By Nicholas Leider

UNDER CONTROL

Rent control is a hot topic in the multifamily sector, but regulation might lead to counterproductive unintended consequences.

Last year, California and Oregon became the first two states to pass rent control legislation. New York has regulated the rental market for decades, with a new statewide bill the latest in a line of state and local ordinances popping up since World War II. The goals of such actions — maintaining affordable housing, minimizing displacement, and discouraging gentrification — are commendable.

But the implications of rent control can be self-defeating. A 2019 study by Stanford University economists found such measures in San Francisco limited mobility by 20 percent and reduced investment in properties by 15 percent. It also stated, "the lost rental housing supply likely drove up market rents in the long run, ultimately undermining the goals of the law."

COMMERCIAL INVESTMENT REAL ESTATE PODCAST

For our February episode of the *Commercial Investment Real* Estate podcast series, we spoke with Spencer Levy, chairman of Americas research and senior economic advisor for CBRE. Levy delved into the issues and implications surrounding rent control, what CRE professionals can do in response to such regulations, and how development can limit rent increases by supplying more affordable housing.

***CIRE:* CITIES ACROSS THE COUNTRY HAVE BEEN IMPLEMENTING DIFFERENT STRATEGIES TO CONTROL RISING RENTS, SO WE WANT TO EXAMINE THE CURRENT AND FUTURE IMPLICATIONS FOR COMMERCIAL REAL ESTATE PROFESSIONALS. COULD YOU GIVE US A QUICK HISTORY OF HOW WE GOT HERE, WHERE RENT CONTROL MEASURES ARE HOT TOPICS IN MANY URBAN AREAS?**

SPENCER LEVY: We've been studying rent control now going back over 100 years, starting in London. Quite candidly, when rent control first became an issue a century ago, there were many more rental units than there are today. We have found that rent control — while certainly it is coming from the right place in terms of intention and trying to do the right thing — ends up being self-destructive in terms of eliminating additional supply. We also see it crimping the capital flows into existing units, to the extent that you are limited in the amount you're able to raise rents even if there is a new capex. We've arrived at this point because of an affordable housing crisis, but rent control is a solution that's being offered that I think is more destructive than constructive. The most constructive solutions are those that increase supply — not those that decrease capital flows.

***CIRE:* IN PLACES LIKE NEW YORK AND SAN FRANCISCO, WHERE RENT CONTROL IS A REALITY, HOW CAN DEVELOPERS AND INVESTORS INCORPORATE THESE REGULATIONS IN PROJECTIONS FOR COSTS AND REVENUES?**

LEVY: Well, that's really the biggest risk factor from an investor's or developer's view — the uncertainty of what's coming next. How much more are they going to restrict my ability to take a unit to market rate pricing? How are they going to restrict my ability to make capital improvements to the building and be able to pass that along to both investors and tenants? The best thing a developer can do is be very politically aware, be politically savvy of what's happening on the ground, and do their best to underwrite it. Some places have seen a restriction in capital flows, in part due to these rent controls, which have materially changed the dynamic of the marketplace. That could create opportunity for some folks who see through these issues, but for many, it has caused them to pull back on capital in some of the more restrictive markets.

***CIRE:* IF LEGISLATION AND REGULATION AREN'T THE ANSWER, WHAT CAN THE CRE INDUSTRY DO TO CONTROL INCREASING RENTS?**

LEVY: I'm going to give a shoutout to Minneapolis, if I can. Why Minneapolis? Well, not because I was there three weeks ago and had a great time with some terrific people. I'm giving Minneapolis a shoutout because they did what I consider to be the most constructive solution to this problem, one that I would like to see implemented all over, which is they changed their zoning laws withing city limits. In single-family areas, you're now able to go upward several floors to create more vertical density. This is precisely the type of solution that they tried to do in California, but it was shot down by the state legislature when they were trying to do it near transit-oriented developments in suburban areas. In the absence of going vertical, you're going to see more suburban

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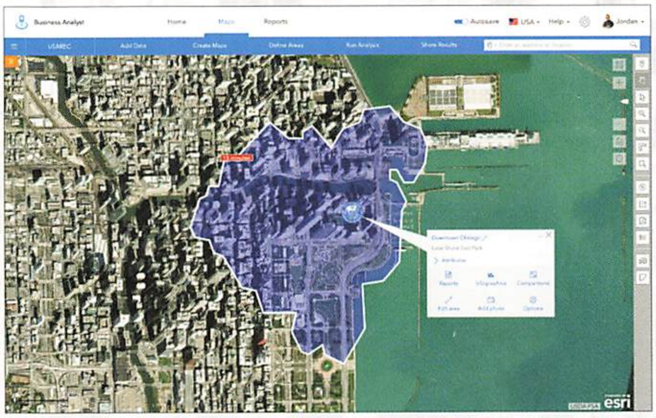

