Banning Airbnb Investor Units Reduces Market Values by up to 40 Percent but Should Other Social Goals Dominate?

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Introduction

Recently, Boston decided to ban Airbnb type rental units suggesting that this transition to short term rentals reduced the supply of longer-term rentals while adding to the supply of visitor units competing with hotels.[1] It is possible that tourism is higher as a result of short-term rentals that are slightly cheaper than staying in hotels and also accommodate seasonal peak demand. Stated another way, cities like Boston may get fewer visitors if more expensive hotel accommodations were all that was available. The flip side of this market is that some of the rental housing stock is reduced by this sharing economy which the internet has facilitated. Cities like Boston, San Diego, San Francisco and New York all have experienced high rental rate increases, as the supply of net new units has become increasingly more difficult. Political regulation and a series of more complex development barriers, as well as rising labor costs have significantly increased in the past few decades across all US cities resulting in cries that we have a housing crisis.[2]

[1] See Oct. 25th discussion by Kathleen Howley at Share On at https://www.housingwire.com/articles/boston-airbnb-ban-eases-housing-shortage/

[2] See https://www.naahq.org/news-publications/units/july-2019/article/us-barriers-apartment-construction-index

The Libertarian View

For pure property right enthusiasts, any reduction in the maximum productivity in a property is a reduction in value and a taking. From an investor point of view, the bid price on many properties was predicated on being within an area where short term rentals were permitted. In discussions with investment brokers, we get a differential value impact of about 40 percent in those markets where significant tourism exists. A case example illustrates the value impact. Using a well located one-bedroom unit in San Diego, the current Airbnb rent per week is $888 but the peak season rates are much higher such that the average weekly rent on a year-round basis is approximately $1,190. There is a weekly cleaning fee of $100, a service fee of $101 and occupancy taxes of $109 all paid in addition to the short term rent. The vacancy rate on the short-term rental is 30 percent per year at maximum, an often less. If the same unit were rented on a longer-term basis the rent would run $2,150 per month with 5 percent vacancy.

The effective gross income on the apartment unit is $24,510 and $57,120 for the short-term rental. The operating expenses run higher on the short-term rental at about 40 percent of effective gross income and 30 percent for the longer-term rental, such that the net operating income for the short- term rental is $23,990 compared to $17,157 on the longer-term rental per year. Current cap rates are approximately 4.28 percent for these units resulting in a value of approximately $560,000 for the short-term rental and $400,000 for the longer-term rental. The bottom line is that the type of restriction which Boston just imposed on owners results in a property value decline by as much as 40 percent (The example above translates to a 29 percent reduction in value). That will cause some more recent buyers to walk away from loans and give these units back to the bank. Other owners may let the unit deteriorate and do little maintenance as they accept unexpectedly low returns on their investment. The older lower quality stock will remain and the newer stock will deteriorate faster than otherwise in this new environment of coerced supply. Critics of high housing costs may rejoice at this new regulation, but it is a partial interest property taking and one that does not require just compensation. It also adds risk to the housing market that will drive up those cap rates going forward.

Concerns of Society

There are legitimate concerns for society at large that result from the growth of short term rentals relative to the overall market. While short term rentals provide a less expensive option than hotels and may add net new tourist demand, based on a lower cost option, tourist growth does not produce many high paying jobs for a local economy. It is strange that so many markets seem to want to expand tourism, especially in areas where housing is already unaffordable, as tourism growth only make the housing problem worse. To some extent, short-term rentals do hurt the hotel industry and when marketed via less obvious web sites, the collection of hotel taxes may not be as reliable as with traditional hotels. In markets where tourism is significant, and that includes most major cities, the transition from longer term rentals to short-term rentals is a reduction in the supply of housing units and this clearly reduces vacancy and spurs higher rental rates. At the same time, we should note that the transition of many owner-occupied housing units to rentals, whether short-term or long-term, has added to the rental stock such that single family units now supply about one third of all rental units and this has helped to keep rental rates lower than otherwise.

Within a neighborhood afflicted by a large share of short term rentals, the permanent residents will have a number of complaints, including but not limited to:

1) An increase in the number of loud parties at night (noise pollution) making it harder to sleep.
2) More rental cars filling up the streets as often the number of temporary residents in a rental unit exceeds the number that would normally live there.
3) The lack of permanent kids in a neighborhood as visitors do not befriend locals.
4) More trash in the streets, possibly more crime, as it becomes easier to slip into a neighborhood unnoticed, when so many transients are commonplace.
5) A general deterioration of the neighborhood as the temporary residents do not care about contributing to local arts, culture and other activities.
6) States such as Hawaii have worked to define sustainable targets/levels for tourism relative to resort location, available infrastructure, and resident population numbers. Airbnb effectively negates these efforts by promoting visitor accommodations in neighborhoods not designed for the visitor industry.

The list above can be described as negative externalities and they could have a negative impact on the well-being of permanent residents who do not succumb to transitioning their home into a short term rental and moving elsewhere, and of course, that is one solution. Short-term rentals can be legally encouraged in special zones, such that the negative externalities are concentrated. Other areas can exclude short-term rentals, although it may be politically difficult to get neighborhood residents to recognize that they are in fact an optimal location for short-term rentals.

The real cause of high rental rates and high home prices is, of course, the challenge of adding supply in a not-in-my-back yard world with increasing regulatory barriers. Short-term rentals are not the cause of this general lack of supply, but it seems they are, at the margin, a slight reduction in supply and as such, a current target of politicians wishing to show they are trying to do something about housing affordability.