on Housing]; M. Lett, Rent Control: Concepts, Realities, and Mechanisms 42–48 (1976); Rent Control, Myths and Realities: International Evidence of the Effects of Rent Control in Six Countries (W. Block & E. Olsen eds. 1981) [hereinafter W. Block & E. Olsen]; Resolving the Housing Crisis: Government Policy, Decontrol, and the Public Interest (M. Johnson ed. 1982) [hereinafter M. Johnson]; C. Baird, Rent Control: The Perennial Folly (Cato Public Policy Research Monograph No. 2, 1980).

2. See, e.g., W. Baumol & A. Blinder, Economics: Principles and Policy 64–69 (2d ed. 1982); C. McConnell, Economics: Principles, Problems, and Policies 715–16 (8th ed. 1981); P. Samuelson, Economics 396–97 (11th ed. 1980). But see W. Baumol & A. Blinder, supra, at 606 n.5 for virtually the only reference in an introductory economics textbook to the possibility of "salutory effects" of rent control in the short run.

3. See Frey, Pommerehne, Schneider & Gilbert, Consensus and Dissension Among Economists, 74 Am. Econ. Rev. 986, 987–991 (1984).

supply and demand model is inadequate for an understanding of the residential rental housing market and that there is little empirical data to support many of the economic criticisms made about the new generation of rent regulations. It also argues that policy makers need to consider contemporary rent regulation as more complex, sophisticated, and purposeful than a simple price ceiling in a competitive market.

I
THE BASIC ECONOMIC MODEL

The basic analytical tool used by economists in their criticisms of rent control is the simple supply and demand model of a competitive market.[4] In this model the supply of housing services is considered fixed within a short period of time or, at best, is not very responsive to price changes in the "short run."[5] Supply is drawn as a vertical (or nearly vertical) line. (See Figure 1.) Demand, on the other hand, is drawn sloping downward to reflect the inverse relationship between price and the amounts people are willing and able to purchase. While the degree to which people will adjust their demands to price changes in the "short run" is subject to dispute, there is little doubt that price changes will trigger some response.[6]

In a competitive market, the rent will tend to be that price at which the amount of housing services[7] landlords are willing and able to supply equals the amount tenants are willing and able to purchase. (Rm for "market rent" in Figure 1.) If there were no shortages for any significant period of time, people would offer higher than existing rents to induce landlords to rent to them. If there was a surplus of housing, landlords whose units were not being rented would agree to accept lower rents rather than take the loss that comes from a vacant unit.[8] Fluctuations in demand or supply (if any) therefore would be

4. Most serious housing analysts modify their analysis to take into account the fact that the housing market is segmented into various submarkets and that the wide variety of types of housing are not totally substitutable. However, the simplified supply and demand model presented here is the one usually appearing in the basic economics textbooks and is implicitly used by most of the economic critics of rent regulation. The existence of market segmentation is important here primarily because differences in local attitudes and regulations concerning rent and eviction controls may affect the relative attractiveness of investment in rental housing.

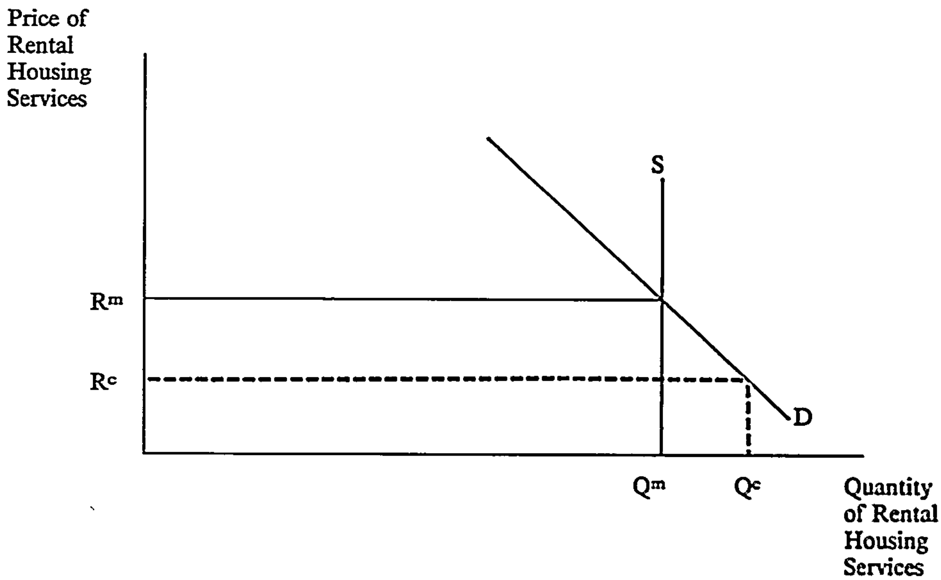
5. The "short run" is conceptually a period of time of undefined length in which the total level of investment in housing cannot be significantly changed. Most students of rental housing markets believe that the short run for rental housing may be quite long, especially as compared to other goods and services. See M. Stegman & H. Sumka, Nonmetropolitan Urban Housing: An Economic Analysis of Problems and Policies 89 (1976); Moorhouse, Optimal Housing Maintenance Under Rent Control, 39 S. Econ. J. 93 (1972).

