# *The Impact of*
# *Market Rate Vacancy Increases*
# *Ten-Year Report*

## January 1, 1999 - December 31, 2008

Santa Monica Rent Control Board
March 2009

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# IMPACT OF MARKET RATE VACANCY INCREASES

## SUMMARY

The state-initiated vacancy decontrol-recontrol law has now been in effect for ten 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 tenth year, 15,340 units had been rented at market rates. This represents 56% of the 27,296 controlled rental units for which the Agency has registered rents.[1] For comparison, at the end of 2007, 54% of the units (14,672 units) had been rented at market rate. Less than two percent of the controlled units (474 units) were rented at market rates for the first time during 2008. Another 193 units (less than 1%) were rented at market rates in previous years, but those tenancies were not registered by the owners until 2008. The Agency's records indicate that 44% of the controlled rental housing units (11,956 units) have not received market rate increases.

The impact of vacancy decontrol-recontrol 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 2008, 474 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 tenth year, 63% of the units rented at market rate have been re-rented at least once since the first market rate rental. Nineteen percent (19%) of the units have been rented at market rate four or more times.

- Upon re-rental, median MARs have increased from $700 to $1,130 (61%) for 0-bedroom units, from $792 to $1,506 (90%) for 1-bedrooms, from $1,014 to $1,995 (97%) for 2-bedrooms and from $1,286 to $2,623 (104%) for 3 or more bedroom units.

[1] Excluded from these totals are 9,200 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 These include: units on properties with owner-occupied exemptions (approximately 1,666); units withdrawn under the Ellis Act (approximately 1,945); units that have received removal permits (approximately 1,606); units with various other use exemptions (approximately 2,733); 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 $64,572 to $96,700. This is $24,576 - $49,284 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 15,340 units have resulted in the loss of 10,446 units that formerly had rent levels affordable to low-income households (80% of median income) including 7,108 units with rent levels formerly affordable to very low-income households (50 and 60% of median income).[2]

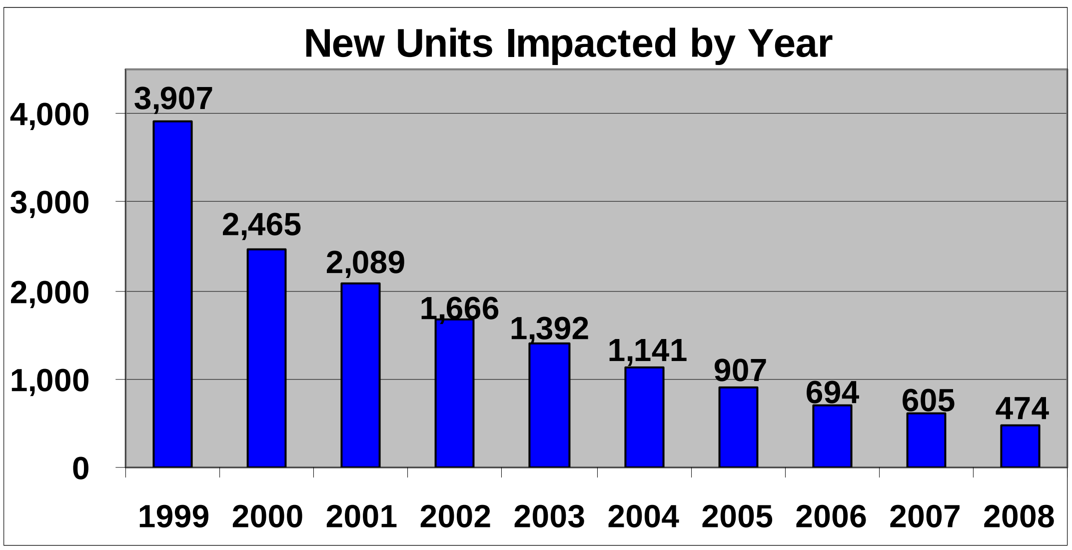
- Market rate vacancies continue to be distributed throughout the city, closely paralleling the distribution of all controlled rental units.

[2] See page 10 Affordability Standards, for the maximum income at each level.

## Units Impacted

In ten years of vacancy decontrol, 15,340 units experienced at least one market-rate increase. As the table below shows, the number of new units impacted each year has declined. In 2008, 667 units were registered as being rented at market rate for the first time: 474 rented in 2008 and 193 rented in previous years. The 474 units rented in 2008 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. This downward trend is anticipated to continue as current difficult economic conditions are likely to reinforce the stability of pre-1999 tenants.

