Property Tax Pass-Through to Renters: A Quasi-Experimental Approach

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Federal Reserve Bank of Philadelphia

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Disclaimer

The views expressed here are my own, and do not represent the official views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

Research Questions

- **Do renters bear the incidence of property taxation?**
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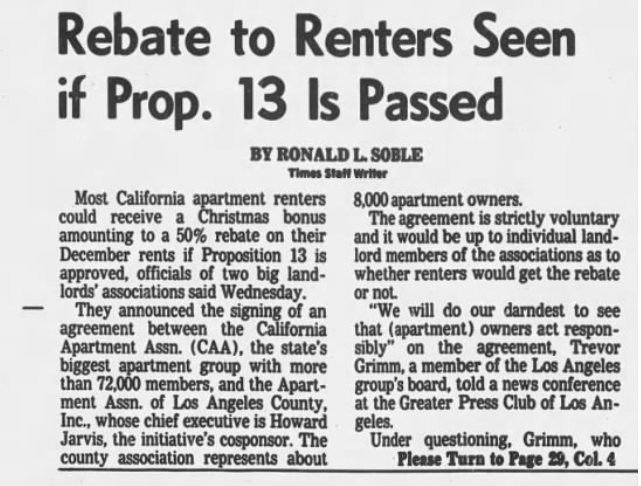
  - **Setting:** Does a landlord's property tax bill affect a new tenant's rent?
- **How do landlords price?**
  - Can landlords charge different rents for similar units?
  - Are landlords pricing 'correctly'?

Outline

Setting

- Prop. 13 in California: Property is taxed on its purchase value plus 2% per year
  - If sold, property is reassessed to new purchase value
  - $\rightarrow$ Large increase in property taxes, potentially as good as random
  - Many other states have laws like Prop. 13 (FL, MI, OR, AZ, MA)
  - Good for long-time homeowners, good for renters?

Los Angeles Times, May 1978



Rebate to Renters Seen if Prop. 13 Is Passed

BY RONALD L. SOBLE
Times Staff Writer

Most California apartment renters could receive a Christmas bonus amounting to a 50% rebate on their December rents if Proposition 13 is approved, officials of two big landlords' associations said Wednesday.

They announced the signing of an agreement between the California Apartment Assn. (CAA), the state's biggest apartment group with more than 72,000 members, and the Apartment Assn. of Los Angeles County, Inc., whose chief executive is Howard Jarvis, the initiative's cosponsor. The county association represents about 8,000 apartment owners.

The agreement is strictly voluntary and it would be up to individual landlord members of the associations as to whether renters would get the rebate or not.

"We will do our darndest to see that (apartment) owners act responsibly" on the agreement, Trevor Grimm, a member of the Los Angeles group's board, told a news conference at the Greater Press Club of Los Angeles.

Under questioning, Grimm, who

Please Turn to Page 29, Col. 4

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  - Good for long-time homeowners, good for renters?
- Rent data from Berkeley, California
  - Rent data is not systematically collected: Rely on surveys, incomplete samples
  - Novel data set of unit-level leases from the Berkeley Rent Board, near-universal city coverage
  - Vacancy decontrol (1999): Landlords can set rent freely upon vacancy. **No rent control for new tenants.**
  - Use only **new tenant (unrestricted) rents**

Unique Quasi-Experimental Setting

Neighboring multi-unit buildings:

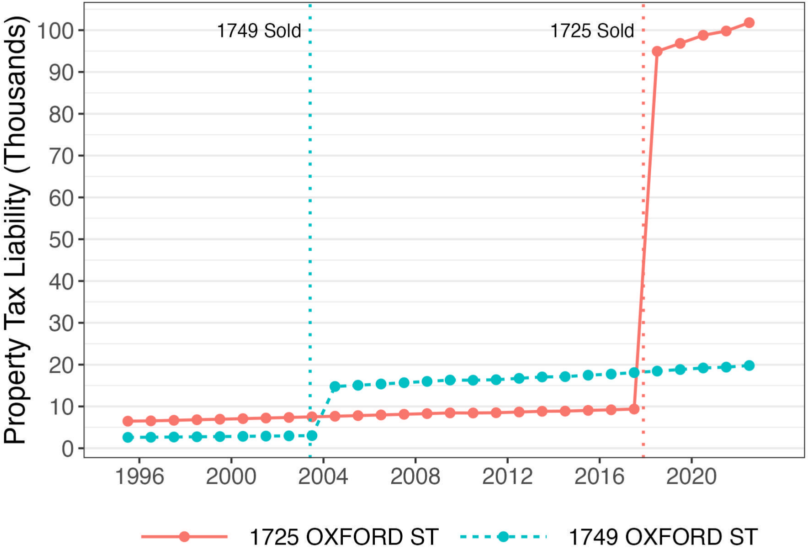
(a) 1725 Oxford Street

(b) 1749 Oxford Street

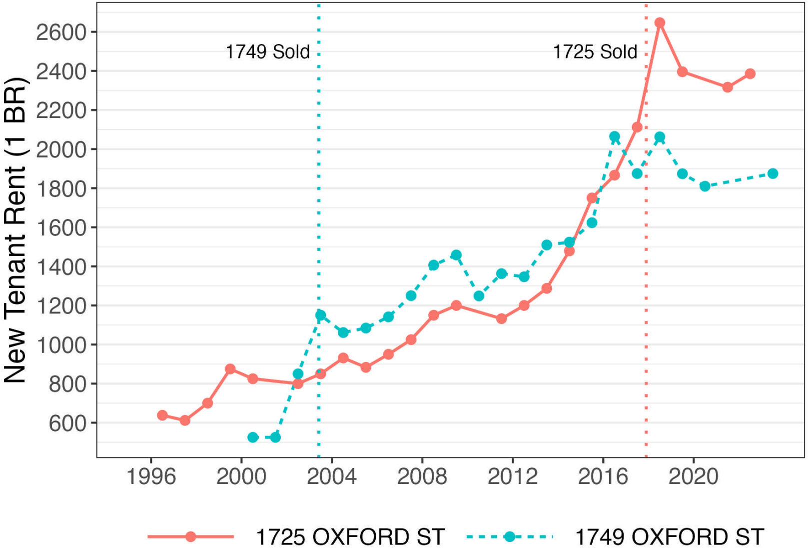
- Last sold in 2018 (for $9.5m)
- Current tax burden: $100,000

