

# SANTA MONICA RENT CONTROL BOARD

## The Impact of Market-Rate Vacancy Increases

Year 13  1999–2011



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### THE IMPACT OF MARKET-RATE VACANCY INCREASES

A summary, with analysis, of vacancy decontrol-recontrol in the thirteen years from January 1, 1999 to December 31, 2011.

# Introduction

**W**hen state-mandated vacancy decontrol went into effect in 1999, it was feared to be (or in some quarters hailed as) the end of rent control. Some people predicted that every rent-controlled unit in Santa Monica would be at market level by 2009.

From our vantage point in early 2012, we can see that both of those predictions landed wide of their mark; rent control has not ceased to exist, and roughly a third of controlled units continue to be rented at their original rent levels (albeit adjusted for inflation). The remaining two-thirds, though rented at market level, remain subject to controls on the rate of rent increase during the course of a tenancy.

But there is no question that vacancy decontrol has precipitated change. The two-thirds of units rented at market level are beyond many renters' economic reach. A one-bedroom apartment that would have cost less than \$800 per month under the original rent control law now rents for over \$1,500. People earning 100 percent of the area median income can no longer begin a tenancy in Santa Monica without being rent burdened, if they can afford to do so at all.

As the result of these changes, a core concept of any rent control law—the idea that controls cannot deprive landlords of a fair return—has become little more than an academic footnote. Most landlords have rented the majority of their units at market level, thus achieving income that is so far beyond the amount needed to achieve a fair return that the concept has become all but

irrelevant. This reality has become more apparent over the past year, as the rental market has improved and rents have recovered to pre-recession levels.

This year's report posits ways of thinking about, and possibly addressing, some of these new realities. For example, given that landlords can account for expenses like taxes and utilities when they set initial rents, does it still make sense for the law to allow the “double dip” of imposing a surcharge for those costs? And has the time come to abandon the original general adjustment formula—abandoned by every jurisdiction but ours—in favor of a straight-forward calculation method?

This report does not definitively answer each of these questions; that is the role of the Board and the public that it serves. But I hope that the data included here will pave the way for a meaningful and productive conversation that will lead ultimately to a strengthened Rent Control Law that will continue to advance the goals that the voters envisioned for it 34 years ago.

Tracy Condon, Administrator

February 1, 2012

## ***Report Highlights***

- Sixty-one percent of controlled units are now rented at market rate.
- Across properties of all sizes, roughly 9 out of 10 owners have registered that they are collecting at least some market-rate rents.
- Rent levels in 2011 have recovered from recent economic softening.
- Market-rate rents are a financial burden for households at or below moderate income levels.
- Market-rate rents are outpacing inflation and increasing by a great deal more than is necessary to ensure a fair return.
- Units at market-rate rents have high turnover whereas tenants with affordable rents tend to maintain longer tenancies.
- Turnover is greatest among smaller unit sizes and varies by neighborhood with the Pico neighborhood remaining the most stable.

# Rent Control

## A two-tiered system

The citizens of Santa Monica passed the Rent Control Law as a way to protect residents from rapidly rising rents that resulted from exploitation of the high demand for the limited supply of rental housing stock of this small city. The law, which took effect April 10, 1979, continues to provide affordable rents for many long-term tenants. A change to the law that occurred with the passage of the Costa-Hawkins Rental Housing Act by the state legislature in 1995, however, has since allowed owners to negotiate market rents for new tenancies. Although these new tenancies remain subject to rent control (the rent is “decontrolled” when the old tenant moves out and “recontrolled” at the negotiated rate when the new tenant moves in), the impact has led to a Santa Monica that has become, for many, unaffordable.

This 13th year report quantifies the impact of vacancy decontrol-recontrol (or vacancy decontrol, for short) by putting the numbers in context and showing how the state-mandated change in the law is leaving an indelible mark on Santa Monica. Owners are required to file Vacancy Unit Registration forms to register the initial Maximum Allowable Rents (MAR) and amenities of market-rate tenancies. In 2011, the Rent Control Board received the 50,000th such form since full vacancy decontrol began on January 1, 1999<sup>1</sup>. This report is largely based on the increases that have occurred to rent levels in the city as reported on these registration forms. The availability of 2010 Census data this year also makes it possible to add context to the accumulated rent-level data.

Depending on whether tenants moved in before or after 1999, rent levels vary dramatically. In many cases, rents established at market rates are now double those of similar units occupied by long-term tenants. As recognized by the voters who passed the Rent Control Law, the market forces of a limited supply and high demand for Santa Monica apartments continues to play a big role in increases to rental rates. Indeed, the combination of vacancy decontrol and market forces are driving rental costs significantly above what would be indicated by area inflation alone. Changing rent levels are detailed in this report by city area, unit size and by each year since vacancy decontrol took effect.

