

# Economic Impact Statement

Office of Legislative Oversight

## BILL 52-20

## Landlord-Tenant Relations – Protection Against Rent Gouging Near Transit

### SUMMARY

The Office of Legislative Oversight (OLO) expects Bill 52-20 to have a negative economic impact overall. Residents of rent stabilized units would periodically benefit from lower rent increases. Residents of non-rent stabilized units would likely face increased rent costs. The economic benefit to households is smaller than the economic cost to businesses, in part because the household sector would absorb employment and earnings losses associated with decreased revenue for businesses in the real estate industry. Artificially constrained rents will also have a negative impact on asset values and property tax revenues.

Research indicates that rent stabilization could lead to reduced supply of rental housing and upward pressure on the prices of unregulated units (including owner-occupied units). This reduced supply could occur as a result of condominium conversion or reduced construction activity. Research also indicates that rent stabilization programs often result in disinvestment by owners, including deferred or foregone maintenance. There is evidence that rent stabilization has led to neighborhood deterioration or increased crime in some locations.

Available evidence does not indicate that rents are increasing more quickly near transit, more quickly than inflation, or more quickly than they are in nearby jurisdictions. Rents near transit stations have fallen 5.8% in 2020, and over the past 20 years have increased more slowly than they have for the County as a whole. Rents in Montgomery County have increased more slowly than they have in nearby/comparable jurisdictions, including Washington, DC which has a form of rent stabilization.

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### BACKGROUND

Bill 52-20 was introduced on December 8, 2020. The purpose of bill 52-20 is to limit the magnitude and frequency of rent increases in rental housing units near transit - to wit, the bill states that it:

- establishes protections against rent gouging for certain units;
- sets the base rental amount for certain rental units;
- provides for exemptions from certain rent protection requirements;
- requires each landlord to submit an annual report regarding rents; and
- generally amend County law concerning rents and landlord-tenant relations.

Bill 52-20 ('Protection Against Rent Gouging Near Transit') would establish a rent stabilization regime to regulate rents in almost all rental units within 1 mile of rail transit stations, and within ½ mile of bus rapid transit stations. Relative to rent stabilization measures in other jurisdictions, Bill 52-20 is narrow in its geographic scope and broad in its applicability within those geographic boundaries.

Under Bill 52-20, 'rent gouging' is any rent increase that is greater than what is allowed under Bill 52-20. The maximum rate of increase allowed would be established by reference to the "voluntary rent guidelines" as described in Section 29-53 of the Montgomery County Code. Those guidelines, which are based on a measure of regional rental housing inflation

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from the previous year, would then establish the maximum rent increase for the year beginning on July 1 and ending on June 30.

To illustrate, the voluntary rent guidelines issued in early 2022 will be based on the initial estimate of regional housing inflation for the calendar year 2021. Those guidelines would remain voluntary for rental units outside of Bill 52-20's geographic boundaries but would represent the maximum allowable increase for all regulated units during the year that begins on July 1, 2022 and ends on June 30, 2023.

The legislation does not include a "vacancy de-control" allowance; put differently, the regulation of rate increases continues in between tenancies with limited exceptions.<sup>1</sup> The bill does not include an allowance for temporary or permanent rent increases to recapture capital expenditures.

### ***Brief History of Rent Control and Stabilization***

Rent control legislation takes a variety of forms, though in all forms it is essentially a redistributive policy. Some forms control the *level* of rents in regulated units whereas other forms limit the *rates of increase* for rents in regulated units.

Many rent control or stabilization regimes allow for de-control when a tenant vacates the unit, whereas in other regimes control or stabilization is maintained between tenancies. In many jurisdictions, the rent control or stabilization only applies to units built before a certain year, or to units in buildings with more than some threshold number of units.

Legislation to control or stabilize rents has a relatively long history in some of America's most expensive metropolitan housing markets. The New York City area, the Boston area, the Los Angeles area, and the San Francisco Bay area are among the regions with the most extensive histories of rent control. However, rent control is not actually a recent American innovation – rent control has emerged in many places and under a variety of circumstances over the centuries, often as a political response to an exogenous economic shock like war or famine.<sup>2</sup>

Rent stabilization was first enacted in Washington, DC in 1985. Generally, DC's rent stabilization law limits rent increases to 2% above inflation, though rents for registered elderly or disabled tenants can only increase by the lower of either inflation or the annual social security cost of living adjustment. When a tenant vacates a unit, the landlord may increase the rent by up to 10% or 20% (depending upon the length of the previous tenant's tenure) above the last rent that the previous tenant paid. Many units are exempt from the law, including units in buildings built after 1975 and units owned by housing providers who own fewer than 5 units. DC's program also includes rehabilitation and capital improvements exceptions under which rents can be permanently or temporarily (depending on the scale of the improvements) increased to allow the landlord to recover the capital expenditure. The District is currently considering several proposals for changes to its rent control laws.

### ***Rent Control and Stabilization in the Economics Literature***

Within the field of economics there is broad agreement that rent control and stabilization laws produce negative economic consequences. Housing analyst Lisa Sturtevant succinctly summarized the consensus in the field: "Economists nearly

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<sup>1</sup> Line 115 of Bill 52-20 does include an exception for certain units that have been discontinued and not occupied by a tenant for a period of 5 years. Lines 190-196 permit an owner to "bank" any unused rent allowances that were not charged to a vacating tenant.

<sup>2</sup> See, e.g., John Willis, "Short History of Rent Control Laws," *Cornell Law Review* 36, no. 1 (1950): 54-94. The title is intended to be ironic – the article is a comprehensive history of rent control measures up to 1950.

