LEGAL LINES

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At What Point Does Rent Control Become Unconstitutional?

Both federal and state law recognize the government's so-called "police power" to enact rent control, but the law also recognizes a property owner's constitutional right to realize a "fair return" on their investment property. It is for this reason that local rent control ordinances permit an owner to file an application to increase rents to a level which the owner believes will give him/her a fair return.

But what happens if the government passes a rent control law without allowing the owner to apply for a "fair return" increase? Unfortunately, the State of California did just that when it enacted Civil Code, section 798.30.5, made part of the Mobilehome Residency Law (MRL). The question is whether such a law (that imposes rent control on the one hand but denies the owner the opportunity to seek a fair return increase on the other hand) is constitutional.

Generally speaking, "police powers" refer to the constitutionally recognized right of the government to adopt laws and ordinances not in conflict with general laws that are considered in the furtherance of public peace, safety, morals, health and welfare. California courts have upheld rent control ordinances as a legitimate exercise of police powers if they are reasonably calculated to eliminate "excessive rents" and, at the same time, provide landlords with a "fair return" on their property.

But it is entirely unclear what "fair return" even means under the law. On the one hand, California courts have recognized that a rent increase that simply maintains a "return" is not good enough. It requires something more than that. In an effort to be more specific, some courts have articulated that the rate of return must be "just and reasonable" and that it must be high enough to encourage good management, including adequate maintenance of services, to furnish a reward for efficiency and to discourage the flight of capital from the rental housing market. Finally, it needs to enable operators to maintain and support their credit. However, there is no constitutional requirement for market rents for a "fair return."

On the other hand, however, the law does not say what method or formula a rent control hearing officer should use in determining a "fair return." The law essentially says that any method is fine, so long as the result achieved is constitutionally acceptable (whatever that means).

One thing that had been settled (at least until now) was that the owner was entitled to some sort of mechanism under the law — a system of applications, briefing and administrative hearings — which at least allowed the property owner to ask for a fair return increase. Otherwise, the law is deemed unconstitutionally "confiscatory." It is for this reason that nearly every local rent control law in California includes a fair return mechanism that allows an owner to file and have heard an application for a rent increase to realize a fair return.

But then, on June 23, 2021, California's Governor Gavin Newsom signed AB 978 into law that added section 798.30.5 to the MRL. The new law says that in parks "located within and governed by the jurisdictions of two or more incorporated cities [defined as a 'qualified mobilehome park']," management may not increase the rent on a homeowner more than 3% plus the percentage change in the cost of living, or 5%, whichever is lower.

What is noticeably missing from the law, however, is any mechanism by which a property owner may seek a fair return increase. There is literally nothing (and I mean nothing) in the new law that allows a community owner to file an application with any agency of the State of California to have heard his/her request to increase rents to realize a fair return.

Without providing the mechanism, the new law completely deprives the owner of his/her constitutional right to realize a fair return. It is for this reason that Rudderow Law Group has filed suit against the State of California on behalf of a park owner affected by the new law. The lawsuit contends that section 798.30.5 is an unconstitutional regulatory taking because it provides no mechanism for a fair return hearing or other type of procedure for a park owner that is not receiving a fair return. The lawsuit also contends that the statute violates the due process clause of the federal and state constitutions.

The State of California recently attempted to have the case dismissed, but the judge ruled that it may proceed through to trial which has been scheduled for next year.

As stated in the beginning of this article, there are two fundamental premises at work here. On the one hand, the government (under appropriate circumstances) has the "police power" to enact rent control. On the other hand, however, any rent control law must be constitutional, which means, among other things, that the law must allow a property owner the opportunity to apply for a fair return increase. Fingers crossed that the court (unlike the legislature) has not forgotten about the latter. ▪

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