

Can California real estate ever forgive its politicians?

Insiders weigh in on California Environmental Quality Act, Measure ULA, SB 9 and Builder's Remedy

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Governor Gavin Newsom, Sean Burton and Los Angeles mayor Karen Bass (Photo-illustration by Kevin Cifuentes/The Real Deal; Getty Images, Burton via Kevin Scanlon)

When Gov. Gavin Newsom signed two budget trailer bills that scaled back an environmental law that's been a frequent scapegoat for the state's housing woes, it seemed like an offering of sorts to the real estate world. Was this recognition that California understood how badly regulations were getting in the way of investment and development? That the state would become a friendlier place to build? "From your lips to God's ears," Cityview Chief Executive Sean Burton said.

But reforms to the landmark California Environmental Quality Act (CEQA) are only one piece of the puzzle when it comes to mending the relationship between the public sector and real estate industry, especially after the City of Los Angeles generated even more friction with Measure ULA, which boosted property-transfer taxes on high-end deals. This worsened the strife with players in the city, who've pushed back against it since day one. Los Angeles Mayor Karen Bass, who once said she was considering a pause on the tax, appears to have backtracked.

So it makes sense that the industry is squinting for any hint of a changing tide.

There have been other attempts to make things better, but so far nothing has come as close as the pitch to fix CEQA — which insiders weren't even expecting, since it failed to pass through the legislature before being tacked on to the governor's budget bill at the last minute, Sheri Bonstelle, a real estate attorney, said.

The Real Deal asked a selection of real estate professionals about the state and local governments' latest real estate-related efforts — or lack thereof — to score how well they might patch up the conflicts between builders and lawmakers.

California Environmental Quality Act

Backstory: Then-Governor Ronald Reagan enacted the California Environmental Quality Act in the 1970s to assess impacts development may have on the environment.

What happened next: Rather than save the trees, the rule has been blamed for blocking development and sowing the seeds of a housing crisis.

For example, a mixed-use development in Studio City that was once home to a historic hotel called the Sportsman's Lodge had the potential to be redeveloped into more than 500 apartments, some affordable, plus thousands of square feet for restaurants and other retail use years ago. But opponents, including the Studio City Residents Association and Erewhon, a luxe grocery store chain, filed appeals. Erewhon later sued the developer, Midwood Investment Development, and then the city on environmental grounds.

The court found in favor of the developer, but had the exemptions existed then, it wouldn't have been a multi-year process that cost millions of dollars, Los Angeles land-use attorney Dave Rand said, and there wouldn't have been a need for the thousands of pages of environmental analysis and myriads of technical reports, he added. "It was your kind of classic CEQA process that swallowed the project," he said.

Developers got the drift. If anyone could turn to CEQA to stop development, their projects would end up held hostage. This is the kind of risk developers avoid, and many left the state rather than deal with delays that could kill their projects.

The update: With reform, Burton's company is taking another look at the state. It hopes to avoid a recent scenario in which the entitlement process for about 500 apartments in Westchester — already greenlit by the Los Angeles City Planning Commission — took four years, including an environmental review, dozens of community meetings and more. That timeline could be cut in half, Burton guessed.

"The governor called this the most important housing bills passed in a generation, and politicians often overstate matters, but the governor was not exaggerating at all," property law professor Christopher Elmendorf said.

It's clear that the reforms mostly remove what was once a substantial barrier to multifamily development, saving developers time and money. But there's no way to tell how much housing could come post-reforms. Still, the California Environmental Quality Act isn't solely to blame. There are other policies that kill development throughout California and its most populous city, Los Angeles. But there are some that boost development and others that don't do much either way.

Grade: B

Measure ULA

Backstory: Measure ULA is a real estate transfer tax that allocates revenue to affordable housing in the City of Los Angeles, which voters passed in a ballot measure in November 2022. The so-called mansion tax actually applies to all properties — not just residences — worth more than \$5 million.

What happened next: A University of California, Los Angeles, paper found that commercial transactions have declined between 30 and 50 percent since the measure was enacted. Bonstelle said that her clients tell her it's killed their ability to buy and sell high-priced real estate. It's also slowed development, since developers know they'll have a tax to pay when they sell, knocking down the value of multifamily properties.