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universally agree that rent ceilings reduce the quantity and quality of housing and that even more moderate forms of rent stabilization have efficiency challenges and negative housing market impacts.”<sup>3</sup>

The research literature indicates that establishing a ceiling on rents does have negative overall impacts, though the nature and extent of those impacts varies depending on research methodology, time, place, and regulatory regime.<sup>4</sup> Two recent overviews of the economics research provide useful, succinct summaries of the findings regarding the effectiveness of rent control and stabilization laws in achieving their objectives.

- The Urban Institute’s 2019 literature review<sup>5</sup> succinctly summarized the research regarding the intended effects of rent control efforts: “Although rent control has generally been found to have positive effects for residents in controlled units, these benefits may be offset by negative effects in the uncontrolled sector.”
- A recent Brookings article, *What does economic evidence tell is about the effects of rent control?*, summarized recent research findings thusly: “Rent control appears to help affordability in the short run for current tenants, but in the long run decreases affordability, fuels gentrification, and creates negative externalities on the surrounding neighborhood. These results highlight that forcing landlords to provide insurance to tenants against rent increases can ultimately be counterproductive. If society desires to provide social insurance against rent increases, it may be less distortionary to offer this subsidy in the form of a government subsidy or tax credit.”

Economists generally conclude that rent control and stabilization laws generally do a poor job of targeting those with the greatest need and often the benefits are inefficiently or inequitably targeted.

- The Urban Institute’s 2019 research review<sup>6</sup> summarized the research literature thusly: “By design, rent control protects incumbency and provides benefits to those living in rent-controlled units, and it is not targeted to those households with the most need. Over time, even if residents in rent-controlled units benefit, the policy may not be distributing benefits equitably if others who could benefit cannot obtain such a unit. Given its weak targeting mechanism and potential to reduce supply of rental units, some have argued that it is an ineffective policy solution for gentrification.”
- Studies generally find that rent control and stabilization efforts lead to increased costs for tenants who are unable to find housing in the controlled sector. One study found that in the first two years after Los Angeles adopted rent

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<sup>3</sup> Lisa Sturtevant, “The Impacts of Rent Control: A Research Review and Synthesis,” National Multi Housing Council, 2018. Similarly, a 1992 survey asked for economists’ views on 40 common economic policy questions.<sup>3</sup> That survey found that there was more agreement on the question of rent control than on *any* other common economic policy issue (92.9% of respondents either *generally agreed* or *agreed with provisos* with the following statement: “A ceiling on rents reduces the quantity and quality of housing available”).

<sup>4</sup> While this analysis includes citations to several research papers, the authors relied heavily on two studies that present particularly strong research methodologies and findings: (1) David Sims’ 2007 article in the *Journal of Urban Economics* on the end of rent control in Massachusetts (“Out of control: What can we learn from the end of Massachusetts rent control?”); and (2) a more recent study of the expansion of rent control in San Francisco by Rebecca Diamond, Tim McQuade, and Franklin Qian (“The Effects of Rent Control Expansion on Tenants, Landlords, and Inequality: Evidence from San Francisco”).

<sup>5</sup> Prasanna Rajasekaran, Mark Treskon, and Solomon Greene, “Rent Control: What Does the Research Tell Us about the Effectiveness of Local Action?” Urban Institute, January 2019.

<sup>6</sup> Ibid.

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control, the policy had caused the rents of uncontrolled units to increase three times more quickly than rents of controlled units.<sup>7</sup>

- Some studies have indicated that rent control and stabilization programs do a poor job of targeting those with the greatest need, or that some of the benefit ends up accruing to higher income individuals. For example, David Sims (2007) found that 30% of the controlled units in Cambridge, MA were occupied by households in the top half of the income distribution.<sup>8</sup>

Many economists conclude that rent control and stabilization laws provide the largest benefits to those who do not move and may encourage individuals to remain in units that no longer suit their needs.

- Multiple studies have found that tenants living in rent-controlled units are less likely to move than tenants in uncontrolled units.<sup>9</sup> Other studies have concluded that the primary beneficiaries are seniors and other groups that are less likely to move (as a result of stable household size).<sup>10</sup>
- Tenants in controlled units may be less likely to change jobs or more likely to commute long distances to remain in their controlled unit.<sup>11</sup> In doing so, those tenants continue to benefit from the rent control or stabilization policy but absorb other costs in order to continue their tenancy (e.g., opportunity cost of lost income, childcare costs, health outcomes).<sup>12</sup>
- Rent control and stabilization leads to a greater mismatch between households and units (e.g., growing families staying in smaller units, aging individuals staying in larger units).<sup>13</sup> This mismatch can have housing supply implications that affect both the controlled and uncontrolled units in the market.

Economic research often shows that rent stabilization laws lead to supply-side pressures, both in terms of *quantity* and *quality* of supply. To wit, such laws increase the number of condominium conversions, may reduce the number of new units constructed, and can lead to disinvestment by landlords.

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<sup>7</sup> George Fallis and Lawrence Smith, “Uncontrolled Prices in a Controlled Market: The Case of Rent Controls,” *The American Economic Review* 74, no. 1 (1984): 193-201.

<sup>8</sup> David Sims, “Out of Control: What Can We Learn from the End of Massachusetts Rent Control?,” *Journal of Urban Economics* 61, no. 1 (2007): 129-151.

<sup>9</sup> See, e.g. Diamond, McQuade, and Qian 2017; Glaeser and Luttmer 2003; Gyourko and Linneman 1989; Sims 2007.

