

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

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**Jay Kelekian, Executive Director  
Stephen Barton, Ph.D., Project Manager**

**Berkeley Rent Stabilization Board  
2025 Milvia Street  
Berkeley, CA 94704**

**Tel: 510-981-RENT (7368)  
E-mail: [rent@ci.berkeley.ca.us](mailto:rent@ci.berkeley.ca.us)**



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## Summary

A majority of the housing units in Berkeley are rented and tenants make up half of Berkeley's household population. Berkeley's rent stabilization program has jurisdiction over three-quarters of Berkeley rental units, those built prior to 1980 in properties with two or more units. The program normally registers about 19,000 units each year, and potentially covers another 2,000 rental units that are temporarily exempt, most often because those units are occupied by tenants who receive rent subsidy. Nearly 2,800 rental property owners own registered units, but more than half are owned by the 281 owners with 15 units or more. Nearly 4,000 units are occupied by tenant households who have been in place since 1998, before the beginning of state-mandated vacancy decontrol. The remaining 15,000 units have tenants who moved in after 1998 and began their tenancy at market rent.

Rents in the Bay Area have consistently increased faster than rents in the rest of the U.S. and are higher than any other major metropolitan area. Current rents in Berkeley are consistent with this trend. According to the American Community Survey the 2008 median monthly rent was \$676 for all U.S. metropolitan areas, while Berkeley rent registration records showed a 2008 median rent of \$1,100. In contrast, for the one fifth of rent stabilized units that have never received a vacancy increase since vacancy decontrol began in 1999 the 2008 median rent was \$679.

Rent control delivers major economic benefits to the rent stabilized tenants who have not moved since 1999 when vacancy decontrol went into effect and delivers modest benefits to later tenants, whose initial rent is set at market but whose subsequent rent increases are limited to 65% of the increase in the Consumer Price Index (CPI). As a result of vacancy decontrol, investors in rental housing receive approximately \$100,000,000 a year more in rent than they would have if Berkeley had continued its strong rent control system and this amount increases as the remaining long-term rent controlled tenants move out. Rent stabilization has reduced rents for long-term tenants by \$27,000,000 annually and for post-decontrol tenants by as much as \$10,000,000.

The average sales price per unit for Berkeley rental properties with five units or more built prior to 1980 has gone from \$53,000 for properties sold in 1998, just prior to full vacancy decontrol, to \$162,500 in 2009 and the price per square foot increased from \$78 in 1998 to \$192 in 2009. The value of the 19,000 pre-1980 rental units in Berkeley has increased by over \$1 billion as a result of vacancy decontrol. Just over 70% of Berkeley's rental properties are still under the same ownership as in 1998, so most owners have enjoyed major increases in property values. Maintenance in Berkeley properties has improved somewhat since vacancy decontrol, but there is still a substantial number of properties where tenants report poor conditions and multiple physical problems with their buildings.

There are around 600 units in properties, mostly with one to four units, that had little or no tenant turnover since 1998. The annual rent increase formula of 65% of the increase in the Consumer Price Index (CPI), which replaced annual cost studies in 2005, may not provide a sufficient rent increase in these properties. Past Rent Board studies found that in Berkeley average rent increases for most properties needed to roughly match the increase in the CPI, although there can be substantial variation in the rents of particular units. Where there is regular tenant turnover, the vacancy increases make up the necessary difference. For the exceptional cases where there is

little or no turnover, the Rent Board should provide an expedited, low-cost procedure to allow owners to request an increase in building rents to match the increase in the CPI.

In the Bay Area as a whole, rents have increased faster than both incomes and the cost of living, and as a result the Bay Area's low and moderate income tenants had less real income left after paying rent in 2008 than tenants had in 1980. In post-vacancy decontrol Berkeley, rent takes an increasing percentage of the income of Berkeley tenants. In 1998 41% of non-student tenants spent more than Federal affordability standard of 30% of income for rent. This increased to 53% in 2009 for non-student tenants who moved in after vacancy decontrol even though new tenants have higher incomes. The rent burden did not change between 1998 and 2009 for the long-term tenants whose rents were set prior to vacancy decontrol. Although its economic effects are reduced, rent stabilization continues to protect tenants from displacement due to drastic increases in rents such as occurred during the dot-com bubble.

The Bay Area housing market does not work the way markets are supposed to. Increases in rents fail to generate sufficient additional housing production to hold rents down to levels that are normal elsewhere in the U.S. As a result, Bay Area and Berkeley rents are based on scarcity and the limits of what tenants can afford, rather than on the actual cost of operating and maintaining the buildings. Rent stabilization protects tenants from rapid increases in rents while they remain in the same apartment, but vacancy decontrol ensures that overall rents are at levels that are far above the level necessary to actually operate and maintain rental housing. It remains an open question what can be done to reduce the rent burden of low-income tenants.

