

*The Impact of
Market Rate Vacancy Increases
Nine-Year Report*

January 1, 1999 - December 31, 2007



Santa Monica Rent Control Board
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TABLE OF CONTENTS

Summary	1
Units Rented at Market Rates	
Rates of Filing -- Units Impacted	3
Rates of Re-Rental -- Multiple Increases per Unit	3
Long Term Controlled Units Compared to Market Rentals	4
Effects on Rent Levels	
Impact on Median Maximum Allowable Rents (MARs)	5
Median MARs at Time of Rental	6
Market Rate Rentals by City Area	7
Median MARs by City Area 2007	8
Median MARs by City Area 2005-2007	9
Effects on Affordability	
Affordability Standards	10
Translating Affordability into Income	10
Loss of Affordability – 1/1/99 – 12/31/07	11
Loss of Affordable Units by Income Level	12
Conclusion	14

IMPACT OF MARKET RATE VACANCY INCREASES

SUMMARY

The state-initiated vacancy decontrol-recontrol law has now been in effect for nine 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 ninth year, 14,672 units had been rented at market rates. This represents approximately 54% of the 27,278 controlled rental units for which the Agency has registered rents.¹ For comparison, at the end of 2006, 51% of the units (14,013 units) had been rented at market rate. Less than two percent of the controlled units (483 units) were rented at market rates for the first time during 2007. Another 176 units (less than 1%) were rented at market rates in previous years, but those tenancies were not registered by the owners until 2007. The Agency's records indicate that 46% of the controlled rental housing units (12,606 units) have not received market rate increases.

The impact of the increases on rents and affordability 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 2007, 483 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 ninth year, 60% of the units rented at market rate have been re-rented at least once since the first market rate rental. Sixteen percent (16%) of the units have been rented at market rate four or more times.
- ◆ Upon re-rental, median MARs have increased from \$682 to \$1,075 (58%) for 0-bedroom units, from \$776 to \$1,436 (85%) for 1-bedrooms, from \$993 to \$1,896 (91%) for 2-bedrooms and from \$1,255 to \$2,508 (100%) for 3 or more bedroom units.

¹ Excluded from these totals are 9,130 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 1,710); units withdrawn under the Ellis Act (approximately 1,855); units that have received removal permits (approximately 1,585); units with various other use exemptions (approximately 2,730); 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).

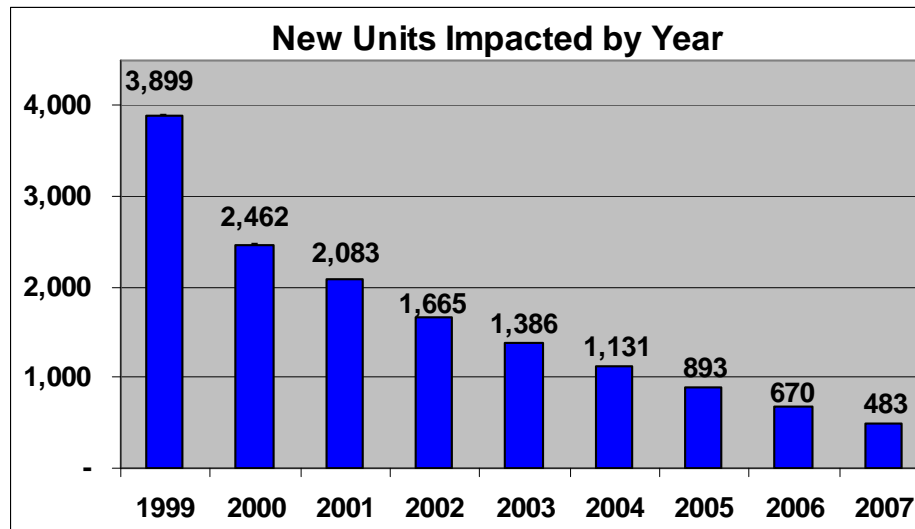
- ◆ Depending on the number of bedrooms in a unit, the household income needed to “afford” the median market rent at 30% of gross income ranges from \$61,429 to \$92,461. This is \$22,465 - \$46,194 higher than the income needed to afford the median rent of that same size unit if it had not received a market rate increase.
- ◆ Vacancy increases on 14,672 units have resulted in the loss of 9,860 units that had rent levels formerly affordable to low-income households (80% of median income) including 6,044 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 10 Affordability Standards, for the maximum income at each level.

Rates of Filing – Units Impacted

In nine years of vacancy decontrol, 14,672 units experienced at least one market-rate increase. As the table below shows, the number of new units impacted each year has declined. In 2007, 659 units were registered as being rented at market rate for the first time: 483 rented in 2007 and 176 rented in previous years. The 483 units rented in 2007 represent just 12% 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. The figures for this table were adjusted 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: between 3,600 and 4,000 per year. As in previous years, the largest number of forms was filed in the third quarter of 2007 following the Agency’s annual June mailing in which owners received reports of current rent levels on file with the Agency. An average of 440 forms was filed per month in July – September 2007 as compared to an average of 253 in the other months of the year.

