

SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2021-2022 Regular Session

AB 889 (Gipson)
Version: June 21, 2021
Hearing Date: July 13, 2021
Fiscal: Yes
Urgency: No
TSG

SUBJECT

Business entities: landlords: reporting requirements

DIGEST

This bill requires landlords who hold rental property in the name of a corporation or limited liability company to report the identity of the beneficial owners of the property to the California Secretary of State.

EXECUTIVE SUMMARY

Transparency has long been one of the hallmarks of the American system of real property recording. One can often determine who owns what parcel of land simply by examining the chain of title and related documents on file in the local recorder's office. However, as more and more property is held by corporations and limited liability companies (LLCs), this transparency has been replaced, increasingly, by anonymity. When 1234 Main Street is titled in the name of 1234 Main Street, LLC, the question remains: who really owns 1234 Main Street? This kind of anonymous ownership can make it difficult to trace ownership patterns in the rental market, enable slumlords to evade responsibility by hiding behind shell companies, and facilitate the use of rental property as a way to launder money obtained illegally. To combat these problems, this bill seeks to lift the veil on such property ownership. It does so by requiring landlords who hold residential rental property in the name of a corporation or limited liability company to report the identity of the "beneficial owners" of the LLC or corporation to the California Secretary of State's Office, where beneficial owner means a natural person who exercises substantial control, owns 25 percent or more of the equity interest, or receives substantial economic benefits from the assets of the LLC or corporation. While the transparency sought by this bill could have significant public policy benefits, the mechanism employed by the bill in print may need further refinement in order to assure that it can be implemented and would achieve the intended outcome.

The bill is sponsored by the California Reinvestment Coalition. Support comes from advocates for tenants and affordable housing. Opposition comes from realtors and landlords who contend that the bill's requirements are unnecessary and burdensome.

PROPOSED CHANGES TO THE LAW

Existing law:

- 1) Requires the owner of residential property offered to the public for rent, or the party signing a rental agreement or lease on behalf of the owner to do all of the following:
 - a) disclose therein the name, telephone number, and usual street address at which personal service may be effected of each person who is authorized to manage the premises and each person who is an owner of the premises or a person who is authorized to act for and on behalf of the owner for the purpose of service of process and for the purpose of receiving and receipting for all notices and demands.
 - b) disclose the name, telephone number, and address of the person or entity to whom rent payments shall be made. (Civ. Code § 1962.)
- 2) Requires the management of a mobilehome park to disclose, in writing, within 10 business days, the name, business address, and business telephone number of the mobilehome park owner upon the receipt of a written request of a homeowner.
- 3) Requires limited liability companies, corporations, or other similar entities to register information about their beneficial owners with the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) beginning in 2023, where beneficial owner is means any of the following:
 - a) the person exercises substantial control over a qualified entity;
 - b) the person owns 25 percent or more of the equity interest of a qualified entity; and
 - c) the person receives substantial economic benefits from the assets of a qualified entity. (31 U.S.C. § 5336.)

This bill:

- 1) Requires a corporation or limited liability company that owns and operates residential rental property to report the identity of the beneficial owner of the property to the California Secretary of State.
- 2) Defines “beneficial owner” to mean natural person for whom, directly or indirectly and through any contract arrangement, understanding, relationship, or otherwise, any of the following applies:
 - a) the person exercises substantial control over a qualified entity;
 - b) the person owns 25 percent or more of the equity interest of a qualified entity; and
 - c) the person receives substantial economic benefits from the assets of a qualified entity.

- 3) Excludes all of the following from the meaning of “beneficial owner”:
 - a) a minor child;
 - b) a person acting as a nominee, intermediary, custodian, or agent on behalf of another person;
 - c) a person acting solely as an employee of a qualified entity and whose control over or economic benefits from that qualified entity derives solely from the employment status of the person;
 - d) a person whose only interest in a qualified entity is through a right of inheritance; and
 - e) a creditor of a qualified entity, unless the creditor meets the requirements specified in subparagraph (A).

COMMENTS

1. LLCs and corporations limit transparency in real property ownership

When the owner of real property takes title in their own name, that ownership will be recorded as part of the documentation pertaining to the property kept at the local county recorder’s office. By contrast, when someone buys property in the name of an LLC or a corporation, the names of the individual or individuals behind the transaction do not appear anywhere in the public record. Often, this is a deliberate choice on the part of the person purchasing the property; they can remain confidential by forming an LLC and making the purchase in the name of the LLC.

2. Potential benefits of increased transparency with respect to ownership of rental property

Increased transparency regarding the ownership of rental property in California would likely have at least three significant benefits.