### The Costa-Hawkins Rental Housing Act

- **Phase 1** allowed for a 15-percent increase if and when a qualifying vacancy took place between January 1, 1996 and December 31, 1998. This increase could be claimed a maximum of two times, regardless of how often the apartment was re-rented within this three-year period. (In Santa Monica, this phase began three months earlier, on October 1, 1995 to encourage owners to rent vacant units that had been withheld from the rental market.)
- **Phase 2** began January 1, 1999. Full vacancy decontrol-recontrol allowed property owners to set the initial rent for new tenancies at market rates. With few exceptions, there are no limits on the initial rent a property owner may establish for a new tenancy.

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<sup>1</sup> By year-end 2011, a total of 50,901 forms had been received; 48,718 forms were processed, the remaining forms being duplicates or otherwise forms filed in error.

## Share of long-term and market-rate controlled housing stock

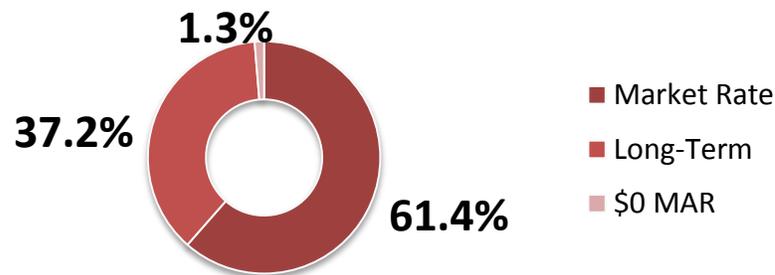
According to the 2010 Census, Santa Monica has a total of 50,912 housing units. Of these, 11,710 are single-family homes generally not subject to rent control. The remaining 39,202 units are located in multi-family structures, of which 28,135 are currently subject to the Santa Monica Rent Control Law. This means nearly 72 percent of units in multifamily structures are under rent control. This number changes year by year according to the exemption, removal and withdrawal status of properties<sup>2</sup>. As shown in Figure 2, for housing stock under rent control, units can be classified as occupied by long-term tenants, market-rate tenants or those which have no registered MAR<sup>3</sup>. In 2006, the number of market-rate units exceeded the number of long-term controlled units for the first time. In that year, 51 percent of units were market rate. Just five years later, by the end of 2011, that percentage had risen to 61.4 percent of controlled units.

Total market of controlled rents (millions)



Figure 1  
Compares registered MARs of 26,936 units controlled as of 12/31/11 that were also controlled 1/1/99.

## Units under rent control



Unit Size # of bedrooms	Total Controlled Housing Stock		\$0/No MAR; Never Rented; Owner Occupied		Long-Term Controlled		Market Rate	
	# of units	%	# of units	%	# of units	%	# of units	%
All	28,135	100%	379	1.3%	10,465	37.2%	17,291	61.4%
0	3,145	11.2%	187	0.7%	842	3.0%	2,116	7.5%
1	13,195	46.9%	33	0.1%	4,510	16.0%	8,652	30.7%
2	9,706	34.5%	92	0.3%	3,987	14.2%	5,627	20.0%
3(+)	2,089	7.4%	67	0.2%	1,126	4.0%	896	3.2%

Figure 2

<sup>2</sup> As of 12/31/11, 8,522 units had either been removed from rent control or had been granted one of the following: owner-occupied (3-units or less) exemption: 1,415; Ellis withdrawal: 1,953; removal permits: 1,642; non-rentals or commercial exemptions: 759; other use exemptions: 2,753.

<sup>3</sup> Reasons for no registered MAR include that units have been continuously owner-occupied since April 10, 1979, never rented or, as of the date of this report, rents were not yet properly registered with the Board.

# Inside the Numbers

## The effect of vacancy decontrol on rent levels

### Vast majority of owners collect market-rate rents

While 61 percent of tenancies are now at market rate and 37 percent remain long-term controlled, this should not suggest that roughly one out of three property owners still has not collected any market-rate rent. When market-rate units are looked at by property, the data indicates that almost all property owners are collecting market-rate rents. In most cases, they collect market-rate rents on more than half of their units.

Figure 3 represents data from approximately 75 percent of controlled properties in Santa Monica. As explained later, the trends indicated in the chart hold true as well for the fewer than 10 percent of properties that have more than 15 units. Properties with three units or fewer, constituting the remaining 15 percent of properties, are excluded from the chart because many of these properties have at times qualified for exemptions and re-rentals may not have been reported to the Board.

- As shown in the chart, even on properties with four or five units, almost 90 percent have at least one market-rate tenancy. On properties with more units, nearly 95 percent of owners have recorded at least one market-rate tenancy.
- Twenty percent of four-unit properties are collecting market-rate rents on every unit.
- As the top two areas of the chart show, the vast majority of properties have market-rate tenancies in half or more of all units.
- As building size increases beyond 15 units, the likelihood of re-rental is higher, and similar to the trends shown here, the vast majority of units are at market rates. However, as the number of units rises higher, 100 percent market-rate rentals become less likely.

