Transferable Sharing Rights: A Theoretical Model for Regulating Airbnb and the Short-Term Rental Market

Stephen R. Miller

Associate Professor,
University of Idaho College of Law

This short essay proposes a theoretical model for regulating the short-term rental market, which is typified by online markets such as Airbnb.com. The basic mechanism proposed here is a "transferable sharing right" (TSR), which is modeled on existing transferable development rights regimes. The proposed TSR regime would provide cities a means of regulating short-term rentals while also charging a fee equal to externalities and lost city revenue resulting from short-term rentals. Further, TSRs could be used to re-invest in neighborhoods where short-term rentals occur or to drive economic development to neighborhoods where cities seek to encourage tourism.

Internet sites, such as Airbnb.com, which allow individuals to rent dwelling units, or rooms within those units, have grown astronomically in the last few years. Airbnb.com alone has grown from 120,000 listings worldwide two years ago to over 300,000 listings today, and over 4 million guests used the service in 2013 alone.[1] This new short-term rental market, which operates illegally in most cities,[2] is a disruptive technology that threatens long-standing business models of hotels as well as regulatory structures, tax bases, and constituencies of local governments. This essay introduces a regulatory framework to legalize the short-term rental market, while also addressing its externalities, which this essay calls "transferable sharing rights," or TSRs. Even if implementation of a TSR regime as proposed here proved politically or logistically impracticable, the proposal is intended to provoke and invite discussion on

[1] AIRBNB ANNUAL: GLOBAL GROWTH, https://www.airbnb.com/annual/ (last visited Sept. 29, 2014).
[2] *See, e.g.,* Leonard Greene, *Airbnb nets $40M in illegal NY listings: AG*, N.Y. POST (Oct. 16, 2014), http://nypost.com/2014/10/16/airbnb-nets-40m-in-illegal-ny-listings-schneiderman/.

alternative methods for regulating the short-term rental market and other aspects of the sharing economy.

The TSR model is based on established principles of existing transfer of development rights (TDR) regimes perfected over the last fifty years in commercial development contexts.[3] TDRs became popular after their explicit approval in *Penn Cent. Transp. Co. v. City of New York*[4] as a way to compensate property owners that were required to maintain certain less-intense use than otherwise permitted by code, such as the historic Grand Central Station in Manhattan. In TDR regimes, this down-zoned "sending" site is permitted to sells its unused development rights to a "receiving site" for a market price, which then permits the receiving site to develop more intensely than otherwise permitted by code but only by a prescribed amount. This proposal for TSRs follows the example of TDR regimes in their more successful iterations while also drawing on a variety of other land use tools, such as impact fees, already used extensively across the country.

A transferable sharing rights regime for the short-term rental market could be structured as follows:

<u>Allocating TSRs</u>. As with any artificial marketplace, designing the initial allocation of transferable sharing rights (TSRs) is of utmost concern. One easy approach would be to provide each dwelling unit within the city a redeemable transferable sharing right, or TSR, which would permit the dwelling unit owner to engage in a short-term rental for a given period of time. The term of a TSR should vary depending upon the tourism market in each city. Such variations could include: number of persons; number of days; or other relevant metrics.

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[3] *See generally* ARTHUR C. NELSON, ET AL., THE TDR HANDBOOK: DESIGNING AND IMPLEMENTING SUCCESSFUL TRANSFER OF DEVELOPMENT RIGHTS PROGRAMS (2011).
[4] 438 U.S. 104, 114 (1978).

Redeeming a TSR. A TSR has no value, and conveys no right, unless redeemed pursuant to terms established by the city for TSRs. An owner of the dwelling unit would use an online site controlled by the city to redeem a TSR.[5] Redeeming a TSR should have two components. First, it should require information that allows the city to further refine its response to the short-term rental market. This could include data such as: location of rental; length of stay; price charged; and number of visitors. Second, TSR redemption should require payment of a TSR Fee.

