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In Focus

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Rent Control—The Wrong Medicine

by Benjamin Tal

While we are sympathetic to those who suggest that the solution to the GTA's affordability crisis is through the tax system, the reality is that you cannot tax your way to real and sustainable change. The rental market must be a big part of the solution. And exactly when we are about to see the light, with purpose-built rental activity rising, rent control again, is being discussed as a possible policy option. Rent control is the exact opposite of what the GTA market needs. We need more rental units not less. If history is a guide, such policy will mostly hurt the people it's trying to protect. Clearly efforts and funds should be devoted to affordable housing in the GTA, but rent control should be a non-starter.

A Bad Idea

The left-leaning Swedish economist Assar Lindbeck asserted that "*In many cases rent control appears to be the most efficient technique presently known to destroy a city—except for bombing*". On the same topic, Milton Friedman, the ultimate free market economist, suggested that "*the introduction of rent control is politically feasible only in areas with no recent experience—because only an electorate uninformed of its consequences will support it*".

It's hard to believe that those two economists have ever agreed on anything else. On this issue, economic theory is very clear: rent control is a bad idea. If rents are established at less than their equilibrium levels, both the quantity and quality of available rental units will fall. Under rent control, developers are less incentivized to build rental properties, a fact that exacerbates any price crunch. The turnover rate under rent control is lower as tenants stay in properties longer. And naturally, landlords would spend the bare minimum to maintain their units given that, in many cases, they do not need to attract other tenants.

But it's not about theory. It's about real life. And there is no shortage of examples showing the negative impact of rent control on the health of the housing market.

New York City should be featured in any economic text book as an example of public policy that achieved the near opposite of its goals. Roughly half of the apartments in the city are under rent control, the other half is constantly undersupplied with a clear impact on prices. And given that most housing programs tie government support to an apartment unit, not a person, the incentive to not move is enormous—further limiting supply. What's more, the share of rent controlled units that are in poor maintenance is almost four times higher than seen among uncontrolled units.

In Stockholm where the average wait time for a rent-controlled property is nine years, the first recommendation of the "Housing Crisis Committee", established in 2013, was that "*rent control should be reformed so that rents better reflect supply and demand*".

But of course we don't need to look far to find the damage that rent control policies can cause.

A bit of history: Rent controls have existed in Ontario since 1975 when they were introduced as temporary measures in the midst of an election campaign. Between 1975 and 1985 the system was based on a pass-through approach in which a statutory increase was determined, and landlords had the option to apply for a higher rent increase via a formal rent review. In 1986 the pass-through approach was modified, and the allowed increase was linked to inflation and the rent review option was removed. In 1992 the NDP government, faced with a significant shortage of rental units, eased rent control by granting a five-year exemption to rentals coming onto the market after 1991. After that, under the Conservative government, the post-1991 exemption became permanent and vacancy decontrol was introduced (a situation in which a landlord can increase the rent after a tenant moves out). That's more or less where we are now.

The fact that an NDP government (in 1992) had to ease rent control requirements is a clear indication that something went very wrong. In fact, a comprehensive study conducted by the University of Toronto about the impact of rent control between 1975 and 1986 found that "The major effects have been:

- to reduce rents on pre-1976 units but to increase rents on newly constructed post-1975 units;
- to reduce new construction;
- to accelerate deterioration and conversion of the existing rental stock;
- to generate a severe rental housing shortage;
- to create an environment for "key money";
- to inefficiently and inequitably redistribute income, and
- to significantly exacerbate government budgetary deficits by reducing tax revenues and inducing increased government housing expenditures."

Hardly a success story...

So ...?

Given all that, the ongoing discussions regarding introducing additional rent control measures in Ontario are alarming. In our recent publication on the GTA housing market (link) we suggested that any solution to the region's affordability crisis must include a significant increase in the propensity to rent, mainly among young families, along with a notable increase in rental supply—mostly via the purpose-built channel. The good news is that it's starting to happen. The number of young families in the rental market is rising and importantly, the economics of purpose-built supply is starting to work. Following decades of a purpose-built rental supply drought (triggered by past rent control regulations), the number of purpose-built units under construction is now north of 5,000, accounting for 16% of new supply. And as of the fourth quarter of 2016, there were almost 28,000 proposed new-purpose built units.

And exactly at this crucial time, when the city is on the verge of an historic transition toward a more rent-oriented real estate market, the issue of rent control is again on the agenda. Some of the damage is already done. Even the very mention of rent control as an option is having a chilling effect on developers. From recent discussions with some developers we know that it's already impacting decisions.

The right course of policy should be the exact opposite. Affordability will be achieved only by increased supply. Policymakers should make it clear that not only is rent control no longer on the agenda, but that it will not be on the agenda in the future.

The Wrong Medicine

The calls for rent control are understandable. After all, rent in the GTA is now rising much faster than inflation, and rent control is seen as a way to ensure that households on low and middle incomes are not squeezed out of the city.

While the intentions are pure, the suggested remedy is wrong. As illustrated, rent control will work to reduce the supply of rental units, and will inflate any segment of the market that is not under rent control. More activity will be diverted toward condo construction, a segment of the market that is much more immune to rent control as condo owners have multiple avenues to require a tenant to leave. Reduced motivation to invest in maintenance will lower the living standards of tenants on an ongoing basis. Unit hoarding will become the norm, creating a static market—clearly a suboptimal outcome for a rapidly growing city. That reduction in mobility also suggests that those who might have initially been the intended beneficiary of rent control, continue to receive benefits long after it is needed which, in this case, reduces the rent-control support available for future disadvantaged groups. Lack of supply will turn not only landlords against tenants, but also tenants against tenants as they compete over dwindling housing supply, resulting in the emergence of a rental black market.

Rather than employing policies that have shown through the years to be not only ineffective but, in fact, harmful, we should pursue solutions with better chances of success. Those should include increased investment in affordable housing, increased inclusion rates in new developments, fast-tracking land development approval processes at the municipality level, reassessing and potentially amending the province's current intensification and density targets, and providing developers with the right incentives to pursue purpose-built developments.