The Impact of
Market Rate Vacancy Increases
Seven-Year Report

January 1, 1999 - December 31, 2005

Santa Monica Rent Control Board
March 2006

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IMPACT OF MARKET RATE VACANCY INCREASES

SUMMARY

The state-initiated vacancy decontrol-recontrol law has now been in effect for seven years. Since January 1, 1999, owners have been allowed to raise the rents on most vacant units to market rate.

By the end of the seventh year, 13,183 units had been rented at market rates. This represents approximately 48% of the controlled rental units for which the Agency has registered rents. For comparison, at the end of 2004, 44% of the units (12,132 units) had been rented at market rate. Another 2.5% of the controlled units (686) were rented at market rates for the first time during 2005. Additionally, 336 controlled units were rented at market rates in previous years, but those tenancies were first registered by the owners in 2005. The Agency's records indicate that 52% of the controlled rental housing units (14,319 units) have not received market rate increases. These figures are based on a group of 27,502 controlled rental units[1].

The impact of the increases on rents is explored in this report and is summarized below.

- The number of new units rented at market rate has decreased each year since 1999 when vacancy decontrol began. In 2005, 686 new units were rented at market rate for the first time, the lowest number yet for a one-year period.
- Once a unit is rented at market rate, the tenant has less incentive to stay in place and therefore the unit may receive subsequent vacancies and re-rentals in a relatively short period of time. At the end of the seventh year, 52% of the units rented at market rate have been re-rented at least once since the first market rate rental. Almost 10% of the units have been rented at market rate four or more times.
- Upon re-rental, median MARs have increased from $643 to $967 (50%) for 0-bedroom units, from $735 to $1,300 (77%) for 1-bedrooms, from $946 to $1,748 (85%) for 2-bedrooms and from $1,192 to $2,248 (89%) for 3 or more bedroom units.
- Depending on the number of bedrooms in a unit, the household income needed to "afford" the median market rent at 30% of gross income ranges from $55,257 to

[1] Excluded from these totals are 8,900 units that have either been removed from rent control or currently hold various use exemptions. These include: units on properties with owner-occupied exemptions (approximately 1,750); units withdrawn under the Ellis Act (approximately 1,575); units that have received removal permits (approximately 1,575); units with various other use exemptions (approximately 2,750); and units that do not have registered base rents because they have been occupied by owners since April 10, 1979 or have received non-rental or commercial exemptions (approximately 1,250).

$82,876. This is $18,500 - $38,900 higher than the income needed to afford the median long-term controlled rent of the same size unit.

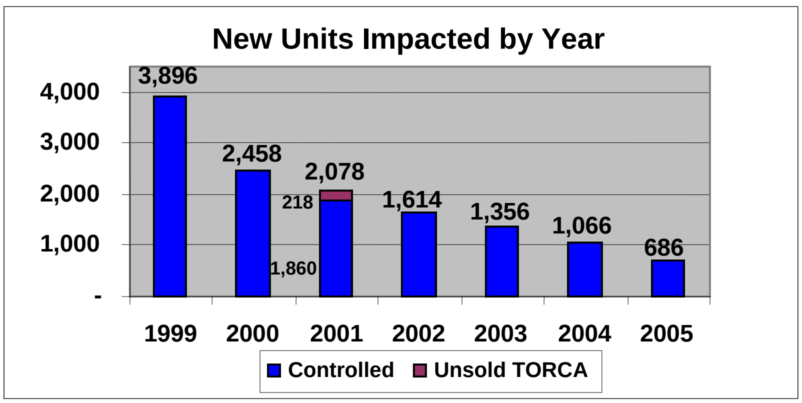
- Vacancy increases on 13,183 units have resulted in the loss of 8,444 units that had rent levels formerly affordable to low-income households (80% of median income) including 5,351 units with rent levels formerly affordable to very low-income households (50 and 60% of median income).[2]
- Market rate vacancies continue to be distributed throughout the city, closely paralleling the distribution of all controlled rental units.

[2] See page 11 Affordability Standards, for the maximum income at each level.

Rates of Filing – Units Impacted

In seven years of vacancy decontrol, 13,183 units experienced at least one market-rate increase. As the table below shows, the number of new units impacted each year has declined.[3] In 2005, 686 units were registered as being rented at market rate for the first time. This is just 17% of the units rented at market rate in the first year of vacancy decontrol and the lowest number yet for a 12-month period.

The table below shows the number of units impacted for the first time in each year of vacancy decontrol. As was done last year, the figures for this table were recalculated this year after identifying a tendency of some owners to delay registering units rented at market rates in previous years. The chart reflects the year the rents were implemented as opposed to the year they were registered with the Rent Control Board.



Vacancy Increase Registration Forms have been filed at approximately the same rate each year: 3,796 in 1999; 3,684 in 2000; 3,669 in 2001; 3,730 in 2002; 3,667 in 2003, 3,968 in 2004 and 4,000[4] in 2005. As in previous years, the largest number of forms were filed in the third quarter following the Agency's annual June mailing in which owners received reports of current rent levels on file with the Agency. An average of 460 forms were filed per month in July – September 2005.

