Economic Impact Statement

Office of Legislative Oversight

Expedited Bill 22-22 — Landlord-Tenant Relations – Limitations on Rent Increases

SUMMARY

The Office of Legislative Oversight (OLO) anticipates that enacting Expedited Bill 22-22 would have a net negative impact on economic conditions in the County in terms of the Council's priority indicators. By effectively extending the County's rent stabilization policy for nine months, the Bill likely would reduce rents for certain tenants of rent-regulated properties/units. Certain property owners and managers likely would respond by decreasing operating expenses associated with maintenance, repair, and other building services, removing properties from the rental market (i.e., through condo conversion), or replacing existing tenants with new tenants to take advantage of vacancy decontrol. Based on their relative economic multiplier effects, reduced landlord spending likely would yield economic costs that exceed the economic benefits of increased household spending (holding all else equal). Moreover, extending the rent stabilization policy may moderate certain residential property values and/or decrease the County's competitiveness in the residential rental sub-market relative to jurisdictions in Northern Virginia that lack rent stabilization policies.

BACKGROUND

The County's rent stabilization, which prohibited rent increases exceeding the voluntary rent guidelines, expired on May 15, 2022. The goal of Expedited Bill 22-22 is to mitigate economic hardship and risk of displacement for tenants in the County caused from rent hikes since the expiration of the rent stabilization measure.[1] The Bill would attempt to achieve this goal by:

- prohibiting rent increases more than 4.4% for six months after it becomes law;
- prohibiting landlords from notifying tenants of rent increases above 4.4% during this time; and
- requiring landlords who previously notified tenants of rent increases above 4.4% to either retract the increase or amend it to 4.4% or below.[2]

The 4.4% threshold is based on the March 2022 Bureau of Labor Statistics Consumer Price Index (CPI) for the total housing cost change from March 2021 to March 2022.[3] According to the County Executive's memo enclosed in the Introductory Staff Packet, this threshold was chosen "to provide a period of adjustment to new higher rents and to provide landlords with increases for operating costs."[4]

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[1] Elrich to Albornoz, Memorandum.
[2] Bill 22-22.
[3] Elrich to Albornoz, Memorandum; Consumer Price Index, Washington-Arlington-Alexandria area – March 2022.
[4] Ibid.

Due to the County's requirement that landlords provide 90-day advance notice of all rent increases, **the Bill, in effect, would limit rent increases of more than 4.4.% for nine months after the Bill's effective date**.[5]

Two features of the County's rent stabilization policy are important to note: First, extending the rent stabilization policy would apply only to existing tenants. Because the program does not include a vacancy control, extending the policy would not prevent landlords from increasing rents for new tenants above the 4.4% threshold. Second, the policy does not in any way restrict landlords from converting rental properties/units to condos or removing them from the market. For these reasons, the County's policy is best described as "moderate rent stabilization."[6]

INFORMATION SOURCES, METHODOLOGIES, AND ASSUMPTIONS

Per Section 2-81B of the Montgomery County Code, the purpose of this Economic Impact Statement is to assess the impact of Expedited Bill 22-22 on residents, private organizations, and overall economic conditions in the County in terms of the Council's priority indicators.[7] To do so, OLO does the following in this analysis:

1. *Assess whether the rental market can support rent increases above 4.4%.* The primary way the Bill would affect stakeholders and economic conditions in the County is through preventing landlords from raising rents above the 4.4% threshold for certain properties and units. For the Bill to affect prices, conditions in the market (e.g., supply and demand for rental housing, information asymmetries) would need to support rent increases above the threshold. Otherwise, extending the rent stabilization program would lack a real-world impact on rental prices. To assess market conditions, this analysis draws on rent and vacancy trends in data from CoStar, a commercial estate information and analytics provider, which staff from Montgomery Planning Department provided to OLO.
2. *Review the econometric literature on rent regulations.* To understand the economic impacts of rent regulations, this analysis synthesizes findings from Paster, et al's (2018) literature review of the econometric evidence on the topic and Gardner's (2022) study on the effect of rent stabilization on evictions. These studies were identified using the Google Scholar database.
3. *Draw on the above evidentiary sources to infer the likely impacts of extending the rent stabilization policy on economic stakeholders and conditions.* Among residents, the stakeholders include:
    - existing tenants;
    - new tenants; and
    - homeowners and buyers.