1 Bring your data into context.

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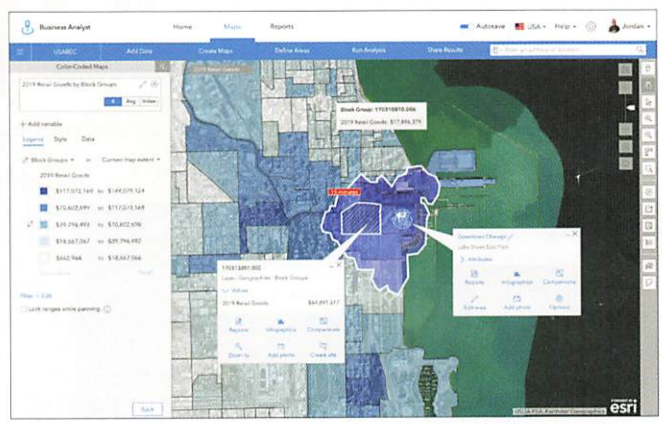
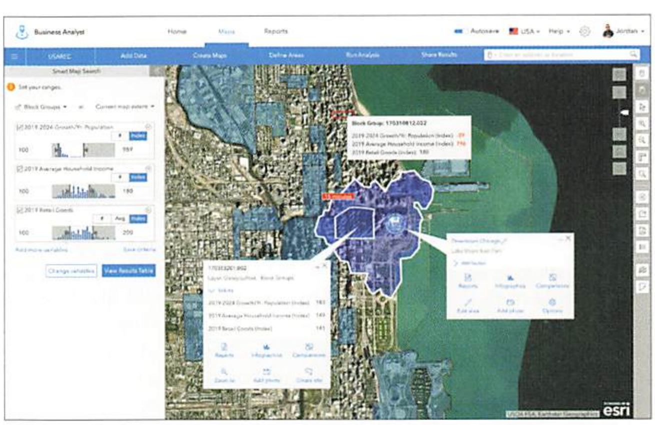


2 Locate gaps.

Identify the gaps and opportunities that others have overlooked.



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sprawl, you're going to see more single-family homes, and you're going to have a continued affordable housing crisis. What I suggest to everybody else — and I'll say it again right now — is that the sky is the solution. Vertical density is the solution to the affordable housing crisis, and the best way to solve that issue is to change the restrictive single-family zoning restrictions. This is what Minneapolis has done, and it's a great initiative.

CIRE: IN MARKETS WHERE RENT CONTROL IS ALREADY AN ISSUE OR IS BEING DISCUSSED, HOW CAN OWNERS AND OPERATORS PLAN FOR CAPITAL EXPENDITURES KNOWING THEIR INCOME IS SOMEWHAT CAPPED?

LEVY: Well, that's the challenge. It really comes down to what you are willing to not only pay for your building if you're buying into the market, but what you are going to pay for capex in that building. And you probably are capped at a certain level. The downside of that isn't just you're not going to put capex in; the real downside is you're not employing the plumbers, the carpenters, and the other trade professionals who would have done the work. It has this trickle-down negative impact not only on not creating more affordable housing units, more updated modern units. It also destroys jobs for trades that would have worked on these units.

CIRE: YOU MENTIONED THE SOLUTION IS IN THE SKY FOR MARKETS LIKE MINNEAPOLIS. BUT IN URBAN AREAS WHERE RENT CONTROL IS ALREADY AN ISSUE, WHAT CAN BE DONE TO BOOST AFFORDABLE HOUSING?

LEVY: There are a lot of creative solutions out there. I'll give you a few examples that might sound a bit off the wall, but they are real proposals. Hong Kong is proposing an $80 billion island right in the middle of the harbor to build more affordable housing. Copenhagen is proposing to put a $20 billion island in the middle of the harbor to build affordable housing for 35,000 people. Every time I go to San Francisco, I take a look out of the CBRE office and I see Treasure Island, which is between San Francisco and Oakland, right under the Bay Bridge. I ask myself, why isn't that being developed for affordable housing? Right now, it's completely underdeveloped, with a few military bases on it. To me, that's Exhibit A of where we should look to build. I would also support changing zoning laws to allow more affordable density.

CIRE: OUTSIDE OF MULTIFAMILY, ARE OTHER MARKET SECTORS FACING CHALLENGES RELATED TO RENT CONTROL, WHETHER IT BE OFFICE, RETAIL, OR INDUSTRIAL?

LEVY: These other sectors don't seem to produce the same political will to cap rents. But at the same time, we are seeing, in certain markets, changes in tax assessments on office buildings, in particular, which shift some of the burden from single-family onto [the office sector]. This has the same essential implication of rent control by increasing taxes on commercial buildings (as opposed to capping revenue). You are essentially putting a lid on rent growth in those markets.

CIRE: FROM A PUBLIC RELATIONS STANDPOINT, WHAT CAN THE INDUSTRY DO TO SHOW RENT CONTROL ISN'T THE ANSWER?

