Institutional Investors in Single Family Rentals and Build-to-Rent: The Myths, the Problems, and the People They Serve

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Opinions about single family homes for rent, referred to in the development and investment worlds as "SFR," vary widely based on perspective. In the past several years we've seen disparate headlines such as Did Wall Street kill the American Dream of homeownership?[1]; Access to Single-Family Rental Homes in Higher-Quality School Zones Drives Educational Gains[2]; and BTR & SFRs | The Rising Stars of Rental Housing[3].

In this publication, we seek to dispel the myths surrounding who owns rental housing, who rents SFR, the impact renters have on communities, and to suggest solutions to the problems raised in the popular, but inaccurate, negative narrative.

Problems with Housing Affordability

There is no debate that America has a housing crisis caused by lack of supply, high home prices, and higher interest rates[4]. Of these factors, home prices and interest rates fluctuate in relatively short periods of time due to sweeping federal authority, but the lack of supply has been steadily increasing since 2010[5]. After the 2008 housing crisis, housing starts (new construction of homes) plunged. Since 2008, homebuilders have faced one hurdle after another including the availability of capital, supply chain problems related to the COVID-19 crisis, multiplying materials and labor costs, and increasingly burdensome local government regulation. Overcoming these hurdles to build new housing results in higher priced homes and the affordability crisis increases.

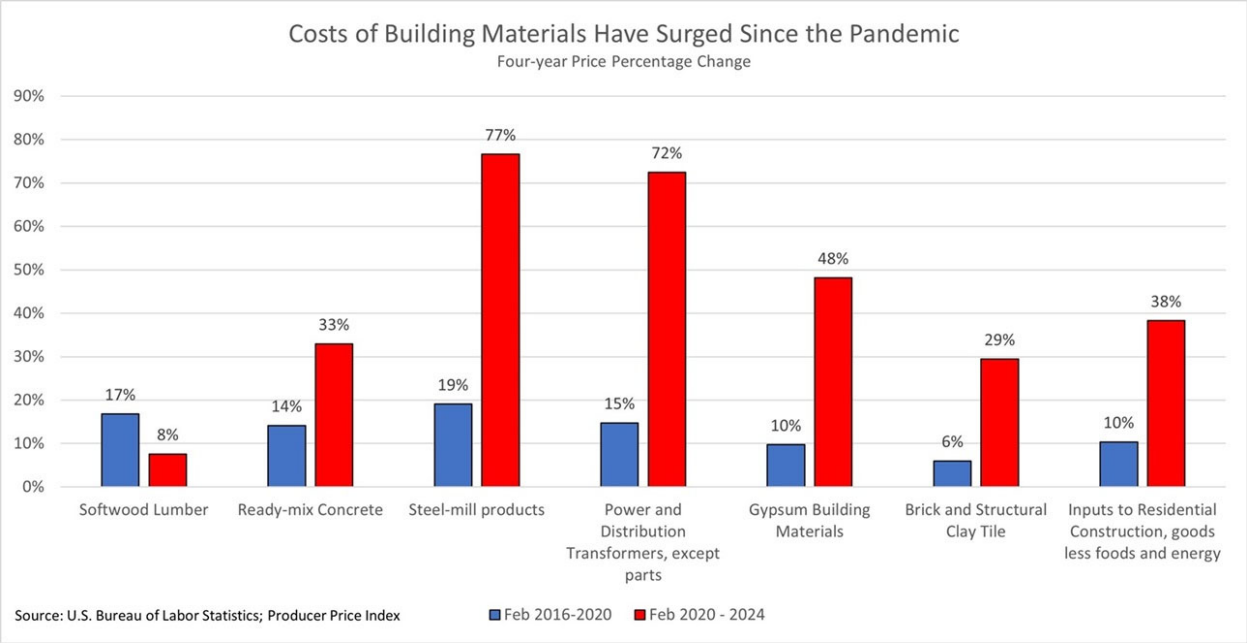
Let's talk about these hurdles to affordability on the homebuilding side. The largest homebuilders in America are publicly traded companies. They manufacture a product (homes), sell them to customers (homeowners) and pay dividends to the company owners (shareholders). They finance their manufacturing with debt and equity. When interest rates are low, debt is cheap, so homebuilders may borrow money to fund their projects. As interest rates increased over the past two years, borrowing (for home buyers and homebuilders) became more expensive. The alternative mechanism to pay for building homes is private equity.