- Last sold in 2003 (for $1.45m)
- Current tax burden: $20,000

Property Taxes on Oxford Street

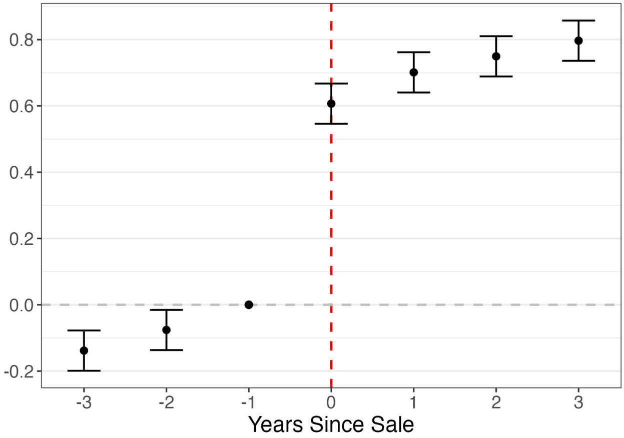


Rent on Oxford Street



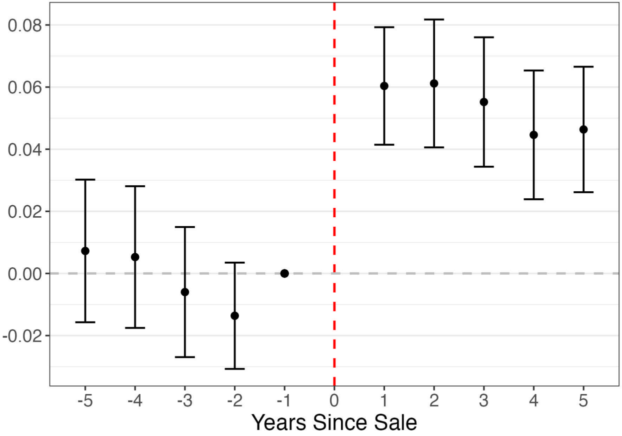
Outline

Spec. 1: Event Study of Log Property Taxes



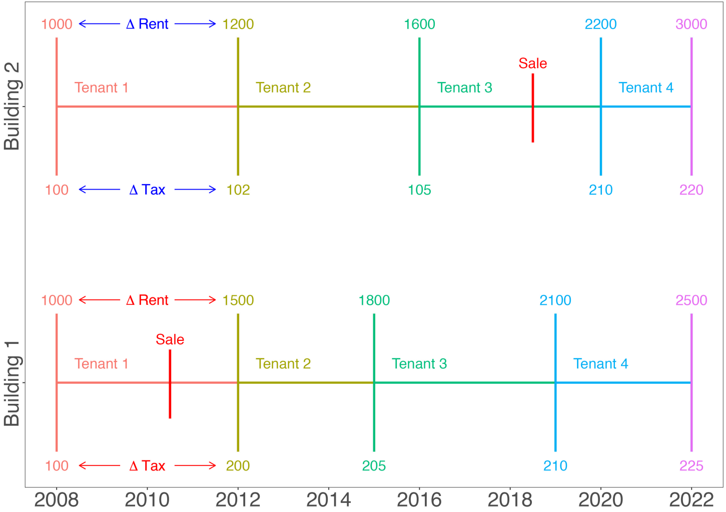
$$\ln[TaxableValue_{it}] = \sum_{t \in [-5,5]} \gamma_j \cdot D_{i,t-j} + \epsilon_{it}$$

Spec. 1: Event Study of Log New Tenant Rent



$$\ln[Rent_{it}] = \sum_{t\in[-5,5]} \gamma_j \cdot D_{i,t-j} + \lambda_{g,t} + \alpha_i + \gamma_{m_t} + \epsilon_{it}$$

Spec. 2: Pass-Through Specification Setup



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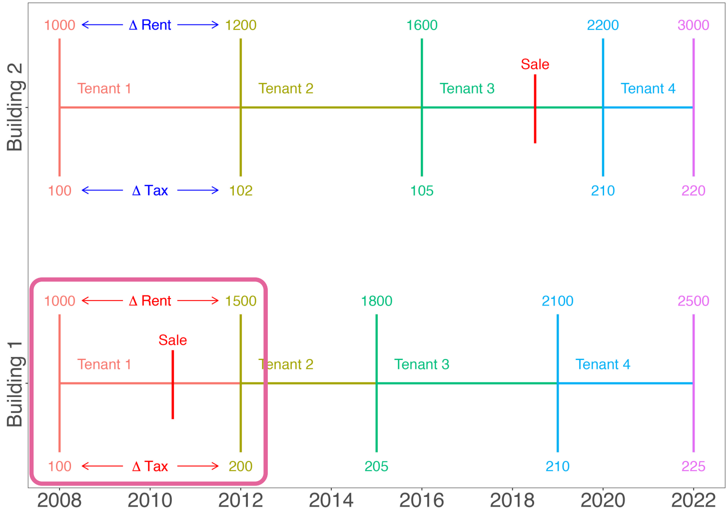