Rates of Re-Rental – Multiple Increases per Unit

After nine years of vacancy decontrol, sixty percent (60%) of the units rented at market rate have been re-rented at least once since the first market rate rental.³ Of the 14,672 units rented at market rate, 28% (4,063) have experienced two vacancies and re-rentals, 16% (2,389) have had three, and 16% (2,371) have had four or more re-rentals.

³ At the end of 2006, 56% of the units rented at market rate had been re-rented at least once.

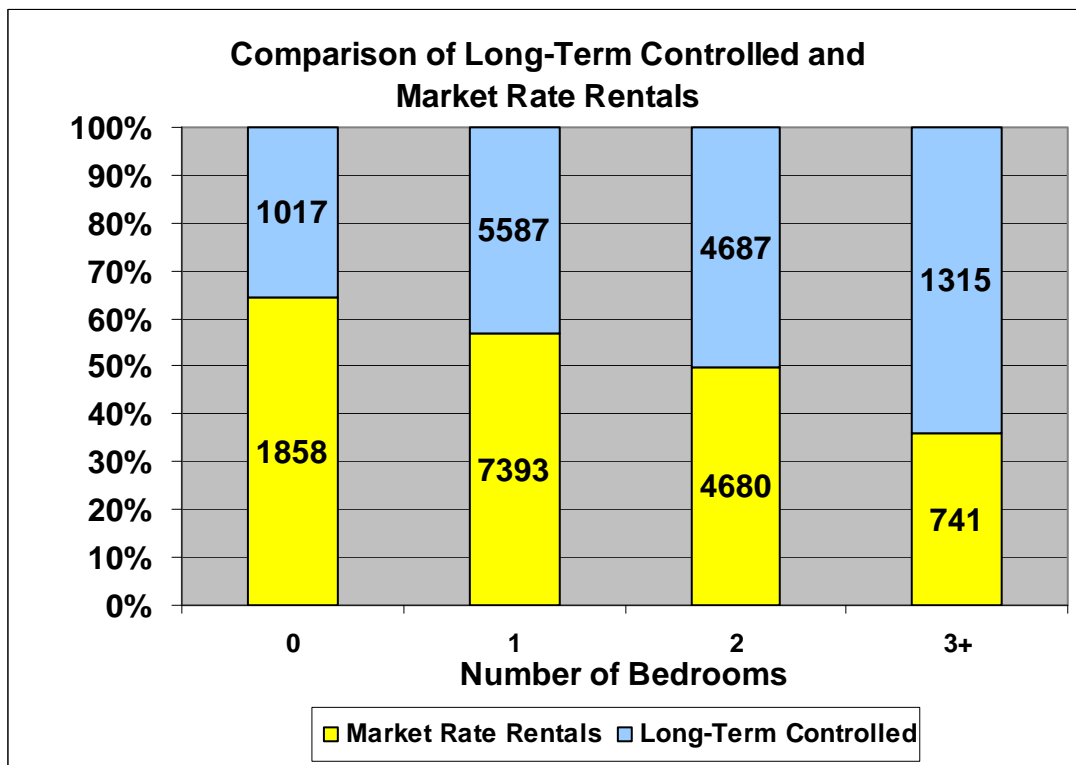
The continuing increase in units with more than one market rate rental shows that once a unit is rented at market rate, it is likely to receive subsequent vacancies and re-rentals in a relatively short period of time. In fact, of the 3,406 market rate tenancies established in 2007, only 483 were in units rented at market rate for the first time. More than 85% of the market rate rentals in 2007 (2,923 tenancies) were in units that had been rented at market rate at least once before.

Long-Term Controlled Units Compared to Market Rate Rentals

Overall, the 14,672 units rented at market rate since 1999 represent 54% of the controlled units for which the Agency has registered rents. For comparison, at the end of 2006, 51% of the units (14,013) had been rented at market rate. Agency records indicate that 46% of the controlled units (12,606) have never received market rate increases. 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	35	43	50	64	46
Percent Market Rate Rentals	65	57	50	36	54

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 36% of the three or more bedroom units have experienced 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 483 units were rented at market rate in 2007, the percentage distributions described here have not changed significantly 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	50	32	5

EFFECTS ON RENT LEVELS

Impact on Median Maximum Allowable Rents (MARs)⁴

The chart below summarizes median rent information for the 14,672 units that received market rate increases between January 1, 1999 and December 31, 2007. The post-increase medians reflect the cumulative effect of nine years of rentals at market rate.