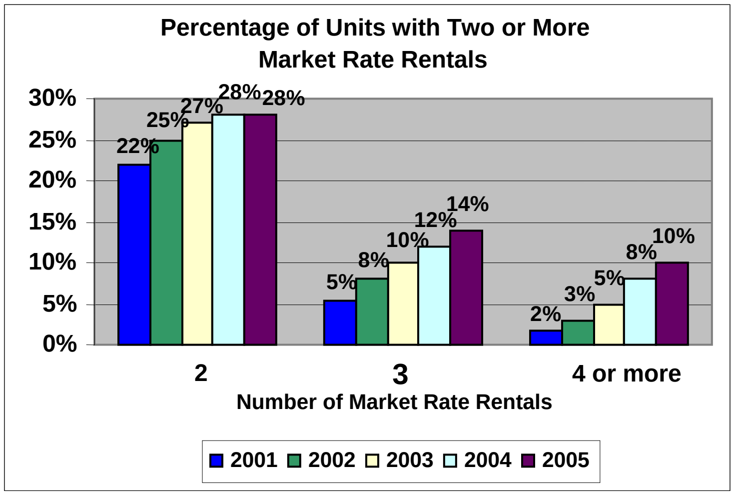
Rates of Re-Rental – Multiple Increases per Unit

After seven years of vacancy decontrol, more than half of the units rented at market rate (52%) have been re-rented at least once since the first market rate rental. Of the 13,183 units rented at market rate, 28% (3,697) have experienced two vacancies and re-rentals, 14% (1,852) have had three, and 10% (1,344) have had four or more re-rentals.

[3] A 2002 change in state and local law required owners of unsold TORCA units to register established market rate rents as of May 2001 for these units re-controlled after a period of decontrol. Of the 2,078 units impacted in 2001, 218 were unsold TORCA units.

[4] Of the 4,000 forms filed, 3,371 were for tenancies starting in 2005, 336 were for tenancies starting between 1999 and 2004, 120 were determined to be ineligible and 51 were duplicates of other forms. At the end of 2005, 122 forms had not yet been processed.

The graph below shows the breakdown for the units with two or more market rate rentals at the end of each year since 2001. The continuing increase in units with more than one market rate rental shows that once a unit is rented at market rate, it is likely to receive subsequent vacancies and re-rentals in a relatively short period of time. In fact, of the 3,371 units with market rate rents established in 2005, only 686 were rented at market rate for the first time. Almost 80% of the market rate rentals in 2005 (2,685 units) had been rented at market rate at least once before.



As is noted later, affordability to low-income people is generally lost with the first market rate increase.

Long-Term Controlled Units Compared to Market Rate Rentals

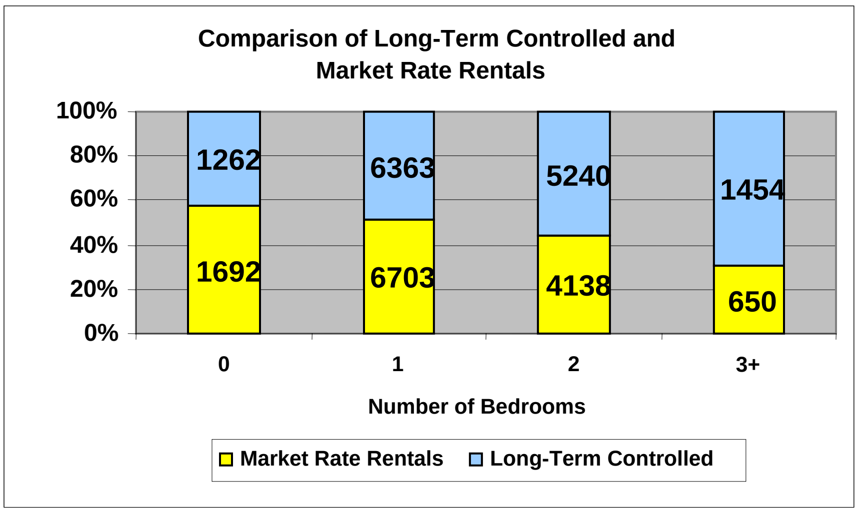
Market rate rentals were again evaluated to determine if certain size units (i.e. number of bedrooms) were impacted disproportionately by vacancy increases. As the table below shows, market rate rentals continue to be distributed between the various sized units in approximate proportion to their existence in the rental housing stock. Although an additional 686 units were rented at market rate in 2005, the percentage distributions described here have not changed since this factor was first examined at the end of 2002.

Number of Bedrooms	0	1	2	3+
Percentage of Units Overall	10	48	34	8
Percentage of Market Rentals	13	51	31	5

Overall, the 13,183 units rented at market rate since 1999 represent 48% of the controlled units for which the Agency has registered rents. For comparison, at the end of 2004, 44% of the units (12,132) had been rented at market rate. In 2005, another 4% of the controlled units were registered as having been rented at market rates (2.5% during 2005 and 1.5% in earlier years). Agency records indicate that 52% of the units (14,319) have not received market rate increases.[5] The following table shows the percentage of long-term controlled units compared with market rate rentals by unit size and overall.