## Section 1: Overview of Rent Stabilization and the Rental Housing Stock

### The Rent Stabilization and Eviction for Good Cause Ordinance

Berkeley Municipal Code Section 13.76: “Rent Stabilization and Eviction for Good Cause Ordinance” has two main components, as described in its title.<sup>1</sup> Rent stabilization limits rent increases for most tenants who live in properties with two or more units constructed prior to 1980, which is the year the ordinance went into effect. Good cause for eviction requirements apply to all rental units, even those units exempt from rent stabilization, with the exception of duplexes that were owner-occupied in 1979 and are owner-occupied currently.<sup>2</sup>

Rent stabilization in Berkeley began in 1978, when the voters passed a local initiative that temporarily reduced rents, requiring landlords to pass through to tenants the majority of the operating cost savings the landlords received from the property tax reductions resulting from passage of Proposition 13. During the campaign for Proposition 13, proponents had claimed that reduced costs to owners would result in lower rents. Since rents continued to increase after its passage, tenant advocates in a number of cities including Berkeley successfully proposed measures to require rent reductions. Then, in 1980, Berkeley voters passed the Rent Stabilization and Eviction for Good Cause Ordinance, making rent controls permanent, requiring rent registration and establishing a Rent Stabilization Board to implement the requirements of the ordinance. In 1982, the voters passed a Charter Amendment establishing an elected Rent Stabilization Board (Berkeley Charter, Article XVII, section 121). From 1980 through 1998 rents in units built prior to 1980 were controlled permanently, so that the rent did not change when a tenant moved out and new tenants moved in.<sup>3</sup>

In 1995 the State of California passed new legislation denying local governments the power to place units under permanent rent controls. From 1996 to 1998 there was a phase-in period in which owners could rent vacant units for 15% more than the previous rent ceiling. Then as of January 1, 1999, local governments could no longer limit the initial rent for new tenancies, although they can limit subsequent rent increases on the tenants as long as they remain in the unit.<sup>4</sup> This system is usually called “vacancy decontrol” although it is really “vacancy decontrol – recontrol.” The new law also permanently removed all single-unit properties from rent control, including both single-family houses and condominiums, except for tenancies that began prior to 1999.

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<sup>1</sup> Berkeley Municipal Code, Chapter 13.76, *et seq.*

<sup>2</sup> Eviction for good cause does not apply when a tenant does not rent a unit but rather shares one with the owner.

<sup>3</sup> For a detailed history of Berkeley’s rent stabilization program and changes in the ordinance up to 1994, see Planning & Development Department, City of Berkeley, *Rent Control in the City of Berkeley: 1978 to 1994: A Background Report*, May 27, 1998.

<sup>4</sup> California Civil Code sections 1954.50 through 1954.535

In 2004 voters approved an amendment to the Rent Stabilization Ordinance to cease doing annual cost studies and simply index the Annual General Adjustment to the rent at 65% of the increase in the CPI-All Items.<sup>5</sup>

The major purpose of the Rent Stabilization and Eviction for Good Cause Ordinance is to provide a stable housing environment for tenants while assuring that landlords are able to receive a fair return on their investment. It assures tenants in rent-stabilized units that once they move in their rents will not drastically increase, giving tenants a level of security similar to that of homeowners who are protected from rapid cost increases by the state property tax limitation and fixed-rate mortgages. In addition to annual rent increases (through the Annual General Adjustment, or AGA), landlords can apply for individual rent adjustments if the increases they receive through tenant turnover and the AGA are not sufficient to provide them with the legally required fair rate of return. The ordinance also protects tenants from arbitrary evictions through a system of eviction controls and twelve defined just causes for eviction. Good cause for eviction requirements apply to virtually all rental units, including those built after 1980, condominiums and single-family houses.

#### Rental Units Subject to Rent Stabilization

Berkeley currently has approximately 27,700 rental units.<sup>6</sup> Virtually all of these rental units are subject to Berkeley's "good cause for eviction" ordinance. About 21,000 of them - about 75% of Berkeley's rental housing stock - are currently or potentially subject to rent stabilization.

