Rent Control Problems: Banks Begin Flashing Warning Signs

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There is no pixie dust in rental housing, only rent. Like any other business, owners and investors in rental housing product depend on customers paying for the product and that what they are paying and can pay is enough to cover costs. But when it comes to housing, a combination of wishful thinking, misinformation, and a desire for chaos shapes advocacy for rent control, a policy that arbitrary limits tracking rents to costs. Most rent control supporters will argue one of two things or both; rental housing is all profit and housing is a right and should be free of charge. Growing concerns about one New York bank are once again proving that basic economics, not egalitarian fantasy, are what govern how rental housing works in the United States.

First, its important to note that rent control doesn't work, failing everywhere to achieve its stated goal of lowering rents for people who earn less money. There isn't a single place with the measure that doesn't have stubbornly high housing costs; this is because rent control, among other things, discourages and complicates the development of new rental housing. This means less supply and higher prices. Worse, because of what's going on with banks who lend to buildings and projects with rent control, there may be even fewer rental housing units around, making the problem of scarcity even worse.

According to its website, New York Bancorp (NYBC) is "one of the largest regional banks in the country" with assets of $116.3, $85.8 billion in loans, $81.4 billion in deposits, and $10.8 billion in shareholder value (NYBC is publicly traded). But recently, the company has become something a canary in the coalmine for the troubled commercial real estate market, at least in New York City. Stories in the Wall Street Journal, Yahoo Finance, Reuters, The Real Deal, and others have raised concerns about the recent drop in NYBC's share value. But each of the stories has also pointed out something else: the effect of rent control.

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With low vacancy rates, high demand, and the ability to move rents to match the market and increasing costs, banks like NYBC were eager to lend to rent controlled buildings. While returns might have been smaller than larger development projects, everyone needs a place to live, and these apartments would always provide steady returns. But with Covid dislocation, people not paying rent during that crisis, and then, in the last few years, interest rates going up, things changed. Add to that the law passed in 2019 which limited rent increases.

This set the stage for falling rent collections, rising costs for maintenance and operations, and no way to increase rents to cover those costs. Suddenly these good investments are starting to look a lot riskier. And when buildings and properties become riskier, loans for improvements become impossible. Finally, if rents simply don't cover the cost of a mortgage, the building will go into receivership as part of bankruptcy.

"Who cares?" the rent control advocates might ask again, "As long as tenants get lower rents." But nobody is going to make a product and sell it at a loss. Eventually, buildings that are not producing enough to cover costs as housing will end up being converted to something else, even parking lots. There's an analogy to the problems dairy farmers experienced during the Great Depression: when they saw prices fall dramatically, they made an effort to slow and stop production, even destroying the product rather than sell it at a loss.

When inflation and interest rates are high and regulations limit and stymie production of housing, costs of building and operating rental housing will keep going up, especially if demand for housing does too. Imposing arbitrary price controls on the one source of capital in rental housing, the money charged for monthly rent, ensures provoking at least a crisis in confidence in the sector. This means reluctance to invest in the buildings and even in rental housing more broadly, especially if the reaction to trouble in the rental housing market is more price controls where none exist.

Lack of investment means less maintenance and fewer new units created, and those units that do get built will be scarce and even more expensive, provoking more controls. All of this could lead to abandonment of the assets for housing and conversion to other uses, or, as I suggested more than 4 years ago, a government takeover of big parts of the rental housing sector. Whether NYBC manages its problems well is only part of the story. Even if it succeeds, the fundamental challenge of trying to run a marginal business while prices for the product are set arbitrarily with no reference to costs isn't a recipe for success. And lack of investment in rental housing doesn't help people struggling to find housing; the opposite is true because those families will find it even harder to find a place at a price they can pay.