

SPECIAL REPORT

Prospective Rent Control in Boston

April 2022

Rent Control Debate Heats Up in Boston

The prospect of rent-regulating legislation raises concerns. Apartment rent control discussions are occurring across the country and have the potential to notably alter the nation's multifamily investment landscape. The inability to raise rents in line with rapid cost increases creates numerous issues for multifamily properties, apartment renters and investors. By artificially limiting future potential income, rent controls can dissuade development. The imposition of rent regulating measures may also prompt property owners to convert rentals to for-sale condominiums. Both outcomes constrain inventory, which runs counter to the common objective of rent control legislation to provide for more, affordable housing options. The impact of rent regulations on property operations may also impact the individual outlook and quality of properties over time. As such, investment flows could shift geographically. Capital might move away from the places with the most stringent regulatory restrictions, even in the face of robust rental demand drivers, and toward locations that offer more open market environments. Any or all of these factors could come into play in the city of Boston, which is now considering implementing rent regulations.

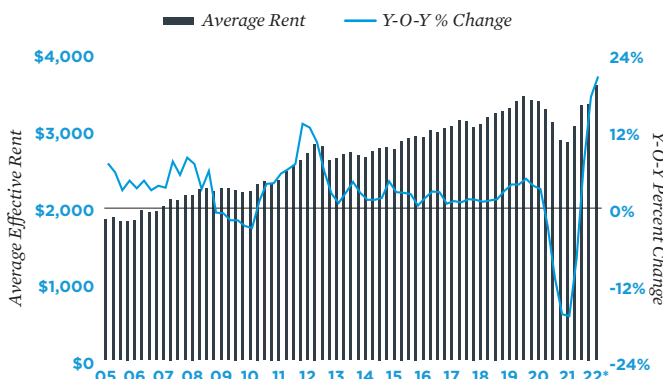
Recent rent control enactments elsewhere offer insights for Boston.

Rent controls have existed in several major markets over the years, but recently, multiple U.S. locations have implemented new regulations. In 2019, the state of New York made meaningful changes to current laws, while the state of Oregon implemented statewide controls. Most recently, the city of St. Paul enacted rent growth caps of 3 percent, including for new construction — one of the most stringent laws in the country. How these regulations have impacted the operations and investment of apartments in these settings offers insight into what could be in store for Boston in the future.

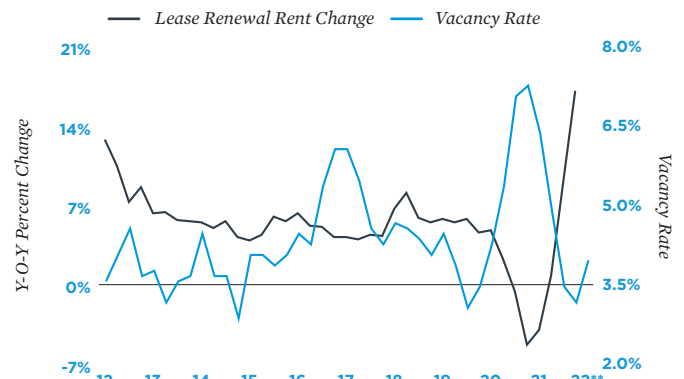
History of Rent Control in Boston

- Rent control was repealed in Boston in 1994, when voters determined that putting constraints on rent growth discouraged construction and lessened availability.
- Boston Mayor Michelle Wu, elected in late 2021, has brought this topic back into the main political discourse.
- A proposal was turned down by the Massachusetts Legislature at the beginning of 2022. Governor Charlie Baker indicated at the time that he would likely veto any pricing restriction plans that made it to his desk.
- Mayor Wu has since formed a local Rent Stabilization Advisory Committee to prepare recommendations on actions to take in addressing housing cost burdens.
- If Massachusetts legislators again reject proposals in early 2023, Boston officials can file a home rule petition that would allow the city to establish its own set of guidelines for rent pricing.
- The commonwealth legislators and the Massachusetts governor would still have to agree to the city of Boston's exemption from the set of rules in place elsewhere.

City of Boston Rent Trends



City of Boston Leasing Trends



* Preliminary estimate through 1Q
** Preliminary estimate through 1Q for vacancy rate;
lease renewal rate changes as of 4Q 2021

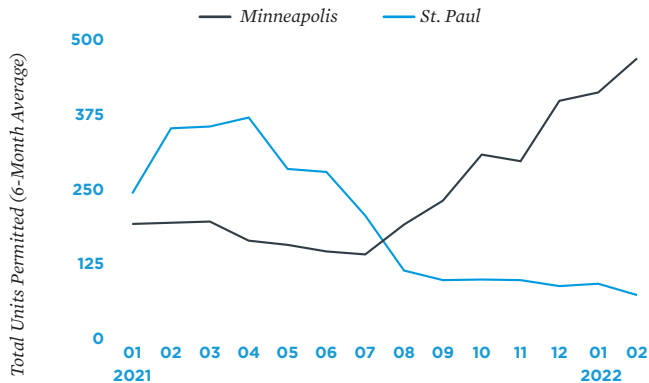
Rent Control in Boston Poses Risks to New Development