The major categories of units not subject to rent stabilization are:

- Units built after 1980. There are approximately 2,700 such rental units.
- Single-family or condominium units. Currently there are only 144 tenants in one-unit properties who moved in prior to 1999 and are still covered by rent stabilization.<sup>7</sup> There are approximately 4,000 exempt single unit rentals.
- Rental units in two-unit properties which were owner-occupied on December 31, 1979 as long as an owner occupies the other unit. These units are covered by the ordinance when an owner does not occupy the other unit. Currently there are 270 such exempt units.<sup>8</sup>

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<sup>5</sup> The Rent Board and the Berkeley Property Owners Association jointly proposed this amendment in settlement of litigation brought by the BPOA challenging the Rent Board's practice of reducing increases for maintenance of net operating income by the amount of past increases that were more than legally necessary.

<sup>6</sup> The U.S. Census found that as of April 1, 2000 Berkeley had 46,875 housing units, of which 26,498 were either rented or vacant and for rent. By the end of 2009 approximately 1,200 additional multifamily rental units were completed, for a total of about 48,100 units and 27,700 rentals. The Census counts rented rooms as separate units if they have direct access to public spaces, such as a hallway, leading to an exit. Otherwise they are considered group quarters. According to the Housing Department, the Rental Housing Safety Program (RHSP) inventory includes 25,708 rental units and 3,011 rooms for rent. This inventory likely includes many rooms that the Census counts as group quarters but likely also misses a number of rented single-family homes, which are often rented only temporarily.

<sup>7</sup> As of August 3, 2009.

- Units whose tenants receive rental assistance from the government through programs such as the Section 8 Housing Choice Voucher Program or Shelter Plus Care are not covered by rent stabilization as long as the landlord does not charge a rent above the “payment standard” set by the Berkeley Housing Authority. Currently there are 1,426 such units. When occupied by a tenant who is not receiving rental assistance, these units are subject to rent stabilization unless another reason for exemption applies.
- Units in non-profit housing provided at below-market rents to low-income tenants are exempt unless the occupant is an original tenant who moved in prior to the non-profit organization taking ownership. Currently there are 114 such units.

A total of about 21,000 rental units are normally subject to rent stabilization.<sup>9</sup> For the 2008-2009 fiscal year landlords paid registration fees for 19,050 units, indicating that they were subject to rent stabilization. Another 1,810 units were reported exempt, either because they were occupied by tenants receiving rental assistance or because they were in a 1979 owner-occupied duplex. There are also as many as 1,000 units in multifamily properties that would be subject to rent stabilization if they were rented out, but are currently owner-occupied or otherwise used by the owner, occupied rent free, or vacant and not available for rent.<sup>10</sup> This suggests that the maximum potential coverage of Berkeley’s rent stabilization ordinance is around 22,000 units.

### *Physical Characteristics of the Rental Housing Stock*

Berkeley’s rental housing stock is quite diverse, with about one-quarter in one- and two-unit buildings, one-sixth in each of the following size categories: 3-4 unit buildings, 5-9 unit buildings and 10-19 unit buildings, and one quarter in buildings with 20 or more units. Almost all of the rental housing constructed since 2000 has been in buildings with 20 units or more.

Table 1 compares the 2000 Census data for rental units by the number of units in the building with 2009 Rent Board data for rent-stabilized units and units temporarily exempt while occupied by tenants receiving monthly rental assistance, mostly through the Section 8 Housing Choice Voucher program. There are differences of definition to deal with, for example two duplexes on

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<sup>8</sup> As of August 3, 2009.

<sup>9</sup> The registered and exempt units almost exactly match the 2000 Census data. According to the 2000 Census, 24,028 of Berkeley’s 25,748 occupied rental units were built prior to 1980. The Census also reports 750 units that were vacant and for rent, but does not give a construction date for them. Assuming these are similar to the occupied units, we can add another 700 rental units to the total built prior to 1980. Of this total of 24,728 rental units built prior to 1980, the Census reports that 4,033 of these were in single-family houses, and all but 144 of these are now permanently exempt due to tenant turnover since 1999. This leaves about 20,850 units subject to rent stabilization. There are two offsetting sources of error in this estimate. The Census counts units in the structure, rather than units on the property. Berkeley has a number of multi-unit properties with separate cottages, so single-family rental units of this type are generally subject to rent control. In addition, some rental units in pre-1980 multi-family buildings are not subject to rent control because they are condominiums.

<sup>10</sup> According to the 2000 Census there are a total of 25,021 units in multifamily structures in Berkeley, of which about 23,400 units were built prior to 1980. Of these, about 2,300 units were owner-occupied at the time of the 2000 Census. At least 1,000 of these owner-occupied units are condominiums and thus permanently exempt from rent stabilization. Another 270 are in 1979 owner-occupied duplexes that are exempt as long as they are owner-occupied.



one lot would count as two duplex rentals for the Census and one four-unit rental for the Rent Board, but the broad trends are clear. Exempt rentals are concentrated in single-family units, smaller multi-family properties where condominium conversion has been concentrated, and in newly constructed larger properties.