6. In technical terms, short run supply has a price elasticity approaching zero, while price elasticity of demand is negative.

7. Housing economists often use the term "housing services" rather than "number of units" to reflect that a given dwelling unit can vary in the amount to which it yields services valued by tenants (e.g., quality, space, and amenities). "Housing services," or what I will simply refer to as "housing," is the abstract unit of analysis used in this paper. See Olsen, An Econometric Analysis of Rent Control, 80 J. Pol. Econ. 1081, 1082 (1972).

8. Provided that rents exceed operating costs, a vacant unit can only reduce net income.

Figure 1



met by changes in rents that would tend to restore the balance between the amount desired and the amount offered.[9]

Two important consequences follow from the model. First, in a competitive market no landlord can succeed in raising rents above the market level. This is another way of saying that there is no exercise of monopoly power to "exploit" tenants.[10]

Second, if the housing rentals yield profits greater than other markets, investment capital will flow into residential construction, supply of rental housing will gradually be expanded through new construction, rehabilitation, or conversion, and any excessively profitable rents will ultimately be eliminated.[11] On the other hand, if rentals yield low returns, investors will gradually withdraw their capital from rental housing. The market would experience less construction, more conversion to other uses and, perhaps, accelerated deterioration or abandonment of properties.

No other benefit can accrue to a landlord by keeping a unit off the market because no individual landlord can influence the market rent.

9. The market's function is to set a price or rent that will tend to equate supply with demand. Nothing in this market-clearing process guarantees a socially acceptable minimum housing standard or rental levels that meet any particular definition of "affordability."

10. See Block, Postscript: A Reply to Critics, in W. Block & E. Olsen, supra note 1, at 292–93; Hazlett, Rent Controls and the Housing Crisis, in M. Johnson, supra note 1, at 280.

11. It is a fundamental tenet of market-oriented capitalism that investment capital will tend to flow into industries where the rate of return (adjusted for risk) is greater than average and will tend to leave industries where the rate of return (adjusted for risk) is less than average. The existence of above normal ("excess" or "pure") profits is the key to expansion or contraction of industries.

Major negative effects of rent control are inferred from this portion of the analysis. Controls lower rents below unregulated market levels and allegedly force property owners to accept a less than competitive return on their investment.[12] This is illustrated in Figure 1, where the permissible controlled rent is denoted by Rc. At this rent level the quantity of housing services demanded (Qc) exceeds the amount landlords are willing and able to supply (Qm). Tenants are legally barred from offering rents higher than Rc and, as a result, there will be a housing shortage. If rents were allowed to rise, they would compel some people to demand less housing either by moving to smaller apartments, doubling up, or moving to other localities or into a public shelter; thus, the conclusion that controls are "inefficient" and lead to a misallocation of resources.[13] The heart of the economic analysis, however, is that rent controls reduce the profitability of rental housing, thereby stifling new construction, generating undermaintenance of existing properties, reducing the local property tax base, encouraging conversion to other uses such as for cooperatives and condominiums, and leading to housing abandonment. Since each of these is an undesirable consequence, and because the housing "shortage" is thus perpetuated, rent controls can do very little good in the short run and lead to a disaster in the long run.

