CALIFORNIA STATEWIDE RENT CONTROL – THE GOOD, THE BAD AND THE UNKNOWN

What this new law means for Landlords and Tenants

By Barry Saywitz, President of The Saywitz Company

The new California Statewide rent control law was just recently signed into law by Governor Newsom. This bill also known as Assembly Bill 1482 or the Tenant Protection Act of 2019 is the biggest reform of the state's rental housing industry in decades and provides statewide rent control laws which places annual limitations or "caps" on rental increases that landlords may impose and has other significant impacts to both landlords and tenants.

This new law takes effect January 1, 2020. Highlights of this new law include the following:

- Statewide rent control which imposes a 5 percent annual "cap" plus a cost of living increase based on the regional change in the Consumer Price Index.
- The law also imposes additional restrictions on landlords for evicting tenants with cause.
- This law applies to some segments of the market including single-family homes which are used for investment purposes by corporate owners but does not include condominiums and new (built within the last 15 years) construction.

While on the surface it appears to be a big win for tenants and will hinder a landlord's ability to significantly increase rents on a go-forward basis, when one digs deeper into the ramifications and practical applications of this law, the impacts become more vague and what appears to be a law constructed strictly for the benefit of tenants, may ultimately have other impacts which will affect vacancy rates, renovations and availability of quality housing in the future.

So, let's examine the pluses and minuses from both the landlord and tenant's perspective.

Landlords are only able to increase rent by a 5 percent plus the cost of living adjustment. In Los Angeles, Orange County and the Inland Empire, that cost of living adjustment based on the change in the Consumer Price Index (CPI), and as it stands today, that would be a total of 8.3 percent. One must keep in mind that the average annual rent increases for the region have been 4 to 5 percent over the past several years even though the market has continued to remain hot with limited availability. Therefore, the average landlord will not be impacted by having their rents capped to the point where it would constrict their ability to raise rents going forward.

Conversely, the average tenant would not yield any savings, only the security that someone could not significantly raise their rent for no reason. One must also keep in mind that there is still a supply versus demand issue causing a housing shortage, and there is still market competition which precludes landlords from just raising the rent dramatically without any cause or justification. In many instances, landlords raise rents due to renovations or remodeling and therefore the tenants who ultimately pay the higher rent, also receives a better product and a nicer place to live at the end of the day.

If the tenant is not interested in paying for this value-added feature or is unable to afford it then the tenant will ultimately look for an alternative place to live. The impact of this law is that it will, by design, discourage landlords from making renovations and providing upgrades to tenants such as new flooring or appliances since their return is now limited by the rent cap. The result is that tenants may ultimately receive rental increases without any real benefit.

Keep in mind that this new state law does not apply to new construction or to recently constructed properties and therefore those properties with high-end amenities or newer finishes are not precluded from raising rents significantly as a result of its passage. What this law will also do is force landlords who are doing major renovations or building new construction to attempt to achieve the highest rent possible as a starting point knowing that the rents will be capped in the future under this new state law. What this does is it forces the landlord to achieve rents at the higher end of the rental spectrum and from a practical standpoint, does not provide any real savings to tenants with these property types.

As we have already seen in the areas that have had previous rent control such as parts of Los Angeles and San Francisco, incentives for a tenant to relocate from a property that is under a rent control, are extremely low due to the fact that they may ultimately be receiving a significantly below market rent. However, an owner who elects to renovate or remodel the property, may not elect to renovate the units under rent control until the unit is vacated. Once again, the landlord has no other choice but to provide inferior housing conditions.

One of the segments which is expected to be significantly affected would be those investors and property owners that would look to renovate existing product. While there is no expectation that these investors will slow down their appetite for good properties with value-added opportunity, what it will do is add an additional line item to the expense of these investors and developers. This additional line item expense would be the relocation costs that they would need to incur to incentivize existing tenants to move from the property. Whether the investor pays this or whether that additional line item expense is deducted from the purchase price, remains to be seen and may be approached on a deal-by-deal basis. This will ultimately affect sellers who would look to sell properties with deferred maintenance and below market rents at prices predicated on the proforma or future rent of the property.

Since the apartment market is extremely tight and in high demand, many properties are being marketed under the premise that rents could be raised, and the building could be remodeled to achieve higher return. While this will still be the case in limited instances, there will be more work for the value-added property investor and discounts for sellers now that the state rent control bill has passed. The other result of this new law is that if an existing property owner knows that his older property requires upgrades and his rents are potentially capped, then it would provide an incentive for him to sell now rather than wait several years to be able to achieve market rents. This will force the existing tenants to have to relocate and while they may receive compensation for the process, it would put them in the market of looking for a new place to live and being forced to pay current market rents which would be significantly higher than their current situation. In this scenario, the tenant really isn't saving any money and is forced to pay a market rent at a new property.

The other impact to tenants is that if landlords believe that their rents are below market, they will look to impose the maximum rental increase going forward in an effort to bring their rents as close to up to market as possible. This new rent control law has now brought to the forefront the need for the smaller and middle-size landlords to educate themselves on the nuances of the law and the impact to their property which now may cause existing tenants to have larger increases than they would have been exposed to before the law was passed.

