

THE IMPACT OF RENT CONTROL POLICIES ON BAY AREA HOUSING SUPPLY: DEVELOPER PERCEPTIONS AND DEVELOPMENT CALCULUS



PURPOSE AND CONTEXT

As policymakers grapple with increased housing costs in the Bay Area, some communities have implemented rent control as a strategy to stabilize renter households. While there is general acknowledgement that many households benefit from rent control policies, there is debate about its impacts, including how rent control policies might influence new housing production. If a rent control policy stabilizes certain households while restricting new housing production, it might have unintended consequences for long-term housing affordability. Proponents and detractors of rent control policies continue to argue over the nature and magnitude of any impact on housing supply and affordability. This study seeks to understand how rent control policies might impact the supply of housing in the Bay Area.

METHODS

While many academic studies about the impacts of rent control exist, none focus specifically on the policy parameters that drive those impacts. To cut through conjecture and learn more about how rent control policies drive impact on new housing development, **ECONorthwest** worked with UC Berkeley's **Center for Community Innovation** on research funded by the **Silicon Valley Community Foundation** to fill this gap in the literature. We conducted a mixed-methods analysis to understand how different types of rent control policies might impact housing development feasibility. This

work included a review of academic and other literature; interviews with 12 developers, lenders, and real estate researchers; a regression analysis of historical transaction data from the Bay Area compared with different policy formulations; and detailed pro forma analyses of how different stringencies of rent control policies might impact the development feasibility of hypothetical multifamily developments in the Bay Area.

FINDINGS

✓ **California's existing anti-price gouging policy is different from what is typically thought of as "rent control," and has limited or no impact on the feasibility of new housing development.**

Under AB 1482, Bay Area cities are unlikely to see a measurable impact on feasibility for new development. Effective January 2020, AB 1482 limits rent increases to 5% plus inflation but does not supersede local rent control regulations. Because the policy does not apply for the first 15 years of the life of a building, it delays the impacts on building operations. In addition, AB 1482's high rent increase limit does not serve as a binding constraint on market rent increases. Delayed implementation and a high rent increase limit make it so that the policy has no measurable impact on development feasibility. This means that any mitigation strategies for the policy may not be necessary at this time.

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However, some developers are wary that the policy may become more stringent. Even if there are no foreseeable impacts to a building's operating income from AB 1482 or an existing local policy, if investors perceive that rent increases may become further limited or that the policy could eventually apply before year 15, they might start to account for the risk of these changes by rethinking their investment decisions.



Transaction data demonstrate that investors value properties subject to local rent control policies less than properties that are not subject to the policies, with the valuation impacts correlating with the stringency of the rent control policy.