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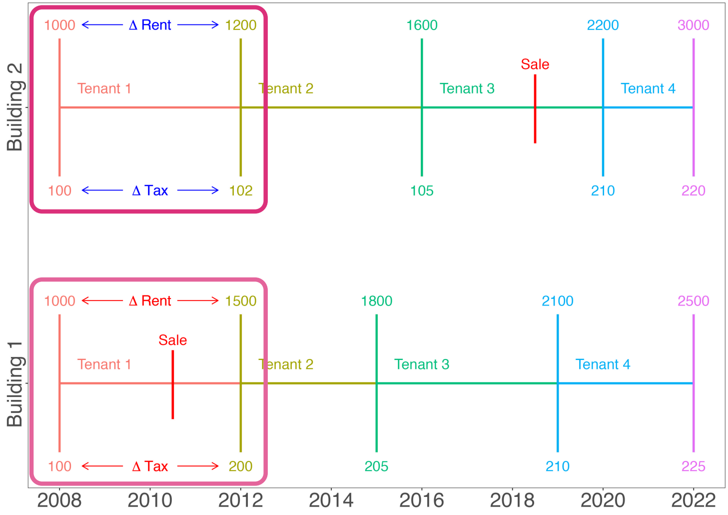

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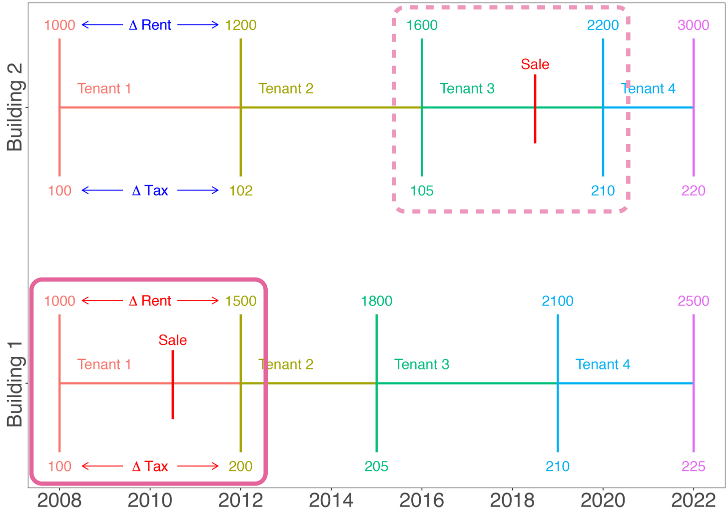

Spec. 2: Pass-Through Specification

For unit i, with a new tenant in periods $t-k$ and t, in Census tract g, with rent R and unit taxable value TV:

$$\begin{aligned}\Delta\ln[R_{i,g,t,t-k}] = {} & \beta_1 \Delta\ln[TV_{i,g,t,t-k}] \\ & + \beta_2 \mathbb{1}\{Sale_{i,t-k,t}\} \\ & + \beta_3 \mathbb{1}\{Sale_{i,t-k,t}\} \cdot \Delta\ln[TV_{i,g,t,t-k}] \\ & + \lambda_{g,t,t-k} + \alpha_i + \gamma_{m_t,m_{t-k}} + \epsilon_{i,t,t-k}\end{aligned}$$

Where:

- $\Delta\ln[R]$ controls for unobservables captured in pre-sale rent
- $\lambda_{g,t,t-k}$: Tract $\times$ Year$_t$ $\times$ Year$_{t-k}$ FE: Time-varying nbhd trends
- α_i: Unit FE: Unit-specific characteristics
- $\gamma_{m_t,m_{t-k}}$: Month$_t$ $\times$ Month$_{t-k}$ FE: Seasonality in rent prices
- SEs clustered by building: Within-building error correlation

Pass-Through Estimation

Table: Effects of Sale-Triggered Property Tax Changes on Rent

	Dependent variable:		
	$\Delta \ln[Rent_{t_{ij}-k_{ij},t_{ij}}]$		
	(1)	(2)	(3)
$\Delta \ln[TV_{i,g,t_{ij},t_{ij}-k_{ij}}]$	0.050***	0.036***	−0.004
	(0.005)	(0.005)	(0.009)
$Sale_{t_{ij}-k_{ij},t_{ij}}$		0.029***	0.017***
		(0.004)	(0.005)
$Sale_{t_{ij}-k_{ij},t_{ij}} \times \Delta \ln[TV_{i,g,t_{ij},t_{ij}-k_{ij}}]$			0.048***
			(0.010)
Implied Pass-Through Per $1			$0.53
Observations	97,017	97,017	97,017
Adjusted R^2	0.698	0.699	0.699

