

Urban Economics

Rent Control

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Next week

Our final quiz is on April 29th

Final briefing note is due on May 3rd and this is a hard deadline

Rent Control



Why housing policies?

Having housing is crucial, families without it face significant challenges to health (physical and mental), safety, and employment (to name a few)

Many families face challenges either getting housing at all, or getting adequate housing

A Housing Crisis Amid Tens of Thousands of Abandoned Homes

Ten years after Katrina, many New Orleans residents struggle to find an affordable place to live even though the city is full of vacant properties.

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Can rent control help?

Rent control creates legal restrictions to what can be charged in rent

Rent control creates a price ceiling – price cannot increase above this ceiling

The goal is to make housing rent cheaper by forcing rents lower

Types of rent control laws

Rent control laws differ by region but they typically limit the rate of increase of rent for a dwelling during a tenant's period of residence

So if you rent a property that has rent control, your landlord can only increase rent up to the maximum percent increase per year

But if you move out and the landlord rents to someone else, she can then increase the rent before she puts your old dwelling back on the market (called "vacancy decontrol")

New buildings are often exempted from rent control laws

Types of rent control laws

While most rent control laws have this feature (“vacancy decontrol”), some don’t

Laws that do not allow vacancy decontrol (landlords can’t re-adjust rents when tenants leave) are deemed to be strong rent control

Strong rent control laws: CA (West Hollywood, Santa Monica, Berkeley, East Palo Alto, Cotati)

But these strong rent control laws are unenforceable since 1996 after the Costa-Hawkins Rental Housing Act

What does economics say about Rent Control?

Two types of economics research will help us determine the effects of rent control:

1. Predictions from economic models
2. Empirical evidence (e.g., difference-in-difference statistical studies)

We will look at both sets of evidence, starting with (1)

Predictions from economic models

There are different models of the economy that will generate different predictions of the impact of rent control.

Consider two extremes:

1. Perfect competition
2. Monopoly

Under perfect competition, rent control will have adverse consequences, making it undesirable

