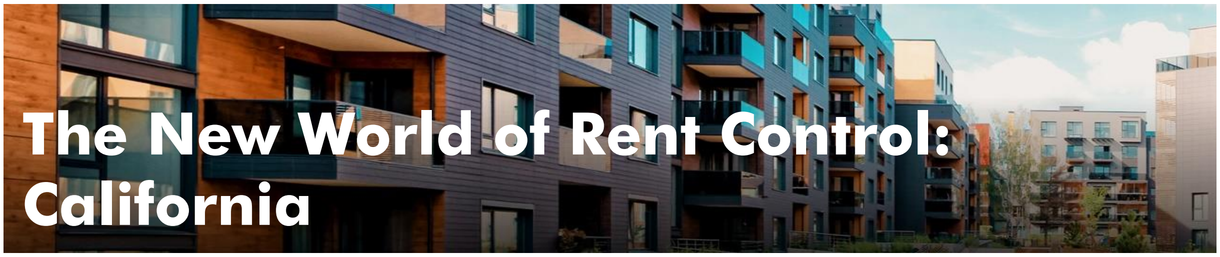
HOUSING POLICY



The New World of Rent Control: California

Key Takeaways

- California became only the second state in the U.S. this year with statewide residential rent control.
- The Tenant Protection Act of 2019 took effect on January 1, 2020 and caps annual rent increases at 5% plus inflation for 15+-year-old properties.
- The law currently affects an estimated 8 million of the state's 17 million renters, according to the California Legislative Analyst's Office (LAO).
- The Rental Affordability Act (RAA), up for consideration by California voters in November, would effectively derail the current law (Costa-Hawkins) and allow local jurisdictions to implement stricter forms of rent control, including "vacancy control."

Second State to Adopt Rent Control

California followed Oregon to become the second state in the nation with statewide residential rent control. The Tenant Protection Act of 2019 (TPA) that went into effect on January 1, 2020 has profound implications for the national multifamily industry in that it could be used as a model for other states. Through 2030, the TPA limits annual rent increases to 5% plus the percentage change in cost of living (consumer price index) or 10% total, whichever is lower. To avoid discouraging new development, the law applies only to properties that are 15+ years old on a rolling basis (i.e., a property built in 2006 is not covered in 2020 but is regulated in 2021). The bill also offers more housing security by banning owners from evicting tenants without "just cause."

The TPA does not override certain provisions of existing municipal rent control laws. For example, Los Angeles apartments that opened before 1978 had rent increases capped at 4% last year. If the asset opened after 1978 and is at least 15 years old, state law applies and rent is capped at 5% plus inflation.

Figure 1: Summary of Rent Control Legislation - TPA

Measure	Tenant Protection Act of 2019 (Assembly Bill 1482)
Basic Rent Control Law	Rent increases capped at 5% plus inflation, not to exceed 10% (for renewals of existing residents)
Effective	January 2020
Geography	Entire state of California (but does not override certain provisions of local rent control measures currently in place)
Covered	Multifamily properties 15+ years old
Vacancy Decontrol	Rents on vacated units are not subject to rent caps (with some exceptions)
Additional Measures	Greater resident protection with respect to lease terminations; evictions without cause no longer allowed
Prior Related Laws	Costa-Hawkins bars local municipalities from having rent control on apartments built after 1995 or earlier in cities that already had rent control in place (e.g., Los Angeles, where the cutoff is 1978)

Source: CBRE Research, multiple sources, April 2020.

COVID-19 Environment Creating New Concerns

COVID-19 and associated job losses have created a new housing policy concern, as many states consider temporary moratoriums on evictions from rental housing. More broadly, the multifamily industry is facing softer market conditions from the economic fallout of the pandemic. Disruption of capital markets—in particular, reduced investor activity and tighter loan underwriting—has added worries for owners and investors, making it more difficult to offset the effects of rent control legislation.

The situation is dynamic and there could be more aggressive rent-control and related measures impacting the multifamily market. The coming months may also bring moderate relief to high housing costs, the roots of rent control advocacy.

RAA Could Remove Vacancy Decontrol

If the statewide Rental Affordability Act (RAA) is approved by voters in November, it would remove limits on cities and counties to impose and expand rent control policies. It would replace the Costa-Hawkins Rental Housing Act of 1995, which prevented municipalities from keeping rental rates below market upon vacancy (vacancy decontrol).

