

**The Effects of Rent Stabilization and
Vacancy Decontrol
on Rents, Rental Property Values
and Rent Burdens
in Berkeley, California**

Berkeley Rent Stabilization Program,
March 15, 2010

75% of Rental Units Covered by Rent Stabilization

- 19,100 units registered or should be registered
- 1,900 rental units are temporarily exempt
 - 1,500 units in rental assistance programs
 - 400 rentals in owner-occupied duplexes or owned by non-profit housing organizations
- 21,000 rental units subject to rent stabilization
- 6,700 rental units are permanently exempt from stabilization but subject to good cause for eviction
 - 4,000 single unit properties (single-family or condo)
 - 2,700 multi-family units built after 1980
- 27,700 total rental units

Diverse Size and Ownership of Registered Units

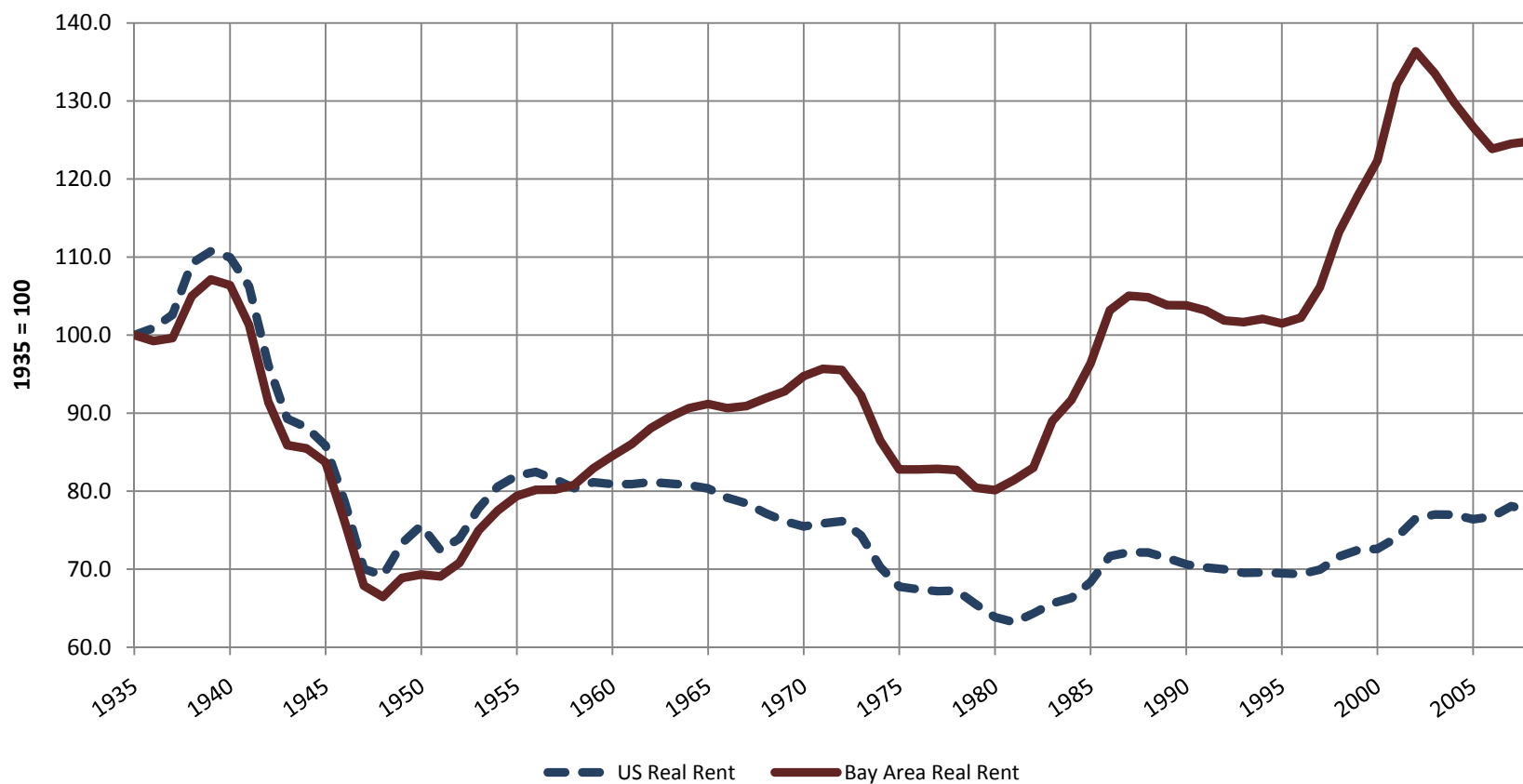
- 1-4 units 25%
 - 5-9 units 24%
 - 10-19 units 22%
 - 20+ units 29%
-
- 10% of landlords own half the registered units
 - 281 owners of 15+ units own 9,458 units
 - 635 owners of 5-14 units own 5,170 units
 - 1,876 owners of 1-4 units own 4,104 units

2008 Median Monthly Rents and Median Rooms per Unit

• San Francisco Bay Area	\$1,188	3.8
• Alameda County	\$1,091	3.8
• Berkeley	\$1,069	3.4
• Portland MSA	\$720	4.1
• Berkeley pre-1999 tenancies	\$679	
• All U.S. Metro Areas	\$676	4.1
• Pittsburgh, PA MSA	\$495	4.2

