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The Case for Preserving Costa-Hawkins: The Potential Impacts of Rent Control on Single Family Homes

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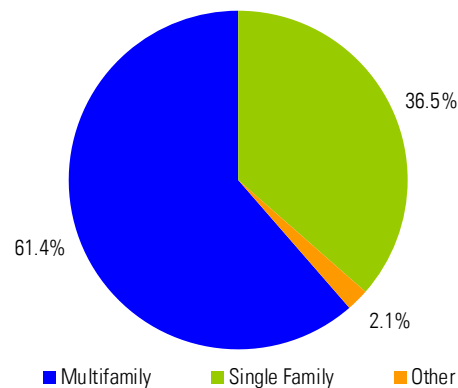
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The Case for Preserving Costa-Hawkins: The Potential Impacts of Rent Control on Single Family Homes

A Broad Threat

Insufficient residential construction over several decades, combined with rapidly increasing demand, created a housing availability and affordability crisis in California. As employment opportunities and the state population continue to increase, housing supply remains far below statewide needs. The resulting shortage has left many households with little choice but to pay for increasingly unaffordable housing options, or leave the state entirely. Statewide single family home prices surged following the end of the Great Recession, and surpassed the pre-recession peak in the first quarter of 2018. Affordability continued to decline, and RCG estimated that only 30% of households in the state could afford the median-priced single family home, as of the second quarter of 2018. As a result, a large number of California households are renters by financial necessity. This includes many families with young children who often rely on renting single family homes as their only viable option to find housing with three or more bedrooms in communities with good schools and access to amenities. Illustrating the popularity of single family rentals, nearly 37% of all renters in the state reside in single family homes.¹ However, California's persistent demand-supply mismatch has made renting these homes increasingly unaffordable.

Share of Single Family vs. Multifamily Renter Households



Note: Other category includes mobile homes, RVs, and boats. Latest data as of 2017
Source: Census

Currently, the Costa-Hawkins Rental Housing Act prevents cities from applying rent control to single

family rental properties. However, Proposition 10 on the November 2018 ballot would repeal Costa-Hawkins and give cities unrestricted power to control rents on all types of rental properties at any time, including single family homes. If applied to single family homes, rent control would significantly reduce the existing supply of single family homes available for rent – eliminating housing options for thousands of families across the state. Moreover, the repeal of Costa-Hawkins would also harm property values and discourage new residential development activity, further exacerbating the statewide housing crisis.

While some single family rentals are owned by larger institutional investors, the vast majority are owned by “mom-and-pop” businesses who typically lease out a small number of homes, or by individuals and families who rent out a single home (often a former residence). Imposing rent control on single family homes would significantly reduce rental income potential for these small-scale owners, and thereby decrease the value of the underlying properties for these businesses. As a result, many mom-and-pop property owners would be incentivized to hold units vacant, move into the unit themselves, put less profitable homes up for sale, or even exit the rental business by converting homes from rentals to owner-occupied properties.

The scale of this trend is difficult to predict, depending heavily on which cities would decide to extend rent control to single family homes if Costa-Hawkins were repealed. However, there is considerable risk that the net effect of expanding rent control to single family homes would: 1) greatly reduce the number of homes available for rent; and 2) negatively affect single family property values for both rental businesses and individual homeowners. Ultimately, extending rent control to include single family homes would be a threat to thousands of small businesses, millions of California homeowners and, perhaps most critically, the very group that rent control advocates hope to help – the large number of families who rely on renting single family homes as their only viable housing option.

