

★ NOVEMBER 2018 ★

VOTE NO ON PROP 10

PROPOSITION 10: A THREAT TO
ALL RENTERS AND PROPERTY OWNERS

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NEGATIVE CONSEQUENCES FOR ALL CALIFORNIANS

In November, California residents will vote on Proposition 10. The measure would allow cities to impose a wide range of rent-control policies. Proponents say they are trying to fix the affordable housing crisis. But rent control actually does the opposite: It reduces the supply of rental housing, drives up overall housing costs and dramatically slows new construction, according to extensive research on cities that have enacted rent control. Rent control also limits owners' ability to maintain and improve their properties, diminishing quality of life for renters and causing neighborhoods to deteriorate.

Introduction

California's lack of adequate housing for working class families has created a crisis that can only be resolved by increasing the amount of moderately priced homes and apartments. Proposition 10 has been named "The Affordable Housing Act," but this is a mirage: It doesn't create a single new housing unit. Instead, the measure would repeal a 1995 state law, the Costa-Hawkins Rental Housing Act. Costa-Hawkins regulates the type of rent control rules that cities can impose and limits rent control to apartments built before February 1995 (and in some cases earlier). By repealing Costa-Hawkins, Proposition 10 would:

- Open up all multifamily units in California to rent control
- Make the housing shortage crisis worse
- Benefit a very select number of tenants
- Result in deteriorating quality of rental units for working class families
- Apply rent control to single-family homes and individually owned condominiums and townhomes
- Force landlords to keep regulated rents in place even after a tenant moves out

While repealing Costa-Hawkins and expanding rent control might seem like an easy and obvious solution to high rents, the actual outcome would be highly destructive—making housing less available, more expensive and a drain on California's quality of life and economic growth. The sections below explain these effects in detail. But first, an analysis of what's really causing California's housing crisis.

IT'S NOT COSTA-HAWKINS

Proposition 10 states that California has the nation's worst housing affordability crisis and 22 percent of the nation's homeless. There's not enough housing close to jobs, so workers face long commutes, families double up and young adults live at home with their parents. Proposition 10 says Costa-Hawkins is to blame for these problems because it "puts limits on how California cities can address the housing crisis and protect residents from displacement."¹

Compared to major cities across the country, California coastal metros are not keeping pace with demand—this is causing rents to increase significantly

Figure 1:

Change in Housing Stock 1980-2013	Change in Average Rents 1980-2013
Fast-growing U.S. Counties population 500K+ Up 99%	Fast-growing U.S. Counties population 500K+ Up 18%
California's Coastal Urban Counties population 500K+ Up 32%	California's Coastal Urban Counties population 500K+ Up 50%

Due to less housing construction, the average low-income household in California's coastal urban counties now spends around 54 percent of income on housing, compared to only 43 percent in the fast-growing counties outside the state. Source: California Legislative Analyst's Office, 2016 report (<http://www.lao.ca.gov/reports/2015/finance/housing-costs/housing-costs.pdf>)

On the first score, proponents are correct: Rents have risen dramatically in recent years. But that's not because of Costa-Hawkins. It's because the state, and many local governments, have put regulations in place that make it incredibly difficult and expensive to build new housing. In addition to the cost of land, labor and regulatory fees are sky high in California. (See "Why the Rent Is so High" on the next page.) Lenders won't provide money to build new housing if the rents won't cover those costs. As a result, there's not enough housing—particularly workforce housing near major employment hubs—to meet the demand.

Here are the numbers: Between 2000 and 2015, the U.S. produced 7.3 million fewer homes than it needed to keep up with demand and population growth—and 3.4 million of that shortage was in California.² The situation is the worst in urban coastal areas: The Bay Area, for example, added 546,000 jobs between 2010 and 2015 but only 62,600 housing units.³

In a recent study, California's non-partisan Legislative Analyst's Office found a direct correlation between lower levels of construction and higher rents in the state's coastal urban counties. (See Figure 1.) The Office has said that the solution to the state's housing crisis is "a substantial increase in ... building in the state's coastal urban communities."⁴

But Proposition 10 won't create new housing. Instead, it would cause a housing shortage, lower property values and stunt economic growth. Some 93 percent of economists polled by the American Economic Association agreed that "a ceiling on rents reduces the quality and quantity of housing."⁵ A closer look at the unintended consequences of Proposition 10 is in order.