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[1] Did Wall Street kill the American Dream of homeownership? It depends on where you live (yahoo.com)
[2] Access to single-family rental homes in higher-quality school zones drives educational gains – Inside UNC Charlotte
[3] BTR & SFRs | The Rising Stars Of Rental Housing (matthews.com)
[4] The U.S. is now short 4.5 million homes as the housing deficit grows - Jun 18, 2024 (mediaroom.com)
[5] Why houses are so expensive, explained in one chart (axios.com)

Private equity is a type of investment that involves purchasing an ownership interest in a company that is not publicly traded. Private equity investors are driven by the potential for a high return on their investment. The desire for high returns on investments by private equity leads to the logical result that the cost of the product (homes) has upward pressure.

Not only have the financing conditions for increasing affordable housing stock been unfavorable, the cost to build homes has unexpectedly and exponentially increased in recent years. The below chart[6] published by the National Association of Home Builders on July 16, 2024, shows the dramatic increase in building materials costs comparing the four-year periods of 2016 through 2020 and 2020 through 2024. Some explanations given in the accompanying article are inflation, global factors (e.g., geopolitical tension, changes in trade policies), and sustainability initiatives. All of these explanations are wide reaching and intersect with the interests of macroeconomic controls and environmentalism; which impact the entire planet, let alone regional housing starts.



Government Regulation's Impact on Affordability

Thinking further about sustainability initiatives, one of the above-listed reasons that the cost to build homes is increasing, we should consider the impact that not only sustainability regulations, but all regulations, have on housing affordability.

[6] Material Costs | NAHB

In a special study for housing economics by Paul Emrath, Ph.D. published on May 5, 2021, he stated that the ever-increasing government regulation hinders supply and affordability. "On a dollar basis, applied to the current average price ($394,300) of a new home, regulation accounts for $93,870 of the final house price. Of this, $41,330 is attributable to regulation during development, $52,540 due to regulation during construction.[7]"

By these numbers, about one-quarter of the total cost to build a home is attributed to satisfying government regulations. If government "red tape" was reduced, so too would be the price of houses. While many state legislatures have a stated goal of creating more affordable housing, they not only ignore the cost of regulations, but continue to impose more regulations on homebuilding.

The Texas legislature, which meets only every other year to propose and vote on new legislation, adopted the "shot clock" bill[8] in 2019, which, like a ticking shot clock in basketball, set state-wide time frames within which local governments must return plat and building permit submissions. The legislature heard the frustration of homebuilders and recognized the hinderance to affordability that government regulation poses. The changes to Chapter 212, Texas Local Government Code require initial plat and permit reviews to be completed within thirty calendar days, and fifteen days for resubmissions. The municipalities are required to "approve," "disapprove," or "approve with conditions" the submissions. Though this attempt to expedite the platting and permitting process has curtailed some extreme delays, municipalities are still returning comments in a piecemeal fashion causing multiple resubmissions and months of time spent obtaining permits. While everyone certainly wants regulations for minimum design and construction standards to protect health and safety, many homebuilders believe legislatures are regulating a much larger and unreasonable scope.

The California legislature, despite a massive affordability problem, shows no signs of curtailing regulation to expedite home building and ease affordability. The California Building Industry Association says that "The regulatory landscape in California continues to be a major impediment towards meeting the housing needs of the state. California homebuilders have first-hand experience in dealing with numerous state agencies that have regulatory jurisdiction over environmental and natural resources. All of these agencies have the ability to create unnecessary delay, add exorbitant costs, and require onerous mitigation requirements on projects throughout California.[9]" By empowering and funding numerous state agencies to add layer upon layer of regulation, the California legislature keeps housing unaffordable.

The California Department of Housing and Community Development, one example of an agency regulating housing, operates the Affordable Housing and Sustainable Communities (AHSC) Program. The words "affordable housing" are in the program name, but the AHSC's

[7] Government Regulation in the Price of a New Home (nahb.org)
[8] HB 3167
[9] Regulatory Activities – California Building Industry Association | CBIA

stated purpose is funding "Projects that implement . . . practices that reduce greenhouse gas (GHG) emissions." While eligible projects must include housing that meets the definition of "affordable," the initiative does not serve to actually lower the cost of housing, but rather, it incentivizes green building methods and materials which often increase the cost of building.