Precedent exists, implying rent regulations can limit construction. The implementation of rent control can create incentives that curtail development. To avoid this outcome, local officials generally exempt properties completed in recent years from rent cap rules. Definitions of newer properties vary quite a bit from one location to another, and regardless of intentions, at least some pullback in construction tends to occur. Development has come to a near-complete halt in St. Paul, Minnesota, where voters approved some of the nation's most restrictive rent control rules last November. Likewise, there have been no recent building initiations in Santa Ana, California, which late last year became the first city in metro Orange County to put rent control regulations in place. While apartment openings were already rare in St. Paul and Santa Ana, similar statistics have been observed in metro Portland, where development is generally more active.

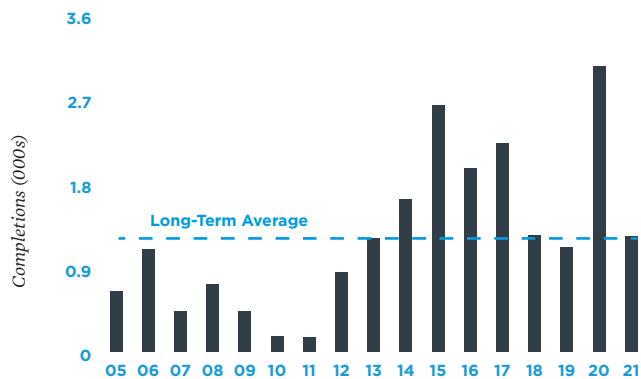
Pronounced permitting slowdown in Portland a caution for Boston. State-wide rent control was initiated in Oregon in 2019. Metro Portland's volume of multifamily permitting activity had been trending upward, prior to that introduction. The annual approval volume peaked at nearly 11,000 units in spring 2018; however, the permit tally immediately slowed when rent control went into place, cooling to a low of 4,200 units approved in the year-ending spring 2021. While there has been some uptick of late, early 2022's annual permit total of roughly 6,500 units remains well under what was seen prior to the introduction of rent control. If similarly stringent regulations were put in place in Boston, permitting activity would likely trend in the same direction. This could be a problem for the metro, as, like many of these markets, residents in the area are dealing with limited housing availability.

City of Boston already contending with limited available rental supply. As is the case for much of the nation, all types of housing are in short supply in Boston. Construction in the area has been limited for decades. Minimal site availability, high development costs and an involved approval process make it difficult to deliver more product. Going back to 2005, market-rate apartment additions in the city of Boston have averaged just about 1,200 units annually. While deliveries did increase to some degree beginning in 2014, the pace of arrivals really picked up only recently. The most product finished in any single year was some 3,000 units finalized in 2020. Ongoing construction coming into 2022 was held to only 2,635 units. Before the health crisis, the city's apartment stock remained virtually full all the time. The local vacancy rate averaged 3.8 percent from 2005 to 2019. Vacancy rose to 7.2 percent in late 2020, as some net move-outs occurred when COVID-19 emerged, the same time that completions reached their recent peak; however, the window of greater availability shut very quickly. Vacancy moved back down to 3.9 percent by early 2022, aligning roughly with the city's long-term norm.