<sup>10</sup> See, e.g., Ed Glaeser, “Does Rent Control Reduce Segregation?” Harvard Institute of Economic Research, Discussion Paper No. 1985 (2002).

<sup>11</sup> One study found a statistically significant relationship between the presence of rent regulation in a city and commute times who live in those cities. Robert Krol and Shirley Svorny, “The Effect of Rent Control on Commute Times,” *Journal of Urban Economics* 58, no. 33 (2005): 421-36.

<sup>12</sup> See also, e.g., John Nagy, “Increased Duration and Sample Attrition in New York City’s Rent-controlled Sector,” *Journal of Urban Economics* 38, no. 2, (1995): 127-137.

<sup>13</sup> One study found that between 15% and 21% of New York City apartment renters lived in units that were either larger or smaller than the units that they would live in if they lived in a city without rent control or rent stabilization, and that misallocation also occurred in non-controlled units and owner-occupied units in New York City. Ed Glaeser and Erzo Luttmer, “The Misallocation of Housing Under Rent Control,” *American Economic Review* 93, no. 4 (2003): 1027-1046.

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- Rent control and stabilization can result in some existing rental units being converted into owner-occupied condominium units.<sup>14</sup> One study of San Francisco’s housing market found that conversion of units in small (unregulated) buildings by itself was responsible for a 7% increase in rents for the entire city.<sup>15</sup>
- Studies have reached a variety of conclusions regarding the effect of rent control regimes on new construction and have generally struggled to separate the impact of rent control from other factors such as the economic cycle and credit availability. That said, new construction and units in newer buildings are often exempt or otherwise outside of the control of local rent control regimes.<sup>16</sup>
- Some studies find a relationship between rent control and disinvestment by landlords, increased spending by tenants on unit or building upkeep, and even neighborhood deterioration and crime.<sup>17</sup> One study concluded that while the relationship between control and maintenance problems was significant, the maintenance problems tended to be aesthetic in nature.<sup>18</sup>

### **Montgomery County Rental Market – Regional and Historical Context 2000 to 2020**

Co-Star’s dataset includes nearly 100,000 multi-family rental units in Montgomery County. Approximately 6% of those units are characterized as senior housing, corporate housing, military housing, or vacation housing. An additional 6% of total units are characterized in the Co-Star dataset as “affordable” units - those that are in a community in which all rents are discounted or below market and may include units that have tenants with Section 8 vouchers or be units financed with low-income housing tax credits (LIHTC). Co-Star’s dataset has 86,986 rental units in Montgomery County after excluding those units categorized as ‘affordable’, senior, corporate, military, and vacation rentals.<sup>19</sup>

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<sup>14</sup> Sims (2007) concluded (page 143) that “[T]here is weak evidence that rent control affected the extensive quantity of housing units supplied in Boston, but much stronger evidence that rent control led owners to shift units away from renting. The 6-7 percentage point change in rental probability between controlled and uncontrolled zones may seem small, but when applied to all three cities it implies that rent control kept thousands of units off the market.”

<sup>15</sup> Rebecca Diamond, Tim McQuade, and Franklin Qian, “The Effects of Rent Control Expansion on Tenants, Landlords, and Inequality: Evidence from San Francisco,” NBER Working Paper No. 24181, 2017.

<sup>16</sup> The restrictions/protections of Bill 52-20 would apply to units in new buildings as well, which could lead to a greater negative impact on new construction than one would anticipate in a jurisdiction that only applies rent control or stabilization to older buildings.

<sup>17</sup> Sims’ 2007 study of Cambridge, Massachusetts is one study that did find a relationship. In that study, Sims found that rent control there did result in some deterioration in the quality of the rental housing stock.

<sup>18</sup> Sims (2007) wrote about his findings that indicate a relationship between controlled units and chronic aesthetic maintenance issues (page 144): “The estimates demonstrate that ending rent control leads to a significant reduction in these maintenance problems. A unit was almost 6 percentage points less likely to experience such problems once its zone is decontrolled. Though rent control does not seem to lead to catastrophic maintenance failures, it appears to reduce maintenance performed on rental units. As landlords can be fined for allowing water and heat failures, but not for cracked paint, this result is not surprising.”

<sup>19</sup>For purposes of analysis, it makes sense to exclude “affordable” units because the rents for those units are not determined by the market. Roughly 40% of the Montgomery County units categorized as “affordable” in Co-Star’s dataset are owned by either the Housing Opportunities Commission or Montgomery Housing Partnership. If the intent is that some subset of the units categorized as “affordable” should be subject to the requirements and prohibitions of Bill 52-20, then some effort should be made to seek input from those providers to determine whether Bill 52-20 would negatively affect their operating revenues.

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Average effective rents in Montgomery County’s rental housing market generally increase only modestly.<sup>20</sup> According to Co-Star Analytics, the average annual change for Montgomery County’s rental multi-family housing stock from 2001 to 2020 is 1.48% per year.

**Table 1: Annual Effective Rent Changes 2000 to 2020, Montgomery County**

<b>Year</b>	<b>Annual Effective Rent Change</b>
2020 YTD	-3.6%
2019	3.1%
2018	3.4%
2017	0.0%
2016	0.4%
2015	1.6%
2014	0.5%
2013	1.3%
2012	1.9%
2011	1.3%
2010	4.0%
2009	0.9%
2008	2.3%
2007	4.6%
2006	5.1%
2005	2.1%
2004	-0.3%
2003	-2.3%
2002	-1.7%
2001	5.0%
<b>Mean Annual Rate of Change</b>	<b>1.48%</b>

Source: Jacob Sesker, OLO, Co-Star Analytics (2020)

<sup>20</sup> The Co-Star Analytics dataset includes two measures of rent – ‘effective rents’ and ‘asking rents.’ Effective rents are preferable for economic analyses because they represent a more meaningful economic number – the rent charged by the landlord net of concessions. While effective rents more accurately reflect the economics of the transaction, it is worth noting that the difference over time is minimal. For example, the average annual rate of change for effective rents, as shown in Table 1, is 1.48%. The average annual rate of change for asking rents during the same time period is 1.50%.