<u>Vacancy Increases 1/1/99 – 12/31/07 (14,672 units)</u>				
Number of <u>Bedrooms</u>	Adjusted 1998⁵ Median <u>MARs</u>	Post- Increase Median <u>MARs</u>	Dollar Amount <u>Change</u>	% <u>Change</u>
0	\$682	\$1,075	\$393	58%
1	776	1,436	660	85
2	993	1,896	903	91
3 or +	1,255	2,508	1,253	100

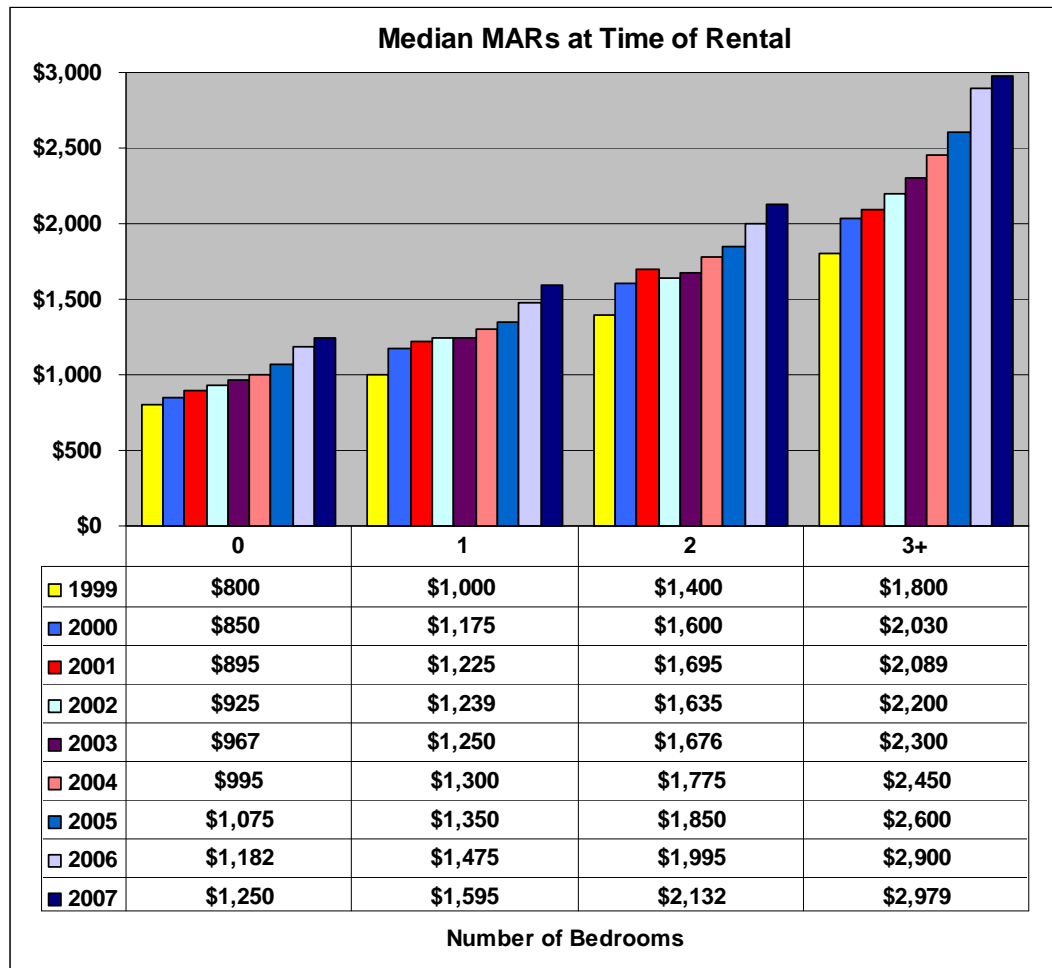
The chart details rents based on the number of bedrooms in the units. The second column is the median rent in effect as of December 1998 (before any market rate increases were implemented) with the 1999 – 2007 general adjustments added. Adding the general adjustments allows a comparison of what the medians of these 14,672 units would be as of December 2007 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.

⁴ 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.

⁵ December 1998 median MARs with 1999-2007 general adjustments added.

Median MARs at Time of Rental

The table below shows the medians by year for all units in which market rate rents were established in a given year. If a unit was rented in 1999 and re-rented again in 2007, the first market rent is reflected in the figures for 1999 and the later market rent is reflected in the figures for 2007. Additionally, if a unit was rented more than once in a year, all new rental amounts are included to calculate the medians.



In looking at the year-to-year change in median rents, for all unit sizes except singles the largest year-to-year percentage increase occurred between 1999 and 2000. For singles, the largest year-to-year increase occurred between 2005 and 2006 with a 10% increase.