II
EMPIRICAL EVIDENCE

Sound public policy analysis requires that the claimed propensity of rent regulation to cause undermaintenance, reduced construction, lower property tax base, and abandonment should be amply demonstrable. Some of the less technical literature on the subject points to the post–World War II experience in New York City where it is argued that rent control brought about the housing disasters in the South Bronx, Harlem, East New York, and elsewhere. Rent control is also blamed for the general slowdown of private investment in New York City's rental housing stock.[14] A number of more intensive studies

12. Olsen & Walker, Alternatives, in W. Block & E. Olsen, supra note 1, at 272–73.

13. There is little doubt that a situation where the quantity of housing demanded exceeds the supply at regulated rent levels tends to generate black or "grey" markets and along with it illegal overcharges, side payments, favoritism, and discrimination. It potentially denies landlords profits that they might otherwise realize. The existence of these conditions is at the heart of the economists' claim of inefficiency. See notes 1–2 supra. There is every reason to believe that such conditions do, in fact, occur but their evaluation is subject to dispute. See Achtenberg, The Social Utility of Rent Control, in Housing Urban America 439–41 (J. Pynoos, R. Schafer & C. Hartman eds. 1973). To the extent that the above situation is expected and could be considered an intended result of a program with other overriding objectives, it may not be correct to call rent control "inefficient." See Musgrave, Policies of Housing Support: Rationale and Instruments, in 1 Housing in the Seventies 222 (U.S. Dept. of HUD ed. 1976).

14. See, e.g., P. Samuelson, supra note 2, at 370; W. Baumol & A. Blinder, supra note 2, at 64–66. A vivid example is contained in W. Block & E. Olsen, supra note 1, at 320–21, where the reader is presented 15 photographs of destroyed buildings and neighborhoods and challenged to determine whether the damage was done by World War II bombing or rent controls. Seven of the photos were from the South Bronx.

suggest that post-World War II rent controls may have had adverse effects on maintenance of the City's housing stock.[15]

The problem with this approach is that regardless of the validity of the above studies, they fail to explain why identical trends were also found in non-rent controlled inner city neighborhoods all over the country. This raises two issues: to what extent rent controls were an independent factor impacting on the housing stock, and whether there were specific features of the law which unnecessarily brought about undesirable consequences.

The latter issue may be moot because contemporary rent regulation in New York City and elsewhere is significantly different than the post-World War II rent control legislation.[16] The evidence that this new type of regulation contributes substantially to undermaintenance, abandonment, loss of tax base, and decreases in construction of new rental housing is, at best, inconclusive.[17]

It is not the purpose of this paper to engage in a systematic critique of our understanding of the effects of rent controls, although in the conclusion I will have some suggestions about improving it. What is apparent, however, is that the competitive market model is not adequate to explain the workings of the real estate industry, nor does it give a realistic picture of the purposes and operation of the new type of rent regulation enacted in the late 1960s and 1970s and still generally on the books today. In the following sections I will present a view of the rental housing market which will demonstrate why the conventional analysis of the effects of rent controls is not necessarily correct. I will then briefly examine some of the major features of so-called "second generation" or "moderate" rent controls to demonstrate that they are more than simple price ceilings. They operate in substantially different ways and serve other major policy objectives. Finally, I will discuss some of the implications of these findings.

15. C. Rapkin, The Private Rental Housing Market in New York City (1966); G. Sternlieb, The Urban Housing Dilemma (1972); Rental Housing in New York City: Confronting the Crisis (I. Lowry ed. 1970).

16. See text accompanying notes 28-35 infra.

17. J. Gilderbloom, Moderate Rent Control: The Experience of U.S. Cities (1980); J. Gilderbloom, Redistributive Impacts of Rent Control in New Jersey, Colloquium on Rent Controls and the Property Tax, Lincoln Institute of Land Policy (Nov. 1983); W. Keating, Rent Control in California: Responding to the Housing Crisis (California Policy Seminar Monograph No. 16, 1983); Community Dev. Dep't of the City of Los Angeles, 1984 Rental Housing Study—Executive Summary (Apr. 1985); P. Marcuse, Housing Abandonment: Does Rent Control Make a Difference? (1981); M. Stegman, The Dynamics of Rental Housing in New York City 171 (1982); P. Weitzman, Rent Controls and the Community Tax Base: A Critique of the Empirical Literature, Colloquium on Rent Controls and the Property Tax, Lincoln Institute of Land Policy (Nov. 1983); Gilderbloom, Moderate Rent Control: Its Impact on the Quality and Quantity of the Housing Stock, 17 Urb. Aff. Q. 123 (1981) [hereinafter Gilderbloom, 17 Urb. Aff. Q.] (see comment by G. Sternlieb, id. at 143 and Reply by Gilderbloom, id. at 147).