    Among private organizations, the stakeholders include:

[5] Wellons to County Council, Memorandum.
[6] Pastor, et al, "Rent Matters."
[7] Montgomery County Code, Sec. 2-81B.

- landlords;
- building service providers;
- residential remodelers; and
- other businesses.

VARIABLES

Some of the variables that would affect the economic impacts of enacting Expedited Bill 22-22 are the following:

- total annual rent revenues;
- total household income;
- residential property values; and
- building services expenses.

IMPACTS

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

Rental Market Conditions

OLO anticipates that conditions in the residential rental market support rent increases above the 4.4% threshold for certain existing tenants in rental properties/units.

First, from the standpoint of many property owners and managers, there is a need to increase rents to cover increasing operating expenses and maximize profit margins. In the current inflationary environment, landlords have been facing rising costs related to staffing, utilities, maintenance, etc. To illustrate, in the Washington metropolitan area, wages and salaries increased by 3.8% and the price of fuels and utilities increased by 11.2% for the 12-month periods ending in June and July 2022, respectively.[8]

Second, while wages continue to lag cost of living increases and many renters face housing insecurity,[9] some portion of tenants would be willing to pay rents above the 4.4% threshold, particularly higher-income tenants of Class A apartments. This is suggested from what new tenants, who have not been subject to the County's rent stabilization policy, have been willing to pay. CoStar has data on average annual effective rents for brand new units and existing units where occupancy changed. (The data does not reflect price changes for existing tenants re-leasing units.) As shown in **Table 1**, average

[8] Changing Compensation Costs in the Washington Metropolitan Area — June 2022; Consumer Price Index, Washington-Arlington-Alexandria area – July 2022.
[9] See Census Bureau's Household Pulse Survey.

effective rents across all building classes increased by 4.6%—a rate slightly above the proposed threshold. Meanwhile, overall vacancy rates have generally lowered over the past two years, despite rising rents. See **Table 2**.

Thus, with rising operating expenses cutting into landlord profits and market conditions allowing landlords to continue to increase rents, it is clear certain existing tenants would experience rent increases above this threshold in the absence of extending the rent stabilization program.

Table 1. Average Effective Rents for Multi-family Rental Units in Montgomery County

Building Class	2021	2022	Annual Percent Change
All	$1,877	$1,968	4.8%
A	$2,291	$2,414	5.4%
B	$1,823	$1,905	4.5%
C	$1,560	$1,633	4.7%

Data source: CoStar

Table 2. Overall Vacancy Rates for Multi-family Rental Units in Montgomery County

	Building Class			
Period	All	A	B	C
2022 YTD	4.580%	7.573%	4.128%	2.592%
2021	4.829%	6.583%	5.025%	3.020%
2020	6.224%	8.071%	6.495%	4.289%

Data source: CoStar

Economics of Rent Regulation

What does the economics literature suggest about the potential impacts of preventing rent increases above 4.4% for existing tenants? Researchers have examined both, the economic impacts of rent regulations and their removal. Based on Paster, et al (2018) and a study published after their review, the econometric evidence on the impact of rent regulations points to the following conclusions:

- **Rent regulations generally improve affordability for tenants in rent-regulated units, particularly for long-term tenants who move into their units around the time when regulations are established**. Rent regulations have been shown to decrease rents for lower-income tenants and those in social groups with relatively greater economic needs (e.g., elderly, people of color, and single parents). As a universal program, rent regulations also reduce rents for middle- and upper-income tenants; therefore, they are inefficient in targeting tenants with greater needs.

- **Rent regulations may have mixed impacts on affordability for tenants in non-regulated units**. Some studies have found rent regulations can slightly lower rents in non-regulated units. This effect may be due to declining building/unit quality from lower maintenance, decreasing appeal to higher-income renters or other factors. In contrast, rent regulations may increase rents for new tenants during and after periods of supply-induced price hikes. In fact, Diamond, et al (2019) find San Francisco's rent stabilization policy incentivized landlords to convert rental buildings to condos, thereby decreasing the city's supply of rental units by 15 percent. The loss of supply "likely led to rent increases in the long run, consistent with standard economic theory."

- **Rent regulations can increase chronic maintenance problems.** To compensate for lower rental income, rent regulations can reduce landlord incentives to maintain units. This negative side-effect of rent regulations is especially prevalent in jurisdictions that do not permit rent increases contingent on quality improvements and/or lack stringent code enforcement.