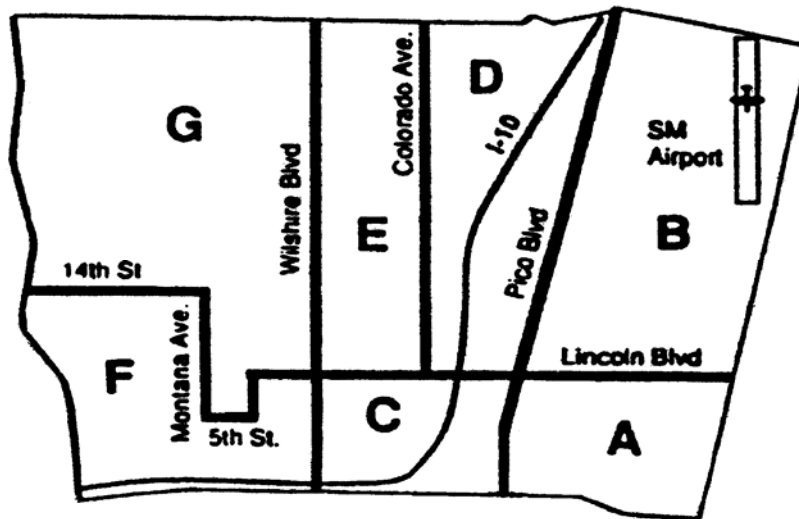
As compared to 2006, market rate rents established in 2007 increased 6% for singles, 8% for one-bedrooms, 7% for two-bedrooms and 3% for three-bedrooms.

As the above graph shows, the general trend of rents has been upward over the past 9 years reflecting the high demand for rental housing in Santa Monica.

The overall increases in median rents between 1999 and 2007 have been more than 50% for all unit sizes. Singles increased 56%, one-bedrooms increased 60%, 2-bedrooms increased 52% and 3 or more-bedrooms (the smallest category of units) had the largest increase, 66%.

Market Rate Rentals 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 nine 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 23% of the market rate rentals have occurred in this area. These percentages have not changed significantly 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	4	8	19	16	23

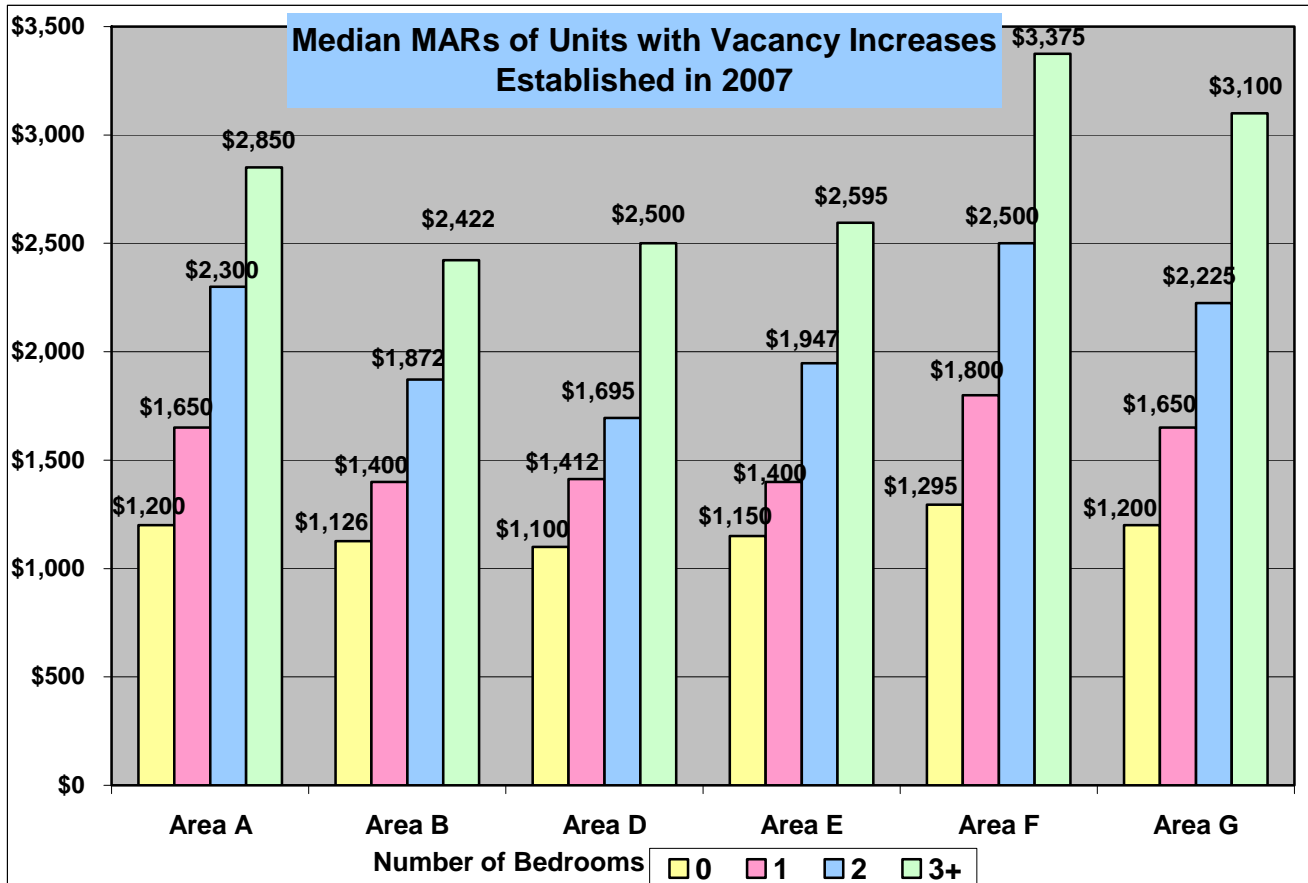
Median MARs by City Area in 2007 and 2005-2007