III
RISING RENTS AND LANDLORD PROFITS WILL NOT NECESSARILY BRING FORTH EXPANDED SUPPLIES OF RENTAL HOUSING

The vision that rising rents and rising profits induce expansion of the housing supply stems directly from the notion that rental housing exists in a more or less competitive housing market. In such a market, demand-induced increases in prices in the short term lead to higher profits, making investment in new rental properties increasingly attractive. At some point, expected profits from newly constructed housing are greater than those expected from alternative investments. New housing is constructed, or old housing rehabilitated, in pursuit of these greater than normal profit levels. Expanded supplies eliminate or modify rent increases and ultimately reduce overall profits in the industry to "normal" levels. Competition in the market ultimately yields new supplies to meet increased demands.

There will be more to say about competition and monopoly later on, but the central point here is that competition in the housing market will not necessarily yield the predicted results. The problem is that the model of supply and demand most instructive in understanding simple agricultural commodity and labor markets is not simply applicable to the housing market. In many markets, the cost of producing an additional unit of output is directly related, although not necessarily equal, to the cost of providing the last unit. Although expanding the supply of an item may lead to higher input prices and costs, a relatively smooth and direct relationship exists between costs of current output and costs of additional output.[18]

Housing is unusual, however, because structures are highly durable and yield their services over a long period of time. Though the length of time that a rental housing unit will be in service is subject to many profit and loss considerations,[19] the costs of providing current housing services are often significantly different than the costs of producing additional housing structures. Current costs include the costs of operation and maintenance and, from the owner's perspective, interest charges and profits on invested capital at least equal to what could be earned in alternative investments. The costs of new housing are affected not only by the foregoing, but by costs which arise from new building codes and construction standards, availability of land, zoning regulations, tax incentives or disincentives for new construction, and real property tax assessment practices as well as the risks that go along with any new investment. The willingness and ability of private investors to expand the housing supply are thus dependent in large part on tax policy, federal mone-

18. Recent literature on the economics of commodity markets where large inventories play a major role also recognize that the link between current market price and long-run equilibrium price may be tenuous. Ackley, Commodities and Capital: Prices and Quantities, 73 Am. Econ. Rev. 1, 5-6 (1983).

19. Moorhouse, supra note 5, at 93.

tary and fiscal policy, costs of vacant land, zoning and development controls, and building codes.[20] And more importantly, changes or fluctuations in these factors will have substantial impact on the costs of new construction or rehabilitation even though they may have little or no effect on the costs of providing existing housing.

An increase in rent above the costs of providing current housing services will lead to one of two possible scenarios. The first occurs in a competitive market where the costs of supplying new housing are near existing rent levels. An increase in rents will then generate "excess" profits and spur new housing production.[21] The second scenario occurs when the market is not competitive or the rents required to support new housing ("replacement rents") are significantly above market rents. In this situation an increase in rents will not necessarily induce housing production. The increase in rents generates "excess" profits, but new construction is inhibited by the prohibitive costs of new construction or by monopolistic elements. New investment will only flow into the industry in the form of higher asset values of the existing housing stock.[22] The result of the second scenario will be windfall profits for the owners of the buildings and higher costs of providing existing housing, but no new housing supplies. The capital values of existing housing will continue to rise so long as the market rents yield "excess" profits. New building owners or old owners who have refinanced their buildings based on their higher values will then report that they can earn only normal profits. Only in the first scenario, where market rents exceed or are expected to exceed "replacement rents," and the market is sufficiently competitive, will the housing stock expand.

Although data are skimpy, there is empirical evidence that the gap between existing rent levels and replacement rents is not only considerable but has been increasing.[23] Rising rents are not generating significant new construction and are not likely to do so for the foreseeable future. We observe that what little new construction there is only takes place at the upper end of the luxury scale which can support the highest market rents and/or consists of those projects which receive considerable subsidies to lower the effective cost of producing the new housing.[24] Under current conditions, new, privately fi-

20. M. Lett, supra note 1, at 34; President's Comm'n on Housing, supra note 1, at 90–91.

21. See text accompanying note 18 supra.

22. The higher current costs result from increased interest costs on the additional capital investment, increased property insurance costs, and eventually the possibility of higher real property tax assessments.