Single Family Rent Control Would Harm Mom-and-Pop Businesses

The vast majority of the single family rentals in California are owned by individuals and small, mom-and-pop businesses. While there are several sizable institutional investment firms that acquired portfolios of single family rentals in recent years, in aggregate, the total number of homes owned by these firms represents a small fraction of the statewide single family rental market. In fact, the six largest single-family institutional investors, which account for a significant portion of the overall institutional market, held fewer than 200,000 homes nationwide, or only 1.3% of the more than 14.9 million renter-occupied single family homes nationwide as of 2017.² In California alone there are more than 2.1 million single family rentals and institutional investors similarly account for an extremely small fraction of the market. Many of these institutionally-owned single family homes represent post-foreclosure homes that were purchased by investors at a discount in the early stages of the economic recovery following the Great Recession. However, institutional

Major Institutional Investors	
Company	Approx. Homes Nationwide
Invitation Homes	82,000
American Homes 4 Rent	50,000
Progress Residential	20,000
Main Street Renewal	17,000
Tricon American Homes	17,000
Front Yard Residential	12,000
Major Investor Total	198,000
Total U.S. Renter-Occupied Single Family Homes	14.9 (mil.)
Sources: Company Filings, Curbed	

purchases peaked in 2012 and 2013, subsequently decreased sharply in the following years, and currently represent an extremely small share of the for-sale housing market in California.³ Moreover, numerous former single family rentals have since been sold to tenants or made available through lease-purchase options. Overall, institutional investors, which are defined as companies that buy ten or more homes in a given year, accounted for less than 2% of California single-family home and condominium sales in 2017, according to statistics from ATTOM Data Solutions.⁴

Mom-and-pop businesses represent a critical segment of the rental housing market, and the repeal of Costa-Hawkins would negatively impact these small business owners far more than it would harm institutional investors. If Costa-Hawkins were repealed, cities would generally be most likely to adopt rent control on older buildings. However, as more than 60% of single family homes were constructed before 1980, according to the Census, there is an elevated risk that single family rentals would be affected substantially by any new rent control ordinances, even if exemptions for new construction are retained.⁵

Without the current statewide protections, rent control on single family homes would squeeze the margin between rental income and operating expenses for mom-and-pop businesses. This substantial reduction in net operating income for mom-and-pop rental owners could easily make it no longer profitable to rent out a single family home, or at least reduce profits to a level where owners would do better by simply investing in other assets such as stocks or bonds. Many small business owners rely on this income for their livelihood and future retirement. However, under these circumstances, rent control would pose a significant risk, potentially forcing many of them to sell their properties, scale back operations, neglect property maintenance as revenue fails to keep pace with rising expenses, or even exit the single family rental business entirely.

Single Family Rent Control Would Harm California Homeowners

The impact of a repeal of Costa-Hawkins would also extend to individual homeowners. As of 2017, there were more than 7.1 million homeowner households in California, or roughly 55% of all households in the state.⁶ If cities decided to extend rent control to single family homes, many of these homeowners could see the value of their homes drop significantly. Specifically, rent control could decrease California home values in several ways. First, as discussed previously, rent control policies that limit rents to incremental increases or even restrict rent increases to less than the overall rate of inflation, largely neglect the fact that the expenses of owning and maintaining a rental property continue to rise

over time. By definition, this means a decline in net operating income for mom-and-pop businesses, directly reducing the value of the underlying homes. This issue could be further exacerbated if cities decide to eliminate the guarantee of vacancy decontrol. Currently a provision protected by the Costa-Hawkins act, vacancy decontrol allows owners to reset the monthly rent to market levels after a tenant leaves before leasing the property out to a new tenant. Should Proposition 10 pass, cities could choose to eliminate these rent adjustments when tenants leave (a policy known as vacancy control), which would further decrease potential income for property owners and corresponding property values.

Second, small mom-and-pop businesses and individual investors may decide to sell properties, as opportunity costs are weighed against declining profit margins. As the return on investment for owning single family rentals decreases and potential owners choose to invest in other types of assets with higher returns, demand for these properties would also likely decrease. The combination of owners of single family rentals flooding the market with homes for sale and decreased demand from potential operators of single family rentals could cause single family home prices to drop dramatically.

While this impact would be most concentrated in cities that adopt single family rent control, if Costa-Hawkins protections were repealed, there would be significant uncertainty surrounding exactly what each city might choose to do today, and how rules may change in any given community over time. In fact, this uncertainty alone could be enough to trigger a drop in new single family rental investment and to cause mom-and-pop owners to sell properties, both of which could negatively impact home prices across the state in communities with or without existing rent control.

