

# THE AFFORDABILITY CRISIS

## HOW RENT CONTROL IS MAKING WAVES IN MULTIFAMILY

Formerly known as the War Emergency Tenant Protection Act, rent control was proposed during the World War II era to protect tenants from war-related housing shortages. These policies were first enacted in New York and Washington, D.C., as they experienced the most significant shortages. Fast forward to today, rent regulation has spread to California, Maryland, New Jersey, and most recently, Oregon.

**THREE YEARS POST WWII, 2.5 MILLION NEW HOMES  
WERE BUILT ACROSS THE COUNTRY.**

Although there are no housing shortages today as severe as during World War II, the rent regulation policies have evolved with the intention to create more affordable housing options and simultaneously protect tenants who live on a fixed or low-income, such as the elderly. Rent control is a law implemented by the government in which they control and regulate the amount a landlord can charge a tenant for rental housing. This policy prevents landlords from overcharging rent and protects tenants from eviction without just cause, such as late payments.

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Rent control has been a buzzing topic as of late, with new statewide enforcements within New York, Oregon, and most recently, California. *In this article, Matthews™ will discuss the current state of rent regulation laws and how tenants and investors are reacting.*

## ADVANTAGES OF RENT CONTROL

Policymakers tend to account for the voice supporting rent regulation laws by implementing rent control to combat affordability issues. Despite economists and real estate professionals voicing their strongly opposing views, government officials must react to the outcries of citizens desperately seeking housing. **Their supporting claims are:**

### PROTECTION FOR FIXED-INCOME TENANTS

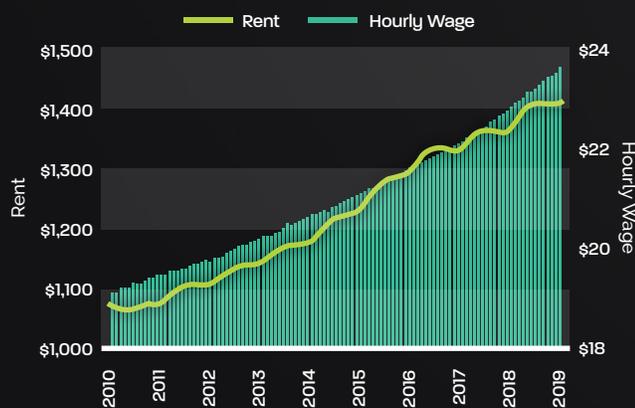
It's been proven that rental prices are rising faster than wages for moderate-income jobs in the U.S. Rent control enables these families and the elderly who live on fixed incomes to live free of the concern from unexpected rent hikes. Tenants cannot be priced out of their rent controlled unit, making neighborhoods stronger and more stable with a base of long-term tenants.

### MORE CAPITAL FUNDS FOR INVESTORS

Investors spend less on the acquisition of a rent controlled property, giving them leftover capital that can be used to fund additional investments, such as repairs. Furthermore, if repairs are needed after purchase, many cities temporarily allow rent increases to help recover the cost so long as the repairs benefit the tenants. Moreover, rent control properties are ultimately immune to recession losses as they are not dictated by the state of the market; therefore, they are a reliable source of consistent revenue.

### NATIONAL WAGE VS. RENT INCREASE

SOURCE: Tradingeconomics.com | U.S. Bureau Of Labor Statistics



## DISADVANTAGES OF RENT CONTROL

The audience speaking out against rent control laws is primarily investors. Professionals and experts in the commercial real estate industry personally experience how the market reacts to rent regulation. As a result, investors often flee the affected neighborhoods and move their activity to non-regulated areas. **Their arguments include:**