RAA's removal of vacancy decontrol is considered much more drastic than the TPA's restrictions and was the biggest concern for the apartment industry prior to the COVID-19 outbreak. Under RAA, local governments would have the right to prevent landlords from increasing rents to market rate on regulated units that are vacated.

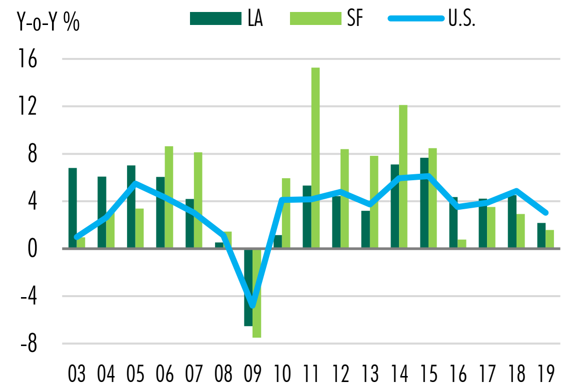
Roots of Rent Control Sentiment

California has an acute housing shortage, with inadequate new supply to meet demand, resulting in rising home prices. The shortage through 2025 may total 3.5 million homes, according to McKinsey Global Institute. Since 2010, only one new home has been built for every 4.7 California households formed, compared with one home built for every 1.4 new U.S. households. New supply is meeting less than 25% of demand in the Golden State.

Annual rent growth from 2014 to 2015 was exceptionally high overall, averaging 7.4% in Los Angeles and 10.3% in San Francisco. For the entire post-2008-recession period, annual rent increases averaged 4.4% and 6.7% for the two markets, respectively. San Francisco and San Jose had the highest median rents in the country at $1,840 and $1,580, respectively, as of Q4 2019. Although Bay Area rents are extremely high, the "rent burden" is most acute in Southern California. In 2018, 54.4% of Los Angeles renters were considered rent burdened (paying 30%+ of monthly income on rent) and 28.5% severely burdened (paying 50%+).

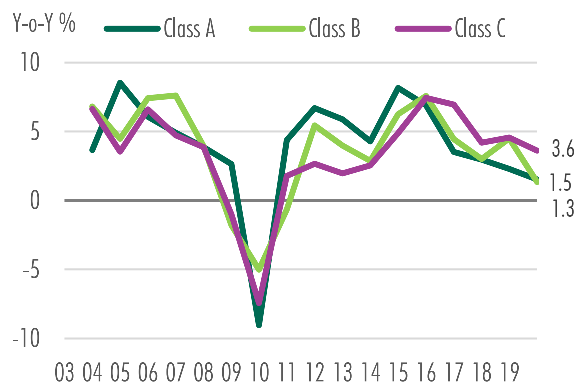
The percentage of renters considered rent burdened has always been high in California, and the overall average has not been rising, due partly to an increase in high-income renters. Yet for workforce households the percentage of those considered rent burdened has been climbing significantly. In Los Angeles, 62.7% of workforce households were rent burdened, up from 46.6% in 2010. San Francisco did not rise as much, but was still very high at 57.1% in 2018.

Figure 2: Los Angeles & San Francisco Rent Change



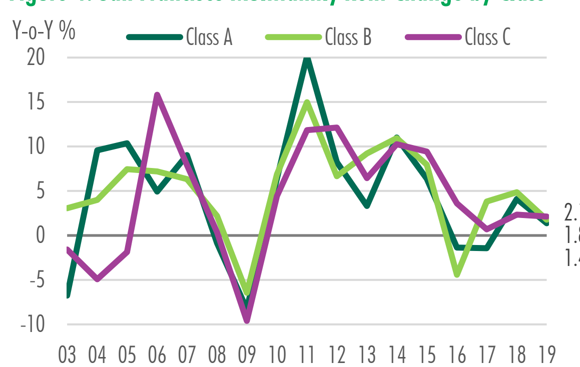
Source: CBRE Research, CBRE Econometric Advisors, Q4 2019. Los Angeles and San Francisco are for LA County and SF County only.

Figure 3: Los Angeles Multifamily Rent Change by Class



Source: CBRE Research, CBRE Econometric Advisors, Q4 2019. For Los Angeles Metropolitan Division (Los Angeles County).