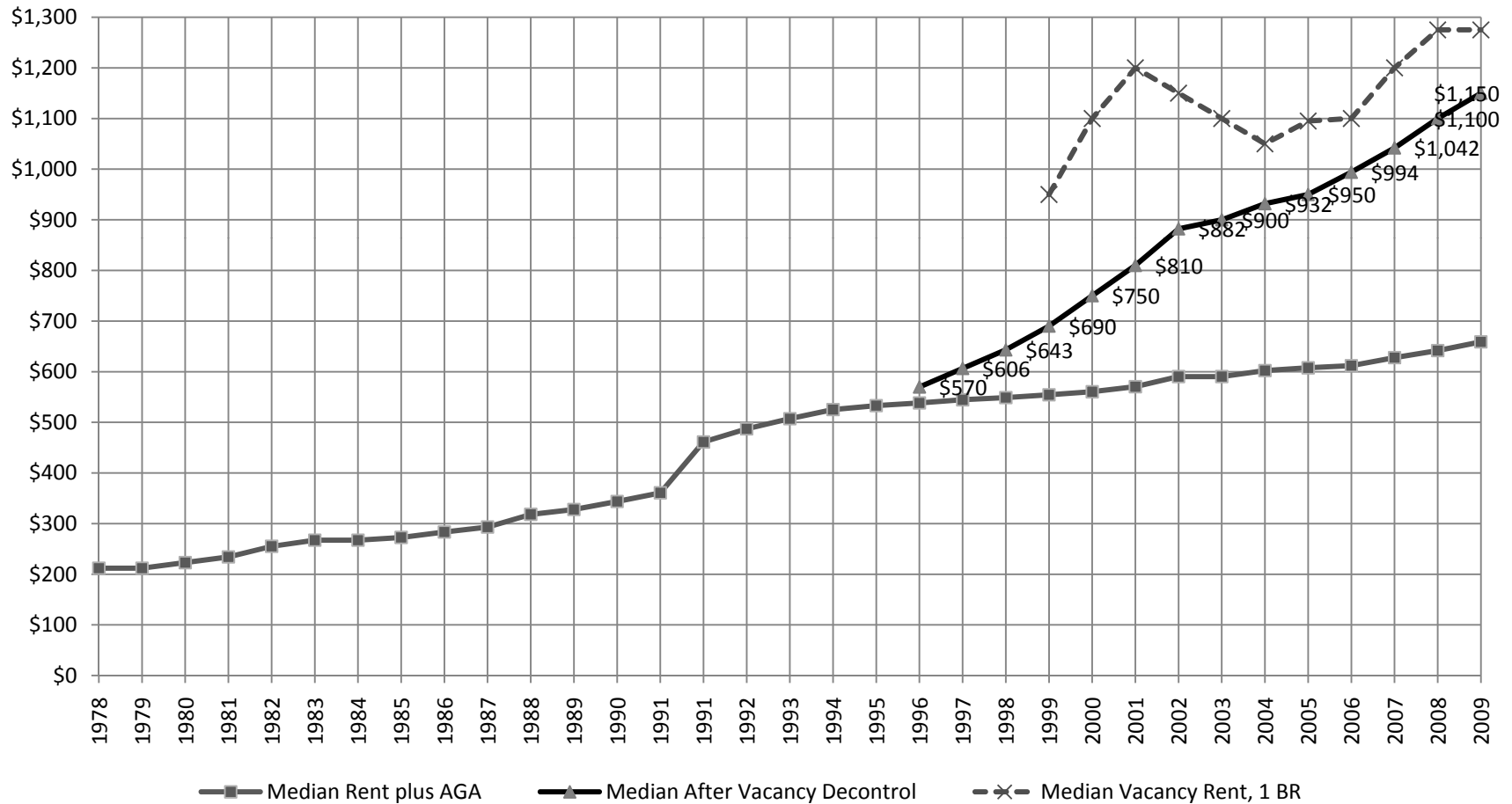
Bay Area Rents Increased Most: Bay Area and U.S. Inflation-Adjusted Rent, 1935 – 2008s

(CPI-R/CPI-Less Shelter)