The table below shows the number of units impacted for the first time in each year of vacancy decontrol. The chart reflects the year the rents were implemented as opposed to the year they were registered with the Rent Control Board.




## Rates of Re-Rental – Multiple Increases per Unit

After ten years of vacancy decontrol, sixty-three percent (63%) of the units rented at market rate have been re-rented at least once since the first market rate rental.[3] Of the 15,340 units rented at market rate, 27% (4,091) have experienced two vacancies and re-rentals, 17% (2,662) have had three, and 19% (2,887) have had four or more re-rentals.

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

[3] At the end of 2007, 60% of the units rented at market rate had been re-rented at least once.

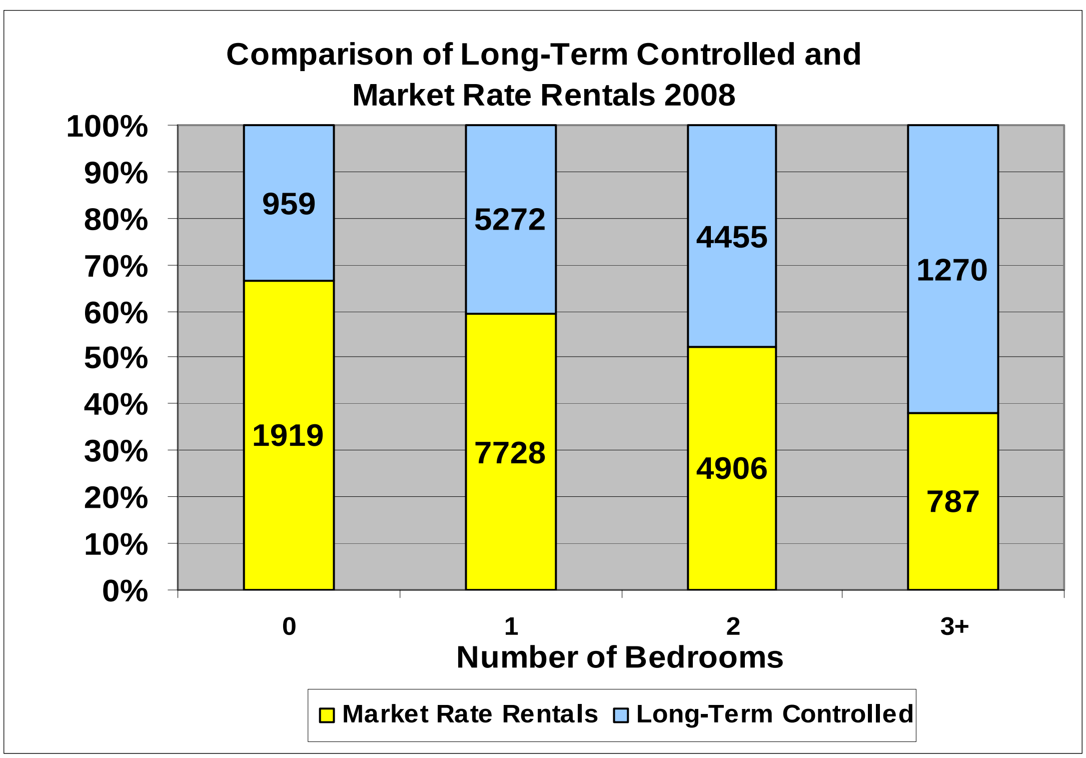
relatively short period of time. In fact, of the 2,801 market rate tenancies established in 2008, only 474 were in units rented at market rate for the first time. More than 83% of the market rate rentals in 2008 were in units that had been rented at market rate at least once before.

## Ten Year Totals

Overall, the 15,340 units rented at market rate since 1999 represent 56% of the controlled units for which the Agency has registered rents. For comparison, at the end of 2007, 54% of the units (14,672) had been rented at market rate. Agency records indicate 44% of the controlled units (11,956) 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 | 33 | 41 | 48 | 62 | **44** |
| Percent Market Rate Rentals | 67 | 59 | 52 | 38 | **56** |

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. For all size units, except three or more bedroom units, more than 50% have been rented at market rate.



