LAO

June 10, 2019

Hon. Xavier Becerra
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Anabel Renteria
Initiative Coordinator

Dear Attorney General Becerra:

Pursuant to Elections Code Section 9005, we have reviewed the proposed statutory initiative pertaining to rent control (A.G. File No. 19‑0001).

Background

Rental Housing Is Expensive in California. Renters in California typically pay 50 percent more for housing than renters in other states. In some parts of the state, rent costs are more than double the national average. Rent is high in California because the state does not have enough housing for everyone who wants to live here. People who want to live here must compete for housing, which increases rents.

Several Cities Have Rent Control Laws. Several California cities—including Los Angeles, San Francisco, and San Jose—have laws that limit how much landlords can increase rents for housing from one year to the next. These laws often are called rent control. About one-fifth of Californians live in cities with rent control. Local rent boards administer rent control. These boards are funded through fees on landlords.

Court Rulings Limit Local Rent Control. Courts have ruled that rent control laws must allow landlords to receive a "fair rate of return." This means that landlords must be allowed to increase rents enough to receive some profit each year.

State Law Limits Local Rent Control. A state law, known as the *Costa-Hawkins Rental Housing Act* (Costa-Hawkins), limits local rent control laws. Costa-Hawkins creates three main limitations. First, rent control cannot apply to any single-family homes. Second, rent control can never apply to any newly built housing completed on or after February 1, 1995. Third, rent control laws cannot tell landlords what they can charge a new renter when first moving in.

State and Local Government Tax Revenues. Three taxes are the largest sources of tax revenue for the state and local governments in California. The state collects a personal income tax on income—including rent received by landlords—earned within the state. Local governments levy property taxes on property owners based on the value of their property. The state and local governments collect sales taxes on the retail sale of goods.

Property Sales Drive Increases in Property Taxes. A property's taxable value is based on its purchase price. In the year a property is purchased, its taxable value is its purchase price. Each year after that the property's taxable value is adjusted for inflation by up to 2 percent. This continues until the property is sold and again is taxed at its purchase price. In most years, the market value of most properties (what they could be sold for) grows faster than 2 percent. This means the taxable value of most properties is less than their market value. Because of this, the taxable value of a property typically increases when the property is sold and its taxable value is reset to its purchase price.

Proposal

Narrows Costa-Hawkins. The measure narrows the limits on local rent control laws in Costa-Hawkins, allowing cities and counties to apply rent control to more properties than under current law. Specifically, cities and counties can apply rent control to all housing that is more than 15 years old, with the exception of single-family homes owned by landlords who own no more than two properties. In addition, cities and counties can limit how much a landlord can increase rents when a new renter moves in. Communities that do so must allow a landlord—should the landlord wish—to increase rents by up to 15 percent during the first three years after a new renter moves in.

Requires Fair Rate of Return. The measure requires that rent control laws allow landlords a fair rate of return. This puts the results of past court rulings into state law.

Fiscal Effects

Economic Effects. If communities respond to this measure by expanding their rent control laws it could lead to several economic effects. The most likely effects are:

- To avoid rent regulation, some landlords would sell their rental housing to new owners who would live there.
- The value of rental housing would decline because potential landlords would not want to pay as much for these properties.
- Some renters would spend less on rent and some landlords would receive less rental income.
- Some renters would move less often.

These effects would depend on how many communities pass new laws, how many properties are covered, and how much rents are limited.

Changes in State and Local Revenues. The measure's economic effects would affect property tax, sales tax, and income tax revenues. The largest and most likely impacts are:

- ***Less Property Taxes Paid by Landlords.*** A decline in the value of rental properties would, over several years, lead to a decrease in property tax payments made by owners of those properties. On the other hand, increased sales of rental housing likely would result in higher property tax payments. Revenue losses from lower property values would be larger than revenue gains from increased sales. Because of this, the measure would reduce overall property tax payments.
- ***More Sales Taxes Paid by Renters.*** Renters who pay less in rent would use some of their savings to buy taxable goods.

- ***Change in Income Taxes Paid by Landlords.*** Landlords' income tax payments would change in several ways. Some landlords would receive less rental income. This would reduce their income tax payments. On the other hand, over time landlords would pay less to buy rental properties. This would reduce expenses they can claim to lower their income tax payments (such as mortgage interest, property taxes, and depreciation). This would increase their income tax payments. The measure's net effect on income taxes paid by landlords in the long term is not clear.

Overall, the measure likely would reduce state and local revenues in the long term, with the largest effect on property taxes. The amount of revenue loss would depend on many factors, most importantly how communities respond to this measure. If, for example, communities that already have rent control expand their rules to include newer homes and single-family homes, revenue losses could be in the tens of millions of dollars per year. If many communities create new rent control rules, revenue losses could be larger. If few communities make changes, revenue losses would be minor.

Increased Local Government Costs. If cities or counties create new rent control laws or expand existing ones, local rent boards would face increased administrative and regulatory costs. Depending on local government choices, these costs could range from very little to tens of millions of dollars per year. These costs likely would be paid by fees on owners of rental housing.

Summary of Fiscal Effect.

- Potential reduction in state and local revenues of tens of millions of dollars per year in the long term. Depending on actions by local communities, revenue losses could be less or more.

Sincerely,

Gabriel Petek
Legislative Analyst

Keely Martin Bosler
Director of Finance