Share of market rents by property size (4–15 Units)

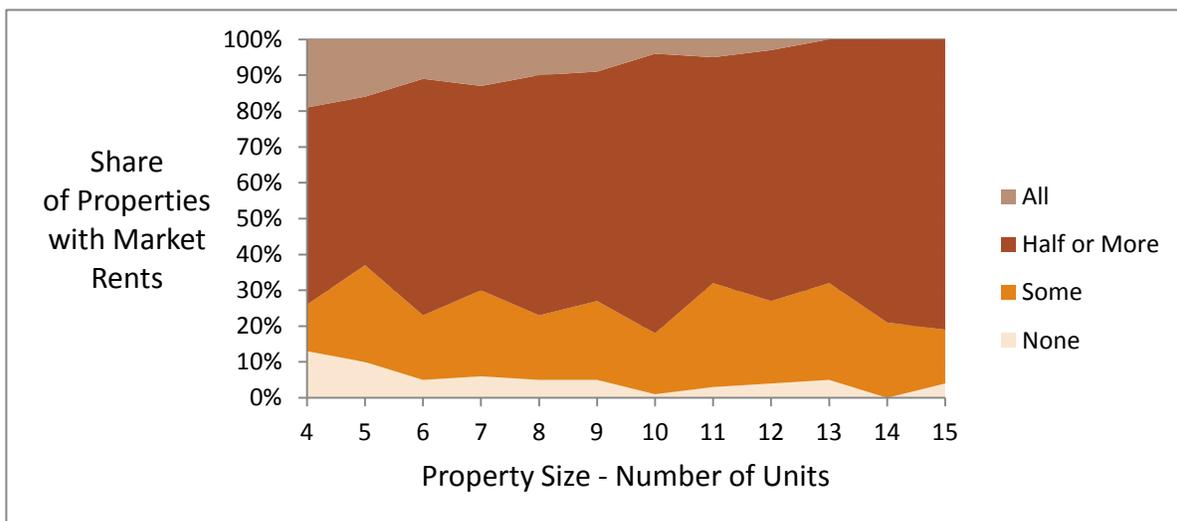


Figure 3

## Fewer long-term rent-controlled tenancies remain

In 1999 when full vacancy decontrol began, nearly 4,000 market-rate tenancies were registered with the Rent Control Board. Those units represented 11 percent of the total housing supply subject to the Santa Monica rent control law.

### Units given first market-rate increase

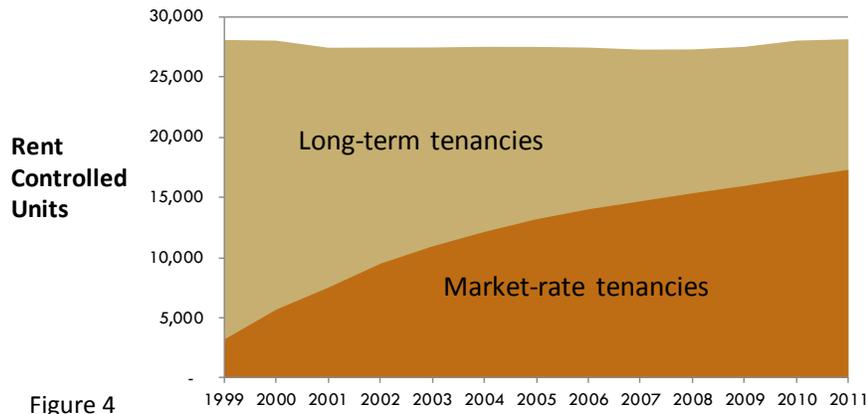


Figure 4

Since then, the number of units rented at market rates for the first time has continued to grow, albeit at a more moderate pace. Since 2007, the rate at which long-term rent-controlled units were rented for the first time at market rate has been approximately two percent of the remaining long-term units. In 2011, 426 units were rented at market rate for the first time, the fewest since full vacancy decontrol began.

## Projections for full transition to market-rate units

When vacancy decontrol was first enacted, there was speculation that most, if not all, rent-controlled units would be at market-rate levels within ten years. This did not happen.

Recent trends show that long-term controlled units have been converting to market-rate levels at a pace of 1.5 to 2.6 percent per year since 2006. If a two-percent annual conversion rate continues, all of Santa Monica's controlled units will have received at least one market-rate increase by the year 2031.

## Rents rebound post-recession

Market rents are significantly higher than long-term controlled rents with much of the difference resulting from sharp increases in the decade between January 1999 and December 2008.

While there remains debate about whether the recession that began in December 2007 has ended<sup>4</sup>, what is clear is that after a two-year decline, initial market-rate rents across all bedroom categories and sectors of the city increased in 2011. Initial rents on 0-, 1- and 2-bedroom units have returned to levels equal or close to the 2007 median MARs. Larger units (3-bedrooms or greater) have also experienced rent increases, but at a slower pace.

<sup>4</sup> Casey Mulligan, *What Caused the Recession of 2008? Hints from Labor Productivity*, National Bureau of Economic Research (NBER Working Paper No. 14729 issued February 2009).