Figure 4: San Francisco Multifamily Rent Change by Class



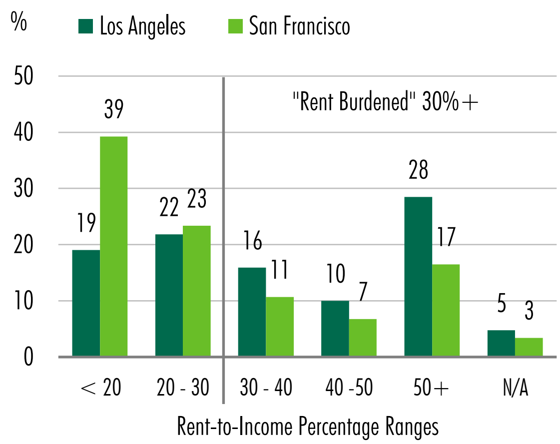
Source: CBRE Research, CBRE Econometric Advisors, Q4 2019. San Francisco represents San Francisco Metropolitan Division (San Francisco, San Mateo and Marin counties).

Figure 5: Rent-to-Income Ratios - All Households

	Rent as % of Income			% of Households Where Rent is 30+% of Income		
	LA	SF	U.S.	LA	SF	U.S.
2010	35.1	28.3	31.6	56.4	43.9	48.9
2014	35.5	27.1	31.0	57.2	40.6	47.9
2017	34.0	23.9	29.8	55.0	35.8	46.0
2018	33.8	23.8	29.9	54.4	34.0	46.2

Source: CBRE Research, U.S. Census Bureau (American Community Survey), Q4 2019.

Figure 6: Rent-to-Income Ratios, 2018



Source: CBRE Research, U.S. Census Bureau (ACS), Q4 2019. For example: in Los Angeles, 28% of all renter households pay 50+% of their gross income on rent.

Housing Economics & Rent Control

There is a significant body of research that indicates inefficiencies and market distortions occur from rent control, including reduced housing supply and affordability, less maintenance and increased vulnerability for those at risk of homelessness.

When San Francisco enacted a rent control measure in 1994, housing supply was reduced by 15% and rents increased by 5.1%, according to the National Bureau of Economic Research (NBER). Another NBER study found that the end of rent control in Cambridge, MA in 1995 raised the overall valuation of its housing inventory by $1.8 billion between 1994 and 2004, almost a quarter of Cambridge's total residential price appreciation in this period.

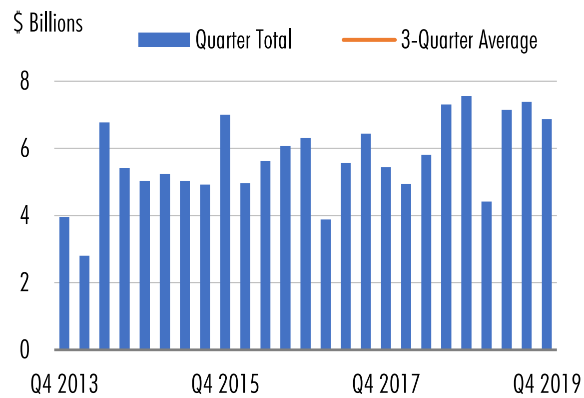
Economists agree, however, that other government policies may be beneficial in helping create more affordable housing inventory.

Figure 7: Percentage of Workforce Households That Are "Rent-Burdened" (Pay 30%+ of Income on Rent)

	Los Angeles		San Francisco	
Income*	$35-50K	$50-70K	$35-50K	$50-70K
2010	61.3	33.2	67.8	43.7
2014	67.4	38.8	61.5	47.2
2017	75.9	46.8	66.3	46.9
2018	78.7	50.6	61.9	53.9
Combined $35-70K		LA	SF	U.S.
2010		46.6	53.7	26.3
2014		52.1	53.3	30.1
2017		59.5	55.1	33.8
2018		62.7	57.1	36.2

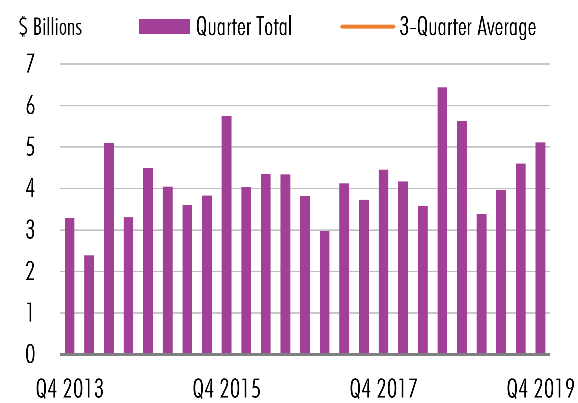
Source: CBRE Research, U.S. Census Bureau (ACS), Q4 2019. *Household Income.