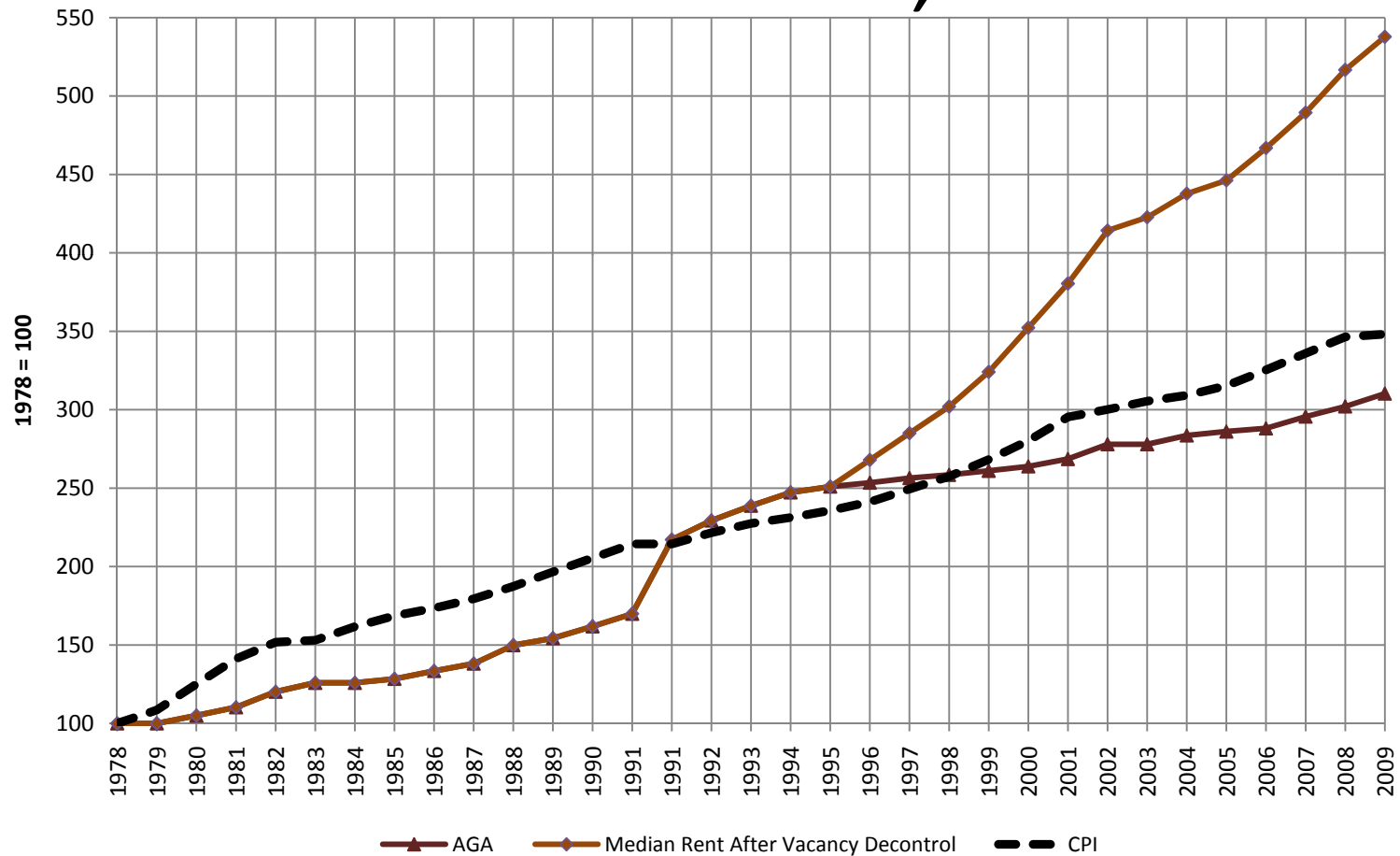


Median Berkeley Rent, 1978 – 2009

(Rent Stabilized Units)



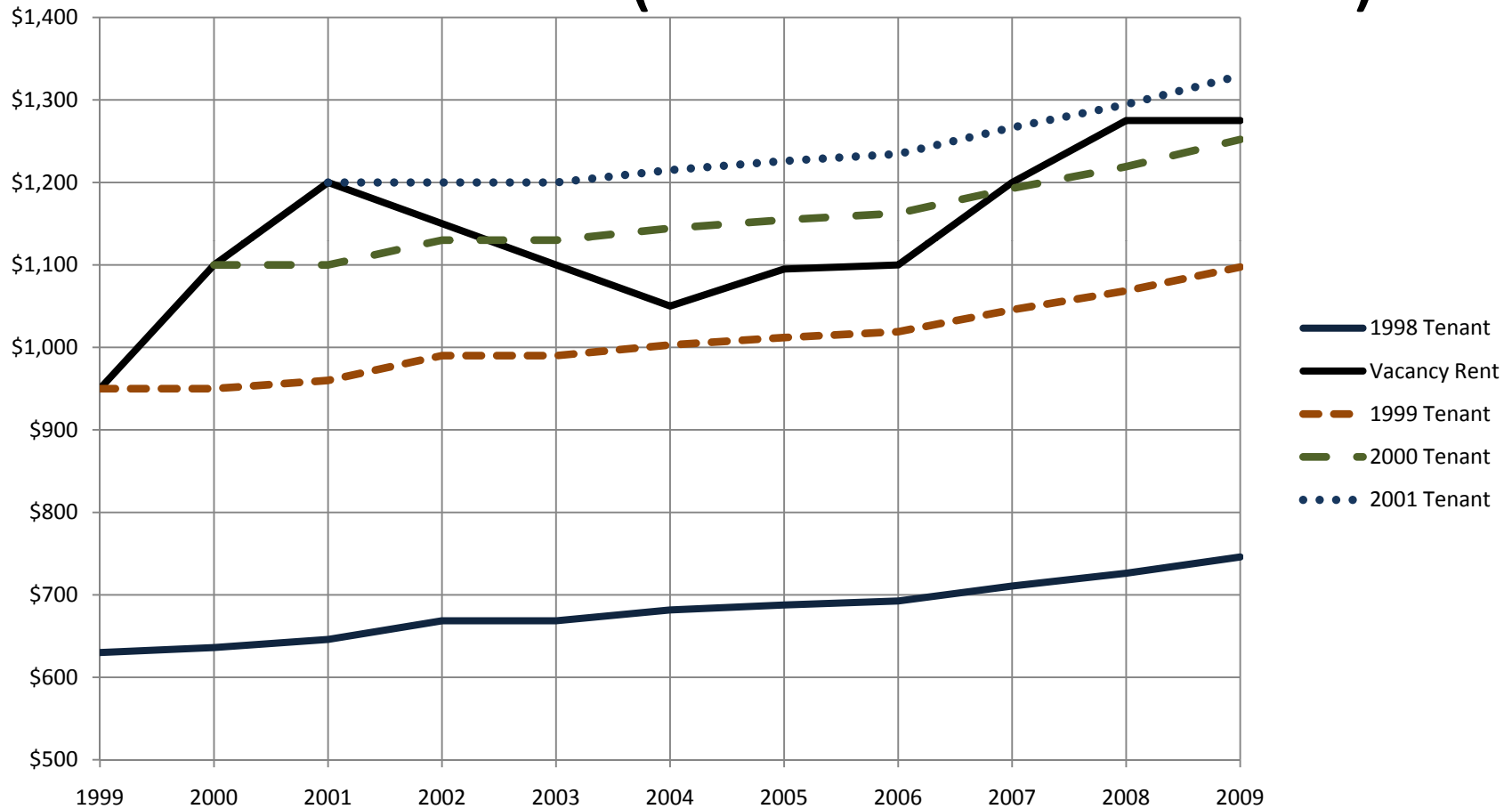
Average Berkeley rent increases by 50% more than the Bay Area Consumer Price Index, 1978 - 2009