The TSR Fee. The TSR Fee is equal to a monetization of externalities arising from the operation of short-term rental markets. In this regard, the TSR Fee is no different than an impact fee that is applied to new development to pay for that project's externalities. The city would be required to conduct a nexus study, similar to an impact fee nexus study, to evaluate the impacts to the city of permitting the short-term rental market. This may include increased police, health and safety, fire, building department and TSR compliance enforcement services. In addition, the TSR Fee study could also evaluate foregone hotel occupancy taxes and any other costs or fees lost by the city to the short-term rental market. Collection of the TSR Fee would place the city in the same position it was in prior to the arrival of the short-term rental market.

The right of a redeemed TSR. Upon completion of the informational portion of the redemption system and payment of the TSR Fee, the TSR Owner could then engage in a short-term rental for the term of the TSR without regard to other limitations imposed by the city, including those that might otherwise prohibit the short-term rental market, such as zoning, building, or fire codes.

[5] The site described here would likely utilize the same technology needed for the TSR Market described below.

TSR Fee passed on to consumer. Most impact fees imposed on developers of new construction are passed on to the purchasers of the new units. Here, the TSR Fee would most likely be passed on to the consumer through the rental rate for the short-term rental. In time, sites like Airbnb.com, would likely reflect the TSR Fee in the advertised price for the short-term rental.

Alienability of TSRs. TSRs would be alienable from the dwelling unit. TSRs must be alienable from the dwelling unit to which they are allocated in order to facilitate the creation of a market for the TSRs.

The TSR Market. A TSR Market would permit those that do not wish to use TSRs to sell them to others who want to engage in the short-term market beyond their initial allocation. Unredeemed TSRs could be sold through an online marketplace, the TSR Market, controlled by the city. The city needs to have control over the TSR Market to ensure market transparency. It is especially important that the city retain control of the TSR Market in order to ensure (i) that proper records are maintained of the redemption of and sale of unredeemed TSRs; and (ii) that aggregators cannot manipulate the market, both of which have been problems in poorly designed TDR marketplaces. While it is important for the city to retain control of the TSR Market, it could also be operated on the back-end by existing Internet sites. For instance, a site like StubHub.com, which facilitates the resale of game and concert tickets, already provides the type of market platform necessary to enable a TSR Market. Such companies could be incentivized to offer their technology to cities for free upfront by, in turn, receiving a small percentage of each redeemed TSR. Presumably, it would be easy for such third-party providers to quickly commodify the TSR Market software through deployment in major cities, which would then drive down the cost of implementation in smaller cities.

Avoiding market manipulation. Only other dwelling unit owners should be permitted to purchase TSRs; otherwise, institutional players, such as hotels, might try to purchase TSRs to manipulate the market. Preventing market manipulation is another reason to limit the number of TSRs that any one dwelling unit can utilize.

Necessity of scarcity. If the TSR Market is designed properly, there will be scarcity in TSR "receiving" areas—locations where tourists want to stay—and a surplus in TSR "sending" areas—locations where tourists don't want to stay. This is perhaps the most important part of designing a TSR Market: if there are too many TSRs allocated initially, no market will emerge, which eliminates the rest of the marketplace's benefits in reducing externalities outlined below. It may be that scarcity necessitates multiple TSRs to permit one short-term rental, a calculus that could be performed with some precision given knowledge of a city's typical tourism and dwelling unit data.

In addition, TSRs would also need to have an effective date; for instance, non-redeemed TSRs might be issued on January 1 of a given year and voided after December 31 of that same year. This is equally necessary to preserve market scarcity.

The TSR Market Demand Fee. The TSR Market is where TSR sending and receiving sites meet to determine the price of an alienable, unredeemed TSR. If designed correctly, the market price for TSRs on the TSR Market would be in excess of the TSR Fee. The TSR seller and the city would split the TSR Market Demand Fee.

Neighborhood benefits from the TSR Market Demand Fee. The portion of the TSR Market Demand Fee that is retained by the city should then be allocated in a manner that seeks to mitigate the externalities of the short-term rental market. One possibility is to give the city's share of the TSR Market Demand Fee to neighborhood groups in those locations where the bulk of TSRs are used. The money could be used at the discretion of neighborhood groups to permit them to improve their neighborhood and thereby reap some benefit from the increased tourism in that location.