Table 1: Renter-occupied units by units in structure		
	All 2000 Rentals by Units in Structure	2009 Registered Rentals by Units in Property
1 unit	4,428	152
2 units	2,504	1,201
3 or 4 units	4,282	3,299
5 to 9 units	4,425	4,491
10 to 19 units	4,258	4,082
20 to 49 units	4,163	4,340
50 or more units	1,666	1,163
Total units	25,748	18,728

Sources for Table 1: U.S. Census Bureau, 2000 Census (does not include rentals built after April 1, 2000, all of which are exempt from rent stabilization); Berkeley Rent Stabilization Program, August 25, 2009 (point in time data gives several hundred fewer units than the total for registrations during a full year.) The 2000 Census is used instead of the 2006-8 American Community Survey because there are major discrepancies between the Census and ACS unit totals and the Census count methodology is more accurate than the ACS survey.

Table 2 shows the size of Berkeley's rental housing by number of bedrooms. Exempt units are fairly evenly distributed among zero, one and two-bedroom units, but make up more than half of rental units with three or more bedrooms because many of the larger rental units are in single-family houses that are exempt.

Table 2: Renter-occupied units by number of bedrooms		
	All Rentals	Registered Rentals
Bedrooms in Unit		
No bedroom	5,184	3,792
1 bedroom	10,532	7,890
2 bedrooms	7,371	5,677
3 bedrooms	1,945	873
4 or more bedrooms	716	293
Total units	25,748	18,525

Sources for Table 2: U.S. Census Bureau, 2000 Census (does not include rentals built after April 1, 2000); Berkeley Rent Stabilization Program, August 25, 2009 . Point in time data gives several hundred fewer units than the total for registrations during a full year. Several hundred units with missing data are excluded. Units with no bedrooms include both studio apartments and rooms in a rooming house or residential hotel as long as the rooms have independent access to hallways and entry areas.

The distribution of ownership of registered rental units in Berkeley is very diverse, ranging from a family that owns only one unit to a family that owns over a thousand units. Table 3 shows the distribution of ownership by number of units owned as reported to the Rent Stabilization Board. This table somewhat overstates ownership dispersal, because the Rent Board data do not take into account situations in which one owner or a group of owners use different corporations or partnerships. Two-thirds of the owners have from one to four registered units, but all together they own only 22% of all the registered units. The ten percent of owners with 15 units or more own over 50% of the registered units. The average number of registered units per owner is 6.7.

	Separate Owners	Currently Registered Units
Total	2,792	18,732
Owners with 1-4 units	1,876	4,104
Owners with 5-14 units	635	5,170
Owners with 15-29 units	193	3,996
Owners with 30+ units	88	5,462
Owners with 1-14 units	2,511	9,274
Owners with 15+ units	281	9,458

<sup>11</sup> The number of units owned does not include rental units exempt from registration, such as units rented to tenants with Section 8 vouchers.

## Section 2. Berkeley Rents, 1978 to 2009

### Rent Levels in Berkeley, the Bay Area and the U.S.

Rents in Berkeley, as in the Bay Area as a whole, are among the highest in the United States. The major exception is units that have not received a vacancy decontrol increase.

