Economic Impact Statement

Montgomery County, Maryland

Bill 16-23 Landlord-Tenant Relations – Rent Stabilization (The HOME Act)

SUMMARY

The Office of Legislative Oversight (OLO) anticipates that enacting Bill 16-23 would have a moderate to large net negative impact on economic conditions in the County in terms of the Council's priority indicators. The Bill would establish a rent stabilization policy that would prohibit annual rent increases either above 3 percent or, if lower, the rental component of the Consumer Price Index (CPI) for certain rental units. Based on a review of peer-reviewed economic studies on rent stabilization, OLO concludes the Bill likely would significantly reduce rents for certain tenants of rent-regulated units. Certain property owners and managers likely would respond by decreasing operating expenses, or removing properties from the rental market (i.e., through condo conversion). 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 rental housing market relative to jurisdictions in Northern Virginia that lack rent stabilization policies.

BACKGROUND AND PURPOSE OF BILL 16-23

Rent regulation policies generally establish how much landlords can increase rents each year. Across the U.S., two states and nearly 200 municipalities regulate their rental market.[1] As explained in the "Minneapolis Rent Stabilization Study:"

> "The details and implementation of rent regulations vary based on jurisdictional goals. Broadly, these goals include protecting tenants from excessive rent increases, alleviating the affordable housing crisis, preserving existing affordable housing, providing housing habitability and security of tenure for renters, maintaining economic and racial diversity, and preventing real estate speculation."[2]

The intent of Bill 16-23, the Housing Opportunity, Mobility, and Equity (HOME) Act, according to its sponsors, is to help "keep renters in their homes by preventing rent gouging, reducing displacement, and creating cost predictability for renters and landlords."[3] If enacted, Bill 16-23 would:[4]

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[1] Edward G. Goetz, et. al., Minneapolis Rent Stabilization Study, University of Minnesota Center for Urban and Regional Affairs, 2021. https://www.cura.umn.edu/sites/cura.umn.edu/files/2021-08/Minneapolis-Rent-Stabilization-Study-web.pdf

[2] Ibid.

[3] "Councilmember Will Jawando, Councilmember Kristin Mink, and County Executive Marc Elrich Spearhead the Housing Opportunity, Mobility and Equity (HOME) Act," Press Release, Montgomery County Council, March 2, 2023. https://www2.montgomerycountymd.gov/mcgportalapps/Press_Detail.aspx?Item_ID=42957&Dept=1

[4] Introduction Staff Report for Bill 16-23, Montgomery County Council, March 7, 2023. https://www.montgomerycountymd.gov/council/Resources/Files/agenda/col/2023/20230307/20230307_1B.pdf

- **Establish an annual maximum rent increase for rental housing.** The maximum rent increase would be up to 3 percent or the rental component of the Consumer Price Index (CPI), whichever is lower. The increase could only occur once within a 12-month period with the landlord providing at least a 90-day notice before increasing the rent.
- **Provide exemptions for certain buildings from rent stabilization requirements,** including newly constructed units for ten years, accessory dwelling units, certain owner-occupied properties, certain moderately priced dwelling units in buildings, health facilities, religious and non-profit organizations, and licensed facilities.
- **Permit a landlord to submit a petition for a rent increase to obtain a fair return.** If a petition is granted, the landlord would have to provide the tenant a 90-day notice before increasing the rent. If a petition is denied, the landlord would have the right to appeal the decision to the Commission on Landlord-Tenant Affairs.
- **Establish an excise tax for vacant rental units.** An owner of rental property with two or more units and determined as vacant for more than 12 months would be subject to an excise tax of $500 per year per unit subject to interest and penalties. Funds collected through the tax could be used only for the acquisition of affordable housing and the administration of the Bill. The tax would take effect one year after the Bill is enacted.
- **Limit on rent increases for vacant units.** If a vacant unit returns to the market for rent, the new rental amount may include the allowable annual rent increase for each year the unit was vacant but cannot exceed 30 percent of the base rent amount paid by the prior tenant. However, the landlord may not reset the rent for the next tenant in an amount higher than the base rent paid by the previous tenant if a tenancy is terminated "for a reason not provided for in the lease or during the first year of a tenancy."

Bill 16-23 contains several other provisions, including, among others, reporting requirements and rent increase banking allowances for landlords, and administrative requirements for DHCA. The Bill would be enforced by DHCA.

Bill 16-23, Landlord-Tenant Relations – Rent Stabilization, was introduced by the Council on March 7, 2023.