Evidence from academic research on communities with past rent control policies further supports the potential for rent control to significantly reduce property values. For example, a 2012 study from MIT analyzed the effects of rent control in Cambridge, MA. Specifically, researchers found that in the period after rent control ended in 1995, assessed properties values surged by 18% to 25% for buildings that were previously under rent control.⁷ In addition, rent control was found to have negatively affected the values of other nearby properties that were exempt from rent control. In fact, subsequent research from MIT published in 2017, showed that 10% to 22% of the rise in properties values in Cambridge that occurred when rent control ended was the result of decreased crime and improvements in public safety.⁸ While this research focuses on removing rent control, it is reasonable to conclude that the impact of rent control on property values is symmetrical. That is, just as removing rent control after an extended period led directly to an increase in property values, imposing new rent controls (particularly highly restrictive rules such as vacancy control) would be highly likely to lead to a decline in property values over time.

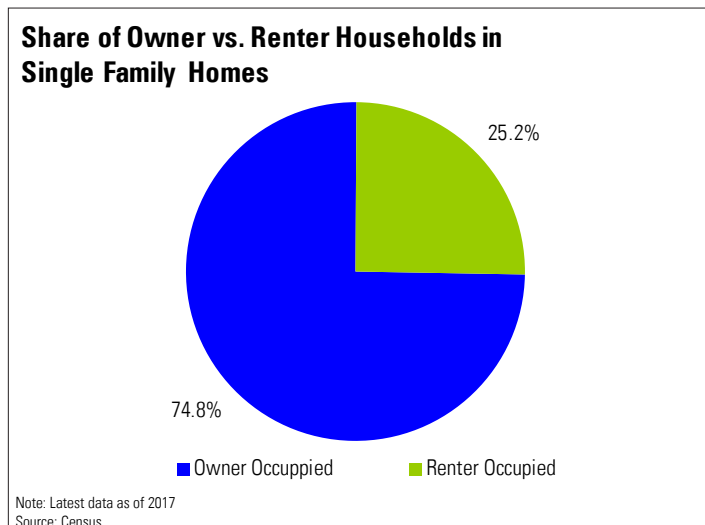
It is important to note that this research on property values was based broadly on assessed property values for all residential properties, rather than a specific focus on the single family market. However, considering the existing research on the relationship between rent control and property values, as well as the sizable share of single family homes that are currently part of the rental market in California, extending rent control to include single family homes could reduce single family property values by 10% to 15% over time. Notably, the extent of the impact would depend largely on the specific rules that individual communities choose to adopt, such as exemptions for newer properties or a preservation of vacancy decontrol. Importantly, however, declines in home prices would not be limited to those who own rental properties, but would instead include all homeowners in the community. Moreover, considering the level of policy uncertainty, concerns surrounding which cities would adopt rent control on single family homes could negatively impact home prices for millions of homeowners statewide.

Single Family Rent Control Would Harm Families Who Rent

Single family homes are a popular and necessary housing option for families throughout the state. In fact, as of 2017, there were 2.1 million households who rented single family homes in California, according to the Census.⁹ Following the end of the Great-Recession, many California households were forced to rent out of financial necessity, including a large number of families previously foreclosed upon who had no other viable housing options. As a result, the number of single family renter households in California increased by nearly 138,000 from 2010 through 2017.¹⁰ In fact, rental units accounted for more than 25% of all occupied single family homes. Moreover, there are now approximately 450,000 more homes used as rentals in California than in 2006, most of which are owned by small mom-and-pop operations, individuals or families.¹¹

Many of these households represent families with children who rent single family homes rather than

apartments as their only viable option to find housing with three or more bedrooms, a backyard, access to nearby parks, and safe neighborhoods with good schools. In total, there were roughly 1.3 million single family renter households with three or more people statewide as of 2017.¹² Moreover, these households account for more than 60% of the single



family rental market. Similarly, approximately half of all renter households with three or more members lived in single family homes rather than multifamily apartment buildings.¹³