Under a monopoly, there is a greater likelihood for beneficial outcomes

Rent control under perfect competition

Under perfect competition, the market is extremely competitive

No firms have market power

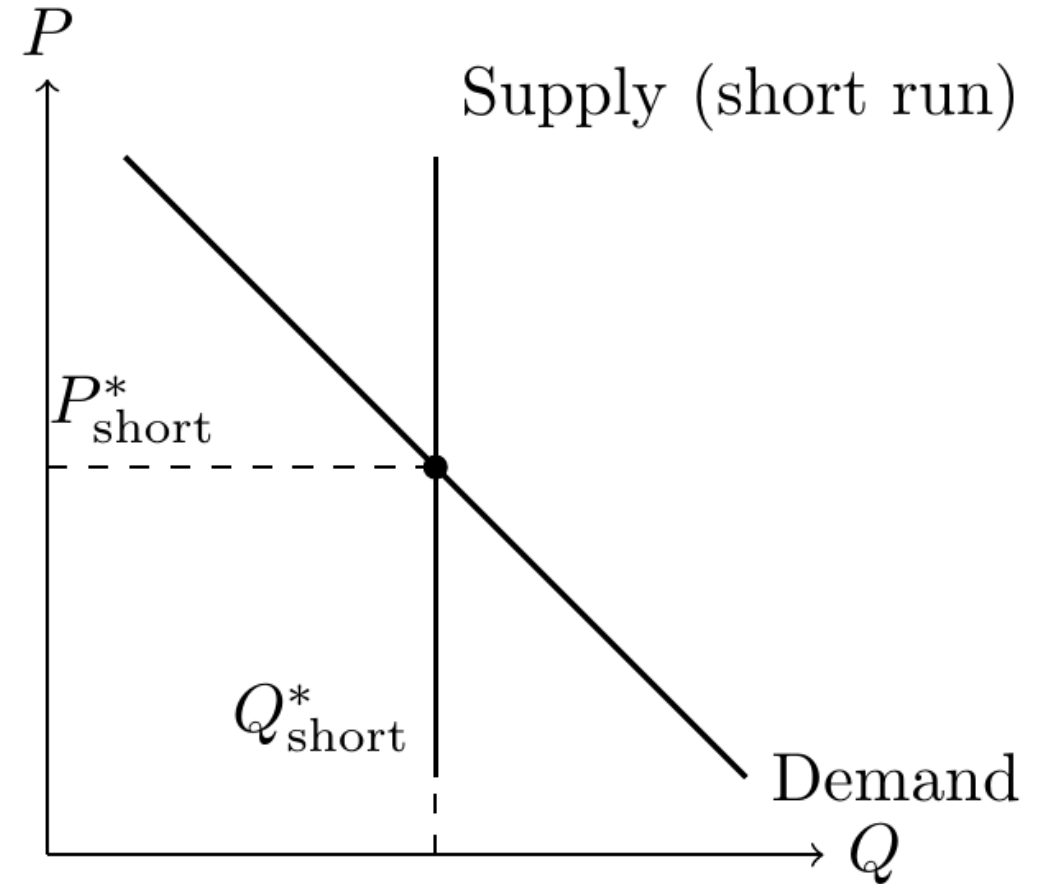
No consumers have market power

Market price is determined by supply and demand and is exogenous

Rent control: Long-run vs. short-run

Housing developers can't build new housing immediately, so housing supply in the short run is fixed (vertical line)

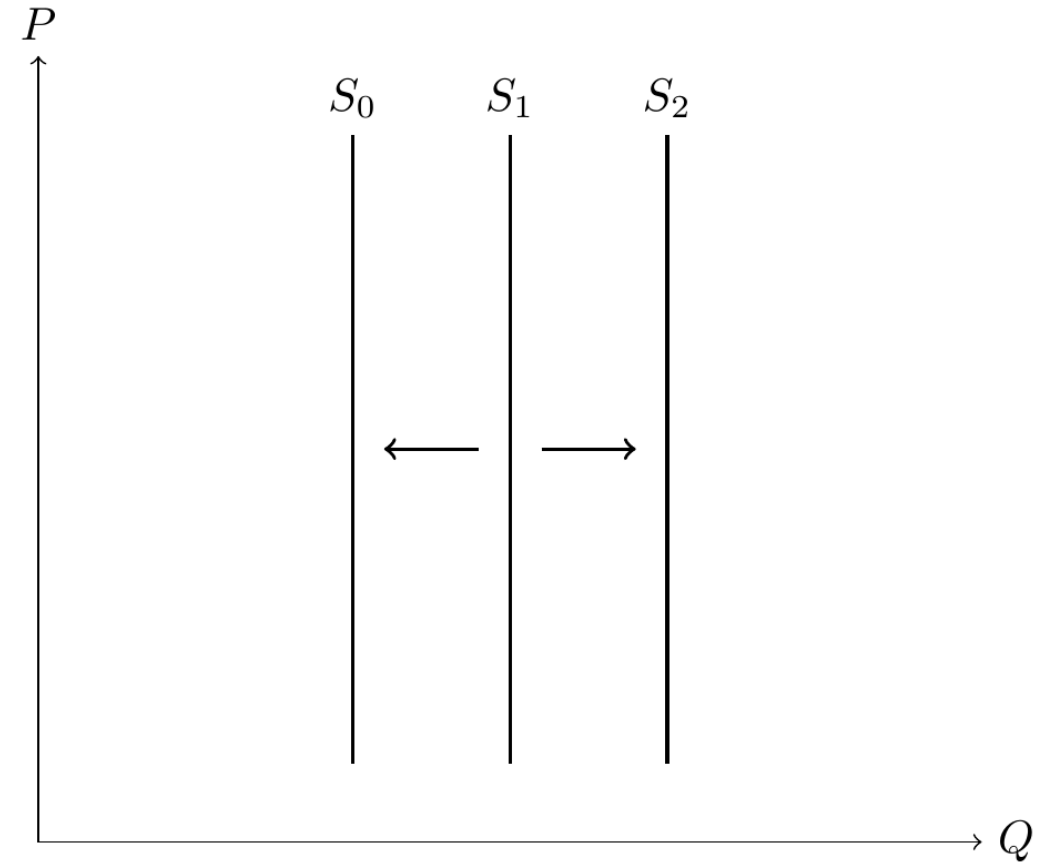
Equilibrium occurs where the downward sloping demand curve intersects the short run supply curve