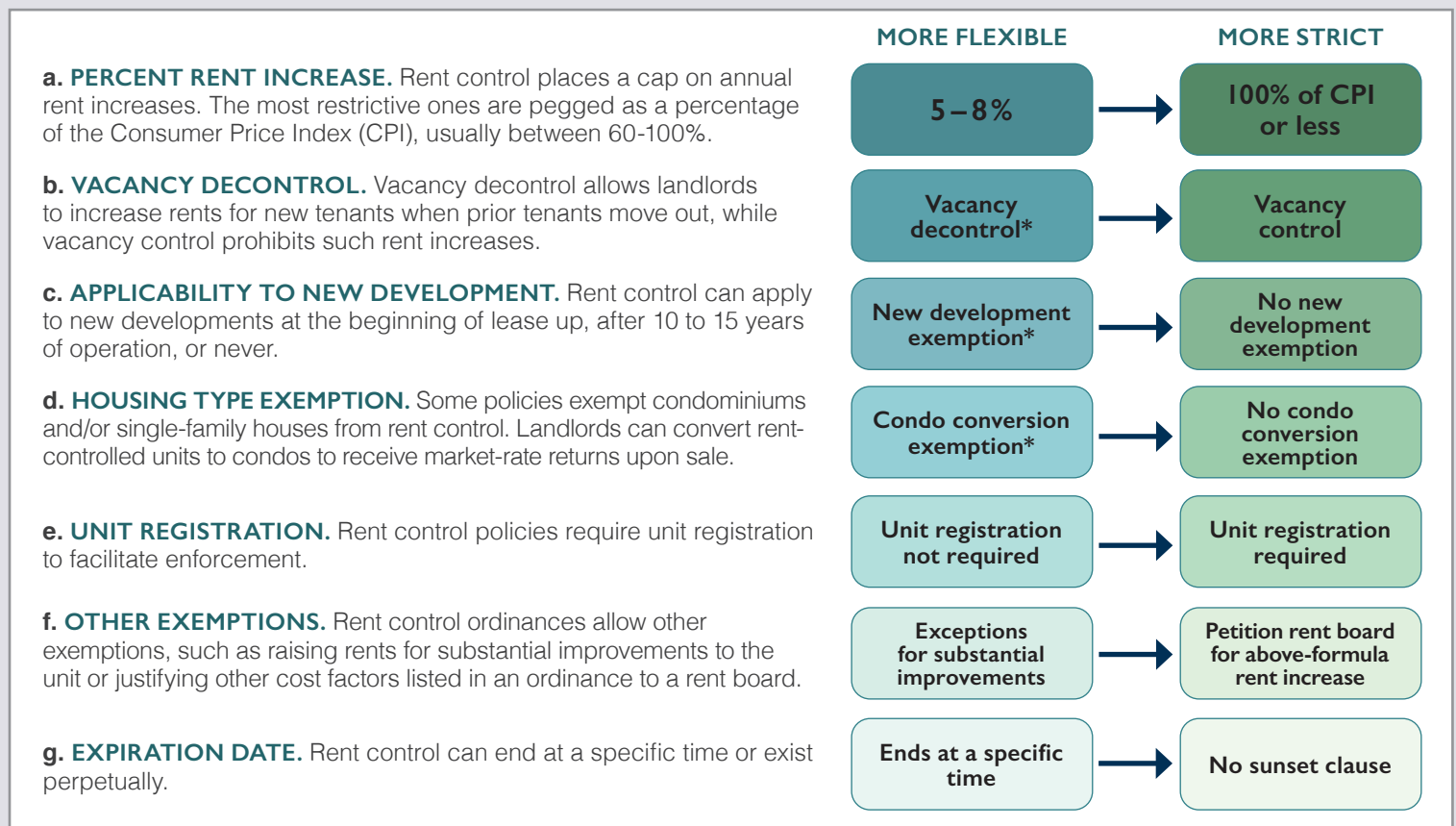
While new construction is not subject to pre Costa Hawkins¹ rent control policies, we ran an analysis that controlled for building age and other attributes to isolate the influence of rent control on valuations. We found a measurable perception of risk among investors related to existing rent-controlled buildings. This is because developers are wary of future policy changes to state and local rent control regulations that could impact a building's operating income. This impact was most prominent in San Francisco.



Changes to the current parameters of California's state-wide policy or local rent control policies could decrease the feasibility of new development.

The infeasibility of building under stricter rent control policies is driven by (1) the policy parameters themselves and (2) how developers and investors respond to these parameters. Exhibit 1 provides a summary of different policy parameters and examples of their various levels of stringency.

Exhibit 1. Rent Control Policy Parameters that Inform a Policy's Stringency



Source: ECONorthwest analysis; California Tenants' Rights (2016). Note: Three other policy parameters include rent rollback, eviction regulation, and rent control board composition. The asterisk (*) in the above graphic denotes levers that are limited by the Costa-Hawkins Rental Housing Act. This law limits rent control in California to buildings built before 1995, prohibits vacancy control, and exempts single family dwellings, condos, and new construction from rent control.