Residential brokers have said that their clients are looking to places without the tax such as Malibu and Beverly Hills, or dishing out the cash. About 60 percent of deals that meet the threshold for the transfer tax are for single-family homes, according to an analysis published by researchers at the University of California, Los Angeles.

Rand, who called it the "housing death tax," said he's never seen a single piece of policy be so destructive to the development of multifamily properties. "It's just been an absolute train wreck when it comes to the production of multifamily housing in L.A.," he said.

Developers have looked outside the city for other options. Cityview is developing an eight-story apartment building in Gardena, near the SpaceX headquarters. Burton explained that the company couldn't have done that deal in the city of Los Angeles because of the mansion tax would hurt returns to investors. The measure basically "redlined" Los Angeles, Burton said.

The update: In the aftermath of the wildfires earlier this year, Bass said that she was looking into a potential pause on Measure ULA, but she hasn't taken any action since. Appeals have been filed and dismissed, but that hasn't stopped such billionaire developers as Rick Caruso from calling for a moratorium on Measure ULA.

Grade: F

Senate Bill 9

Backstory: Senate Bill 9, which went into effect in January 2022, allows up to four homes to be built on an existing parcel of land if an owner splits a lot in half and develops a duplex on each part.

What happened next: Hailed as a single-family-zoning killer, the bill sounded great in theory to developers. In practice, SB 9 has been a "nothingburger," per Elmendorf, and a "big, fat snoozer," according to Rand.

That's because there's an owner-occupancy requirement attached to the law that calls for applicants to sign affidavits saying that they intend to live in one of the units for three years after approval. "This takes developers out of the market for SB 9 projects," Elmendorf said, leaving it to homeowners.

But a typical homeowner, who has no development experience and less access to capital, probably won't want to go through the process of either dividing his or her lot to construct another home, or potentially tearing down one home and building up to four in place of it, if the homeowner took that route. It would also mean hiring and managing architects and contractors and living amid construction for a couple of years. For most, it's easier to build an accessory dwelling unit in a backyard, which was already allowed. The real value of the lot split law would be if a developer could come in and work with a willing homeowner, Bonstelle explained.

The update: From nothingburger to actually nothing. After Pacific Palisades residents raised concerns about increased density in their neighborhoods and how that could make evacuation more dangerous in the event of another fire, Newsom and Bass issued executive orders so that SB 9 is now restricted in the Palisades and other fire-ravaged areas.

Grade: C

Builder's Remedy

Backstory: Builder's Remedy has been around for decades. It's a legal mechanism that takes away local control and hands it to developers as a consequence if a municipality hasn't built enough housing per state specifications. Developers took heed of it in the last half-decade as a way to build in certain areas, but some of their plans have wound up in legal fights.

What happened next: In Beverly Hills, a council member once said the city would pay whatever fine the state came up with to avoid a rezoning that would include affordable housing, Bonstelle remembers. But the city never got fined; instead, developers came in with proposals that bypassed local zoning. The threat of Builder's Remedy had become a reality, although Beverly Hills hasn't thrown in the towel in the fight.

Then, in 2022, developer Leo Pustilnikov submitted a preliminary application for the Linden Project, a 19-story mixed-use building with 165 apartments, some affordable. The city denied it; the state sent a notice of violation letter to Beverly Hills; Pustilnikov sued.

The update: In August, a judge found in favor of Pustilnikov, a vote of confidence in the Builder's Remedy process.

Beverly Hills "threw everything at us under the sun, stonewalled every step of the way, fought these projects bitterly with every possible, imaginative delay tactic that you could ever think up," said Rand, who represents various Builder's Remedy applicants. "But that playbook fell apart."

The victory was helped in part by changes to state law, which strengthened Builder's Remedy in the meantime. (That includes CEQA reform, since its infill exemption applies to some Builder's Remedy projects.)

Until recently, there were all kinds of plausible arguments a city could make to delay or reject a Builder's Remedy project, Elmendorf said, but now "there is almost nothing left for cities that want to deny Builder's Remedy projects."

Grade: B