- **Rent regulations, particularly those lacking limitations on condo conversions, can reduce the supply of existing rental housing through conversion and market removal**. Rent regulations impact the *existing rental stock* by incentivizing landlords to remove rent-regulated units from the market. This is typically done in several ways—owners convert rentals to condos, sell the property, or move into the property. While rent regulations can reduce the supply of existing rental units, there is limited evidence they impact *new housing construction*. This is especially the case in jurisdictions that exempt new construction from any price controls and include vacancy decontrol.

- **Rent regulations decrease tenant mobility**. On the one hand, decreased mobility can improve housing stability when rent regulations prevent tenant displacement due to sharp rent hikes. On the other hand, decreased mobility can lead to housing misallocation when rent regulations discourage tenants from moving into units that better fit their needs (i.e., when family sizes increase).

- **Rent regulations lacking vacancy controls can increase the risk of eviction for tenants.** Without vacancy controls, landlords have an incentive to remove tenants and re-rent units at market rate. Using a quasi-experimental methodology,[10] Gardner (2022) examines the risk of eviction—measured as eviction filings—for tenants in controlled and uncontrolled units in San Francisco from 2007 to 2017. He finds that while eviction notices impacted a small share of total tenants, rent-controlled units were 2.4 times more likely than their uncontrolled counterparts to receive eviction notices on an annual per unit basis. Thus, Gardner (2022) shows the impact of rent regulations can have more heterogenous impacts on housing stability than indicated by the studies reviewed in Pastor, et al (2018).

The evidence on the economic impacts of removing rent regulations points to the following: Removing rent regulations **increases rental prices** in regulated and non-regulated units, **raises property values** in regulated and non-regulated buildings, and **forces out certain lower-income tenants** who can not afford higher rents.

[10] The study uses a regression discontinuity design that leverages San Francisco's 1979 Rent Ordinance which stabilized rents in properties built in or before 1979, but not in properties built after.

Residents

Based on the econometric evidence reviewed above, OLO anticipates that enacting Expedited Bill 22-22 likely would have a positive impact on residents in terms of several economic indicators prioritized by the Council.

Existing Tenants: The primary residents affected by the change in law would be current tenants of residential rental units. By extending the temporary rent stabilization policy, the Bill would decrease rents for residents who otherwise would experience rent increases above the 4.4% threshold in the absence of the change in law. Holding all else equal, lower rents would increase net household income for affected residents. Given the long-standing affordability crisis in rental housing in the County, lower rents would be particularly beneficial to cost-burdened and lower-income tenants.[11]

In addition, OLO expects the Bill to prevent certain existing tenants who otherwise would be unable to afford rent hikes above 4.4% from being displaced through eviction, non-renewal, or some other means. In these cases, the change in law may prevent tenants from incurring the various economic costs associated with housing instability—job loss, lost income, work disruptions, moving costs, legal fees, loss of possessions, etc.[12] However, because the County's rent stabilization policy lacks vacancy controls, some landlords may remove certain tenants to bring in new tenants subject to higher market rate rents.

New Tenants: As previously discussed, studies on rent regulations suggest the County's rent stabilization policy may have had mixed impacts on rents for new tenants. On one hand, the policy may have decreased rents through building/unit quality decline, residential sorting, etc. On the other hand, it may have increased rents by exacerbating the lack of affordable rental housing in the County. While extending the County's rent stabilization program for nine months likely would decrease maintenance in rentals and encourage certain landlords to either convert their units to condos or remove them from the market, OLO is doubtful these impacts would be sufficient in magnitude to meaningfully affect rents given the duration of the program extension.

Homeowners/buyers: The Bill also may affect certain homeowners and homebuyers. Based on the studies reviewed above, extending the rent stabilization program may temporarily moderate property values for certain residential properties. On the one hand, this effect may negatively impact certain residents who plan to sell their homes during the timeframe of rent stabilization extension. On the other hand, reduced property values may benefit certain homebuyers, particularly first-time homebuyers.

Other residents: As further discussed below, OLO anticipates certain owners and managers of rent-regulated properties would protect profit margins from lower rent revenues by reducing operating costs associated with building services. Net household income may decrease for any residents who experience employment loss or work hour reduction because of these business decisions.

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[11] Montgomeryplanning.org, Rental Housing Study.
[12] Bryant, et al, "Evictions in Montgomery County." For more on the costs of eviction, see the Eviction Lab.

Beyond these potential impacts, OLO does not expect Expedited Bill 22-22 to significantly affect residents in terms of the Council's other priority indicators.

