

Overview

Rental property owners and developers are easy targets to blame for California's newest round of housing affordability issues and shortages. It is unfortunate because the misguided blame may lead to significantly harsher regulations over the industry in the coming years—regulations that will likely serve to perpetuate and exacerbate the problem in the long run.

California's Housing Shortage and Affordability Problems

The problem is well documented. California does not have enough housing to meet demand. In fact, according to a recent independent report by the State's Legislative Analyst's Office, the State produces 100,000 fewer housing units than is needed to meet demand.¹ Supply and demand economics are therefore in full force here in the State. When everyone is competing for the same limited supply of housing, costs are going to go up.

But supply and demand is not the only driving force creating affordability and shortage problems. Community resistance to housing, stringent environmental policies, lack of fiscal incentives for local governments to approve housing, limited land, lack of incentives for developers to build, burden some government regulations, long and difficult permitting process, and the high cost of building all serve to constrain new housing construction.²

And it is not just the popular and dense coastal urban areas of California that are impacted by the current shortage. As people get priced out of major cities, they begin to migrate inland; ultimately creating a supply and demand problem that increases housing costs, rents, and prices in sub urban and other inland areas.

The shortage and affordability issues create widespread problems for all Californians, and those seeking to move here. Rents become unaffordable for more and more people. People are forced to move further away from where they work, or move out of state completely. It discourages people from living in California, which not only impacts the State's economy, it keeps California businesses from attracting the most qualified people to work for them. Rental property owners also feel the squeeze because local governments and State lawmakers begin passing laws aimed at regulating the rental and construction industries.

What the Experts Recommend

In 2015, the Legislative Analyst Office (LAO) provided recommendations to the California Legislature about how to begin addressing California's housing issues. In sum, it told the Legislature that it needed to pass laws to help facilitate the development of market rate housing in coastal areas. The LAO followed up with a report in 2016 after certain tenant advocacy groups expressed concerns that building market rate housing will not help low-income tenants, and that the Legislature should focus on regulations that help low-income tenants, such as stronger rent controls. The LAO's response was swift and clear:

“Many housing programs—vouchers, rent control, and inclusionary housing—attempt to make housing more affordable without increasing the overall supply of housing. This approach does very little to address the underlying cause of California’s high housing costs: a housing shortage. Any approach that does not address the state’s housing shortage faces the following problems.”³

The LOA went on to state voucher programs, rent control and inclusionary housing programs only help select few, while doing nothing in terms of addressing the real problems. Forcing rental property owners to provide below market rate does not reduce or eliminate competition, the driving force of supply and demand economics. Moreover, forcing owners and developers to provide below market rate rentals ultimately discourages development and improvement of rental property.

Government’s Reaction to the Housing Problems

So how have the State and local governments responded to the housing shortage? To begin with, in 2017, the Legislature introduced over 130 housing related bills, nearly 50 percent more than typical legislative years. Among the bills are ones that help generate funding to build affordable housing and remove obstacles to development. Then there are the ones that seek to regulate the rental property ownership and development industry.

On the supply side, a few bills are aimed at increasing funding to build affordable housing. ACA 11 (Caballero) imposes a quarter per cent sales tax to generate yearly funding for middle-income earner housing. SB 3 (Beall) is a 3-billion-dollar one-time State general obligation bond to build and rehabilitate low-income housing. SB 2 (Atkins) would impose a \$75 fee on all real estate recordings (with the notable exception that the fee would not apply to a single-family home sale), which in turn would generate a regular stream of funding for affordable housing. While these bills promote development of housing, none of them increase market rate housing.

On the regulation side, there appears to be a target on the backs of rental property owners, managers and developers. Both on the State and local level, rent control is on the agenda. Despite consensus among experts that rent control does nothing to solve the State’s housing supply problems, and actually leads to the development of fewer homes, and homes remaining off the market, lawmakers continue to target rental property owners for regulation. AB 1506 (Bloom) is probably the worst bill in years.

It essentially allows all cities and counties in the State to adopt the strictest forms of rent control on all types of housing. Currently, under the Costa-Hawkins Act of 1995, newly constructed units and single-family homes are protected from rent control. Moreover, owners of controlled units are able to raise rents to market rate when a vacancy occurs.