POLICY PARAMETERS

Of the policy parameters tested, the timing of when policy applies and the limit on annual rent increases had the biggest impact on feasibility of new construction:

- **Timing:** The market response for policies that apply starting in year 15 is different than for policies that apply in year 1. Based on our assumptions, our modeling shows a developer could pay approximately twice as much (and potentially more) for land subject to policies that impact new construction in year 15, as compared to the same parameters when applied at year 1.
- **Rent Growth Limit:** Many of the developers we spoke with said that AB 1482's rent growth limit of 5% plus inflation was above what they would model for underwriting. But there are precedent policies with lower rent increase limits, and some developers perceive that future legislation could lower AB 1482's limits.

HOW INVESTORS AND DEVELOPERS RESPOND

We found that even in the case of rent control policies with high annual rent increase limits, investors and lenders still factor some risk into how they value a property. This takes the form of:

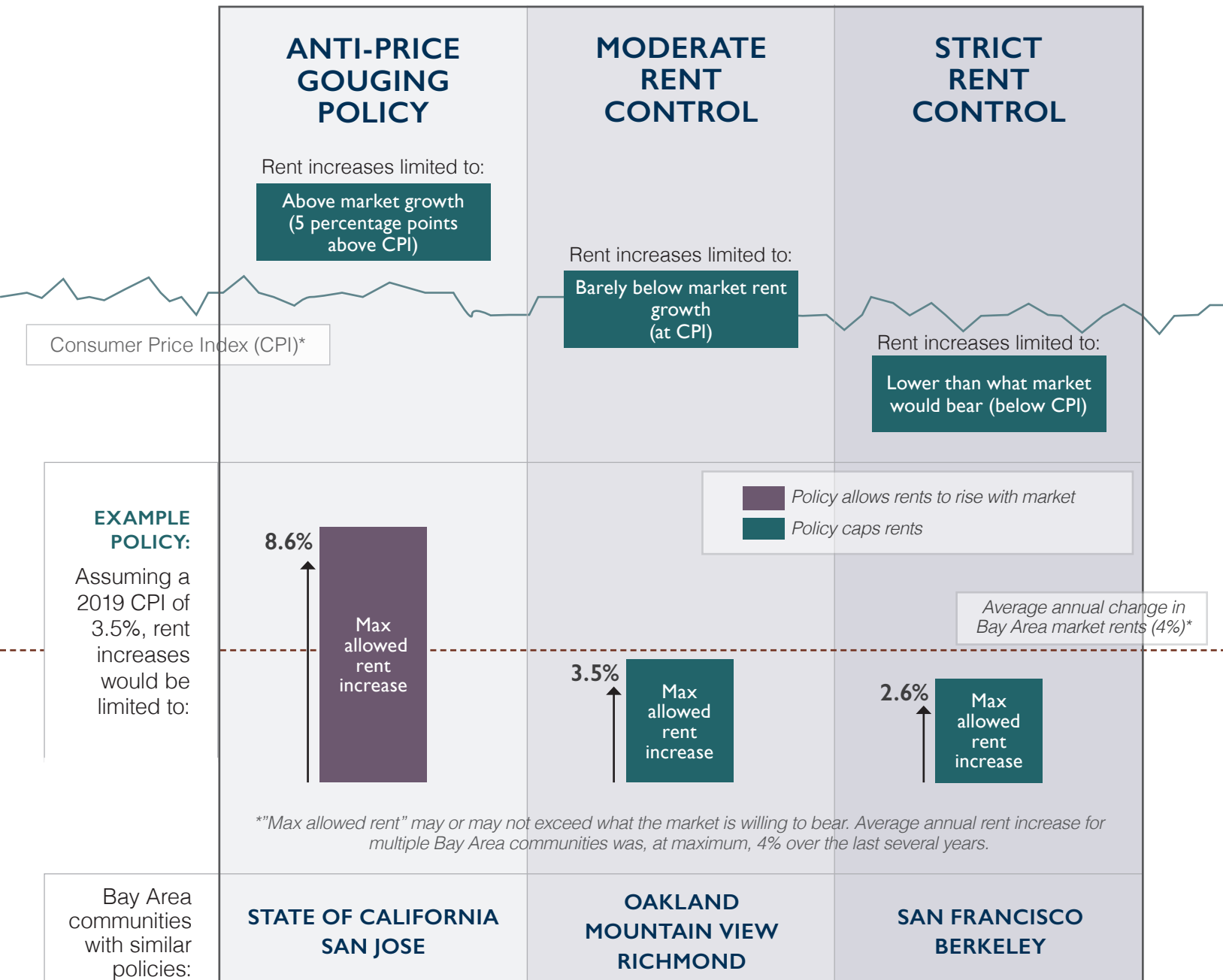
- **Risk Premiums on Building Valuation.** Our interviewees indicated that strict rent control policies could impact how much a potential buyer would be willing to pay, based on the (reduced) net operating income of the building. Developers confirmed that a building's value might be reduced upon sale for multifamily housing developments under a more stringent rent control policy.
- **Reduced Loan Amounts from Banks.** Lenders noted they would likely reduce the total loan amount relative to total value for new developments with a more stringent rent control policy.

