

The Heated Debate Over Rent Control in California

As many Californians can attest, California is in the midst of a major housing crisis. Simply put, there is not enough housing (either for sale or for rent) to meet the current demand. This imbalance between supply and demand is pushing up home prices and rental rates statewide. Moreover, it is forcing people to move further from their jobs, in some cases out of state, and, some would argue, exacerbating the homelessness problem. According to the Legislative Analyst's Office, on average, renters in California pay 50 percent more for housing than renters in other states and, in certain areas of the state, rental rates are more than double the national average.

In an effort to tackle this crisis, Proposition 10, titled "Local Rent Control Initiative", has made its way to the ballot for the upcoming election (Tuesday, November 6). If passed, the 1995 Costa-Hawkins Rental Housing Act ("Costa-Hawkins") will be repealed. There is a heated debate going on among tenant advocacy groups, real estate owners and developers, economists and others about whether Proposition 10 will ameliorate, exacerbate, or have no impact on California's housing crisis. Below is a summary of Costa-Hawkins and Proposition 10, as well as a brief description of the arguments in favor of and against Proposition 10.

What is Costa-Hawkins?

Costa-Hawkins is a law that was passed in 1995, which limits local rent control to multifamily communities built before 1995 (single-family homes and condominiums are exempt from this law) and permits owners to adjust rental rates to market rates when a resident vacates a unit. Costa-Hawkins was enacted in response

to earlier, more restrictive rent-control laws, referred to by some as "vacancy control,"¹ which were intended to combat rising inflation and significant rental rate increases by artificially setting market rent levels and future rental rate increases that landlords had to adhere to when leasing to new residents. Unfortunately, these vacancy control-type laws resulted in a decrease in the rental housing stock as the market rent levels and rental rate increases set by the local governments were not sufficient to provide apartment developers/investors/owners with sufficient income to meet their required returns. As soon as it became marginally profitable (or even unprofitable) to build and/or own apartments, many owners converted rental properties into other, more profitable uses. Developers postponed or canceled planned development projects because they could no longer justify the construction costs.

What is Proposition 10?

Proposition 10 would remove restrictions currently in place by extending the ability to impose rent control on single-family homes and condominiums, and enabling

**\$3,200-
\$4,560**

Median rental rate ranges for a two-bedroom apartment in major cities like San Francisco and Los Angeles.²

^{*} Please see last page for important disclosures.

¹ Fisher Center for Real Estate Economics, Kenneth T. Rosen, "The Case for Preserving Costa-Hawkins: Three Ways Rent Control Reduces the Supply of Rental Housing", September 2018

² CoStar. FAQ: What You Need to Know About California's Costa-Hawkins Law Limiting Rent Control, June 2018

local governments to set their own rent control laws as they deem necessary to accommodate the renters in their jurisdictions.

What Proponents of Proposition 10 are saying?

Proponents of Proposition 10 believe the measure will provide for more affordable housing units for all renters, particularly those who have been “priced out” of several markets, by setting a cap on market rents and future rental rate increases on all types of rental housing.

What Opponents of Proposition 10 are saying?

Opponents of Proposition 10 feel the measure will worsen the housing crisis by further shrinking California’s rental housing stock. Opponents believe multifamily developers will pull back on residential construction projects due to an inability to meet required return thresholds caused by a diminution in the rental income stream. Moreover, opponents predict that many single-family, condominium, and apartment owners will

remove their rental units from the rental market, as they will also not be able to meet their required returns. Ultimately, restricted supply would worsen the housing crisis, especially for affordable/workforce housing. In addition to exacerbating the supply/demand imbalance, some opponents argue that more restrictive rent control will lead to lower tax revenue for cities as rental rate caps will lead to a reduction in values of rental properties, which, in due course, will lead to lower property tax payments.

Some cities, such as Berkeley, are preparing for the measure to pass and will be asking voters in the November election to approve updates to their existing rent control ordinances. Despite this, given laws may differ widely city by city, it is hard to predict what the overall impact will be if Proposition 10 is passed.

It is safe to say, however, that there will likely be, at a minimum, a short-term slowdown in multifamily development and sales activity due to high levels of uncertainty among both debt and equity investors.

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