### REPAIR NEGLIGENCE AND THE RESULTING DECREASE IN PROPERTY VALUE

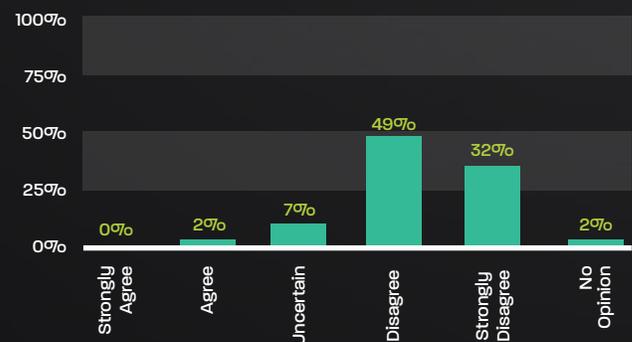
The intent behind rent regulation is to protect tenants, however, it often has the opposite effect because the buildings protected by these laws are in sub-par condition. Investors will feel the consequences through low tenant retention. With poor return on investment, landlords will make minimum repairs to meet safety codes, provide little or no services, and supply improper maintenance. Moreover, landlords are unable to accomplish beyond the bare necessities because they are restricted from increasing rents to compensate for the costs.

### DEVELOPMENT AND INVESTMENT HINDRANCE

Investors see no benefit building in proximity to rent control buildings as they are unable to compete with the low rents they offer. Additionally, landlords cannot charge high rental prices while being within neighborhoods of disarray. Investors often argue that rent control does not take into account inflation or increasing construction costs.

### ECONOMISTS RESPOND TO QUESTION: WILL RENT CONTROL LAWS HAVE A POSITIVE IMPACT?

SOURCE: IGM Economic Experts Panel





The pros and cons of rent control have been long debated among government officials, investors, and economists alike. Many believe that because rent control policies enforce rent ceilings and affect investor profit, it discourages new investments in rental housing. With rent ceilings instated in the policy plan, investors have less to spend on repairs, which can lead to housing deterioration, decrease in value, and neglected maintenance.

Economists suggest that instead of enforcing rent control policies, the federal government should focus on increasing the affordable housing supply. Every state in the U.S. has a deficit of affordable rental housing. More than seven million affordable units are needed to house families in the U.S. whose income is below the poverty level, according to a report by National Low Income Housing Coalition. Out of the 43.8 million households that rent in the U.S., 11.2 million are considered to be extremely low income.



**29% OF RENT CONTROLLED HOUSING WAS DETERIORATING**

-- COMPARED TO THE --



**8% OF NON-RENT CONTROLLED HOUSING IN THE SAME CONDITION IN THE U.S.**

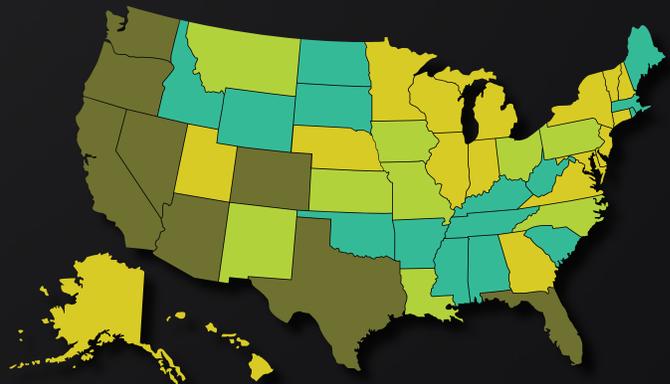
SOURCE: The Rent Control Debate by Paul Niebanck

Rent regulation policies not only affect investments in individual properties, but also those within surrounding neighborhoods as well. The reason is due to investor fear of the policy bleeding into their new property, and consequently affecting their value. However, rent control policies state that newer buildings are exempt from these restrictions, although there have been cases where the local government inevitably enforced rent regulation.

