



## **Berkeley Rent Control's effects on investment property sales**

By James Kilpatrick of Kilpatrick & Company

A common question among owners of buildings heavily burdened by rent control is how much the limitation affects their ability to sell at a reasonable price. There is no question that a building burdened by many substantially below market rents generally sells at a lower price per foot and price per unit than a building where most rents are close to market. At the same time however, there are mitigating factors to the problem.

Investors value the perceived upside. Statistically a certain number of those under-market tenants will move out over (for example) a 5 year period of time. Eventually they all must move--either voluntarily or when they pass away. Particularly with a larger number of units, then chances of all or most tenants remaining until death is quite slim. Consequentially buyers will be willing to pay a certain premium for the building as far as GRM and "Cap" are concerned. Remember that the Gross Rent Multiplier (GRM) is a common measurement of a buildings worth and is the price divided by the annual current rents. The Capitalization rate (Cap) is the net income from the property (rents minus all expenses except mortgage) divided by the price. Often buyers look at the "proforma" GRM and Caps or what the GRM and Cap WOULD BE if all rents were brought up to market. People buy buildings based mostly on current cash flow but most agree that there is value in the eventual upside of under market units.

The other upside to a building with very low rent controlled income is the predictability of the income. Generally there will be fewer move outs with low rent buildings. Additionally, when there is a move out of a low rent paying tenant, then owner is consolated by the Costa Hawkins rent increase that can be taken. With Berkeley's vacancy rate at a historical high, a 100% rented building is valuable.

Of course many buyers will complain that it may be many years before low-rent-paying tenants move out. They will also place increased concern on any perceived problem tenants. Tenants that are both problematic and also paying very low rent will tend to fight tooth and nail against any attempt to get them out. They also often know the law and rent board well and are adept at finding ways to exploit Berkeley's tenant slanted laws. This is one of the many reasons it is very important to maintain amiable tenant relationships wherever possible.

Overall, and particularly with pride of ownership buildings a Seller with rents 50% below market can count on the fact that the building is worth substantially more than 50% of what comparable buildings are selling for. The price per unit and price per foot for the subject building at a market price is likely to be lower, but the GRM and CAP rate will generally be substantially higher than the other sales comparables.

*Please keep in mind that my area of expertise is Real Estate Brokerage. The tax consequences, exchange validity, accounting rules and legality of various strategies are best discussed with the appropriate professional. I have several that I will be happy to recommend. If you missed last month's installment, you may contact me for a copy of the last issue.*

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