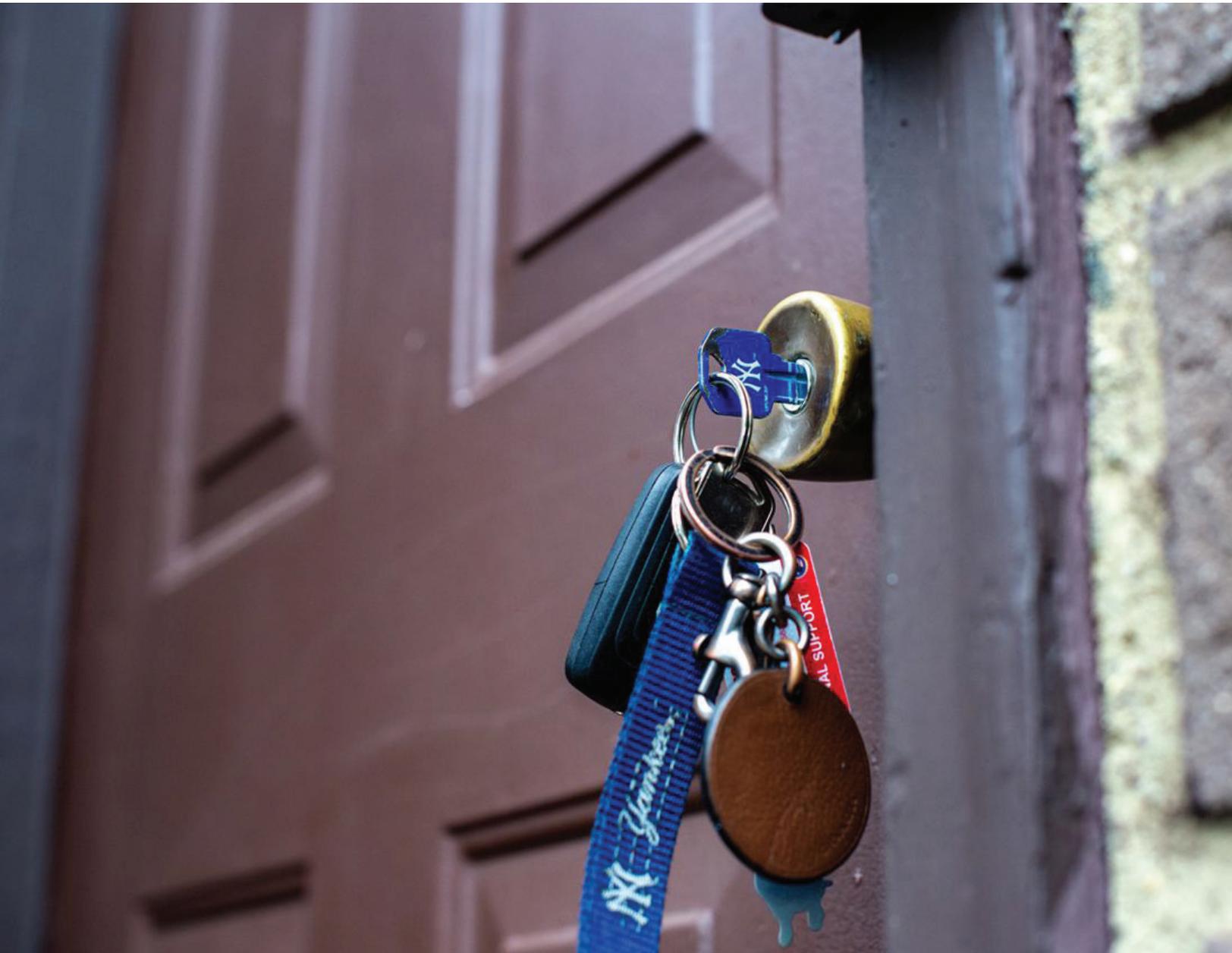


# IMPACTS OF RENT CONTROL ON AFFORDABLE HOUSING IN HUDSON COUNTY

*A Study Presented by the Liberty Board of Realtors*



## Introduction

Affordable housing in cities is consistently listed as one of the top concerns for millions of Americans and their local elected officials across the country. In 2017, housing was listed in 42% of the state of the city speeches<sup>1</sup>. The only new supply of rental apartment buildings across Northern New Jersey urban cities is the ever-increasing, high-priced new residential construction. However, this needs to be considered as a false reading of average market rents since it is mostly high-priced new apartment rentals being created, while affordable housing is vanishing because of the change of demographics in two and three-family buildings.

With very little new affordable housing being created in Northern New Jersey and the elimination of existing affordable housing – especially as Federal lending programs from the 1970s and 1980s expire – working families are excluded from high-demand areas in many neighborhoods. Rent controlled housing units, which sometimes are mischaracterized as affordable housing due to their below-market rents, not only continually reduce in volume, but too often are rented to high-income tenants transplanted from Manhattan.

Without additional new affordable housing, and the natural loss of affordable housing to other uses, many long-time residents have no mobility or are priced out of those cities. Many cities have looked for ways to create affordable housing using a number of initiatives at the local level. Some localities, like Jersey City, have erroneously promoted the implementation or expansion of rent-control as a solution, despite the overwhelming data from studies that prove rent control reduces instead of increases affordable housing.

Rent control came to New Jersey in 1973 as a reaction to the inflation that occurred after the release of wage and price controls the Nixon Administration enacted in 1972. Higher rents were a consequence of higher costs for property owners, and in response to the public outcry, politicians adopted rent control. Rent control has never produced one unit of truly affordable housing and therefore has not provided an equitable playing field to allow residents to stay and grow with the city and environment that they love.