First, greater transparency about who owns rental property in California could provide the data that public policy makers need in order to make informed decisions. Currently, the anonymous nature of a lot of California property ownership makes it difficult to detect patterns and trends. That, in turn, makes it hard for public policy makers to determine how best to respond. For example, most of the supporters of this measure strongly criticize the increasing presence of institutional investors in California’s rental housing market. The supporters argue that this presence is ruining communities. They point out that institutional investment in real estate drives up the price of real estate and drives down rates of homeownership. They further assert that corporate landlords, motivated primarily by profit, raise rents as high as possible while cutting costs on things like maintenance, as much as they can. This bill would not prevent institutional investors from buying and renting out real estate, but it would, in theory, provide the Legislature and other policy makers with more detailed information with which to

assess the role of institutional investment in the housing market and take corrective action where warranted.

Second, greater transparency would help make it harder for slumlords to shirk accountability for what happens at their properties. Setting up ownership in the form of shell companies and then layering on other LLCs, partnerships, and corporations is, according to the author and sponsors, one of the ways that slumlords make it difficult to trace their involvement with the property and hold them responsible for what goes on there. The opposition responds to this point by highlighting existing law that requires whoever owns a rental property or whoever signs the lease on the owner's behalf, to provide, among other things, a name and address for service of process. (Civ. Code 1962.) There is a similar provision in the Mobilehome Residency Law requiring mobilehome park owners to disclose their identity and contract information in response to a mobilehome owner's request. (Civ. Code 798.28.) It appears that a landlord or park owner could claim to comply with these provisions by indicating that the owner is the shell LLC or corporation, thus leaving tenant and mobilehome owners with no individual from whom to demand a response.

Finally, when rental property can be purchased in cash and titled in the name of an anonymous LLC, it makes a convenient and difficult-to-detect way for criminals to launder ill-gotten money. Forcing LLCs and corporations to disclose the beneficial owners behind a real estate transaction has proven to be an effective method for deterring this sort of money-laundering through real estate investments. That is the strategy behind the federal government's Geographic Targeting Orders (GTOs) that require title companies to gather and report information about the beneficial owners in real estate purchases for \$300,000 or more that are paid in cash in certain geographic locations.

3. Questions regarding how the bill would be implemented and whether it would be effective to achieve its goals

While a strong argument can be made for policy benefits that the bill is intended to provide, the Committee may wish to inquire about how effectively the bill in its current form could be implemented and whether, in its current form, the bill would necessarily achieve its intended purpose.

As a preliminary matter, it is worth observing that the current version of the bill is closely modeled off of recently passed federal legislation, the Corporate Transparency Act, which will go into effect in 2023. (William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub.L. No. 116-283 (H.R. 6395), 134 Stat. 338, 116th Cong. 2d Sess., §§ 6001-6403.) The U.S. Treasury Department is currently in the process of developing regulations that will operate to implement the bill.

Under that law, corporations, LLCs, and “other similar entities” will have to register their beneficial owners with FinCEN beginning in 2023. Beneficial ownership is defined under the Corporate Transparency Act using the exact same language as this bill proposes to adopt for California. On the one hand, this should mean that complying with this bill should not be too much of an additional burden on California LLCs and corporations that own rental property. On the other hand, since the federal regulations are under development and the statutory language upon which they rely is quite broad, waiting until the federal regulations have been developed might help California entities better understand what they will have to report.

For example, both the federal law and the bill in print state that a beneficial owner includes any natural person who “receives substantial economic benefits from the assets” of the LLC or corporation. In the case of a publicly traded corporation, this could potentially be thousands of individuals. Would an LLC or a corporation have to list every shareholder? If so, it is not immediately clear how this would help achieve any of the potential benefits from the bill discussed in Comment 2, above. If not all individual shareholders must be listed, then how would the threshold for what a “substantial economic benefit” be determined? It is quite possible that the forthcoming federal regulations will help to answer these and similar questions, but probably not for another year.

Further development of the bill could also probably benefit from consideration of alternative formulations of who should constitute a beneficial owner. As the author and sponsor point out, the City of Philadelphia has adopted an ordinance requiring disclosure of beneficial ownership, but it is noteworthy that the Philadelphia law uses a different system for determining whose information must be disclosed. Under the Philadelphia law, if an owner of the property is not a natural person or a publicly traded company, the application must identify, in addition to the owner of the property, the name and preferred mailing address of:

each natural person who has an equity interest in such owner or owners of the property that exceeds one or more of the following, regardless of whether the natural person has a direct equity interest or such natural person’s equity interest is held through one or more tiers of a corporate structure, such as parent-subsidary structure: (a) forty-nine percent (49%) of the value of the property or (b) forty-nine percent (49%) of the value of the owner of the property. If no natural person has such an interest, the application shall identify the name and preferred mailing address of the two natural persons who have the largest equity interest in the property. (Philadelphia Administrative Code § 9-3901.)