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Nearly half of the rental units in the County are within 1-mile of existing rail transit. The data shows that rents in the 42,649 units within 1 mile of existing Metro and MARC train stops have increased more slowly than units that are not within the 1-mile radius. A cursory review of variables indicates that a possible explanation for this is the prevalence of smaller units (studios, 1-bedrooms) near transit which are more volatile in terms of occupancy and rents.

**Table 2: Transit Proximity and Annual Effective Rent Changes 2000 to 2020**

Year	Annual Effective Rent Change - Within 1 Mile of Rail Transit	Annual Effective Rent Change - Montgomery County as a Whole (from Table 1)
2020 YTD	-5.8%	-3.6%
2019	2.9%	3.1%
2018	3.0%	3.4%
2017	-0.8%	0.0%
2016	0.2%	0.4%
2015	2.2%	1.6%
2014	0.3%	0.5%
2013	1.0%	1.3%
2012	1.6%	1.9%
2011	1.1%	1.3%
2010	3.8%	4.0%
2009	1.0%	0.9%
2008	2.3%	2.3%
2007	4.6%	4.6%
2006	5.2%	5.1%
2005	2.1%	2.1%
2004	-0.2%	-0.3%
2003	-2.2%	-2.3%
2002	-1.7%	-1.7%
2001	5.0%	5.0%
<b>Mean Annual Change</b>	<b>1.28%</b>	<b>1.48%</b>

Source: Jacob Sesker, OLO, Co-Star Analytics (2020)

During the past 20 years, effective rents within 1 mile of existing rail transit stations have usually increased modestly - not more than 3% - when compared to rents during the same quarter in the previous year. Increases of more than 3% have occurred in 19 of the past 80 quarters. Effective rents have declined in 15 of the past 80 quarters.

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**Table 3: Rail Proximate Units, Effective Rent Changes vs. Prior Year Quarter 2000 to 2020**

Directional Change	Number of Quarters
Increasing more than 3% per 4 quarters	19
Increasing up to 3% per 4 quarters	46
Decreasing	15
<b>Total</b>	<b>80</b>

Source: Jacob Sesker, OLO, Co-Star Analytics (2020)

The information in Tables 1-3, taken together, indicates that average rents in Montgomery County are increasing modestly, that average rents near existing transit have actually increased more slowly than average rents countywide, and that average rents increase modestly during most 3-month periods. While there are periods in which rents increase more steeply, the “long view” illustrates that rents charged by landlords are not increasing quickly relative to overall inflation.<sup>21</sup>

When examined in the context of the region, rents are increasing more slowly in Montgomery County than they are in comparable nearby jurisdictions, including Washington, DC.<sup>22</sup>

**Table 4: Annual Average Effective Rent Changes, 2000 to 2020, Selected Geographies**

Geography	Avg. Effective Rent Change	Median Effective Rent Change
Montgomery County, MD	1.48%	1.45%
Prince George's County, MD	2.15%	1.80%
Washington, DC	1.54%	1.95%
Fairfax County, VA	1.53%	1.70%
Arlington, VA	1.42%	2.00%
Alexandria, VA	1.69%	1.55%

Source: Jacob Sesker, OLO, Co-Star Analytics (2020)

None of this general data indicates that rents are increasing rapidly in Montgomery County and does not indicate that any such problem is more acute near rail transit stations. Program-level data tells a similar story. In response to our questions, the Department of Housing and Community Affairs' (Office of Landlord-Tenant Affairs) indicated that it received only 19 complaints about rent increases in FY19 and 44 such complaints in FY20.

<sup>21</sup> The average effective rent of Montgomery County multi-family rental housing units in 1Q 2000 was \$1,178. Inflating that number using the Bureau of Labor Statistics' inflation calculator would result in a rent of \$1,816 per month in November 2020. However, actual average effective rents in 4Q 2020 are only \$1,677 (or nearly 8% below the inflated 2000 rents). [https://www.bls.gov/data/inflation\\_calculator.htm](https://www.bls.gov/data/inflation_calculator.htm)

<sup>22</sup> As noted previously, Washington, DC has had some form of rent control or stabilization continuously since 1985.



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### **Additional Context: The Voluntary Rent Guidelines and Measures of Inflation**

Bill 52-20 establishes a maximum allowable annual rent increase via reference to Section 29-53 of the County Code. Section 29-53 establishes the County's voluntary rent guidelines, which heretofore have been voluntary for all units in Montgomery County. Subsection (b) describes the method the County is to use in establishing the guidelines.

*29-53 (b): The guidelines must be based on the increase or decrease in the residential rent component of the Consumer Price Index for All Urban Consumers (CPI-U) for the Washington-Arlington-Alexandria Core Based Statistical Area (CBSA) as published by the United States Department of Labor, Bureau of Labor Statistics, or any successor index, for the preceding calendar year, unless an alternative standard better reflecting the costs of rental housing in the County is established by regulation.*

The BLS reports several housing-related inflation figures, but the appropriate measure of inflation would be the CPI-U Rent of Primary Residence for the Washington region. Due to time limitations, the authors did not reach out to DHCA to determine how the CPI-U factors into the voluntary rent guidelines.