Preventing TSR hot-spots. To prevent "hot-spots" of short-term rental markets from changing the character of a building or neighborhood, the city could limit the number of TSRs that a dwelling unit could use in a given period. In addition, the city could limit the number of TSRs that are used in a desirable neighborhood. This would also likely eliminate the concern of some that short-term rentals raise rents.[6] The limit on TSRs should be sufficiently high to permit the TSR Market to operate, but sufficiently low to retain residential character of city neighborhoods. This limit may vary by neighborhood. For instance, some neighborhoods may come to covet the financial gain that it would receive through its share of the TSR Market Demand Fee, and thus want a higher TSR threshold in that neighborhood, while other neighborhoods may not be incentivized by such financial reward.

Economic development. Once a TSR Market is properly established, the city could use the market as an economic development tool. For instance, the city could begin requiring multiple TSRs to stay in fashionable areas, while areas where the city seeks to encourage economic development would require fewer TSRs. Of course, the city would want to engage the community to ensure there was support for driving growth to an area, but such an incentive would flow both to individual dwelling unit owners and to the neighborhood at large through the neighborhood's share of the TSR Market Demand Fee.

Enforcement. Enforcement of TSR compliance could take several approaches. First, the city could use its traditional nuisance abatement power to respond to citizen complaints of non-

[6] Ken Rosen, *Short Term Rentals and the Housing Market*, URBAN LAND (Nov. 22, 2013), http://urbanland.uli.org/news/short-term-rentals-and-the-housing-market/.

TSR-enabled short-term rentals. Residents could be empowered to assist nuisance abatement efforts by access to information about redeemed TSRs within a relevant area, such as 300-feet of a building or, more broadly, within a neighborhood. Such data on redeemed TSRs would need to be sufficiently specific to inform residents, but also sufficiently vague to protect the privacy and safety of the visitors. Second, monetary fines for non-compliance would be essential. The fine would need to be sufficiently high to discourage an "efficient breach" in which short-term rentals proceed without TSRs and simply pay the fine. In addition, the city could encourage enforcement by providing for citizen suits through the local city code that would reimburse attorney fees, costs, a portion of the monetary fine, and even a multiplier on attorney fees to reward the public benefit, where citizens bring to light TSR abuse.

There are three major problems to resolve with a TSR approach to the short-term rental market.

Landlords and renters. This proposal gives the TSR to the dwelling unit owner. Complications will emerge between landlords and renters. Cities should preemptively address these issues. For instance, a city ordinance could require landlords to permit renters to use TSRs allocated to the dwelling unit; if left to private negotiation, standard forms used in most rental agreements would likely eliminate renters' access to TSRs. A city ordinance could also state that use of TSRs by renters does not otherwise violate subletting or rent control provisions.

Large condominium buildings or homeowners associations would also likely revise their bylaws to address TSRs. Such private agreements could limit the use of TSRs within a building or neighborhood, just as such bylaws already provide additional restrictions on those communities today. If such limitations were pursued in large number, it could affect the market price of the TSR Fee and the TSR Market Demand Fee, which the city could then re-adjust from time-to-time, just as cities readjust their impact fee schedules.

Labor unions. Hotel-based labor unions are major opponents of the short-term rental market because such unions fear the loss of union jobs if the hotels in which they work go out of business. Cities with labor issues could consider using some portion of the TSR Market Demand Fee to provide worker training, or subsidize benefits, for those workers who would be affected by the rise of the short-term rental market.

Jurisdictionality. TSRs raise the cost of short-term rentals, and so those seeking bargains might choose to stay just over the city border in a neighboring city that does not charge a TSR. This is a persistent problem in local government law and, incidentally, is currently a persistent issue with existing hotels and hotel occupancy taxes. Nonetheless, if a TSR Market becomes commodified by a third-party provider, as proposed above, then even small jurisdictions could charge TSRs. Absent transaction costs, all cities have an incentive to charge TSRs because, like hotel occupancy taxes, they would be paid by transient populations that do not vote. Thus, a TSR Fee is a valuable way to raise revenue without raising taxes on voters for all cities.

In conclusion, a transferable sharing rights regime appears uniquely capable of addressing many of the complexities, and externalities, arising from the short-term rental market. The implementation of such a regime may, at first, seem onerous. It should not: existing Internet sites already deploy the technologies needed to establish and maintain the TSR Market, which could be re-purposed to this end.