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 474 units were rented at market rate in 2008, 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 | 11 | 47 | 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 15,340 units that received market rate increases between January 1, 1999 and December 31, 2008. The post-increase medians reflect the cumulative effect of ten years of rentals at market rate.

**Vacancy Increases 1/1/99 – 12/31/08 (15,340 units)**

| Number of Bedrooms | Adjusted 1998[5] Median MARs | Post-Increase Median MARs | Dollar Amount Change | % Change |
|---|---|---|---|---|
| 0 | $700 | $1,130 | $430 | 61% |
| 1 | 792 | 1,506 | 714 | 90 |
| 2 | 1,014 | 1,995 | 981 | 97 |
| 3 or + | 1,286 | 2,623 | 1,337 | 104 |

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 – 2008 general adjustments added. Adding the general adjustments allows a comparison of what the medians of these 15,340 units would be as of December 2008 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.

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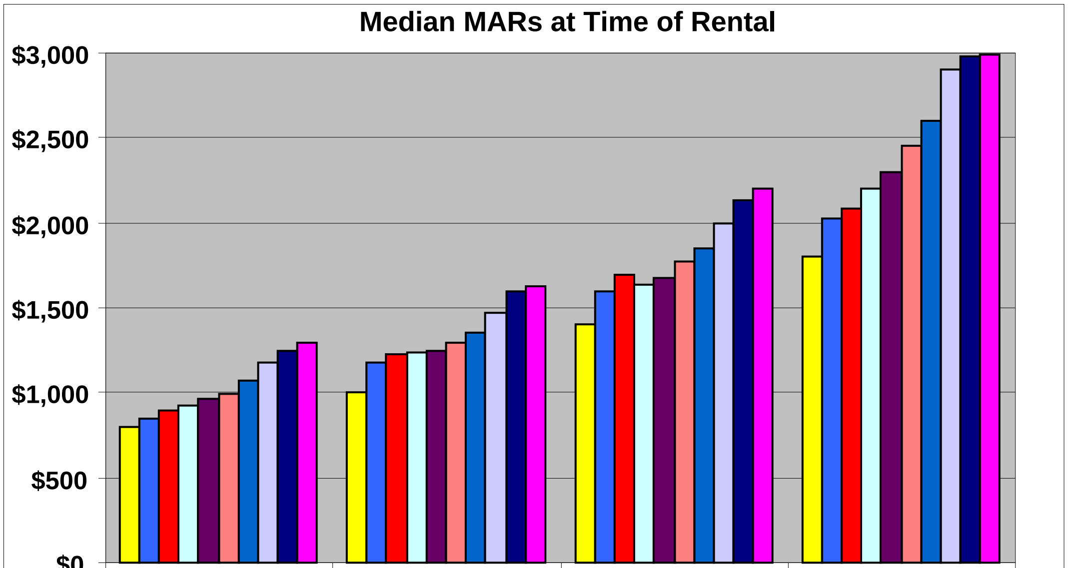
[4] Median rent levels (the point at which half the rentals were higher and the other half were lower) are used throughout this report because they are considered more statistically accurate than average rents. Medians filter out the effect of rents at the extreme high and low ends.

[5] December 1998 median MARs with 1999-2008 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 2008, the first market rent is reflected in the figures for 1999 and the later market rent is reflected in the figures for 2008.  Additionally, if a unit was rented more than once in a year, all new rental amounts are included to calculate the medians.




| | 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 |
| 2006 | $1,182 | $1,475 | $1,995 | $2,900 |
| 2007 | $1,250 | $1,595 | $2,132 | $2,979 |
| 2008 | $1,295 | $1,631 | $2,200 | $2,987 |

