

2018

Affordable Housing Act (Costa-Hawkins Update)

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JULY 2018

CALIFORNIA'S RENT CONTROL BATTLES RAGE ON: REVIEWING THE LATEST COSTA-HAWKINS REPEAL UPDATES

The debate around rent control policy in California is hotter than ever thanks to a fast-approaching November ballot initiative. If passed, the measure would repeal the Costa-Hawkins Act, a critical set of rent control restrictions that have been the law of the land in California since 1995.

The ballot initiative, now known as the “Affordable Housing Act,” is seen as a follow up to Assembly Bill 1506, legislation that also called for a full recall of Costa-Hawkins, after said bill was defeated in the state senate in January 2018. The ballot initiative is seen as move to speed the issue through referendum rather than wait on approval by state legislators.

For investors and developers, the loosening of rent control restrictions is a cause for concern. It's not an exaggeration to say that the nation's largest economy is approaching a far-reaching legislative shift this November. Preparing for an uncertain future will require professionals to consider how these changes will affect California's uniquely robust real estate market.

RENT-CONTROL RESTRICTIONS COULD BE LIFTED FOR RENTAL HOUSING AND NEW CONSTRUCTION

At the heart of the Costa-Hawkins Act are several exemptions that prevent rental housing from being impacted by rent-control laws. Specifically, these restrictions:

- Exclude single family homes, condominiums, and units built after February 1, 1995 from rent control policies
- Restrict the age of eligibility of those units already affected by rent control to the threshold in place when those rent controls were originally adopted
- Limit vacancy decontrol policies (also known as “strict” rent control) which hinder landlords by making it extremely difficult to raise rents, even when tenants move out, except during special circumstances

If the Costa-Hawkins Act is repealed, municipal governments could choose to apply rent-control policies to existing rental housing and new construction. Notably, past attempts to introduce rent control created new hurdles for affordability, discouraged investors from building units in cities where rent controls appeared to limit growth, and left development of affordable housing at a standstill.

As a result, municipal governments may choose not to adjust or update current rent-control policies depending on their respective community's need for affordable housing. For example, voters in Inglewood, Long Beach, and Pasadena have already rejected local ballot initiatives that would introduced new rent control policies to their respective cities.

Regardless of how individual cities and municipalities respond to a statewide rent control reform, a successful vote in November will usher in a major period of transition.

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MOVING FORWARD: STRATEGIES FOR RESHAPING THE RENT CONTROL DEBATE

The latest attempt to repeal Costa-Hawkins may very well be finished in November, but the rent control debate will continue regardless. Thankfully, commercial real estate professionals are in a better position than ever to communicate the risks of rent control and discuss solutions that are far more likely to improve the state of affordable housing in California.

The latest academic research on the topic was released in June 2018 by the Turner Center for Housing Innovation at UC Berkley. Their report, titled “Finding Common Ground on Rent Control,” emphasized the dangers of restrictive rent control while outlining solutions for making housing more affordable without hindering economic development.

POTENTIAL COMPROMISES AND SOLUTIONS

It is critical for supporters of Costa-Hawkins to re-direct the conversation toward proven solutions for affordable housing. One way this can be accomplished is by highlighting the known risks of counterintuitive rent controls and suggesting potential compromises.

The following solutions recommended by the Turner Center in the institution’s recent report serve as helpful talking points for commercial real estate professionals with the repeal vote just around the corner:

- Update Costa-Hawkins to include all multifamily developments that were built prior to February 1, 1995. As the law stands, several cities with rent control laws on the books have their unit eligibility frozen at the threshold in place when Costa-Hawkins was adopted (In Los Angeles, for example, only units built prior to 1978 are eligible). This update would immediately bring numerous units under rent control that were previously ineligible.
- “Anti-gouging” rent caps, determined annually by a formula and applied equally to all rental units in the state, can protect residents from excessive rent increases without hurting economic growth
- Property tax relief incentives remain a major opportunity to incentivize developers to include below-market rental units in their development profiles

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RENTAL UNITS STATEWIDE MAY BE SUBJECT TO VACANCY DECONTROL

A major component of the Costa-Hawkins Act is limitations placed around vacancy decontrol policies. As the law currently stands, landlords who own rent-controlled properties are only able to change rents to reflect market value once the apartment has been vacated under certain circumstances, such as the voluntary vacancy by the tenant or in case of a “just cause” eviction. If the Costa-Hawkins repeal measure is successfully voted into law, landlords may find themselves subject to even more legal obstacles that limit their ability to charge a rent that reflects each unit’s true market value.

MAJOR TAKEAWAYS AND IMPACTS FOR MULTIFAMILY INDUSTRY

Many commercial real estate professionals are expressing concern about the impact that rent control will have on their markets. They argue that stagnated rent growth, limited investor engagement, and shrinking property values are all common disadvantages related to overreaching rent controls.

Other commercial real estate professionals have expressed more nuanced reactions to the potential rent control update. They point out that many of California’s municipal governments have long been able to balance economic development with the considerable influence they have over how local property owners can manage their rent. The following are a few more reasons that commercial real estate professionals can stay hopeful despite the approaching threat of rent control in California:

- **Costa-Hawkins Repeal Is Not Certain** – A key takeaway from the latest Costa-Hawkins repeal effort is just how much support the act has in the first place. Despite decades worth of bills and ballot measures designed to defeat Costa-Hawkins, the law has yet to be overturned.
- **Impacts of Costa-Hawkins Repeal Are Unpredictable** – Multiple commercial real estate professionals have pointed to the varied impacts of rent control for each city and municipality. Predictions can be made about which local governments will enforce rent control, but it is difficult to determine the full impact of cascading policy updates until they take effect.
- **Rent Control Does Not Equal Catastrophe** – Some members of the real estate industry equate new rent controls to a doomsday scenario. However, most developers recognize that California’s diverse and well-established commercial real estate markets will find a way to overcome any challenges created by new rent control policy.