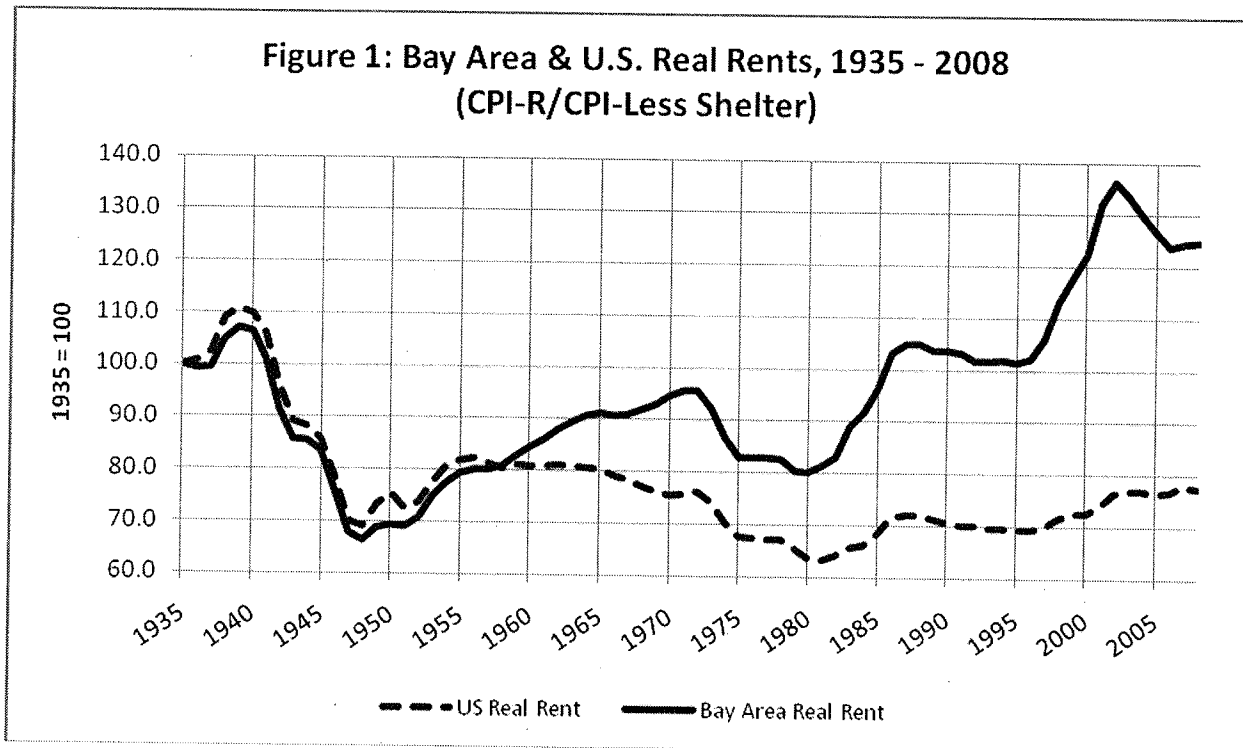
**Table 4: 2008 Contract Rent in 25 Largest Metropolitan Areas and Berkeley Area**

	<u>Lower</u> <u>quartile</u>	<u>Median</u>	<u>Upper</u> <u>quartile</u>
<b>San Jose-San Francisco-Oakland, CA CSA</b>	<b>\$882</b>	<b>\$1,188</b>	<b>\$1,623</b>
Washington DC-Arlington, VA-MD-WV	\$850	\$1,127	\$1,484
San Diego-Carlsbad-San Marcos, CA	\$861	\$1,126	\$1,524
<b>Alameda County, CA</b>	<b>\$828</b>	<b>\$1,091</b>	<b>\$1,438</b>
<b>Berkeley, CA</b>	<b>\$762</b>	<b>\$1,069</b>	<b>\$1,488</b>
Los Angeles-Long Beach-Santa Ana, CA	\$790	\$1,046	\$1,420
Boston-Cambridge-Quincy, MA-NH	\$653	\$983	\$1,323
New York-N. New Jersey-Long Is., NY-NJ-PA	\$678	\$956	\$1,295
Riverside-San Bernardino-Ontario, CA	\$709	\$950	\$1,247
Miami-Fort Lauderdale-Pompano Beach, FL	\$702	\$923	\$1,219
<b>Oakland, CA</b>	<b>\$694</b>	<b>\$912</b>	<b>\$1,204</b>
Sacramento--Arden-Arcade--Roseville, CA	\$707	\$892	\$1,184
Seattle-Tacoma-Bellevue, WA	\$656	\$839	\$1,125
Baltimore-Towson, MD	\$601	\$812	\$1,094
Phoenix-Mesa-Scottsdale, AZ	\$607	\$777	\$1,015
Chicago-Naperville-Joliet, IL-IN-WI	\$602	\$766	\$978
Minneapolis-St. Paul-Bloomington, MN-WI	\$606	\$761	\$969
Philadelphia-Camden-Wilm., PA-NJ-DE-MD	\$561	\$748	\$960
Denver-Aurora, CO	\$578	\$743	\$979
Tampa-St. Petersburg-Clearwater, FL	\$588	\$741	\$948
Atlanta-Sandy Springs-Marietta, GA	\$588	\$738	\$905
Portland-Vancouver-Beaverton, OR-WA	\$596	\$720	\$913
<b>Berkeley, CA -- pre-1999 tenancies</b>	<b>\$599</b>	<b>\$679</b>	<b>\$813</b>
<b>United States</b>	<b>\$466</b>	<b>\$676</b>	<b>\$965</b>
Dallas-Fort Worth-Arlington, TX	\$531	\$665	\$848
Houston-Sugar Land-Baytown, TX	\$507	\$638	\$827
Detroit-Warren-Livonia, MI	\$497	\$637	\$810
Cincinnati-Middletown, OH-KY-IN	\$423	\$549	\$708
Pittsburgh, PA	\$362	\$495	\$643