Rent control: Long-run vs. short-run

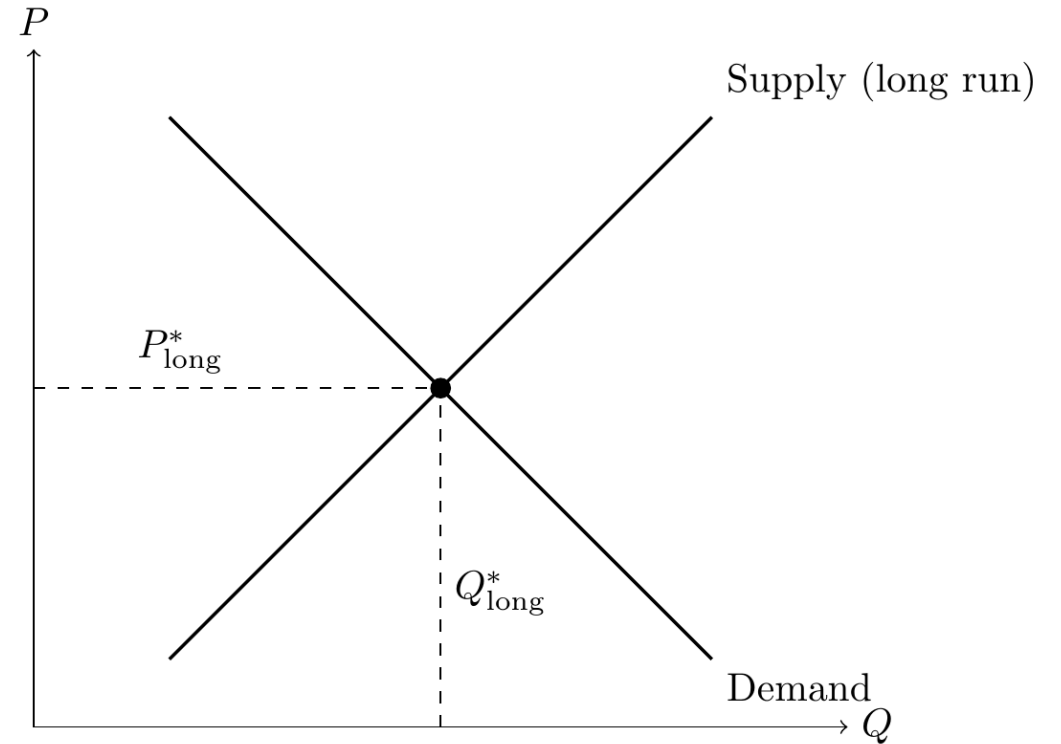
In the long run, housing developers can change the housing stock by building more units (S_1 to S_2) or by letting some units fall into disrepair (S_1 to S_0).

Since populations are increasing in more cities, it's usually a matter of how much housing gets built in the long run (a lot vs a little)



Rent control: Long-run vs. short-run

The long run supply curve is upward sloping, as in the long run more housing gets built when prices are higher



