

HISTORIC AND CONTEMPORARY RESPONSES TO HOUSING SHORTAGES: THE IMPACT OF RENT CONTROL USING SAN FRANCISCO AS A CASE STUDY

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1906 San Francisco Earthquake and Subsequent Rebuilding

The San Francisco earthquake of 1906 followed by great fires destroyed 28,000 buildings in 490 city blocks or 3,400 acres of land.¹ As described by Major General Greely, the commander of the federal troops in the city: “(n)ot a hotel of note or importance was left standing. The great apartment houses (had) vanished.... Two hundred and twenty-five thousand people were not only homeless....”²

Twenty six refugee camps for temporary housing were established following the earthquake and fires and the last camp closed in 1908 as the city quickly rebuilt with the city hosting the 1915 Panama-Pacific Exposition.³ Because new construction proceeded rapidly aided by grants and loan programs used to help finance housing construction, a wide range of housing options at varying prices were available relatively soon after the calamity. While rents did rise, the higher rents stimulated new construction and motivated people to economize on the consumption of housing. For example, even the richest families in San Francisco “doubled up”. Warren Hellman, grandson of Isaias Hellman, the president of Wells Fargo and other banks who contributed to the transformation of California into modernity recalled in the immediate aftermath of the calamity that a “whole bunch of relatives joined us; in fact, so many that there were not beds available for everybody and some of them slept on mattresses in the attic.”⁴

Contemporary Responses to Housing Shortages

The policy response to the chronic contemporary housing shortage in San Francisco and elsewhere in California has not focused on stimulating new construction but rather on limiting the increase in rents. California lawmakers recently approved AB 1482, which caps rent increases at five percent per year plus inflation, and prevents landlords from evicting tenants without citing a government-approved reason. Oregon has also passed a statewide cap on rents. The New York legislature passed a bill strengthening existing rent controls in New York City while giving other cities in the state the ability to pass their own rent control regulations.

Rent-control laws typically restrict the rate of increase in rent for a housing unit during a tenant's period of residence. When a new tenant moves into a housing unit, usually the rent control laws permit

¹ <https://stories.wf.com/helping-san-francisco-rise-ashes/>.

² *Annual Reports of the War Department*, Vol I, 1906, pp. 91-253. EARTHQUAKE IN CALIFORNIA APRIL 18, 1906 SPECIAL REPORT OF MAJ. GEN. ADOLPHUS W. GREELY, U.S.A., COMMANDING THE PACIFIC DIVISION <https://history.army.mil/documents/SFEarthquake/GreelyReport.htm>.

³ <https://www.nps.gov/prsf/learn/historyculture/1906-earthquake-relief-efforts-living-accommodations.htm>. <http://www.shelterprojects.org/shelterprojects2010/B2-USA-sanfrancisco-1906.pdf>

⁴ Dinkelspiel, Frances, *Towers of Gold*, St. Martin's Press, 2008, 247.

the rent to be raised to a market rate. The subsequent rate of increase, however, like that for an existing tenant is limited; provided the new tenant remains in the unit.

Consensus Economic Theory About Effects of Rent Control

Households which reside in rent-controlled units pay less rent for housing than occupants of units in buildings not subject to rent control.

Rent control generates negative effects including inadequate maintenance because rent control incentivizes landlords to reduce maintenance to wring out income lost from lower than market rents. Empirical analysis by Gyourko and Linneman using data from New York City demonstrates that buildings subject to rent control are more likely to be “dilapidated” than buildings not subject to rent control.⁵

Rent control serves to reduce the number of housing unit created even when newly constructed buildings are exempt from the regulation. Developers recognize that future governments may elect to change the law and make their buildings subject to rent control and therefore can be wary of constructing as many units as they would otherwise build in the absence of the threat of imposition of rent control.⁶

Rent control misallocates housing resources by eliminating the price signal-by keeping the price artificially low in conditions of scarcity and high demand- so that less housing supply increases occur. The efficient solution to a housing shortage that would otherwise cause prices to increase is an increase in the housing supply. Rent control constrains this solution. Tenants of rent-controlled apartments may also overconsume housing while tenants not in rent-controlled buildings may under consume housing.⁷

Case Study Evidence from San Francisco of Effects of Rent Control

A current issue of the American Economic Review includes a sophisticated empirical analysis summarized in an article that reveals the effects of the expansion of rent control. Diamond, McQuade, and Qian analyzed the effects of a change in the San Francisco rent control law that resulted in some San Francisco buildings suddenly subject to rent control while leaving comparable buildings not subject to rent control.⁸

The findings of the empirical analysis are consistent with consensus economic theory and prior empirical studies. These include that tenants in rent-controlled buildings remain longer in their

⁵ Gyourko, Joseph, and Peter Linneman 1990, “Rent Controls and Rental Housing Quality: A note on the Effects of New York City’s Old Controls,” *Journal of Urban Economics* 27 (3): 389-409.

⁶ Downs, Anthony, 1988, “Residential Rent Controls: An Evaluation,” Washington, D.C., Urban Land Institute.

⁷ Gyourko, Joseph, and Peter Linneman, 1989, “Equity and Efficiency Aspects of Rent Control: An Empirical Study of New York City,” *Journal of Urban Economics* 26 (1): 54-744.

⁸ Diamond, Rebecca, and Tim McQuade and Franklin Qian, 2019, “The Effects of Rent Control Expansion on Tenants, Landlords, and Inequality: Evidence from San Francisco,” *American Economic Review* 109 (9): 3365-3394.

apartment units than tenants without the benefit of below market rent controlled units. This is especially the case for older households and households which had already resided in their units for an extended time. (Younger households move more frequently than older households and therefore do not benefit as much from rent control laws).

The imposition of rent control, however, motivates landlords of properties subject to expansion of the rent control law to convert their buildings to for-sale condominiums and/or to redevelop them to uses not subject to rent control. As a result, primary long-run effects of the change in the rent control law includes:

- decreasing the supply of lower cost rental housing;
- shifting the mix of housing toward higher cost for-sale housing; and
- increasing citywide apartment rents.

In addition, the expansion of rent control has incentivized landlords to convert apartment units to for-sale condominiums or redevelop the sites with new construction (to be exempt from rent control) in highly desirable (amenity-laden) neighborhoods. As a result, tenants in units in the nicest neighborhoods have been displaced (as opposed to living longer in rent-controlled units).

The 15 percentage point decline in the inventory of units in smaller apartment buildings (21 percent decline in higher amenity neighborhoods and 12 percent increase in the numbers of owners in these same neighborhoods) as the result of landlords converting rental units to for-sale condominiums or replacing existing rental units with newly constructed units has led to citywide rent increases and led to a shift in the make-up of renters in San Francisco to higher income households.

Results of Rent Control Counter to Policy Goals Intended

Ironically, the research and analysis by Diamond, McQuade, and Qian presented in the American Economic Review article summarized above demonstrates the expansion of the rent control law in San Francisco has had consequences opposite of those intended. The expansion of rent control while benefiting those tenants in lower amenity neighborhoods which stayed in place that may otherwise have been displaced caused all future tenants to pay higher rents as a result of the decrease in rental inventory. Because of the shift of lower cost rental housing to higher cost rental and for-sale housing, the expansion of rent control has stimulated the gentrification of San Francisco.

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