The graphs on the following two pages show the median market rents for units rented in 2007 and 2005–2007. 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 controlled units and both in size and character are not representative of other buildings in the area. Because of the small size of this area and the distorting impact of these two buildings, rents for Area C are not included.

Median MARs by City Area—2007

This graph details for the various areas of the city by number of bedrooms the current median rents for the 1,994 units in which a vacancy increase was implemented in 2007.



The table below details the number of units in each category rented at market rate during the time period.⁶ 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 5 which shows that the largest percentage of units overall (48%) are one-bedroom units. Conversely, very few 3-bedroom units were rented in 2007. Area A had just 6 units of this size rented and Area G had the largest number, but this was just 32 units.

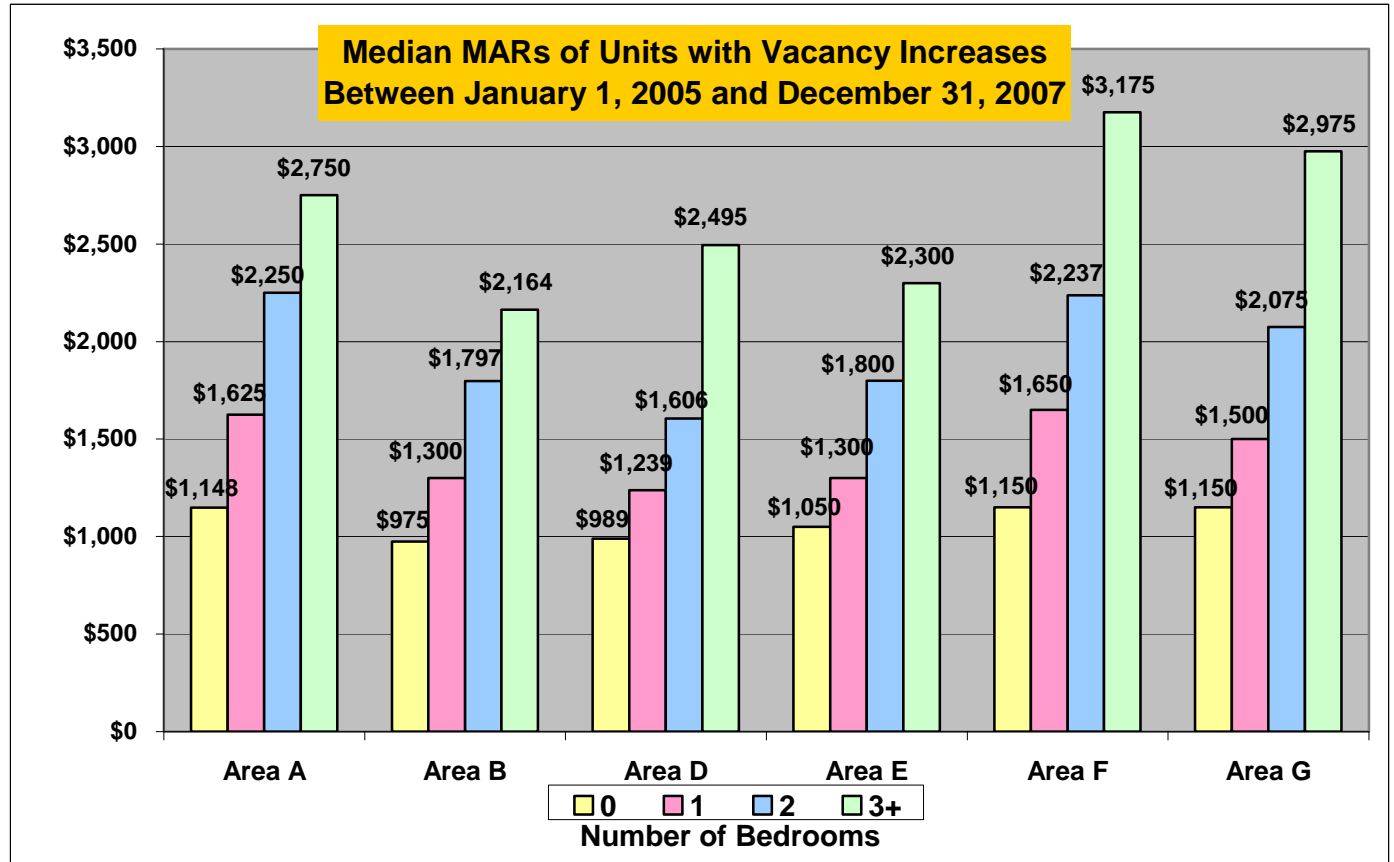
Bedrooms	Area A	Area B	Area D	Area E	Area F	Area G	Totals
0	30	39	11	73	53	42	248
1	208	141	80	185	174	217	1,005
2	94	98	55	124	95	185	651
3+	6	12	11	19	10	32	90

