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DETROIT BALLOT ISSUE: RENT CONTROL ORDINANCE

The Issue The proposed ordinance is designed to force landlords of substandard properties to bring their rental units into substantial compliance with health and safety codes and to limit annual rent increases. Economic theory postulates that rent control provides disincentives to investment, causing decreases in the number of rental units available and increases in the demand for those units. Detroiters must decide whether rent control is the best means to insure the availability of decent, affordable housing. Basic to this question is the effect rent control would have on marginal rental units: would landlords invest the resources necessary to bring these units up to code, or would they allow them to deteriorate further, and abandon them faster?

Proposed Ordinance Provisions Detroit tenants' organizations collected the signatures necessary to place a proposed rent control ordinance on the August City of Detroit ballot. This proposed addition to the Detroit City Code would "establish a Rent Review Commission to stabilize and regulate rent increases in the City of Detroit and require owners of rental property to be in substantial compliance with city health and maintenance codes before getting a rent increase."

The "Detroit Fair Rent Ordinance" defines a rental unit as one or more rooms used as a residence and occupied by a tenant. The proposed ordinance would exempt units receiving state or federal subsidies where federal preemption from local rent control is mandated, commercial and industrial space, any new unit being rented for the first time, units in owner-occupied dwellings of three units or less, and cooperatively-owned units.

The proposed Detroit ordinance would establish a five-member Rent Control Commission. Two members would be tenants of covered rental units, selected by the mayor from a list of no more than five applicants supplied by the Detroit Organization of Tenants. Two members would be owners of rental property or their representatives, selected by the mayor from a list of no more than five applicants supplied by a local real estate association. The fifth member would be neither a tenant nor a landlord, but an independent member appointed by the mayor.

Rent reductions could be granted by the commission in either of two ways. A tenant would be empowered to apply to the Rent Review Commission for a rent reduction when his/her landlord reduced services in the rental unit. Conversely, the landlord would be allowed to seek approval for a reduction in service, accompanied by a rent reduction in an amount equal to the cost of that service. Such a request would require notification to the affected tenant, and hearing, review, and approval by the Rent Review Commission. The reduction in services could not take effect during the current lease term, but the rent reduction would take effect the next date rent was due following the hearing.

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Annual rent increases granted by the commission upon petition of the landlord could be based on three factors: cost of living allowance (COLA) adjustments of the lesser of 5% or the consumer price index (CPI) increase; capital improvement costs approved by the Rent Review Commission, apportioned over the life of the improvement and the degree of benefit to each rental unit; and economic hardship, defined as a rate of return on equity of less than 6% above the maximum passbook demand deposit savings account interest rate. In any given year, only one increase of any type would be allowable, and the maximum allowable increase based on all three factors could not exceed 15% of the base rent. Base rent is defined as that rent actually charged on April 1, 1988, plus any increases allowed under the ordinance.

To be granted a cost of living allowance rent increase on a rental unit, the landlord would be required to send a 30-day written notice to the tenant and to file a copy with the commission at the expiration of the notice. While such increases might be relatively automatic, increases in the Detroit CPI exceeded 5% (the maximum allowable COLA increase under the proposed ordinance) in 11 of the past 20 years. If this regulation had been in effect since 1967, allowable COLA increases would have lagged the compound CPI increase in 1969, and every year thereafter.

Effect of Proposed Rent Control Ordinance Limitations on Cola Increases

Year	Annual Average CPI	Percentage Increase in CPI	Allowable COLA Rent Increase	Rent Revenue with COLA Increase
1967	100.0			100.0
1968	104.3	4.3%	4.3%	104.3
1969	110.6	6.1	5.0	109.5
1970	117.4	6.2	5.0	115.0
1971	121.7	3.6	3.6	119.1
1972	126.2	3.7	3.7	123.5
1973	134.5	6.6	5.0	129.7
1974	149.0	10.8	5.0	136.2
1975	160.2	7.5	5.0	143.0
1976	168.8	5.4	5.0	150.2
1977	180.4	6.9	5.0	157.7
1978	194.1	7.6	5.0	165.6
1979	218.7	12.7	5.0	173.8,
1980	252.1	15.3	5.0	182.5
1981	273.1	8.3	5.0	191.6
1982	284.9	4.3	4.3	299.9
1983	297.8	4.5	4.5	208.9
1984	300.9	1.0	1.0	211.0
1985	307.9	2.3	2.3	215.8
1986	311.5	1.2	1.2	218.4
1987	321.7	3.3	3.3	225.6

In the past 20 years, the cost of doing business, as indicated by the average annual CPI, increased by 221.7%. If the proposed rent control ordinance had been in effect,

rent increases based on the cost of living would have generated a total increase in rental rates of 125.6%, 96.1% less than actual index increases. Some of these increases could have been recovered through economic hardship increases, as the normal costs of maintaining the rental units squeezed out profit.