Figure 8: California Investment Volume - Assets of All Ages



Source: CBRE Research, Real Capital Analytics, Q4 2019.

Figure 9: California Investment Volume - Assets 15+ Yrs Old



Source: CBRE Research, Real Capital Analytics, Q4 2019.

Empirical Impacts of Rent Control in California

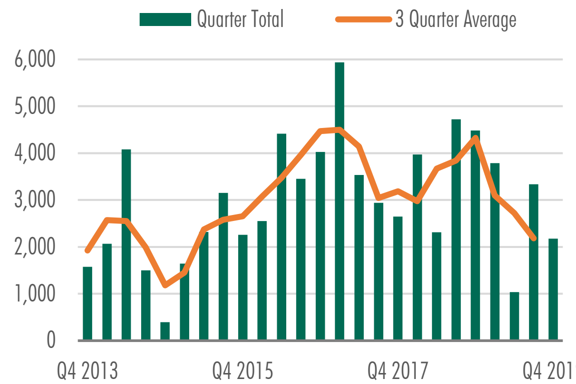
New rent control legislation typically impacts the multifamily sector in five areas: investor sentiment, investment volume, asset pricing, development and potential for proliferation. Since statewide rent control is new in California and market environment is changing due to COVID-19, it is too early to fully assess TPA's impact on the state's multifamily markets. However, there are relevant data points and anecdotal evidence for an initial picture.

Investor Sentiment. CBRE professionals reported sustained strong investor interest in multifamily assets before the COVID-19 outbreak. The TPA has also led many California-based investors to explore investment opportunities in other states, including Arizona, Nevada, Utah and Idaho.

Investment Volume. Rent control often leads to reduced investment. Last year, sales of older California assets (15+ years) fell 13.9% from 2018 (vs. -2.1% nationally). Even with this drop, the total was substantial at $17.1 billion. The trend reversed in January and February 2020 with a 13.3% year-over-year increase. Investors were not dissuaded from buying newer California assets last year. The 2019 all-asset total was $25.8 billion, up 0.8% from 2018 and the highest level in 20+ years. In the first two months of 2020, total multifamily investment rose 26.4% year-over-year. COVID-19 and the resultant economic fallout began impacting deal flow in March. These factors will be the most important influencers of investment volumes over the medium term, rather than rent control policy or other pre-COVID factors. Closer to the November elections, more attention will be given to RAA and the possibility of its approval.

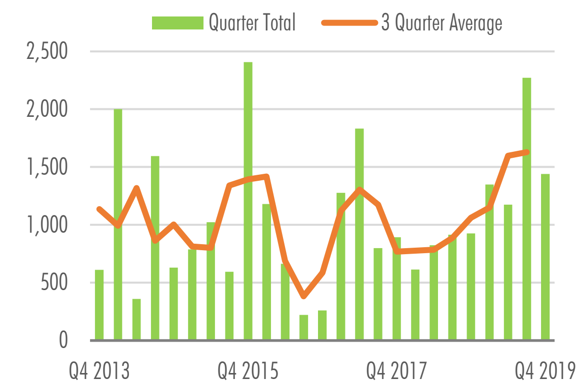
Asset Pricing. Impending rent control did not impact asset pricing in 2019. CBRE's North America Cap Rate Survey H2 2019 found that cap rates for stabilized assets and expected returns on cost for value-add assets in California held firm from H1 2019. The pattern held for all classes. The rates were also some of the lowest in the U.S. Real Capital Analytics data revealed a small uptick in the median cap rate for older properties in Q1 (4.8% to 5.0%). It is unclear whether the widening was due to the TPA, COVID-19's influence in March or a change in asset composition. Over the next several months, COVID-19 and the weaker economy, rather than rent control, will have the most significant impacts on pricing.

Figure 10: Los Angeles Multifamily Construction Starts



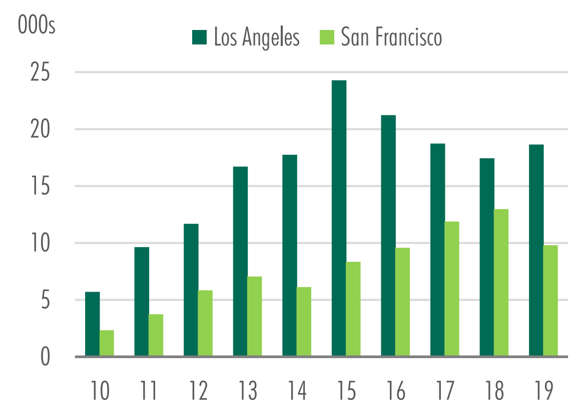
Source: CBRE Research, CBRE Econometric Advisors, Q4 2019. Data for LA County.

