

An Analysis of the Pacifica Community
Reservation, Rent Stabilization,
And
Renter's Rights Act

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At the request of The Coalition for Housing Equity, I have been asked to provide an analysis of Measure C an ordinance titled the Pacifica Community Reservation, Rent Stabilization, and Renter's Rights Act (PCRRSRRA)¹. My background includes over 35 years as an academic economist and eight years as a council member for the City of Mountain View (2005-2012). I have produced research on local government services and on housing markets². Specifically, I have authored several publications on affordable housing and its impact on housing markets³. I have also dealt with rental issues in Mountain View while serving on council. In 2016, the City of Mountain View passed Measure V as a charter amendment,⁴ similar to what is being proposed by the City of Pacifica. I was appointed this past year by the Mountain View City Council to serve on the Rental Housing Committee (RHC) and provide input and policy on our rent control measure.

I have read the measure being proposed and the pro/con and rebuttal arguments provided online. As a trained academic economist and an RHC member I am particularly aware of the potential problems that arise from imposing rent controls. Rent controls have a poor history of helping the people they are intended to help. If they are binding they lead to huge queues of renters hoping to take advantage of the lower rents. They allow landlords to use non-price characteristics to discriminate between buyers rather than using the rental rate. Current proponents argue that these ordinances provide a modern type of rent control that

is more flexible than past price controls. They argue that the ordinance applies only to units built before 1995, that rents are limited to an annual CPI growth rate with a cap, and that rents must provide a “fair” rate of return to landlords. However, this is just clever window dressing. These ordinances still impose rent controls on a segment of the rental market and will still create artificial shortages, which will lead to impacts on the non-price controlled rental market.

The Pacifica measure starts out as a resolution by providing some factual information. For example under Purpose and Findings it notes a 51% increase in rents for a selected sample of older units for the years 2010-15. Without context one might assume this increase is unprecedented. One way to put this period in context is to look at housing production and prices. Almost all of the research conducted by housing economists suggests that higher home prices in the San Francisco Bay Area are a result of excessive restrictions on supply. In most non-coastal areas of the United States, an increase in demand for housing eventually leads to an increase in the supply of housing. Restricting the growth of supply results in the demand increase producing a higher price increase in the long run. . The same thing applies to rental housing, which is correlated to housing prices. As noted again under section 8 of Purpose and Findings, the City of Pacifica has not issued one permit for multi-family housing since 2013. With little increase in the supply of housing it's no wonder that rental rates have shot up so much faster than communities that have responded by building more housing.

One example of a supply restriction is the requirement for new development to provide price-controlled units at subsidized prices. Such units are targeted

toward low-income buyers. Unfortunately, this policy leads to a tax on new development, restricting the supply of new housing as landowners either decide to not develop new housing or develop their land for non-housing services. The restriction in supply also has an impact on nearby municipalities as buyers switch to lower priced areas and increase the demand for housing in these nearby communities. My research with Edward Stringham found that these affordable housing mandates increased prices and restricted the supply of housing in communities that imposed these types of mandates on new housing.

The Case-Shiller Housing Price Index is a popular data set used to compare housing prices in different areas. I downloaded the San Francisco Area data, which listed housing prices from January 1987 to December 2016⁵. I looked at several periods of strong increases in the index starting at the low point and ending at the peak. For example the index hit a low value of 125.47 in January 2012 after peaking in July 2010 at 143.23. The rate of increase from January 2012 until December 2016 is 83.50%. This is high but not as high as other runs in the housing market. The run from January 1987 to June 1990 is a mere 61.12%, whereas the run from March 1996 until April 2001 equals 103.85%. Finally the run from January 2002 to May 2006 equals 74.31%. It's safe to say that San Francisco area has experienced many booms and busts since the 1970's, and the current boom is hardly unprecedented.