Addition of rent control

Rent control operates as a price ceiling: price cannot go above the ceiling

This price ceiling can either be binding or non-binding

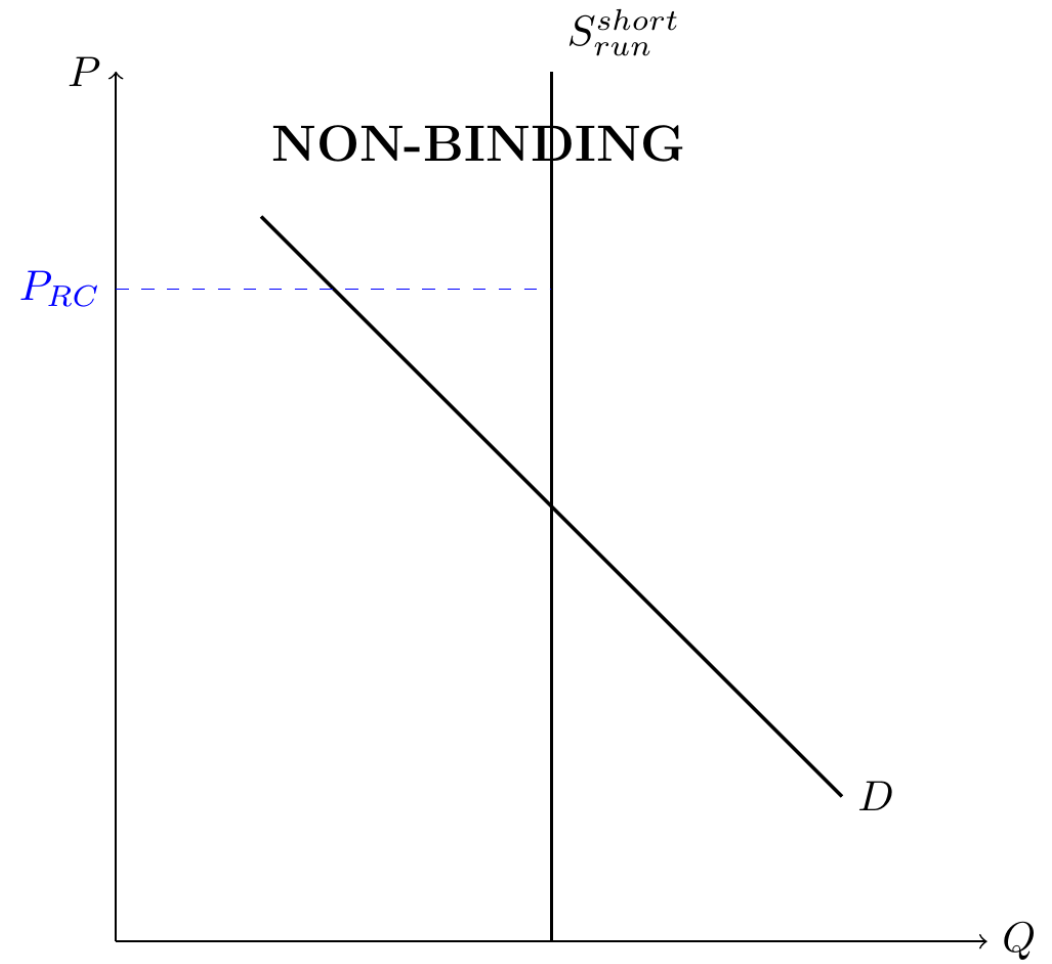
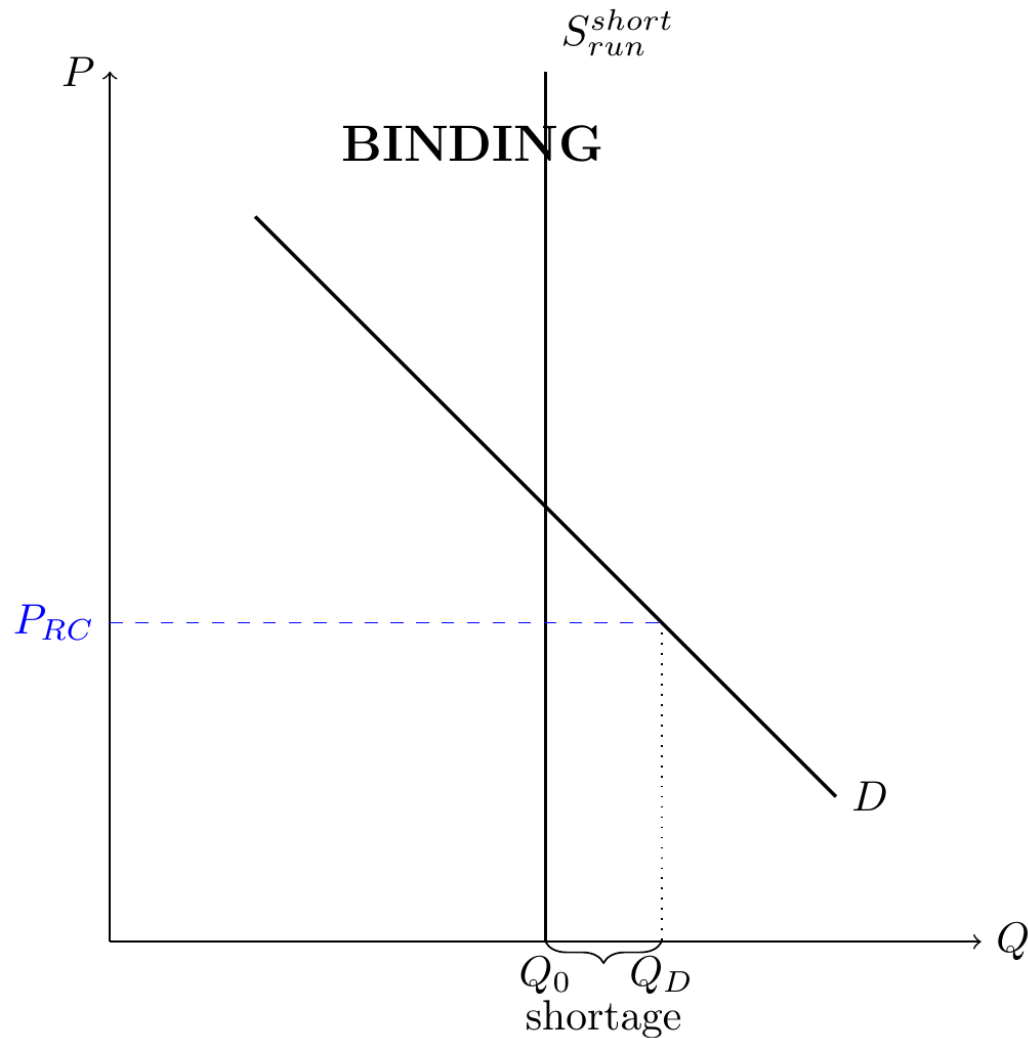
Binding: The price ceiling is less than the equilibrium rent