Figure 11: San Francisco Multifamily Construction Starts



Source: CBRE Research, CBRE Econometric Advisors, Q4 2019. Data for San Francisco Metropolitan Division (San Francisco, San Mateo and Marin counties).

Figure 12: Los Angeles & San Francisco Multifamily Permits



Source: CBRE Research, U.S. Census Bureau, Q4 2019. Regions represent Los Angeles and San Francisco MSAs.

Figure 13: Local Rent Control Ordinances - Selected Cities

City	Annual Rent Increases	Current*
Berkeley	Limited to 65% of regional CPI annually.	2.0%
Beverly Hills	Limited to 3% or regional CPI, whichever is higher.	3.1%
East Palo Alto	80% of increase in regional CPI, not to exceed 10%.	2.6%
Hayward	Limited to 5%. Landlords may "bank" increases but aggregate increases cannot exceed 10% in any year.	5.0%
Los Angeles	Limited to 4% annually.	4.0%
Los Gatos	Limited to 5% or 70% of regional CPI.	5.0%
Palm Springs	Limited to 75% of increase in regional CPI. Rent control permanently removed after tenant leaves.	2.2%
Sacramento	Limited to 6% plus CPI. Total capped at 10%.	9.3%
San Francisco	Limited to 60% of regional CPI.	2.0%
San Jose	Limited to 5%.	5.0%
Santa Monica	Rent Control Board determines each year's annual increase cap.	2.0%
West Hollywood	Limited to 75% of increase in regional CPI during preceding 12 months.	2.3%

Source: CBRE Research, California Tenant Law, multiple sources. Note: assumes rent restrictions are annual (e.g., one increase every 12 months). Many cities have exceptions to the rule. For example, Los Gatos owners can increase rents beyond cap with written consent of tenants. *Approximate current limit based on regional CPI.

Development. Rent control measures typically result in less development over the long term. In California, which has a longer permitting process than many other states, it is still too early to gauge the full impact. Permits appeared to be trending down in early 2020 (before any impact from COVID-19); however, CBRE professionals reported that despite the TPA, development projects were moving ahead pre-COVID-19.

Legislation Proliferation. Many other states are watching California's TPA and the proposed RAA coming to vote in the fall and could follow suit with their own rent control measures.

Related Public Policies

Up-zoning. The California Senate recently defeated a proposal to reform local zoning in transit- and job-rich areas. The measure would have allowed mid-rise apartment complexes near transit stops and job centers, and fourplexes in most single-family neighborhoods. The objective was to allow for higher densities and thereby increase housing supply, especially affordable housing. Subsequently in March, an amended Senate bill was introduced that would provide incentives to cities willing to allow 10-unit communities. Unlike the original bill, it would not impact local zoning control over housing.

Split Roll. This November 2020 ballot measure asks voters to change Proposition 13, a 1978 measure that set both the state's commercial and residential property tax rates at 1% of appraised value and limited any increases to 2% annually. Properties are only reassessed at the time of sale or for new construction. Split roll would split commercial and residential property tax treatment. Commercial properties would be annually reassessed to market rate, while residential properties (including multifamily) would keep Prop 13 protections. However, if a multifamily property has a mixed-use component, the commercial portion of the property would be subject to reassessment and higher taxes. If approved, the tax increase would total between $7.5 billion and $12 billion annually. Current statewide property tax revenue is about $75 billion.

Eviction Moratoriums. With rising job losses due to COVID-19, many California households do not or will not have enough money to pay rent. As a result, the state has banned evictions through May; many cities have implemented longer eviction moratoriums. Additionally, the recently implemented federal CARES Act supplements state action by issuing a 120-day eviction ban for affordable rental housing.

A new California Assembly Bill was proposed in mid-April to provide additional support for renters. AB 828 could require rental reductions of up to 25% if an owner initiates eviction proceedings.

MULTIFAMILY RESEARCH

George Entis
Senior Research Analyst
+ 1 831 402 7828
george.entis@cbre.com

Jeanette I. Rice CRE®
Americas Head of Multifamily Research
+1 214 979 6169
jeanette.rice@cbre.com

cbre.us/multifamily