



RENT CONTROL: SAN FRANCISCO'S SECURITY DEPOSIT

By: Joe Rukus

“San Francisco is a city of many renters - 65% of San Francisco’s occupied units were rented in 2000, compared with only 34% nationally” - Joe Grubb

Introduction

Anna Rodman¹ is a proud, stubborn woman in her 80s. She is devoutly religious and takes great pride that she is still mobile and active. She has lived in her San Francisco apartment longer than anyone can remember. She is a walking history book on the city and remarks that there is very little that she hasn’t seen although occasionally San Francisco can still surprise her. She enjoys her neighborhood for its enduring vitality and for its walkability; allowing her to do her daily errands.

The rent for Mrs. Rodman’s one bedroom apartment is approximately \$600.00 per month. The amount constantly draws disdain from her landlord who believes she should have moved out ages ago and consequently, is never in a rush to make repairs when something breaks.

Anna Rodman and many others like her are at the core of the debate on rent control. Her landlord is able to rent an identical unit in the building to new renters at \$1,500.00 per month, but due to San Francisco’s restrictive rent control ordinance, he cannot raise Mrs. Rodman’s rent more than a few dollars each year. Mrs. Rodman is a widowed senior citizen on a very tight fixed income with no immediate family. If it were not for her \$600.00 per month rent, she could not afford to live in San Francisco and would not have another place to go to. Is the city

putting an unfair burden on her landlord by forcing him to lease to Anna Rodman at a rate substantially below market? Should the law permit Anna Rodman to be evicted, so that a natural state of economic equilibrium can occur in the San Francisco rental market?

History

Modern rent control in San Francisco stems from Proposition 13 which passed in 1978. Proposition 13 dramatically altered property tax collection in California by setting a state wide property tax rate of 1% of assessed value with a maximum annual assessment increase of 2% until property sale at which point the property would be reassessed (CA State Constitution, 2006). It may seem odd that a proposition benefiting property owners would give impetus to legislation protecting renters, but in order to get renter support, Prop 13 proponents made the following argument: lower rents would follow lower property taxes incurred by landlords because landlords would pass tax savings to their tenants.

The promised savings never materialized for most renters as landlords elected to pocket the savings. Only approximately 7,000 tenants in San Francisco received Proposition 13 rent reductions (Forbes, 1999). One large landlord, Angelo Sangiacomo, instead significantly increased rents for his tenants. The increase, coupled with the high inflation rates

1 Name changed

which existed at the time, led to fear among San Francisco's middle class renter population that they would be bombarded with rent increases which they would not be able to afford. As two-thirds of the city's residents were renters, their dismay could not be ignored by San Francisco politicians (Byrne, 2000).

In response, the San Francisco Board of Supervisors enacted a temporary moratorium on rent increases in April of 1979. While designed as a temporary 60 day ordinance, it led to a more permanent arrangement in June of 1979 with the passage of the Residential Rent Stabilization and Arbitration Ordinance, which created a board whose duties included "setting forth guidelines for rent increases" (SF Code 37.1). Rent control had begun in San Francisco. The initial act set the life of the board at 15 months, however, numerous extensions were given until the board became a permanent fixture. Over the years, the reach of rent control has expanded. New categories of units have been added and the amount of allowable rent increase has decreased. Tenant protections have also been added to prevent landlords from evicting below market paying renters (Rent Board, 2006).