A further example is the California Solar Mandate which went into effect on January 1, 2020, and requires new homes, with very limited exceptions, to have solar photovoltaic (PV) systems installed at the time of construction[10]. The mandate applies to single-family homes and multi-family homes up to three stories tall. The solar system must be large enough to meet the home's annual energy needs. Builders estimate the annual energy needs based on the building's floor space and climate zone. The cost of complying with this requirement, including not only the materials and installation but also the costs of determining the required size of the system and if there is sufficient roof space to provide the number of panels necessary, must be factored into the cost of the home, making affordability a secondary priority over the state's desire for renewable energy.

Increasing Costs of Home Buying

The discussion of affordability cannot conclude without highlighting the Federal Reserve's adjustments to the federal funds rate which we commonly call "interest rates." Americans became used to incredibly low mortgage interest rates during the period of 2008 through 2019. In March, 2022, the Federal Reserve began a rapid series of interest rate hikes to put the brakes on rampant inflation. From an economic perspective, this is an expected response to inflation, but its effect was to slow all sectors of the economy, including homebuilding and homebuying which, as detailed above, have remained in short supply since 2008. Most notable to most Americans, when interest rates increase, mortgage rates increase, making housing more expensive.

Mortgage Lending Qualifications Keep People Unqualified

"Oh, it's gotten much more difficult to get a mortgage. The availability of mortgage credit tightened dramatically during the Great Recession, and it never bounced back. So for someone who gets a mortgage today, they're likely to have a higher credit score than someone who's gotten a mortgage in the past. And that means simply fewer people are eligible for homes. And the cost to originate a mortgage has roughly tripled since 2009. And that has meant that lenders don't offer many small mortgages because they tend not to make money on them unless the mortgage is for over about $150,000.[11]" This housing expert highlights multiple issues in the mortgage markets that have made housing less affordable. Not only are mortgage rates higher than they have been in more than a decade, processing the mortgage is more

[10] Title 24, Part 6, Subchapter 2 California Code of Regulations

[11] Housing experts say there just aren't enough homes in the U.S.: NPR

expensive for the lenders, and fewer people have credit scores high enough to even qualify for a mortgage.

Laura Escobar, the president of Lennar Mortgage, recently said: "We're on the verge of a vicious cycle, in which fewer and fewer people can afford the American dream of homeownership. That's not good for America.[12]" Lennar is the second largest homebuilder in America and is publicly traded on the New York Stock Exchange. In 2023, Lennar built 73,087 homes and 2024 numbers will likely outpace that. Despite companies like this building on a large scale, demand exceeds supply and housing remains out of reach for many who cannot overcome credit reporting agency "black marks" on their records.

As discussed in the white paper published by CAI in 2023, titled Long-Term Corporate Owned Rentals in the Community Association Housing Model, "Access to mortgage credit is critical to homeownership. The Federal agencies, including the Veterans Administration & HUD's Federal Housing Administration (FHA) and government-sponsored enterprises (Fannie Mae & Freddie Mac), establish mortgage lending guidelines to manage risks associated with mortgage loans. Notably, these agencies have established guidelines specifically related to owner occupancy requirements [*e.g., limits on the percentage of rentals in a condominium community*]. Generally, these agencies find a direct connection with higher risk with a higher concentration of investor owners in a community association.[13]" (*Parenthetical added*.) In the same way that the Federal Reserve controls interest rates to change behavior, the United States Department of Housing and Urban Development (HUD) through the Federal Housing Administration (FHA) incentivizes and disincentivizes behaviors and practices through its policies. FHA's current policies for a property to qualify for Fannie Mae mortgage insurance vary among housing products in which there are one to four separate units in a building versus more than four units which, in nearly all cases are condominium products. Condominiums are usually more dense and, therefore, more affordable than detached single family homes. Qualifying a condominium property for FHA backed financing is an arduous process and one of the criteria is that no more than fifty percent (50%) of the condominiums in the project be non-owner occupied (e.g., rented). As such, FHA is disincentivizing investment in condominium housing products (i.e., housing density) because there is a leasing restriction inherent in qualifying the property for FHA mortgage protection.

When Americans cannot afford higher priced homes and higher mortgage loan costs, they are forced into the rental market.

[12] U.S. housing market is on the 'verge of a vicious cycle,' which is 'not good for America,' Lennar Mortgage head warns - MarketWatch

[13] CAI White Paper "Long-Term Corporate Owned Rentals in the Community Association Housing Model" (October, 2022)

Who Rents SFR?

Having explored housing affordability issues above, we will now consider who, statistically, rents homes. Contrary to the decreasing supply of single-family homes relative to household creation (new family units seeking non-multigenerational housing), apartment construction hit record highs in 2023[14]. For investors, apartments, or "multifamily" products are losing their luster though because apartment living is no longer what many renters want.