INFORMATION SOURCES, METHODOLOGIES, AND ASSUMPTIONS

Per Section 2-81B of the Montgomery County Code, the purpose of this Economic Impact Statement is to assess, both, the impacts of Bill 16-23 on residents and private organizations in terms of the Council's priority economic indicators and whether the Bill would have a net positive or negative impact on overall economic conditions in the County.[5] To do so, OLO does the following in this analysis:

Reviews the econometric literature on rent regulations. To understand the economic impacts of rent regulations, this analysis presents findings from Gibb, et al (2022) and Paster, et al's (2018) literature reviews of peer-reviewed economic studies on the topic. These reviews were identified using the Google Scholar database.

This analysis also draws on OLO's findings in previous Economic Impact Statements, namely for Expedited Bill 22-22, Landlord-Tenant Relations – Limitations on Rent Increases, Expedited Bill 30-21, Landlord-Tenant Relations – Restrictions

[5] Montgomery County Code, Sec. 2-81B.

During Emergencies – Extended Limitations Against Rent Increases and Late Fees, and Bill 52-20, Landlord-Tenant Relations – Protection Against Rent Gouging Near Transit.

Draws on the above evidentiary sources to infer the likely impacts of the Bill on economic stakeholders and conditions. Among residents, the stakeholders include:

- Tenants of regulated units;
- Tenants of non-regulated units; and
- homeowners and buyers.

Among private organizations, the stakeholders include:

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

The primary assumption made in this analysis is that current and future market conditions would support annual rent increases above 3 percent or the rental component of the CPI for certain rental units. Importantly, data limitations and uncertainties prevent OLO from estimating the percentage of total rental units that, both, would be regulated under the change in law and would experience rent increases above this threshold.

VARIABLES

Some of the variables that would affect the economic impacts of enacting Bill 16-23 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

Economics of Rent Regulation

Importantly, empirical studies in the economics literature indicate that the economic impacts of rent regulations are partly contingent on the policy and regulatory details of specific rent regulations as well as local housing market conditions and trajectories. For this reason, Gibbs, et al (2022) caution policymakers against "drawing far-reaching conclusions from one case study, city, country or time period." They recommend jurisdictions develop the data and operational monitoring capacity required to conduct ongoing empirical evaluations of how the local rental housing market is functioning after the implementation of specific rent regulations.

Notwithstanding the importance of policy/regulatory details and local market conditions, Gibb, et al (2022) and Paster, et al (2018)'s reviews of economic studies on the impact of rent regulations point to several observations:

- **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). However, as a universal program, rent regulations also reduce rents for middle- and upper-income tenants who can afford rent increases. Therefore, economists generally see them as 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, other studies find rent regulations may increase rents for tenants in decontrolled units.
- **Rent regulations may increase maintenance problems.** To compensate for lower rental income, rent regulations can reduce landlord incentives to maintain units. This negative side-effect of rent regulations likely is more common 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 discourage tenants from: (a) moving into units that are closer to work, better accommodate changes to family size, etc.;, (b) purchasing homes, or; (c) finding employment outside the local labor market.
- **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,[6] 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.

[6] 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.

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 surrounding non-regulated residential properties, and **forces out certain lower-income tenants** who cannot afford higher rents.

Residents

Based on the econometric evidence reviewed above, OLO anticipates that Bill 16-23 likely would have an overall positive economic impact on residents in terms of the indicators prioritized by the Council.

Tenants of Regulated Units: The primary residents affected by the change in law would be tenants of rental units that would become regulated under policy change. By prohibiting annual rent increases either above 3 percent or, if lower, the rental component of the CPI for certain rental units, the Bill would decrease rents for residents who otherwise would experience rent increases above this threshold in the absence of the change in law. Holding all else equal, lower rents would significantly reduce nondiscretionary expenses, thereby increasing 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.[7]

It is worth noting that the economics literature indicates rent regulations reduce tenant mobility, which could offset a portion of rent savings for certain tenants who otherwise would decrease commuting expenses, attain higher pay employment in other labor markets, or build home equity by renting elsewhere or purchasing a home. Given the limited scope of allowable rent increases (no more than 3 percent or, if lower, the rental component of the CPI for certain rental units) that would be permitted under the rent stabilization policy, OLO expects it would discourage tenant mobility in ways that could offset rent savings over the long-term for certain tenants.

In addition, OLO expects the Bill to prevent certain existing tenants who otherwise would be unable to afford rent hikes above 3 percent or, if lower, the rental component of the CPI for certain rental units 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.[8] Importantly, because the rent stabilization policy would limit rent increases for vacant units, some landlords would be prohibited from removing certain tenants to bring in new tenants subject to higher market rate rents who would otherwise do so in the absence of a vacancy control.

Tenants of Non-Regulated Units: As previously discussed, studies on rent regulations suggest Bill 16-23 may have mixed impacts on rents for tenants in units that would not be subject to the regulations. On the one hand, the policy may increase rents by exacerbating the lack of affordable rental housing in the County through condo conversion, etc. If so, lower rents would increase nondiscretionary expenses, thereby decreasing net household income for affected residents (holding all else equal).