Note: *p<0.1; **p<0.05; ***p<0.01

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- I find a pass-through rate of...
  - **$0.53 per $1** at baseline
  - **$0.51 per $1** when accounting for landlord size Size Corporate

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- Use **city building permits**: Required for any construction, alterations, repairs; any work on gas/electrical/plumbing
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    - Occur in 74% of buildings, 5% of buildings permitted per year
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1. Explain **positive relationship between rent and property taxes**
2. Explain why below-market taxes $\rightarrow$ below-market rents

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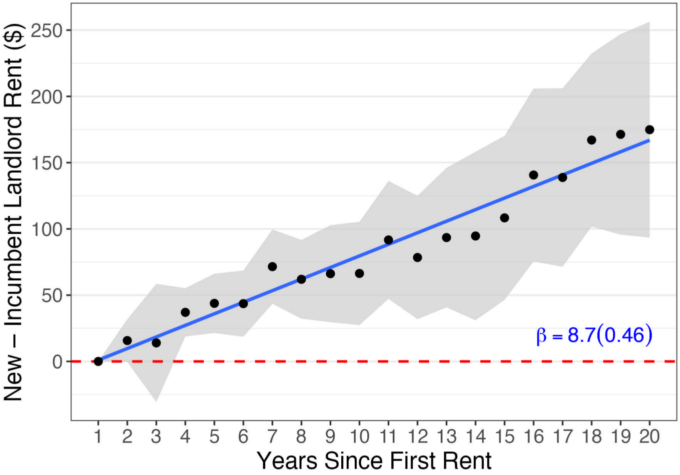
5. Cycle repeats

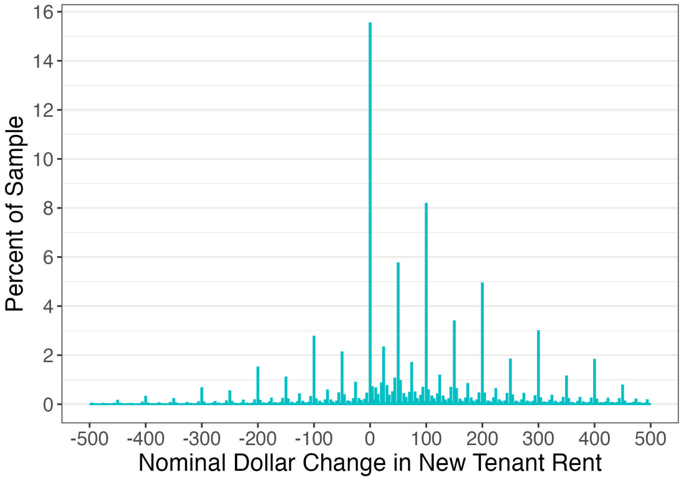
Inattention: New Tenant Rent Gap by Landlord Duration



$\Longrightarrow$ Incumbent landlords **drift** from new landlord rent by \$9 per year

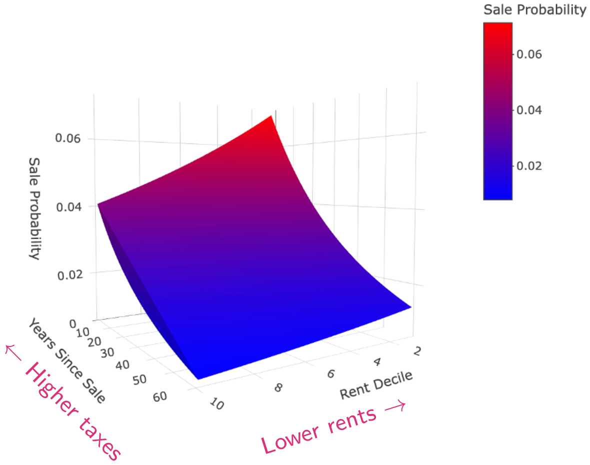
$\Longrightarrow$ 5-year landlord makes \$540 less than new landlord annually