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INFORMING A CLEAR DISCUSSION AROUND RENT CONTROL

Policymakers and stakeholders should more carefully differentiate between strict rent control and anti-price gouging policies, like California's Assembly Bill 1482. Exhibit 2 provides an initial framework that communities can think about to characterize existing and potential policies. We defined stringency as follows: an **anti-price gouging policy** is unlikely to constrain rent increases in the marketplace, a **moderate rent control policy** limits rents from rising more than what might be considered typical in the market, and a **strict rent control policy** might consistently limit rent increases.

Exhibit 2. Types of Rent Control Policies



NOTE: The Consumer Price Index (CPI) is a measure of inflation and provides information about the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

IMPLICATIONS

Developers that we interviewed were not opposed to anti-price gouging legislation because it does not reduce the feasibility of new construction. For the most part, developers were glad to see local rent control limitations remain in place that are limited to older buildings, because more stringent rent control policies could impact development. Our quantitative analyses confirmed that the nuanced concerns expressed by developers and lenders were correct.

Limits on rent increases are the key policy differentiator. If a lower rent increase limit were applied to new development, like San Francisco's rent control policy (60% of inflation), our analysis shows there would be a sharp decrease in development viability. The policies would have a direct impact on development revenues, and conversations with underwriters suggest they would influence how investors and lenders perceive the risk of funding a multifamily housing project

Developers will find other uses of land if policies are too stringent. Our financial modeling suggests that rental housing developers would have less capacity to pay for land and could therefore be outbid by other uses (such as commercial), which could impact the overall supply of housing.

RECOMMENDATIONS

Policymakers and stakeholders need to differentiate among the diverse policies they call “rent control.” Not all rent control policies are created equal. Policies have distinct parameters, each of which can be more or less restrictive: policies may have higher or lower rent increase limitations, offer fewer or more tenant protections, or apply to fewer or more units.

Future research should account for the specifics of each rent control policy. Research on the impacts of one specific rent

control policy in one specific housing market is unlikely to translate directly to another market with a different policy design or market context. To understand how a new policy might impact new housing production, one must consider the area's economic context and policy design.

Cities, housing advocates, developers, and others exploring rent control should be careful when using the literature to make claims about rent control's market distortion or neutral influence. Rather than staking out staunch “for” and “against” positions on rent control, we recommend that stakeholders focus on policy details because they matter considerably. Without clearly differentiating the varied types of rent control policies that exist, the policy discourse around rent control can be divided, with rent control advocates suggesting the policy will not impact development feasibility and the real estate industry strongly opposing rent control. This may reflect the fact that unclear descriptions of these varied tenant protection policies are used and the same “rent control” moniker is universally applied. Tenants' rights advocates are correct, and real estate interests agreed with them in 2019, that anti-rent gouging legislation would have little impact on development interests. However, the slippery slope toward more stringent rent control policies is concerning for real estate interests because more stringent policies would impact housing supply.