**AFFORDABLE AND AVAILABLE RENTAL HOMES PER 100 EXTREMELY LOW INCOME RENTER HOUSEHOLDS**

SOURCE: National Low Income Housing Coalition

● 30 or fewer ● 31 to 40 ● 41 to 45 ● 45 or greater





## RENT REGULATION IN THE U.S.

### OREGON

\$1,544



\$1,144



Average non-rent controlled rent

Average rent controlled rent

SOURCE: CoStar

19,655 | Affordable Units Sold

101,393 | Affordable Units Needed

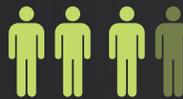
SOURCE: CoStar

In February 2019, Oregon became the first state to enact statewide rent control via Senate Bill 608. This bill is one of the many tactics the state is using to address the housing affordability issues. Rent increases are capped at seven percent annually with inflation, and landlords are prohibited from pushing out tenants through rent hikes or evicting tenants without just cause. In addition to the rent regulation, voters passed Measure 102, allowing local bond measures to pay for private, affordable housing. Opponents of the measure have voiced concerns of deterring investment activity as development costs rise.

Senate Bill 608 will immediately stabilize the rent on half a million households, with low-income earners taking up the majority. The urgency behind this law stemmed from tracked mass evictions in 2015. Due to the displacement concerns heard

across Oregon, House Bill 2001 was introduced. The bill requires cities in Oregon with populations of 10,000 and above to allow "middle housing" in residential areas.

3 OUT OF 4



renters with extremely low incomes are **paying more than 50%** of their income rent

1 OUT OF 3



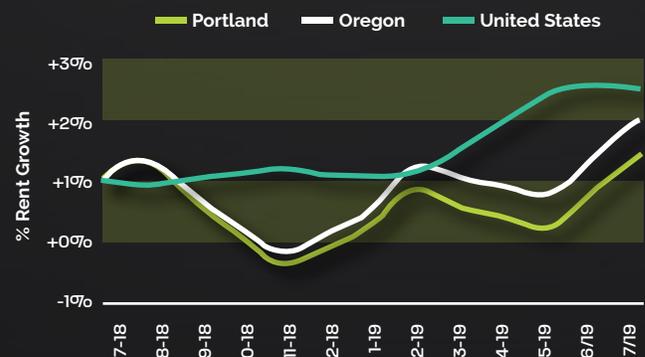
of all renters are **paying more than 50%** of their income in rent

SOURCE: Oregon Housing and Community Services

Portland residents were the voices speaking out as they have experienced the most dramatic rent increases over the last few years. Zillow's analysis found that Portland's rent increased by 4.6 percent to \$1,879 in 2017, marking Portland as one of fastest-rising metros in terms of rent at the time. State Lawmakers heard their outcries for more affordable housing and turned to rent stabilization laws as the solution.

### PORTLAND RENT GROWTH OVER 2019

SOURCE: 2019 Rent Report by Apartment List

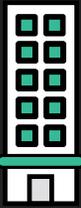


## NEW YORK

\$2,702



\$2,183



Average non-rent controlled rent

Average rent controlled rent

SOURCE: CoStar

122,728

Affordable Units Sold

615,392

Affordable Units Needed

SOURCE: CoStar

It's rare to find properties in New York under rent control policies as only two percent, around 22,000 apartments, are still protected by them. The only remaining units with rent control status are inhabited by those who have lived in the unit since July 1971 or were inherited from a family member who occupied the unit at that time. In its place, rent stabilization serves as the regulation law to half of New York's rental inventory. The Rent Stabilization Law of 1969 limits the percentage landlords can increase on a tenant each year, generally by one percent, and once the rent rate reaches a specific point, the landlord is no longer able to increase it. Lastly, these regulations only apply to buildings constructed before 1974.