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<sup>1</sup> National League of Cities, National League of Cities Reveals Top 10 issues that matter to cities in 2017, 05/24/2017

## The Affordable Housing Landscape of Jersey City

Led by a younger generation, there has been a demographic movement in our urban areas. Measured by the number of new residents, Jersey City is the fastest-growing municipality of any kind in the state<sup>2</sup>. While the City's population increased 6.7% from 2010-2018<sup>3</sup>, the total housing units only increased 3.1%<sup>4,5</sup> and that growth has largely been limited to higher-income residents, which have made affordable housing even more scarce within Jersey City. The City's demographics are rapidly changing. New luxury units are absorbing demand at high prices, and the current efforts to create affordable housing as set-asides in higher-income development projects has not been nearly sufficient to keep up with the demand for affordable housing. While this problem is not limited to Jersey City, there needs to be a local approach that can achieve better results for the increase of sustainable supply of new affordable housing.

At the same time, because of the demographic change, there are demands made by the new residents to change two through four-unit housings to smaller units. The recent change of requirements by these buyers shows a strong appetite for condominiums and one-family homes. This change of combining previous two through four family homes as larger single family-homes or condominiums eliminates many affordable apartments. At first, investors transformed the two through four-family homes to condominiums to avoid rent control in those cities that placed rent control on these buildings in order to receive a reasonable return on their investment. A good example is in Hoboken when they enacted rent control on two and three-family buildings in the 1980's. Thirty years later, there were very few of these two through four family buildings left. When these units are upgraded, as they gradually have been over the last 40 years, a City realizes many benefits:

- it improves property conditions, preserving the quality of the housing stock;
- it increases property value and taxes collected;
- it preserves the form of the housing from being redeveloped;
- and most beneficially, it responds to the requirements of the residents and market demands.