Rents in Pre-Vacancy Decontrol Tenancies

- 1/5th of registered units
- About 4,000 units
- Estimated average tenant savings from current market
 - \$555 monthly
 - \$6,700 annually
- \$26 - \$27 million annual benefit to tenants

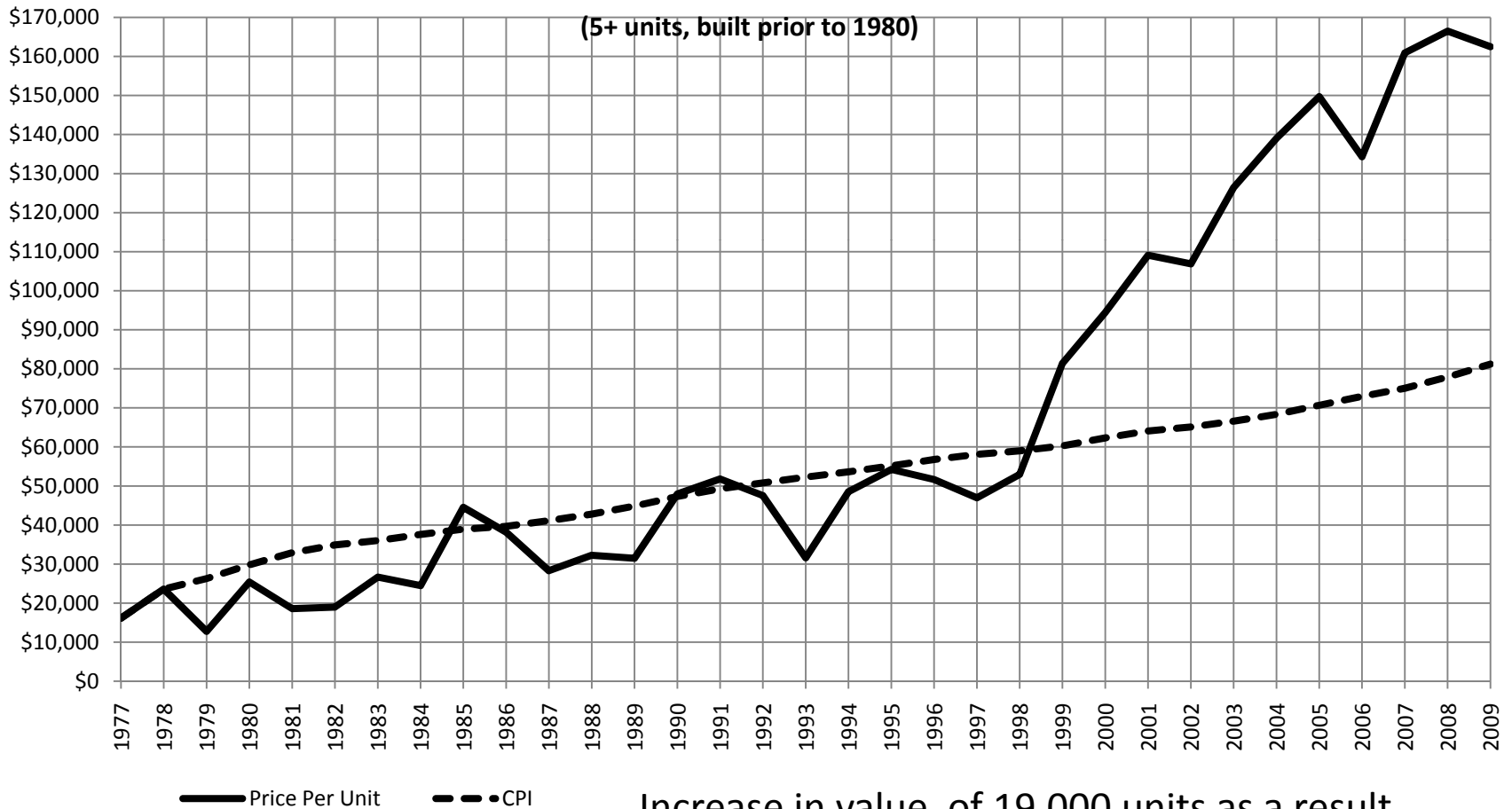
Effects of Year Tenant Moves In Under Vacancy Decontrol – Recontrol 1999 – 2009 (one bedroom unit)



