

# 5840

## RENTING

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### **Abstract**

Landlord-tenant law can be grouped into three major classes - rent control, habitability, and anti-discrimination laws. At times, two or three such laws are in effect at the same time and even may be supplemented by some additional laws needed to assure their effectiveness. When that happens, as in the case where a jurisdiction has both rent control and habitability laws, landlords can find their financial future at risk. The reason is that virtually all landlord-tenant laws, intended to protect the interest of tenants, impose costs on landlords. The more such laws are enforced, the heavier the burdens on landlords, and the more limited the latter's rights and opportunities to manage their enterprise. Moreover, both deductive and inductive studies suggest that some of the landlord-tenant laws, while burdening landlords, are of little, and at times no, help to tenants, though tenants may deserve protection.

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### **1. Introduction**

Renting involves a temporary exchange of rights to occupy and make use of real property - unimproved and improved - in return for a fee, that is a rent payment. While the property may be used for agricultural, industrial, commercial or residential purposes, the law has taken special interest in residential property for a number of reasons. Housing provides shelter which is a necessity, and therefore has inelastic demand; it takes a long time to build new housing, and therefore it has inelastic short-run supply; it is one of the largest, if not the largest, budget item of most families; and it has many intangible characteristics which determine its quality, including spatial location and fixity, durability, age, size and appointments.

This review, therefore, will focus on what law and economics has contributed to the understanding, regulation, and evaluation of landlord-tenant relations and particularly the laws' side effects.

Three classes of laws regulating landlord-tenant relations will be reviewed - *rent control laws* and, in conjunction with them, vacancy decontrol, no-fault eviction and anti-conversion laws since they tend to be associated with rent control, *habitability laws* and *anti-discrimination laws*.

### A. Economic Theory of Rental Housing Markets

#### 2. Housing Market Theory

Nowhere is housing a single market in the neoclassical sense. In fact it is a set of submarkets which differ in their location, housing type, tenure, quality and other aspects (Smith, et al., 1988, p. 30). They also differ in terms of the jurisdiction's tenure strategy, that is, private versus public ownership of residential rental housing. This strategy is well documented for Australia, Germany, Holland, New Zealand, Sweden, Switzerland and the United Kingdom (Kemeny, 1995, pp. 75-129). Renting in a number of countries has also been discussed by Harloe (1985) and Emms (1990). Power (1993) has reviewed renting in five European countries.

From these and other studies it is clear that the distinguishing characteristics of housing in general, and rental residential housing in particular, are many. Some are responsible for governments all over the world frequently interceding in the relations between landlords and tenants. For example, the fact that both the supply of and demand for rental housing tend to be inelastic can lead to sharp rent increases during market adjustments, which interested parties often proclaim to constitute rent gouging (a term basically devoid of economic content).

In order to analyze rental housing in general and the effects upon it of landlord-tenant laws in particular, economists have developed special methods of inquiry. One involves housing stock models and the other flow models which use hedonic price analysis (Kain and Quigley, 1970; Rosen, 1974; Barnett, 1979; Quigley, 1979). Hedonic price analysis also has been applied to estimate the effects of certain landlord-tenant laws (Hirsch, 1981; Hirsch and Law, 1979; Rydell et al., 1981; Marks, 1984).

Hedonic price analysis looks at housing as a complex commodity composed of a host of housing services flowing from the existing housing stock with the number of housing service units determining its quality. The housing services of a dwelling include location, heat, air conditioning, size, appointments, and so on, each valued and consumed by residents. Although the flow of housing services is not well-defined and its quantity hard to ascertain and to price, the monthly rent can be considered the product of the number of housing-service units times the unit's price. The hedonic price approach supposes that the

various housing characteristics of a dwelling have distinguishable values to residents. Thus, the hedonic housing price function estimates the marginal market prices consumers are willing to pay for each housing characteristic. Information from this function can be used to combine any set of measured characteristics into a one-dimensional measure of the value of the total flow of housing services from dwellings in a specific housing market. This approach has major beneficial applications to the analysis of landlord-tenant laws. It allows looking at rent as the product of the number of housing service units and the price of a unit, providing useful insight into the effect, for example, of a rent control law. Thus, even if rent control succeeds in reducing rent, hedonic housing price analysis permits the estimation of the percentage associated with lower housing service unit prices as well as that associated with the reduced number of housing service units. The latter testifies to the extent to which housing quality has diminished as a result of rent control (Rydell et al., 1981). In a similar manner, with the help of hedonic price methods, it becomes possible to determine what, if any, effect a habitability law has had on housing quality and the price of housing service units (Hirsch, Hirsch and Margolis, 1975).

### 3. Housing Market Models

Economists have developed a number of specific rental housing models, which fall into the following categories:

1. Perfectly competitive static stock models which treat rental housing as a homogeneous commodity, thereby neglecting such characteristics as location, quality, size, and so on.
2. Perfectly competitive static flow models which assume the existence of an unobservable homogeneous commodity, that is, housing services (Muth, 1983 and Olsen, 1988). Rental housing has a variety of housing characteristics, each of which has quantitative and qualitative dimensions. This characteristics approach of Rosen (1974) involves a model of demand, supply and competitive market equilibrium. Each housing unit has a vector of  $n$  objectively measurable characteristics. A bundle of such characteristics constitutes a housing unit which has a price in the housing market. In a competitive market, such bundles and their prices indicate the implicit prices of characteristics, defined as hedonic prices. Multiple regression analysis can estimate these hedonic prices. Many of these models assume a group of households and firms to be confined to the rental market, ownership housing to be a substitute for rental housing with the price of ownership housing given, and rather static circumstances which do not identify how quality changes come about, that is, whether through maintenance, rehabilitation, conversion, and so on (Arnott, 1995).

3. Perfectly competitive flow models with select dynamic features. For example, a housing model by Sweeney (1974b) incorporates a number of dynamic features and also explicitly allows quality differentiation. In this model a landlord owning a durable housing unit of a given quality makes, for instance, maintenance decisions. Based on information on rent-quality relationships and the rate at which the housing unit deteriorates subject to maintenance levels, the landlord selects the maintenance expenditure level which maximizes the discounted present value of net revenues from his housing unit. The model allows for construction and abandonment of housing, and a model by Arnott (1987) allows for demolition followed by construction of rentals.

4. Imperfectly competitive flow models which recognize imperfections due to location, heterogeneity of housing units, neighborhood effects, search costs and imperfections in capital markets. Two major classes of such models exist. One is a monopolistically competitive model derived from search-based matching models (Diamond, 1984). Tenants' tastes guide the search for rentals. In an imperfect market, searchers finding the exact housing unit they desire can end up paying a rent above that commanded by rather similar rental units. Should landlords recognize this fact, they could charge a price above marginal cost. Yet, should there be free entry and exit, profits would decline, possibly to zero, and vacancies result.

A second class of models can be referred to as contract models where market imperfections result from asymmetric information (Hubert, 1990). For example, there can be reliable and unreliable tenants, whose identity landlords discover only after occupancy has commenced. Unreliable tenants will move frequently and, in the absence of widespread information about their behavior, impose heavy costs on landlords.

5. Political-economic models theorize about the probability of a jurisdiction enacting landlord-tenant laws (Fallis, 1988). Such models take cognizance of the fact that landlord-tenant relations are significantly affected by the relative size, wealth, and political activity of the two groups to a bargain. Landlords in many communities tend to be richer but fewer in number than are tenants. But in addition to tenants, there are also homeowners. Whether their economic interest is more attuned to tenants or landlords is not altogether clear (Arnott, 1995). A model by Epplé (1994) explicitly recognizes that a community has permanent and temporary residents, each with different interests. Neither group, however, knows the size of the other. Yet, homeowners are not incorporated into the model.

## B. Rent Control Laws

### 4. Legal Analysis

In many countries governments have enacted laws that regulate the rents landlords may charge residential tenants for their property and services. The avowed purpose has been to protect tenants from unwarranted rent increases, particularly if they might force them to vacate the premises. Most of these controls were enacted in times of severe housing shortages, mainly during wartime and periods of hyperinflation. The relation between rent control and inflation has been explored by St. John (1996).

Controls are of two types - first generation or hard controls, that is, virtual rent freezes, and second generation or soft controls which can allow for automatic rent increases (tied, for example, to the rate of inflation), cost passthroughs, vacancy decontrol, and so on.

Rent freezes were imposed on many American and European cities during World War II. Some, including New York, retained these controls long into the post-war period. For example, in the United Kingdom, rent control was enacted by Parliament shortly after the outbreak of World War II (Hirsch, 1981) and Turner (1988). The Rent and Mortgage Interest Restrictions Act of 1939 applied to rent controls as well as to security of tenure. Rents were fixed at September 1939 levels. Also a number of major cities in developing countries have first generation types of rent controls, although they differ in detail and enforcement Malpezzi (1993).

