

# MERCATUS ON POLICY

## Land Use and Homesharing Regulation: A Call for State Preemption

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**IN 2016, THE CITY OF CHICAGO PASSED A SERIES** of restrictions on those who offer short-term rentals via homesharing platforms such as Airbnb and HomeAway.<sup>1</sup> These restrictions effectively ended the use of these platforms for many homeowners across the city because of the licensing, taxes, and fees now associated with the practice. While many jurisdictions and municipalities across the country have been debating the role of homesharing, some have gone beyond the policy debate and have actually enacted the kind of regulation now enforced in the Windy City. Why are homesharing platforms under attack from municipal policymakers and interest groups? What is the economic and political logic behind this opposition? Which level of government should ultimately be responsible for this type of regulation?

Housing affordability advocates complain that homesharing platforms are crowding out long-term rentals, thus limiting the supply of rental housing and increasing rental rates for residents.<sup>2</sup> They view the supply of housing as fixed, so that any unit permanently used as a short-term rental is a unit that can't be used as a long-term rental. In response to these concerns and other considerations,<sup>3</sup> municipalities have implemented a variety of regulations that restrict the right of homeowners to rent out rooms or their whole houses to guests.<sup>4</sup>

Calls to regulate homesharing are by no means limited to large or growing cities, with residents of small towns also advocating for restrictions on homeowners hosting “transient guests.” Cities such as Jacksonville, Florida, and Kansas City, Missouri, prohibit short-term rentals anywhere but commercial districts, which drastically reduces the potential for homesharing.<sup>5</sup> Small vacation towns across the country have seen calls to regulate homesharing as well.<sup>6</sup>

While homesharing may reduce the supply of long-term rentals in markets with an inelastic supply, these practices are not nearly as problematic as zoning and other land use regulations that directly limit the construction of new housing. Blaming homesharing platforms for being a key driver of high housing costs is a distraction from the more insidious problem of stringent zoning regulations. Zoning, or land use regulation more generally, puts limitations on new construction and land use, thus constraining housing supply and driving up housing costs when the demand for housing expands.<sup>7</sup>

The available estimates of the relationship between homesharing and rental rates for long-term renters show a small effect. One recent study found that a 10 percent increase in Airbnb listings can be expected to increase long-term rental rates by 0.42 percent.<sup>8</sup> Since homesharing platforms have a very modest effect on rental rates, the benefits they offer to their users likely outweigh the social costs.

### HOMESHARING AND HOUSING AFFORDABILITY

Reforming those land use regulations that restrict housing supply and reduce prices is politically difficult.<sup>9</sup> Homeowners—one of the most important constituencies for local elected officials—have a financial interest in preserving the regulatory status quo because limits to supply make existing houses more valuable. Activists and policymakers, frustrated by this political inertia, may turn to support homesharing restrictions, since short-term visitors have little political sway. But since the effects of homesharing on housing costs are modest, these regulations will have little to no effect on long-term rental rates.

In addition, the effect of homesharing on long-term rental rates is more likely to be observed in markets where housing supply is inelastic as a result of land use regulations (e.g., San Francisco and Los Angeles) and wherever landlords find it profitable to make their properties available to a series of short-term renters rather than long-term ones (e.g., beachfront properties). When developers are allowed to

build new housing in response to demand increases, or when homeowners rent out rooms or their whole houses when out of town, the effect on the prices of long-term rentals is likely to be negligible.<sup>10</sup>

It is worth noting that homesharing does not directly compete with long-term rentals. Short-term rentals fill gaps in the housing market between long-term rentals, homeownership, and hotels. Tourists on a budget have long used short-term rentals like bed-and-breakfasts and hostels, while tourists interested in culturally immersive experiences have traditionally sought to stay with local hosts. Business travelers are also potential customers for short-term rentals in small towns with few or no hotel rooms. Short-term rentals also provide a housing option for people who are moving to a new city or need temporary residence in their home city—for benign reasons such as remodeling their own home, or for strained situations such as divorce or eviction.<sup>11</sup> These are all examples of a very real demand that is not served well by the current supply of long-term leases or hotels. The affordability and availability of short-term rentals is a benefit to many suppliers and consumers. The total cost of banning homesharing platforms for current users likely exceeds its modest effect on long-term rental rates.

### THE ROLE OF PREEMPTION

If homesharing platforms have at most a marginal effect on housing supply, why are they so resisted by local authorities? Well-organized interests at the local level—including the hospitality industry—homeowners who oppose “transient” guests in their neighborhood, and affordability activists who overestimate the effect of homesharing on home prices work together to support local regulation.<sup>12</sup> In contrast, politics at the state level are different because a plurality of well-organized interests denies hegemonic influence to particular interest groups.

There is a strong argument to be made for allowing homesharing platforms to emerge and compete in the market for short-term rentals: free enterprise thrives when new business and technological models

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emerge and compete to meet consumers' needs. As a result, consumers benefit from more choices, higher-quality products, and lower prices. The artificial barriers to entry imposed upon these platforms should be lifted, allowing consumers and renters to decide which platforms and models will succeed or fail.