Effects of Vacancy Decontrol and Stabilization

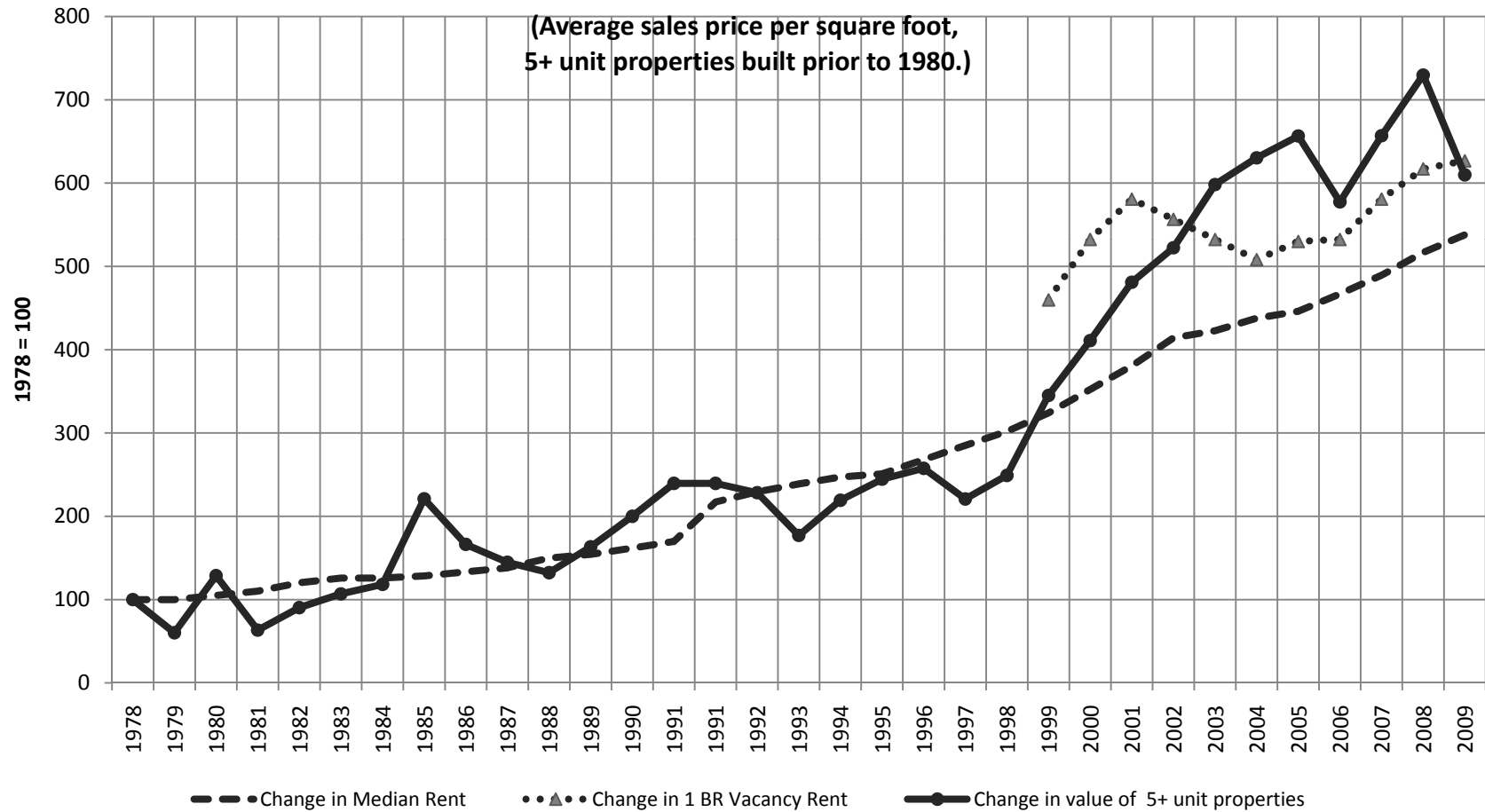
- Annual rent increase due to vacancy decontrol: \$100 million
 - Modest improvement in maintenance
 - Increased City tax revenue of up to \$2 million
- Discount to pre-vacancy decontrol tenants: \$27 million
- Discount to post-vacancy decontrol tenants: \$10 million?