On the other hand, the policy could decrease rents through building/unit quality decline, residential sorting, etc. Because the rent stabilization policy would permit a "petition for fair return" rent increases, the Bill may mitigate this effect. However, it should be noted that depending on how well the ceiling on the petition for fair return captures the upper end

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

of capital improvements and other year-to-year changes in operating expenses as well as the quality of County code enforcement, rental unit quality may still decline in quality, which could put downward pressure on rents.

Homeowners/buyers: The Bill also may affect certain homeowners and homebuyers. Based on the studies reviewed above, the rent stabilization policy could moderate property values for certain regulated and surrounding non-regulated properties. On the one hand, this effect may negatively impact certain residents who would sell their homes. On the other hand, reduced property values may benefit certain homebuyers, particularly first-time homebuyers.

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

Beyond these potential impacts, OLO does not expect Bill 16-23 to meaningfully affect residents in terms of the Council's other priority indicators.

Businesses, Non-Profits, Other Private Organizations

OLO anticipates that enacting Bill 16-23 would have an overall negative economic impact on private organizations in the County in terms of the Council's priority indicators.

Landlords: The primary businesses affected by the change in law would be landlords in the residential rental sub-sector. By prohibiting annual rent increases either above 3 percent or, if lower, the rental component of the CPI for certain rental units, certain landlords would lose rental revenues above this threshold they otherwise would collect in the absence of the change in law. Substantial losses in rental revenues would result in a net decrease in business income for affected landlords (holding all else equal).

To compensate for revenue loss and protect profit margins, certain landlords likely would reduce their operating costs associated with various 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.

In addition, landlords who would be subject to the excise tax for leaving vacant two or more rental units for more than 12 months would experience minor increases in operating costs.

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

As illustrated above, establishing the rent stabilization policy would have conflicting impacts on various residents and business stakeholders. Quantifying the net effect of these impacts is not possible due to data and time limitations. Nevertheless, OLO anticipates that enacting Bill 16-23 would have a moderate to large negative economic impact on overall economic conditions in the County in terms of the Council's priority indicators.

First, as discussed in detail in previous Economic Impact Statements on previous rent stabilization Bills introduced by the Council, 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 rental housing market relative to certain nearby jurisdictions, particularly those in Northern Virginia. There is no rent control in Virginia.[9] While the economic literature generally finds a lack of evidence that rent stabilization measures significantly reduce new housing construction, OLO believes it is worth noting the following: The peer-reviewed economic studies on rent stabilization in the U.S. are at the state- or -major city levels. OLO is unaware of a peer-reviewed study that focuses on a jurisdiction comparable to the County,[10] namely a jurisdiction outside a major metropolitan center in which neighboring jurisdictions have divergent rent and overall business regulatory environments. Moreover, it should be noted that establishing additional rent regulations may undermine the County's reputation for a "business friendly environment." Given the scale of capital improvement projects, the loss of just one major project would have meaningful economic implications.

DISCUSSION ITEMS

Given the variability in findings on the economic impacts of rent stabilization, Councilmembers may want to consider whether the County should develop the capacity to empirically monitor the program based on local market conditions.

WORKS CITED

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Diamond, Rebecca, Tim McQuade, and Franklin Qian. "The Effects of Rent Control Expansion on Tenants, Landlords, and Inequality: Evidence from San Francisco." *American Economic Review* 109, no. 9 (September 2019): 3365–94.

Gardner, Max. "The Effect of Rent Control Status on Eviction Filing Rates: Causal Evidence From San Francisco." *Housing Policy Debate* 0, no. 0 (July 28, 2022): 1–24.

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[9] Tenant-Landlord Handbook 2022 – Fairfax County.

[10] OLO does not include this County-specific study because it was not peer-reviewed.

Gibb, Kenneth, Adrianna Soaita, and Alex Marsh. Rent Control: A Review of the Evidence Base. UK Collaborative Centre for Housing Excellence. February 2022.

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- Expedited Bill 22-22, Landlord-Tenant Relations – Limitations on Rent Increases,
- Expedited Bill 30-21, Landlord-Tenant Relations – Restrictions During Emergencies – Extended Limitations Against Rent Increases and Late Fees, and
- Bill 52-20, Landlord-Tenant Relations – Protection Against Rent Gouging Near Transit

Pastor, Manuel, Vanessa Carter, and Maya Abood. "Rent Matters: What are the Impacts of Rent Stabilization Measures?" October 2018.

Tenant-Landlord Handbook 2022 – Fairfax County. Department of Cable and Consumer Services. March 2022.

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.

AUTHOR

Stephen Roblin (OLO) prepared this report.