Regardless of the law, there is still a housing crisis throughout California and certainly in the major metropolitan markets throughout the state. The simple laws of supply and demand will still hold regardless of this statewide imposed rent cap. Families who are renting single-family homes may look to stay as renters for an even longer period of time to reap the benefits and amenities that a single-family home provides while they try to save up for a home of their own. Many tenants may be perpetual renters and may never own a home of their own based on the cost of residential housing and therefore this creates a tightness in the rental market which then further pushes rents upward.

The law provides leeway for smaller investors who would be renting out individual condos, a second unit in a duplex, a second home or an investment home that they may own and therefore, these tenants do not have any protection under the new rent control law. Additionally, in more suburban or rural areas throughout the state where rents have been more moderately increased by 3 to 4 percent per year historically the rent control cap may not even come into play.

There are many uncertainties with regards to the implementation of the law. The most obvious is that there is generally no local governing body to enforce this law that has been passed. Therefore any dispute with regards to any rental increase, non-renewal of a tenant by a landlord, or termination of a lease by a landlord will ultimately end up in court which puts additional burden on the already taxed court system and forces a tenant to go to court which may not be a process they are familiar with and will then force a judge to rule on each dispute on a case by case basis. Scenarios such as non-renewal for late payment of rent, non-renewal for social problems, smoking or marijuana use which may be legal in California but a violation of a landlord's property rules and regulations also becomes problematic for both landlords and tenants. Landlords may become less willing to work with tenants who are struggling to pay their rent knowing that they can evict them in order to achieve market rents at a much higher rate. Therefore, landlords who may have been previously willing to work out payment arrangements with tenants would look to begin the eviction process immediately without any desire for any type of compromise.

Other repercussions and potential factors resulting from this new law that may come into play are additional charges other than rent. Landlords may try to charge for items such as trash hauling, common utilities, appliance rental, pet rent, rent for parking spaces or storage may look to increase those charges to capitalize on their overall return. Therefore, while tenants may not see a direct rent increase, they may see increases in other additional charges that they would not have otherwise seen. Some landlords who do not currently charge for these additional services or costs may begin to do so in a way to create additional income and to offset the effects of Assembly Bill 1482's rent "caps".

Many experts and prognosticators believe that the "proof will be in the pudding" as to how this law fully impacts the overall dynamics of landlord-tenant relationships, rent and the realistic impact to either party. Future revisions of the law certainly may come to pass as legislators will take time to allow the law to settle in and receive feedback from their various lobbying interests for additional revisions, exemptions, etc. Assembly Bill 1482 also imposes a statewide rent cap which then, at least for the time being, may cause local jurisdictions to re-think implementing their own rent control ordinances. With the statewide rent cap, there is no need for individual cities to look to have local rent control and tenant protection regulations other than those imposed at the state level, and those cities which already had more restrictive ordinances prior to the passage of the new law, will take precedent over the state bill and therefore their existing laws and regulations are unaffected.

The politics of statewide rent control will continue but for the time being, tenants can feel safe that there is a ceiling on what landlords can charge them and that lawmakers in Sacramento including the Governor, have taken a giant step towards trying to protect tenants as best they can. Many real estate investors, agencies and lobbyists for the real estate industry believe that this rent control bill has done little to nothing to address the real issue which is the statewide housing crisis. Many believe that additional tax credits for new development, new housing or rezoning of existing properties for residential development would go a long way towards incentivizing developers to build new housing and create new housing opportunities for either homeownership or a better-quality housing for tenants. This need will continue as the population here in California continues to grow especially in the dense urban areas where good quality housing is a limited resource.

Nonetheless, tenants and lawmakers can feel good that they have taken a step in the right direction. As for landlords, it will be a trickier path going forward to deal with their existing tenants and landlords will need to be far more careful as to who they rent to and will likely scrutinize their applicants even more so than before since the potential of a longer term relationship certainly exists more today than it has in the past. Rental history, credit score and income will all become an even more important factor than they already are in a landlord's decision as to who they should rent to.

As for buyers and investors of multi-family properties and apartment buildings, they will have to incorporate the new law into their ultimate short-term acquisition thinking and their long-term rent strategy, but the fact still remains that there are more buyers than available properties and more money chasing fewer deals at least at the moment. As for the sellers of these types of properties, there is still no doubt that in today's current environment with low cap rates and high demand for these kinds of properties, it is still a seller's market. Those that have issues with below market rent will have to take some type of discount, but they should keep in mind that they are discounting from what historically would be the top end of real estate prices. The real test will be if the real estate market should cool, how will that effect both buyers and sellers and their methodology for the pricing of these types of properties.

The bottom line is that the ultimate overall impact of state law Assembly Bill 1482 is realistically yet to be determined and as the law is implemented next year, both property owners and tenants will have to navigate the nuances and the specific scenarios which apply to their individual property and circumstances. Time will tell as to whether this bill really provides greater opportunities for renters in the marketplace and whether it provides a real cost protection for them or whether it has impact on market demand or rental pricing. There are discussions at the federal level and even propositions by several of the Democratic Presidential candidates for nationwide rent control. The California State law has also prompted other states to begin to look at similar types of laws as well. While California is certainly at the forefront of many advances and challenges due to the overall size of our economy, we will also be a good test for other states and the nation as a whole. AA

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