Number of Bedrooms	0	1	2	3+	OVERALL
Percent Long-Term Controlled Units	43	49	56	69	52
Percent Market Rate Rentals	57	51	44	31	48

The graph below details for each unit size the number of long-term controlled units (blue) and the number of units rented at market rate (yellow). As the table and graph both show, the smaller the unit (number of bedrooms), the more likely it has been rented at market rate. While more than half of the singles and one-bedrooms have been rented at market rate, just 31% of the three or more bedroom units have experienced market rate rentals.



[5] Excluded from these totals are 8,900 units that have either been removed from rent control or currently hold various use exemptions. These include: units on properties with owner-occupied exemptions (approximately 1,750); units withdrawn under the Ellis Act (approximately 1,575); units that have received removal permits (approximately 1,575); units with various other use exemptions (approximately 2,750); and units that do not have registered base rents because they have been occupied by owners since April 10, 1979 or have received non-rental or commercial exemptions (approximately 1,250).

Impact on Median Maximum Allowable Rents (MARs)[6]

The chart below summarizes median rent information for the 13,183 units that received market rate increases between January 1, 1999 and December 31, 2005. The post-increase medians reflect the cumulative effect of seven years of rentals at market rate.

Vacancy Increases 1/1/99 – 12/31/05 (13,183 units)

Number of Bedrooms	**Adjusted 1998[7]** Median MARs	**Post-Increase** Median MARs	Dollar Amount Change	% Change
0	$643	$967	$324	50%
1	735	1,300	565	77
2	946	1,748	802	85
3 or +	1,192	2,248	1,056	89

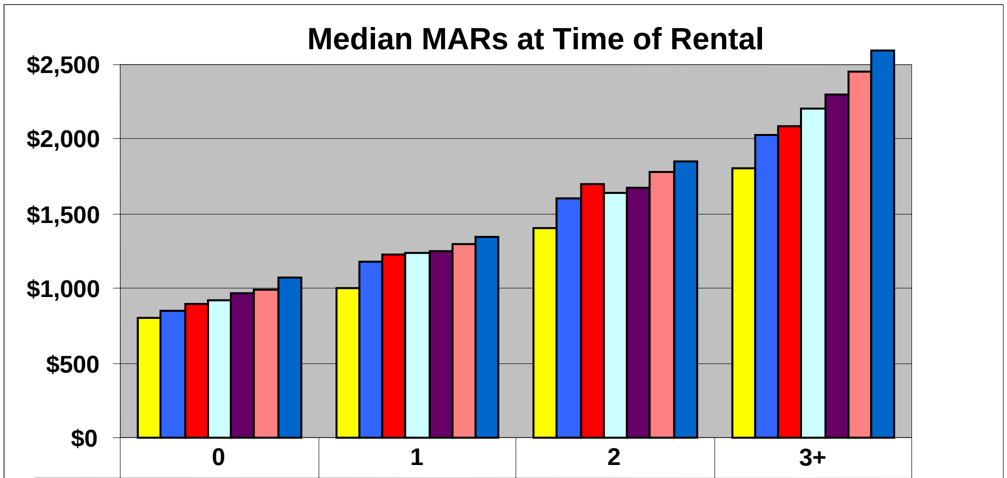
The chart details rents based on the number of bedrooms in the units. The second column is the median rent in effect as of December 1998 (before any market rate increases were implemented) with the 1999 – 2005 general adjustments added. Adding the general adjustments allows a comparison of what the medians of these 13,183 units would be as of December 2005 if they had not received vacancy increases. The next three columns reflect the median rent after the market rate increases, the dollar amount of the change from the pre-increase adjusted rent and the percentage change.

Median MARs at Time of Rental

The table on the next page shows the medians by year for all units in which a market rate rent was established in a given year. If a unit was rented in 1999 and re-rented again in 2005, the first market rent is reflected in the figures for 1999 and the later market rent is reflected in the figures for 2005. Additionally, if a unit was rented more than once in a year, all new rental amounts are included to calculate the medians.

[6] Median rent levels (the point at which half the rentals were higher and the other half were lower) are used throughout this report because they are considered more statistically accurate than average rents. Medians filter out the effect of rents at the extreme high and low ends.

[7] December 1998 median MARs with 1999-2005 general adjustments added.



	0	1	2	3+
1999	$800	$1,000	$1,400	$1,800
2000	$850	$1,175	$1,600	$2,030
2001	$895	$1,225	$1,695	$2,089
2002	$925	$1,239	$1,635	$2,200
2003	$967	$1,250	$1,676	$2,300
2004	$995	$1,300	$1,775	$2,450
2005	$1,075	$1,350	$1,850	$2,600

Number of Bedrooms

In looking at the year-to-year change in median rents, for all unit sizes except singles the largest year-to-year increase occurred between 1999 and 2000. For singles, the largest year-to-year increase occurred between 2004 and 2005 with an 8% increase.