Inattention: Heuristic Rent-Setting By Sale



Reproduced from Baker and Wroblewski (2024)

Lower-Rent, Higher-Tax Properties More Likely to Sell



- **Current** landlord: Sets low rents, pays high taxes → Sold!
- New landlord: Increases rents ↑↑ w/o huge tax increase

Taking Stock: Inattention & Landlord Entry/Exit

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  - **Channel 2** (likely): Incumbent landlords forced to be attentive $\rightarrow$ Rent increases
  - Increased tax revenue could provide targeted rental assistance

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  - Robust to landlord size, renovations
- **How do landlords price?**
  - They pass on heterogeneous cost shocks
  - Incumbent landlords price below market, 'incorrectly'
- Contribution:
  - Unique quasi-experimental setting
  - Novel, near-universal, unit-level rent data
  - Evidence of tax incidence on renters
  - Evidence of non-standard landlord pricing behavior

Thank you!

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Website: www.sarah-baker.com

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Appendix

Contribution to the Literature

1. **Property tax incidence**
   - Inconclusive GE estimates of \$0-\$1.40 per \$1: Oates and Fischel (2016), England (2016), Carroll and Yinger (1994)
   - Distributional effects: Avenancio-León and Howard (2022)
   - **Contribution: PE estimate of high pass-through**
2. **Behavioral pricing: Firms**
   - Stevens (2020), Dube et al. (2018), Reis (2006), Matějka (2016), DellaVigna and Gentzkow (2019)
3. **Behavioral pricing: Housing**
   - Sale price: Genesove and Mayer (2001), Bracke and Tenreyro (2021), Andersen et al. (2022), Badarinza et al. (2024), Guren (2018)
   - Rent stickiness: Genesove (2003), Gallin and Verbrugge (2019), Baker and Wroblewski (2024)
   - Rental pricing: Giacoletti and Parsons (2022), Hirota et al. (2020), Hughes (2022), Watson and Ziv (2024)
   - **Contribution: Behavioral framework to rental housing, novel setting and data, within-property variation**

Landlord Size: Direct Test

Back

Table: Effects of Sale-Triggered Property Tax Changes on Rent by Landlord Status

	Dependent variable:	
	Δ Log Rent	
	(1)	(2)
$\Delta \ln[TV_{t_{ij}-k_{ij},t_{ij}}]$	-0.004	-0.004
	(0.009)	(0.009)
Sale	0.017^{***}	0.018^{***}
	(0.005)	(0.005)
Sale x $\Delta \ln[TV_{t_{ij}-k_{ij},t_{ij}}]$	$\boxed{0.048^{***}}$	$\boxed{0.046^{***}}$
	$\boxed{(0.010)}$	$\boxed{(0.010)}$
$\text{Sale}_{t_{ij}-k_{ij},t_{ij}} x \Delta$ Units Owned		$\boxed{0.0001^{***}}$
		$\boxed{(0.00002)}$
Implied Pass-Through Per $1	$0.53	$0.51
Observations	97,017	97,017
Adjusted R^2	0.699	0.699
Note:	$^{*}p<0.1$; $^{**}p<0.05$; $^{***}p<0.01$	

Landlord Corporate Status Back

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$\Delta \ln[TV_{t_{ij}-k_{ij},t_{ij}}]$	-0.004	-0.003	-0.005	-0.004
	(0.009)	(0.010)	(0.010)	(0.010)
$Sale_{t_{ij}-k_{ij},t_{ij}}$	0.017***	0.010*	0.013**	0.020***
	(0.005)	(0.005)	(0.005)	(0.006)
$Sale_{t_{ij}-k_{ij},t_{ij}} \times \Delta \ln[TV_{t_{ij}-k_{ij},t_{ij}}]$	0.048***	0.046***	0.048***	0.048***
	(0.010)	(0.011)	(0.011)	(0.012)
Corporate		-0.003		
		(0.004)		
Business Owner			-0.004	
			(0.004)	
$Sale_{t_{ij}-k_{ij},t_{ij}} \times$ Corporate		0.028***		
		(0.008)		
$Sale_{t_{ij}-k_{ij},t_{ij}} \times$ Business Owner			0.022**	
			(0.009)	
$Sale_{t_{ij}-k_{ij},t_{ij}} \times \Delta$ County Buildings				0.0003**
				(0.0001)
Implied Pass-Through Per $1	$0.53	$0.50	$0.53	$0.53
Observations	97,017	97,017	96,744	79,464
Adjusted R^2	0.699	0.699	0.699	0.650