During runaway inflation of the 1970s, many local jurisdictions in the United States imposed rent control, including about 100 municipalities in the State of New Jersey alone. In California, when real estate prices skyrocketed in the late 1970s and the electorate passed a revenue limitation measure (Proposition 13), the measure's sponsors promised to reduce rents. When rents were not lowered, a number of local jurisdictions (including the cities of Los Angeles, San Francisco, Oakland, Berkeley, and Santa Monica, and the County of Los Angeles) adopted rent control ordinances. Also, about one third of cities in California had rent control ordinances in effect on mobile home parks. Moreover in the mid 1970s all Canadian provinces introduced rent control, though only four have retained them (Arnott, 1995). In 1995, residential housing under rent control is estimated to fall between 10-15 percent (Arnott, 1995).

In the United States, rent control has typically been justified by local government entities as an exercise of their police power. In the 1920s, the United States Supreme Court held that the use of state police power to enact rental controls was consistent with the due process clauses of the Fifth and Fourteenth Amendments of the United States Constitution only if utilized in response to a housing 'emergency' (*Block v. Hirsch*, 1921). In recent years,

however, for some courts a crisis or extremely exigent circumstances are no longer required to justify rent control. For example, the California Supreme Court, in *Birkenfeld v. City of Berkeley* (1976, p. 129), declared that it 'is now settled California law that legislation regulating prices or otherwise restricting contractual or property rights is within the police power if its operative provisions are reasonably related to the accomplishments of a legitimate governmental purpose.' Thus, in the United States, the court's inquiry in rent control cases is generally whether the ordinance reasonably relates to a legitimate purpose. The more important question of whether the measure will, in fact, achieve its stated objective of controlling rents is typically not reviewed by the courts. This is the traditional dichotomy between *procedural and substantive* due process, and it is this approach that ignores the value of economic analysis. The fact that rent controls may actually make a housing problem worse often appears irrelevant to a court's view of a rent control ordinance. As long as the enacting body could reasonably conclude that the measure is related to a legitimate purpose, the measure is likely to be upheld, even if it is counterproductive (*Palos Verdes Shores Mobile Estates, Ltd. v. City of Los Angeles*, 1983). American courts have two further concerns. In order not to be confiscatory on its face, a rent control ordinance must permit the regulatory board to grant across-the-board increases based upon classification enumerated by the board or statute. Alternatively, the rent control ordinance must institute a unit-by-unit procedure that will operate without what the court considers to be an unreasonable delay. There is also a constitutional requirement for a 'just and reasonable' return, a difficult concept. A requirement of recent vintage and to be discussed below is the 'nexus' test.

Rent control laws differ in stringency and tightness, depending on their coverage and pass-through provisions, the basis on which and manner in which permissible rent increases are calculated, the ease with which landlords can hope to get such increases, and whether the laws allow for vacancy decontrol, demolition of buildings, and use change. Stringent ordinances cover all premises, whereas the less stringent ones exempt single dwellings, luxury apartments, and apartment houses with fewer than four or three units. Also, the less stringent ordinances permit the cost for major repair and minor improvements to be passed on to tenants.

Great differences also exist in the manner in which allowable rent increases are set and enforced. In the most extreme case, there can be rent freezes and even rollbacks to an earlier date. Most laws provide a formula by which annual 'general adjustments' are made: some stipulate a fixed annual percentage increase, while others tie increases to changes in the cost of living. Since rents are more in line with market rent under vacancy decontrol, total decontrol should be easier in its presence than in its absence. However, discrimination can result against groups of tenants that have low turnover rates (that is, senior citizens).

Rent control is not unique to the United States. For example, in the United Kingdom, rent control has had a long history going back to 1939. The Rent Acts of 1965 and 1977 focused on 'fair rents' and allowed tenants to apply to a rent officer (with a right to appeal to a rent assessment committee) for determination of what is a fair rent for the relevant premises. In making the assessment, regard is to be had to the age, character, locality and state of repair of the premises, and also to the provision (if any) of furniture. This determination was to be made on the assumption that in the locality demand does not exceed supply, that is, the market is in equilibrium. While the legislation does not prescribe how this determination is to be made, the favored method had been to look for rents for equivalent premises in comparable jurisdictions. While possibly generating horizontal equality, the method does not assure that the rent is appropriate. This determination of fair rent has been costly to administer and has resulted in a large amount of litigation (Ogus, 1994). In recognizing its harmful effects in a White Paper of 1987, rent controls were abolished by the Housing Act of 1988. The end of fair rents in the United Kingdom has been examined by Davy (1992) and Lee (1992).

### **5. Economic Analysis: General Remarks**

Rent control laws have in common that they reduce the freedom of landlords to set rent levels and diminish the range of rents and property types that can feasibly be offered tenants. As a consequence, opportunities for mutually beneficial trades between landlords and tenants are reduced. Such laws amount to price control and result in distributional and efficiency consequences commonly associated with such controls.

An exercise in positive economics reveals a host of effects on rental housing supply, property values, maintenance and housing quality, new construction and conversion, availability of rentals, potential mismatch of rental units to households and reduced housing mobility. Moreover, distributional effects occur, not only between landlords and tenants, but also among tenant groups with differing income, gender, race and age characteristics.

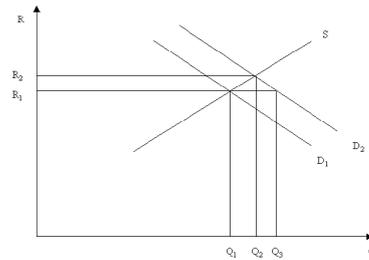
It is helpful to recognize that rent control laws can apply to two major classes of property ownership. Rent control of apartments, unless they are furnished, involve single ownership, that is land as well as improvements are owned by one and the same party. The second class involves divided ownership which occurs when the improvements are owned by one party and the land on which they are placed are owned by another. Examples are housing condominiums and cooperatives as well as mobile home parks on leased land. In relation to an appraisal of effects of rent control, the two ownership patterns differ.

Arnott recognizes, and our review confirms, that there are few empirical studies of first generation rent control in Europe at least in the English-language literature (Arnott, 1995, p. 102). Moreover, there are relatively few contributions that pertain to countries other than the United States. Exceptions are some papers on Canada (Arnott and Johnston, 1981; Smith and Tomlinson, 1981; Marks, 1984; Fallis and Smith, 1985); Germany (Börsch-Supan, 1986); Hong Kong (Cheung, 1975, 1979); Israel (Anas and Cho, 1988; Werczberger, 1988) and United Kingdom (Coleman, 1988; Ogun, 1994).

### 6. Economic Analysis: Rent Control of Single Ownership Property

First-generation or hard rent control laws, that involve a virtual rent freeze, have usually been subjected to what Arnott (1995) refers to as ‘Textbook Analysis.’ This analysis makes use of the first model discussed earlier, that is, a perfectly competitive static stock model. It focuses on rent and availability of rental housing. When, for example, inflation raises the cost of providing rental housing, controls prevent landlords from passing on cost increases to tenants.

Figure 1



Using a housing stock model in Figure 1 the two axes are rent ( $R$ ) and number of dwellings ( $Q$ ). Before the imposition of rent control on apartments, at equilibrium, the number of dwelling units was  $Q_1$  and the market-clearing rent was  $R_1$ . As a result of, for example, increases in the price of input factors (whether repair and maintenance costs, utilities, or property taxes), the supply function shifts to the left ( $S_2$ ). Without a change in demand, a new equilibrium would be reached at  $Q_2$  and  $R_2$ . Rent control would prohibit landlords from

charging the rent that they would otherwise have sought; that is, their rent will be below  $R_2$ . In the most extreme case where no rent increase is permitted, landlords would supply  $Q_1 - Q_3$  fewer dwellings than would be demanded in the short run. In the long run, rent control is likely to have a chilling effect on investors and therefore curtail the supply of housing. Thus, cumulative declines in low-cost dwellings could be anticipated, accompanied by housing shortages. Empirical estimates of the long-run price elasticity of rental housing supply related to land prices in large US metropolitan areas suggest it to be about +0.20 (Hirsch, 1981). Thus, a 10 percent increase in the price of land per year would tend to increase rents by 6.5 percent. If no rent increases were permitted, supply would be reduced by 2.4 percent of low-cost housing units, and if only half of that increase were permitted, the shortage would be 1.2 percent.

The effects of rent control can also be examined from the demand side, where the rental housing demand function shifts to the right. If we assume that, in the short run, the supply of low-cost housing rental units cannot change, a new equilibrium would be reached at a higher rent and number of dwelling units. Rent control does not permit this new price for housing units to be obtained, and a shortage of dwelling units will result. Landlords not permitted to raise rents may reduce repair and maintenance, and thereby the quality of housing. Or they may withdraw dwellings from the market by converting apartments into condominiums, convalescent homes, homes for the aged, or cooperatives. Some may even abandon their properties because of the artificial imbalance between costs and rent.