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<sup>2</sup> Erin Petenko, The County is booming, but most Shore areas haven't recovered their mojo. Here's the breakdown, NJ Advance Media for NJ.com, 06/03/2018

<sup>3</sup> U.S. Census Jersey City Quick Facts

<sup>4</sup> U.S. Census Community Facts Household and Families 2010

<sup>5</sup> U.S. Census Jersey City Quick Facts

All cities with rent control recognize the need for the investment in upgrades but many fall short, unless they allow a vacancy decontrol capital improvement program. The increased rents and improved property values create new ratables, some of which should be reinvested in creating truly affordable housing, but to date almost all cities in New Jersey have been absorbing the excess revenue into their general account or only building up a large affordable housing trust fund. The affordable housing problem in Jersey City is compounded because the entire Gold Coast, including surrounding areas, such as Hoboken, Weehawken, Bayonne, and Edgewater is experiencing record growth in luxury apartment rentals. However, there is not enough additional supply of affordable units with each project to satisfy the need of those that need affordable housing. Thousands of affordable housing units have aged out of their Federal housing programs and are converting to market units. While public officials are decrying the lack of affordable housing, they also are not replacing the lost volume.

## Is Rent Control A Sustainable Solution?

Rent control was a temporary remedy when implemented in 1973, but it has remained on the books for almost 50 years despite the only successful programs to provide affordable housing was implemented with funds from Federal and State grants and subsidies. Now, there are well-intentioned policy proposals to strengthen rent-control in many urban area cities, even though it is known these policies always failed. Jersey City is a good example as recent hearings with national experts and even the City's own housing professionals acknowledged this fact in those hearings.

Rent control plays a role in helping existing tenants predict their housing budget, but it does little to add the desperately needed new housing stock to keep up with Jersey City's growing population, and, in fact, over the long-term, it has aided in reducing affordable rental housing. As MIT professor, Christopher Palmer, who is a leading expert on the impacts of rent control, said:

**"Rent control does a good job at helping current residents stay in their home, but it arguably backfires at making affordable housing more accessible. That is the pernicious effect of the fact that if you are going to cap rents; it is going to reduce incentives for people to supply housing. That might not be new housing – modern laws try to keep full incentives for supplying new housing – but people are more likely to convert to condos or to occupy their own unit. So, we have a lot of leakage from the system. Rents end up rising for everybody else. It becomes harder to find a rent-controlled apartment – everyone is staying there for a long-time – and it makes the problem worse."**<sup>6</sup>

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<sup>6</sup> Megha Chakrabarti These States are Turning to Rent Control: How it Affects Affordable Housing, WAMU, 06/20/2019

If you are a long-time Jersey City resident who never occupied a rent-control unit, your chances of finding one are very slim, given the low-turnover of the existing units and the reduction of the overall stock. Unfortunately, when apartments do turnover, many are taken not by moderate-income families with Jersey City roots, but by higher-income transplants from New York City. Jersey City, as well as many other cities in northern New Jersey, is not taking advantage of the additional revenue they could receive from these higher-income residents. Since higher rents generate higher taxes, the extra revenue would then fund affordable housing. Rent-control apartments are not means-tested, which in turn has allowed high-income residents to pay lower rents needed for moderate-income families.

Beginning in the 1960's and continued through the 1970's, Hoboken was a prime example of the success of Federal, State, and Local governments providing affordable housing programs and became the cautionary tale of what happens when they are allowed to fade. This housing provided working families with quality housing and allowed them to live where they worked or near mass transportation systems, creating a sense of community and a balance of affordability. Most of these families were second-generation residents of Hoboken and remained during the decay of the City in the 1950's and 60's. Many of these affordable housing programs have expired, and soon more will expire, requiring second and third-generation Hobokenites to be permanently displaced. At the same time, since these affordable housing apartments are being eliminated for market rents, it increases tax receipts for the city, therefore, the Mayor and City Council begin to approve stronger rent control regulations to protect the tenants that need affordable housing.