Rent increases due to economic hardship would be based on the rate and amount of equity accrual. Requests for this type of increase would require tenant notification and provision of extensive documentation to the commission, and could include only those costs that are “reasonable, necessary, and usual operating expenses.” Unusual but valid expenses could be prorated by the commission over a reasonable period of time; the commission could also adjust financing charges based on market rates and adjust labor charges, with the Davis-Bacon prevailing wage rate as the maximum. The commission would be required to consider factors other than return on equity in the rental units for which the request was made, including any tax or other economic benefits derived from ownership of the building; revenue available to the landlord from other rental dwellings; appreciation in the value of the rental unit; whether the landlord had purchased, financed, and operated the dwelling in accordance with reasonable and prudent business practices; and other factors determined by the commission.

A landlord could petition the Rent Control Commission for a rent surcharge for capital improvements. Those improvements would be pre-approved by the commission; tenants would be advised of the proposed improvements and the resultant rent increase, computed according to ordinance specifications, and could request a hearing. The proposal does not address emergency requirements, or the possible need for more than one capital expense in a year.

If a rent increase for capital improvements or economic hardship were denied because the unit was not in substantial compliance with applicable codes, the landlord could reapply after bringing the unit into substantial compliance.

The Intent A spokesperson for the Detroit Organization of Tenants stated that the proposed rent control ordinance would provide an economic incentive for landlords to maintain their buildings consistent with city housing codes, and would provide protection for tenants. Petitions for rent adjustments of any kind would require the landlord to file rental statements with the commission and the tenant and to maintain the unit in substantial compliance with applicable health and maintenance codes.

Rent control ordinances are in effect in over 200 communities in the U.S., including Boston, Washington D. C., and New York City. The proposed Detroit ordinance is predicated on the assumptions that “There exists in the City of Detroit a crisis in the availability of affordable, safe and sanitary low and moderate income housing; and ... There is a recognized need to enact rent’ regulations which implement objective standards and which balance the needs and welfare of city residents with the economic requisites of the housing industry.”

Proponents hope to target speculators who purchase rental properties cheaply, charge exorbitant rents, fail to repair or maintain structures, and fail to pay taxes or utility charges. In Detroit, which has lost about 800,000 residents in the past 30 years, the Buildings and Safety Engineering Department has been issuing wrecking permits for an average of 4,850 apartment units a year for the past 20 years. It can be argued

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that these conditions are indicative of excess housing capacity, which leads to low rates of return and produces the kind of environment in which such speculators - rather than honest investors - are likely to be found. If this is the case, rent control would be exactly the wrong answer to the problem because it would tend to worsen the rate of return.

The recognition of the “economic requisites of the housing industry” defines the proposal as a “second generation” ordinance, which attempts to mitigate the historically deleterious effects of rent control on the availability and condition of rental units.

The Economic Impact The economic effects of rent control were summarized in testimony presented in March 1985 by a representative of the Federal Trade Commission, on a Washington D. C. proposal to exempt certain rental properties from rent control: “Economists have studied rent control for many years, attempting to measure its costs and benefits. The consensus among those who have studied the subject is that the distortions caused by controls result in costs to consumers and society as a whole that are higher than the benefits that some individuals receive.”

Were the proposed rent control ordinance to be adopted, landlords of substandard properties would be forced to invest the resources necessary to bring those properties into substantial compliance with applicable codes, or to forego increases and allow the units to deteriorate further. If the costs of repairs were not economically justified based on restrictions tied to April 1, 1988 rental rates, those units would soon be deleted from the housing stock.

The disfunctional economic effects of rent control are widely recognized: limitations on the amount of return on investment make ownership of residential rental property less desirable. New capital flows to other investment opportunities, either to commercial or industrial property or to non-regulated locations. Owners of existing residential rental property may choose to disinvest, either by converting the units to cooperatives or condominiums, or by reducing maintenance, which eventually leads to abandonment. Thus fewer rental units are available over time, although demand for those lower-cost units increases. Demand is not satisfied by supply because restrictions on profit interfere with the marketplace. Because demand exceeds supply, landlords are able to be very selective in choosing tenants, generally deciding against those who cause greater wear and tear on the property, such as families with children, and granting preference to higher income applicants. Historically, stable middle- and upper-income renters have reaped the greatest benefit from rent control.