The magnitude of the likely rental housing shortage can be estimated with the aid of income elasticities for low-cost rentals. An econometric study estimated it to be about +0.98 for 1974-75 (Hirsch, 1981, p. 293). In an uncontrolled rental market, in the presence of an annual per capita income increase of 8 percent, for example, and on the assumption that the short-run supply of low-cost housing does not increase, annual rent increases of about 8.0 percent could be expected. If rent control were to be imposed and were to permit no increase whatsoever, an 8.0 percent shortage of low-cost rental units would develop. If, on the other hand, rent increases were held to half the expected 8.0 percent, or 4.0 percent per annum, a shortage of about 4.0 percent would result. These shortages would be cumulative as long as income increases over time.

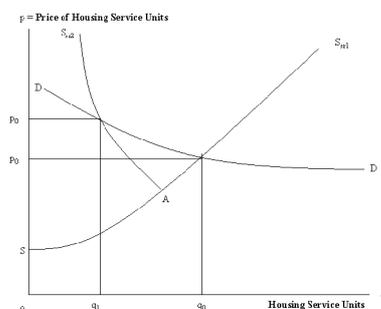
The textbook analysis has been effectively summarized by Arnott (1995). Accordingly, when rents are capped below market-clearing levels, tenants in rent-controlled apartments benefit. The longer the occupancy, the greater the benefit. The below-market rents induce excess demand for housing and in turn a mismatch of apartments to households; reduced mobility of tenants and therefore the labor force; and grey- or black-market phenomena, for example, 'key money'. Furthermore, landlords incur lower returns on their investment

and a corresponding decline in property values. They tend to reduce repair and maintenance, convert to non-controlled land uses and desist from adding apartments.

When the analysis applies the second model, that is, a perfectly competitive flow model, one can show that one effect of the reduced rents takes the form of a reduction in the number of housing service units, that is, quality of apartments provided. Empirical methods permit an estimation of the relative importance of changes in the number of housing service units provided, that is, quality of apartments, compared to housing service unit prices.

If the main concern is with rent control's effect on housing quality, a housing flow model, using hedonic housing price functions, is appropriate. A theoretical model by Frankena (1975) (the second type discussed earlier) separates the effect of rent control on the number of housing service units from that on the unit's price. Frankena does so by examining the effect of rent control as a ceiling on rent (or, equivalently, revenue) per dwelling as opposed to a ceiling on price per housing service unit. His model leads to a kinked supply curve when rent control takes the form of a revenue constraint, as shown in Figure 2.

**Figure 2**



The horizontal axis measures housing service units. Equilibrium price and quantity occur at  $p_0$  and  $q_0$ , respectively, in the absence of controls. If rent control limits revenue per dwelling to price-quantity combinations along the rectangular hyperbola  $AS_{SR2}$ , then the effective supply curve will become  $SAS_{SR2}$ . In this diagram, equilibrium occurs at a lower quality level ( $q_1$ ), but at a higher price per housing service unit ( $p_1$ ). Increased demand, then, will lead to even

more deterioration of quality.

Rydell et al. (1981) built a model that permits the estimation of both the price and the quality effects of rent control. They relied on the housing-services approach in which the variable of interest is a composite of the housing commodity's desirable attributes. If landlords charge the market rent for a dwelling with a certain quantity of housing services, a reduction in rents means that the landlords are now not being paid for all the services they supply. For example, if the rent declines by 5 percent, the landlord will be receiving payment for only 95 percent of what he offers. The landlord then will be tempted to reduce the quantity of services to only those for which he is paid. This is done for the least cost through less maintenance resulting in deterioration, which, of course, is the result predicted by Frankena.

It was projected that, after rent control had been in effect in Los Angeles for four years, the rents of controlled dwellings would be about 4 percent lower than they would have been if rent control had not been in force. Likewise, after four years, the price of rental housing services was estimated to be 3.2 percent lower than it would have been without rent control, and the quantity of rental housing service units was 1.5 percent lower (Rydell et al., 1981, p. VI).

A 1991 paper projected the effect of rent control on housing service units and their prices for eight years (Rydell et al., 1991). It confirms that rent control of the sort enacted by Los Angeles in the late 1970s would confer its benefits early and extract its costs late. The early effects of rent control were exclusively housing service price reductions, whereas, as time passed, landlords reduced the level of rental housing services in line with the rent they were permitted to charge. Thus, controls would reduce benefits to renters and also reduce supply. If the rent-control ordinance were tightened, it would accelerate those reductions without providing proportionate increases in benefits to the renters.

The long-term effect of rent control on rental housing quality was estimated by Mengle (1983). His study of eight large cities estimated that the presence of rent control was associated in 1974 with a 7.4 percent decrease in housing quality, while three years later it was associated with a 13.9 percent decrease. For indigent black tenants, the deterioration was 18.6 percent in 1974 and 26.6 percent in 1977. The deterioration was particularly serious for indigent aged tenants. Thus, in 1979 in the presence of rent control, the housing quality of all tenants had declined by 14.5 percent, of aged tenants 60 years and over by 17.3 percent, and of indigent tenants 60 years and over by 23.0 percent.

Tenant gains and landlord losses that result from rent control have been compared by Rydell et al. (1991, p. 618). Gains are defined as net rent reductions after deterioration minus loss in consumer surplus due to reduced housing and rent control fees levied on tenants. Losses are the decrease in revenue due to rent reductions and decline in housing stock plus landlords' rent control fees, minus reduced maintenance expenditures. The paper makes use

of the Marshallian consumer surplus concept and assumes a constant elasticity aggregate demand function with an 0.7 price elasticity. It concludes that the present value of landlord losses exceeds the present value of tenant gains, pointing to two reasons - (1) housing benefit losses to tenants due to quality declines outstrip landlords' savings from under-maintenance and (2) burden of rent control fees.

In order to estimate the overall effect of rent control, a rent capitalization framework can be used. In it, the expected future flow of revenues from rental properties determines their values, which, in turn, depend on supply and demand conditions and their modification by a changing legal environment (Hirsch, 1987b). An econometric study of nine middle-sized cities in Los Angeles County, California estimated that rent control was associated with an annualized decline in property values of between 7.3 percent and 11.9 percent, *ceteris paribus*. The effect of rent control was also examined by Albon and Stafford (1990).

The third model, that is, a perfectly competitive flow model with dynamic features and explicit quality differentiation, also has been applied to a second-generation rent control analysis. In its simple form it has dynamic features, allows for quality differentiation and articulates specific provisions of rent control laws. A more complicated model by Sweeney (1974b) has been discussed before. It has been expanded to allow for rent control leading to demolition of existing buildings, followed by construction of new ones (Arnott, Davidson and Pines, 1983).

### **7. Economic Analysis: Rent Control of Divided Ownership Property**

Rent control under divided asset ownership has especially extensive effects. Here are some of the reasons: improvements, whether condominiums or mobile homes, are of no residential use without the land on which they are placed. Thus, land and improvements that jointly provide residential shelter are complementary goods. The tenant-owned condominium apartment or mobile home has a negative cross-price elasticity of demand for the stream of housing services associated with the stream emanating from the land on which the improvement is placed. Consequently, a decrease in rent for fee simple condominium or mobile home park land should increase the demand for condominium apartments or mobile homes, thus causing their prices to rise. In short, capping rents of land on which condominiums or mobile homes are placed will lead to an increase in their value, and thereby yield tenants a windfall profit which accrues in addition to benefits from reduced rents. Owners of condominium apartments and mobile homes benefit from unearned appreciated values of their assets.

A capitalization model can be used to analyze, for example, the effect of changes in the rents for mobile home pads on mobile home values. Since the supply of mobile homes is assumed to be inelastic at any point in time, in this model prices are basically demand determined in the short run.

$$P = f(U, V, W, C) \quad (1)$$

where  $P$  is the sales price of a mobile home or its assessed valuation;  $U$  is the flow of housing services derived from the home;  $V$  is the price per constant quality unit of pad services;  $W$  is the price per constant quality unit of alternative housing, mainly apartments; and  $C$  is the cost of transporting and installing the mobile home (Hirsch, 1988). The price of a mobile home unit is assumed to be inversely related to  $(C)$ , the costs of transporting the home and installing it in a park. A home already located in a mobile home park should be relatively more expensive than a comparable one in a showroom, since for the former the costs of transportation and installation are absent.

Mobile home prices should be positively related to the flow of housing services ( $U$ ). The amount of housing services is an increasing function of a number of physical characteristics of mobile home units, including size, quality, and amenities contained in the coach. It is likely that consumers of mobile homes have a negative cross-price elasticity of demand for home services with respect to services of pads ( $V$ ). Consequently, any decrease in the rent for pads should increase the demand for homes, causing their prices to rise.