Section 8 does not solve the problem of housing budgets of lower-income families because there simply is not enough supply despite the growing need for affordable housing. An important window into the plight of lower-income tenants is a guideline adopted by HUD, which states 30% of household income should be allocated to housing costs, including utilities. HUD categorizes those who spend more as "cost-burdened" while those who spend more than 50% to be considered "severely cost-burdened."<sup>7</sup> Jersey City is a good example of the lack of success for Section 8. Not only do 46% of Jersey City households pay more than that suggested amount, but 25% spend more than 50% of their household income, with 53% of Jersey City units having monthly costs that are more than \$2000 a month.<sup>8</sup> Those are significant numbers and a problem that can only be solved with an expansion of affordable housing on a scale that rent-controlled units never supplied.

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<sup>7</sup> Kathleen Elkins, Here's how much of your income you should be spending on housing, CNBC, 06/06/2018

<sup>8</sup> TownCharts Jersey City Housing Data

There is also research-based evidence showing there are unintended negative consequences for those presently in rent-controlled units from extended rent controls. Stanford professor Rebecca Diamond wrote about the problem with the upkeep of existing units. She explained, “Rent control can also lead to decay of the rental housing stock; landlords may not invest in maintenance because they can’t recoup these investments by raising rents.”<sup>9</sup>

What rent control ignores is the needs of renters in the rent-controlled unit change overtime who are often not inclined to move, thus creating a “housing mismatch” which was not the case necessarily when they first occupied the unit.<sup>10</sup> These factors do not incentivize the much needed private investment to expand affordable housing on a wide scale.

Rent Control also stifles innovation by restricting flexibility which would attract investors. As scholars from the Cato Institute noted in the nonpartisan Magazine Governing:

“Faced with this historical evidence, advocates today instead emphasize the benefits of rent control on tenant security. They advocate regulations that limit price hikes in fixed tenancy periods, but with rents free to adjust when a tenancy end. This is said to protect tenants against so-called “economic eviction” – huge unforeseen jumps in rent that force a tenant to move out.”

No doubt tenants value security. However, since such contracts are not widespread in free markets, it suggests that landlords value the flexibility to adjust rents to market conditions bases on their experience with tenants. Therefore, changing the balance of risks in favor of tenants would require higher rents to compensate.

All of this indicates that tenancy rent controls and security regulation will – at best – lead landlords to front-load rent hikes, select tenants likely to stay for short periods, or provide poor service during tenancies if underlying market rents are rising rapidly. At worst, tenancy rent controls would increase overall market rents by raising risks to landlords and reducing investment in new stock, particularly if the controls are perceived as a precursor of more-onerous regulations.<sup>11</sup>

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<sup>9</sup> Rebecca Diamond, What does economic evidence tell us about the effects of rent control?, Brookings Institute, 10/18/2018

<sup>10</sup> Rebecca Diamond, What does economic evidence tell us about the effects of rent control?, Brookings Institute, 10/18/2018

<sup>11</sup> Vanessa Brown Calder and Ryan Bourne, Rent Control: An Old, Bad Idea That Won’t Go Away Governing Magazine 11/5/2018

## Revaluation Confirms Rent Control Increases Taxes for Small Homeowners

The concept of using new tax revenues generated by decontrolling rent-controlled units to fund affordable housing has been demonstrated this decade in Jersey City and Bayonne. It also confirms that condo and small homeowners subsidize the rents of all tenants in rent control buildings, even if the tenant has an income that does not warrant a subsidy.

In 2012, the voters in Bayonne approved a ballot question to enact vacancy decontrol for all rent control buildings. Then in 2020, Bayonne completed a revaluation of property. After the revaluation, the condo and small homeowners paid one percent less taxes needed to support city, school, and county services than they did in 2012. At the same time, the vacancy decontrolled buildings, during the last 7 years, were charging market rents only for new tenants and paid one percent more taxes needed to support city, school, and county services. This one percent represented an annual average savings of \$252 for condo and small homeowners.

