CalTax℠

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Proposition 10
Rent Control

CALTAX POSITION

The California Taxpayers Association opposes Proposition 10 because the measure would result in a significant loss of property tax revenue to state and local governments, as property values decline. The measure would increase pressure to increase the property tax to offset the decline of revenue.

DIGEST

Expands local governments' authority to enact rent controls on residential property by repealing the Costa-Hawkins Rental Housing Act, which among other things prohibits rent control ordinances on single-family homes and new construction after 1995 and authorizes local jurisdictions to govern the establishment of rental rates.

MAJOR PROVISIONS

- **Repeals Rent Control Limitations.** Repeals the Costa-Hawkins Rental Housing Act, which exempted from local rent control ordinances new property constructed after 1995, single-family homes and condominiums, and previously exempt property from local rent control ordinances.

- **Authorizes Rent Control on All Residential Property.** Allows local jurisdictions to impose ordinances restricting a landlord's right to establish and increase rental rates.

- **Allows Property Owners to Charge "Just and Reasonable" Rents.** The initiative will enshrine into statute the California Supreme Court's decision in *Birkenfeld v. City of Berkeley*, in which the court held that local governments have the authority to impose rent controls and set rental ceilings that do not abridge a landlord's rights to a just and reasonable return. However, the court did not define what constitutes "just and reasonable."

FISCAL IMPACT

An economic study predicts if rent control policies are put into place in high-cost areas of the state, there would be a reduction in property tax revenue of $230 million per year initially. This would compound over time, with a possibility of billions of dollars in lost property tax revenue.

BACKGROUND

Rent control allows governments to set rental price ceilings that seek to keep rental rates low. The practice can be traced back to World War I Europe and later in the United States during World War II when governments wanted to keep housing affordable during times of war. However, economists argue that these policies created more problems than solutions, since the policies inhibited new construction and promoted housing discrimination.

In the current second generation of rent control, local governments generally allow for rent increases over time. In some jurisdictions, inflation measures are used to control prices, and others allow rent adjustments to offset costs of improvements and increases in taxes and/or utility costs.

In California, cities did not have complete authority to impose rent control laws until the 1976 California Supreme Court ruling in *Birkenfeld v. City of Berkeley.* The court ruled that local governments have the authority to impose rent control ordinances under the jurisdiction of "police power." The court opined that "rent control is a proper exercise of a local government's police power if it is reasonably calculated to eliminate excessive rents and at the same time provide landlords with just and reasonable returns on their properties."

After the ruling, several local jurisdictions enacted various forms of rent control some of which were considered extreme and led to housing shortages.

In 1995, the California Legislature and the governor approved a bipartisan bill, AB 1164, that established the Costa-Hawkins Rental Housing Act.

The Costa-Hawkins Act allows owners in rent-controlled communities to establish initial rental rates when there is a change in occupancy (known as vacancy decontrol), and additionally sets four parameters for local jurisdictions imposing rent controls:

1. Any housing constructed after 1995 is exempt from rent control.

2. New housing that already was exempt from rent control laws in place before February 1, 1995, must remain exempt.

3. Single-family homes and other units like condominiums that are separate from the title to other dwelling units must be exempt from local rent control.

4. Rental property owners must have the ability to establish their own rates when a dwelling changes tenancy.

Today, 14 jurisdictions have some form of rent control ordinances on the books: Berkeley, Beverly Hills, East Palo Alto, Hayward, Los Angeles, Los Gatos, Mountain View, Oakland, Palm Springs, Richmond, San Francisco, San Jose, Santa Monica and West Hollywood.

POLICY CONSIDERATIONS

- **Decreased Rental Income for Property Owners.** Since rent control places a rent ceiling on rentals below market value, landlords receive less rental income on their properties. With less income, owners have less financial incentive to maintain or improve their properties. Over time, the properties deteriorate, resulting in lower property values.

- **Decreased Property Values.** Rent control affects not only the property value of the properties under rent control, but also nearby properties. A study conducted following the 1994 repeal of strict rent control policies in Cambridge, Massachusetts, found that property values increased 25 percent for those that had been under rent control ordinances and 16 percent for never-controlled properties nearby. The study found that rent control policies reduced property values 20 percent for those under controls and 14 percent for uncontrolled properties nearby. In California, decreased property values would have a direct, negative impact on revenue for schools and local services.

- **Decreased Property Tax Revenue.** Economic research shows that "strict rent control would reduce property values of controlled units by about 20 percent." Additionally, if strict rent control was applied to the coastal regions of the state (where property values and housing costs are higher), property tax revenue could reduce $230 million per year.

  Declining property values would result in less revenue for local government. Compounding the losses in property value, as developers become reluctant to build additional housing, fewer new properties would be added to the county rolls, further exacerbating the lost revenue. State and local governments face the possibility of losing billions of dollars in property tax revenue as a result of rent control policies.

- **Severe Market Distortions.** Rent control creates severe market distortions and disadvantages low-income renters, despite the policy's intention. Additionally, properties not under rent control face increased demand without further increased supply, thereby raising those rents higher than normal market value. This results in low-income renters being crowded out of rent-controlled apartments, and being unable to afford other nearby housing.

- **Less Rental Housing Supply.** Since rent control ordinances cap a landlord's ability to charge rent, developers and landlords receive less rental income. This results in the building of less housing supply, further exacerbating California's housing crisis.

- **Increased Litigation Costs.** This initiative requires the state attorney general to defend every jurisdiction involved in a lawsuit, potentially adding millions of dollars annually to the state's litigation costs.

- **Increased Costs to Local Governments.** Administrative costs are unknown, and are dependent upon each jurisdiction, but could be minimal or in the tens of millions of dollars per year depending upon the sophistication of a jurisdiction's policies.

- **Higher Local "Fees."** To pay increased administrative costs, local jurisdictions likely will create or increase taxes and fees on owners of rental housing or submit general tax measures to the voters for approval.

- **Changes in Constitutional State Budget Requirements (Proposition 98 Funding).** An analysis estimates that "40 percent of the total property tax reduction, $95 million per year, would be lost to school districts." Under Proposition 98, state government is responsible for backfilling the loss of property tax revenue to maintain a guaranteed minimum of funding. Over time, California's payment will increase, placing further strain on the general fund.

- **Effects on California's Pension System.** California's two main pension systems, the California Public Employees' Retirement System and the California State Teachers' Retirement System (CalPERS and CalSTRS), invest in real estate investment trusts (REIT) as a part of their portfolios. Currently, CalPERS holds 326 REITs, 20 of which own rental properties in California. Economic research estimates that this could lead to millions of dollars in additional unfunded liabilities. This could result in tax increases on California taxpayers, who ultimately are responsible for paying pension costs if the pension systems do not have sufficient funds.