**"LOOPHOLES ENABLED [THE DISCONTINUATION OF RENT REGULATION IN APARTMENTS, RESULTING IN THE LOSS OF 300,000 AFFORDABLE, RENT-STABILIZED HOMES, WHILE THE COST OF LIVING HAS FAR OUT-PACED RESIDENTS' ABILITY TO PAY RISING RENTS.]"**

SOURCE: National Low Income Housing Coalition

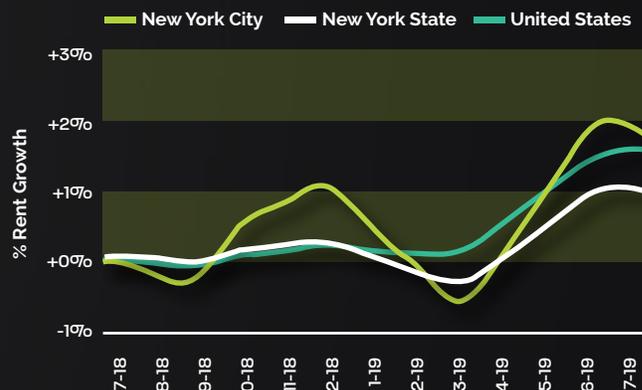
Even with rent stabilization, New York still experiences affordability issues as the law is less restrictive than rent control. More recently, the state has attempted to combat the affordable housing crisis with new legislation that Governor Andrew Cuomo claims to be the "strongest tenant protection in history." The legislation, dubbed the Housing Stability and Tenant Protection Act of 2019, passed on June 14, 2019, primarily targets the Major Capital Improvements (MCI) and Individual

Apartment Improvements (IAI) programs. The intent behind this legislation is to protect tenants from landlords. In this law, MCI rent increases are capped at two percent rather than the original six percent. IAI's are limited to three improvements per year and capped at \$15,000 in a 15-year period.

A month later, on July 15, 2019, two landlord groups, along with seven other individual landlords, filed a lawsuit to fight the rent regulations laws in the U.S. District Court. The lawsuit claims the new laws violate the fifth and 14th amendment by making it more difficult for landlords to convert rentals into condos. The lawsuit was filed to defend landlords who recently purchased dated properties with the intent to renovate and eventually sell. In haste response, some have acted already and sold. This creates a great opportunity for small-time investors to find good deals as these assets become available.

### NEW YORK RENT GROWTH OVER 2019

SOURCE: 2019 Rent Report by Apartment List



Real estate professionals believe had they been involved in the drafting of these laws, the unintended consequences could have been avoided. Brokers further warned it would contribute to the decrease in the investment sales market. According to The Real Deal, New York community banks have already lost \$2.5 billion in market capitalization within the last few months because of the uncertainty with the rent control policies and their consequences in the market. Although the reforms that would have negatively impacted these banks did not pass through the final legislation, the harm will come once an owner is looking to refinance or take out new loans. If property values remain stagnant or decrease, there is no demand for large loans, creating a challenge for banks to grow their portfolio.

## CALIFORNIA

184,778 | Affordable Units Sold

1,400,000 | Affordable Units Needed

SOURCE: CoStar

The 1970s was the decade for apartment growth, especially in California. In McKinsey Global Institute's 2016 report, California was ranked 49th in all the U.S. for per capita housing construction as the state only gained 80,000 homes over the last decade. As single-family homes became increasingly unaffordable, families began residing in apartments driving the demand up and supply low. Currently, California is protected under rent regulation, but the laws vary depending on the city, as it is not enforced throughout the state. But with the notorious housing crisis the state is experiencing, the government is looking to apply stricter protections.

In May 2019, the state of California made another attempt to implement rent control through proposal Assembly Bill 1482 (AB 1482). After passing in the California Assembly, the bill headed for Senate, and was approved in September 2019. AB 1482 will apply statewide rent control throughout California, restricting landlords from increasing rents beyond five percent and enforcing just cause tenant evictions for the next decade. However, homes built within the last ten years are exempt. Lawmakers are hopeful AB 1482 will have a positive impact on rental units experiencing unsustainable rent increases. The law will go into effect January 1st, 2020 and end in 2030.