In 2018, Jersey City did a revaluation of properties. This revaluation was 25 years overdue and confirmed how much tax receipts are being lost and used to subsidize rents of all tenants, including those that do not warrant a subsidy. After the revaluation, rent-control apartment buildings' taxes increased by almost 7%. As an incentive for developers to build rental housing in 1990, the State of New Jersey prohibited cities to place rent control on all newly built residential buildings. After the revaluation, those buildings charging market rents and ones built after 1990 had their taxes increased by 45%. To add insult to injury, many of the rent control apartments no longer have moderate-income residents, but instead have high-income transplants from Manhattan being subsidized by small homeowners struggling to pay their taxes and mortgages.

## Ways Condo Conversions Can Benefit a Community

For many years, local activists and elected officials, while well-intentioned, were misguided in their opposition to the building of condominiums or condominium conversions. It is easy to explain the benefits to a community when a new building is built and marketed as condominiums. It brings new residents into the community for local businesses and increases real estate taxes to help pay for local government services. However, what is never discussed are the benefits to a community for condominium conversions because communities never utilize the increase in tax receipts to provide affordable housing.

For more than 50 years, gentrification has taken place in parts of Hudson County. Only Hoboken truly solved the needs of residents who needed affordable housing using Federal and State assistance in the 1970's and 80's, but these same affordable housing apartment subsidies have begun to expire. As they expire the City's tax receipts increase and second and third generation Hoboken families are generified by government. This affordable housing made it possible for a city that was in decay for three decades to return to its greatness. It also made it possible for the communities along the Hudson River Gold Coast to be viewed by private investor who could best utilize its proximity to Manhattan. One city that has benefited is Jersey City, first in its downtown and now it has begun to spread throughout the entire city. The Jersey City Heights section represents approximately 23% of the assessed value of the City and is a good example of the benefits derived from condominium conversions.

Much of the Heights consist of two through four family buildings that are not rent controlled. A review of the Hudson County MLS sales reported from 2015 to 2019 shows the market demand declined for these buildings because of the changing demographics. Many of the new real estate purchases were transplants from Manhattan and their requirements were different than what home purchasers in the past desired in the Heights. This change in demand for two through four-family buildings would normally result in no increase or a decline in value. As a result, more than 60 two through four-family buildings each year are being converted to condominiums and it reduced the number of buildings for sale. As the supply declined in properties for sale, the average price increased by 30%, and with fewer properties for sale the number of sales also declined by 34%.

Everyone should have benefited from the effects of converting two through four family buildings to condominiums but not everyone did. The most deserving beneficiaries were the homeowners that sold at the increased sales price. Many of these homeowners were long-time residents of Jersey City and this helped fund their retirement plans. The buildings converted to condominiums were reassessed, increasing the tax receipts for the city by more than \$600 thousand dollars annually. However, if the new taxes were used correctly, a portion of them would have been used to provide affordable housing for long-time residents that are not benefiting from the revitalization of Jersey City.

## **Innovative Ideas to Creating Affordable Housing**

Cities have tried several solutions to fix the affordable housing crisis, including those outlined below. These innovative ideas are not necessarily applicable to all cities in Northern New Jersey. Those with unique housing environment are best addressed in two out-of-the-box concepts we explore below. The one thing in common through all

these programs is they have the potential to create more new affordable housing, while rent control fails to even protect the not nearly sufficient existing affordable housing.

## **I. Newark's Approach to Creating Workplace Housing**

Newark is recognizing the need to provide funding. Private industry led by the RBH Group is building workforce housing with the financial and planning support of the City, including the Newark Teacher's Village, which will be financed with majority of private funding (60%) with the rest being public funding (40%).<sup>12</sup> Workplace housing increases the pool of those who are eligible, as the typical affordable housing requirements mandate that a household makes less than 60% of Area Median Income. While workplace housing started off for those in the public sector, it has since expanded. According to the National Association of Realtors:

"Workforce housing was thought of as housing for public employees – teachers, police officers, firefighters, and others who are integral to a community, yet who often cannot afford to live in the communities they serve. However, workforce housing also includes housing for young professionals, workers in the construction trades, retail salespeople, office workers and service workers."<sup>13</sup>