Two econometric studies have applied the capitalization model to estimate the effect of rent control on the value of mobile homes. One covers the State of California in 1984-86, where about 39 percent of all mobile homes were in rent control communities. Sales prices were on average about \$8,800 or 32 percent higher in communities which had imposed rent control on mobile home park rents (Hirsch and Hirsch, 1988). A second econometric study pertains to a particular mobile home park in Ocean City, California in 1987-92. It found that during 1986-92, sales prices of mobile homes under rent control were \$3,531 higher than those in uncontrolled markets (Hirsch, 1995).

When under divided asset ownership income from one asset is capped, the landlord's profit will be negatively affected in at least three ways - first, the annual rent savings benefiting tenants are losses incurred by landlords. Secondly, the lower rent adjustment resulting from rent control will be capitalized into lower prices potential buyers are willing to pay for the land on which the condominium or mobile home is placed. Thirdly, there is the damaging effect of rent control on risks perceived by potential buyers of the land. Because of heightened risks, potential park buyers will use a higher interest rate which they apply to capitalized expected rents into land values. The higher the risk, the lower the prices they are willing to pay for the land.

## 8. Distributional Effects

The issue of equity has been argued from two different points of view. One view holds that in a search for equity, macroeconomic instruments must be relied upon. It recognizes that while some equity in housing consumption is important, governments can pursue an income distribution policy which can make housing policies inefficient and even inequitable (Aaron and von Furstenberg, 1971; Kain, 1974).

The second view distinguishes between general and specific egalitarianism, that is, the general fairness of the income distribution, and concern that all citizens have a minimum amount of essential commodities, including housing (Tobin, 1970). Specific egalitarianism requires an interest in the level of housing services accruing to indigents, minorities and the aged, even if an optimal income distribution were to prevail. An evaluation of equity aspects of landlord-tenant laws clearly is based on the specific egalitarian view, without necessarily determining an optimal housing service level.

Whenever a government caps rents, distributional effects are likely to occur. In the case of single, undivided property ownership, forcing a landlord to charge rents which are below the market-clearing rent will cause his property to decline in value. The capitalization formula presented earlier gives expression to such an outcome.

Inequities tend to occur also among tenants. For example, sitting tenants tend to benefit from reduced rents. As a result, there exist fewer rental opportunities for new tenants, who may be requiring apartments because of changes in their place of work, family circumstances, student status, and so on. The longer tenants stay after rent control is enacted, the more they benefit. In particular, gains accrue to senior citizens since they tend to stay put. Landlords whose rents are controlled tend, whenever possible, to seek new tenants who are good credit risks. In the case of apartments, landlords prefer small families, whose members are not destructive, for example, young professionals. As a consequence, tenants who are poor, have young children and have large families are less likely to gain access to vacated apartments.

The long-term effects of rent control of apartments in Santa Monica, CA are well-documented in a California Court of Appeal ruling (*Santa Monica Beach Ltd. v. The Superior Court of Los Angeles County*, 1996, pp. 2155-2156). The following ten year effects of rent control found the City's stock of rental housing units declined by nearly 5 percent and ... low-income rental units [by] 12 percent ... notwithstanding that, during the same period, the rental housing supply and the number of low-income rental units *increased* in all comparable non-rent-controlled Southern California cities. The City also lost 285 'very low-income' rental units, the largest 'exodus of economically disadvantaged renters' from *any* comparable Southern California city. At the same time, the

City experienced a 37 percent *increase* in the proportion of households with very high incomes (while the proportion of very high-income households *dropped* by more than 8 percent in Los Angeles County as a whole). ... In addition, rental housing in Santa Monica has become 'increasingly unavailable' to young families, with the number of family households with children declining by 1,299, a 6 percent drop during a period when no comparable non-rent-controlled Southern California city lost young family households. ... female-headed households with children under 18 in Santa Monica fell by more than 27 [percent], despite an *increase* in such households in Los Angeles County as a whole. ... Santa Monica's elderly population ... declined by 1.7 [percent] [while] ... the elderly population of Los Angeles County *rose* by more than 15 [percent] over the same decade.

The distributional effects of controls under divided property ownership are even more pronounced and widespread. With the help of the capitalization model it can be shown that the more onerous and continuous the rent control - and therefore the greater the difference between the controlled and market clearing rent - the greater the home sales price appreciation.

In addition to these distributional effects on landlords and tenants, certain tenant classes will be particularly effected. For example, the heightened resale prices of homes placed in parks and the absence of park spaces hurts young families and transient workers especially. At the same time, sitting tenants, many advanced in age, are prime beneficiaries.

### **9. Constitutionality - Is There a Taking?**

In the United States, the constitutionality of rent control, particularly of mobile home parks, has been of concern to the court in recent years. The issue involves The Takings Clause of the Fifth Amendment which provides: '[N]or shall private property be taken for public use, without just compensation.' This Clause generally requires just compensation where the government authorizes a physical occupation of property. But where the Government merely regulates the property's use, compensation is required only if considerations such as the regulations' purpose or the extent to which it deprives the owner of the property's economic use suggests that the regulation has unfairly singled out the property owner who bears a burden that should be borne by the public as a whole.

The US Supreme Court has last ruled in 1992 on the constitutionality of rent control of property under undivided ownership. However, in 1996 a California Court of Appeal in *Santa Monica Beach Ltd. v. Superior Court of Los Angeles County* (1996) ruled rent control of apartments in Santa Monica, California unconstitutional. The alleged reason is that Santa Monica's rent

control law has failed to mitigate the effects of a growing shortage of housing units by assisting the poor, minorities, students, young families and senior citizens and, to the contrary, it has made things worse'. Thus, it did not meet the 'nexus test', to be discussed below.

The US Supreme Court has ruled on the constitutionality of rent control of property under divided ownership. Some of the characteristics of mobile home rent control may make it particularly vulnerable to running foul of the Takings Clause. Courts have employed several tests in determining whether a government action or regulation effects an unconstitutional taking of property without just compensation, typically focusing their inquiry upon: (1) the character of the government action; (2) whether the property owner has been denied his or her reasonable investment expectations; (3) the economic impact of the action on the claimants; (4) whether the action gives rise to a permanent, physical occupation of the claimant's property; and (5) whether the action substantially advances legitimate state interests.

Until 1992, courts evaluating challenges to mobile home rent control ordinances typically focused on the fourth of these factors. Should mobile home park owners be able to characterize the intrusion created by an ordinance as a permanent physical occupation, their challenges could succeed.

The leading case, adopting the position that mobile home rent control constitutes a permanent physical occupation and is, therefore, a taking, is *Hall v. City of Santa Barbara* (1986). Owners of a mobile home park challenged a mobile home park rent control ordinance by arguing that the ordinance transferred to each tenant a possessory interest in the land on which their mobile home was located. They claimed that the transfer was reflected in the facts that the prices for mobile homes in the park had shot up dramatically after the ordinance was enacted, and that many homes in the park were selling for above their bluebook value. A federal Court of Appeal citing, *Loretto v. Teleprompter Manhattan CATV Corp.* (1982), for the proposition that a permanent physical occupation of property is a government action of such a unique character that it is a taking without regard to the other factors that a court might ordinarily examine, concluded that the ordinance interfered with the park owner's property rights as described in *Loretto* and therefore constituted a physical taking. Specifically, the court found that the ordinance directs the landlord to give tenants a lease, a recognized estate in land, lasting indefinitely. Moreover, the landlords' residual rights in the property are largely at the mercy of his tenants: he loses practically all right to decide who occupies the property, and on what terms. If a tenant moves, the tenant alone decides who will be his successor by selecting the buyer for his rental unit; the landlord has no say as to who will live on the property, now or in the future.

Moreover, because of the way the ordinance is alleged to operate, the tenant is able to derive an economic benefit from the statutory leasehold by capturing

the rent control premium when he sells his mobile home. In effect, the tenant is given an economic interest in the land that he can use, sell or give away at his pleasure; this interest (or its monetary equivalent) is the tenant's to keep or use, whether or not he continues to be a tenant.

Moreover, the court is concerned that the ordinance has 'eviscerated' the property rights of the park owners, stating:

as the Santa Barbara ordinance is alleged to operate, landlords are left with the right to collect rents while tenants have practically all other rights in the property they occupy. As we read the Supreme Court's pronouncements, this oversteps the boundaries of mere regulation and shades into permanent occupation of the property for which compensation is due. (*Hall v. City of Santa Barbara*, 1986, pp. 2, 4)

Some state courts, particularly in California, have rejected the *Hall* position for two reasons: (1) mobile home rent control merely regulates the relationship between landlords and tenants, much like ordinary (apartment) rent control, and does not cause a permanent physical occupation of park owners' property, and (2) the original price of the regulated pad was artificially high (as a result of monopolistic aspects of the market) so that resulting recalibration of the prices of both goods may be seen as a restoration of the equilibrium a free market would have reached. Such a restoration is not a taking.