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.

⁶ If a unit was rented more than once in 2007, only the last rent level established is used in these calculations.

Median MARs by City Area—2005-2007

This graph shows median MARs by area and number of bedrooms for 6,902 units with vacancy increases established in the most recent three-year period, January 1, 2005 through December 31, 2007. This three-year view of vacancy increases provides a more complete overview of current market rate rentals because it includes significantly more units overall as well as many more units of each size than the look at 2007 alone.⁷ 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. The units rented in Area C are not included.



The table below details the number of units in each category rented at market rate during the time period.

Bedrooms	Area A	Area B	Area D	Area E	Area F	Area G	Totals
0	131	120	30	208	164	141	794
1	806	410	369	643	602	760	3,590
2	346	252	205	433	364	598	2,198
3+	27	36	34	78	31	114	320

⁷ The rent levels for most units rented in 2005 and 2006 were registered by the owners the year they were rented. However, also included in this graph are 30 units with market rents established in 2005 and 118 units with market rents established in 2006 that were first registered by the owners in 2007.

EFFECTS ON AFFORDABILITY

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 2007, the HUD median income for a "Four-Person Household" in Los Angeles County is \$56,500.

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 2007 and the income limits listed below were determined by HUD and published in an April 18, 2007 Memorandum which is attached to this report as Attachment A.

Very Low 50%	Very Low 60%	Low 80%	Moderate 100%	Moderate 120%
\$37,000	\$44,400	\$55,750	\$56,500	\$67,800

Translating Affordability into Income

Using HUD affordability calculations, the minimum income required to afford the median rents was calculated. A HUD-determined "household adjustment factor" is used to calculate the income needed for various size units and this factor results in the unexpected similarity of the income needed to afford the 0-bedrooms and 1-bedroom units. See calculations below.⁸

This chart shows the *minimum* total household income needed to pay for the median rents without being rent burdened. The 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.

<u>Income Needed to Afford MARs (30% Affordability Standard)</u>					
<u>Units with Vacancy Increases 1/1/99 – 12/31/07 (14,672 units)</u>					
No. of Bedrooms	Adjusted 1998 ⁹ Median MARs	Income needed to Afford MAR	Post- Increase Median MARs	Income Needed to Afford MAR	Income Difference
0	\$682	\$38,964	\$1,075	\$61,429	\$22,465
1	776	38,796	1,436	71,800	33,004
2	993	41,811	1,896	79,832	38,021
3 or more	1,255	46,267	2,508	92,461	46,194

As the chart shows, depending on size of a unit, the household income needed to "afford" the median market rent is \$22,465 - \$46,194 higher than the income needed to afford the median rent of that same size unit if it had not received a market rate increase.

⁸ Annual Income Calculation = (monthly rent/household adjustment factor/affordability standard) x 12
 0-bedroom = \$682/.7/30%=\$3,247 x 12 = \$38,964; 1-bedroom = \$776/.8/30%=\$3,233 x 12 = \$38,796