**Thirteen-year review  
1999 – 2011 median MARs at time of rental, market-rate units**

Year	0 BR	1 BR	2 BR	3 BR
1999	\$800	\$1,000	\$1,400	\$1,800
2000	\$850	\$1,175	\$1,600	\$2,075
2001	\$895	\$1,225	\$1,695	\$2,100
2002	\$925	\$1,239	\$1,620	\$2,264
2003	\$958	\$1,250	\$1,679	\$2,300
2004	\$984	\$1,300	\$1,775	\$2,397
2005	\$1,050	\$1,355	\$1,850	\$2,600
2006	\$1,169	\$1,495	\$1,995	\$2,940
2007	\$1,250	\$1,595	\$2,150	\$2,979
2008	\$1,295	\$1,645	\$2,200	\$2,983
2009	\$1,227	\$1,520	\$2,050	\$2,775
2010	\$1,175	\$1,500	\$2,000	\$2,675
2011	\$1,240	\$1,595	\$2,150	\$2,850

Figure 5

Note: If a unit was re-rented more than once in a calendar year or more than once in the 13-year period, only the last established market-rate rent is used here.

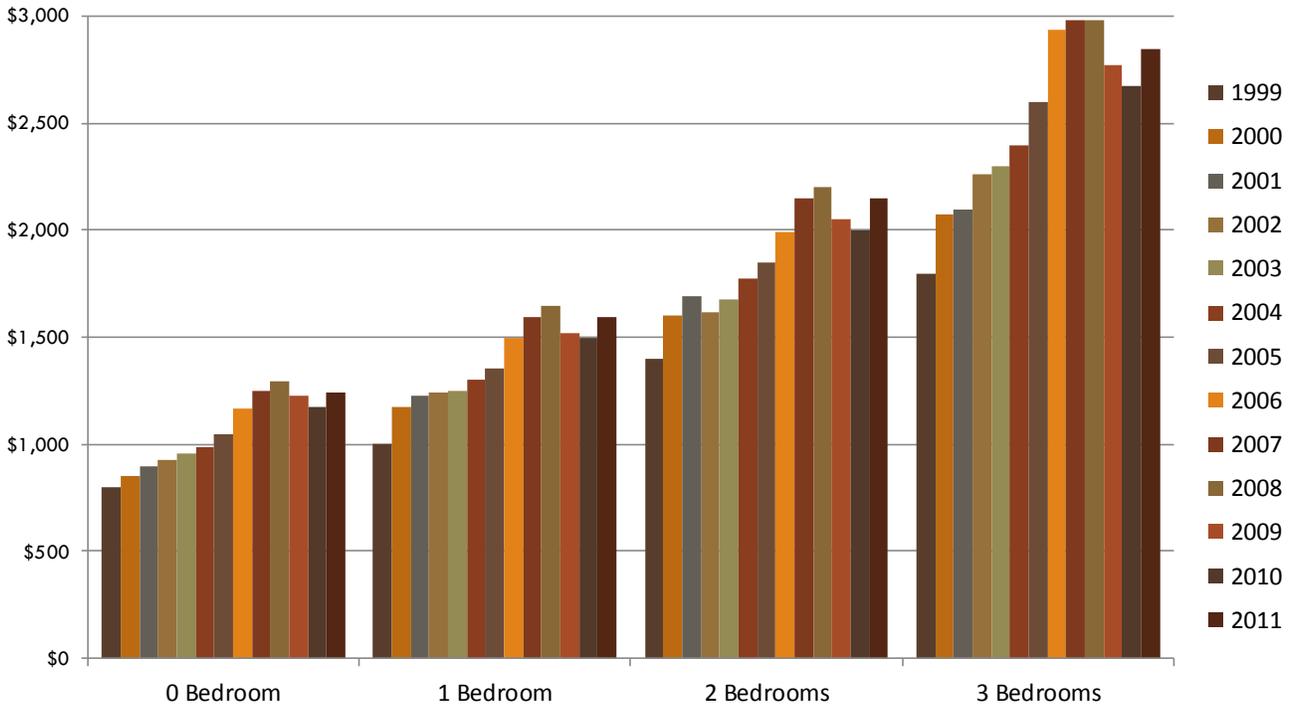
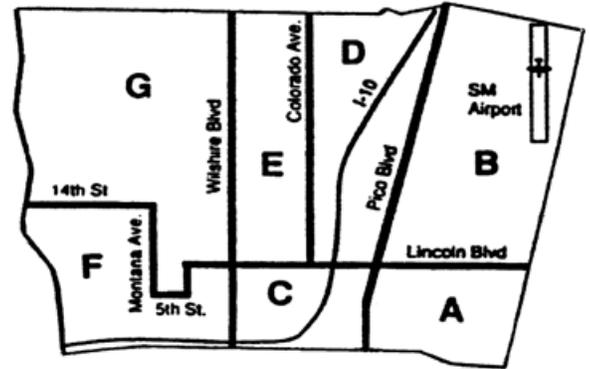


Figure 6

## An analysis of rent levels by city area

In the early 1990s, the Rent Control Board began to track changes in the housing stock in different areas of the city. To do this, the Board divided the city into seven areas, which generally parallel neighborhoods and census tracts. The map to the right shows the city areas identified as A through G.