Average Sales Price per Unit of Berkeley Rental Properties: 1977 – 2009



Increase in value of 19,000 units as a result of vacancy decontrol: \$1.2 billion

Increase in Sales Prices and Rents: 1978 - 2009



The Profitability Paradox

- As rents go up, so do expectations of future increases
- Property sales prices increase
 - new buyers will take on mortgages that leave only a modest cash flow.
 - Long-term owners refinance to take out equity and the higher financing costs leave only a modest cash flow.
- If future rents fail to increase as expected, or maintenance costs or interest rates increase, there is an incentive for under-maintenance.

Los Angeles Study Findings

- From 2000 to 2008 median rents in Los Angeles increased 52% from \$612 to \$933.
- In 2009 only 28% of LA owners reported that they made a profit in the previous year.
 - Very few buyers since 2000 reported a profit
- One quarter are postponing major maintenance.
- Rents Up, Tenants Paying More, New Owners Losing Money, Housing At Risk

Recommendations

- *The Rent Board and the City should investigate measures to reduce the adverse effects of the speculative element in investment in rental property in Berkeley.*
- *Such measures could include requirements that take effect when a rental property is transferred or refinanced, such as:*
 - *Housing code inspection prior to or no more than 30 days after the time of sale or refinance and all code violations cleared.*
 - *Energy efficiency inspection prior to or within 30 days of the time of sale or refinance and must meet required standards (possibly as set by RECO, CECO) within 6 months.*
 - *Soft story buildings fully retrofit to meet a life-safety standard within one year of transfer*

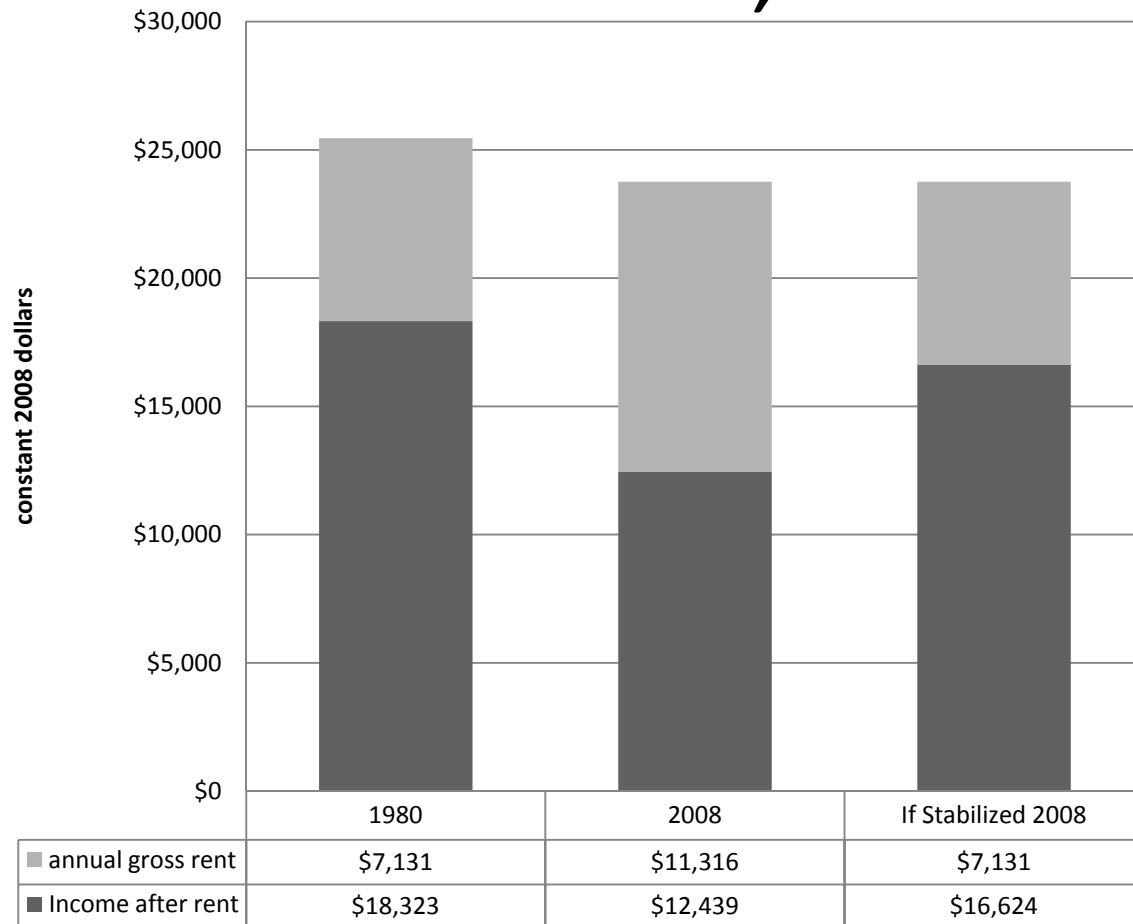
Fair Return in Low-Turnover Properties - 1

- Berkeley's annual cost studies from 1981 to 2004 indicated that the Board could ensure the legally required fair return for most *properties* by increasing rent ceilings at the rate of increase in the CPI.
- During the period from June 2005 to June 2009 the Bay Area CPI-All Items increased by 12.3%
- Average rent for all registered units increased 18% from 2005 to 2009.
- Under the 2004 AGA formula rent ceilings increased by 8.0% from January 2006 to January 2010.