Number of Bedrooms

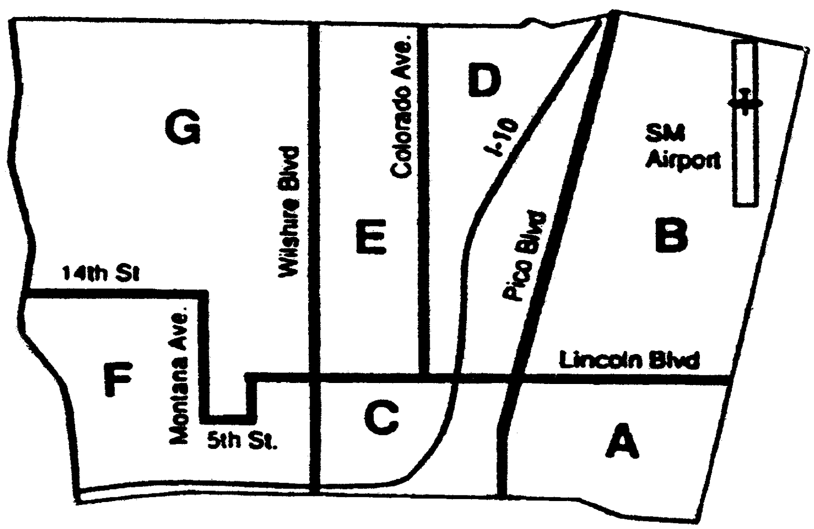
As the above graph shows, the general trend of rents has been upward over the past ten years reflecting the high demand for rental housing in Santa Monica.  The overall increases in median rents between 1999 and 2008 have been more than 55% for all unit sizes.  Singles increased 62%, one-bedrooms increased 63%, 2-bedrooms increased 57% and 3 or more-bedrooms (the smallest category of units) had the largest increase, 66%.

In looking at the year-to-year change in median rents, there was an initial steep increase averaging 12.7% across all unit sizes from 1999 to 2000.  Market rents flattened to an average 3.8% increase per year from 2000 to 2004, but re-established a sizable 7% average annual increase from 2005 to 2007.

In 2008, the increases in newly established market rents began to slow down. As compared to 2007, market rate rents established in 2008 increased 4% for singles, 2% for one-bedrooms, 3% for two-bedrooms and 0.3% for three-bedrooms

## 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 ten years of vacancy decontrol closely parallels the distribution of rental units throughout the city. 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 |

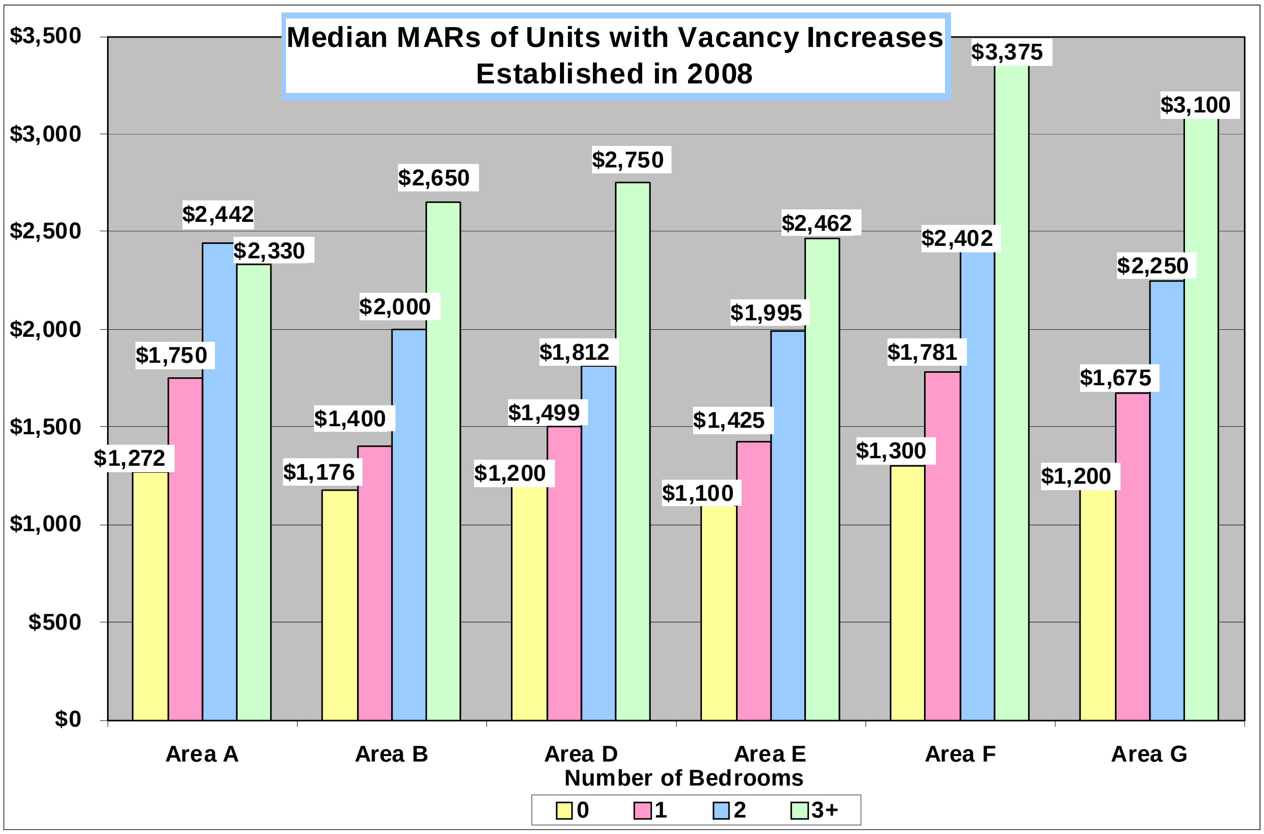
## Median MARs by City Area in 2008 and 2006-2008

