IDEAS

Corporate Landlords Aren't the Real Culprit

They get away with raising rents in places where local regulations impede the construction of new apartments.

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In the fall of 2019, the private-equity company Blackstone Group went on a shopping spree, purchasing three apartment buildings in the Los Angeles metro area. For $177 million, Blackstone became the landlord for nearly 500 households. Over the past several years, the company has been steadily acquiring a portfolio totaling more than 40,000 apartments across some of the country's tightest, costliest housing markets, including California and the Boston and Washington, D.C., metro areas.

Most of Blackstone's buildings fall into a distinct category: They were constructed in the late 1980s and early '90s, and the apartments in them could use a few nips and tucks, but are located in markets with strong population and income growth and where local land-use regulations have limited new apartment construction. Or as the firm's website puts it, they invest in "high-quality assets" with "outside growth potential."

This is the precisely the kind of MBA-speak that infuriates tenant advocates. To some, the influx of global investment money into the most expensive American housing markets—in the form of luxury apartment towers as well as purchases such as Blackstone's—has become both a symbol and a driver of income inequality. More and more, left-leaning politicians blame "corporate landlords" and "corrupt real estate developers" for rising rents and housing instability.

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Global capital is, to be sure, a fundamentally amoral force, and investors' pursuit of quick returns through the purchase of apartment buildings has encouraged rent hikes that greatly outpace income gains for most families. Yet the distortions have been worst where local government policies—such as zoning restrictions, historic-preservation and environmental rules, and other measures—have most tightly restricted the construction of new housing. Indeed, for-profit companies' behavior is entirely predictable, based on the financial incentives that local governments have created. When tight supply sends housing prices skyrocketing, deep-pocketed investors like Blackstone are far better positioned to take advantage than small-scale landlords are.

The American housing market has changed since the Great Recession. The United States has long had explicit policy preferences for homeownership, entrenched through the federal tax code, transportation spending, and local zoning laws. Yet over the past 15 years, the nation has seen remarkable growth in the number and share of households who rent their homes. Nearly 36 percent of households rented their homes in 2019, up from 31 percent at the peak of the subprime-mortgage boom in 2006. Renting has traditionally been more common among young households without children, and among low-income and nonwhite families. But since 2010, the fastest-growing group of renters are households earning more than $75,000—a group that has a wide range of choices in their living situation.

The types of homes that compose the U.S. rental market have also changed over the past decade: both single-family homes and large multifamily buildings (those with 20 or more units) make up more of the market than they used to. The changing composition of rental housing has important implications for affordability, because apartments in small multifamily buildings tend to rent for lower rates than either single-family homes or apartments in large buildings.

Both of these two fast-growing segments are undergoing shifts in ownership. Small rental properties have long been attractive investments for mom-and-pop landlords—that is, individuals who own a few rental units as supplemental-income sources—or small, privately held family businesses. Large apartment buildings have typically been owned either by specialized firms called real-estate investment trusts (REITs), which develop, own, and manage a wide range of real-estate properties, or by insurance companies and pension funds that hold stakes in apartment buildings because they need stable assets with long investment horizons to match their payout schedules.

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When families search for a new apartment, they are less interested in the corporate structure and size of their landlord than in how much their monthly rent will cost, the quality of their home, and its location. Subtle gradations in landlord quality—for instance, how quickly landlords respond to maintenance problems, or how aggressively they raise rents at the end of a lease term—are usually secondary concerns when finding a place to live.

Nor is there good research from academics or policy makers on whether some property owners are systematically better landlords than others. Even basic data on who owns apartments within major cities are hard to find, let alone tallies of renter complaints against landlords.

Even so, there are two reasons to suspect that private-equity firms and related finance companies may be tougher landlords than other types of owners. One reason is that these companies have fundamentally different business models than "traditional" landlords. Other institutional investors, including REITs and insurance companies, are often described as "patient capital." Looking for stable income and gradual appreciation rather than short-term gains, they view real estate as a long-term investment. Tenant turnover is expensive to landlords; providing quality housing at competitive rents keeps vacancy rates low and encourages desirable tenants to renew their leases.

Some evidence suggests that private-equity firms, in contrast, are willing to engage in predatory practices to realize short-term returns. Blackstone's target properties in Southern California suggest an investment strategy similar to flipping single-family homes: Buy old properties, invest in cosmetic upgrades such as new appliances and facade improvements, then increase the rents.

Furthermore, some anecdotal evidence also indicates that private-equity firms are less conscientious landlords in the single-family rental market. Researchers and journalists have documented concerns about poor-quality housing, difficulties faced by tenants trying to communicate with landlords when problems arise, and higher rates of evictions.

Yet landlords of any sort can mistreat tenants more readily when those tenants cannot afford to live anywhere else. Land-use regulations adopted by local governments have contributed to steep increases in housing costs. In California, greater Boston, and the Washington area—not coincidentally, the kinds of markets that Blackstone has targeted—zoning makes it particularly hard to develop apartment buildings. The complex procedures created to build new apartments are partly responsible for the shift toward large buildings, which are more likely to be owned by large institutional investors. Regulation that limits new construction serves as a barrier to entry in local housing markets, creating more market power for existing landlords.

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Local regulations also play a role in the buy-and-rehab strategy employed by private-equity firms. In places where regulation limits new apartment construction, acquiring existing buildings is less risky than trying to build new rental housing. There are stronger financial incentives to maintain and upgrade old apartments in tightly regulated markets, because they face less competition from new, high-amenity buildings. This process of upward "filtering" among existing apartments is particularly harmful to housing affordability because it results in higher rents without expanding the number of homes available.

Improving affordability and housing stability for renters—especially for low-income households—will require multiple policy approaches. Most urban economists and the nascent YIMBY ("Yes in my backyard") movement argue for reducing regulatory barriers to new development. Making it faster, easier, and cheaper to build new apartments would diminish landlords' power to raise rents and would provide renter households more choices about where to live. Some advocates counter that encouraging renters to transition into "sustainable homeownership" is the best approach, implicitly arguing that rentership is inherently less stable or less desirable. Over the past year, three states—California, New York, and Oregon—have adopted or strengthened rent regulations that limit landlords' ability to increase rents substantially.

In some sense, all of these policies are blunt instruments for addressing the issue of "bad" landlords, because they apply to rental markets broadly. Because U.S. cities don't systematically collect data on landlords, they lack the information—much less the regulatory muscle—to identify and penalize bad landlords. One danger of rent regulation and poorly targeted tenant-protection laws may be that they discourage conscientious property owners from being landlords, leaving the market dominated by more ruthless owners. Whether the landlord is the couple upstairs or a faraway private-equity firm, the best tenant protection is when renters have somewhere else to go.

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