One of the largest SFR investment companies in America, Amherst, published their 2023 Impact Report on May 20, 2024[15]. The report details their average resident as a member of a three-person household, age 29-45 years, household income of $92,800, and credit score of 653. These households are relatively high earning, but with lower-than-average credit scores. They tend to be small families who seek out safe neighborhoods with space to play and good schools for their children. A generational increase in the desire for pet ownership and pet-accessible homes also drives SFR as opposed to traditional apartment living. Single-family housing renters are much different than those in the apartment market.

SFR renters are more educated, most with a bachelor's degree, they desire a garage and more bathrooms than traditional apartments provide, and they tend to stay longer with less turnover than apartment tenants[16]. These sound like desirable tenants and neighbors.

A December, 2022, article stated that "These data paint a picture of the SFR sector filling a critical need for young households. The average SFR renter has a more youthful head of household compared with single-family owners while having a higher average number of children. As structural and cyclical trends continue to support the sector, SFR's importance, and our understanding of its core tenant base, is poised to grow.[17]"

Freddie Mac published a paper in its *Spotlight on Underserved Markets* series on SFR. The paper identifies that more than fifty-eight percent (58%) of all rental housing in the United States is not dense, urban apartments, but rather, single-family homes. "SFRs are home to nearly 23 million households, 5 million of which are located in rural markets, and represent the single largest source of rental housing in the country. They offer renters choice in both where and how they live, and are particularly in demand among growing families and new households[18]." The Freddie Mac paper also provides great statistical insight into who owns SFR, which is discussed in depth below.

[14] Apartment building construction on track to hit record high (axios.com)
[15] 2023 Impact Report - The Amherst Group LLC
[16] The Profile of a SFR Renter (globest.com)
[17] Who is Making Single-Family Rentals the New Starter Homes of Choice? (arbor.com)
[18] single-family-rental-markets.pdf (freddiemac.com)

Who Invests in SFR?

The clickbait internet narrative is that Wall Street is killing the American dream of homeownership. As Mark Twain, and our high school statistics teacher, warned, "there are lies, damned lies, and statistics." The manipulation and misrepresentation of data regarding SFR investors has formed public opinion. As homeownership becomes, in reality, less attainable, the blame has been erroneously pointed at institutional investors in SFR. In a December, 2023, article, it was claimed that 44% of all Single-Family home purchases were from private investors in 2023[19]. This is wildly inaccurate and misleading and, as many despotic leaders are alleged to have believed "a lie told often enough becomes the truth."

Freddie Mac published data showing that "very small" investors who own 1-10 rental homes comprise 88% of the market, while institutional investors, defined by FHA as owning more than 2000 rental homes, comprise a scant 1% of the market[20]. Another recent publication of compiled data states that: "In aggregate, Parcl Labs calculates institutional operators own around 0.73% of the total U.S. single-family housing stock (less than one in 100 homes), with it reaching as high as 4.4% in the Atlanta-metro market. Despite institutional investors jumping into the housing market following the 2008 housing bust, most landlords are still small operators with between one and 10 homes.[21]" So how does an article saying 44% of rentals are owned by Wall Street become viral when it is so far from the truth?

The simplest explanation is that people are overburdened by housing costs and looking for someone to blame and a way out of the housing crisis. "To state the obvious, stories can be compelling without being true. Especially suspect are stories that scapegoat a group or an entity that is impossible or at least very difficult to defend: banks or oil companies or criminals, say. The scapegoat takes the blame for a complex problem. The trick is to cast a villain such that the surrounding facts become irrelevant. . . . But false narratives are dangerous because they distract attention from real problems, and plausible solutions.[22]" (January 26, 2023 article in The Atlantic by Jerusalem Demsas.) This finger pointing fails to acknowledge the markets being served by SFR and that the SFR market is money flowing into housing supply.

Homebuilders and BTR

Build-to-Rent ("BTR") is a subsector of SFR. As a subsector of SFR, BTR occupies a unique space within the U.S. residential rental market. The broader category of SFR includes scattered homes for rent while BTR communities are entire neighborhoods of new homes being rented instead of sold.