In addition to reducing the supply of residential rental units, the lower income potential of rent controlled apartments makes those properties less valuable: the income stream is reflected in the sale price. Because assessments for property tax purposes are based on capitalization of the income stream, the property tax base reflects the erosion in the value of residential rental property. The owner’s equity is worth less, and the lower value is reflected in the assessment of the property for tax purposes, so the property tax yields less revenue for city, county, and school purposes. In order to maintain revenues, taxing units must increase the tax rate on all property, or increase the assessments of other classes of property to compensate for the lost rental residential tax base. In Detroit, where the highest property, income, and utility users’ tax rates in the state already act as disincentives to investment, 54.2% of the \$5.3 billion

state equalized value derives from residential real estate. Rent control would shift much of the property tax burden from tenants to home owners. Because Detroit property tax rates for operations are already at the legal maximum, reductions in the property tax base must lead to reductions in public services. Property tax rates to repay debt will necessarily increase to compensate for the erosion of the tax base. Thus it is clear that with rent control, homeowners as well as landlords tend to subsidize tenants, either through increased property taxes or through decreased public services.

In addition to causing further tax base erosion, the administration of the proposed rent control ordinance might also increase the financial burden on the city. The cost of implementing rent control in Detroit would depend largely on the size of the staff required to support the proposed Rent Control Commission. In Boston, where rent control is being phased out, the Rent Equity Board's 1987-88 budget of just over \$1 million includes 37.5 full-time equivalent (FTE) positions. Rent control in New York City is administered by a state agency, the New York State Division of Housing and Community Renewal's Office of Rent Administration. That office has a budget of \$24.9 million and 606 FTE positions, and devotes nearly 80% of its activities to administering rent control and rent stabilization for the 1.2 million affected apartments in New York City. In Santa Monica, California, the autonomous rent control agency spends about \$4.5 million to oversee 40,000 units. That organization, which has 52 FTE positions, is funded by fees paid by landlords; the fee per unit is determined by dividing the agency's budget by the number of rental units registered in the city. Rent control in Washington, D. C. costs \$1.9 million, and affects 112,000 units built prior to 1975.

Alternatives One of the primary goals of rent control could be accomplished by other means. Increasing the resources devoted to enforcing existing ordinances, specifically those requiring that all rental units be registered with the city, and that these units be inspected annually by code enforcement inspectors from the Housing Inspection Unit, may be a more effective approach. According to the 1986 annual report of the Detroit Buildings and Safety Engineering Department, there are 83,672 buildings containing rental units in Detroit. Of these, 8,900 are classified as multiple dwellings, including apartment buildings, hotels, motels, and rooming houses. The Housing Inspection Unit reported 8,392 inspections of multiple dwellings, and 9,470 rental inspections of one- and two-family dwellings, as well as inspections that may have fallen in different categories (463 complaint inspections, 360 miscellaneous inspections) among the 37,482 total inspections reported for the year. City inspectors issue notices of violation to landlords of units that do not meet code, and bring suit against those who do not correct the code violations within the time allowed.

**CITY OF DETROIT DEPARTMENT OF BUILDING AND SAFETY ENGINEERING
HOUSING INSPECTION SECTION STATISTICS FOR 1985-86**

Type of Building	Number of Buildings	Inspection Frequency Goal
Multiple Dwellings	8,900	Annually
One Family Dwellings (Rental Property)	38,257	Annually
Two Family Dwellings (Both Units Rented)	16,041	Annually.
Two Family Dwellings (One Unit Rented)	<u>20,424</u>	Annually
Total Buildings	83,672	

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The poorest Detroiters received increased protection when the Michigan Department of Social Services (DSS) implemented a revised vrending policy on January 1, 1988. A DSS client and his/her landlord may request direct payment of the client's shelter allowance to the landlord -- a policy much favored by landlords. However, the client/tenant may authorize DSS to refer the rental unit to the local code enforcement agency for inspection. Should that review indicate that the unit is substandard, DSS would discontinue vrending the shelter allowance to the landlord and instead transfer the payment to the client, who may negotiate with the landlord or find alternate housing.