23. "Replacement rents" are those rents that would be needed to support new construction. In 1974 the estimated gap between market and replacement rents was $64 per month or 40% of current rents. By 1981 the gap had widened to $232 per month or 91% of current rents. A. Arnold, Real Estate Investor's Deskbook S11–40 (1983 Supp.). See also Wall St. J., June 23, 1982, at 29, col.1. It should be emphasized that these figures reflect national averages and may not be indicative of the situation in any given geographic area.

24. If new construction of luxury housing took place rapidly enough it could potentially lead to a chain reaction known as "filtering" whereby better quality units are vacated by higher income people and become available to those on the next lower rung of the income ladder. It is by no means clear that the amount of new construction is sufficiently rapid to generate this

nanced, unsubsidized rental housing construction will most likely not occur in most areas of the country unless rents rise above their present level and even greater capital gains are earned in the interim by current owners.[25]

In housing markets such as we have now, the sole function of rising rents is to reallocate housing to those who are willing and able to pay the higher rents. If demand increases or rents go up for any other reason, existing tenants must either pay more, use less housing, move to other areas, or even use no housing at all—a situation considered perfectly appropriate by advocates of unfettered markets. Higher rents do not necessarily stimulate construction and may generate significant capital gains. At this point, society may decide to use rationing devices other than rising rents in order to protect existing tenants and to prevent an "unearned" income transfer from tenants to landlords. Society may also decide to encourage production of more affordable housing, which the private sector does not otherwise find sufficiently profitable.

IV
Greater Than Normal Profits Can Persist in the Rental Housing Industry

Key to the defense of unregulated housing markets is the assumption of the prevalence of competition. Competition is the mechanism which prevents market rents from rising above costs by calling forth new supplies and preventing excess profits from being earned by landlords for any but the briefest periods. The evidence presented to support the proposition that competition flourishes is the large number of tenants and building owners, the apparent absence of concentration in the ownership of housing units, and the relative ease of entry into and exit from the industry.[26]

But this is fundamentally an unexamined hypothesis, especially for urban metropolitan housing markets. There are virtually no data concerning ownership patterns in such markets[27] and we are unlikely to obtain any meaningful data in view of the increasing corporate ownership of property and the difficulties in obtaining information about actual control over these corporations. Equally relevant to the question of competition is the unknown degree to which large management companies operate the housing on a day-to-day basis. To the extent that relatively few companies are concerned with setting rent levels, especially if their incomes are a fixed percentage of the rents, the possibilities for anticompetitive practices are increased. In addition, the prev-

process. Nor is it clear that the process could enable lower income people to gain access to improved housing without substantial increases in rent. Lowry, Filtering and Housing Standards: A Conceptual Analysis, 36 Land Econ. 362 (1960).

25. See M. Stegman & H. Sumka, supra note 5, at 113.

26. Block, supra note 10, at 287.

27. For some evidence on ownership patterns in slum neighborhoods, see C. Rapkin, The Real Estate Market in an Urban Renewal Area (1969); G. Sternlieb, The Tenement Landlord (1969).

alence of organized groups of apartment owners and real estate developers which frequently advise and influence their members on rent levels, marketing, and maintenance strategies, must be considered. The emergence of standard leases is one of the more obvious examples of restriction of competition in residential rental housing.[28] Such contracts of adhesion are not nearly as prevalent in commerical leasing where there is greater equality of bargaining power between landlord and tenant.

There is a body of literature that suggests the possibility of a dual housing market. One side of this type of market is made up of profit-maximizing, often absentee, and professionally managed operators and the other made up of small, personally managed, and usually resident owners who are more concerned with earning a "satisfactory" income, attracting personally compatible tenants and neighbors, and maintaining neighborhood stability.[29] To the extent that this duality exists, the results of a competitive market cannot be expected.[30]

More data over an extended period of time about the level and distribution of profits realized by owners of rental properties would provide a contribution to a greater understanding of this issue. There are no generally reliable data on this subject, but what little there are tend to be consistent with the notion that residential rental real estate is able to earn profits substantially in excess of alternative investments, even when adjusted for risk.[31]

Further research could shed light on the question whether significant monopolistic or collusive practices are a source of long-term, above normal profits in urban rental housing markets. It is, however, not justifiable at this time to conclude that these markets behave as if they were highly competitive.