### Median MARs for Area C

	1 Year (2011)	3 Year (2009-2011)
0 bedroom:	\$1,633	\$1,573
1 bedroom:	\$2,273	\$2,118
2 bedrooms:	\$2,752	\$2,475
3 bedrooms:	-	-

Figure 7

Note: These MARs exclude reported rental data for 1221 Ocean Avenue.

Area C has traditionally been omitted from the analyses in this section of the report because a substantial number of units in that area were removed from rent control after the area lines were drawn, leaving the area with just four percent of the total number of rent-controlled units in Santa Monica (See Figure 24, page 21).

In their place, a large number of non-rent-controlled, market-rate units have been built. With just over 1,100 controlled units, two buildings on Ocean Avenue (one with 120 units and one with 288 units) together account for more than 35 percent of the total. Those units, generally luxury rentals, are unrepresentative of the remaining 65 percent in both size and character. Because of Area C's small size and the distorting impact of these two buildings, including the area could create misleading results.

In 2009, the Rent Control Board asserted jurisdiction over 168 units in Area C that had been built within five years of previously controlled units being demolished following their withdrawal from rent control under the Ellis Act. These units are all rented at market rates. For additional information, see the *2009 Impact of the Ellis Act* report.

### One-year review 2011 median MARs, market-rate units

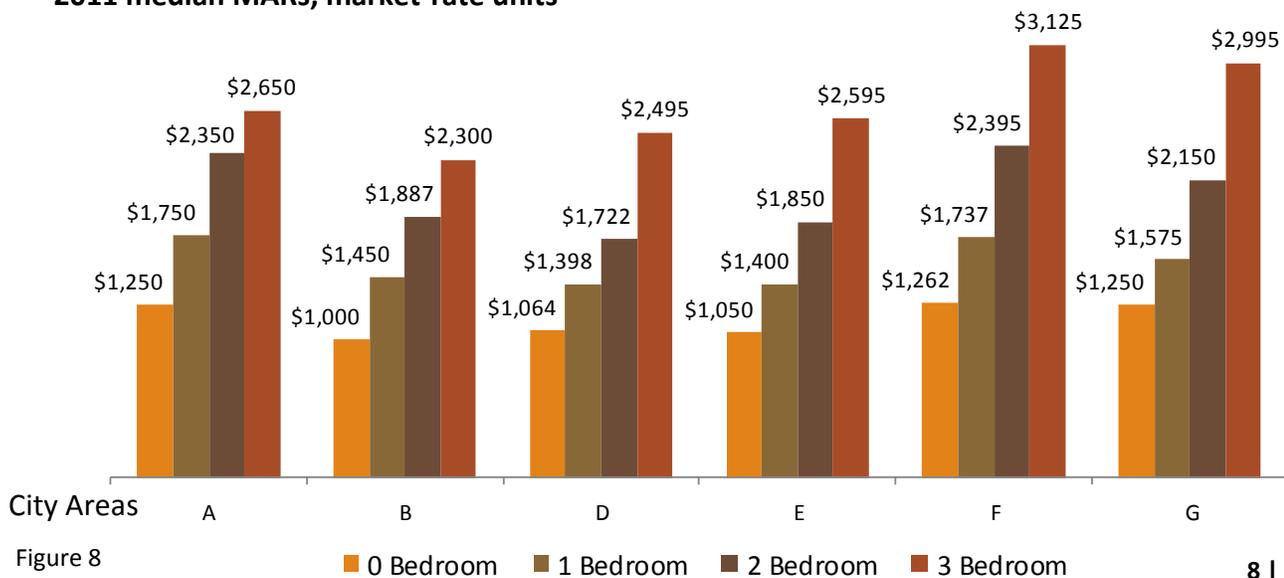


Figure 8

**Three-year review  
2009 – 2011 median MARs, market-rate units**

City Area	0 BR	1 BR	2 BR	3 BR
A	\$1,227	\$1,700	\$2,295	\$2,600
B	\$1,000	\$1,381	\$1,824	\$2,400
D	\$1,009	\$1,330	\$1,650	\$2,300
E	\$1,000	\$1,363	\$1,825	\$2,400
F	\$1,218	\$1,699	\$2,350	\$3,077
G	\$1,250	\$1,550	\$2,100	\$2,824

Figure 9

These charts reflect the median MARs by area and number of bedrooms for 8,404 units with vacancy increases established in the most recent three-year period, January 1, 2009 through December 31, 2011.

In this, as well as in the one-year review shown in Figure 8, if a unit was re-rented more than once in a calendar year or more than once in the three-year period, only the last established market-rate rent is used in the calculations. The units rented in Area C are not included.