The graphs on the following two pages show the median market rents for units rented in 2008 and 2006–2008. 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—2008

This graph details for the various areas of the city by number of bedrooms the current median rents for the 2,015 units in which a vacancy increase was implemented in 2008. [6]




The table below details the number of units in each category rented at market rate during the time period. 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 (47%) are one-bedroom units. Conversely, very few 3-bedroom units were rented in 2008. Areas A, B, D and F had fewer than 10 units of this size rented and Area G had the largest number, but this was just 40 units.

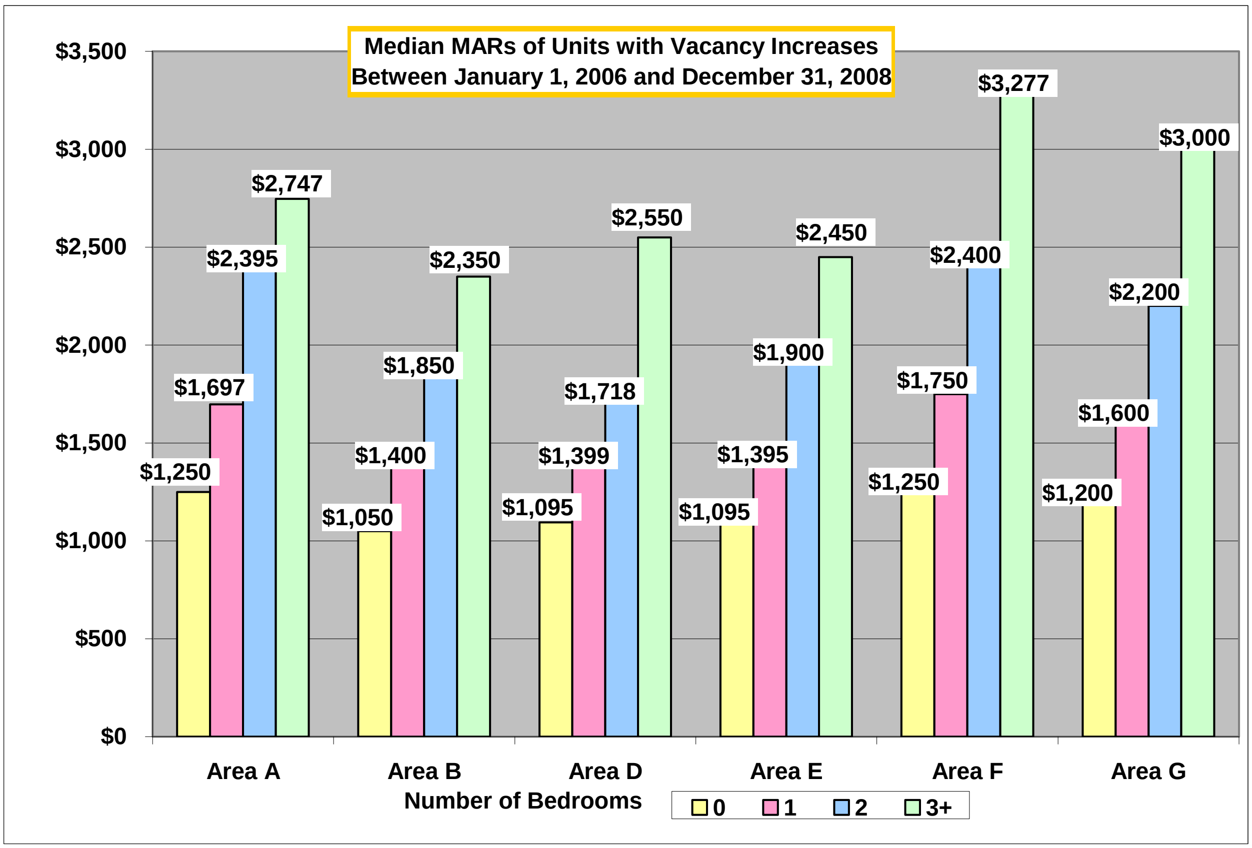
| Bedrooms | Area A | Area B | Area D | Area E | Area F | Area G | Totals |
|---|---|---|---|---|---|---|---|
| 0 | 34 | 31 | 7 | 51 | 63 | 33 | 219 |
| 1 | 236 | 109 | 155 | 176 | 164 | 239 | 1,079 |
| 2 | 104 | 58 | 66 | 130 | 98 | 168 | 624 |
| 3+ | 7 | 5 | 4 | 30 | 7 | 40 | 93 |