WHY THE RENT IS SO HIGH

Proposition 10 doesn't address the real reason that housing is so scarce—and consequently so expensive—in California: It's nearly impossible to build. More than two-thirds of cities and counties in California's coastal metros have adopted policies explicitly aimed at curbing housing growth, according to the Legislative Analyst's Office.⁶ Some cap the number of new homes that can be built each year, or limit building heights and densities. Each additional growth-control policy added by a community was associated with a 3 percent to 5 percent hike in home prices, one study found.

Meanwhile, development fees—charged to builders as a condition of development—are outsized in California: About \$22,000 per single-family home, compared to about \$6,000 in the rest of the country. Slow, complex approval processes also add costs: It takes seven months in California (and more than a year in San Francisco) to obtain a building permit, compared with an average of four to five months in other U.S. metros. One study found that in the Bay Area, each additional layer of independent review was associated with a 4 percent increase in a jurisdiction's home prices.⁷ In addition, the state has more stringent building codes that often require more expensive materials and labor.

Finally, there is the California Environmental Quality Act (CEQA), which requires local jurisdictions to provide a detailed review of the environmental impact of new housing prior to approval. It includes the impacts on parking, traffic, air and water quality, endangered species,

and historical site preservation. Between 2004 and 2013, California's 10 largest cities took about two and a half years on average to approve housing projects that required an environmental impact report, according to the Legislative Analyst's Office.⁸

RENTS ARE HIGH BECAUSE THERE IS A SUPPLY SHORTAGE. RENT CONTROL WILL MAKE THE SHORTAGE WORSE.

"It's hard enough to build new rental housing for Californians without rent control," said Barry Altshuler, Executive Vice President of Investments, Equity Residential, one of the state's largest multifamily housing owners. "Rent control may be the proverbial straw that breaks the camel's back."

Shortening the state's land-use approval process could accelerate average project approval times by four months, according to a 2016 report by McKinsey & Company's Global Institute. Reducing construction permitting times would result in the ability to deliver new apartments at lower rents for tenants.⁹

DEEPENING THE HOUSING SHORTAGE

In city after city, putting restrictions on rents has reduced the supply of housing and driven up prices. A 2017 Stanford study looked at what happened to tenants, buildings and rents after San Francisco expanded rent control in 1994. Many apartments were converted to condominiums or replaced by single-family homes. The controlled housing supply tumbled by 15 percent and the overall housing stock fell by 5 percent. The number of renters living in rent-controlled units declined by 25 percent.¹⁰ “It dramatically limited the supply of rental housing,” the paper’s author said.¹¹

Expanding rent control would also discourage new construction in California, according to a 2016 forecast by the Legislative Analyst’s Office.¹² That’s what has happened in other cities, such as Portland, Oregon, which enacted “inclusionary zoning” on all new construction in February 2017. It requires 20 percent of new units to be affordable to residents earning less than 80 percent of median family income. (Developers also have the option to offer deeper discounts on a smaller number of units.)

The impact was massive: Since the adoption of inclusionary zoning, fewer than 600 units have moved through the city’s approval pipeline—compared to 3,200 apartments per year on average from 2012 to 2016.¹³ The problem? Builders can’t make the numbers work for multifamily housing, so the projects can’t get bank financing.

“Developers do extensive market research to determine the market rents for an apartment building,” said John

Sebree, National Director of Multi Housing with Marcus & Millichap. “But under Proposition 10, rents could be determined by a third-party board. There’s no reason for developers to take on the risk of a development of any size because they have no idea whether they can generate enough income to cover their debt service.” As a result, capital to finance new multifamily housing evaporates.



Rent control is the wrong medicine to solve the rental housing crisis, and will in fact make it worse.