The data is derived from surveys based on a sample. Survey responses are adjusted to account for several factors, such as whether parking or utilities are included. Per BLS,<sup>23</sup> survey questions include the following:

*"What is the rental charge to your household for this unit including any extra charges for garage and parking facilities? Do not include direct payments by local, state or federal agencies. What period of time does this cover?"*

**Table 5: Measures of Rent Increases and Inflation (Indexed to 2010)**

Year	Montgomery County's Voluntary Rent Guidelines (set each spring based on previous year's CPI, then applied for the upcoming fiscal year)		CPI-U for Washington-Arlington-Alexandria CBSA - Rent of Primary Residence	
	%	Index	%	Index
2020 YTD	2.6%	126.4	2.8%	128.4
2019	1.5%	123.2	2.0%	124.9
2018	3.1%	121.3	2.6%	122.4
2017	1.8%	117.7	2.4%	119.2
2016	2.1%	115.6	1.5%	116.5
2015	2.3%	113.2	2.5%	114.8
2014	1.5%	110.7	1.7%	112.0
2013	4.0%	109.1	2.8%	110.0
2012	2.8%	104.9	3.9%	107.1
2011	2.0%	102.0	3.0%	103.0
2010	-	100.0	-	100.0

Source: Jacob Sesker, OLO, Bureau of Labor Statistics, Montgomery County, Co-Star Analytics (2020)

<sup>23</sup> BLS Factsheet, *How the CPI Measures Price Change of Owners' Equivalent Rent of Primary Residence and Rent of Primary Residence*. <https://www.bls.gov/cpi/factsheets/owners-equivalent-rent-and-rent.pdf>

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### **METHODOLOGIES, ASSUMPTIONS, AND UNCERTAINTIES**

In preparing this Economic Impact Statement, OLO relied upon data from public data sources and from Co-Star (a third-party private sector vendor). OLO reviewed applicable economic research. OLO also relied on the Bureau of Economic Analysis RIMS-II datasets, which were used to create an example that would help to illustrate the relative economic impact of reduced private industry activity and benefits of additional household spending. OLO's conclusions are also based on the authors' economic and local policy expertise.

From an economic perspective, the rent stabilization regime is a tax on the real estate industry for the direct benefit of tenants of certain units. It is assumed that the primary economic impacts of Bill 52-20 would occur as result of the reduced private sector economic activity and increased resources available to certain households. These impacts are the subject of the illustrative example discussed towards the end of this Economic Impact Statement.

Secondary impacts result from the distortionary effect of that tax. Those impacts are not quantified, but could include the following:

- Artificial limits on price increases leading to faster increases in prices for unregulated units, including owner-occupied housing;
- Rent stabilization resulting in fewer instances of rents being reduced in response to economic factors because establishing a new, lower base rent could “lock in” the effects of the downturn for years to come;
- Rent stabilization affecting the quantity of supply, as existing rental units are converted to condominium ownership and as construction of new units declines;
- Rent stabilization affecting the quality of supply as the levels of investment and maintenance in the regulated housing stock falls in response to price controls; and
- Rent stabilization resulting in geographic distortions because the bill would impose a tax on owners of land in some locations but not in others and would benefit tenants in some locations but not in others.

Quantifying the economic impacts of Bill 52-20 would require detailed information about all housing units (renter and owner occupied, near and far from transit), modeling macroeconomic scenarios, modeling microeconomic decisions (such as whether to convert a building to condos), modeling spillover effects in neighborhoods, and modeling price responses to changes in supply.

The scope of the analysis was limited by several key uncertainties. Those uncertainties generally fall into the following broad categories:

- Challenges relating to the underlying assumption;
- Challenges relating to measurement and indexing;
- Challenges related to macroeconomic volatility and the business cycle; and
- Challenges related to modeling pricing and microeconomic decisions.

#### ***Challenges and issues relating to the underlying assumption***

Reducing rents would certainly help families that are squeezed by stagnant real wages, skyrocketing healthcare and college tuition costs, and childcare costs that are unaffordable to all but the most fortunate families. However, it may very well be that rent increases are not among the top causes of that squeeze.

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In any event, the data available does not indicate that rents in Montgomery County generally - and specifically in proximity to transit - are rising rapidly. As a result, it is difficult to quantify the cost to businesses or the benefit to individuals and households of stabilized rents.<sup>24</sup>

One uncertainty limiting this analysis is the distribution of rent increases across the universe of transit-proximate units. Co-Star's dataset includes averages by geography and at the building level but does not include either the entire distribution or the medians. Moreover, Co-Star does not separately report rents for new tenants and existing tenants. It is possible that rents for existing tenants increase modestly, reflecting the reduced vacancy risk for the property owner, while lease rates for first time tenants increase more rapidly, and that these differences are obscured even in the building-level averages reported. It is also possible that there are individual property owners who choose to increase rents much more steeply, though determining whether this is indeed a problem would require reviewing hundreds of buildings individually.

### ***Challenges and issues related to measures of inflation***

Additional uncertainty results from the mismatch between the price to be regulated (rents) and the index that would establish the maximum price increases. The housing components of the Consumer Price Index seem to have little relationship to the data available regarding reported rents during the same time periods.<sup>25</sup> In addition, the voluntary rent guidelines do not appear to be based on the actual annual average inflation of the CPI-U for rent of primary residence, and OLO has not verified whether the County has used the measure consistently or correctly.

