

Cap Rates Are Already Rising In Markets With New Rent Control Laws

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When New York passed a **sweeping set of rent control regulations** earlier this year, multifamily investors and landlords saw it as a catastrophe.



Capping the amount that a landlord can increase rent is far from a new concept, but its **rapid rise in popularity** among urban activists has put **political pressure** on cities and states to take action. The result has been **plummeting confidence** from investors and lenders in the current value of multifamily assets, a **new study** from **Real Capital Analytics** found.

“It was worse than expected,” Hornig Capital Group Managing Partner Daren Hornig said. “Once this law went into place in New York, it’s been **horrific** and there’s no way to work

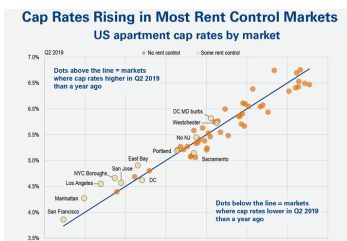
around it. There’s no upside.”

Hornig, a developer who has invested in and built apartment and office projects in New York City, Ohio and Florida, said he intends to look in other markets for apartment investment as long as New York’s law is on the books.

“Now, **nobody wants to buy** that type of product, and banks don’t want to finance it,” he said. “[Multifamily] went from the most valuable asset class in the city to arguably the worst asset class in the city, and owners have lost billions of dollars in value.”

Last week, California’s state legislature **passed a bill** creating a statewide cap on annual rent increases at 5% plus inflation, while making it more difficult for landlords to evict tenants. Gov. Gavin Newsom, who was deeply involved in negotiating and strengthening the bill, is expected to sign the bill, **Bisnow reports**.

If the law takes effect Jan. 1, California will join Oregon as the **only states** to not just permit **rent control**, but require it — the vast majority of states still require a city to gain state approval before imposing rent control, **according to The New York Times**.



While the New York regulations were enacted at the state level, they don't apply to the entire state, and a statewide rent control measure **failed to pass** the statehouse in Colorado this spring. Massachusetts' and Florida's legislatures recently introduced measures for their larger cities akin to that in New York, the Times reports. The movement is also gaining speed politically: at a campaign stop on Saturday, presidential candidate Bernie Sanders debuted a \$2.5 trillion affordable housing plan that would make rent control a federal policy, **the Times reports**.

Investors may react similarly to how Hornig and **his counterparts in New York** have, U.S. **National Multifamily Housing Council** Vice President Jim Lapides said. “Developers are like water, and will flow towards the path of least resistance,” Lapides said. “And that path may lead many to leave California.”

Some investors who prefer to stay in familiar markets may look to other asset classes, Lapides and Hornig said. Though Hornig himself plans to stick to multifamily as he searches farther afield from New York, he said he doesn't believe other asset classes in his home city will follow multifamily down in value.

In the 12-month period ending with Q2, multifamily cap rates have risen in 83% of major cities with rent control

regulations, the RCA report stated. Only 41% of markets without rent control have seen cap rates increase over that same time frame. To RCA Senior Vice President [Jim Costello](#), that disparity underscores investors' reluctance to deploy capital in rent-controlled cities.

"Investors and lenders are repricing assets in markets where rent control exists or is being introduced," Costello wrote in the RCA report.

Though landlord lobbying group California Apartment Association did not oppose its state's bill in its latest form, according to the Times, the similar California Rental Housing Association has been loud in its own opposition.

[Landlords have also appealed](#) the New York law in federal court. In both cases, it may take more time for market pricing to fully adjust to the new reality.



"Cap rates are unknown right now, because no one wants to buy" multifamily assets in New York, Hornig said.

Despite the longest economic recovery in modern U.S. history after the Great Recession, wages have only [started to meaningfully increase](#) in the past year for most Americans. Rents have grown steadily for a decade, especially in [primary markets](#) like [New York](#), San Francisco and Los Angeles.

"The rent is, in fact, too damn high, and I want to stress that," Costello told *Bisnow*. "But [rent control] isn't going to solve it — you're scaring off lenders that would be the source of financing for the multifamily market, because they're not sure how much it is going to change."

Rent control's effectiveness at preserving housing affordability has been hotly debated. Community activists and progressive politicians have increasingly regarded landlords and developers as their [enemies in the battle](#) for affordable housing, but 86% of Americans favor increased investment into the new construction of affordable units, a [CityLab survey found](#).

California and New York have been the sources of perhaps the loudest calls for rent reform, and both movements recently produced legislation. But neither Hornig, Costello or Lapidès consider the matter settled, saying that uncertainty about future changes is still the biggest concern among potential investors.

"One would hope that these laws provide some certainty, but within a week of Oregon passing statewide rent control legislation, advocates started pushing for a tighter cap," Lapidès said. "In California, there is already a [2020 ballot measure in the works](#) designed to expand rent control.

"So while one would hope that there is more certainty with this legislation, instead you have a climate that is only generating more and more concern."

CORRECTION, SEPT. 18, 12:15 P.M. ET: *A previous version of this article misstated the opposition to California's rent control bill. This article has been updated to note that the California Rental Housing Association publicly opposed the legislation.*

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