LEVY: Affordable housing needs to be a consideration, but these legislation and regulation initiatives are not the way to get it done. I'll say this in a humorous way, even though it's a serious issue — but the issue isn't Gordon Gekko who's preventing new affordable housing units, though a lot of people like to think so. The issue is, for example, a little old lady in Pasadena who through NIMBYism, or not-in-my-backyard-ism, will simply not allow the vertical density in her community. In the absence of loosening these restrictions, I think we're going to be in a fight of misperception that it's the industry that's somehow at fault, that we are not willing to build these units. There is nothing further from the truth. If you give us the ability to build, we will. But if we can't, the restrictions are such that land then gets more expensive. It's an unfortunate vicious cycle. As you restrict the availability of inexpensive land to build, the other land gets more expensive, and you build even less affordable housing units because you have to build with a certain amount of rent to recoup your land costs.

CIRE: AS FAR AS THE HESITATION TO BUILD VERTICALLY, IS THAT RELATED TO A LACK OF INFRASTRUCTURE TO MATCH THE INCREASED DENSITY?

LEVY: There's some of that. But there are some very good people who don't want to have vertical density in their communities for bad reasons — and those reasons are not allowing, quite candidly, people of a lower socioeconomic strata to live in their communities and go to their schools. That's the No. 1 reason why we don't see a lot of vertical density. It's unfortunate, but it's out there. The infrastructure issue is solvable. How? It's solvable because, even in California, when they were looking at putting additional vertical density into these communities, it was going to be near transit stops in Los Angeles. Actually, L.A. has been at the forefront of actually getting some of this stuff done, trying to change the zoning laws near transit stops. But suburban communities within California shot it down, even near transit stops. To me, the infrastructure issue is solvable by building more density, expanding out from urban centers to suburban transit areas.

CIRE: THE INDUSTRY, BY ITS NATURE, IS GOING TO BE HESITANT TO AGREE TO RENT CONTROLS AND INCREASED REGULATIONS. BUT WHAT'S A PLAN B FOR CRE PROFESSIONALS? HOW CAN WE LET COMMUNITIES KNOW THAT BOTH AFFORDABLE RENT IS AN ISSUE AND RESPONSIBLE DEVELOPMENT IS ALSO POSSIBLE?

LEVY: All I can say is that your city is immobile, but capital and talent can go anywhere, and it will go where it's most efficient. Those cities that are going to be most restrictive in their ability to attract new capital and new development are eventually going to get left behind.

Spencer Levy

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MARKET TRENDS

COWORKING INSTABILITY TEMPERS OFFICE LEASING ACTIVITY

Considering the headine-grabbing troubles of WeWork in late 2019, leasing activity in office spaces were expected to see consequences. According to a JLL's office outlook for 2020, coworking dropped from a primary driver of tenant demand to an afterthought in 4Q2019. The tech sector leased the largest amount of office space by far, accounting for 23.58 msf compared to runner-up finance/insurance's 15.93 msf.

Deliveries will continue to roll in through 2020 and 2021, which could boost vacancy in highly competitive markets like Silicon Valley; Austin, Texas; and Charlotte, N.C. More mature markets like Chicago, New York, and Washington, D.C., could face diminished absorption compared to additions in supply. But tight markets such as San Francisco (5.6 percent vacancy), New York (7.3 percent) and Grand Rapids, Mich., (8.7 percent) seem primed for additional supply.

VOLUME UP, PRICES DOWN IN LAND DEALS FOR 2020

The good news: The size and volume of land sales increased from October 2018 to September 2019 by 2.2 percent and 2.1 percent, respectively, according to the 2019 Land Market Survey by the National Association of REALTORS®. The not quite as positive news: The 826 respondents expected volume to increase another 2.2 percent in the next year, but price growth to drop to 1.6 percent.

Other key factors include:

- Due to reduced sales of timber, recreation, and land sales, the median land sale decreased in size by 47 acres.
- The median price per acre of land in transactions jumped $1,000 to $5,500, due primarily to a boost in residential sales.
- CCIMs represented 9.5 percent of respondents this year, compared to 7.4 percent the previous survey.

RESTAURANTS STREAMLINE FOOTPRINTS FOR DELIVERY-ONLY SERVICE

Off-premise dining has been on the upswing for years, with third-party delivery options and app-based ordering services making it easier to ditch the restaurant for the couch. The latest trend ditches dine-in and takeout options altogether. These so-called ghost kitchens operate entirely for delivery services. Such operations allow restaurant chains to reduce real estate overhead and employment while reaching new customers with new products.

According to the National Restaurant Association's 2019 survey, compared to the previous year, 39 percent of consumers are using drive-thru more often, 34 percent are using delivery more often, and 29 percent are more likely to order takeout. In response, major chains, like Red Lobster and Chick-fil-A, and smaller operations, like high-end sushi in New York, are exploring ghost kitchens.

EAT, SLEEP, PLAY AT VIDEO-GAME HOTEL

If you had any question that gaming has gone mainstream, Atari announced plans to build video game-themed hotels across the United States, with the goal of breaking ground on an initial location in Phoenix later this year. According to a Jan. 27 release, Atari Hotels plans to include immersive entertainment and virtual reality experiences for various demographics and gaming abilities.

The locations will also feature venues and studios to accommodate esports, a growing industry with an estimated 1.57 billion participants worldwide spending $152.1 billion on games, representing an annual increase of 9.6 percent. Atari is partnering with True North Studio, a Phoenix-based real estate developer, and GSD Group, an innovation and strategy group.

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