[6] If a unit was rented more than once in 2008, only the last rent level established is used in these calculations.

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.

## Median MARs by City Area—2006-2008

This graph shows median MARs by area and number of bedrooms for 6,839 units with vacancy increases established in the most recent three-year period, January 1, 2006 through December 31, 2008. 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 2008 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 | 134 | 119 | 31 | 198 | 159 | 133 | 774 |
| 1 | 793 | 400 | 380 | 624 | 590 | 788 | 3,575 |
| 2 | 333 | 253 | 226 | 430 | 340 | 591 | 2,173 |
| 3+ | 28 | 33 | 27 | 77 | 34 | 118 | 317 |

[7] The rent levels for most units rented in 2006 and 2007 were registered by the owners the year they were rented. However, also included in this graph are 24 units with market rents established in 2006 and 122 units with market rents established in 2007 that were first registered by the owners in 2008.

## 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 2008, the HUD median income for a "Four-Person Household" in Los Angeles County is $59,800.

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 2008 and the income limits listed below were determined by HUD and published in a February 28, 2008 Memorandum which is attached to this report as Attachment A.

| **Very Low 50%** | **Very Low 60%** | **Low 80%** | **Moderate 100%** | **Moderate 120%** |
|---|---|---|---|---|
| $37,900 | $45,480 | $57,100 | $59,800 | $71,760 |

## 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.

**Income Needed to Afford MARs (30% Affordability Standard)**
**Units with Vacancy Increases 1/1/99 – 12/31/08 (15,340 units)**

| 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 | $700 | $39,996 | $1,130 | $64,572 | $24,576 |
| 1 | 792 | 39,600 | 1,506 | 75,300 | 35,700 |
| 2 | 1,014 | 42,696 | 1,995 | 84,000 | 41,304 |
| 3 or more | 1,286 | 47,412 | 2,623 | 96,696 | 49,284 |

As the chart shows, depending on size of a unit, the household income needed to "afford" the median market rent is $24,576 - $49,284 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 = $700/.7/30%=$3,333 x 12 = $39,996; 1-bedroom = $792/.8/30%=$3,300 x 12 = $39,600