V
A Reduction in Landlords' Revenues From Market Levels Does Not Necessarily Lead to Reduced Housing Services

There is also no clear answer to the question whether rent controls neces-

28. J. Eckert, The Effects of Rent Controls on Assessment Practices and Income Adjustment Mechanisms for Rental Housing in Brookline, Mass., Colloquium on Rent Controls and the Property Tax, Lincoln Institute of Land Policy 16 (Nov. 1983); Gilderbloom and Appelbaum, Why Rents Rise: A Reconsideration, in Rent Control: A Sourcebook 49 (J. Gilderbloom ed. 1981).

29. See J. Eckert, supra note 28, at 22–24; R. Krohn, B. Fleming & M. Manzer, The Other Economy: The Internal Logic of Local Rental Housing (1977). The existence of a dual housing market for nonmetropolitan urban areas has been disputed. M. Stegman & E. Sumka, supra note 5.

30. J. Eckert, supra note 28, at 25–29.

31. Webb & Sirmans, Yields for Selected Types of Real Property vs. the Money and Capital Markets, 50 Appraisal J. 228, 241 (1982). See also G. Sternlieb, supra note 27, at Ch. 4; Sporn, Emprical Studies in the Economics of Slum Ownership, 36 Land Econ. 333 (1960). It should be noted that the above studies estimated returns on a before-tax basis. Given that there are substantial income tax incentives to the ownership of residential properties, we might expect profit levels to be even higher on an after-tax basis.

sarily lead to reduced maintenance and deterioration of the housing stock. When residential income property is purchased with knowledge of an existing or proposed system of rent regulation, the purchase price should reflect the buyer's ability to earn a competitive return on investment at current levels of maintenance.[32] An unexpected rent control ordinance, reducing above normal profits to normal levels, should not generate economic "need" to reduce maintenance levels. However, an absence of a "need" for reduced maintenance does not prevent landlords from finding it profitable to reduce maintenance or begin to engage in what is notoriously known as "milking."[33] Reduced or deferred maintenance is one method by which landlords may increase net revenues without violating legal rent ceilings. In tight or controlled housing markets where the quantity demanded exceeds the amount available, it is possible to reduce housing quality without fear of vacancies.[34] The question for a profit-maximizing landlord is simply put: will reduced (or increased) maintenance add to profits?[35] When controls limit revenues, some suggest that landlords' decisions to reduce maintenance will depend on these factors: their ability to shift maintenance to tenants; their ability to reduce operating costs through certain types of maintenance; their expectations concerning the lifting of controls; and their assessment of the likelihood of penalties by the housing code or rent control authorities.[36] Observers of the operation of rent regulatory systems support this hypothesis in noting that if a rent control ordinance links rent increases to adequate maintenance levels or housing maintenance codes are rigorously enforced or both, adequate incentives can be generated to prevent deterioration of the housing stock.[37]

From a public policy perspective, preservation of the housing stock is a major objective of government intervention in the housing market. It follows that rent regulations must contain a meaningful system of incentives and penalties to encourage sound maintenance. Without such a system some of the observations about post-World War II rent controls in New York City and elsewhere may well come back to haunt us.

32. See Olsen, supra note 7, at 1088. Another hypothesis is that unforeseen imposition of rent controls may induce only a one time drop in housing quality followed by a subsequent stability of maintenance at free market levels. Kiefer, Housing Deterioration, Housing Codes, and Rent Control, 17 Urb. Stud. 53 (1980).

33. "Milking" is a process of "aggressive rent collection efforts, minimal maintenance, tax delinquency, low purchase down payments, and delinquency in paying off purchase money mortgages [which] can permit an owner to make a handsome profit for a limited time, even as he writes off a larger portion of the rent roll and depreciates the asset value of the property to zero by walking away from his building when its economic potential is exhausted." P. Salins, The Ecology of Housing Destruction 14 (1980).

34. Moorhouse, supra note 5, at 95. This also has the effect of raising the price of any given quantity of housing services. Frankena, Alternative Models of Rent Control, 12 Urb. Stud. 303, 304 (1975).

35. More specifically, will the discounted value of additions to revenue resulting from an expenditure equal or exceed its discounted costs? Moorhouse, supra note 5, at 98.