Bloom’s bill would remove all of those protections, allowing local governments to control even vacant units (a form of rent control called “vacancy control”). Owners would be required to keep their rents artificially below markets forever.

Rent control, especially the most severe kind like vacancy control, makes building rental units cost prohibitive. Owners cannot make money off of them, so investors stop investing. Owners of current rental units eventually get out of the rental business because renting property becomes unprofitable. Ultimately, rent control increases the housing shortage problem, which then increases competition and costs, and makes housing even more unaffordable. It also encourages legislative bodies to adopt additional restrictions on rental properties.

Assembly Member Bloom has since pulled his bill back for this year, but promised to bring it back next year with some amendments.

Several members of the Legislature that seek to repeal the Costa-Hawkins Act or amend the Act to severely injure the important aspects of the Act join Assembly Member Bloom. Tenant groups are using AB 1506 as a platform to organize and demand changes in several laws.

Inclusionary housing mandates are also back on the table. Inclusionary housing mandates force developers to build affordable housing units as part of a larger market rate development without the requirement of the government providing density bonuses or sufficient cost offsets. Without offsets, the costs associated with the "affordable units" are borne by the property owner and possibly the other tenants.

Again, the more burdensome development is, the less investors are inclined to develop. These kinds of mandates, as noted by the LAO, do nothing to address the housing shortage.

Locally, there are several communities considering adopting rent control regulations to address affordability issues. Rent control is a hot topic, promoted by well-organized tenant advocacy groups. It will continue to be discussed, and ultimately, some communities will cave. Communities that ordinarily would not have given a second thought to regulation a few years ago have recently considered rent control. Concord and Burlingame are just two of many examples that considered rent control. Other cities are "strengthening" rent control laws.

This past April, the City of Long Beach considered adopting an ordinance that would permit every tenant to use the same credit report for 90 days. One significant explanation to adopt the ordinance is the cost of credit reports is simply too expensive.

If rent control and inclusionary housing mandates have not captured your interest, the State administration, notably the Department of Fair Employment and Housing Council (DFEHC) has proposed three significant regulations that should affect every property owner and manager.

Occupancy limits have not changed in decades. If the DFEH draft regulation becomes law, owners and managers could not discriminate against tenants that want 15 occupants in a three-bedroom, nine occupants in a two-bedroom, and six occupants in a one-bedroom rental unit. Owners would no longer be permitted to advertise that a rental unit has a living room, dining room, and kitchenette because those rooms could be used as a bedroom.

The second draft regulation would sharply limit an owner's/manager's ability to refuse to rent to previously convicted felons. Our concerns are legitimate.

We are liable and subject to forfeiture and nuisance abatement laws for criminal activity on our property; we have the “unequivocal” right to deny registered sex offenders to “protect a person at risk or for some other reason.” We have the legal duty and moral obligation to keep tenants and property safe. And on top of all of this we would be required to understand how to consider a new legal standard... we would have to establish a legally-sufficient justification relating to criminal history information by proving that our screening standards are substantial and legitimate and nondiscriminatory without any guidance as to what those terms mean. We would even be required to understand the “nature and severity” and the appropriate amount of time that has passed since conviction and we are not given any specific guidance as to what those factors mean.

Finally, one very topical issue DFEHC is considering is adopting a regulation concerning emotional support animals. Unfortunately, the proposed regulation does not curb rampant support animal fraud. It does not adequately address verification requirements including: 1) assessment by a licensed medical or mental health professional; a prescription by a licensed professional; the need for the animal does not need to be current; and 2) the verification process does not discuss what additional information an owner can ask for and from what sources. The vagueness is concerning because of risk of asking the wrong question and the potential for a discrimination lawsuit. We are also very concerned that the draft regulations do not adequately consider the quiet enjoyment of other tenants, nuisance issues, and the safety and health of other tenants.

Rent control, price control, affordable housing mandates for new housing, tenant screening, use (or abuse) of credit reports, and occupancy limits represent just some of the major issues we are confronted with today. We hope you will join us in supporting the industry.

As one notable industry leader has said: join us at the table or you will be on the table.