When binding, rent control has an effect on the market

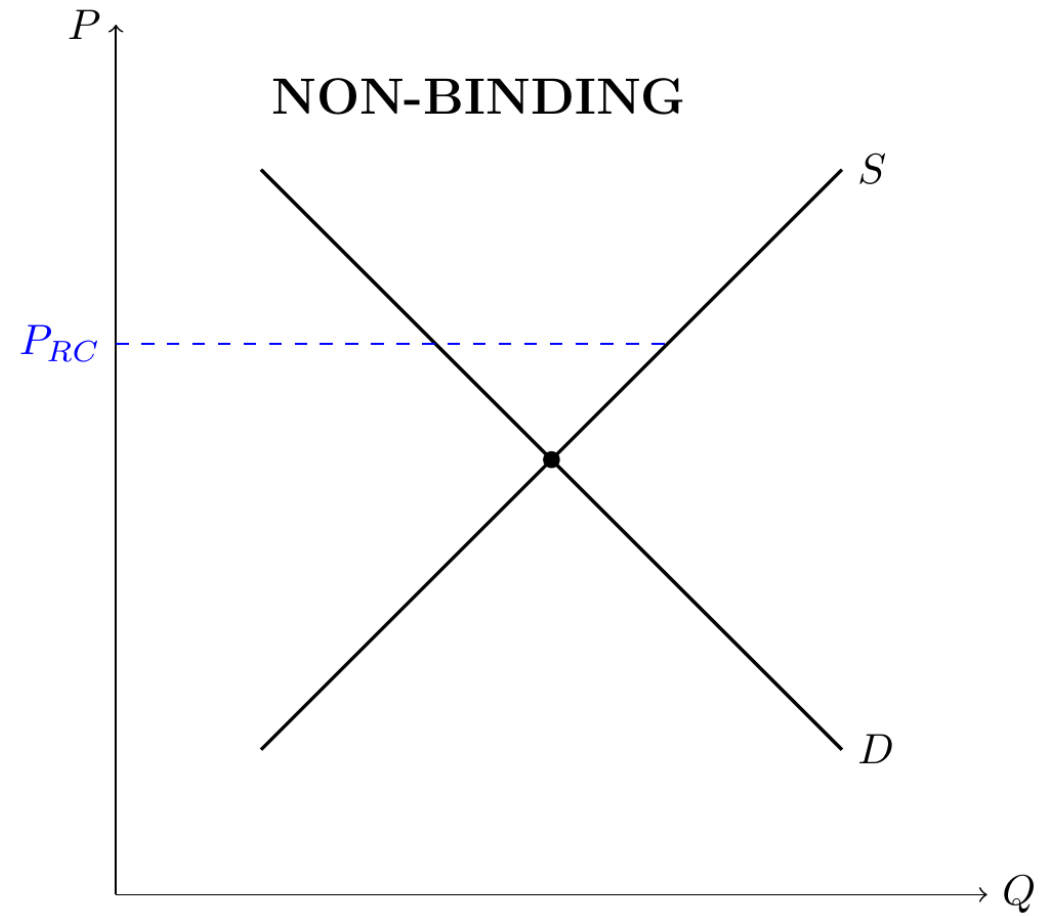
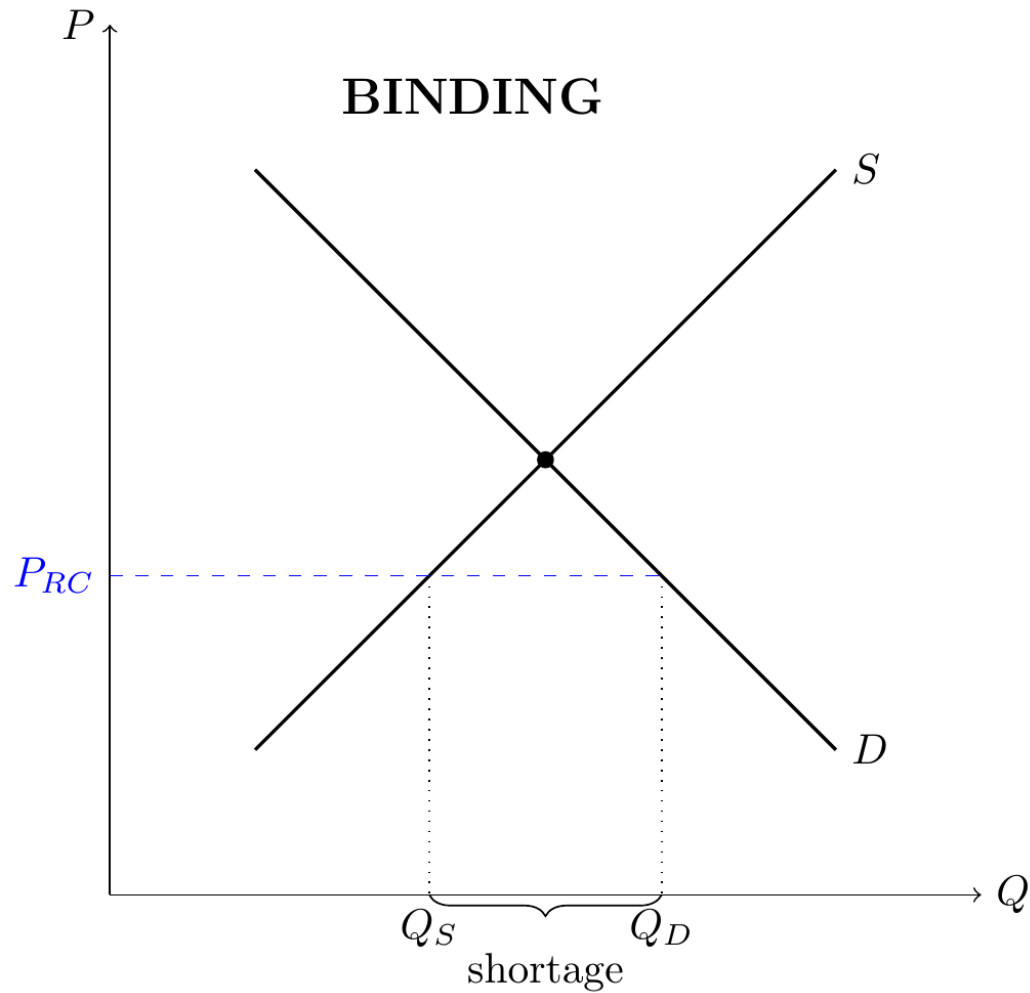
Non-Binding: The price ceiling is equal to or greater than the equilibrium rent