Thus, Philadelphia’s structure makes it clear that in the case of relatively dispersed ownership, the LLC or corporation only has to list two people as the beneficial owners.

This is not meant to suggest that Philadelphia's approach is necessarily better. The point is just that there are a variety of ways that the bill could be structured. Modeling things off of how the federal government will be carrying out the Corporate Transparency Act may make the most sense, but it will probably be hard to evaluate that until after the corresponding regulations come out. The Committee may wish to inquire further about the bill's timing in light of these considerations.

Relatedly, the Committee may wish to ask about whether the definition of beneficial ownership in the bill aligns with one of the major stated goals of the bill. The bill in print defines beneficial owners as *natural persons* who meet certain thresholds of ownership or control. But if a major purpose behind the bill is to track the influence of *institutional investors*, will long lists of natural persons achieve that aim?

Feasibility represents another challenge for the bill in print. The Committee may wish to inquire about whether the Secretary of State's Office would be able to implement the bill in print. In their letter supporting the bill, the sponsors indicate that only a "small change to [the Secretary of State's Office] registration form" would be necessary to operationalize the bill in print. The Committee may wish to inquire further into that claim. While the Secretary of State's Office has no formal position on the bill, preliminary analysis from the Secretary of State's Office concluded that: "AB 889 is inconsistent with current Secretary of State (SOS) operational and fiscal procedures and presents multiple implementation challenges."

Finally, it should be noted that the Secretary of State's Office has few enforcement powers, and the bill in print does not provide it with any new ones. That raises a number of questions. Will anyone be monitoring the LLC and corporations filings under this bill to ensure that they are accurate? If there is someone doing that monitoring, how would they go about making sure the filings were accurate? Lastly, what would the Secretary of State's Office be able to do about it in the event that a corporation or LLC did not file or filed inaccurate information? The bill in print does not say. This is in strong contrast to the federal Corporate Transparency Act, which imposes hefty fines on LLCs and corporations that fail to register as they are supposed to do.

Ultimately, the lack of an enforcement mechanism also raises questions about whether the bill in print would achieve the intended benefits. One of the primary stated purposes of the bill is to prevent slumlords from hiding behind shell companies. Yet if there is no enforcement mechanism behind the bill, it may not make sense to expect slumlords to register their beneficial owners. After all, these are landlords who are already demonstrating little interest in following the law.

In sum, though the intended benefits of this bill arguably make for good public policy, the Committee may wish to inquire whether additional time and further refinement could result in a stronger bill: one that is enforceable, that the agencies in question can

implement more readily, and that would be even more assured of achieving the author and sponsor's goals.

4. Immediate necessity for the bill?

In spite of the questions raised in Comment 3, above, the author and sponsors urge immediate passage of this bill. They cite to reports that institutional investors are stockpiling cash in apparent preparation to buy up another large swath of rental property in California,¹ especially if the real estate market experiences another downturn, wave of foreclosures, or both. To be clear, however, nothing in the bill would prevent institutional investors from buying up rental property. At best, the bill would gather helpful data about the prevalence of institutional investors in California's rental market, thus enabling public policy makers to make more informed decisions about what, if anything, to do about that prevalence. Again, however, it is not crystal clear that the bill in print would provide that information, since the bill requires the disclosure of the names of individual beneficial owners, not institutions.

With this in mind, the Committee may wish to inquire about the timing of the bill, and whether its benefits would be better captured through rapid passage or more careful deliberation about the content.

5. Arguments in support of the bill

According to the author:

My concern is that working families in my district and throughout the state are being deprived of the American Dream as a result of large corporate landlords continuing to purchase homes in our neighborhoods. Homes in California are being purchased by large corporations who hide behind a web of Limited Liability Companies. Disclosing who the beneficial owners are of these properties would help to prevent and resolve disputes over property rights and facilitate the enforcement of tenant rights. AB 889 seeks to increase transparency by requiring corporate landlords to report the beneficial owners of the corporation or limited liability company.

¹ Myklebust *et al.* *Cashing in on Our Homes: Billionaire Landlords Profit as Millions Face Eviction* (Mar. 2021) Bargaining for the Common Good; Institute for Policy Studies; Americans for Financial Reform Education Fund <https://ips-dc.org/wp-content/uploads/2021/03/Cashing-in-on-Our-Homes-FINAL-revised.pdf> (as of Jul. 11, 2021) at p. 9.