Moreover, there could be feedback loops between the index upon which the voluntary rent guidelines are based and future economic activity. Under the bill, future Montgomery County allowable rent increases would be based on a measure of past rent increases across the region. Montgomery County is one of the larger jurisdictions in the region, meaning that future allowable rent increases in Montgomery County would depend on a measure of recent rent increases in a region of which Montgomery County is a significant component. In other words, indexing rents based on the voluntary rent guidelines would impact rental rates in the County, which in turn could influence future values of the index. This feedback effect introduces a level of complexity that would be challenging to model.

An additional challenge is that Section 29-53 (Voluntary Rent Guidelines) makes clear that the guidelines should be based on the increase *or decrease* in rental housing inflation. It is possible that the inflation measure that is used to set the voluntary rent guidelines could decrease at some point during this or a subsequent economic downturn. Whether that occurs, when it occurs, and to what degree would have a large effect on any calculation of the costs to landlords of regulated units or the benefits to tenants of regulated units.

### ***Challenges and issues related to unusual macroeconomic volatility***

The legislation would establish base rents during a period of unusual economic volatility. The legislation could potentially "lock in" some portion of this year's 5.8% decline in effective rents for units within 1 mile of rail transit. That lost income

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<sup>24</sup> While it is indisputable that many middle-class families are feeling squeezed, several factors are at least as significant as annual rent increases: stagnant real wages, a loss of employment protections, longer lifespans and reduced retirement security, the skyrocketing cost of college education, childcare costs that are unaffordable to many families, and health care inflation that continues to burden employees and employers (placing downward pressure on wage and salary growth).

<sup>25</sup> One recent paper examined the historical inaccuracies and measurement challenges for rent inflation. "The official rate was overestimated by 1.7 to 4.2% annually during the Great Recession but underestimated by 0.3 to 0.9% annually during the current expansionary period." Brent Ambrose, Ed Coulson, and Jiro Yoshida, "Housing and Inflation Rates," Center for Research and Education for Policy Evaluation, Discussion Paper No. 43, July 2018.

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would function as a substantial ongoing tax on the real estate industry. Furthermore, since many periods of steeper rent increases occur either when the economy is overheating or when the economy is recovering from recession, business cycle scenarios would need to be developed in order to model the impact of this legislation.

In addition, it is hard to know how this legislation would affect landlords' choices during subsequent economic downturns. Landlords often reduce rents for new tenants during significant economic downturns. One potential response to rent regulation would be for landlords to hold the line and maintain rents even as landlords in surrounding jurisdictions are reducing rents. Similarly, tenants in an unregulated market can choose to take advantage of a period of declining rents by obtaining cheaper or higher quality housing. This opportunity would not be available if landlords chose to maintain rather than reduce rents during a downturn.

### ***Challenges and issues related to prices and microeconomic factors***

A critically important challenge is understanding the extent to which changes to supply will affect the price of rental housing in the unregulated market.

Behavioral responses to price signals and market regulation will also affect economic outcomes. For example, one challenge is modeling the degree to which landlords will attempt to recoup some actual or potential lost revenue by decreasing capital and operating expenditures.

Another challenge is modeling the degree to which tenants will respond to landlord disinvestment. For example, tenant responses could include increased spending by tenants on building and unit upkeep and maintenance, or tenant location preferences could change in response to perceived deterioration of transit-proximate neighborhoods.

Research literature suggests that the degree to which such regulations affect construction investment varies depending on timing relative to the business cycle, factors related to the specific nature of the legislation in question (such as whether it exempts new construction or only applies to buildings built before a certain year), and factors such as the nature and quality of the existing inventory. Modeling the impact on construction would be time consuming, and the results could potentially affect prices in the regulated market, prices in the unregulated market, as well as employment, income, and output in construction, real estate, and other affected industries.

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## **VARIABLES**

The primary variables that would affect the economic impacts of Bill 52-20 include:

- Timing of the business cycle;
- Annual costs (both one-year and long-term averages) to landlords of limiting rent increases to the percentage increase or decrease each year as established in the voluntary rent guidelines;
- The distribution of rent increases across the universe of regulated units and properties;
- The degree to which the costs of the regulation are borne by local, as opposed to non-local property owners;
- The degree to which the benefits and costs of the regulation accrue to current County residents versus non-County residents who might subsequently seek housing in Montgomery County;
- Income, household size, employment status, and age of residents in transit proximate units.

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### IMPACTS

WORKFORCE ■ TAXATION POLICY ■ PROPERTY VALUES ■ INCOMES ■ OPERATING COSTS ■ PRIVATE SECTOR CAPITAL INVESTMENT ■ ECONOMIC DEVELOPMENT ■ COMPETITIVENESS

### Businesses, Non-Profits, Other Private Organizations

The *Real Estate and Rental and Leasing Industry*, as defined for the purpose of government statistics, generated more than \$16.3 billion of economic output in 2019. The industry constitutes more than 17% of Montgomery County’s economic output and more than 21% of the private industry output in the County.

Table 6: County GDP (2019)

Real Estate and Rental and Leasing	Private Industry Subtotal	Gross Regional Product (2019 \$)
\$16,347,430,000	\$76,740,259,000	\$95,585,447,000

Source: Jacob Sesker, OLO, Bureau of Economic Analysis

Reducing income in the real estate industry would reduce economic activity in other private industry and would result in a loss of earnings and employment as well as economic activity and output. Assets with reduced income-producing potential are less valuable, meaning that there would be a negative impact on property values and tax revenues generated by properties that are near transit. Other potential impacts, such as landlord decisions regarding expenditure on maintenance and general levels of construction activity, are likely to be negative. Furthermore, condominium conversion is a common outcome when rent stabilization measures are adopted.