While it did not adopt the California courts' approach, the US Supreme Court specifically rejected the *Hall* approach in *Yee v. City of Escondido* (1992), holding that a mobile home rent control ordinance without a vacancy decontrol provision did not effect a physical taking. The Court held unanimously that a physical taking can occur only when the government requires that the landowner submit to a physical occupation of his or her land. Yet the Escondido ordinance did not impose such a requirement, because a park owner could choose to evict all tenants and change the use of his or her land. It merely established the terms of the landlord-tenant relationship for those landowners who chose to devote their property to mobile home parks.

Even as it rejected the argument that the Escondido mobile home rent control ordinance effected a physical taking, the *Yee* Court may have opened the door to challenges to mobile home rent control ordinances as regulatory takings. The Court implicitly invited such challenges by noting that the plaintiffs' argument was 'perhaps within the scope of our regulatory taking cases' (*Yee*, 1992, p. 165). The Court also stated that rent controls 'are analyzed by engaging in the "essentially *ad hoc*, factual inquiries" necessary to determine whether a regulatory taking has occurred' (*Yee*, 1992, p. 166). Also, commenting on the plaintiffs' argument that the Escondido ordinance transferred wealth from landlords to incumbent mobile home owners, the Court stated that:

This effect might have some bearing on whether the ordinance causes a *regulatory* taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance. See *Nolan v. California Coastal Commission*, supra, at 834-835, 97 L.Ed.2d 677, 107 S.Ct. 3141. But it has nothing to do with whether the ordinance causes a *physical* taking. (*Yee*, 1992, p. 167)

Finally, in response to plaintiffs' argument that the Escondido ordinance effected a physical taking because it deprived landlords of the ability to choose their incoming tenants, the Court stated:

This effect may be relevant to a regulatory taking argument, as it may be one factor a reviewing court would wish to consider in determining whether an ordinance unjustly imposes a burden on petitioners that should 'be compensated by the government, rather than remaining disproportionately concentrated on a few persons.' [Citation]. But it does not convert regulation into the unwanted physical occupation of land. (*Yee*, 1992, p. 167)

With each of these statements, the Court hinted that a regulatory takings challenge might succeed where the physical takings challenge failed.

As the *Yee* Court suggested with its citation of *Nollan v. California Coastal Commission* (1987), a challenge to a mobile home rent control ordinance as a regulatory taking could be based on the fifth of the five Takings Clause factors: whether the ordinance substantially advances a legitimate state interest. As is set forth in *Nollan*, this test requires more than just a rational basis for the state's action. For the action to pass constitutional muster, there must also be an essential *nexus* between the stated ends of the state action and the means employed. An argument that mobile home rent control is a regulatory taking could be based on the absence of a substantial nexus between mobile home rent control and the objectives it is supposed to advance. For example, if the objective of rent control is to alleviate a housing shortage and economic theory suggests, and empirical evidence confirms, such an outcome to be unlikely, a regulatory taking would have occurred.

In a more recent decision, the US Supreme Court appears to have added a further requirement to the nexus test. In *Dolan v. City of Tigard* (1994) the Court added a 'rough proportionality requirement'. It held that the city's exactions for flood control purposes and a pedestrian bicycle path were unconstitutional. Although both were legitimate public purposes, and there was a significant nexus between these ends and the exactions required by the city, the degree of the required exactions was disproportionate to the impact that the planned land development would have on problems addressed by the exactions. In short, it failed the 'rough proportionality' test. There is still the question to

what extent *Dolan* is applicable beyond the context of exactions required for permit approval, for example, rent control.

### C. Laws Complementing Rent Control

Rent control laws, particularly those of the first generation, often create conditions that appear to require follow-up legislation. They include vacancy decontrol, just-cause eviction laws and anti-conversion and anti-demolition laws.

#### 10. Vacancy Decontrol Laws

All over the world rent controls, once imposed, have been politically difficult to lift. Obstacles to terminating rent control are particularly formidable after controlled rents have fallen substantially below market levels. In order to avoid this situation, some jurisdictions allow vacancy decontrol of the following major types: once the tenant vacates the premises, the landlord can charge higher rents, for example, whatever rent the market will bear and (1) the premises remain decontrolled or (2) rent control is reconstituted at the higher rent. Some jurisdictions prescribe by how much rents can increase once premises have been vacated.

Particularly the first type of decontrol would allow market forces to correct the disequilibrium created by rent control. The result would be particularly favorable under divided property ownership, for example, when the tenant sells the mobile home or condominium (Hirsch and Hirsch, 1988).

Vacancy decontrol of mobile home parks, in particular, raises the question of who gains and who loses. While the unearned windfall profits of sitting tenants will clearly be reduced, the effect on new tenants requires analysis, specifically whether potential mobile home buyers will be better off with or without decontrol. Using a simple supply-demand housing stock model, controls can be shown to limit quantity supplied. With rent control, the supply curve moves up and prices increase. With vacancy decontrol, the supply curve shifts down. If vacancy decontrol results in an increased quantity, then the price will necessarily fall. While new purchasers clearly benefit in terms of lower initial prices, they are worse off due to pad rents starting at a higher level. This will lower the demand curve for mobile homes, but it would be hard to imagine a shift that lowered it enough to get a new equilibrium at a lower number of units. Sitting mobile home owners will generally be worse off due to the change. With permanent controls, they are free to sell the future rights to the controlled land rents, but lose this option with vacancy decontrol. They lose by

the price decrease if they sell and by a lesser amount if they stay. For those planning to stay indefinitely, there is only a minor impact.

### 11. Just-Cause Eviction Laws

In the presence of vacancy decontrol, landlords have a strong incentive to create circumstances conducive to tenants vacating their premises. To counteract these tendencies, jurisdictions often enact just-cause eviction laws, which enumerate the specific causes which allow eviction. Causes include among others, failure to pay rent, disorderly conduct, willful damage to premises, and so on (*New Jersey Stat.*, 1974). Some states have attempted to apply such laws solely to senior citizens (California Assembly A.B.1202, 1974).

The effect of a just-cause eviction law is to increase the security of tenancy. The demand function for apartments with just-cause eviction guarantees is higher, that is, further to the right, than that without such guarantees, *ceteris paribus*. Thus, the law by protecting tenants enhances their utility. But while just-cause eviction laws increase the welfare of tenants, they also impose costs on landlords. Specifically, such laws reduce landlords' rights and thereby flexibility, and place greater risk upon them. Moreover, legal costs are likely to increase. As a consequence, the rental housing supply function shifts to the left in the presence of just-cause eviction laws, *ceteris paribus*.

Depending on the relative shifts of the demand and supply functions, three different outcomes are possible. In the most likely case, the cost to the landlord of operating under a just-cause eviction law are higher than is the law's value to tenants; the result can be fewer dwellings. In a second case, the cost to the landlord is smaller than the increased value to the tenant. The result usually will be more dwellings, however, at a higher rent. In a further case, law-induced benefit and cost increases are about equal with all parties left in the same welfare situation as before.

### 12. Anti-Conversion and Anti-Demolition Laws

To protect tenants from landlords circumventing rent control laws, some jurisdictions have enacted anti-conversion and anti-demolition laws. The former prevent apartment house owners from converting properties into condominiums, cooperatives, or convalescence homes. While these laws protect tenants, they interfere with landlords' rights to seek the most efficient and profitable use of their property. Thereby they can create inefficiencies as well as inequities, particularly when they prohibit ownership of residential rental property to go out of the housing business.

### D. Habitability Laws

Habitability laws (or housing codes) compel landlords to make sure that a rental meets minimum standards of habitability, that is, is not substandard housing.

#### 13. Legal Analysis

Laws regulating landlord-tenant relations historically favored landlords over tenants. Specifically, the doctrine of *caveat emptor* was applied to relieve landlords of responsibility for warranting that a building rented for residential purposes was fit for that purpose at the inception of the tenancy. Landlords had no responsibility for a building to remain habitable during the term of tenancy. Repair of damage caused by ordinary wear and tear was considered the tenant's responsibility.

In 1826, the doctrine of *constructive eviction* was first recognized in the United States (*Dyett v. Pendleton*, 1826). Grounds for constructive eviction, which permitted the tenant to surrender possession and vacate premises, were the *covenant of habitability* and the *covenant of quiet enjoyment*. The covenant of habitability required the premises to be delivered in tenantable fit or suitable condition. Concerned that the only relief for tenants was to vacate the premises, some state statutes and court decisions in the post-World War II period modified the doctrine of constructive eviction. In so doing, the doctrine of *caveat emptor* was reinterpreted in relation to the rights and obligations of landlords and tenants. In light of the complexity of rental housing and the inequality of bargaining power in present-day society, a move towards the doctrine of *caveat venditor* occurred. As a result, an implied warranty of habitability in urban rental leases evolved (Markovits, 1976; Schwallie, 1990).