The argument for economic opportunity may carry greater weight with the broader constituent base that elects state legislatures than it does with the more parochial local governments.<sup>13</sup> What's more, state law takes precedence over local law. This means that the final authority as to legality of homesharing and the nature of homesharing regulations rests with state governments, regardless of municipal decisions.<sup>14</sup>

However, when it comes to giving local governments the power to enact specific regulations, municipalities may be subject to either Home Rule or the Dillon Rule from their states.<sup>15</sup>

Under Home Rule, local governments have a wide range of authority to legislate on any issue not already legislated by the state government. Alternatively, municipalities under the Dillon Rule have the authority to pass legislation only in policy areas the state government has expressly delegated to them. Preemption, then, of local restrictions on land use—including homesharing regulations—is within the scope of state government power under both Home Rule and the Dillon Rule, and it presents the opportunity to create a level playing field for both local jurisdictions and property owners. State governments have a clear reason to preempt municipal policies when local government rules unduly constrain economic opportunity and free enterprise.<sup>16</sup>

State experiments in homesharing policy can provide lessons about how preemption succeeds or fails. Virginia provides an example of how state

preemption can remedy anticompetitive local land use rules. In 2016, the legislature passed a law that limited the use of the state's "proffer system" by municipal governments. The proffer system is a tool that allows municipalities to seek seemingly voluntary commitments from landowners during the rezoning process with the goal of mitigating the public impact of a proposed project. These commitments could take a variety of forms from improved sidewalks, to aesthetic design changes, to money to offset the costs of greater demand for public services.

Before it was implemented, the proffer system had been predicted to soothe local concerns about nuisances from new development.<sup>17</sup> What happened in practice was that municipalities used the mechanism to seek impact fees to mitigate impacts unrelated or indirectly related to the development being rezoned.<sup>18</sup> With fees unlinked from the nuisance they were supposed to be used to mitigate, the reason for the proffer system's existence was no longer relevant. As such, the state preempted the use of the proffer system. In short, when municipalities began abusing a legitimate regulatory tool, the state stepped in to correct the abuse. Virginia's proffer reform provides a useful example of preemption's place in American federalism.

Arizona provides another example of state intervention in land use regulation protecting homesharing against anticompetitive local restrictions. State policymakers passed legislation—the first of its kind—to preclude localities from restricting or regulating short-term rentals by classification, use, or occupancy.<sup>19</sup> Under the law, municipal regulations on homesharing must be narrowly intended to protect health and safety. The law also allows platform companies to collect and remit taxes to the state on behalf of users of short-term rental websites, itself a preemption of municipal

attempts to tax short-term rentals. The Arizona law embodies many of the ideas in the proposed Property Ownership Fairness Act, a piece of model legislation from the Goldwater Institute.<sup>20</sup> This model legislation was written to demonstrate the potential for state preemption in local land use regulation.

Preemption is not always successful, and attempts to pass preemption bills of various sorts run into roadblocks in state legislatures. As urban economist William Fischel writes, “Zoning and related land use regulations are the most jealously guarded local prerogatives.”<sup>21</sup> Municipalities are loath to give up land use decision-making powers, even when they lack the expertise or resources necessary to regulate efficiently. In a special session in 2017, the Texas legislature failed to pass a bill that would have protected homeowners from municipal bans on homesharing.<sup>22</sup> A similar bill failed by a single vote in Indiana earlier in the same year.<sup>23</sup>

Successful state attempts to rein in localities are often bipartisan, seeking to mitigate abuse by localities and limit regulatory costs.

Arizona’s bill won bipartisan support for protecting the ability of property owners to offer rooms as a source of supplementary income. The use of short-term rentals in this capacity appeals to the entrepreneurial spirit and consequently it also enjoys of bipartisan political appeal. This contrasts with Texas, where a preemption bill was seen as an attempt to limit local control rather than an attempt to protect economic opportunity.

## CONCLUSION

Homesharing is most likely to affect the supply of long-term rental housing in cities where housing supply is tightly regulated and thus inelastic. Rather than focusing on restricting homesharing platforms—which at worst have a modest effect on housing costs—advocates of housing affordability would better advance their cause by focusing on zoning reform, which is a key policy instrument in curbing the housing supply. Reforming zoning policies would

make the supply of housing more elastic, which in turn would further mitigate any effect of homesharing platforms on prices.

Where municipalities have become captured by special interests, state law can exercise its preemption rights in the public interest. The model laid out in the Arizona bill, allowing homesharing regulation limited to health and safety, may be the best option for other states wishing to embrace free enterprise and innovation.