No effect on the market (for now)

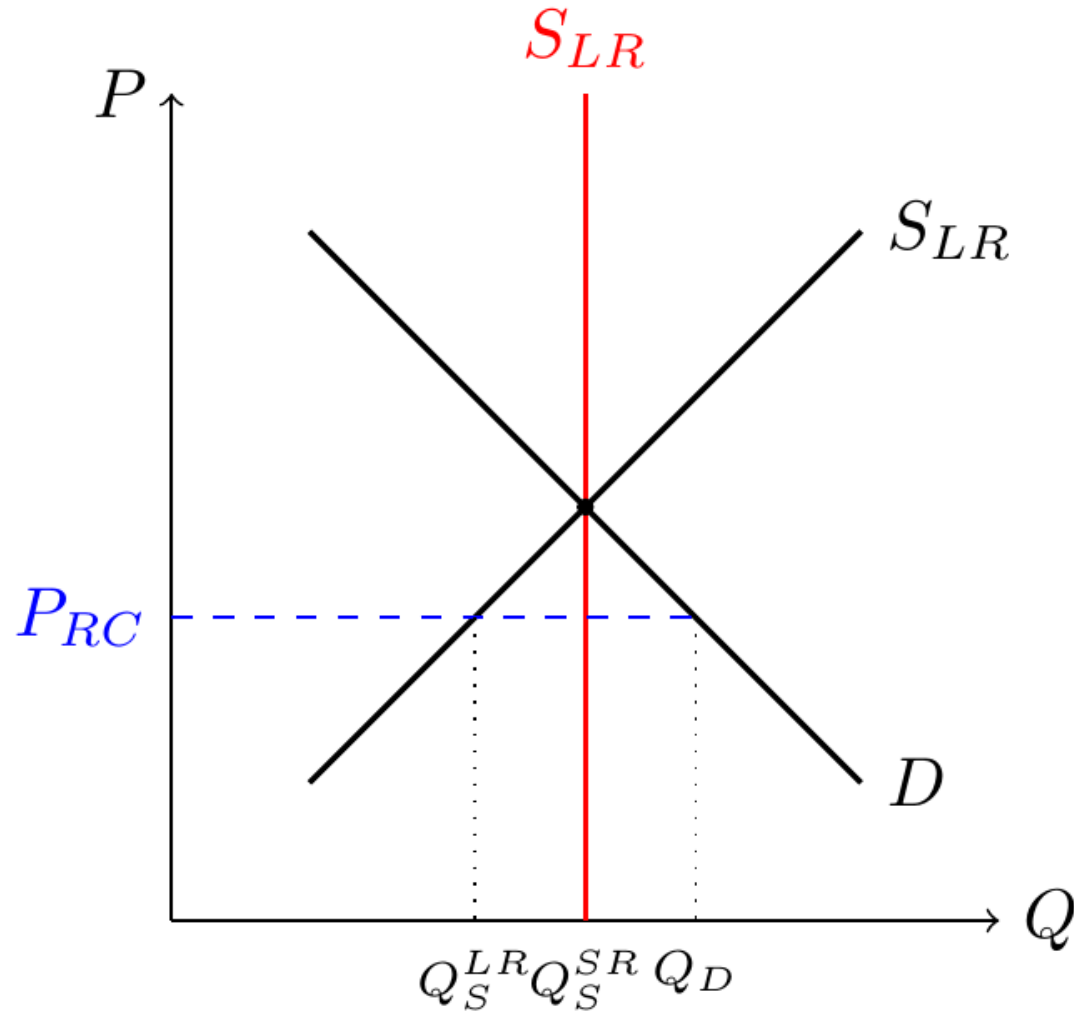
Short run effects of rent control



In the long run



Short run vs long run shortage



Quality of housing

In addition to a decrease in the quantity of housing in the long run, there is also a decrease in housing quality

Since landlords get less in rent and face excess demand for their housing, they are less likely to make necessary repairs to buildings

In competitive markets that are unregulated, price is used as a mechanism to allocate the good to those who are most willing to pay

With rent control, there is excess demand. Landlords can't increase rents to clear the market

How is housing allocated?

Illegal fees and bribes

Attempt to bypass rent control by charging fees (usually illegal): e.g., key pickup fee, “deposits” beyond a security deposit

Prospective tenants may also try to become the favored tenant by offering side payments

Discrimination

With excess demand, landlords can be picky about who they want to rent to

Landlords may screen out applicants based on perceived credit, socio-economic status, family type, pets, race, language, religion, sexual orientation, etc

Those in poverty who need the cheaper housing are the most likely to be screened out

While discrimination against protected groups is often illegal, it is not well enforced and not all groups are protected (e.g., LGBTQ+)

Inefficient allocation of housing

With allocation of housing not determined based on price, there is scope for some individuals who have weaker preferences for housing to consume more housing than others who would have stronger preferences

For example, suppose the equilibrium rent for an apartment would be \$1,000 but under rent control it is \$900. Suppose Steve is willing to pay \$1,000

With the rent being \$900, there are some individuals who would try to rent the apartment who have a willingness to pay of \$900 to \$999. If they get the apartment over Steve then they get less consumer surplus than Steve, because the apartment is worth more to him

Who benefits from rent control?

The hope would be that rent control would allow poor families to pay less in rent, thus partially alleviating their poverty

But those lucky enough to get cheaper housing under rent control aren't necessarily those who need it most

According to Gyourko and Linneman (1989), the beneficiaries of rent control are varied and the relationship is non-systematic. Beneficiaries aren't from any particular social group

Inefficient mobility

Rent control can also encourage individuals and families to stay in apartments longer than they would normally, because if they move to rent a new place, the new places may have higher rent because landlords can increase the rent once individuals move out