JOHN EUDY
EXECUTIVE VICE PRESIDENT, DEVELOPMENT
ESSEX PROPERTY TRUST

New housing development also declined in Ontario, Canada, following rent-control legislation. Developers had built about 28,000 apartments per year in the five years before controls were enacted—and about 5,500 per year in the five years after.¹⁴ The impact of rent control was “to reduce new construction, to accelerate deterioration and conversion of the existing rental stock, to generate a severe rental housing shortage” and to slash government tax revenue, according to a University of Toronto study.¹⁵ In 2017, after the Toronto government proposed expanding rent control, 1,000 new units that had been planned as rental apartments were immediately converted to for-sale condominiums.¹⁶

Experts say Proposition 10 would likely cause an immediate halt in construction housing, since California’s 450+ local cities and municipalities and 58 counties could all enact different rules and regulations around rents. That process would likely last for months. “If this measure passes, builders are going to wait and see—and that means less housing for renters,” said John Eudy, Executive Vice President, Development, Essex Property Trust, which built about \$3.5 billion in new housing over the last decade in California. “Rent control is the wrong medicine to solve the rental housing crisis, and will in fact make it worse.”

Proposition 10 “will cause a major chilling effect on housing construction in the state, if not a total freeze in activity,” agrees Damon Conklin, Director of Government Affairs for the Federation of California Builders Exchanges, which represents about 4,000 companies, including general contractors, architects, engineers, electricians and plumbers. The halt would immediately affect the livelihoods and families of thousands of workers in multifamily housing construction and renovation, and, of course, the renters who are trying to find housing.

“At best, California needs 664,000 new apartments by 2030 just to keep up with current levels of population growth,” said Jim Lapidis, Vice President, Strategic Communications with the National Multi Housing Council. “The state will struggle to keep up in a perfect world. With rent control, there’s no way we will be able to support the housing needs of the people who want to live here.”

A FEW PEOPLE WILL WIN THE RENT LOTTERY (BUT PROBABLY NOT YOU)

Proposition 10 states that the measure will “ease the burden on renters.”¹⁷ The fact is, only a lucky minority will score below-market rents, and it’s probably not going to be the teachers, firefighters or other middle- and lower-income people who need it most.

That’s because rent control is applied haphazardly. “Numerous studies have found rent control doesn’t help the neediest people, because there’s no mechanism in the laws requiring a means test for the people living in these units,” said Jim Lapidés, Vice President, Strategic Communications with the National Multi Housing Council.

In fact, higher-income people with connections get the spoils. A 2015 report in *The Economist* noted that “those living in rent-controlled flats in New York tend to have higher median incomes than those who rent market-rate apartments,” possibly because “wealthier households may be in a better position to track down and secure rent-stabilised properties.”¹⁸

Separately, a study of rent control in Boston found that only 26 percent of rent-controlled apartments were occupied by renters in the bottom quartile of household income, while 30 percent were occupied by tenants in the top half of income. “This suggests that much of the transferred surplus may have been received by wealthier households,” the study noted.¹⁹

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JIM LAPIDÉS

VICE PRESIDENT, STRATEGIC COMMUNICATIONS WITH THE NATIONAL MULTI HOUSING COUNCIL

Those who do win the rent-control lottery will stay put, locking up the supply of open apartments, and creating more competition for what’s available. Higher demand means higher prices. That’s what happened when San Francisco expanded rent control in 1994. The people who got in at the start gobbled up the benefits—and tenants who came along later experienced equally big losses in the form of higher rents, a Stanford study found.²⁰

DECLINING NEIGHBORHOODS AND PROPERTY VALUES

Proposition 10 states that rents are high because “developers, landlords and Wall Street speculators are given free reign over our cities.” But this isn’t actually true, since the vast majority of the rental stock in California is supplied by local private owners who rely on rental income to pay their mortgages and educate their children. (Public corporations control just 3 percent.) With a cap on rents, these smaller owners won’t be able to afford to maintain their properties, resulting in lower quality housing for renters and declining neighborhoods, which affects all property values. By one estimate, property values could decline by 10 to 30 percent.²¹

“I work hard to provide quality housing for my tenants,” said a Bay Area private investor who owns 70 apartments. “I rent primarily to working-class families. Every time a tenant leaves, I paint, re-carpet and replace appliances. Plumbing, electrical and roofing eventually deteriorate. If rents are controlled, I can’t afford to replace them.” Costs for lumber and steel, for example, have jumped 25 percent in the past year because of new tariffs, he said.