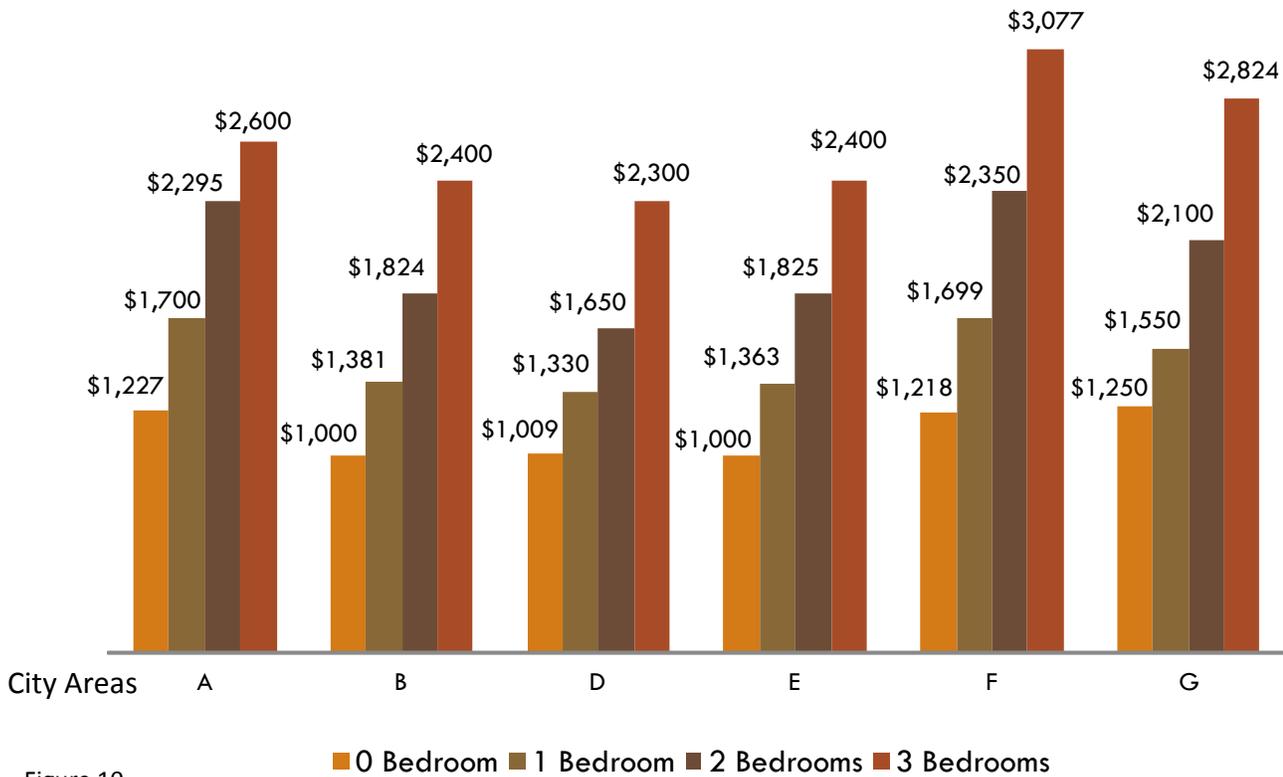


Figure 10

## Market-rate rents outpace inflation: an analysis of rent increases using the CPI

To better understand the effect of vacancy decontrol, it helps to compare increases in market-rate rents against various benchmarks.

According to a November 10, 2011 staff report to the Santa Monica Rent Control Board, the cumulative average increase in rents approved by the Santa Monica Rent Control Board since 1979 has equaled 77.85 percent of the change in the Consumer Price Index (CPI) over the same period. Using 1995 as the baseline year, Figure 11 compares the increases on median MARs to increases in the CPI to identify the impact of vacancy decontrol.

- Between 1996 and 2011, the Rent Control Board approved sixteen general adjustments (GA), with a cumulative increase in rents totaling approximately 44 percent. The third column (labeled "2011 Median MAR") calculates what median rents would have been had vacancy decontrol never been implemented.
- The sixth and seventh columns demonstrate how the rents paid by market-rate tenants are significantly higher than they would have been under full rent control. Over the same period, the MARs for these units have increased between 153 and 203 percent.
- For comparative purposes, the eighth and ninth columns illustrate the amount by which the market-rate rents exceed the cumulative general adjustments approved by the Santa Monica Rent Control Board as well the cumulative CPI for Los Angeles County.

If vacancy decontrol had not been enacted, the median MAR for 1-bedroom apartments in Santa Monica would be \$771. Instead, the median MAR for market-rate units is \$1,556. This market-rate rent is more than twice what would have been allowed under full rent control, reflecting an increase of 191 percent over the 1995 median MAR.

### Comparative analysis of rents by unit size

Unit Size	1995 Median MAR*	If Vacancy Decontrol Had Not Existed		CPI Inflation Rate	With Vacancy Decontrol-Recontrol			
		2011 Median MAR	1996–2011 General Adjustments (GA)		2011 Actual Median MAR	Market Increase	Exceeds GA	Exceeds CPI
0	\$463	\$670	45%	50%	\$1,172	153%	75%	69%
1	\$534	\$771	44%	50%	\$1,556	191%	102%	95%
2	\$695	\$998	44%	50%	\$2,055	196%	106%	97%
3	\$898	\$1,285	43%	50%	\$2,721	203%	112%	102%

Figure 11

Inflation Rate Source: U.S. Department of Labor, Bureau of Labor Statistics. Change in CPI, All items, for Los Angeles, Riverside & Orange County (December 1995–December 2011).