[19] Report: 44% of all Single-Family Home Purchases were from Private Investors in 2023 | by HR NEWS | Medium
[20] single-family-rental-markets.pdf (freddiemac.com)
[21] How much of the housing market does Wall Street really own? (fastcompany.com)
[22] Meet the Latest Housing-Crisis Scapegoat - The Atlantic

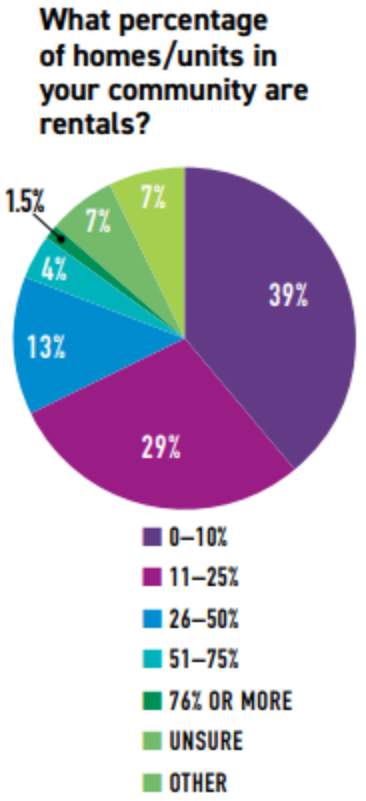
Traditional homebuilders are making their way into the SFR market through their BTR communities. Rather than building homes and selling them as soon as they are completed, many homebuilders have adopted a different strategy. They are holding the homes after completion and renting them. For homebuilders BTR presents an alternative revenue stream that may provide some protection from the cyclical fluctuations of the traditional homebuilding market. This diversification has insulated some homebuilders from slowed sales in the last two years due to higher mortgage rates. This is good news for sharedholders in the publicly traded homebuilders, but also for the tenants in the brand new homes who otherwise could not qualify for or afford to buy a new home.

The narrative about institutional investors driving up housing prices and shutting out first-time home buyers is dispelled by the picture of who rents the homes and fact that institutional investors do not even own a statistically significant portion of SFR.

Rentals Within HOAs

Although institutional investors are a statistically insignificant percentage of owners within common interest developments, renters elicit a lot of negative attention within HOAs. In April, 2022, CAI published a Snap Survey on the topic of "Rentals and Leasing in Community Associations."[23] The survey was well received with results from 865 individuals from 41 states representing at least 7,500 community associations. The below chart shows that the vast majority of communities have less than 25% of homes rented and most of those have less than 10% of homes rented.

[23] SnapSurveyRentals.pdf (caionline.org)



The survey also inquired as to what types of regulations the associations have in place regarding rentals. Most communities surveyed (64%) prohibit short term rentals of less than 30 days. Only 7% of communities surveyed prohibit all rentals while another 20% limit the total number of homes within the community that may be rented at any given time. Approximately one-quarter of this representative sample has policies in place to ban or strictlyl limit rentals. Why would communities want to keep renters out?

The role of a community association is, in part, to enforce the rules and regulations adopted by associations' boards of directors with the goal of maintaining uniformity, well maintained homes and landscaping, and curtailing nuisance behaviors. The CAI survey referenced above asked the respondents "Which of the following concerns does your community have as a result of rentals or investor-owned property?" The biggest concerns were that tenants are not familiar with the community covenants, tenants do not follow the community covenants, and the investor owner does not maintain the home to the standards of the community. So the perceived problems with renters are that they do not follow the rules, including those governing maintenance standards.

Community associations have authority to impose discipline for rule violations which can include suspending the rights of homeowners or their tenants and imposing monetary fines. State statutes and the communities' own governing documents distate a process to be followed by the associations in enforcing their rules and regulations. Most times that entails giving the

homeowner notice of the violation and an opportunity to cure the violation and/or present a defense at a hearing before the board of directors. This enforcement process requires communication between the association and the homeowner. When an owner does not live within the community, communication can be more difficult, and when an owner owns thousands of homes, the owner may not even be responsive once communication is received.

The discipline methods that would normally be impactful to owner-occupants may not have the same deterrent effect on multi-million dollar companies that own investment properties. Does an institutional owner care if their voting rights are curtailed so they cannot vote in an election? Does a $100 fine affect the institutional owner's bottom line? Probably not.

So, how can community associations hold rental homes to the same standards as the rest of the community? At large institutional investor companies it can be difficult to work through the maze of customer service representatives to reach an individual who has authority and the follow-through to address and cure violations. However, that is the best solution. The onus on the community associations is to make and sustain contact with off-site owners. The onus on the off-site owners is to make that contact information readily available, to sustain contact over the term of homeownership, and to educate renters about their obligations under the community's rules and regulations. Both parties should be collaborative as they ultimately all have the same goals: attractive homes to live in and rent at optimal rates, and increasing home values.