With this expansion in mind, cities are turning to workforce housing as a solution. Washington DC has seen some of the starkest inequality in recent years between their higher and lower-income residents, the latter of which are increasingly being pushed out because of the rising housing prices in the District. Mayor Muriel Bowser, as part of her ambitious plan to build 36,000 new housing units by 2025, created a \$20 million Workforce Housing Fund to help leverage nearly \$200 million in private sector funding to help build a vibrant workforce housing market in the District.<sup>14</sup>

Again, there are many variables which create the opportunity to introduce affordable housing, and this example, like others, would not apply to all cities. A major difference between Northern New Jersey and Washington DC is that in New Jersey, the mass transit system was designed to bring high-income workers into New York City, while Washington's enables local moderate-income workers to reach their jobs. In Northern New Jersey, the lack of affordable housing creates another economic consequence – it inhibits growth within the cities as low- and moderate-income jobs are difficult to fill.

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<sup>12</sup> Lisa Wirthman, 3 Great Initiatives Revolutionizing Affordable Housing in the U.S., Forbes, 10/13/18

<sup>13</sup> National Association of Realtors Workforce Housing Overview

<sup>14</sup> Cheryl Cort and Patrick McAnaney What Housing Does the District's Workforce Need?, Greater Washington, 03/20/2019

Without local affordable housing, commuting cost prevents workers from taking those jobs. This reduces the value of the commercial buildings and therefore, these workers are out of the market and do not patronize local stores.

## **II. Attracting Small-Scale Investors to expand the market**

Research from Harvard University shows in Chicago's areas of need, particularly the South & West sides, The Community Investment Corporation and The Chicago Community Loan Fund have provided micro-financing to incentivize small-scale investors to rehab one-to-four units. The upside of this dedicated funding is a streamlined process that makes it easier for small-scale investors to get timely approval. Their strategy with a 5-million-dollar investment was as follows:

"The partner CDFIs proposed to address the problem by leveraging the City of Chicago's Micro-Market Recovery Program to help small-scale investors and owner-occupants to rehabilitate one-to-four-unit properties in distressed communities. The partners had more experience with larger multifamily buildings, but selected this strategy as a way to use their capital and expertise to address the shortcomings in the private market forces that shape the one-to-four-unit landscape: namely, the lack of access to capital and the difficulty of acquiring distressed properties in areas identified by the city's Micro-Market Recovery Program. By pursuing this strategy, the partners hoped to create a critical mass of housing density in disinvested neighborhoods to catalyze revitalization."<sup>15</sup>

## **Jersey City Specific Concepts**

As we have seen, when communities take an inventory of their circumstances, they often find collaborative approaches to stimulating affordable housing development. Sadly, Jersey City has historically not shown enough creativity in its approach to affordable housing, which relies on an approach that increases affordable housing by less than it is eliminated to try to address the significant imbalance between affordable housing supply and demand. There have been alarming trends outside the City's control that limited its ability to create truly affordable housing. These include:

- a) on facilitating Federal programs, principally Section 8 where there is a steady decline of vouchers;
- b) and Inclusionary Housing in new developments, which requires that residents have stable credit and incomes of 40-80% of the County Median Income, which

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<sup>15</sup> Alexander von Hoffman and Matthew Arck, PRO Neighborhoods: Innovative Strategies for Affordable Housing, Joint Center for Housing Studies of Harvard University

can mean that households must earn as much as \$60,000 to participate. Those households could also qualify for market-rate rental housing – but the truly need end of the spectrum, which earns \$40,000, is left out of the market. Based on their salaries, even the aides to the Jersey City Council Members cannot qualify for these homes, and those are the very hardworking people who are dedicated to the betterment of the City that we should be creating affordable housing for.