Fair Return in Low-Turnover Properties - 2

- In buildings with little or no turnover since 1998 this disparity creates a potential issue.
- 643 units in 245 properties where two-thirds or more of the units have not received any vacancy increase.
- Mostly in properties with 1 – 4 units.
- *Recommend an expedited IRA process for properties with increases less than CPI.*

Bay Area Rent Burden: Tenant Income & Rent at 25th Percentile, 1980 & 2008

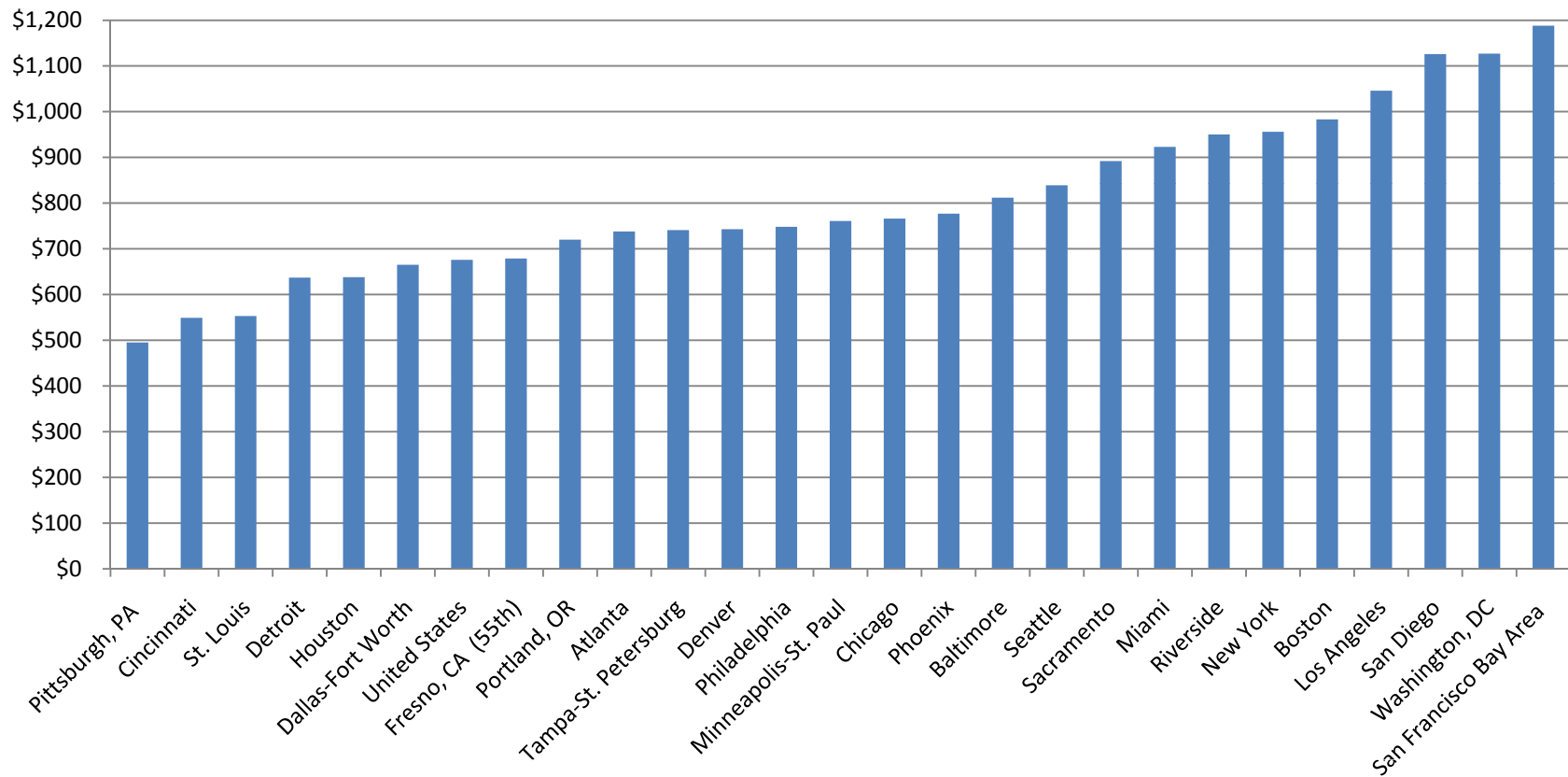


Why is Rent Stabilization Needed?

- Critics of rent control argue that price controls are inherently harmful and will reduce the production and maintenance of housing.
- In an ideally-functioning housing market, prices are held to the minimum level necessary.
- Are rents in the Bay Area at the minimum necessary level?