Some HOAs are Controlled by Institutional Owners

As briefly discussed above, many homebuilders have expanded their business models to include BTR communities. Additionally, some institutional investors are buying entire communities in one transaction. Both scenarios result in the institutional investor having control of the applicable HOA. Some investors operate their SFR communities like multi-family rental projects whereby the homes are not built on separately platted lots but are constructed on one large lot that can only be conveyed as one property. The norm, however, is that rental homes are individually transferrable lots within community associations. When one entity owns all of the lots within a community association, the need to operate the community association in accordance with its governing documents may be questioned. It is our position that there are benefits to institutional owners in keeping community associaitons operative and in retaining the expertise of common interest development experts.

In some neighborhoods, the development and permitting process included a requirement by the municipality that a community association be formed to maintain shared faciliites such as private streets or drainage facilities. In those cases, local law requires that the community association remain active and conduct the required maintenance.

Some communities have common area amenities shared by the residents which are often owned by the community association. If an institutional owner who owns all of the homes does not keep the association's corporate stauts active and compliant, there will be issues with the ownership of the shared amenities. Without an active association, it may not be possible to insure the common amenities.

Additionally, for the institutional owner there is liability protection in the association owning amenities like a swimming pool, tennis courts, or a fitness center. In the event of an injury on those amenities, the association would be the liable property owner, not the institutional owner. This serves to limit liability to the assets of the association, while protecting those of the institutional owner.

The institutional owner may find operating an association burdensome because state laws vary widely and there are many corporate governance laws that apply to community associations differently than other types of business entities. Therefore, institutional investors should retain HOA managers to exclusively handle HOA-related issues within their communities. Such managers have different knowledge and skill sets than the leasing or property managers that might otherwise be engaged by an institutional owner in the operation of a rental community.

Additionlly, attorneys who specialize in HOA law and have regional expertise can provide benefit to institutional owners. When an institutional owner owns an entire community, HOA counsel can ensure compliance with niche laws. When an institutional owner operates SFR rentals at scattered sites within community associations that it does not control, an HOA attorney could represent the institutional owner in addressing tenant violaions and relationship building with the communities and their managers.

HOA Rental Restrictions' Impact on SFR

Authority of HOAs to Restrict Rentals

Community Associations are governed by deed restrictions which are recorded in the public records of the county in which the peoperty is located. Those deed restrictions are often referred to as Covenants, Conditions and Restrictions ("CC&Rs"). Most states have statutory or case law confirming that CC&Rs may be amended from time to time by the group of homeowners whose property is bound by them. Consumers understand community association covenants are legally binding contractual obligations that govern the use of real

property (both the common property and the unit owner's property) and establish rights and responsibilities of the association and property owners[24].

Some CC&Rs are drafted by their declarants (usually the homebuilder or developer of the community) to prohibit or restrict rentals. Sometimes the prohibition is for a certain period of time while the declarant is still actively selling homes, but most often, rental restrictions are imposed in perpetuity, like other restrictions in the CC&Rs. If CC&Rs are adopted without rental restrictions, it is possible for them to be amended by a vote of the homeowners to add rental restrictions. The power to prohibit a property owner from renting their home is significant, especially to SFR owners in the business of renting homes.

Rental restrictions in CC&Rs raise a host of issues including constitutional property rights, fairness, and discrimination.

Predictably, SFR owners oppose rental restrictions and have made efforts to exempt themselves therefrom. A question that was posed to CAI was whether or not amendments to deed restrictions should be imposed to limit or ban rentals within particular communities in light of SFR owners' opposition to such amendmentsAs discussed in the white paper published by CAI in 2023, titled Long-Term Corporate Owned Rentals in the Community Association Housing Model,[25] CAI supports the status quo of democratic governance of community associations by their elected representatives and recommended against exempting special interest groups (such as institutional SFR owners) from the democratic community association process.

The white paper goes on to explain in broad strokes the community association housing model and individual homeowners' agreement to abide by deed restrictions by virtue of purchasing a home subject to such deed restrictions. Despite the well established law regarding the amendable nature of CC&Rs, a discussion of the impact of and issues raised by imposing rental restrictions should be revisited.

