Economic Impact Statement

Montgomery County, Maryland

Bill 15-23 Landlord-Tenant Relations – Anti-Rent Gouging Protections

SUMMARY

The Office of Legislative Oversight (OLO) anticipates that enacting Bill 15-23 would have a small to moderate 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 more than the sum of local annual Consumer Price Index for All Urban Consumers (CPI-U) plus 8 percent for certain rental units. Based on a review of peer-reviewed economic studies on rent stabilization, OLO concludes the Bill likely would reduce rents for certain tenants of rent-regulated units. Certain property owners and managers likely would respond by decreasing operating expenses associated with ordinary maintenance and repair, 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 15-23

"Rent gouging" is a term that refers to the practice of landlords raising tenants' existing rents to levels far above what is required to cover higher costs. Rent gouging is a form of "price gouging" in which a business increases the price for a good or service much higher than is considered fair or reasonable. Price gouging can occur when businesses take advantage of emergencies, demand or supply shocks, non-competitive markets, or other circumstances to boost profits.[1]

The goal of Bill 15-23 is to prevent rent gouging in the rental housing market in the County. The Bill would aim to achieve this goal by establishing protections against certain rental increases. The "anti-rent gouging" policy would have the following core features:

Rent Increase Restrictions – Annual rent increases for certain rental units in the County would be prohibited from exceeding the "rent increase allowance," defined as 8 percent of existing rent plus the CPI-U for the Washington-Arlington-Alexandria Area. The Director of the Department of Housing and Community Affairs (DHCA) would publish the annual rent increase allowance, which would remain in effect from July 1 of each year and end on June 30 of the following year.

Rental Unit Exemptions – As stated in the Bill, the following rental units and facilities would be exempt from the rent increase restrictions:

(1) a unit that has been offered for rent for less than 15 years;

(2) a unit in a licensed facility, the primary purpose of which is the diagnosis, cure, mitigation and treatment of illnesses;

(3) a unit in a facility owned or leased by an organization exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code if the primary purpose of the organization is to provide temporary shelter for qualified clients;

(4) an owner-occupied group house;

(5) a religious facility, including a church, synagogue, parsonage, rectory, convent, and parish home;

(6) a transient lodging facility subject to Chapter 54;

(7) a school dormitory;

(8) a licensed assisted living facility or nursing home;

(9) a building originally designed and constructed to contain only 2 dwelling units, one of which the owner currently occupies as a principal residence;

(10) an accessory dwelling unit;

(11) a unit subject to a regulatory agreement with a governmental agency that restricts occupancy of the unit to low- and moderate-income tenants;

(12) a single-family home; and

(13) a condominium owned by an individual.

Capital improvements Surcharge – For units subject to the annual rent increase allowance, landlords may apply for an exemption to allow to fund certain capital improvements. As stated in the Bill, if granted by the Director of DHCA, an exemption to allow a surcharge to fund capital improvements would be subject to following conditions:

(1) the surcharge is limited to an amount necessary to cover the costs of capital improvements to the regulated unit, excluding the costs of ordinary repair and maintenance;

(2) the surcharge does not take effect until after the capital improvements are completed;

(3) if the capital improvements are building-wide, the surcharge is prorated over 24 months;

(4) if the capital improvements apply only to certain regulated rental units and are not building-wide, the surcharge is prorated over 12 months; and

(5) the surcharge ends once the costs of the capital improvements have been recovered by the landlord.

Financial Hardship Exemption – Landlords subject to the annual rent increase allowance would also be allowed to exceed the allowance in cases of undue "financial hardship." The Director of DHCA would determine whether a landlord adhering to the allowance "would cause undue financial hardship." If granted, the exemption would expire after one year. The Director may renew an exemption annually.

Reporting Requirements – Landlords would be required to submit an annual report regarding "regulated rental units, rents, and notices of rent increases" to DHCA.

If the Bill is enacted, DHCA would be required to submit Method (2) regulations required under the Act by three months after its effective date. The Act would take effect six months after becoming law.[2]

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 15-23 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.[1] 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 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 more than the sum of local annual CPI-U plus 8 percent 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 15-23 are the following:

- total annual rent revenues;
- total household income;
- residential property values; and

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

- 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,[2] 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.

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 15-23 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 more than the sum of local annual CPI-U plus 8 percent 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 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.[3]

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 scope of rent increase allowance (sum of local annual CPI-U plus 8 percent) that would be permitted under the rent stabilization policy, OLO does not expect it to significantly discourage tenant mobility in ways that would offset rent savings over the long-term.

In addition, OLO expects the Bill to prevent certain existing tenants who otherwise would be unable to afford rent hikes above the sum of local annual CPI-U plus 8 percent 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.[4] However, because the rent stabilization policy would lack vacancy controls, some landlords may remove certain tenants to bring in

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[2] 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.
[3] Montgomeryplanning.org, Rental Housing Study.
[4] Bryant, et al, "Evictions in Montgomery County." For more on the costs of eviction, see the Eviction Lab.

new tenants subject to higher market rate rents. This said, OLO expects this effect to be minimal given the scope of rent increase allowance that would be permitted under the rent stabilization policy.

Tenants of Non-Regulated Units: As previously discussed, studies on rent regulations suggest Bill 15-23 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 surcharge for capital improvements, the Bill may mitigate this effect. However, it should be noted that the exemption would not include "the costs of ordinary repair and maintenance." Depending on how these concepts are defined in regulations and/or 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 associated with "ordinary repair and maintenance." 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 15-23 to meaningfully affect residents in terms of the Council's other priority indicators.

Businesses, Non-Profits, Other Private Organizations

OLO anticipates that enacting Bill 15-23 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 more than the sum of local annual CPI-U plus 8 percent 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. Forgone 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 ordinary 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

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 15-23 would have a small to moderate economic negative 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.[5] 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,[6] 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.

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[5] Tenant-Landlord Handbook 2022 – Fairfax County.
[6] OLO does not include this County-specific study because it was not peer-reviewed.

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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.

AUTHOR

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