\* Reflects the MAR as of September 1, 1995 for 17,291 units that have received at least one vacancy increase.

## **Why the CPI is relevant**

The Bureau of Labor Statistics compiles monthly surveys on the cost of many household items including food, energy, clothing and housing. This information forms the basis of the Bureau's Consumer Price Index (CPI), which is used in part by the Santa Monica Rent Control Board to determine the annual general adjustment. The CPI, therefore, provides a useful barometer with which to evaluate increases in housing costs.

### **Why is the cumulative general adjustment different for 0- and 3-bedroom units?**

The general adjustment, usually expressed as a percent, is the same for every unit in Santa Monica. However, more often than not, the Board also imposes fixed-dollar minimum and/or maximum rent increases. For example, the general adjustment in 2003 was three percent with a \$15 minimum (for units with MARs of \$516 or less) and a \$30 maximum (for units with MARs of \$984 or higher).

Over time, these fixed dollar minimums and maximums create small but measurable disparities in the cumulative general adjustment for the smallest and largest units.

## **Increases in market-rate rents dramatically exceed the amount required to ensure fair return**

Whether a controlled rent is long-term or market rate, Santa Monica Rent Control and other rent control jurisdictions in the region and state allow general adjustments to address owners' increased operating expenses and to provide a fair return to them. Unlike Santa Monica, other jurisdictions typically use a percentage of the change in the CPI to calculate their adjustment. Each jurisdiction varies in terms of when the general adjustment can be applied, local CPI, the percentage of the CPI to be used, the months used to calculate the change in the CPI, and whether allowed increases can be postponed or banked for implementation in future years. Similarly, jurisdictions vary in terms of whether surcharges can be passed through or whether adjustments are made for owner-paid utilities.

The percentage of the change in the CPI used to increase rents in other jurisdictions ranges from 60 to 100 percent. Figure 12 shows a hypothetical \$1,000 rent as of January 1, 1999 and how it would have increased over time by applying each jurisdiction's general adjustment. While Santa Monica's method of deriving the general adjustment is unique, since 1999 it has closely paralleled West Hollywood's increases, which are based on 75 percent of the change in CPI from May to May of each year. Meanwhile, market-rate rents have increased at three to four times the rate of inflation, well above the fair return calculations of rent control jurisdictions in the region and state.

## Comparison of general adjustments by rent control jurisdiction

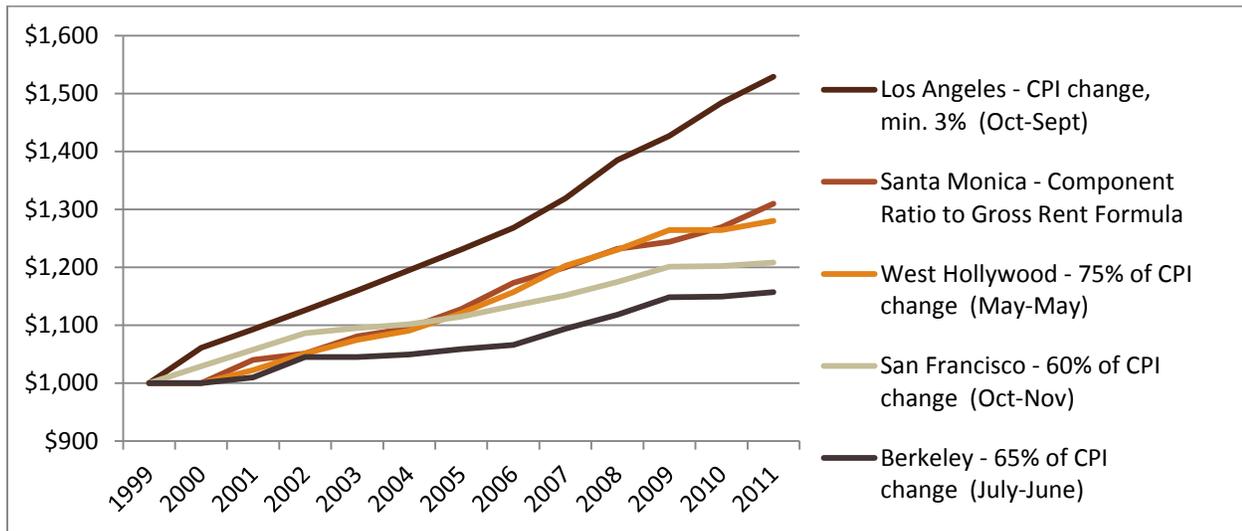


Figure 12

Notes: Amounts indicated do not account for occasional adjustments made for owner-paid gas or water. Amounts for all cities assume the owner took all increases as they were allowed. Berkeley adopted the 65% of the change in CPI formula in 2004.