36. Id. at 100.

37. Id. at 96; Olsen, supra note 7, at 1098.

VI
SECOND GENERATION OR MODERATE RENT CONTROLS

Much of the flawed analysis and unsupported conclusions of the economic literature and industry financed studies stem from an unwillingness or inability to recognize that contemporary rent regulation is significantly different in both concept and operation from wartime and post-war New York City rent controls. Sometimes known as "first generation" or "restrictive" rent controls, these most closely resembled price freezes. To be sure, across-the-board increases were sometimes granted and rents were sometimes allowed to increase on vacancy. For the most part, however, rents were frozen and generally inflexible. With the introduction of "second generation" or "moderate" controls,[38] marked in New York City by the enactment of the Rent Stabilization Law,[39] policy makers favored some upward flexibility for rents, especially in response to rising costs. They also recognized the necessity for landlords to earn a competitive rate of return on investment capital to discourage them from withdrawing their capital. Many jurisdictions also tried to link rent increases with minimum maintenance standards.

Despite considerable variation across the country, the essential features of second generation controls are: (1) a guarantee of a fair and reasonable return on investment; (2) provisions to allow operating cost increases to be passed along to tenants, usually in the form of across-the-board adjustments set by a local rent control agency; and (3) exemption of all new multifamily construction from controls.[40] A central notion of contemporary rent regulation is that it cannot achieve its objectives within a private enterprise framework without adequate consideration of the requirements of investors.

In addition, the emergence of second generation rent controls has been accompanied by new legislative, judicial, and political attitudes towards the rights of tenants and the obligations of landlords. Over the past fifteen to twenty years we have witnessed a rapid spread of warranty of habitability laws, repair and deduct statutes, and anti-retaliatory eviction measures. These new attitudes reflect acceptance of the idea that some of the terms and conditions of the landlord-tenant relationship must be set by the state.

Recently, another set of ideas is beginning to enter the political mainstream: the social, psychological, and economic impact of the private rental housing market requires a further reduction in what previously had been con-

38. For a general description of this type of legislation, see M. Lett, supra note 1, at pt. II; Blumberg, Robbins & Baar, The Emergence of Second Generation Rent Controls, 8 Clearinghouse Rev. 240 (1974);.

39. New York, N.Y., Charter & Admin. Code tit. YY, § YY-1.0 (1984-85 supp.).

40. Gilderbloom, 17 Urb. Aff. Q., supra note 17, at 125. It is beyond the scope of this paper to review the many variations of this legislation. For discussions of different provisions in second generation rent controls, see M. Lett, supra note 1, at pt. II; Baar, Guidelines for Drafting Rent Control Laws: Lessons of a Decade, 35 Rutgers L. Rev. 723 (1983); Rea and Gupta, The Rent Control Controversy: A Consideration of the California Experience, 4 Glendale L. Rev. 105, 113-15 (1982).

sidered landlords' property rights. Examples of these new laws restricting landlords' use of their property include regulations or moratoria on cooperative or condominium conversions, controls over demolition or rehabilitation of rental properties, and laws requiring "just cause" before eviction of a tenant.[41]

The goal of these laws is to grant tenants a degree of security of tenure. Although a definitive study of the origins of these statutes has not yet been undertaken, casual observation suggests that they have been adopted in response to upheavals in urban residential neighborhoods resulting from the declining relative economic status of tenants, increasing frustrations of members of the "baby boom" in their attempts to become homeowners,[42] and the involuntary displacement brought about by public and private neighborhood rehabilitation efforts. Indeed, demands for security of tenure are increasingly heard side by side with demands for rent regulation since it is clear that security of tenure cannot effectively be assured without controls on rent levels.[43]

Pleas for security of tenure and controls on rents are now heard so frequently that it is perhaps not an exaggeration to consider comprehensive rent and eviction controls as part of an overall program for neighborhood stabilization, community preservation, and maintenance of the current stock of "affordable housing."[44] The political rationale for this program is similar to that used by homeowners seeking zoning protections and development controls.[45] We might expect similar results in terms of economic efficiency and distribution of property rights.

It is, therefore, no longer adequate, if it ever was, to analyze rent control in terms of a simple price ceiling in a competitive market. Today's rent control ordinances are much more sophisticated and their policy objectives are

41. Baar, supra note 40, at 833–40.

42. A. Heskin, Tenants and the American Dream: Ideology and the Tenant Movement 185–89 (1983).

43. If an owner wished to dispose of her property at the end of a lease term, tenants could easily be evicted for failure to pay whatever rents were demanded.