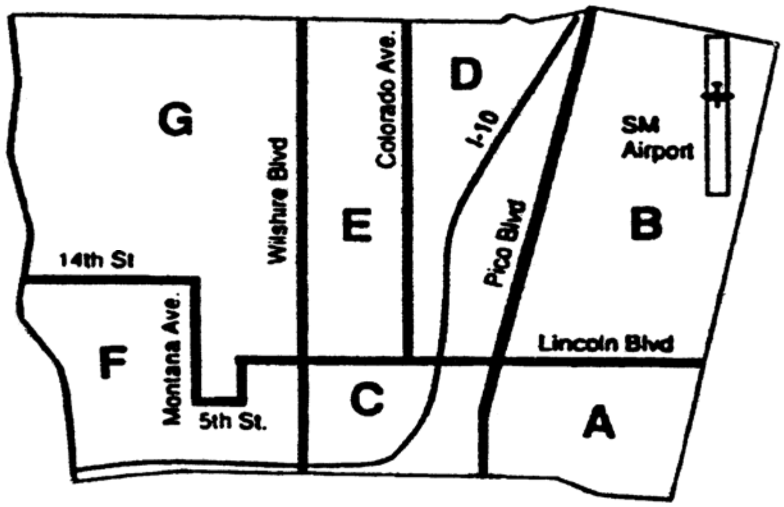
As the above graph shows, the general trend of rents has been upward (note the rents shown above do not include general adjustments). The only exceptions to this were a leveling off of upward movement in 1-bedroom rents between 2001 and 2003 (just $25 increase in two years), and a slight decrease in rents in 2-bedroom units from 2001 to 2002 by $60 per month. The median in 2003 regained some of the 2002 decline, and that trend continued in 2004 and 2005.

The rents for 3 or more-bedroom units have gone up each year, with the smallest annual increase between 2000 and 2001 ($59).

The overall increases in median rents between 1999 and 2005 have been at least 32% for all unit sizes. Singles increased 34%, 1-bedrooms increased 35%, 2-bedrooms increased 32% and 3 or more-bedrooms (the smallest category of units) had the largest increase, 44%.

Median MARs by City Area

To track changes in the housing stock in different areas of the city, in the early 1990s the Rent Board divided the city into seven areas which parallel neighborhoods and census tracts. The map below shows the city areas identified as A-G.



The table below shows that the distribution of units rented at market rate during seven years of vacancy decontrol closely parallels the distribution of rental units throughout the city overall. For example, Area G contains the largest percentage of controlled rental units (22%) and 22% of the market rate rentals have occurred in this area. These percentages have not changed since 2003.

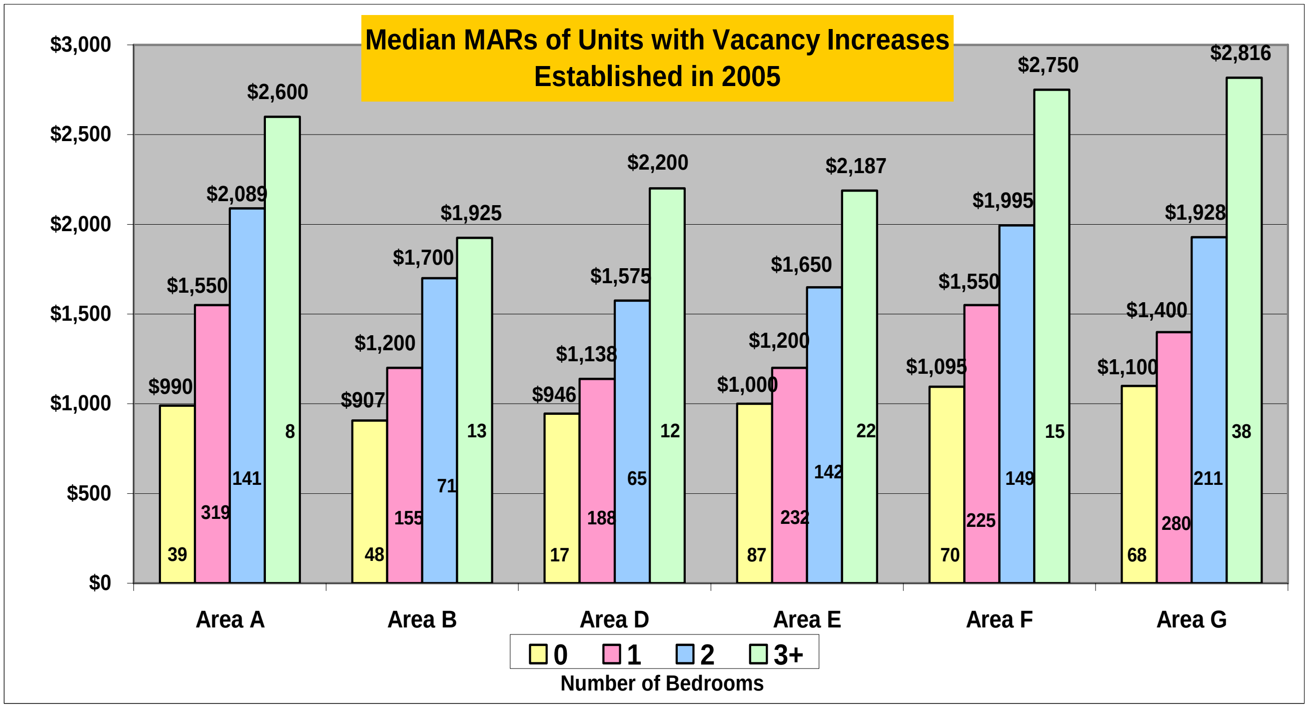
City Area	A	B	C	D	E	F	G
Percentage of Units	17	12	4	10	19	16	22
Percentage of Market Rentals	18	12	5	8	19	16	22

The graphs on the following two pages show the median market rents for units rented in 2005 and 2003–2005. In both of these graphs, for units that have been rented more than once at market rate in the time period, only the latest rental amount established is included.