As sponsor of the bill, the California Reinvestment Coalition writes:

The bill will provide much-needed transparency to the rental property industry such that governments and researchers can study the markets as necessary for effective policy making, and tenants can seek repairs and recourse when landlords are neglectful. [...] Just as large corporate landlords benefited from the last crisis by gobbling up foreclosed homes and renting them out to vulnerable families, the same corporations are once again poised to take advantage of an economic crisis. [...] Without transparency in ownership, connecting the dots to show such extractive business models is time consuming. [...] Secretary of State (SOS) data gathering with this small change to its registration form will bring significant transparency and reveal patterns that are necessary for communities to thrive and be healthy.

6. Arguments in opposition to the bill

In opposition to the bill, a coalition of organizations representing residential and commercial landlords writes:

California law (at Civil Code Section 1962) already requires any owner of residential property or a party signing a rental agreement on behalf of the owner to disclose the name, telephone number, and street address of the person who is authorized to manage the property; the owner of the property or a person who is authorized to act for and on behalf of the owner; and the name, telephone number and address of the person or entity to whom rent payments are to be made. There is no reason to create an expensive system for the reporting of property owner information in California. A tenant is not left wondering who to call when it comes to requests for repairs or other property operations. [...] COVID-19 has resulted in months of lost rent (in some cases, lost rent equal to 12 months per unit) and a sharp increase in vacancies. Right now, property owners and tenants are simply trying to stabilize their lives and businesses. AB 889 is an unnecessary idea that fails to move California forward, introduced during an extremely challenging time for landlords and tenants alike.

SUPPORT

California Reinvestment Coalition (sponsor)
Abundant Housing LA

Alliance of Californians for Community Empowerment
Bend the Arc Jewish Action of Southern California
Berkeley Tenants Union
California Democratic Renters Council
California Housing Partnership
California Rural Legal Assistance Foundation
California YIMBY
Causa Justa :: Just Cause
Community Legal Services in East Palo Alto
East Bay for Everyone
East Bay Housing Organizations
East Bay YIMBY
The Greenlining Institute
Grow the Richmond
House Sacramento
Housing Equality & Advocacy Resource Team
Housing Now!
Housing Rights Committee of San Francisco
Inland SoCal Housing Collective
Inner City Law Center
Law Foundation of Silicon Valley
Long Beach YIMBY
Neighborhood Housing Services of Los Angeles County
North Bay Organizing Project
Northern California Land Trust
Peninsula for Everyone
Public Advocates
Public Law Center
San Fernando Valley YIMBY
San Francisco YIMBY
Santa Cruz YIMBY
Sonoma County Tenants Union
South Bay YIMBY
TechEquity Collaborative
Tenderloin Housing Clinic
Western Center on Law and Poverty
Westside for Everyone
YIMBY Action

OPPOSITION

BOMA California
Business Properties Association California
California Apartment Association

California Association of Realtors
California Building Industry Association
Institute of Real Estate Management
International Council of Shopping Centers
NAIOP of California
National Rental Home Council
Southern California Rental Housing Association
Western Manufactured Housing Communities Association

RELATED LEGISLATION

Pending Legislation: None known.

Prior Legislation:

AB 1188 (Wicks, 2021) would have required the Department of Housing and Community Development (HCD) to save certain data, including data from the statewide rental assistance program, for a period of not less than 10 years. AB 1188 was held on the suspense file in the Assembly Appropriations Committee.

AB 2406 (Wicks, 2020) would have established the Homeless Accountability and Prevention Act which would have required HCD to create an online rental registry of properties which received state or federal rental assistance provided in response to the COVID-19 state of emergency. AB 2406 was held on the suspense file in the Assembly Appropriations Committee.

AB 724 (Wicks, 2019) would have required HCD to create a rental registry for properties owned by landlords with more than 15 properties. AB 724 was held in suspense in the Assembly Appropriations Committee.

AB 294 (Gipson, Ch. 31, Stats. 2017) required mobilehome parks to disclose, in writing, within 10 business days, the name, business address, and business telephone number of the mobilehome park owner on request from a mobilehome owner.

AB 893 (Connelly, Ch. 769, Stats. 1987) required landlords to provide a name and address for service of process on for the owner of the property or the property manager.

PRIOR VOTES:

This bill was gutted and amended in the Senate on June 21, 2021. All prior votes on the bill are unrelated to its present content.