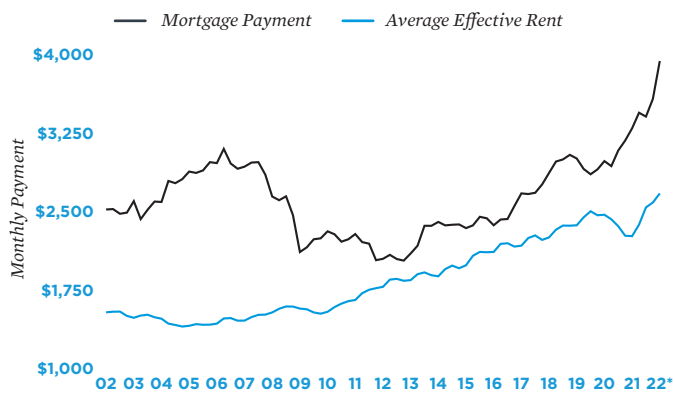
Rent Control Impact on Permitting



City of Boston Apartment Construction

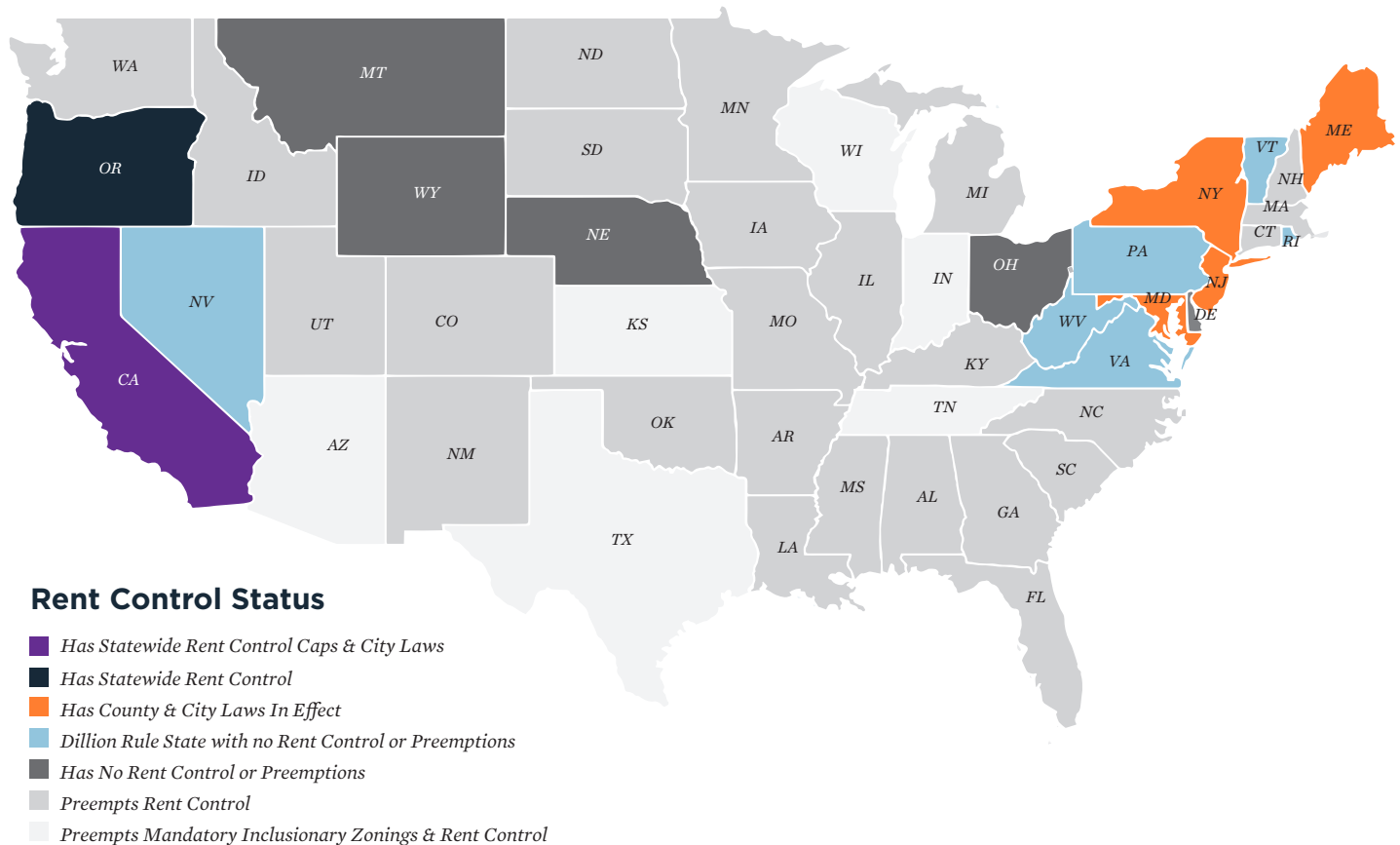


City of Boston Cost of Housing Trends



* Preliminary estimate as of 1Q 2022

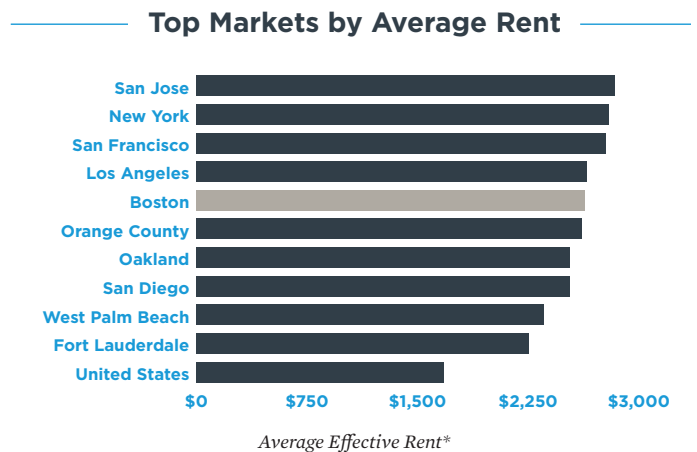
Rent Control Laws by State



Limited Supply Adds to Rent Pressure

Rent regulations could lead to more conversions. Rent control can cause existing unit counts to backtrack if some of the standing rental stock is converted to for-sale condominiums. Properties that are not yet, but soon will be, subject to rent control rules are especially ripe for upgrade and conversion to for-sale condos. Active projects that complete within roughly five years of rent control introduction can also be good candidates for condominium conversion. In a limited construction environment like the city of Boston, conversions of existing apartments to for-sale product could erase the rental stock built throughout the recent past within a short time frame.