In both graphs, Area C is omitted because the majority of market rate rentals in this area have been in two very large buildings (120 units and 288 units) located on Ocean Avenue. Due to a substantial number of units removed from rent control since the area lines were drawn, Area C has a significantly smaller number of controlled rental units than every other area. With just over 900 controlled units in Area C, these two buildings account for more than 40% of all controlled units in the area. Because of the small size of this area and the distorting impact of these two buildings, rents for this area are not included. These buildings, both in their size and character, are not representative of most buildings throughout the city and the market rent levels registered have been significantly different from those in the other areas.

Median MARs by City Area—2005

This graph details for the various areas of the city (except Area C) by number of bedrooms the current median rents for the 2,613 units in which a vacancy increase was implemented in 2005.



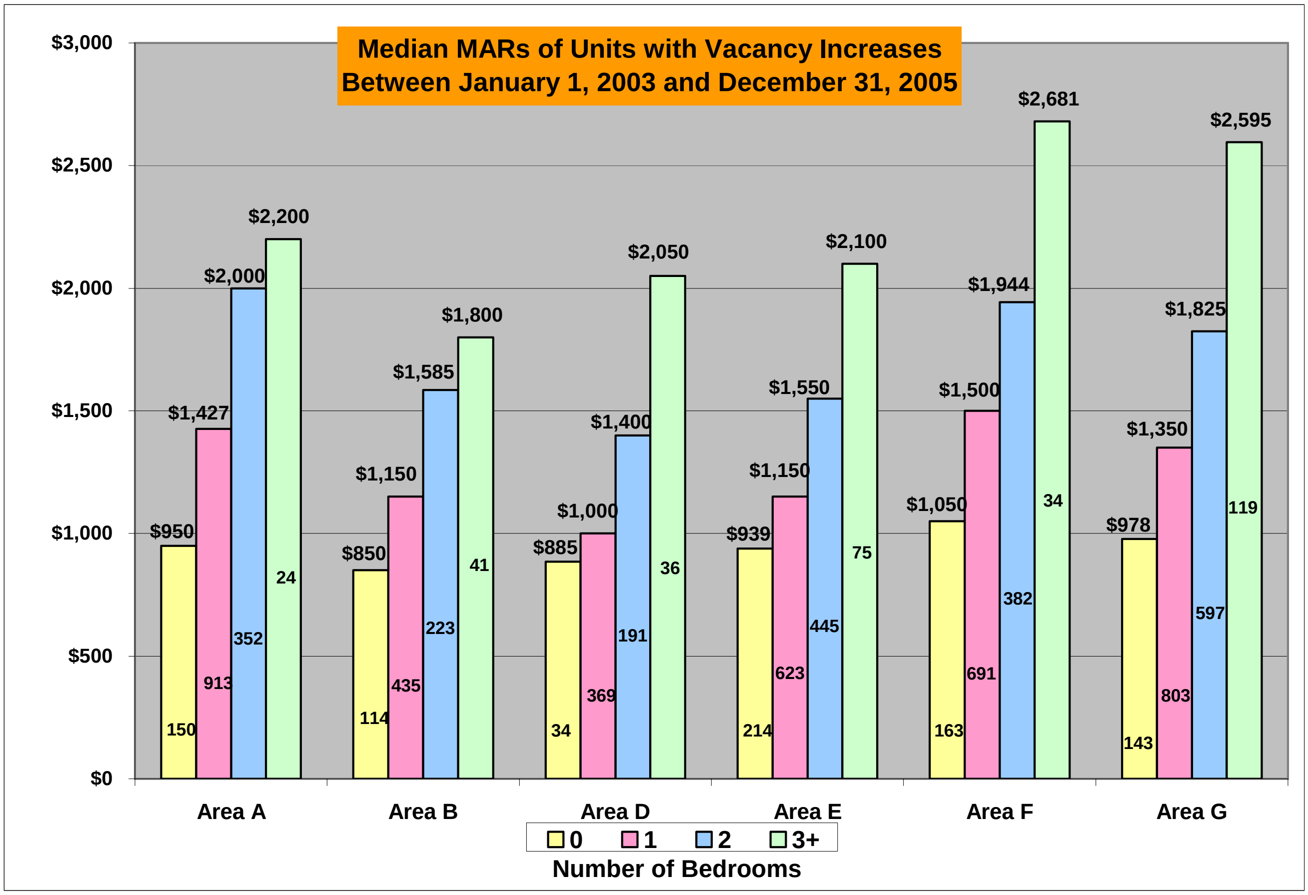
The numbers within the bars are the number of units in each category rented at market rate during the time period[8]. As the numbers inside the pink bars show, in each city area more one-bedroom units were rented at market rate this year than any other size unit. This is consistent with the table on page 4 which shows that the largest percentage of units overall (48%) are one-bedroom units. Conversely, the numbers in the green bars show that very few 3-bedroom units were rented in 2005. Area A had just 8 units of this size rented and Area G had the largest number, but this was just 38 units.