Rental restrictions undeniably limit the free-use of property. Nonetheless, courts throughout the country have consistently upheld such restrictions when rationally calculated to promote the development's greater good[26]. Where some state legislatures think that courts have gone too far in allowing community associations to impose restrictions on property, they have stepped in with piecemeal laws to exempt certain issues from community associations' purvue.

In California, rental bans are prohibited and a property-owner is completely exempt from a rental restriction if he or she owned the property prior to enactment of the restriction

[24] See, e.g., Mathis v. Mathis (1948), 402 Ill. 66, holding in a conveyance of a real estate interest containing a covenant, "the covenant runs with the land and is binding upon subsequent owners." See additionally, Rosteck v. Old Willow Falls Condominium Assn., 899 F.2d 694, "But the condominium declaration is a contract…".
[25] Id at footnote 12
[26] The Do's and Don'ts of HOA Rental Restrictions — Homeowners Protection Bureau, LLC (hopb.co)

and has not explicitly consented to it.[27] Any restrictions on rentals must be "reasonable," with the law making clear that a restriction requiring a minimum rental term is reasonable. Practitioners debate if the statute, as written, means that the only permissible rental restriction is a 30-day minimum rental term or if other restrictions could be deemed "reasonable" under the circumstances.

In Florida, a rental restriction is effective against an owner only if the restriction was in place at the time of purchase or the owner voted for the amendment.[28] Similarly, in Arizona, rental restrictions are not effective against pre-existing owners unless approved by a unanimous member vote.[29]

A Constitutional Question of Property Rights

The Fifth Amendment to the United States Constitution protects the right to private property in two ways. First, it states that a person may not be deprived of property by the government without "due process of law," or fair procedures. In addition, it sets limits on the traditional practice of eminent domain, such as when the government takes private property to build a public road. Under the Fifth Amendment, such takings must be for a "public use" and require "just compensation" at market value for the property seized. It can be argued that banning homeowners from renting their homes amounts to a taking without a legitimate public purpose and just compensation.

CAI's white paper titled: "Short-Term (Vacation) Rentals and Community Associations"[30] includes a thorough analysis of the constitutional questions raised by banning short term rentals within community associations. Regarding the due process clause of the Fifth Amendment, the paper summarizes the legal standard as follows: a land use regulation will be found invalid if it does not further a legitimate public purpose. A regulation furthers a legitimate public purpose if it advances public safety, health, or welfare. Further, the government must demonstrate a rational relationship between the regulation and legitimate public purpose.

As applied to rental restrictions in community associations, does a vote by a majority of homeowners to amend the CC&Rs banning rentals further a legitimate public purpose by advancing public health, safety, or welfare? Does having renters in a community make the community less healthy, safe, or well? We would argue that there is a less restrictive means of addressing health, safety, and wellbeing within communities than banning renters, rather, associations can police behaviors, not "the type of people who rent."

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[27] Cal. Civ. Code §4740(a), (b)
[28] Fla. Stat. §718.110(13)
[29] A.R.S. §33-1227
[30] Community Associations Institute white paper "Short-Term (Vacation) Rentals and Community Associations" Updated December, 2023

Rental restrictions in CC&Rs even more clearly fail to meet the "just compensation" standard. In analyzing "just compensation," courts use a balancing test set forth in Penn Central Transportation Co. v. City of New York[31] to determine whether a regulatory taking has occurred. The court aims to balance the public and private interests by looking at several factors such as the economic impact on the property owner, character of the regulation and the property owner's "distinct investment-backed expectations." When a rental ban is imposed, no compensation is paid. An advocate for rental restrictions might assert that the benefit to the community allegedly provided by keeping renters out amounts to compensation. However, we believe it amounts to discrimination.

Discriminatory Imact of Rental Restrictions

The Fourteenth Amendment to the United States Constitution includes the Equal Protection Clause stating that: No state shall "deny to any person within its jurisdiction the equal protection of the law." The CAI white paper identified at footnote 29 contains a succinct summary of the legal treatment of the Equal Protection Clause which is copied here: If a law is challenged based on equal protection, the issue is whether the government can identify a sufficiently important objective for its disparate treatment. What constitutes a sufficient justification depends entirely on the type of discrimination. If a law does not involve a suspect class or fundamental right, the law is analyzed using the rational basis test. The law will be upheld if it is rationally related to a legitimate government purpose. The test is extremely deferential to the government and only rarely have laws been declared unconstitutional for failing to meet this level of review. The Fourteenth Amendment applies to private CC&Rs in only some circumstances, but it can be argued that rental restrictions amount to discrimination in violation of the Fourteenth Amendment.