In the mid-1970s two parallel developments occurred in the United Kingdom and the United States. In 1975 the Law Commission (Law Com. No. 67) handed to the Lord High Chancellor its proposed *Codification of the Law of Landlord and Tenant*. He in turn laid this *Report on Obligations of Landlords and Tenants* before Parliament Law Commissioners (1975). The Report proposes *inter alia* that particular obligations of landlords and tenants be divided into two classes - mandatory obligations that cannot be varied or excluded, and variable obligations that can be varied or excluded by agreement of the parties. The important mandatory obligations included the tenant's right to exclusive possession of the premises and their quiet enjoyment; the tenant's mandatory obligation was to pay rent, to protect the premises and to disclose his identity; as well as the landlord's obligations to disclose his identity.

The Law Commission also recommended that tenancy for a term of less than seven years be governed by an overriding covenant obliging the landlord

to repair the structure and interior of a dwelling. In tenancies of a furnished dwelling for a term not exceeding 20 years there should be an implied, but variable, covenant by the landlord to keep the entirety of the premises in repair. In tenancies over 20 years and in the absence of expressed agreement, the entire responsibility for repairs of the premises should be imposed on the tenant.

In 1976, the American Law Institute adopted *Restatement of the Law: Property 2d - Landlord and Tenant* (American Law Institute, 1976). According to the document's section on habitability, a court could hold that a landlord had breached a covenant of habitability even though he had an agreement with a tenant on a month-to-month basis that clearly indicated that both landlord and tenant were fully aware of housing code violation. Remedies available to tenant include rescission, damages, rent abatement and rent withholding. Moreover, tenants are protected against retaliatory eviction.

The United Kingdom has various laws providing for compulsory improvements and repair. For example, the Housing Act of 1974 in Part VIII provides powers to compel landlords to provide a bathroom and other standard amenities on request from a tenant (Haden, 1978). This requirement, which had existed since 1964, was intended by the 1974 Act to include repairs associated with the provision of standard amenities, and also to permit local authorities to act without a formal request from a tenant. In response to representation from a tenant, local authorities inform the owner and then inspect the premises and finally prepare a schedule of work and an estimate of costs. Under certain circumstances steps are initiated by the local authority as a result of house-to-house inspection. At any time within six weeks, the owner may appeal to the county court on the ground that the notice is invalid, for example that the expense involved is unreasonable or that the standard of repairs required is unreasonable in relation to the age, character and locality of the house. Once the notice has become operative, the owner has a further six months to decide whether or not to serve a purchase notice on the local authority. If no action of any kind has been taken by the owner on the expiration of the six month period, the local authority may then serve a formal reminder asking whether the owner intends to carry out the work. Should this not produce a satisfactory response, the local authority may then serve further notice stating that it intends to carry out the work in default and, after a further 21 days, may do so. Alternatively, it may wait until the full 12 months have expired and then act in default, though it must still give the owner 21 days notice of its intention to do so. In either instance, the cost of the work may then be recovered from the owner, subject to further provision of an appeal against the amount claimed.

Procedures for compelling owners to carry out repairs on their property have been successfully instituted under the Public Health Act of 1936 and 1961. Large authorities are reported to issue hundreds or thousands of formal and informal notices per year under these statutes, compared to tens or hundreds

under the Housing Act. Compulsory repair under the Public Health Act requires a finding of a statutory nuisance. As such it must either be prejudicial to the health of an occupier of the house in question, or a nuisance that is a danger or an annoyance to adjoining occupiers or other people in the area. It appears that the Public Health Act has been mainly used to require owners to remedy relatively inexpensive defects.

By means of housing codes, many large American cities have shifted to the landlord the responsibility for repairing leased premises and maintaining them in habitable condition. Toward this end in the United States, for example, three remedies were developed - repair-and-deduct, rent withholding and receivership, with the first two often supplemented by retaliatory eviction laws, designed to protect tenants from eviction by former landlords for complaining about housing code violations.

The implied warranty of habitability has been used as a defense in action of eviction, if the tenant is able to show that a 'substantial' violation of the housing code existed during the period rent was withheld. In addition, the tenant may take affirmative action against the landlord for breach of contract, though remaining liable for the reasonable value of the use of the premises.

Of the three remedies listed, receivership is potentially the most costly to the landlord. It results in a complete stoppage of rental income to him, since all tenants in the building, not only aggrieved ones, pay rents into escrow. Moreover, the landlord loses control over his building altogether. Instead, control is temporarily transferred to a receiver, who may be enthusiastic about fixing up the building, possibly even above minimum standards established by housing codes. The repair decisions are thus made without due consideration of their potential profitability. Finally, contrary to most repair-and-deduct and withholding actions, receivership is usually initiated by government, which has vast resources behind it.

It must be remembered that these laws were designed to protect tenants in view of their unequal bargaining power as well as their inability to effectively inspect a dwelling in the light of its structural and technological complexity. The unequal bargaining power issue affects mainly poor tenants and, in particular, members of minority groups. The great complexity of today's rental housing is of concern to all tenants, though the rich can quite readily cope with complexity. In response to both conditions, courts have extended warranties of habitability to leases of rental housing.

Concerning inequality in bargaining power, Judge Skelly Wright has argued in *Javins v. First National Realty Corporation* (1970, p. 1071)

The inequality in bargaining power between landlord and tenant has been well documented. Tenants have very little leverage to enforce demands for better housing. Various impediments to competition in the rental housing market, such as

racial and class discrimination and standardized form leases, mean that landlords place tenants in a take it or leave it situation. The increasingly severe shortage of adequate housing further increases the landlord's bargaining power and escalates the need for maintaining and improving the existing stock. Finally, the findings by various studies of the social impact of bad housing has led to the realization that poor housing is detrimental to the whole society, not merely to the unlucky ones who must suffer the daily indignity of living in a slum.

In connection with the complexity of today's dwellings which affects everybody, including the richest tenants, Judge Skelley Wright has stated in *Javins v. First National Realty Corporation* (1970, p. 1073):

the increasing complexity of today's dwellings renders them much more difficult to repair than the structures of earlier times. In a multiple dwelling repair may require access to equipment and areas in the control of the landlord. Low and middle income tenants, even if they were interested in making repairs, would be unable to obtain any financing for major repairs since they have no long-term interest in the property. ... The tenant must rely upon the skill and bona fides of his landlord at least as much as a car buyer must rely upon the car manufacturer. In dealing with major problems, such as heating, plumbing, electrical or structural defects, the tenant's position corresponds precisely with the 'ordinary consumer' who cannot be expected to have the knowledge or capacity or even the opportunity to make adequate inspection of mechanical instrumentalities, like automobiles, and to decide for himself whether they are reasonably fit for the designed purposes.

#### **14. Economic Analysis: Short-Term Welfare Effects**

By 1972 about half the states in the United States had a habitability law. Moreover, a number of local jurisdictions enacted such laws. An example is the City of Los Angeles with its Habitability Enforcement Program (Los Angeles City Ordinance 171074, 1996).

While many legislators and judges are likely to agree that provision of habitable rental housing is a socially desirable goal, a crucial issue is whether enacting habitability laws is likely to have socially desirable effects, especially on indigent and minority tenants. The outcome depends to a large extent on whether landlords can pass on significant parts of their increased maintenance and repair costs to their tenants.

In the early 1970s, this issue began to be researched, first by applying economic theory and later by carrying out econometric studies. Ackerman (1971, p. 1093) reasoned that 'when code enforcement is seriously pursued, market forces will generally prevent landlords from passing on their increased

costs through rent increases'. In opposition to this position, Komesar (1973, p. 475, 1187) argued that in many housing markets landlords were unlikely to be able to pass on their cost increases. An econometric study attempted to empirically estimate the effects of various habitability laws not only on cost but also on demand functions of rental housing (Hirsch, Hirsch and Margolis, 1975). In this manner an understanding of the welfare-effects of such laws became possible.

Habitability laws have forced landlords to improve repair and maintenance of their dwellings and thereby improve the welfare of their tenants. It is clear that the cost to landlords increases in the presence of habitability laws. However, it is less clear on *a priori* grounds, whether and, if so, to what extent the well-being of tenants increases, let alone whether tenants' welfare increases exceed landlords' losses. One reason why tenants' welfare may not increase relates to tenants' preferences. There can be instances, admittedly not too many, where tenants prefer to live in substandard housing as long as their rent is commensurately low. Whether, on balance, the gains of tenants exceed the costs of landlords is affected by the relative importance of those tenants who are forced against their will to live in improved housing at higher cost.