Where the number of units impacted is quite small, the applicability of the median to other units in the area is less accurate. Therefore, looking at just one year of rentals does not always give a true picture of general market conditions. A three-year graph follows.

[8] If a unit was rented more than once in 2005, only the last rent level established is used in these calculations.

Median MARs by City Area—2003-2005

This graph shows median MARs by area and number of bedrooms for 7,171 units with vacancy increases established in the most recent three-year period, January 1, 2003 through December 31, 2005. This three-year view of vacancy increases provides a more complete overview of current market rate rentals because it includes significantly more units overall (7,171) as well as many more units of each size than the look at 2005 alone.[9] The units rented in Area C are not included.



The numbers within the bars are the number of units in each category rented at market rate during the time period. The median rents on these units were used to determine the median for each unit size within each area. As in the previous graph, if a unit was rented more than once in a year or more than once in the 3-year period, only the last established market rate rent is used in the calculations.

[9] The rent levels for most units rented in 2003 and 2004 were registered by the owners the year they were rented. However, also included in this graph are 91 units with market rents established in 2003 and 212 units with market rents established in 2004 that were first registered by the owners in 2005.

Affordability Standards

HUD affordability standards assume 30% of a household's gross income may be used for rent before the household becomes "rent burdened". For the year 2005, the HUD median income for a "Four-Person Household" in Los Angeles County is $55,100 (unchanged since 2002).

Each year, HUD establishes the very low-income limits (at 50%) and then uses those to calculate the limits for the other income categories. In counties where HUD identifies adjustment factors such as high housing costs relative to incomes, they issue an elevated very low-income limit and also make adjustments to the 60% and 80% categories. HUD made such an adjustment for Los Angeles County in 2005 and the income limits listed below were determined by HUD and published in a February 25, 2005 Memorandum which is attached to this report as Attachment A.

Very Low 50%	Very Low 60%	Low 80%	Moderate 100%	Moderate 120%
$32,750	$39,300	$52,400	$55,100	$66,100

Translating Affordability into Income

Using HUD affordability calculations that include adjustments for number of bedrooms[10], staff calculated the minimum income required to afford the median rents.

The chart below shows the *minimum* total household income needed to pay for the median rents without being rent burdened. The light blue numbers show the median income needed today to afford the various-size units if they had not been rented at market rate. The pink numbers show the median income necessary to afford the market rate rent levels.

Income Needed to Afford MARs (30% Affordability Standard)
Units with Vacancy Increases 1/1/99 – 12/31/05 (13,183 units)

No. of Bedrooms	Adjusted 1998[11] Median MARs	Income needed to Afford MAR	Post-Increase Median MARs	Income Needed to Afford MAR	Income Difference
0	$643	$36,743	$967	$55,257	$18,514
1	735	36,750	1,300	65,000	28,250
2	946	39,832	1,748	73,600	33,768
3 or more	1,192	43,945	2,248	82,876	38,931

As the chart above shows, depending on size of a unit, the household income needed to "afford" the median market rent is $18,500 - $38,900 higher than the income needed to afford the median rent of that same size unit if it had not received a market rate increase.

[10] A HUD-determined Household Adjustment Factor is used to calculate the income needed to afford the MAR and results in the unexpected difference for the 0 and 1-bedroom units.
Income Calculation = annual rent/household adjustment factor/affordability standard

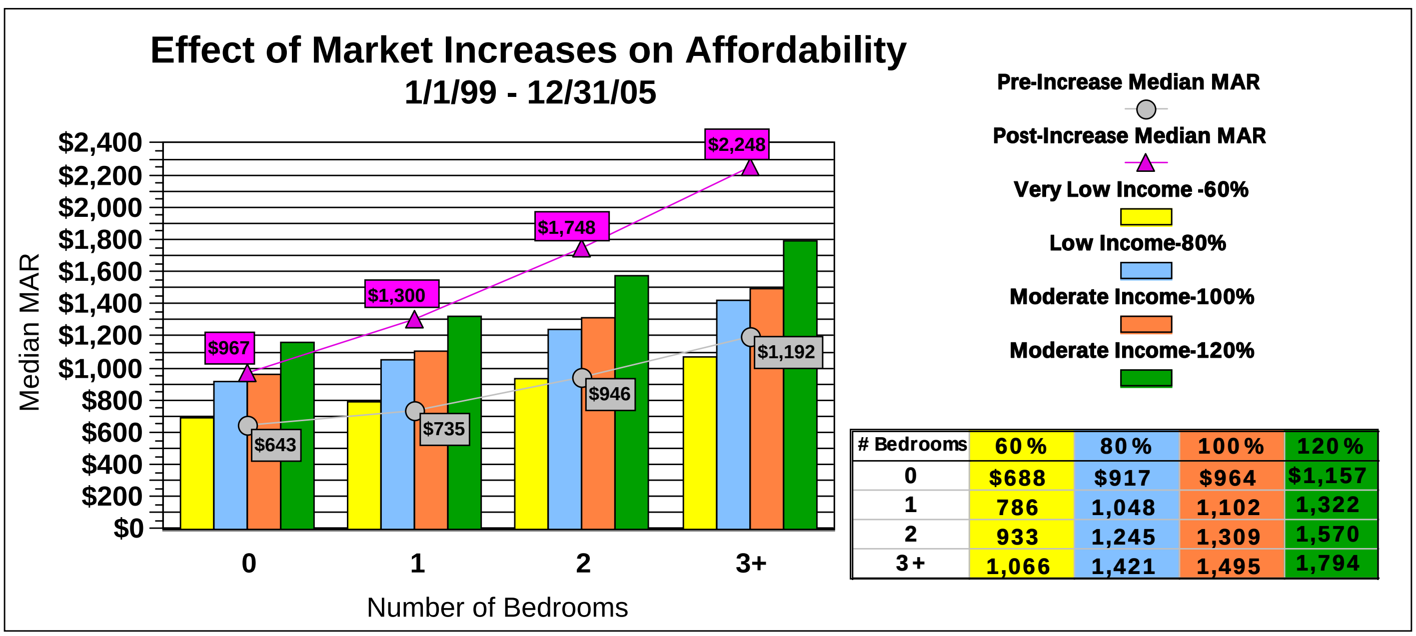
[11] December 1998 median MARs with 1999-2005 general adjustments added.