Table 4 sources: U.S. Census Bureau American Community Survey 2006-2008 (ACS). Berkeley 2009 Tenant Survey median for pre-1999 tenancies was \$697, less the 2.7% AGA increase is \$676. The U.S. median is at the low end because it includes all U.S. metropolitan areas, not just the 25 largest shown in this table.

The median Berkeley rent is slightly lower than that of Alameda County, but Berkeley rental units are significantly smaller, with a median of 3.4 rooms each compared with 3.8 for Alameda County and the Bay Area as a whole.

Figure 1 shows the long-term trend of San Francisco Bay Area and U.S. real rents.<sup>12</sup> The term “real” in this context means adjusted for inflation.<sup>13</sup> When the other items people buy increase in price faster than rents, then “real” rents go down and when rents increase faster than the other items people buy, “real” rents go up.



Prior to 1959, changes in Bay Area rents closely tracked changes in rents nationally. Since then Bay Area rents have increased while nationwide rents have remained largely stable. The Bay Area real rent has also been more volatile, including the rapid rise and decline caused by the dot-com bubble. Figure 1 shows that by 2008, Bay Area real rents had increased by nearly 170%

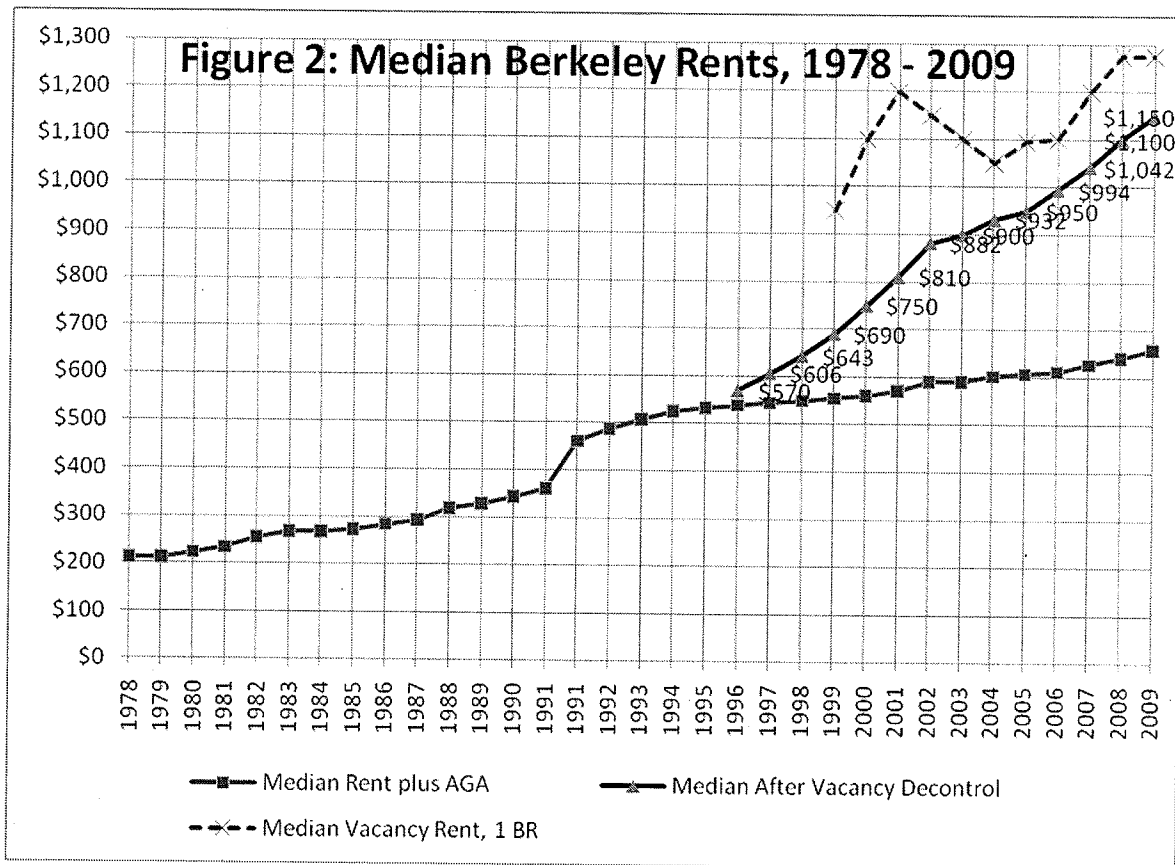
<sup>12</sup> “Bay Area” statistics from the U.S. government are based on the San Jose-San Francisco-Oakland Consolidated Statistical Area covering the eleven counties of Alameda, Contra Costa, Marin, Napa, San Francisco, San Benito, San Mateo, Santa Clara, Santa Cruz, Solano and Sonoma. The nine-county area covered by the Association of Bay Area Governments does not include Santa Cruz and San Benito Counties.