Rent Control

As it currently stands, San Francisco has one of the most restrictive rent control ordinances in the nation which covers, as shown in Figure 1, 71% of the city's rental units. It applies to most older units in the city and exempts most new construction. Rent in a rent controlled unit is negotiated between landlord and tenant at the time of lease signing based on current market conditions (SF Code 37.2). After occupancy, rent increases are set annually by the San Francisco Rent Board and are calculated as percentage equal to 60% of the increase of the previous years' Consumer

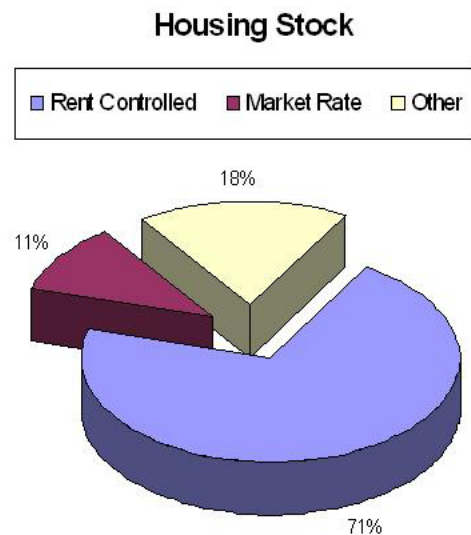


Figure 1 SF Housing Data Book, Grubb 2002

Price Index and are capped at a 7% maximum. Some additional increases may be allowed for specific expenditures such as building capital improvements, excess water usage, and certain voter approved bond measures. The amount of these increases must also be approved by the San Francisco Rent Board (SF Code 37.3). Landlords are required to keep their buildings maintained and continue to offer all amenities available at time of lease renewal. Tenants have the right to petition for a rent reduction if amenities are withdrawn (SF Code 10.10). Eviction is not an easy process. Landlords may only evict for a valid cause such as non-payment of rent, violation of lease provisions, illegal use of residence, or creation of a nuisance. Tenants are also offered opportunities to correct problems or appeal evictions. Eviction for the purpose of getting a higher paying tenant is not permitted. In limited circumstances, non-cause evictions are permitted but are highly regulated. Reasons falling into these categories are for owner move in or approved conversion of building. In these circumstances, landlords are required to compensate tenants up to \$16,500.00 per unit based on a rent board formula (SF Code 37.9).

The Critics

One would have hoped this legislation would have moderated rents, but this has not occurred in San Francisco. Median rent for new rentals rose at a rate of 8.1% between 1979 and 2001, compared to an overall Bay Area inflation rate of 4.8%. The rental vacancy rate, as measured in the year 2000, was 2.5%; well below the healthy standard of between 4%-5% (Grubb, 2002).

This, at a cursory glance, would seem to indicate rent control has been a failure and has added fuel to the fire of rent control's many critics.

One of the most outspoken critics of rent control is William Tucker. Tucker, who has a knack for getting his word out in the popular media, describes rent control as "a disease of the mind which soon becomes a disease of the market." His critique of rent control is based on the standard arguments used by most economists which

is that rent control is an unnecessary and unhealthy policy intervention into the rental market. The result is that all parties, landlord, tenant, and the community, are left worse off by the intervention. He believes that rent control creates a shortage of rental units as those who benefit from below market rents hoard their units and keep them off the market. This shortage results in higher prices for available apart-

ments as per the basic laws of supply and demand leaving those unprotected by rent control paying artificially high prices. He supports this conclusion by observing that rent controlled cities have much lower vacancy rates than cities without rent control such as Dallas, Houston, and Phoenix which routinely have vacancy rates of 15%. He further asserts rent control creates an environment where builders will

not build housing out of fear of rent control ordinances. The result is an untenable situation for urban areas which may experience increased rates of homelessness.

He believes that cities are better served by elimination of all rent control. He cites the example of the state of Massachusetts where state legislation eliminated rent control in three cities, Boston Cambridge, and Brookline. He acknowledges that unregulated rents rose but that the increase was counterbal-

anced by increases in rental housing construction which ultimately lowered rents due to increased supply. A safety net also helped those who qualified for hardship status to assure a smooth transition. This, he claims, is a model which should be duplicated in all rent controlled municipalities (Tucker, 1998).



Figure 2 Source: *San Francisco Housing Data Book, Grubb, 2002, taken from 2000 Census*

“The shortage, created by tenants holding onto below market priced units, permits the landlord to charge what could be termed, a ‘rent control premium.’”