Loss of Affordability – 1/1/99 - 12/31/05

Affordable units have been lost at <u>every</u> affordability level and <u>every</u> bedroom size as a result of market rent increases since January 1, 1999. For the 13,183 units that have received market increases, their pre-increase median MARs at all bedroom sizes (with 1999-2005 general adjustments added) would be affordable to a household whose income is 80% of the adjusted County median. *None* of the post-increase medians are affordable to a family making 80% of median income.

After the increase, the median MARs of only the 0-bedroom units ($967) are even close to being affordable at 100% of median ($964) and above. The median MARs of 1-bedroom units are only affordable to households at 120% of median and above. Even more significantly, the median rents for 2 and 3-bedroom units are no longer affordable even to households at 120% of the median income. (The median MAR for a 2-bedroom unit is $178 above the amount affordable at 120% of median income and the median MAR for a 3-bedroom unit is $454 above the amount affordable at 120% of median income.)

This information is shown in graph form below. The vertical bars represent the rents affordable to households with incomes at 60%, 80%, 100% and 120% of the adjusted county median.[12] The chart shows the corresponding rents affordable for each of the four household sizes. The gray line shows the pre-increase median MARs (with 1999-2005 GAs) and the pink line shows the post-increase median MARs for the various bedroom sizes. In order for a unit to be affordable, the top of the bar representing that income category must be above the line representing the median MARs. The table shows that the post increase median rents are higher than the affordable rents for almost every income category and bedroom size.



# Bedrooms	60%	80%	100%	120%
0	$688	$917	$964	$1,157
1	786	1,048	1,102	1,322
2	933	1,245	1,309	1,570
3+	1,066	1,421	1,495	1,794

[12]Due to HUD adjustments to low-income limits at 80% of median, there is only a small difference in rent levels affordable at 80% and 100% of median income. This is represented by the slight difference between the blue and orange bars on the graph. It also accounts for the small number of units with post-increase MARs affordable at 100% in the table on the next page.

Loss of Affordable Units by Income Level

The 13,183 units impacted by market rate increases had a mixture of rents affordable to families at all income levels before the increases were implemented. The table below and graph on the next page detail the dramatic shift in affordability levels for the units that have received market rate rent increases.

Distribution of 13,183 Units Before and After Increases

Affordability Category	Number of Units Before Increases	Number of Units After Increases	Difference
Very Low – 50%	2,519	210	-2,309
Very Low – 60%	3,322	280	-3,042
Low – 80%	4,752	1,659	-3,093
Moderate – 100%	1,624	702	-922
Moderate – 120%	524	3,198	+2,674
120% +	442	7,134	+7,134

Affordability to low-income people is generally lost with the first market rate increase. Therefore, the filing of a subsequent market rate increase on the same unit usually does not result in the additional loss of an affordable unit.