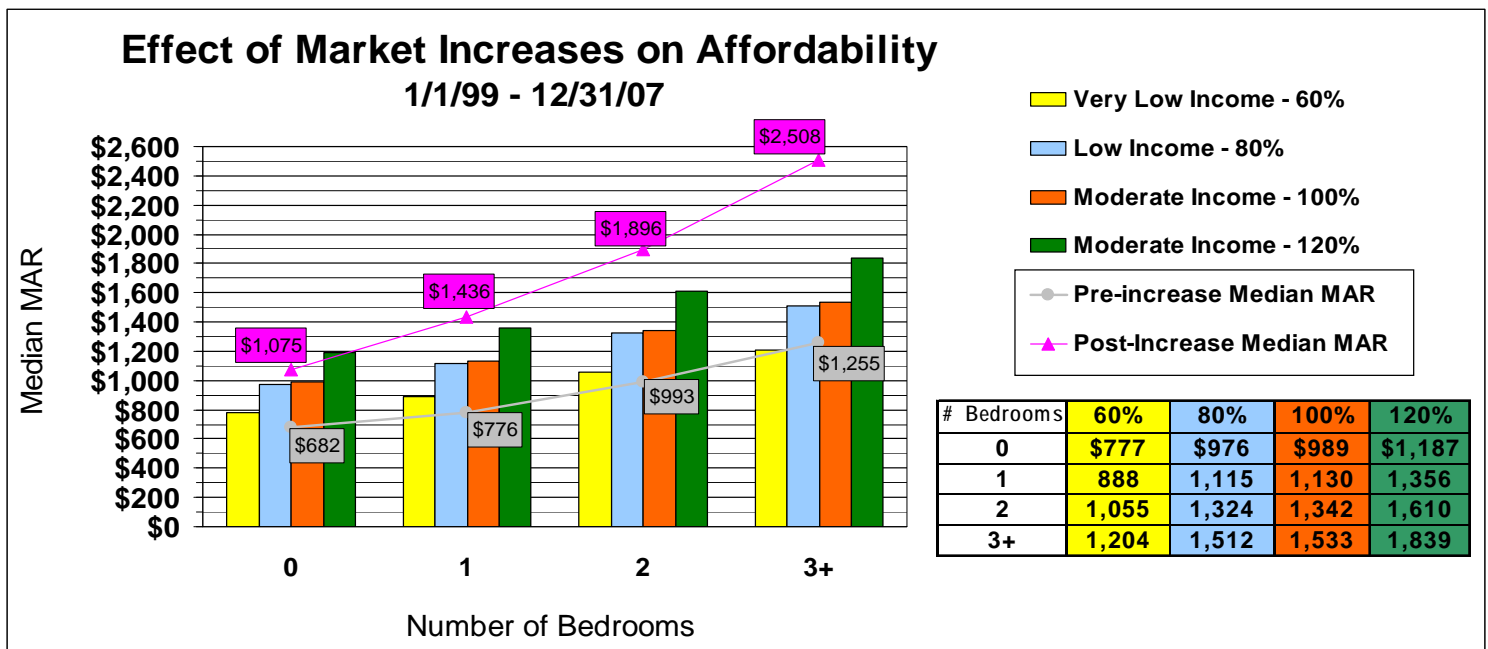
⁹ December 1998 median MARs with 1999-2007 general adjustments added.

Loss of Affordability – 1/1/99 - 12/31/07

Affordable units have been lost at every affordability level and every bedroom size as a result of market rent increases since January 1, 1999. For the 14,672 units that have received market increases, their pre-increase median MARs for 0, 1 and 2- bedroom units (with 1999-2007 general adjustments added) would be affordable to a household whose income is 60% of the adjusted County median. None of the post-increase medians are affordable to a family making even 100% of median income.

After the increase, the median MARs of only the 0-bedroom units (\$1,075) are even close to being affordable at 120% of median (\$1,187). The median MARs of 1-bedroom units are \$80 above the affordable rent level for households at 120% of median. 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 \$286 above the amount affordable at 120% of median income and the median MAR for a 3-bedroom unit is \$669 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.¹⁰ The chart shows the corresponding rents affordable for each of the four household sizes. The gray line shows the pre-increase median MARs (with 1999-2007 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.



¹⁰Due to 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.

Loss of Affordable Units by Income Level

The 14,672 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.

<u>Affordability Distribution of 14,672 Units Before and After Increases</u>			
<u>Affordability Category</u>	<u>Number of Units Before Increases</u>	<u>Number of Units After Increases</u>	<u>Difference</u>
Very Low (50 & 60%)	6,697	653	-6,044
Low (80%)	5,192	1,376	-3,816
Moderate (100 & 120%)	2,317	3,076	+759
Above 120%	466	9,567	+9,101

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, 46% of the units had median rent levels affordable to **very-low income** households. After the increases, just 4% of the units remained affordable at this income level. This represents a loss of affordability of 6,044 units.
- ◆ Before the increases, 81% of the units had median rent levels affordable to **low or very-income** households. After the increases, only 13% of the units remained affordable to these households.
- ◆ Sixty-five percent (65%) of units rented at market rate are affordable only to people making more than 120% of the median income for a family of four (\$67,800).