**ON SEPTEMBER 11<sup>TH</sup>, 2019, THE ASSEMBLY BILL 1482 PASSED THE ASSEMBLY WITH 42-22 VOTES**

## SAN FRANCISCO

\$3,720



Average non-rent controlled rent

\$2,356



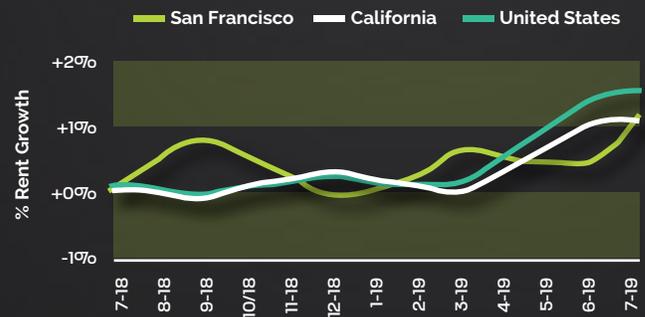
Average rent controlled rent

SOURCE: CoStar

San Francisco's rent control laws apply to multifamily buildings built before June 13, 1979. The laws state that landlords must provide formal 30-day eviction notices with just cause, and are restricted to increase rent beyond seven percent annually.

### SAN FRANCISCO RENT GROWTH OVER 2019

SOURCE: 2019 Rent Report by Apartment List



A study conducted by the National Bureau of Economic Research revealed that rent control was beneficial for long-term tenants, but not for newer tenants. The investigation found that rent control discouraged and decreased rental housing development, renovations, and improvements. In fact, the number of condominiums converted from rental housing increased by ten percent in the area.

The same study found that the policy encouraged tenants over the age of 40 to extend the length of stay by ten to 20 percent in their current apartment. On the contrary, younger tenants moved more often as a result of the policy. Those living in neighborhoods experiencing rapid rental growth were more inclined to move once rent control was implemented. Their response supports the idea that landlords leveraged the policy as an incentive for tenant turnover through rent increases to market rates. Although rent control proved tremendously beneficial to tenants, in the end, the policy drove rent increases up by 5.1 percent from 1995 to 2012.

## LOS ANGELES

\$2,235



\$1,861



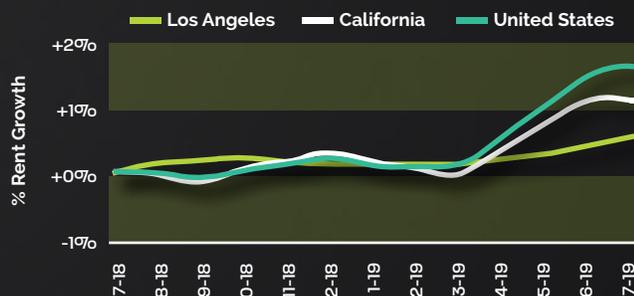
Average non-rent controlled rent

Average rent controlled rent

SOURCE: CoStar

## LOS ANGELES RENT GROWTH OVER 2019

SOURCE: 2019 Rent Report by Apartment List



The City of Los Angeles has a Rent Stabilization Ordinance (RSO) in place to protect tenants residing in rental housing built before 1978.

Following the precedent of rent regulations, RSO prevents landlords from unexpected and unreasonable increases in rents and evicting tenants without just cause.