<sup>13</sup> The CPI-Rent is adjusted by the CPI-All Items Less Shelter because increases in rents are included in the overall CPI, with housing costs making up one-third of the total index. Using the CPI-All Items would place rents in both the numerator and denominator of the adjustment and this circularity would minimize the actual increase. The change in U.S. real rents is adjusted by the U.S. CPI-All Items Less Shelter and the Bay Area CPI-Rent is adjusted by first the U.S. CPI-LS from 1935-76 and then the Bay Area CPI-LS for 1976-2008 because the Bureau of Labor Statistics only provides the CPI-LS for the Bay Area since 1976 although it provides it nationally since 1935.

over U.S. real rents, which is the main reason why the median Bay Area rent is 175% of the median U.S. rent as shown in Table 4.

Rent Increases Under Rent Stabilization in Berkeley, 1978 to 2009

Figure 2 shows median Berkeley rents from 1978 to 2009. The line that starts in 1978 shows the median rents under Berkeley’s rent stabilization system.<sup>14</sup> The AGA figures in this and all subsequent figures and tables underestimate the actual increases between 1980 and vacancy decontrol in 1999 and illustrates the most restrictive possible situation. Diverging off from the AGA line in 1996 is a line showing the rate of increase in the average rent of all controlled units, including those that received a vacancy increase. Hovering above both lines is a line showing the median vacancy rent for a one-bedroom apartment.<sup>15</sup>



<sup>14</sup> This figure assumes that all increases after 1979 were only those allowed under the AGA, so all individual rent adjustments (IRAs) are omitted, and it assumes that there was partial compliance between 1978 and 1980 prior to rent registration so that rents on average were flat rather than reduced between 1978 and 1979 and increased by 5% in 1980. The starting point is the median Berkeley rent of \$223 reported in the 1980 Census. In some years the AGA was a fixed dollar amount, so that units with rents below the median had a higher percentage increase and units with rents above the median had a lower percentage increase.

<sup>15</sup> Medians for all vacancy registrations are not available, but the one-bedroom rent is usually only slightly below the median rent for all units since over half of Berkeley’s registered rental units are one-bedroom or less.

The AGA line does not include the additional “utility allowance” increases for those units, about a quarter of the total, in which the landlord pays for gas or electricity within the individual unit. It also leaves out individual rent adjustments made for over 6,000 units to compensate owners for “historically low rents”, capital improvements and various other purposes.<sup>16</sup> The year 1991 is shown twice in order to show the special increase for maintenance of net operating income that was added to the normal AGA in that year pursuant to a court order.

Within the history of rent stabilization in Berkeley there are distinct periods with quite different policies. From 1978 to 1980 there were a series of temporary ordinances. In 1978 voters passed an initiative under which rents were supposed to be rolled back by 80% of the amount of the decrease in property taxes, estimated to be approximately 7% of the rent for an average unit, with increases allowed only for operating costs over and above the landlords’ 20% of the decrease in property taxes. This was followed by another temporary rent ordinance which allowed a limited rent increase of up to 5% in 1980 to cover increased operating expenses.<sup>17</sup> At that time there was no agency with the administrative capacity to systematically enforce the requirements of the ordinances. Surveys conducted in 1979 and 1981 found widespread non-compliance and an informal practice of vacancy decontrol during this period.<sup>18</sup> Figure 3 follows this finding and assumes partial compliance during this period averaging out to a rent freeze from 1978 to 1979, rather than a roll-back of rents as required under the ordinance.

In 1980 a voter initiative established the Rent Board and a process for setting general and individual rent increases and required landlords to register all rents. From 1980 to 1991 the Annual General Adjustments (AGAs) increased by 61%, compared with the increase in the Bay Area CPI of 72%. AGAs were based on an annual operating cost study and no increase was provided for Net Operating Income (NOI). NOI increases were allowed at 40% of the rate of inflation through an individual adjustment process. In 1990 the California courts ruled that this did not provide owners with a fair rate of return because it was overly burdensome to expect each owner to separately file for an individual rent adjustment to gain an increase for NOI and the 40% of CPI formula was not adequately supported.