San Francisco’s Model

If one were applying standard economic theory, Tuckers conclusion would seem logical, however, San Francisco has proven again and again that standard notions of economics do not function here as it appears we are unable or unwilling to take the steps required to create an open market. Leaving current rental housing subject to the laws of supply and demand would create social and economic havoc. The reason for this is two fold. First, the land supply of San Francisco is extremely limited at 47 square miles and is unable to expand. The city is also a location which is highly desirable. As shown in figure 2, San Francisco’s small space is the second most densely populated area of the country at 16,634 people per square mile. Secondly, the city’s zoning and anti-growth ordinances restrict any hope of significantly denser development. While city policies such as inclusionary housing have helped, they supply too few units to make any significant dent in the city’s housing shortage. The city’s economy relies on an educated, middle class workforce. In 2004, 79.4% of the city’s residents worked in the city (Franklin, 2005). According to the Housing Element of the San Francisco General Plan, the income required to afford a two bedroom housing unit in the city is \$98,000 per year and most middle class workers make significantly less with wages ranging from \$15,000 to \$70,000 a year (SF Housing, 2004). An exodus of the middle class workforce, due to lack of finding affordable housing, would have dire consequences on the city’s economy. The ability of this work force to be able to live a middle class life style and afford shelter is essential. For the city, as a whole to prosper, this must be protected.

The result of lifting rent control would create a situation where the supply of new housing, due to geographic and political constraints, would not compensate for the effects of market forces. Even William Tucker, a very outspoken rent control opponent, grudgingly acknowledges, “San Francisco...does so much to discourage construction of new housing...that with a 1% vacancy rate, the city adds just 500 residential units a year” (Tucker, 1998).

San Francisco, faced with these challenges, has crafted ordinances which provide an equitable solution to this quandary. Rent control, in its current San Francisco form, has altered the dynamics of the housing market, so that its middle class can be maintained. The nature of a residential lease has changed from a short term renewable living arrangement to a long term housing contract and the market has adapted to this change.

At the time of new rental, where price is allowed to be set by market forces, landlords are able to factor rent controls effects, long term tenancy with below market annual rent increases, by charging a higher rent. The shortage, created by tenants holding onto below market priced units, permits the landlord to charge what could be termed, a “rent control premium.” Due to the transitory nature of the city, San Francisco’s annual turnover rate is 10% which gives landlords ample opportunity to charge new rent control premiums (Grubb, 2002). In addition, the landlord receives a benefit which comes with long term tenancy; not having to worry about the costs associated with an empty unit.

The tenant receives, in return for payment of the rent control premium, the security which comes from a stable rent. Because annual increases are



Source Alexandra Iselin Waldhorn

priced below the inflation rate, the tenant is able to get a return on the rent control premium paid in the form of below market housing rents during later periods of the lease. If rent should go down, the tenant has the option of renegotiating with their current landlord or to find other housing arrangements at the time of lease renewal. One final indirect benefit to the tenant is that as the market price for new rental units increases, employers are forced to pay workers higher wages to live in the area. These factors shift the landlord/tenant relationship slightly in to the tenant's favor, however, the landlord is compensated for this shift through payment of the rent control premium.

Rational economic behavior dictates that the existence of a rent control premium on new rentals would encourage landlords to try to turn their apartments over as quickly as possible when market prices are increasing. The landlord can obtain the rent control premium only because other tenants are taking below market units off the market and that the premium would disappear if all units were rented at

market rates. Due to this fact, the city has had to put numerous protections in place to protect tenants from landlords looking to rent their unit at market. These protections are sorely needed for the system to work effectively.

The Poor

Rent control is a solution which helps the middle class, but it does little for the city's poor. In 1990, William Tucker published a highly publicized and influential study stating that rent control caused homelessness. A later study, conducted by Richard Applebaum and Michael Donnelly found fault in the methodology of the Tucker study and concluded that there was no statistical relationship between homelessness and rent control. Their analysis showed that the variables most statistically associated with homelessness were high mean temperatures, high unemployment, high percentage of renters in a city, and low vacancy rates (Applebaum, 1991).