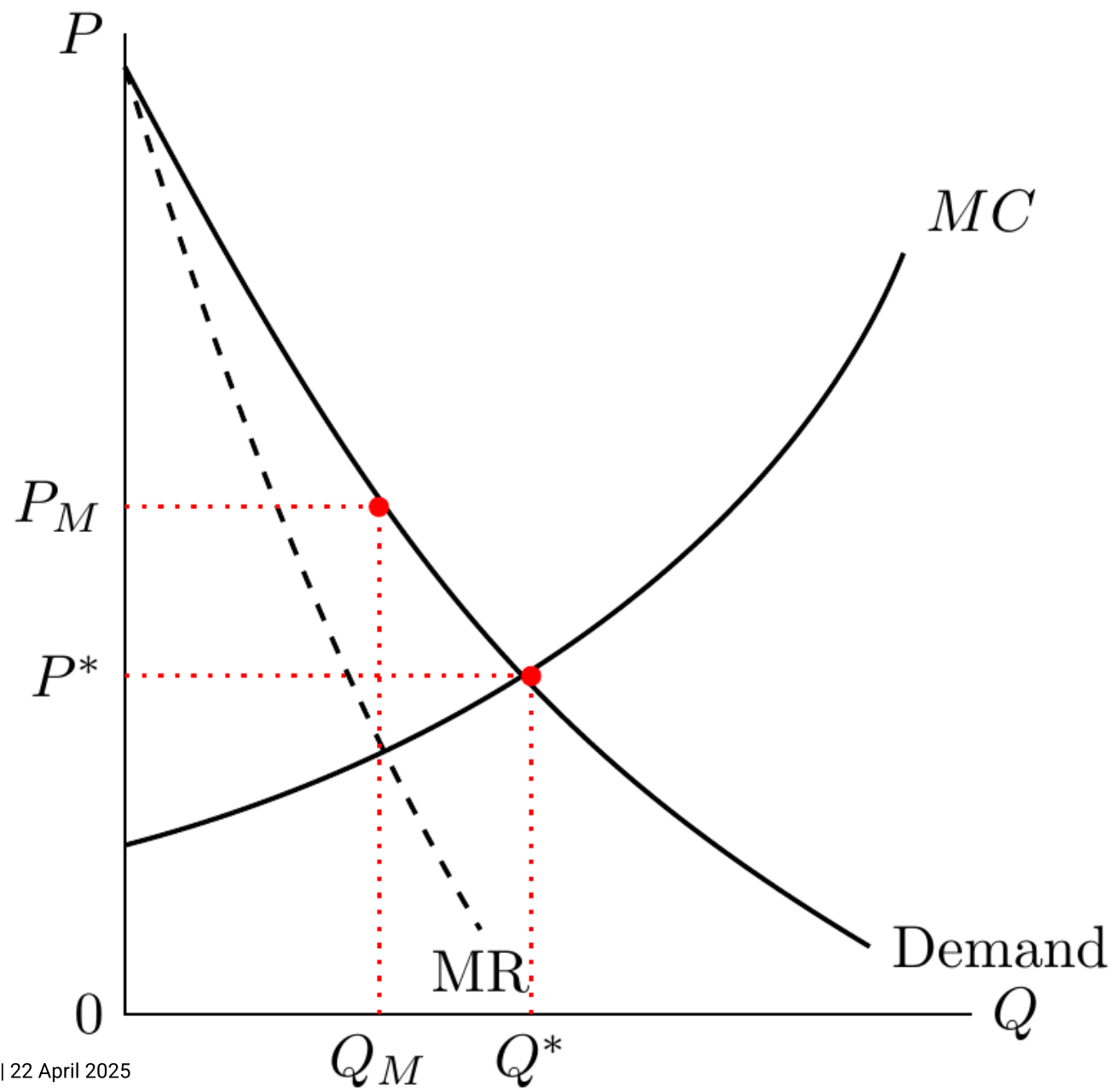
Thus some moves that would be efficient don't happen. This reduces social welfare as there is some mis-match between where people live and where they should live

Effects of Rent Control Under Monopoly

There are two models of the economy that represent different extremes:

1. Perfect competition
2. Monopoly

Perfect competition predicts many negative effects of rent control. But under a monopoly, rent control isn't so bad



Which case is more realistic?

In most cities, there are many landlords and many tenants, so the market is very competitive

Thus the perfect competition model is closer to reality, and the predictions of that model are more plausible

But there are some cities where companies have lots of market power because they own all or most of the housing (e.g., Irvine Company in Irvine, CA). In this case, rent control might get prices closer to the efficient level if rent control is applied correctly