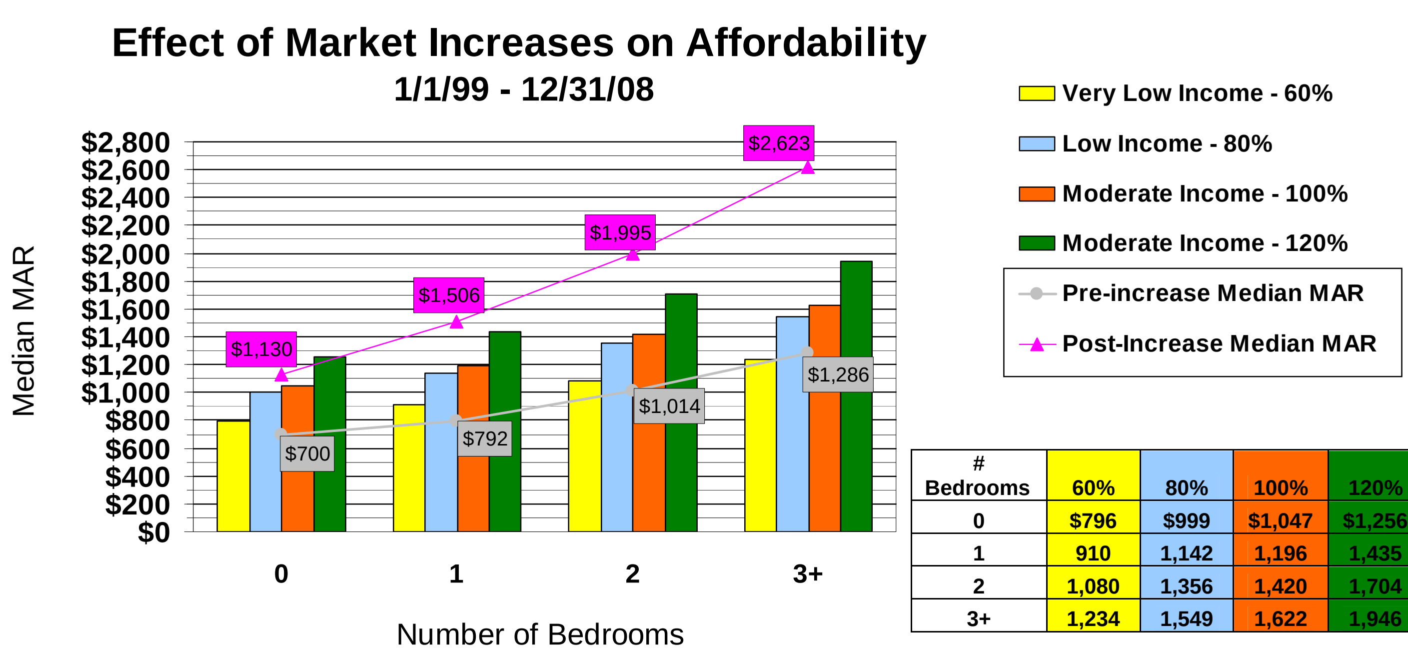
[9] December 1998 median MARs with 1999-2008 general adjustments added.

## Loss of Affordability – 1/1/99 - 12/31/08

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 15,340 units that have received market increases, their pre-increase median MARs for 0, 1 and 2- bedroom units (with 1999-2008 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 ($1,130) are even close to being affordable at 120% of median ($1,256). The median MARs of 1-bedroom units are $71 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 $291 above the amount affordable at 120% of median income and the median MAR for a 3-bedroom unit is $677 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 1999-2008 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 | $796 | $999 | $1,047 | $1,256 |
| 1 | 910 | 1,142 | 1,196 | 1,435 |
| 2 | 1,080 | 1,356 | 1,420 | 1,704 |
| 3+ | 1,234 | 1,549 | 1,622 | 1,946 |

[10]Due 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 15,340 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.