Some econometric studies have attempted to estimate the welfare effects of repair-and-deduct, rent-withholding, and receivership laws, respectively (Hirsch, Hirsch and Margolis, 1975). The econometric analysis uses hedonic price methods, and includes habitability laws among the explanatory variables in the rental housing demand and supply equations. The extent to which the demand and supply functions shift upward in the presence of a particular habitability law can be estimated, and so can the resulting change in consumers' surplus. If such laws are enforced and lead to improved repair and maintenance, the tenants' wellbeing will be enhanced and the demand function will shift upward.

On the supply side, habitability laws can affect maintenance and repair decisions, and, as a result, they can increase landlords' costs. In consequence, they can make the supply function shift upward. Welfare conclusions can be derived by comparing the magnitude of the vertical shifts of these demand and supply functions. Using a hedonic price approach, an econometric study found that, of the three types of habitability laws, in 1974-75 only receivership had a statistically significant effect on both the demanders and suppliers of low-cost rental housing in 34 large metropolitan areas with more than 1/4 of the United States population. Receivership laws were found to be associated with a statistically significant increase in rental expenditures incurred by indigent tenants, which, however, was not matched by benefits. Costs exceeded benefits by a factor of three and the consumer's surplus declined by more than 10 percent (Hirsch, 1981, p. 272). Thus, although habitability laws were designed to improve the welfare of indigent tenants, in the sample studied they had failed to do so. Receivership laws may even have been counterproductive.

An econometric analysis of black and aged indigent tenants, respectively, reveals that habitability laws affect them differently. For black indigents, again the vertical shift of the supply function related to a receivership law is more than three times that of the demand function and the difference again is statistically significant (Hirsch, 1983, p. 128). Yet, for aged indigents, the vertical shifts of the two functions are about of equal size. In short, for black indigents, receivership laws were counterproductive, while for aged indigents they were of no consequence.

Why are habitability laws inconsequential or even counterproductive? One reason is that these regulations are not accompanied by an increase in the indigents' purchasing power which should have permitted them to pay for improved housing. Without income transfers, habitability laws can be counterproductive. Schwallie (1990, p. 525) recently concluded that the implied warranty of habitability and habitability laws incorporating this warranty have often failed indigent tenants. The main reason is that 'the warranty of habitability results in scarcer, more expensive housing for the poor. Moreover, the quality of low-rent housing is a consequence of inadequate demand due to the low incomes of renters...'. The effects of making the implied warranty of habitability compulsory on repairs, maintenance and safety and on equity have been discussed by Singer (1993, pp. 756-759).

### **15. Economic Analysis: Alternatives**

Consistent with the objectives of habitability laws, housing subsidy laws for rental housing meeting minimum standards have been enacted. When subsidies go directly to landlords, and only to those who meet minimum quality conditions, improved housing is assured. Moreover, the entire subsidy is then used for housing.

In the United States, one such program is Sections 501 and 504 of the Housing and Urban Development Act of 1970, often referred to as a housing-allowance program. Under it, tenants who meet an income test are paid a rent subsidy as long as they do not live in substandard housing. The rent subsidy amounts to the difference between the rent payments and 25 percent of the tenant's income. Such an earmarked subsidy is very different from a general welfare payment that can be used by recipients for whatever purpose they choose. Whenever the income elasticity of rental housing is smaller than one, and there exists evidence that this is the case for indigents, an earmarked subsidy is to be preferred (de Leeuw, 1971). As tenants receive such a rent subsidy, their housing demand function shifts to the right. Depending on the demand and supply elasticities and the nature of the demand function shift (that is, whether it is parallel or not), part, all, or none of the subsidy will be shifted

to landlords in the form of rent changes.

### **16. Economic Analysis: Long-Term Welfare Effects**

Beyond short-run welfare effects of habitability laws, there exist also long-run effects, particularly in terms of housing stock deterioration. If such laws reduce dilapidation, upper income groups who by and large can assure themselves of habitable housing are little affected. The benefits to low and low-middle income groups are less clear. While the result is an increase in the supply of habitable rentals, their demand will also increase.

There is some empirical evidence regarding the effectiveness of habitability laws in reducing substandard housing. An econometric study of the relation between habitability laws and two different measurements of dilapidation in the United States in 1960-75 produced the following results: among the different habitability laws receivership laws have the greatest effect on housing quality. In their presence, renter-occupied dilapidated and deteriorating housing units declined on average by 12.4 percent (Hirsch and Law, 1979). The law's effect was even more pronounced if substandard housing is defined as housing lacking some or all plumbing facilities. By this measure, substandard housing declined by an average of 17.0 percent.

It would be a mistake, however, to look upon a decline in substandard rental housing as an unmitigated gain. In fact, in the absence of substandard housing, options for indigent tenants are reduced. Some tenants are likely to end up in over-crowded standard units, or even homeless.

### **E. Laws Complementing Housing Codes**

Landlords may be tempted to evict tenants who invoke habitability laws. For such cases, anti-retaliatory eviction laws exist in some jurisdictions and they can be supplemented by anti-speedy eviction laws.

### **17. Anti-Retaliatory Eviction Laws**

Such laws, designed to protect tenants from being penalized by their landlords for complaining about housing code violations, can be looked upon as a means to assure tenants continued occupancy for a specified period. Already in the mid-1970s, about half the states in the US had such laws, usually with a 3-6 month rent freeze. Determination of the landlord's motive is of critical importance.

In terms of economic effects, anti-retaliatory eviction laws can be viewed as miniature, temporary rent control laws which preserve the existing rent status quo in the face of a changed buyer-seller relationship. The force of the rebuttable or conclusive presumption tends to deter landlords from raising rents for the statutory period, while operating and maintenance costs increase. The temporary and rather limited scope of retaliatory eviction laws is unlikely to cause many landlords to abandon their property. However, when the landlord feels legally 'safe' in raising rents, the increase may be larger than would have been the case otherwise.

### **18. Anti-Speedy Eviction Laws**

In the United States, for a long time the judicial process of ejecting a tenant was heavily burdened with procedural complexities and of slow pace. During the middle and end of the nineteenth century, legislation was enacted to provide a more efficient remedy through the institution of special summary proceedings for landlords seeking to evict tenants. The new proceedings were to prevent landlords from taking the law into their own hands through self-help. In the recent past, laws to rein in the use of summary proceedings and self-help have been enacted.

Under a summary eviction law procedure, a basic pattern followed in most states is that upon a judgment for the landlord, in the absence of an appeal, a writ of restitution will be issued. Then, after a short period, the sheriff will execute the writ by evicting the tenant. However, in some states a concern for the wellbeing of the tenant and a desire to mitigate the harshness of an eviction has led to the adoption of legislation which permits a court to delay the enforcement of the writ of restitution. The major mitigating circumstance is that the tenant cannot find alternative housing.

In many states, the courts recognize some variation of the common law right to self-help by landlords. The minimal conditions are a clear right to possession by the landlord without use of unreasonable force in retaking possession. Generally, peaceable entry in the absence of the tenant will be recognized as a legitimate exercise of the landlord's authority. However, an increasing number of states have abrogated this common law right to self-help. They have recognized the existence of a tort claim by the tenant against the landlord who enters to retake the premises, even with reasonable force.

One group of states permits a tenant a tort cause of action against the landlord for removal of the tenant without resort to judicial process, if the removal is against the will of the tenant. A second group expressly bars any use of self-help by the landlord, permitting the tenant a cause of action for the mere act of entry by the landlord in an attempt to remove the tenant. An example is

California (*Jordan v. Talbot*, 1961).

Analysis of the economic effects of anti-speedy eviction laws can be similar to that of habitability laws. Both types of speedy eviction impose burdens on tenants while benefiting landlords; laws modifying or negating them should result in upward shifts of the rental housing demand and supply functions. If the vertical shift of the demand function in the presence of anti-speedy eviction laws exceeds that of the supply function, and the difference is statistically significant, welfare is enhanced, and vice versa. An econometric study of black indigent tenants indicates that laws reining in landlords' use of self-help measures may be socially desirable (Hirsch, 1983).

#### **F. Anti-discrimination Laws**

Housing discrimination is said to exist when members of one or more groups, commonly defined by race, gender, age, religion, or family status, are denied housing that is available to other groups, regardless of formal qualifications. Not only does discrimination violate concepts of fairness, but it can also result in many social and economic side effects.

#### **19. Racial Discrimination: Legal Analysis**

Countries have enacted a variety of laws to combat housing discrimination. Discrimination on the basis of race has played a major role in the history of the United States. A housing discrimination survey of 25 large metropolitan areas with central city populations in excess of 100,000 and where at least 12 and 7 percent of the population was black or Hispanic, respectively (Turner, 1991, pp. 3-17) produced the following findings. In the United States in 1989 black and Hispanic renters faced a 39 and 36 percent probability, respectively, of being denied information about housing availability, and a 17 and 16 percent probability, respectively, of being told that the advertised unit is no longer available even though it was available to comparable whites. For blacks and Hispanics the index of unfavorable treatment in completing the renting transaction was 44 and 42 percent, respectively.