I also looked at the Bay Area Consumer Price Index for All Urban Consumers: Rent of Primary Residence in San Francisco-Oakland-San Jose, CA (CMSA), (Index 1982-1984=100, Monthly, Not Seasonally Adjusted). This index measures the

average rental price of rental units. The table below lists similar boom periods to the ones mentioned above.

Start	End	Total % Change	Total # of Months	Annualized Rate
Oct. 1986	Dec. 1990	20%	50	4.41%
Mar. 1996	Dec. 2001	52%	69	7.59%
Jan. 2006	Dec. 2008	12%	36	3.84%
Jan. 2010	Dec. 2015	29%	72	4.33%

While the 2010-2015 period yielded annual rental prices equal to 4.33% per year, this was hardly unusual for similar boom periods.

One final point concerns the comparison between rental price increases and median household income for the City of Pacifica. Proponents of rent control like to tell a narrative of low-income renters being forced out of their homes after receiving extremely high rent increase notices. No doubt rents, like housing prices, have risen in San Mateo County at higher rates than the rest of the country. Lets concede this is caused by the huge increases in highly skilled and highly paid workers hired by tech companies. When proponents argue that income is not rising as fast as rents, they are clearly wrong, since landlords would not be able to charge higher rents unless potential renters have higher incomes. For example, if as stated under the Purpose and Findings section, rent prices had increased slightly above 50%, while median household income increased slightly below 3%, it would mean that households that were paying 35 % of their income towards rent would now be paying over 50% of their income towards rent. Given the turnover in this market it is highly unlikely

that landlords are renting out to individuals who would have to spend over 50% of their income on rent.

Another misconception held by the proponents is whether the measure is focused only on low-income renters. Since rent control applies only to units built before 1995, proponents falsely assume that old units must also be low-rent units rented by low-income workers. However it's very likely that some of these units have already been updated. During my term as a council member I observed many older units being upgraded. Imposing rent control on these units will merely help subsidize wealthy renters who live in higher priced rental units built before 1995.

Similar to other rent control measure, the proponents claim that landlords will receive a "fair" rate of return, but the measure excludes several cost factors that will impact a landlord's return. A council appointed rent committee is expected to decide what is a "fair" return and will only include improvements necessary to bring a unit up to code. Specifically excluded in this measure are capital improvements that are not required by state and local codes. What landlord in his right mind would invest \$100,000 or more in capital improvements only to be told they are not required and therefore not considered as part of a "fair rate of return". The net result is that landlords will be reluctant to improve the quality of their units and will just invest in basic maintenance.

In order to receive a higher rate of return, many landlords will be incentivized to remove their rent-controlled units from the market place and replace them with ownership units. I obtained census data from 1990 and 2015 and calculated the percentage change in units built before 1980⁶. For example, East Palo

Alto, a city that passed an emergency rent freeze soon after their residents voted to incorporate⁷ has experienced a 25.69% reduction in the number of units that were built before 1980. The City of Pacifica experienced a 5.37% reduction during the same time period. Mountain View and Richmond, cities that recently voted to impose rent control experienced reductions of 11.07% and 2.52% respectively. Nearby Palo Alto, which does not have rent control experienced a reduction of 12.29%. Clearly there are economic factors and other local policies that control how fast older units are replaced, but its clear that East Palo Alto has lost more than one quarter of the number of units during a time period under rent control. This result suggests that rent control has not been successful in preserving units and rents in East Palo Alto.

There are also issues with a city council delegating decision making to an unelected rental committee. Three of the members must be from the public, which means they have no “skin” in the game. Except for the two landlord appointed members, the others will lack the detailed knowledge of either the landlord or the tenant in setting rental rates and determining a “fair” return. They are not stakeholders and bear no financial risk in making poor decisions. A similar point applies to hearing officers that will decide rent increases or decreases. Individual buyers and sellers have far more knowledge in setting prices, quality, and terms for an exchange. Adding more bureaucracy to a voluntary exchange between a landlord and a tenant is a bad idea.