In 1990 the courts mandated that the Board provide an increase in AGA for maintenance of NOI retroactive to 1979 in order to meet constitutional fair return standards. The year 1991 is entered twice in Figure 3 in order to show the major increase that resulted. The Rent Board decided to provide a retroactive NOI increase indexed at 100% of the CPI-Less Shelter going back to 1979. The City Council sued on the grounds that the increase was excessive, presenting evidence that NOI increases could reasonably be indexed at 50% of the increase in the CPI. This could provide rental property owners with a fair return because most investors in rental property leverage their investment by borrowing a substantial part of the purchase price of the property. For example, if the owner’s mortgage payments take up half of the NOI, leaving the other half for cash flow,

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<sup>16</sup> Planning & Development Department, City of Berkeley, *Rent Control in the City of Berkeley: 1978 to 1994: A Background Report*, May 27, 1998, p.148 indicates 6,326 IRAs made by 1993.

<sup>17</sup> For a detailed discussion of the effect of Berkeley’s temporary rent ordinances see “The Temporary Ordinances: June 1978 – May 1980”, pp. 139-142 in Planning & Development Department, City of Berkeley, *Rent Control in the City of Berkeley: 1978 to 1994: A Background Report*, May 27, 1998, Appendix A.

<sup>18</sup> Ibid.

then an increase in NOI at 50% of the rate of increase in the CPI would increase the landlord's cash flow sufficiently to maintain its real, inflation-adjusted value.<sup>19</sup>

The courts ruled that the Board had substantial flexibility in choosing an appropriate percentage increase and held that while the increase granted might or might not be good public policy, it was within the discretion of the Board. After changes in its composition, the Board it changed its regulations. A 1995 study determined that indexing NOI at 65% of the CPI-Less Shelter would provide a fair return and meet constitutional requirements and the Board adopted this standard.<sup>20</sup> From 1996 to 2005 the Board held annual AGA increases to the amount necessary to cover increases in operating expenses and provided little or no increase for maintenance of NOI on the grounds that previous increases had surpassed what was necessary under the new standard. By 2005 this process of absorbing the "excess" NOI increase was completed.<sup>21</sup>

In 2004, voters approved an amendment to the Rent Stabilization Ordinance to cease the annual cost studies and simply index the Annual General Adjustment to the rent at 65% of the increase in the CPI-All Items, beginning with the 2005 AGA. The Rent Board and the Berkeley Property Owners Association jointly proposed this amendment in settlement of litigation brought by the BPOA in opposition to the Board's AGA policy.

Vacancy decontrol began in 1999 just as the dot-com bubble took off in the Bay Area. Market rents in Berkeley and throughout the Bay Area increased dramatically, reaching a peak in 2001. Rents declined somewhat between 2001 and 2004, then began to rise again. As shown in Figure 3, median Berkeley rents continued to increase as long-term tenants gradually moved out and new tenants moved in at market rate. Despite the recession of 2008-2009, Berkeley vacancy rents in the first half of 2009 were virtually unchanged from the first half of 2008 and then declined by 3% in the third quarter of 2009 compared with the third quarter of 2008.<sup>22</sup> Bay Area rents stabilized in 2009 at a level 3% higher than the average for 2008.<sup>23</sup>

Figure 3 compares the rate of increase in Berkeley rents with the increase in the Bay Area Consumer Price Index since 1978. Each indicator starts at 100 in 1978 so that all increases refer back to that starting point.

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<sup>19</sup> The clearest and most comprehensive analysis of fair return standards is Kenneth K. Baar, "Guidelines for Drafting Rent Control Laws: Lessons of a Decade", *Rutgers Law Review*, V.35, No.4, Summer 1983, pp.723-885.

<sup>20</sup> Kenneth K. Baar, "Issues and Options for Rent Increase Standards Under Berkeley's Rent Stabilization Ordinance", October 26, 1995.

<sup>21</sup> Memorandum dated October 18, 2004 from Jay Kelekian, Executive Director, to Members of the Rent Stabilization Board, "2005 Annual General Adjustment", pp.4-5.

<sup>22</sup> Berkeley Rent Board, "Market Medians: January 1999 through June 2009", September 18, 2009.

<sup>23</sup> Bureau of Labor Statistics, Consumer Price Index – All Urban Consumers, Rent of Primary Residence. San Francisco-Oakland-San Jose.