Excluding renters from community associations amounts to modern day redlining. Redlining is the practice of denying or limiting services to certain neighborhoods based on race, color, national origin, or other illegally discriminatory reasons. The federal government created maps in 1934 identifying areas where it would and would not insure mortgages. The red areas on the maps had the lowest rating indicating loans should not be insured in those areas, which all happened to be Black neighborhoods. The concept of redlining can be applied to zoning and deed restrictions as well.

As to zoning laws, they have a history of discrimination as early zoning ordinances explicitly prohibited Black Americans and other racial minorities from living in certain areas. Zoning has been implicitly exclusionary as well when used as a tool to regulate housing density. Exclousionary zoning laws require large lots as a means to exlude more dense housing, which is usually more affordable. An interview with Alex Horowitz, the director of Pew's Housing Policy Initiative, was published by NPR to help understand why affordable housing

[31] 438 U.S. 104 (1978)

feels like a pipe dream, and what can be done about it. Mr. Horowitz explained that "restrictive zoning is the primary culprit. It's made it hard to build homes in the areas where there are jobs. And so that has created an immense housing shortage.[32]"

Like exclusionary zoning, deed restrictions have been used to keep racial minorities out of certain neighborhoods. A set of deed restrictions of a prior client of mine had a provision that prohibitied "Hindus" from living in the community. While many states now have laws making racially discriminatory deed restrictions void, an argument can be made that rental restrictions in CC&Rs have a disparate impact on racial minorities that rises to the level of illegal discrimination and is akin to redlining.

A 2023 publication by the National League of Cities says "People of color are more likely to be renters. The share of renter households headed by a person of color (48 percent) is nearly twice that of homeowner households (25 percent)."[33]

Some states recognize that excluding renters who receive housing choice vouchers creates unlawful discrimination. In Texas, in a move unusually friendly to renters, in 2023, the legislature enhacted Section 202.024 of the Texas Property Code which prohibits associations from banning rentals to recipients of housing choice vouchers, sometimes referred to as Section 8 vouchers.

Similarly, at the federal level, enforcement aimed at only homeowners that fall within certain groups is subject to challenge by the singled-out homeowners. See, for example, Bloch v. Frischholz[34], a 2008 United States Court of Appeals for the Seventh Circuit case in which an HOA repeatedly removed the Bloch family's mezuzah from the common area door frame of their condominium unit. The mezuzah was placed on the doorframe in observation of the family's Jewish faith and the court determined that, even though the rule prohibiting "objects of any sort" in the common area was, on its face, religiously neutral, its application was intentionally discriminatory because it impacted only Jewish residents. In this same way, because renters tend to be people of color, to prohibit renters is to prohibit people of color. Rental restrictions have a disparate impact on people of color.

In the 2015 United States Supreme Court case, Texas Dept. of Housing and Community Affairs v. Inclusive Communities Project, Inc.[35], the court discussed that, like any other policies, an HOA's rental restriction policies need to comply with the federal Fair Housing Act. Policies which are discriminatory on their face are obviously banned. The FHA can, however, also apply to policies and actions that are unintentionally discriminatory. If a policy results in a disproportionate "disparate impact" on a protected class, the policy may violate the FHA.

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[32] Housing experts say there just aren't enough homes in the U.S.: NPR

[33] Housing For: Renters - National League of Cities (nlc.org)

[34] 533 F.3d 562 (7th Cir. 2008)

[35] 135 S.Ct. 2507 (2015)

In addition to racial discrimination, HOAs should be aware that "familial status" discrimination can be a potential FHA tripwire for HOAs. Under federal court decisions interpreting the FHA, "familial status" does not just mean things like whether a person is married, single, or divorced. The term has also been interpreted to include most age-based discrimination[36]. Restrictions against families with children—or restrictions that appear designed to prevent rentals to families with children—can likewise amount to familial status discrimination in violation of the FHA.

Conclusion and Recommendations

This paper merely scratches the surface of several global and centuries old causes of unaffordable housing in an effort to raise the issue that HOAs' rental restrictions are perpetuating discriminatory housing practices and institutional owners of SFR are the undeserving scapegoats for HOAs' perceived problems with renters. We hope that the reader's biases have been challenged and that the discussion continues.

[36] See, Iniestra v. Cliff Warren Investments, Inc., 886 F. Supp. 2d 1161, 1164 (C.D. Cal. 2012).