## NOTES

1. See Chicago ordinance no. O2016-5111. Chicago, Ill., Code tit. 2, § 4, 17 (2016), <https://chicago.legistar.com/LegislationDetail.aspx?ID=2766507&GUID=F8717CE1-379A-42A3-8C32-88DOB189FBBD>.
2. Letitia James and Michael McKee, “Airbnb Is a Disease; We Have the Cure,” *New York Daily News*, October 21, 2016.
3. For instance, a bill put to the Washington, DC, city council in 2017 lists affordability as its primary motivation. Kenyan R. McDuffie, “Short-Term Rental Regulation and Affordable Housing Protection Act of 2017,” accessed January 23, 2018, <http://www.kenyanmcduffie.com/homesharing/>.
4. See, for example, Alexis Brachel, “5 Legal and Regulatory Considerations for Short-Term Rentals,” *Wolters Kluwer*, July 12, 2017, <https://ct.wolterskluwer.com/resource-center/articles/5-legal-and-regulatory-considerations-for-short-term-rentals>. For another review of municipal restrictions on home sharing, see Stephen Fishman, “Legal Restrictions to Renting Your Home on Airbnb or Other Rental Services,” accessed January 23, 2018, <https://www.nolo.com/legal-encyclopedia/legal-restrictions-renting-your-home-airbnb-other-rental-services.html>.
5. Andrew Moylan, “Room Score 2016: Short-Term Rental Regulation in U.S. Cities” (Policy Study No. 55, R Street Institute, Washington, DC, February 23, 2016).
6. For examples in Colorado, see Jason Blevins, “Mountain Towns Learn to Love — and Regulate — Short-Term Rentals” *Denver Post*, February 20, 2015; for an example in Long Island, see Stefanie Dazio, “Hempstead Supervisor Proposes Ban on Airbnb,” *Newsday*, June 19, 2017.
7. For a review of the economic literature on the relationship between land use regulations and housing supply, see Joseph Gyourko and Raven Molloy, “Regulation and Housing Supply” (NBER Working Paper No. 20536, National Bureau of Economic Research, Cambridge, MA, October 2014). In a nationwide study, Matthew A. Turner, Andrew Haughwout, and Wilbert van der Klaauw identify a causal relationship between land use regulation and house prices. They find that a one-standard-deviation increase in the level of land use regulations reduces land prices by 36 percent. These lower land prices reflect that developers have fewer opportunities to put land to more intensive uses under more binding regulations, resulting in higher housing prices. Matthew A. Turner, Andrew Haughwout, and Wilbert van der Klaauw, “Land Use Regulation and Welfare,” *Econometrica* 82, no. 4 (2014): 1341-1403.

8. Kyle Barron, Edward Kung, and Davide Proserpio, "The Sharing Economy and Housing Affordability: Evidence from Airbnb" (working paper, 2017).
9. For an exploration of homeowners' outside influence in elections and the political process more generally, see William A. Fischel, *The Homevoter Hypothesis: How Home Values Influence Local Government Taxation, School Finance, and Land-Use Policies* (Cambridge, MA: Harvard University Press, 2005).
10. Christopher Koopman and Jim Pagels, "The Hard Truth about Airbnb: It's Not the Villain," *Medium*, November 4, 2016.
11. For a discussion among Airbnb hosts who have hosted guests who are without permanent shelter, see AirHostsForum.com, "Homeless Guests," accessed February 7, 2018, <https://airhostsforum.com/t/homeless-guests/12562>. Another example of homesharing providing a resource for people in strained situations is when Airbnb provided a platform for residents displaced by wildfires in California to find housing with hosts who were willing to provide shelter free of charge. See Bill Swindell, "Airbnb Offers Free Temporary Housing for North Bay Fire Victims," *North Bay Business Journal*, October 27, 2017.
12. This is an example of political activity that Bruce Yandle characterizes as "bootleggers and Baptists" working together to support regulation. Adam Smith and Bruce Yandle, *Bootleggers and Baptists: How Economic Forces and Moral Persuasion Interact to Shape Regulatory Politics* (Washington, DC: Cato Institute, 2014).
13. David Schleicher, "The City as a Law and Economic Subject," *University of Illinois Law Review* 2010, no. 5 (2009): 1507-64.
14. Emily Hamilton, "The Case for Preemption in Land Use Regulation," Mercatus Center at George Mason University, July 20, 2017.
15. Jon D. Russel and Aaron Bostrom, "Federalism, Dillon Rule and Home Rule" (Arlington, VA: American City County Exchange, 2016).
16. Schleicher, "The City as a Law and Economic Subject."
17. Peter Van Doren and Nick Zaiac, "Unintended Consequences of Proffer Reform in Virginia," *Cato at Liberty* (Cato Institute), February 8, 2016.
18. Edward A. Mullen and Michael A. Banzhaf, "Virginia's Proffer System and the Proffer Reform Act of 2016," *Richmond Public Interest Law Review* 20, no. 3 (2017): 203-20.
19. S.B. 1350, 52nd Leg., 2nd Reg. Sess. (Az. 2015).
20. Christina Sandefur and Timothy Sandefur, *The Property Ownership Fairness Act: Protecting Private Property Rights* (Phoenix, AZ: Goldwater Institute, 2016).
21. William A. Fischel, *Zoning Rules: The Economics of Land Use Regulation* (Cambridge, MA: Lincoln Institute of Land Policy, 2015). For an exploration of homeowners' outside influence in elections and the political process more generally, see Fischel, *The Homevoter Hypothesis*.
22. S.B. 451, 85th Leg., Reg. Sess. (Tx. 2017).
23. Chris Sikich, "Bill Aiming to Protect Airbnb Users Fails," *Indianapolis Star*, February 7, 2017.

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