

Repeal of Costa-Hawkins on California Ballot: Proposition 21 Has Potential to Reshape Multifamily Housing

Initiative could tighten existing restrictions. Under Proposition 21, vacancy control will be introduced in areas with rent control as Costa-Hawkins is repealed. Currently, operators are able to lift rents up to the market rate upon vacancy. The initiative will now limit the rise in rents to 15 percent during the first three years of a new tenancy in addition to increases allowed by local ordinances. The restrictions will apply to properties that were first occupied more than 15 years ago and continue on a rolling basis. Units that were exempt from local rent control laws due to Costa-Hawkins will no longer enjoy those exceptions and permanent rent caps can be installed. Last year, statewide rent control was enacted with Assembly Bill 1482 which caps annual rent gains in areas without rent control at 5 percent.

Alternative measure failed in 2018. Proposition 10 appeared on the California ballot two years ago and was soundly defeated. The initiative was a wholesale repeal of Costa-Hawkins. A much closer outcome is anticipated with Proposition 21 because of the narrower limits, higher turnout during a presidential election year, and shifting attitudes on rent control. Statewide shutdowns due to the health crisis may also influence the result.

Proposition 21 Highlights

- Repeals Costa-Hawkins that enabled rents to be reset to the market rate upon vacancy in rent controlled municipalities. Initiative allows landlords to raise rents 15 percent plus the local rate over three years upon turnover.
- Properties first occupied 15 years prior will be subject to control on a rolling basis. Removes restrictions for units that could be controlled previously cemented by Costa-Hawkins.
- Exemption for single-family and condo rentals under AB 1482 reduced to owners with less than three homes in the state regardless of title. Rentals held in trust are not exempt from control.
- No avenue for moving rents to the market rate regardless of improvements is provided within the legislation.

Impact from enacted Proposition 21. If passed, several factors will influence the California apartment market. Since statewide rent control exists on top and concurrent to local measures, an uneven pace of rent growth could be present at properties relatively proximate to each other. Underwriting will be more challenging and require a greater level of due diligence in cities with rent control. Los Angeles and San Francisco, for example, can only dictate rent increase caps on properties constructed prior to 1979. If Proposition 21 becomes law, the city will be able to enforce control on all properties older than 15 years. Another challenge is the volatility of rents during the health crisis. Operators may be encouraged to leave units off the market in rent controlled areas until conditions stabilize rather than immediately seeking new tenants.

Construction and renovation at risk. While the addition of a 15-year exemption on rental housing first included in last year's assembly bill is intended to alleviate concerns from developers, the impact on new construction may persist. A 2016 report from the state's Legislative Analyst's Office found that rent control measures would likely slow development. Furthermore, there will be little incentive for owners to upgrade units without a carveout enabling them to reset to market rents.

Encino Office:

Adam Christofferson | Senior Vice President, Division Manager
Tel: (818) 212-2700 | adam.christofferson@marcusmillichap.com

San Diego Office:

John Vorsheck | Senior Vice President, Division Manager
Tel: (858) 373-3100 | john.vorsheck@marcusmillichap.com

Chicago Downtown Office:

John Sebree | Senior Vice President, National Director | NMHG
Tel: (312) 327-5400 | john.sebree@marcusmillichap.com

For information on national commercial real estate trends, contact:

John Chang

Senior Vice President, National Director | Research Services Division
Tel: (602) 707-9700 | john.chang@marcusmillichap.com

Price: \$1,000

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