Policymakers should be aware that developers account for the threat of more restrictive policies when they are considering investments in California. This showed up specifically in the historical transaction analysis but also was a theme in our conversations with developers.

Local jurisdictions should continue to explore potential local incentives and statewide policies. A regional or statewide policy could help mitigate unintended effects of a rent control policy, including a policy that would allow a property owner to bank rent increases

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over several years. Other incentives might include tax abatements, flexible development standards, advantageous financing products, and direct subsidies. Such incentives could ensure that developers could achieve adequate investment returns and pay enough for land to incentivize landowners to part with their properties. This would allow new housing supply to continue at the same pace and in the same locations as was feasible before rent control was enacted.

AREAS FOR FUTURE RESEARCH

While our findings suggest that there would be relatively little impact from AB 1482 in California, the reality on the ground may differ. Real-world evidence is growing and could be studied. Potential ideas for future research include:

Oregon's establishment of a statewide rent control policy provides an interesting opportunity to look at the differences in development activity and trends between Oregon and nearby Clark County, Washington (which lacks a statewide rent control policy).

- **Comparison of adjacent communities with and without rent control.** To better understand the impacts of rent control policies on development, one could compare building transaction data for a community with rent control with an adjacent community without a rent control policy (controlling for age and other factors). This natural experiment would also allow researchers to observe the impact of rent control on values and development trends.

- **Further exploration of how different types of property owners are impacted by rent control policies.** We heard in our interviews that developers with access to funding from larger investment institutions (those that tend to build much of the new rental housing) have different perceptions of rent control than smaller developers (those who tend to buy existing projects and/or hold onto projects long term). Additional study would help jurisdictions to shape policies that mitigate potential impacts on rental housing supply.

CONCLUSION

While California's current rent control policies do not appear to impact new housing production, we found that the stricter local policies can have a large impact on property valuation. If they were applied to new development, they would make that development infeasible. In contrast, less strict policies would have a smaller impact; California's AB 1482 anti-price gouging policy, for example, has little or no impact on how developers think about new projects, and developers won't need any specific incentives or mitigations to offset impacts to development feasibility.

To support their position, proponents of rent control may cite studies that show a particular rent control policy had little effect on supply. To reinforce their opposition to rent control policies, detractors may look to evidence and theory based on strict forms of rent control that can have profound impacts on housing supply. Both proponents and detractors of rent control policies may be correct, depending on the rent control policy details.

1 The Costa-Hawkins Rental Housing Act was enacted in 1995, limiting the scope of rent control policies at the local level. The law limits rent control in California to buildings built before 1995 or the date of local rent control policy adoption, prohibits vacancy control, and exempts single-family dwellings and condos.

FULL REPORT

Carlton, Ian, Michelle Anderson, Renee Roy Elias, Carson Hartmann, James Kim, and Emily Picha. "The Impact of Rent Control Policies on Bay Area Housing Supply: Developer Perceptions and Development Calculus." Center for Community Innovation at UC Berkeley and ECONorthwest, 2021.

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Center for Community Innovation and the Urban Displacement Project. The Center for Community Innovation (CCI) is a research institute at UC Berkeley whose mission is to nurture effective solutions that expand economic opportunity, diversify housing options, and strengthen connection to place. CCI conducts community-engaged, data-driven research to understand the problems and identify solutions around pressing housing, land use, and urban sustainability issues. The Urban Displacement Project (UDP) is a research and action initiative of CCI that produces rigorous research to reframe conversations, empower advocates and policymakers, and train and inspire the next generation of leaders in equitable development.

ECONorthwest. ECONorthwest is a consulting firm based in the Pacific Northwest that specializes in economics, finance, and planning. ECONorthwest serves a range of public and private sector clients across the United States: business management and labor unions; conservationists and energy companies; public planning departments and private developers; litigation plaintiffs and defendants.

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