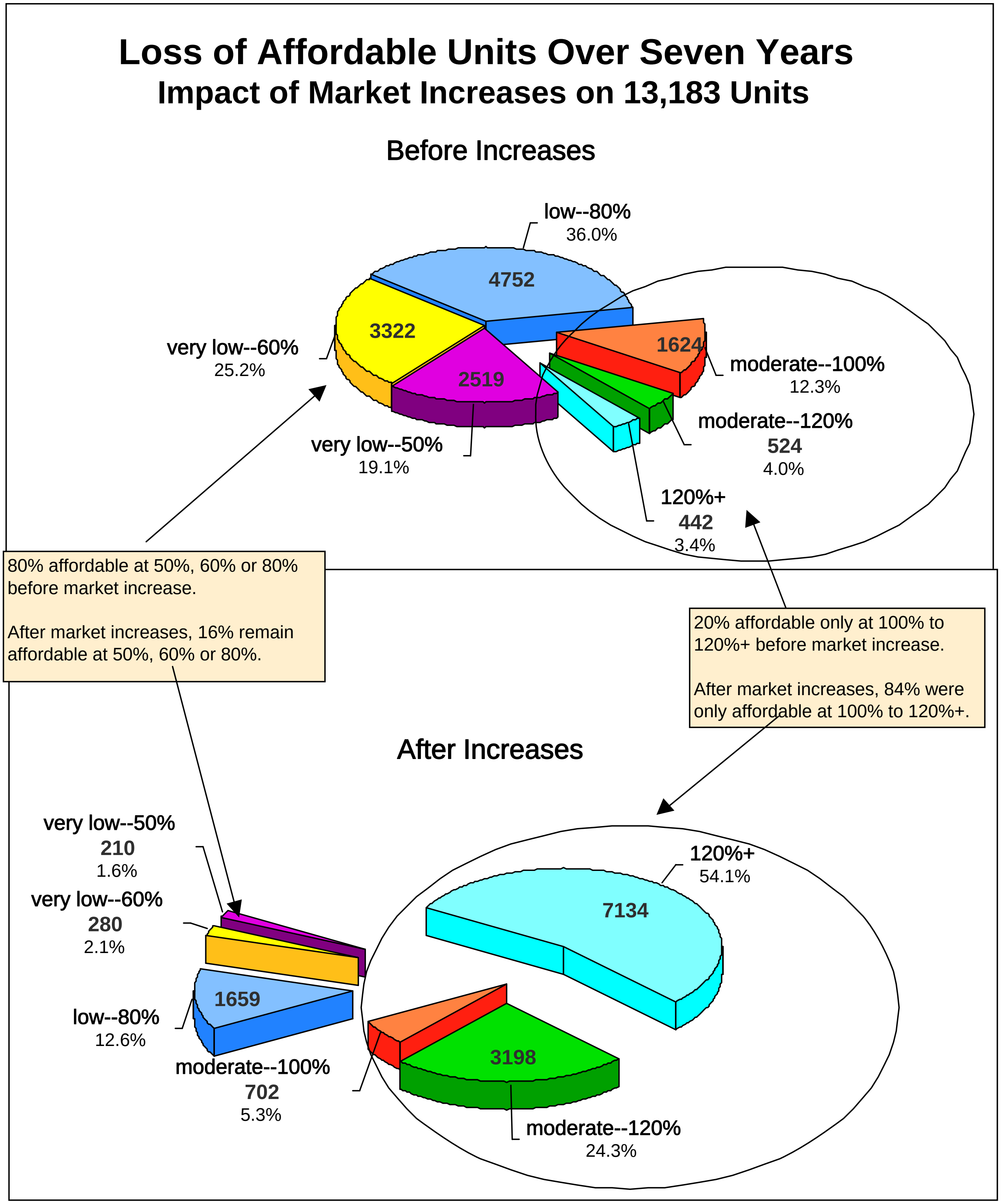
In summary:

- Before the increases, 44% of the units had median rent levels affordable to **very-low income** households. After the increases, less than 4% of the units remained affordable to these households. This represents a loss of affordability of 5,351 units.

- Before the increases, 80% of the units had median rent levels affordable to **low-income** households. After the increases, only 16% of the units remained affordable at this income level.

- Fifty-four percent (54%) of market rents are affordable only to people making more than 120% of the median income for a family of four ($66,100).

The pie chart on the next page graphically details the shifts in affordability of the units rented at market rate.


Loss of Affordable Units Over Seven Years
Impact of Market Increases on 13,183 Units
Before Increases
low--80%
36.0%
4752
very low--60%
25.2%
3322
2519
1624
moderate--100%
12.3%
moderate--120%
524
4.0%
very low--50%
19.1%
120%+
442
3.4%
80% affordable at 50%, 60% or 80% before market increase.
After market increases, 16% remain affordable at 50%, 60% or 80%.
20% affordable only at 100% to 120%+ before market increase.
After market increases, 84% were only affordable at 100% to 120%+.
After Increases
very low--50%
210
1.6%
120%+
54.1%
7134
very low--60%
280
2.1%
1659
low--80%
12.6%
3198
moderate--100%
702
5.3%
moderate--120%
24.3%

CONCLUSION

Seven years into vacancy decontrol, 48% of the controlled rental housing stock has been rented at market rate and 52% remains rented to long-term tenants. The rate at which new units receive market rate increases has slowed each year since 1999, the first year of vacancy decontrol. In that year, almost 3,900 units were first rented at market rate. In 2005, less than a fifth of that number (686 units) received market rate increases for the first time.

However, once a unit is rented at market rate and loses its affordability, it is much more likely to turnover again. Fifty-two percent (52%) of the market rate rentals have turned over at least once since the first market rental.

As a result of vacancy decontrol, a dramatic shift has occurred in the affordability of the 13,183 units that received vacancy increases. Before the increases, 80% of the units had rent levels affordable to low-income households. After the increases, just 16% remain affordable at the low-income level. Additionally, the number of units affordable only to households of moderate income or above has grown from just 20% before the increases to 84% after the market rate rents were established

Despite the significant loss of affordability in those units that have had a vacancy increase, a substantial number of units (approximately 14,300) have not received vacancy increases and continue to provide housing at affordable rents.