Removing Costa-Hawkins and extending rent control to single family homes could dramatically reduce the supply of housing for families that depend on these homes. Moreover, by compounding the existing scarcity of larger rental units, the reduction in availability would further increase rents on any non-controlled homes and exacerbate affordability challenges for many households. The effects would be felt most severely in communities with particularly strict rent control, where units are most likely to be converted to owner-occupied homes and where new development would be most challenging. Indeed, the decrease in single family rental supply could eliminate housing options, increase cost burdens and displace renter families from desirable neighborhoods – the very outcomes many rent control advocates aim to prevent.

Conclusion

Rent control on single family homes would be a threat to mom-and-pop businesses, homeowners and low and moderate income families. If proposition 10 passes, cities could decide to apply rent control to single family homes, which could dramatically decrease profit margins for small businesses that rent out single family homes. This could lead to a sell-off of rental properties and a drop in investor demand with the potential to reduce the price of single family homes considerably for businesses and homeowners alike. Critically, the removal of rental units from the housing supply could have wide-ranging impacts for renter families who often rely on single family homes in order to remain in their neighborhoods. Over time, the negative impact of rent control on supply is likely to push families out of their existing communities to lower cost alternatives and to cities, or states, with a greater variety of available housing options. Overall, rent control would lower the supply of single family homes for rent and reduce the potential for new residential development – factors that would compound the mismatch between supply and demand and exacerbate our current crisis. In this way, Proposition 10 is effectively a threat to anyone in California who owns or lives in a single family home.

End Notes

¹ Tenure by Units in Structure, American Community Survey, U.S. Census Bureau. (2017). Retrieved from <https://factfinder.census.gov>

² Note: Major institutional investors include: Invitation Homes, American Homes 4 Rent, Progress Residential, Main Street Renewal, Tricon American Homes, Front Yard Residential.

Several sources: Tenure by Units in Structure, American Community Survey (2017), U.S. Census Bureau; Company 10-Q Quarterly SEC Filings; Wall Street's New Housing Frontier: Single-family Rental Homes, Jeff Andres, Patrick Sisson. (May 2018). Retrieved from: <https://www.curbed.com/2018/5/18/17319570/wall-street-home-rentals-single-family-homes-invitation>.

³ Data dig: Big investment firms have stopped gobbling up California homes, CALmatters, Matt Levin. (April 2018). Retrieved from: <https://calmatters.org/articles/data-dig-big-investment-firms-have-stopped-gobbling-up-california-homes/>. Citing data from AT-TOM Data Solutions.

⁴ Ibid.

⁵ Tenure by Year Structure Built by Units in Structure, American Community Survey, U.S. Census Bureau. (2017). Retrieved from: <https://factfinder.census.gov>.

⁶ Tenure, American Community Survey, U.S. Census Bureau. (2017). Retrieved from: <https://factfinder.census.gov>.

⁷ Housing Market Spillovers: Evidence from the End of Rent Control in Cambridge Massachusetts. David Autor, Christopher Palmer, Parag Pathak. (June 2012). Retrieved from: <https://economics.mit.edu/files/9760>.

⁸ Gentrification and the Amenity Value of Crime Reductions: Evidence from Rent Deregulation. David Autor, Christopher Palmer, Parag Pathak. (September 2017). Retrieved from: <https://www.semanticscholar.org/paper/Gentrification-and-the-Amenity-Value-of-Crime-%3A-%E2%88%97-Autor-Palmer/25175de7448eddf43c132cb7ded33d68ec67e52>.

⁹ Tenure by Units in Structure

¹⁰ Ibid.

¹¹ Ibid.

¹² Tenure by Household Size by Units in Structure, American Community Survey, U.S. Census Bureau. (2017). Retrieved from: <https://factfinder.census.gov/>

¹³ Ibid.