While academics debate back and forth about the chicken and egg syndrome of whether homelessness is caused by low vacancy rates resulting in rent control or whether homelessness is caused by rent control resulting in low vacancy rates, San Francisco's poor continue to suffer. As of May, 2005, there were an estimated 6,248 homeless individuals and families in the city and only 3,600 new affordable units in the pipeline. As 40%-50% of the homeless are estimated to be suffering from mental illness and 40% have substance abuse or dual-diagnosis issues, expanding the economic base will do little to help these individuals as they are not currently employable (Franklin, 2005). The city must deal with this situation and come up with funding and zoning variances

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to rectify the problem. This must become a priority of the highest order.

Future Study

The argument I have presented for rent control is based on a theoretical model and needs empirical data to support it. The theory of rent control premium's effect on the market needs further study. It would be interesting to attempt to quantify the amount of the premium. My intuitive feeling is that the premium is lower when the market rents are increasing at quick levels as there is a greater possibility of tenants moving out when the market goes down.

Anecdotally, there appears to be no significant difference in prices between rent controlled and non rent controlled apartments of similar size and quality. The theory of a rent control premium would expect to find a price difference between the two because rent controlled apartments carry the insurance that comes from below inflation rate rent increases. Rent controlled apartments should cost more than non rent controlled apartments. I would like to see if indeed there is a price differential and if one does not exist, propose the theory that the reasoning for this is the market has already accounted for the fact that these apartments will, at some future point, become subject to rent control and has priced accordingly. A finding of this nature could have profound policy implications.

Conclusion

Rent control, in its San Francisco form, is an ideal solution for a city with severe geographic and political impediments toward the development of new rental housing. Rent control, in essence, alters the dynamics of the market and changes the nature of

the lease into a long term housing contract. Landlords receive a rent control premium at the beginning of each lease to compensate for the fact they will only be allowed below inflation increases for the lease duration. Tenants get the benefits of a secure tenancy in an under supplied and unpredictable rental market. Payment of the rent control premium protects them from market volatility while allowing them to enjoy the benefits of decreased rents when the market goes down. Strong anti-eviction ordinances protect tenants from most landlord attempts to force them out of below market apartments. As loopholes are found, San Francisco voters see to it that amendments are added to the rent control ordinance to close them. The latest loophole involves the conversion of units into "Tenancy in Common" and with housing prices rising much quicker than apartment rents, it is changing from a nuisance to an all out assault on rent control. The San Francisco Tenants Union and other community organizations are actively working to make sure adequate safeguards become enacted (SF Tenant's Union, 2006). Unless San Francisco plans to fill in more of the Bay or allow more development, rent control is one of the few ways to protect the lifestyle of middle class citizens which the city's economic base relies on.

So where does that leave Anna Rodman and her landlord? Her landlord will continue, as he has for many years, to complain that rent control and Anna Rodman are costing him a lot of money. He will continue renting out vacant apartments at market rates and enjoy the rent control premium resulting from the market shortages created by long term tenants like Mrs. Rodman. Until age finally does catch up to Anna Rodman, she will continue to enjoy the diversity of her adopted city and each day go to local merchants to run her errands. To her landlord's chagrin,

she probably will live to be 100 and never pay more than \$700.00 a month for her one bedroom apartment in a trendy San Francisco neighborhood.§

Joe Rukus is attending San Francisco State to receive a second Bachelor's Degree in Urban Studies. Joe returned to school out of a passion for social justice issues. He realized that idealism must be combined with hard research skills in order to be successful and feels San Francisco State's applied curriculum has given him many skills to make him a more effective advocate. He lives the Castro District where he has leased a rent controlled apartment for the last ten years.

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