Meanwhile, Proposition 10 would extend rent control to single-family homes and individually owned condominiums and townhouses, crushing property values and hitting older owners particularly

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BAY AREA PRIVATE INVESTOR

hard. Currently, 76 percent of Californians aged 65 and over are homeowners, far above the state’s overall home ownership rate of 53 percent.²²

PROPOSITION 10 WILL RESTRICT A HOMEOWNER’S ABILITY TO RENT THEIR HOME AND WILL NEGATIVELY IMPACT HOME VALUE

The way Proposition 10 is drafted, regulators could dictate how much homeowners can charge to rent out even one room in their home, according to the California Apartment Association.²³ Proposition 10 will depress property values at a time when many older home-

owners will be relying on real estate—by downsizing, relocating or renting out their properties—to achieve their retirement goals.

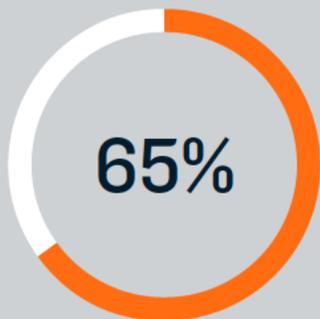
“For many seniors, their homes are an important funder of their retirements,” said Lapidés. “Rent control would hurt their property values significantly and limit what they could do in terms of renting it out. Imagine an aging couple needs to rent out their home to pay for long-term care and they face a price cap on what they can charge. It will hurt their ability to take care of themselves.” Meanwhile, anyone who owns a second home—a vacation property, for example—could be limited in what they can charge for rent.



Texas is attracting so many young professionals because they see all of the opportunity and quality of life that comes with housing affordability.

JOHN SEBREE

FIRST VICE PRESIDENT / NATIONAL
DIRECTOR NATIONAL MULTIHOUSING GROUP



LEAVING CALIFORNIA

A recent poll found that 65 percent of 18- to 29-year-olds and 69 percent of 30- to 39-year-olds say they've considered moving out of California as a result of housing costs.²⁴

STUNTING ECONOMIC GROWTH

A repeal of the Costa-Hawkins Act will stymie talent recruitment and economic growth as educated workers in the 20- to 34-year-old age group seek opportunities in areas with more attractive housing options. It will accelerate an exodus that is already underway: About 1 million more people migrated out of California between 2007 and 2016 than moved in because of soaring housing costs, according to the Legislative Analyst's Office.²⁵

The University of Southern California and the Los Angeles Business Council recently surveyed 15 of the city's largest employers, 60 percent of whom said the region's high cost of living was affecting employee retention.²⁶ Cities such as Seattle are exploiting California's woes: San Francisco has served as a top source of talent, according to one recent report, which noted that Seattle's housing costs are about half that of San Francisco's.²⁷

Between 2018 and 2022, the 20- to 34-year-old age group is expected to grow by just 0.2 percent in Southern California, compared with 1.8 percent in Dallas-Fort Worth, 1.7 percent in Houston and 2.6 percent in Austin, Texas.²⁸ "Texas is attracting so many young professionals because they see all of the opportunity and quality of life that comes with housing affordability," said Sebree. "That begets a virtuous cycle, as they start companies, and more workers are attracted there."