Rental income from rail-proximate units is more than \$930 million, equivalent to nearly 1% of the County’s economy (See Table 7). These figures do not represent the entire universe of rental units that would potentially be affected.

- Not included are units that would be proximate to future transit stations (i.e. those that are within 1 mile from a Purple Line stop, or within ½ mile from a Bus Rapid Transit stop).
- Also not included are units that are categorized by Co-Star as corporate housing, military housing, vacation rental, senior housing, or subsidized affordable units.

If the voluntary rent guidelines limited rent increases to 2% when market forces otherwise would have led to a 3% increase in rent, that 1% difference would function as a tax on the owners of real estate for the direct benefit of their tenants. The one-year cost of this tax for the owners of real estate (using 2020 effective rents) would be \$9.3 million (1% x \$930 million). Note that much of that amount would be lost in each subsequent year as a result of the compounding effect of basing each year’s allowable rent on the previous year’s rent as adjusted by the price index.

An uncertainty in this instance is what affect this legislation would have on non-profit organizations whose primary purpose is not to provide temporary shelter to qualified clients (the exception on lines 33-40). It is conceivable that some non-profit affordable housing providers who do not qualify for this exemption would be negatively affected by the legislation – that impact has not been modeled.

### Residents

Households in Montgomery County and across the nation are under increasing financial pressure, and there is a growing awareness and body of research related to this “middle class squeeze.” That squeeze is not simply the result of increased housing costs but is the result of several factors: stagnant wages, decreased employment and retirement security, limited

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savings and longer lifespans, rapid inflation of health care costs, and childcare and college education costs that are high and continue to rise.

As previously stated, it is not possible to forecast or project the impact on the County’s economy without additional information. However, the primary impact on households in the regulated rental units would be a benefit in the form of reduced rent, which would then enable those households to spend more on other categories of goods and services.<sup>26</sup>

Benefits to residents and households would also include the benefit of being able to maintain the social capital that is tied to their location. Such social capital includes maintaining neighbors and connections to friends, household service providers, neighborhood businesses and amenities, schools, and support networks.

Other potential negative impacts on residents and households include higher rents in the uncontrolled sector (e.g., in housing that is outside of the 1-mile radius from existing transit stops), landlord disinvestment resulting in increased spending by tenants on unit/building maintenance, and economic costs associated with the mismatch of units and tenants that results from individuals and households remaining in units that no longer meet their needs.

### **Illustration: One-time Economic Impacts of a One-time Reduction in Allowable Rent Increases**

While it is not possible to model the impacts of rent stabilization without having additional information, it is possible to illustrate the relative magnitude of some such impacts. Returning to the example of a one-time, 1% reduction in achievable rents will enable a quick analysis of the relative costs and benefits of the redistribution of rent income/costs.

- This reduction in rents would result in reduced private sector economic activity. The real estate industry would spend less money, both on labor inputs (affecting employment and earnings from employment) and would on other inputs.
- At the same time, households who benefit from the reduced rent increase at their transit-proximate unit would have additional money available to spend. In the abstract, that amount should equal the lost income for the real estate industry. However, the household sector is also losing earnings in the form of reduced spending on labor by the real estate industry.
- An additional key assumption is that the extra resources available to households will *not* be spent on real estate (i.e., it is assumed that the savings would not be used to rent more expensive housing units that otherwise would have remained vacant and which are outside of the regulated geography).

**Table 7: Rental Income Associated with Units Near Existing Rail Transit**

<b>Illustrative Impacts: Capitalized Value, Property Tax Revenue, and Economic Multiplier Impacts</b>		
	# of Units, >1 mile existing rail	42,649
Times	Average Effective Rent/Unit/Mo.	\$1,818
Times	Mo./Yr.	12
<i>Equals</i>	<i>Gross Rent Income/Yr.</i>	<i>\$930,430,584</i>
<b>Illustrative Capitalized Value and Tax Revenue Impacts</b>		
	Illustrative: Income Loss from 1% Reduced Rent	(\$9,304,306)
Divide	Cap Rate (for converting net operating income to asset value)	5.31%

<sup>26</sup> Note, however, that not all of the reduced rent accrues to households as a benefit because some households will have lost earnings as a result of the reduced revenue among businesses in the real estate industry.

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<i>Equals</i>	<i>Illustrative: Asset Value Lost</i>	<i>(\$175,222,332)</i>
Times	Weighted Average Tax Rate / \$100	\$1.0264
<i>Equals</i>	<i>Illustrative: One Year Property Tax Impact</i>	<i>(\$1,798,482)</i>
<b>Illustrative: Economic Impacts on Private Industry From Reduced Real Estate Income</b>		
	Input: Cost to Real Estate Industry of Reduced Rent Increase Equal to 1% of Rent	(\$9,304,306)
	Final Demand Output Change (Reduced Economic Activity)	(\$11,744,825)
	Earnings Impact (Reduced Earnings) in Montgomery County	(\$1,395,646)
	Employment Impact (Fewer Jobs) in Montgomery County	(41.4)
	Final Demand Value Added (Reduced GDP or Economic Output)	(\$8,427,840)
<b>Illustrative: Economic Impacts on Household Sector from Reduced Rents</b>		
	Input: Benefit to Households from Reduced Spending on Rent	\$9,304,306*
Less	Offset: Reduced Income to Households from Contraction of Real Estate Industry	(\$1,395,646)
<i>Equals</i>	<i>Net Benefit to Household Sector</i>	<i>\$7,908,660</i>
	Final Demand Output Change (Increased Economic Activity from Household Spending)	\$4,795,811
	Earnings Impact (Earnings from Employment Resulting from Household Spending)	\$1,105,631
	Employment Impact (More Jobs) in Montgomery County	25.5
	Final Demand Value Added (Increased GDP or Economic Output)	\$2,811,529
<b>Illustrative: Net Economic Impacts of 1% Reduction in Real Estate Income (Rents)</b>		
	Net Final Demand Output Change	(\$6,949,014)
	Net Earnings Impact	(\$290,015)
	Net Employment Impact	(15.9)
	Net Final Demand Value Added Change	(\$5,616,312)

Source: Jacob Sesker, OLO, Bureau of Economic Analysis, Co-Star Analytics (2020)

\*The transfer to households is equivalent to \$18/month per unit.