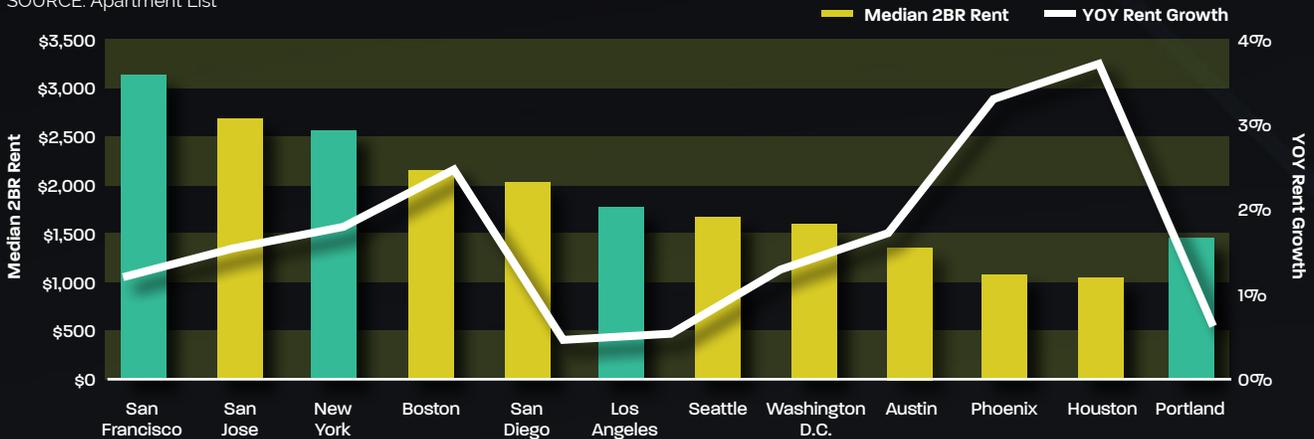
The Costa Hawkins Rental Housing Act was introduced as an effort to limit RSO with regulations placed on the types of rent control rules that Los Angeles can implement. The act is implemented in 15 of California's cities that reside within Los Angeles, West Hollywood, and Santa Monica. The act went into effect in 1995 to combat California's notorious homeless and affordable housing crisis. Proposition 10, inspired by the Affordable Housing Bond Act, was introduced in February 2017 to repeal these regulations. If passed, it would allow local governments to implement any rent regulations they choose to all rental housing types; including single-family homes, duplexes, condominiums, and properties built after 1995. **Arguments against this repeal included reasonings such as:**

- Disincentivizing investments
- Deteriorating quality of buildings
- Decreasing affordable supply while increasing costs
- Slowing current construction
- Discouraging future development

Californian landlords actively spoke out against the repeal of Costa Hawkins; however, local supporters gathered enough signatures to include Proposition 10 on the November 2018 ballot. To prepare for the worst, some multifamily investors began selling their assets in the market to move their equity to other parts of the country. Ultimately, even with all the local support, the Proposition was defeated. Policymakers believe this to be only the beginning of many discussions regarding rent control in California. Local government officials and investors alike grow concern for California's economy.

## JULY 2019 RENTAL TRENDS BY METRO

SOURCE: Apartment List



## ALTERNATIVE SOLUTIONS

While the intent behind rent control is to produce more affordable housing options, it has created controversy within the industry. **Here are a few alternatives to rent control that serve the same purpose:**

### ● Opportunity Zones:

An incentive program created by congress in the Tax Cuts and Jobs Act 2017 to encourage investors to concentrate activity in economically challenged areas through preferential tax treatment.

### ● Section 8:

A federal government program known as the Housing Choice Voucher Program. Fixed or low-income earners are given vouchers that are assisted by subsidizing their rent payment based on income and covering the market-rate gap.

### ● Transit-Oriented Communities:

Implemented in Los Angeles in 2017, this program encourages development in the vicinity to transit stations. TOC further incentivizes the use of public transportation that the city has been developing.

### ● Rezoning:

The act of reassigning land or properties under different regulations and restrictions on use and development. Rezoning is often a response or tactic used to stimulate population and economic growth.

Although 37 states in the nation have banned rent regulation, state governments facing similar affordability issues have begun considering rent control laws as a solution. With the idea of rent regulation spreading across the country, owners must look at options where they can maintain strong investments and future growth opportunities. The story that will play out in the coming years will be determined by how the market reacts. Will the control and regulation by the government better the nation, or isolate those who have built what it is today? As an owner or a renter, the best practice is to stay educated with the facts on the economic consequences if these regulation laws are enacted.

For more information on rent control laws and how they can affect your property, **contact a Matthews™ specialized agent today.**



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