Without examples of cities similar to size and changing demographics to provide a model for creating affordable housing in Northern New Jersey, they must invent something that is uniquely ours. The truth is that Northern New Jersey cities have many options which have never been tried. Two that we explore here are available right now:

1) It can create its own affordable housing. Of course, it has no funds to do so based on its general account, and lack of oversight into the effects of PILOTs by previous administrations that were corrected too late. In Jersey City, the Fulop Administration has been making strides correcting these issues, which will undoubtedly require more time and financial resources. But, if it looked at its current approach and instead of relying on developers to build new products with an affordable housing component, it instead maximized its tax collection and then allocated those funds to affordable housing, it would have an enormous capacity to build. For example:

a) Instead of only setting aside affordable units, the City should allow developers to make a cash contribution that could be used as equity for the construction of affordable housing. At current interest rates and construction costs, the City would be far better off taking the funding directly, and enjoying a higher tax assessment, than it is by generating units that do not go to the truly needed. This is only exacerbated by poor oversight and record-keeping, an uneven and unreliable application of the law through generations of administrations with differing policies and skill-levels, and conflicting policies on PILOTs that create inequity.

b) By vacancy decontrolling rent control properties, the City would generate higher taxes from those properties and could use the additional tax proceeds to fund construction of new affordable units or giving direct rent vouchers to qualified households.

2) The City also could “exchange” vacancy decontrol to apartment owners who would permanently deed affordable units from rent-controlled housing. This program would require that developers’ portfolios identify units that could be made available to existing or new tenants with qualifying incomes at affordable

rents. For every unit provided, another unit in the same building could be identified for permanent decontrol upon vacancy. The landlord would take the risk of a pace of vacancies and the variables in the market while the City would be able to fix rents based on affordability on a permanent basis, and even when those units vacated, they could be made available on an income-qualified basis in perpetuity.

## Conclusion

After five decades of rent control failing to solve the affordable rental shortage issue, it is time for change! All cities that need affordable housing should start using some of the new tax ratables for the tenants who need rental assistance. There is little doubt, affordable housing solutions are needed to ensure that Jersey City, and all the cities along the Hudson River Gold Coast, retain their place as a vibrant and diverse community. Moderate-income families need quality housing at affordable prices. None of these cities has directed itself to the challenge, because instead of maximizing the dynamics of their new tax base, it continues to portray its rent control policies as the main solution to protect affordable housing, despite seeing with their own eyes this failed policy.

No government in the Hudson River Gold Coast community offers the quantity of resources needed to attract investors to create the amount of affordable housing needed, instead they watch long-time families being displaced from their homes. Even though their public statements and actions continue to announce new rent control policies to solve the shortage or they announce steps to create affordable housing, it is never enough of a supply to solve the problem. What is often forgotten by these communities is their promises consistently result in displacing those they claim to help. Commerce is an important part of these communities. If commerce does not have access to the residents that need affordable housing, it will not be able to remain in their communities. In New Jersey, the mass transit systems were designed to move executives to Manhattan. These residents are needed to have commerce prosper. Without commerce, the tax receipts will diminish from the commercial and retail real estate properties. Many of these private sector services are needed to support the new arrivals with higher incomes.

After almost 50 years, it is time for those responsible to promote the services our urban communities need and to admit their same solutions have not accomplished the goals of affordable housing. It is also time for them to realize demographics are always changing in urban areas. The housing needs of those that lived in Northern New Jersey cities 50 years ago are different than this new generation of residents.

Condominium conversions should be looked upon as a positive resource to provide affordable housing which can halt the displacement of long-time residents and give tax relief to homeowners. Most importantly, understanding the new residents' housing needs should be served, and if they believe residing in a condominium serves their needs, their preference should not be shunned upon.

The public also has a responsibility. When our public officials declare that they do not have the resources to solve the problem, the residents in the Hudson River Gold Coast communities need to ask, what are the new tax rates being used for if not for the residents that need it the most?

This report confirms that controls on real estate only solves the problem temporarily and the definition of temporary is far less than 50 years. It also proves that rent control too often assist tenants that do not need assistance and that rent control properties are subsidized mostly by residential property owners.