Financial Advisory

California Rent Control Has the Other Foot Dropped?

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Back in 2018, as you'll recall, California voters overwhelmingly rejected (59% against vs. 41% for) Proposition 10 – which looked to strengthen rent control laws in California. (I discussed the Costa-Hawkins Rental Housing Act in detail in a previous article, so we don't need to review it again here.)

California's government took note of the voters' wishes, and performed the opposite action in passing AB 1482, which enacts rent control across the entire state. This bill was announced as passed on September 11, 2019, (is there some symbolism in that date?), and Governor Newsom announced at the time that he will sign it. As of this article's writing, (October 1, 2019), he has not signed it yet – but has until October 13 to do so. Let's talk about what this bill – as written – would mean for landlords.

WHAT THE LAW SAYS – A BRIEF SUMMARY

The law says that this rent control will exempt buildings constructed in the last 15 years. Note that this is a "rolling date," however: a 2004-built property will be exempt this year, but would fall under these regulations in 2020. This could certainly dampen developers' enthusiasm for building new competing units. Although the law is set to expire in 2030 – Santa Monica apartment owners know all about these "temporary" rent control laws. (In reality, they can often end up permanent.)

Under AB 1482, rent increases will be limited to 5% per year plus the local rate of inflation. The rules will also call for evictions only with just cause; but do allow relocation of tenants for condo conversions or "substantial" property remodels with the payment of relocation fees equal to one month's rent.

WHAT THIS MEANS

Remember that the value of your apartments is tied to the income it produces: The higher your income, the higher someone will be willing to pay

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you for it. A cap on your rent growth through rent control regulations is also a cap on your value growth.

MY CONCERNS ABOUT THIS REGULATION

How many times have our gas taxes risen to "Fix our crumbling roads?" Also – surprise! – Governor Newsom just signed an executive order (#N-19-19) diverting 5 Billion of these "crucially needed dollars" towards "green power." Given California's track record of legislation; can we believe that this will be the end of the regulations? Do you believe that these rent control regulations will get less or more stringent in the future?

WHAT LANDLORDS MUST DO

Now that rent control is the "law of the land," we as landlords need to make sure to keep up with our rent increases. If you look on the MLS today, you'll see plenty of apartment complexes trumpeting their "below market rents", (as if that's a good thing – because I've noticed their prices are rarely "below market" to match.) Last year, I could buy some apartments with rents at 60-75% of market, try to get the seller to budge on his price, and raise the rents close to market after I take possession – for much better cash flow. After these new regulations, it will take a long time for me to raise those rents up to market at only a few percent a year – and it will take a lot of money to pay both relocation fees and "substantial renovation" costs. These extra costs mean that buyers have less money to pay for your property in the first place – which could mean lower sales prices for you in the future.

I have been talking to many investors this year who are wondering if now is the time to sell their California properties and complete 1031 Exchanges out of state for more cash flow and growth potential. Some of these investors were very concerned about potential rent control regulations – now they may be convinced to take action.

Are you interested in out-of-state 1031 Exchange Options? Call my office toll-free at (877) 313-1868, and I'll be happy to talk with you about them.

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- Potential for foreclosure – All financed real estate investments have potential for foreclosure;
- Illiquidity – Because 1031 Exchanges are commonly offered through private placement offerings and are illiquid securities. There is no secondary market for these investments.
- Reduction or Elimination of Monthly Cash Flow Distributions – Like any investment in real estate, if a property unexpectedly loses tenants or sustains substantial damage, there is potential for suspension of cash flow distributions;
- Impact of fees/expenses – Costs associated with the transaction may impact investors' returns and may outweigh the tax benefits

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