There is one final issue regarding establishing an unelected and unaccountable rent control committee. The committee must establish fees to charge

landlords to pay for implementing and maintaining the measure. Measure C imposes a one-time fee of \$6 per unit for “startup costs” and sets a \$19 monthly fee (\$228 per year) per unit. Proponents argue that this fee will raise \$500,000 and be sufficient to cover the ongoing costs of the program. Based on my experience as a RHC member, I believe this budget estimate is way too low. There will be enormous fixed costs in setting up and writing the specific policies of how tenants and landlords will apply for rent increases or decreases. For example, the RHC in Mountain View has already spent \$500,000 in setting up policies using staff resources and outside consultants⁸. The RHC of Mountain View has tentatively established a budget of approximately \$500,000 for only the first 6 months of the 2017-18 fiscal year. The City of Richmond, which also passed a rent control ordinance in 2016, has a tentative budget of 2.4 million dollars for the 2017-18 fiscal year. A 2015 report on the City of East Palo Alto rent control measure reported that the committee was severely underfunded and understaffed, even though it adopted a fee similar to the City of Berkeley, at \$234 per year for each unit. The City of Berkeley leads this group with an annual budget over 4.8 million. While the above mentioned budgets are for municipalities with larger populations than the City of Pacifica, most of the budgets consist of fixed costs, which are independent of population size. Based on the proposed fee, a half million budget implies 2200 units under rent control. A more realistic estimate for the budget would be range from 1.5 to 2 million dollars. This budget range implies a rental-housing fee in the range of \$682 to \$909 annually. It is unrealistic to assume the annual fee of \$228 will be sufficient to cover the normal expenditures of the rental committee.

To conclude, economists in general oppose rent controls because they do more harm than good.

¹ Proponents argue that the City Attorney of Pacifica wrote Measure C. This may be technically true but most of the ordinance is lifted/copied from other sources that are being pushed by special interest groups. If this were a school assignment, the City Attorney would be guilty of plagiarism.

² "Bureaucracy, Competition and the Tax Share Elasticity of Local Government Output", with Rodolfo A. Gonzalez, *National Social Science Journal*, vol. 15, n. 1, Fall 2000

"Estimating the Publicness of Local Government Services: Alternative Congestion Function Specifications", with S. Mehay, *Southern Economic Journal*, January 1995

"Empirical Tests of the Samuelsonian Publicness Parameter: Has The Right Hypothesis Been Tested ", with R. Gonzalez and S. Mehay, *Public Choice*, Vol. 77, no. 3, November 1993, p. 523-534

³ "What Factors Determine Support for a Parcel Tax: Evidence From Survey Data", with Abishek Fatehpuria, *California Journal of Politics and Policy*, 7(4), 2015: 1-18.

"Unintended or Intended Consequences? The Effect of Below-Market Housing Mandates on Housing Markets in California", with Edward P. Stringham, *Journal of Public Finance and Public Choice*, 30(1-3): 39-64.

"Below-Market Housing Mandates as Takings: Measuring their Impact", with Edward Peter Stringham, and Edward J. Lopez. In Bruce L. Benson, ed: **Property Wrongs: The Law and Economics of Takings**, New York Palgrave and Macmillan. 2010

⁴ The City of Richmond also passed a rent control measure this past November. Other municipalities such as Berkeley, San Francisco, San Jose, and East Palo Alto passed measures sometime ago but have amended them to reflect modern rent control ordinances.

⁵ Admittedly, this a limited time period and excludes the housing booms in the 60's and the 70's, but more recent data may accurately reflect current housing conditions.

⁶ Unfortunately the data does not separate out rental units from owner occupied units. However, my experience is that older single-family housing units are usually updated rather than demolished.

⁷ East Palo Alto eventually passed a voter approved rent control measure in 1988, which was amended in 2010.

⁸ We employed consultants because they have more experience in setting up the specific policies and how to implement them.