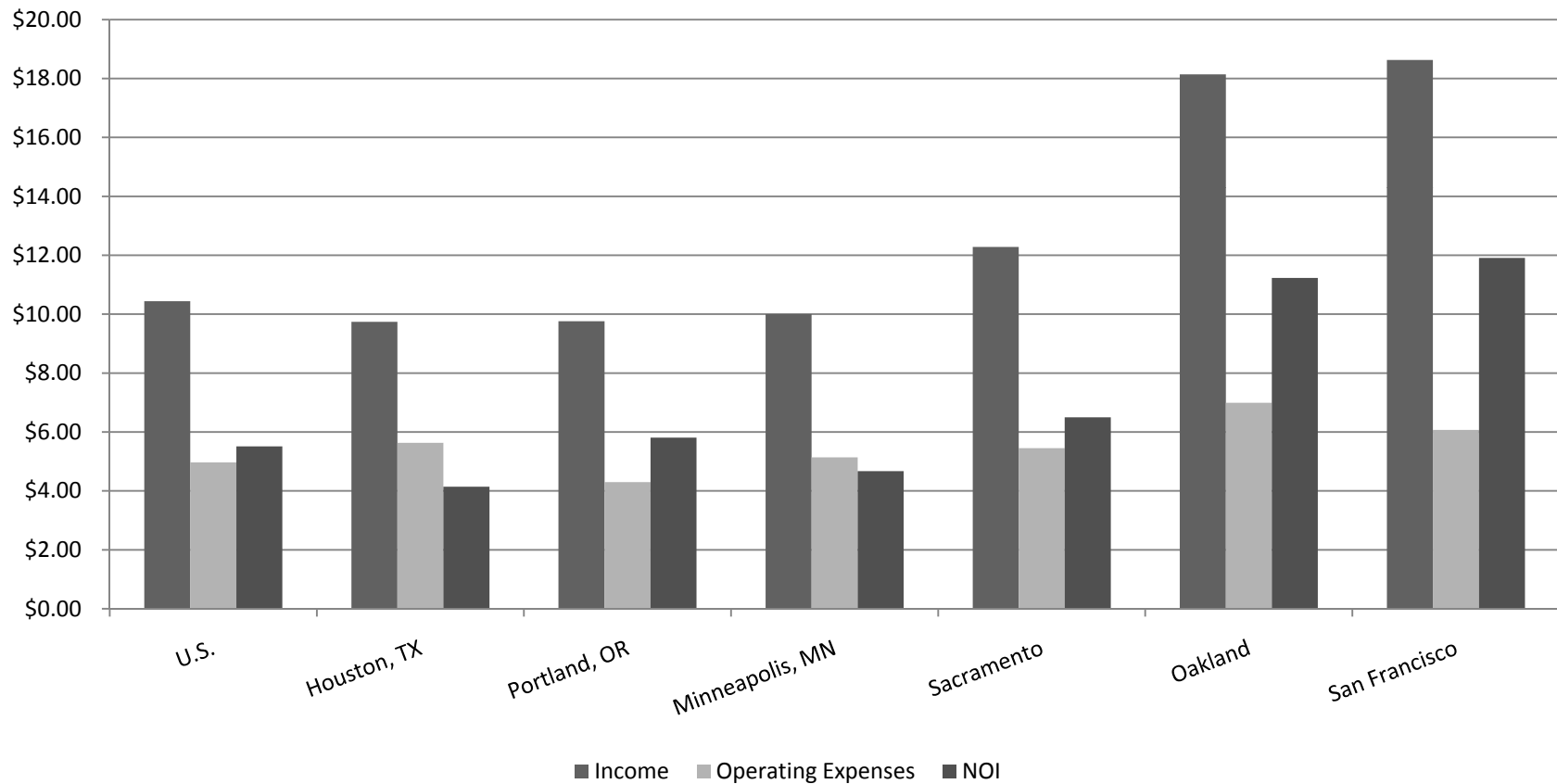
Median Rent in 25 Largest Metropolitan Areas, 2008

American Community Survey, 2006-8



Do Operating Expenses Explain Why Bay Area Rents are so High?

Income, Operating Expenses, NOI Per Square Foot in Selected Metro Areas, 2007 (IREM)



Building Rent and Land Rent

- Residential real estate combines a building and land. Rent pays for both.
- Building rent pays for construction, operation and maintenance of the building.
- Land rent pays for the value of the location. In an urban area this value is created by public investment and the activities of the people who live and work near by.

Land Rent in Economic Theory

- Land rent represents rent increases caused by scarcity in a housing market that is not working.
- The Bay Area's dense, compact development patterns and tough land use regulations constrain new housing development and increase land value and land rent.
- Economic theory says that regulation or taxation of land rent will not reduce production and maintenance of housing if done correctly.

Land Rent in the Bay Area Rental Housing Market

- In the Bay Area $1/3^{\text{rd}}$ of rent paid is land rent, most of the difference between rents in the Bay Area and the Portland, Oregon area.
- Vacancy rate is not the measure of balance in the market – rent levels are the measure of balance.
- Tenants contribution to their community increases its land values, which increases the rents they pay.

Rent Stabilization and Good Cause for Eviction After Vacancy Decontrol

Purposes

- Provide balance between landlords and tenants and enable tenants to have stability in their homes by preventing unwarranted rent increases and arbitrary evictions
- Provide affordability for low-income people

Current Role

- Rent stabilization provides stability to tenants after they move in.
- It does not prevent unnecessarily high increases upon vacancy and this reduces affordability

Recommendation

- *The Rent Board should sponsor or cosponsor an affordable housing workshop or conference to examine:*
 - *a range of approaches to improving maintenance and seismic safety*
 - *reducing the harmful effects of the speculative element in the rental housing business*
 - *making housing more affordable to low-income tenants.*
 - *This should include consideration of ways to generate additional funding for housing that is removed from the market through alternative forms of ownership such as land trusts, limited-equity cooperatives and non-profit housing corporations.*