Limited inventory fosters high rents. About 25 percent of metro Boston's apartment inventory, or roughly 100,000 units, are within the city of Boston. The typical monthly payment in that area reaches \$3,580, approximately 36 percent over the metro average and a 113 percent premium to the U.S. norm of \$1,681. The metro-level monthly rent is a little under the \$2,800-per-month pricing zone found in metro New York, San Francisco and San Jose, while aligning with the rates in Los Angeles and Orange County. A decrease in available apartment stock would add further upward pressure to market rates for a metro that is already in the upper echelon from a price point perspective.



* Preliminary estimate as of 1Q 2022

Product Quality Could Suffer

Limiting income affects ability to provide maintenance. Deterioration of product quality is another downside risk that tends to be associated with rent control. Some property owners may become slow to perform needed maintenance when those costs cannot be recouped by the needed rent bumps. While property deterioration occurs over time and is tough to quantify, the city of Boston could be especially vulnerable to downgrades in apartment appeal and viability. That expectation simply reflects that much of the local stock is older than in other markets. Older properties tend to be more expensive to maintain. Note that propensity for deterioration is impacted by whether rent control regulations allow rents to reset when a vacancy occurs, shifting to reflect what has happened with move-in resident pricing across the market.

Potential Impact to Investment Sales

Investment objectives in Boston could shift with new regulations. Regardless of the outcome of the current rent control debate in Boston, there will always be a case to be made for apartment sector investment here and in other gateway cities in the Northeast and along the West Coast. There are chronic undersupplies of housing in these areas, and they tend to register solid economic expansion that is heavy on jobs that pay comparatively well; however, rent control is now on the table in many of these areas, and there are other ongoing shifts in regulations that favor renters over landlords. A recent survey of National Multifamily Housing Council member firms showed that 58 percent of the responding companies are avoiding further investment in places where rent control is currently in place. Another 15 percent are considering cutbacks to their exposure in such locations. As apartment investors tweak their portfolios and capital deployment plans, gateway metros might not have quite the level of appeal that was seen in the past several economic cycles, especially when apartment sector performances have been soaring in the Sun Belt and the Mountain/Desert regions. It is also possible that the investor profile for those opting for locations like Boston will evolve a bit. International capital sources tend to be much more familiar with gateway metros over locations in the rest of the country.

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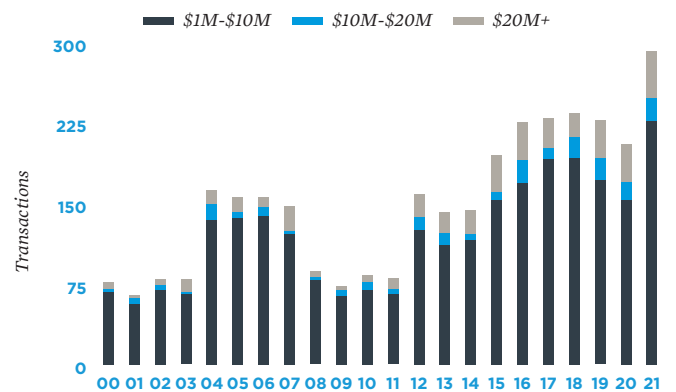
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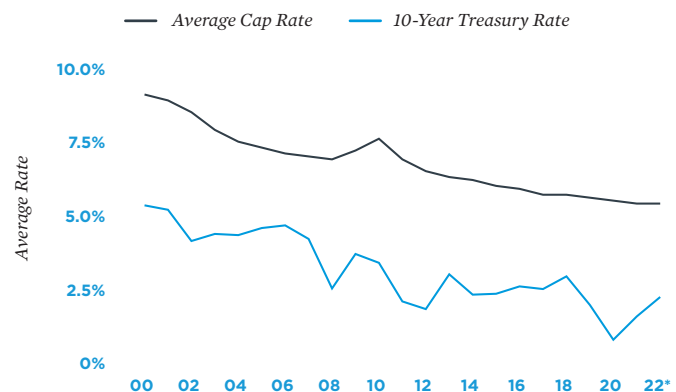
Boston Apartments 10 Years Older on Average



Boston Apartment Transaction Activity



Boston Apartment Cap Rate vs. Treasury



Note: Average apartment age calculated at the per rental unit level
* Preliminary estimate through 1Q