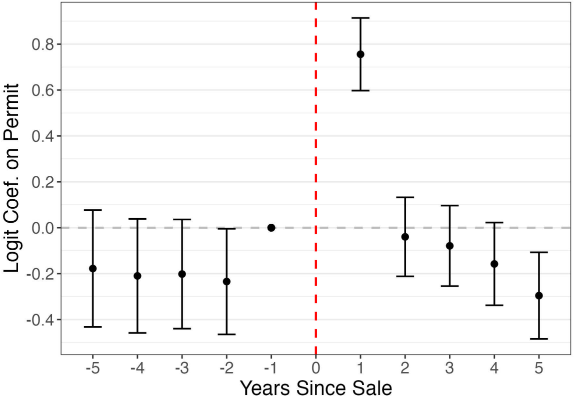
*p<0.1; **p<0.05; ***p<0.01

Improvements: "90s Kitchens" in 2024 Back

(a) 1725 Oxford St, 2024

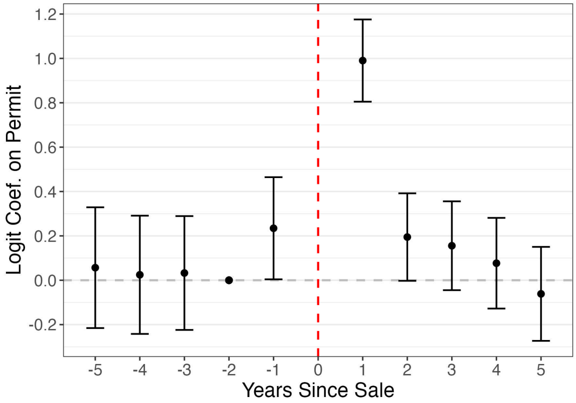
(b) 1749 Oxford St, 2024

Renovations: Permits More Likely Post-Sale Back



- Probability increases from 4.7% → 9.5% after sale, consistent with Benmelech et al. (2023) Event Study, $t = -2$
- Permits are common, occur in 74% of buildings Sale/Permit Freq.

Renovations: Permits More Likely Around Sale Back



- Probability increases from 3.6% → 4.5% → 9.1% → 4.3%, consistent with Benmelech et al. (2023)

Renovations: What's in the Permits? Back

Renovations: Results

Back

Table: Effects of Sale-Triggered Property Tax Changes on Rent

	Dependent variable:	
	$\Delta \ln[Rent_{t_{ij}-k_{ij},t_{ij}}]$	
	(1)	(2)
$\Delta \ln[TV_{i,g,t_{ij},t_{ij}-k_{ij}}]$	−0.004	−0.004
	(0.009)	(0.009)
$Sale_{t_{ij}-k_{ij},t_{ij}}$	0.017***	0.016***
	(0.005)	(0.005)
$Sale_{t_{ij}-k_{ij},t_{ij}} \times \Delta \ln[TV_{i,g,t_{ij},t_{ij}-k_{ij}}]$	0.048***	0.044***
	(0.010)	(0.009)
Number of Permits		−0.003***
		(0.001)
NLP Permit Score		0.273***
		(0.020)
Implied Pass-Through Per $1	$0.53	$0.49
Observations	97,017	97,017
Adjusted R^2	0.699	0.702
Note:	*p<0.1; **p<0.05; ***p<0.01	

Heuristic Rent-Setting

Back