**Affordability Distribution of 15,340 Units Before and After Increases**

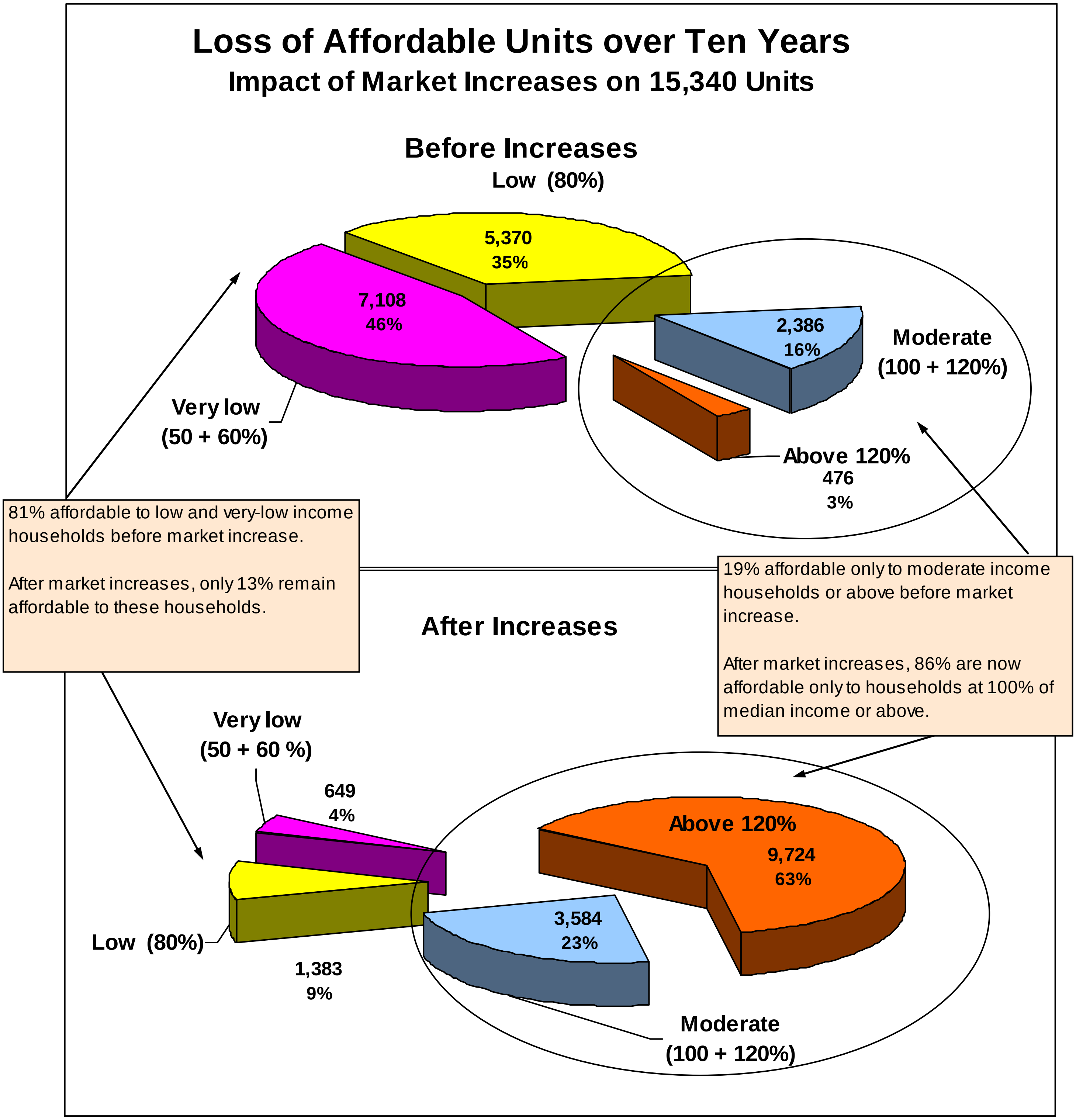
| Affordability Category | Number of Units Before Increases | Number of Units After Increases | Difference |
|---|---|---|---|
| Very Low (50 & 60%) | 7,108 | 649 | -6,459 |
| Low (80%) | 5,370 | 1,383 | -3,987 |
| Moderate (100 & 120%) | 2,386 | 3,584 | +1,198 |
| Above 120% | 476 | 9,724 | +9,248 |

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 6,459 units.
- Before the increases, 81% of the units had median rent levels affordable to **low or very-low income** households. After the increases, only 13% of the units remained affordable to these households.
- Sixty-three percent (63%) of units rented at market rate are affordable only to people making more than 120% of the median income for a family of four ($71,760).

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 Ten Years
Impact of Market Increases on 15,340 Units
Before Increases
Low (80%)
5,370
35%
7,108
46%
2,386
16%
Moderate
(100 + 120%)
Very low
(50 + 60%)
Above 120%
476
3%
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% are now affordable only to households at 100% of median income or above.
After Increases
Very low
(50 + 60 %)
649
4%
Above 120%
9,724
63%
3,584
23%
Low (80%)
1,383
9%
Moderate
(100 + 120%)

After a decade of vacancy decontrol, a sizeable portion of the controlled housing stock has been rented at market rate. At the end of 2008, 56% of the units are occupied by tenants paying market rents and 44% are occupied by longer-term (pre-1999) tenants.

Every year additional units are rented at market rate for the first time, but the pace has slowed significantly since 1999. In 2008, just 474 units received initial market rate increases. Given the current economic uncertainty and the apparent stability of the longer-term tenants, it is reasonable to expect the number of initial market rate rentals to remain near this level or to continue to decline in 2009.

Conversely, the tenants in market-rate units appear to be a mobile group. Once a unit is rented at market rate, it is likely it will turn over again: 63% of market rate units have been re-rented at least once and 19% have been rented four or more times.

As a result of vacancy decontrol, a dramatic shift has occurred in the affordability of the 15,340 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 (15,340), a substantial number of units (11,956) have not received vacancy increases and continue to provide housing at affordable rents.