Since the end of the Civil War in the United States, a number of affirmative steps have been taken to combat discrimination. In terms of housing activities, Section 1982 of the Civil Rights Act of 1866 together with its interpretation by the US Supreme Court in *Jones v. Alfred H. Mayer Co.* (1968) was first. Next came the Fair Housing Act of 1968 and Fair Housing Amendments Act of 1988.

For housing, one of the most important acts is that of 1968 which is often referred to as the 'Fair Housing Act'. It prohibits discrimination based on race, color, religion, sex, and national origin in the sale or rental of most housing. While it covers a host of activities related to real estate and housing, it includes real estate brokers, apartment owners and extends to federally owned and operated dwellings and dwellings provided by federally insured loans and grants. Title VIII prohibits such discriminatory activities as refusal to rent a dwelling; terms, conditions, or privileges of renting dwellings; indicating preferences or limitations in advertising; and so on.

## **20. Racial Discrimination: Economic Analysis**

Racial housing discrimination appears to exist in many countries with racially diverse populations (Page, 1995). In many Western countries, especially the United States, such discrimination has been on the decline. Economists have been interested in the reasons responsible for housing discrimination and how anti-discrimination laws affect them, and welfare effects of anti-discrimination laws.

A number of theories have been advanced to explain the existence of rental housing discrimination and the resulting segregation by race. They include the aversion theory (Muth, 1970), racial prejudice theory (Becker, 1957; Bailey, 1959), and amenity theory (Yinger, 1976).

Effects of race discrimination which have been explored include segregation, employment opportunities, crime, drug use, homelessness, and so on (Sander, 1988). Laws prohibiting racial discrimination in rental housing impose on landlords costs which often can be sufficient to persuade them not to engage in this practice. If this is the case, these laws can do more than merely contribute to fairness. Since racial housing discrimination is inefficient, as it restricts the housing choices of minority families and their efficient access to housing, employment, and educational opportunities, these laws also enhance efficiency.

## **21. Age Discrimination: Legal Analysis**

In the United States until recently little attention was paid to housing discrimination of age groups. Even as late as 1971, the US Supreme Court in *Graham v. Richardson* (1971) included among 'suspect' categories requiring strict scrutiny only race, national origin and alienage. Recently, state legislatures and courts, as well as local governments, have shown concern about housing discrimination against families with children. By 1981 nine states and the District of Columbia had enacted laws dealing with age discrimination in

housing, and many courts began to interpret discrimination laws to cover age. For example, the California Supreme Court, in *Marina Point, Ltd. v. Wolfson* (1982) interpreted the California Civil Rights Act as preventing housing discrimination against children. The court also found that the strongest basis for this position rested upon California's Unruh Civil Rights Act (1982) which provides that '[a]ll persons ... are entitled to ... full and equal accommodations in all business establishments'. California courts have interpreted the phrase 'business establishments' to include housing.

Comprehensive federal legislation only arrived with enactment of the Fair Housing Amendments Act of 1988. It prohibits landlords to refuse to rent or show a house or apartment to a family with children younger than 18, or to require such a family to pay higher rent, impose restrictions or create unfair barriers not required of someone without children. However, under some circumstances, families with children can be excluded, for example, in 'housing for older persons'. There are two classes of such housing: (1) '62 or over housing', if all tenants in the housing complex are 62 years or older, and (2) '55 or over housing', if at least 80 percent of all units in the complex have at least one occupant 55 years or older and there exist significant facilities and services to meet the needs of older people.

Major concerns have been voiced concerning the facilities and services requirement of '55 or over housing', mainly its vagueness (California Senate Select Committee on Mobile Homes, 1989). Fear has been expressed about the potential for litigation and cost of providing appropriate facilities and services for senior citizens, particularly since approximately 60 percent of the more than 5,000 mobile home parks in California in 1988 had adult-only restrictions (California Senate ..., 1989, p. 13).

Thus, age discrimination laws relating to housing have been directed mainly at tenants with children and at senior citizens. The interests of these two classes of tenants can be in serious conflict. Senior citizens favor a tranquil life which often becomes difficult with young children as close neighbors. Thus, some mobile home parks are dedicated to senior citizens. Young families, like all families, want to be free to live wherever they choose.

Arguments in opposition to anti-age discrimination laws were advanced, for example, in *Flowers v. John Burham & Co* (1971) where a California appellate court determined that, because of children's 'independence, mischievousness, boisterousness and rowdyism', age discrimination within housing was not arbitrary discrimination. Also, the dissent in *Marina Point Ltd. v. Wolfson* (1982) argued that regulations regarding children are reasonable and rationally related to the services performed by the landlord when it has been determined that the apartment complex has been constructed for all-adult housing and its facilities are ill-adapted for use by children. Thus, landlords are faced with two costs associated with the Wolfson decision: Not only will landlords be

prohibited to choose tenants on the basis of whether or not they have children, but they will also be forced to incur expenses to alter their premises to accommodate children.

Arguments in favor of such laws include the serious impact on family stability as well as a deep psychological effect on children. Moreover, since many minority families have many children, child discrimination might be disguised racial discrimination and no doubt contributes to such discrimination.

## **22. Age Discrimination: Economic Analysis**

The conflict that can arise when children and senior citizens are housed in great proximity can be looked upon as an externality problem. In the abstract, price discrimination can help solve this conflict. Depending on each market's demand, either families with children or senior citizens would be forced to pay higher rents, which in some instances could be prohibitive. Clearly such a resolution of the conflict is likely to run into political opposition.

Furthermore, traditional economic theory tends to indicate that landlords in highly competitive housing markets will seldom, if ever, refuse to rent to families with children. In such a setting, a landlord could satisfy his distaste for families with children at the expense of a higher vacancy rate. Therefore, housing markets with age discrimination probably contain elements of monopoly. The landlord has some locational monopoly as well as some market power due to any unique characteristics his building may have. More important, exclusionary maximum density zoning laws and slow growth policies of local governments, combined with a growing demand for housing rentals, have tended to widen the gap between the quantity of dwellings supplied and those demanded. While rents should have adjusted to this situation and helped to close these gaps, in reality price adjustment in the housing market has been slow. This result is due to institutional features, as well as the existence of long-term leases.

Microeconomic analysis of welfare effects can utilize a demand and supply housing stock model. Since children impose costs on landlords, for example, for heightened repair and maintenance, the supply curve shifts upward as the number of children increases. With children affecting negatively the utility of some tenants, their demand function will shift downward. The welfare effect of such laws depends on the relative importance of tenants who enjoy children in their building compared to those who are ill-affected and if so by how much.

## **G. Policy Implications**

### **23. Policy Implications**

Many countries have a host of landlord-tenant laws and there exists an extensive legal, economic and law and economics literature on the subject. By far the greatest interest has been shown in rent control. Until recently virtually all appraisals of its effects on society were negative, perhaps for two reasons - economists' misgivings about any form of price control and excessive focus on first generation, hard rent controls analyzed by perfectly competitive, static economic housing models. A few voices have recently been heard claiming that analyses of second generation controls which recognize the imperfection of housing markets are much less conclusive. Arnott (1995, p. 118) concludes, 'the case against second-generation rent control is so weak that economists should at least soften their opposition to them'. However, Arnott concedes that '[E]ven if the optimal rent control package would be beneficial, the actual ... package thrown up by the political process may be harmful' (p. 109).

Habitability laws are also common to many countries, although in only a few instances have their welfare implications been subjected to careful economic analysis. Some deductive and one econometric study in the United States raise serious doubts about their desirability.

Anti-discrimination laws have also become common all over the world as society is seeking to free itself from race and age discrimination in rental housing. While society has good reason to oppose housing discrimination, and anti-race discrimination laws tend to be socially desirable, the efficacy of anti-age discrimination laws is less clear. The reason is that both young and old families have valid claims. The former lay claim to their right to live wherever they want, and the latter to the quiet enjoyment of their homes and surroundings.

Additionally, and perhaps most importantly, law and economics should not look at the various laws in isolation. All too often jurisdictions have enacted a number of laws, for example, rent control laws with anti-conversion and anti-demolition provisions together with habitability laws. The former prevent landlords from using their best judgment in deciding on rent levels and on the best use of their property, thereby reducing their investment's profitability and their ability to preserve housing quality. Yet, habitability laws compel them to provide tenants with habitable housing. In the extreme case, thus, landlords find themselves between a rock and a hard place.

In conclusion, this review of renting confirms the judgement of Williamson (1996) that law and economics is a success story. This assessment is clearly correct in so far as Renting is concerned. Contributions to tools of economic analysis, legal thought and public policy have had a major impact and proved

valuable.

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