**RENT CONTROL WILL WEAKEN
CALIFORNIA'S ECONOMY AND ABILITY
TO ATTRACT TALENTED EMPLOYEES.**

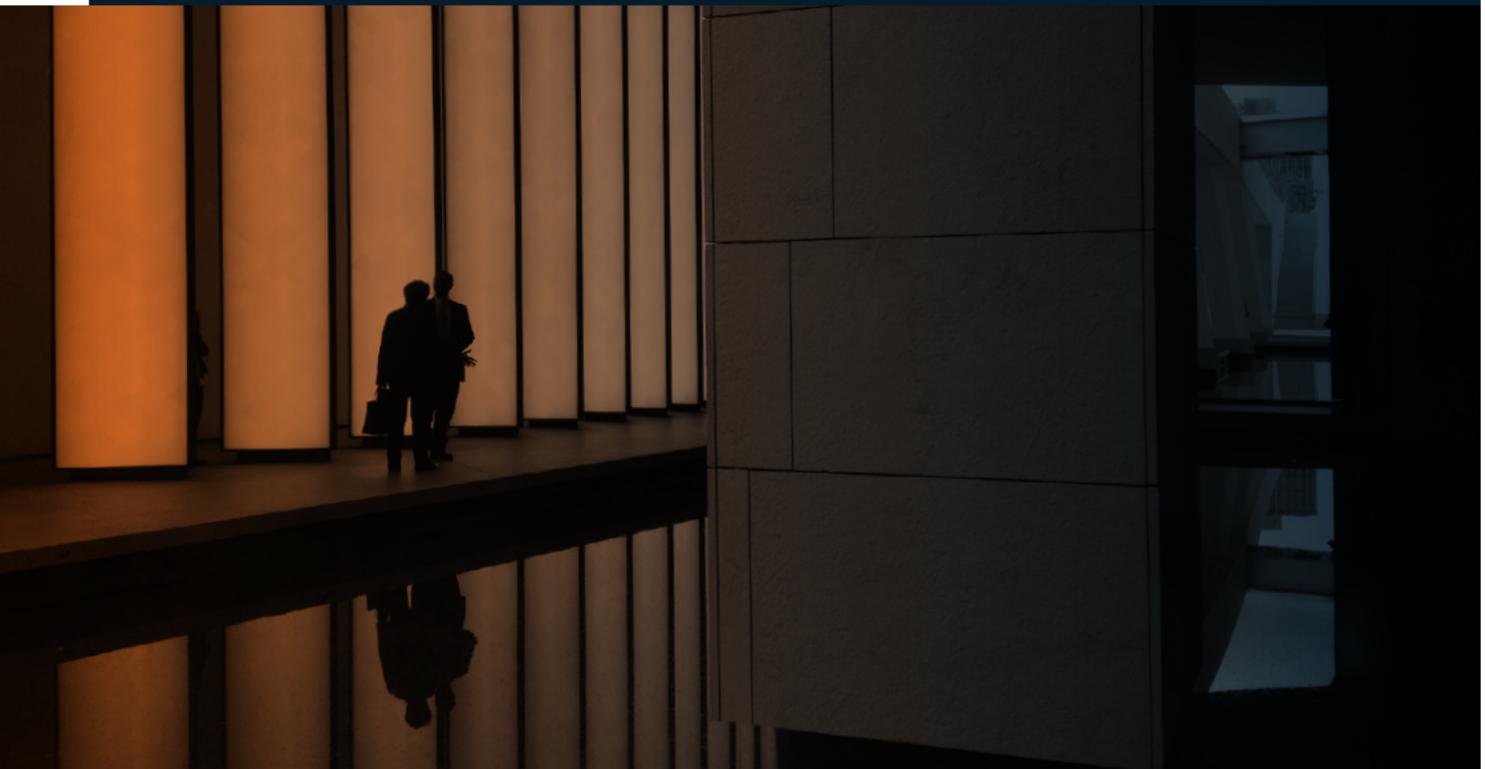
NEXT STEPS

Groups from across the political spectrum have joined together to oppose Proposition 10. They include The California Apartment Association, California Association of REALTORS, The State Building and Construction Trades Council of California, the California Chamber of Commerce and more than a dozen other veterans, labor, and housing groups.

Both of California's gubernatorial candidates, Democrat Gavin Newsom and Republican John H. Cox, are opposed to Proposition 10. The measure "may have unintended consequences on housing production that could be profoundly problematic," Newsom noted at a forum on housing issues. Said Cox: "I don't believe rent control works."²⁹

"Proposition 10 distracts from real solutions that would make housing more affordable," said Sebree. For example, the November ballot also includes Proposition 1, which would provide \$4 billion in bond money to support building affordable housing for veterans.³⁰ Proposition 2 would provide \$2 billion in bond money for housing for people who are homeless or at risk of chronic homelessness.³¹ Trying to control prices doesn't work—California needs to increase its housing supply if it wants to create a meaningful long-term solution.

To better understand the potential implications of Proposition 10 for your property and corresponding strategic options for your commercial real estate investments, contact your Marcus & Millichap agent.



End Notes

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