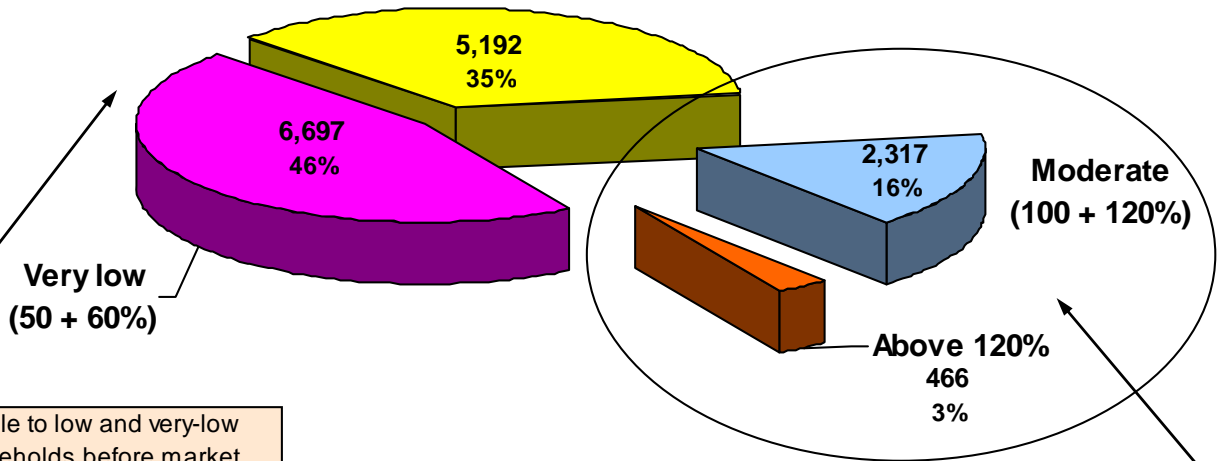
The pie chart on the next page graphically details the shifts in affordability of the units rented at market rate.

Loss of Affordable Units over Nine Years

Impact of Market Increases on 14,672 Units

Before Increases

Low (80%)



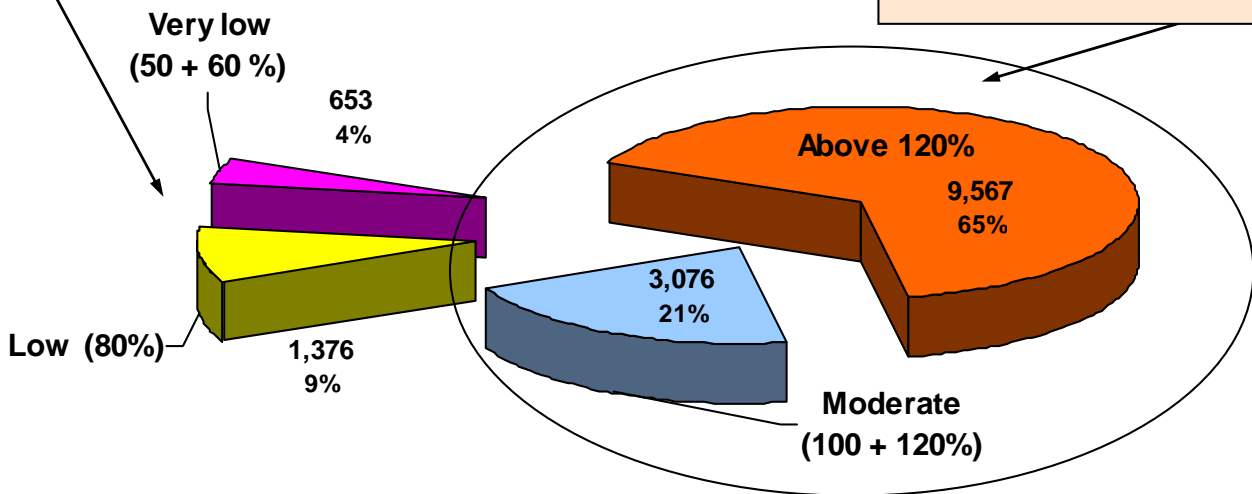
81% affordable to low and very-low income households before market increase.

After market increases, only 13% remain affordable to these households.

19% affordable only to moderate income households or above before market increase.

After market increases, 86% remain affordable only to households at 100% of median income or above.

After Increases



CONCLUSION

Nine years into vacancy decontrol, 54% of the controlled rental housing stock has been rented at market rate and 46% 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 2007, just 12% of that number (483 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 turn over again. Sixty percent (60%) 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 14,672 units that received vacancy increases. Before the increases, 81% of the units had rent levels affordable to low-income households. After the increases, just 13% 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 19% before the increases to 86% 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 12,606) have not received vacancy increases and continue to provide housing at affordable rents.