Businesses, Non-Profits, Other Private Organizations

OLO anticipates that enacting Expedited Bill 22-22 would have an overall negative impact on private organizations in the County in terms of several economic indicators prioritized by the Council.

Landlords: The primary businesses affected by the change in law would be landlords in the residential rental sub-sector. As previously discussed, OLO anticipates that market conditions would support rents above the 4.4% threshold for certain properties/units. By extending the rent stabilization measure, certain landlords would lose rental revenues they otherwise would collect in the absence of enacting the Bill. Forgone rental revenues would result in a net decrease in business income for affected landlords.

To compensate for revenue loss and protect profit margins, certain landlords likely would reduce their operating costs associated with repair and maintenance or other building services. Owners and managers of highly profitable rental properties may be able to absorb revenue loss without significantly reducing operating costs. However, owners and managers of properties with tight profit margins likely would reduce expenses. While a thorough assessment of the profitability of the residential rental sub-sector is beyond the scope of this analysis, OLO suspects small rental properties would be hardest hit by revenue loss.

Other Businesses: Extending the rent stabilization policy likely would have mixed impacts on other business groups. On the one hand, certain *building service providers* likely would experience net decreases in business income from property owners and managers reducing building services for rental properties/units in response to the rent stabilization extension. On the other hand, certain *residential remodelers* may gain business income through condo conversions. Moreover, lowering rents would increase household spending for certain tenants in rent-regulated units and, thus, result in additional revenue for certain *retail and other businesses*.

While the Bill may affect other private organizations in terms of the Council's priority indicators, it is beyond the scope of this analysis to identify all potential impacts.

Net Impact

Extending the rent stabilization policy would have conflicting impacts on various resident and business stakeholders. Quantifying the net effect of these impacts is not possible due to data and time limitations. Nevertheless, OLO anticipates enacting Expedited Bill 22-22 would have an overall negative impact on economic conditions in the County in terms of the Council's priority indicators for several reasons.

First, as discussed in the Economic Impact Statement on the previous extension of the rent stabilization measure (Expedited Bill 30-21, Landlord-Tenant Relations – Restrictions During Emergencies – Extended Limitations Against Rent Increases and Late Fees), the total multiplier effect for the real estate industry is greater than the household sector, holding all else equal. The multiplier effect captures how changes in economic activity affect other rounds of spending, and how additional spending impacts certain economic indicators. To illustrate, an increase in household income may in turn increase demand for local restaurants, resulting in restaurant owners hiring more workers. Using the Regional Input-Output Modeling System (RIMS II) final-demand multipliers, OLO shows the negative impacts from, for instance, a $1,000 reduction in spending from the real estate industry are greater than the positive impacts from a $1,000 increase in household spending.

Second, enacting the Bill may reduce the County's competitiveness in the residential rental sub-market relative to certain nearby jurisdictions, particularly those in Northern Virginia. There is no rent control in Virginia.[13] Extending the rent stabilization policy may increase fears among investors that the County plans to adopt a permanent, more stringent policy (i.e., vacancy controls and/or restrictions on condo conversions), which could reduce the attractiveness of the County for investment.

DISCUSSION ITEMS

Councilmembers may want to consider the following discussion items: whether the residential rental sub-sector has been sufficiently profitable to absorb the loss of rental revenue; the extent to which the Bill would reduce housing insecurity and the economic costs associated with it; and if there is a more targeted approach that can target resources for tenants facing housing insecurity.

Furthermore, Councilmembers may want to consider whether the March 2022 CPI for housing (4.4%) is an appropriate threshold for achieving the Bill's goals of helping renters adjust to increasing rents and providing landlords with rent increases for operating expenses. For one, there are significant differences in the housing CPI over time. To illustrate, July 2022 CPI for housing is 5.7%—1.3% more than the March 2022 housing CPI.[14] Moreover, the threshold may not capture what the average tenant could afford, as wage gains have lagged increases in cost of living. Nor does it capture rising operating costs for landlords (i.e., cost of fuels and utilities has been significantly higher than the housing CPI). In short, it is unclear to OLO why the March 2022 CPI for housing was chosen as the threshold.

WORKS CITED

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[13] Tenant-Landlord Handbook 2022 – Fairfax County.
[14] Consumer Price Index, Washington-Arlington-Alexandria area – July 2022.

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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.

CONTRIBUTIONS

Stephen Roblin (OLO) prepared this report.