44. Canadian Council on Social Dev., Is There a Case For Rent Control? (1973) (see especially comments by Donnison at 6, Audain & Bradshaw at 96–107, and Cassidy at 140–41). See also C. Hartman, D. Keating & R. Legates, Displacement: How to Fight It (1982); P. Marcuse, supra note 17, at 44; An Advocacy Guide to the Community Development Block Grant Program, 12 Clearinghouse Rev. 601, 638–40 (Jan. 1979 supp.). Interestingly, one historian of rent controls has concluded that the original purpose of World War II federal rent controls was to stabilize the social structure, promote the war effort, and maintain domestic order—not to aid either landlords or tenants. Lebowitz, Above Party, Class, or Creed: Rent Control in the United States, 1940–47, at 7 J. Urb. Hist. 439, 463 (1981).

45. It has been recognized that housing and whatever is meant by "neighborhood" are jointly produced and that some of the components of that joint product are social goods (e.g., government services). This feature of housing can thus be considered part of a public policy concern regarding who is to have access to the community and who is to have control over it. See Musgrave, supra note 13, at 217–18. A proponent of a more laissez faire approach to this issue has stated: "the problem of rising rents, rather than being a general problem is a squeeze on the established neighborhoods in the 'nice' parts of town. It is an adjustment necessitated by the increased demand to live in (relatively) crime-free areas and by the government imposed prohibition placed on new development in any neighborhood pretty enough to play host to a local chapter of the Sierra Club." Hazlett, supra note 10, at 286.

much more complex. The impact of this change in attitudes about the public nature of the operation of the rental housing market may well have a significant impact on the attitudes of potential investors.[46] Equally important is that we may be moving, as a society, towards a review of the nature of private rental housing by beginning to consider it in terms of a public utility.[47] This may have a profound influence on the mechanisms for controlling rent levels and in attracting and keeping capital in the industry.

CONCLUSION: AN AGENDA FOR RESEARCH

The existing empirical literature does not take into account the rise of second generation rent controls, nor does it attempt to respond to the concerns expressed by tenants and neighborhood leaders for preservation of their homes and communities. It is also not clear that enlightened public intervention necessarily has all the adverse effects so confidently predicted by economists.

It is my own view that concentration on the ill effects of regulating a competitive market has served to stifle, rather than promote, creative thought and discussion about regulation of rental housing. Policy makers need not sacrifice their views on the efficiency of competitive markets to encourage empirical and policy-oriented research that would address the issues raised by the proponents of rent regulation. To that end, I suggest that significant contributions could be made to the rent control discussion by an examination of the following issues.

First, an investigation is needed into the ownership and control patterns of rental housing in urban communities. The extent of the dual housing market, as well as the nature and extent of anticompetitive practices on the part of landlords and suppliers of capital to the industry must be determined.

Second, knowledge of the rates of profit earned by owners of rental properties is almost nonexistent. Our understanding of profit levels in rent regulated communities is no greater. An especially important component of this information would be data on what proportion of profits is attributable to capital appreciation and tax shelter benefits. A greater understanding of these factors could be of substantial assistance in devising appropriate rent regulatory mechanisms.

Third, more needs to be learned about the economic factors leading to undermaintenance and abandonment of rental properties. In particular, we need further use of multivariate analysis to learn how and to what extent rent

46. G. Sternlieb & J. Hughes, The Future of Rental Housing 94 (1981); Starr, An End to Rental Housing?, 57 The Public Interest 25 (Fall 1979).

47. There have been a number of calls to begin thinking of rental housing as a public utility. These include: Achtenberg, supra note 13, at 471–72; Berger, A Public Utility View of Rental Housing, 50 Pa. Bar Asso. Q. 234 (1979); Frank, To Control "Slumlord" Abuses—Private Rental Housing Proposed to Become Public Utility, 20 J. Housing 271 (1963). But see Berger, The New Residential Tenancy Law — Are Landlords Public Utilities?, 60 Neb. L. Rev. 707 (1981).

controlled communities differ in this regard from uncontrolled communities. We need additional study of which provisions of the rent control laws on the books are effective, and which do not achieve sound maintenance. Can we develop a workable system of rewards, penalties, and subsidies to maximize incentives to preserve the housing stock in rent controlled areas?

Finally, assuming that communities are gradually moving towards a consensus that rental properties are quasi-public utilities, analysts could use their experience in public regulation of other industries to study housing controls. They could suggest ways that controls might best protect the public, minimize administrative costs, and enhance the ability to attract and hold the capital required to provide socially determined levels of rental housing in the new political environment.