Table 7 shows that the impact of reducing rents on asset values is substantial and affects real property tax revenues, and that the negative economic impacts of reduced income in the real estate industry exceed the positive economic impacts of increased household spending. Keep in mind that input-output analyses are linear – the impact of a one-time, 2% reduction in rents would be double the impact shown in Table 7.

- Illustrative impact on asset values:** Assuming that operating expenses are unchanged, a reduction of rental income will result in a corresponding reduction of net operating income (NOI). That reduced NOI, when capitalized at the appropriate “cap rate”, produces an estimate of the value of the income producing asset at that moment in time. The example in Table 7 illustrates the impact of a 1% reduction in rents (reduced increase) capitalized at 5.31% - the value of regulated residential rental buildings would decline by \$175 million. Not included in this number is any other adjustments as a result to changes in operating expenses, occupancy rates, maintenance expenditures, compliance costs, etc. Also not included is any indirect impact on real estate values or spillover effect resulting from neighborhood deterioration. The reduced rents also result in reduced property tax revenue for the County (by \$1.8 million), though this analysis does not attempt to model the impact of that reduced revenue.
- Illustrative Impact on Earnings and Employment:** Table 7 illustrates that the net effect on earnings and employment is likely to be negative – a loss of jobs, and a corresponding loss of earnings by County workers



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(earnings include sole proprietor and partnership income, and exclude several items including taxes and social insurance costs). While household spending offsets a portion of the losses, this illustration shows that a one-time 1% decline in allowable rents would result in the loss of 16 jobs and close to \$300,000 of earnings for County households.

- **Illustrative Impact on Economic Activity and Output:** The impact of a 1% reduction in allowable rents would be more substantial when viewed through the lens of economic activity and output. Increased household spending offsets approximately 40% of the reduced economic activity (final demand output) and 33% of the reduced gross regional product (final demand value added). However, on balance the result of this 1% reduction in allowable rents would be to reduce the level of activity and overall size of the County's economy.

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## QUESTIONS FOR CONSIDERATION

OLO has recently produced economic impact statements for three bills (Expedited Bill 50-20, Bill 51-20, and Bill 52-20) related to rental housing and landlord responsibilities. All three are likely to have a negative economic impact on landlords. Should the Council desire more economic analysis, OLO suggests conducting an examination of the aggregate economic impact of these bills.

One question for consideration is the legality and practicality of mandating that rents decrease in accordance with the voluntary rent guidelines, which under Section 29-53 may either increase or decrease depending on the underlying index.

Some rent stabilization measures are based on broad measures of affordability (e.g., the broad consumer price index) and include a buffer that provides some additional flexibility for the market while retaining the circuit-breaker function of regulation (e.g., Washington, DC's CPI + 2% rent stabilization). THE CPI for rental housing is a measure of housing cost, though it is not limited to measuring rents, and the regional measure is likely to be heavily influenced by Montgomery County's housing costs given that Montgomery County is one of the largest jurisdictions in the region. OLO recommends further consideration of whether this measure – which may be adequate for the purposes of establishing a voluntary guideline – is appropriate for the purpose of establishing a statutory maximum for all regulated units.

To the extent that the Council is interested in learning more about the distribution of rent increases, OLO recommends a statistical analysis of DHCA's housing dataset to determine whether rent gouging is common, and to determine whether instances of steep rent increases correspond to other factors related to the buildings (such as age), the units (such as size), the property owners (such as whether they are local), or the tenancy status (such as re-leasing or vacated).

Additional objective, third-party analysis of Takoma Park's housing stock, neighborhood performance relative to peer neighborhoods, and economic outcomes for property owners and residents may be helpful in reaching a better understanding of the impact of rent control measures in a local context. Such analysis may be particularly helpful in understanding issues related to property disinvestment by landlords, neighborhood deterioration, spillover effects in surrounding neighborhoods and in the unregulated stock, and crime. In addition, it may be worth exploring the fiscal costs to the City of Takoma Park and to Montgomery County of landlord disinvestment, e.g. whether buildings in Takoma Park have lower capitalized values than similar/paired buildings outside of the municipal boundary, the impact if any on tax revenues, and a review of the cost of any subsidies related to that disinvestment.



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### CAVEATS

Two caveats to the economic analysis performed here should be noted. First, predicting the economic impacts of legislation is a challenging analytical endeavor due to data limitations, the multitude of causes of economic outcomes, economic shocks, uncertainty, and other factors. Second, the analysis performed here is intended to *inform* the legislative process, not determine whether the Council should enact legislation. Thus, any conclusion made in this statement does not represent OLO's endorsement of, or objection to, the bill under consideration.

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### CONTRIBUTIONS

Jacob Sesker, contractor for OLO, prepared this report with contributions from Stephen Roblin (OLO).