# Santa Monica, Then & Now:

## The effect of vacancy decontrol on the community

### Changes in the economic makeup of Santa Monica renters

As the previous discussion explains, market-rate rents are significantly higher than long-term controlled rents. While one can assume that new renters are not renting units they cannot afford, relatively high rent levels potentially affect the city in two ways. First, it could mean that the renter population is shifting to one with higher household incomes. Second, it could mean that new and existing tenants are required to spend more of their income on rent versus other spending. Census data indicates that both are true.

Figure 13 below shows how household incomes in Santa Monica have risen significantly since the advent of vacancy decontrol in 1999. According to census figures from 2000 and 2010, median household income in Santa Monica rose from \$50,714 to \$66,269 per year. While it is possible that long-term residents who moved in ten years ago or more are enjoying higher incomes as they advance in their careers, the large number of re-rentals during the period also suggests that incomes have risen because people with higher incomes have moved to the city. As revealed in census data, from 2000 to 2010, Santa Monica saw a percentage decline in households of every income category below \$75,000 and an increase in households of every income category above that.

**Santa Monica households by income range**

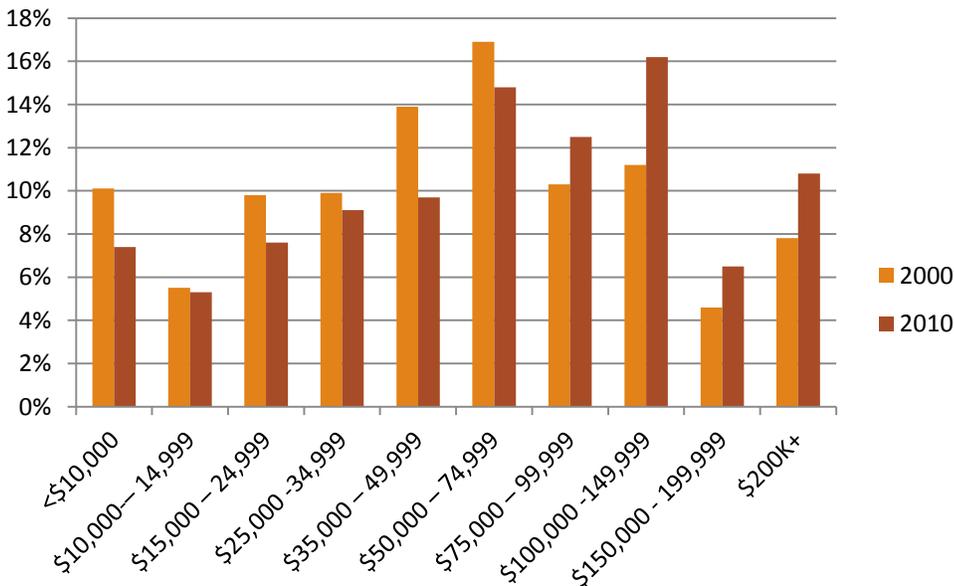


Figure 13

Source: U.S. Census 2000 Summary File; Census 2010 American Community Survey.

## Decreased affordability

The second possible explanation for how tenants can pay increased rents is that they spend a greater proportion of their income on rent. The U.S. Department of Housing and Urban Development (HUD) maintains that tenants are rent burdened if more than 30 percent of household income is used for rent. Using Los Angeles County median household income as a guide, it is clear from the charts below that many households are rent-burdened. Long-term rents, increased only by the general adjustments allowed since 1999, remain affordable across all unit sizes. Market-rate rents, however, have increased far beyond what is affordable to a median income household. As tenants direct more of their income to rents, money available for other household spending is reduced.

Affordability is even more challenging when the rent control registration fee and surcharges are added to the MAR. Surcharges vary depending on assessed property values, the number of units and other factors. Because surcharges are divided equally among all of the units on a property, the total number of units affects the size of each tenant’s share of the taxes. In other words, when taxes are divided among four units, each unit’s share is greater than when the same amount is divided among 15 units. Columns 5 and 8 of Figure 15 show the increase in unaffordability when the median surcharge of 4–10 unit buildings of \$18.30 plus the \$13 rent control registration fee are added to the rent.

**Los Angeles County area median income and HUD maximum housing budget**

Unit Size	Estimated Household Size	Household Adjustment Factor	Area Median Income Adjusted by Household Size	30% of Adjusted Household Income	Monthly Housing Budget
0	1	70%	\$44,800	\$13,440	\$1,120
1	1 – 2	75%	\$48,000	\$14,400	\$1,200
2	2 – 3	85%	\$54,400	\$16,320	\$1,360
3+	4	100%	\$64,000	\$19,200	\$1,600

Figure 14

Source: U.S. Department of Housing and Urban Development, State Income Limits for 2011, Los Angeles County.

Notes: Affordability based on HUD \$64,000 median income for a 4-person household in LA County. Household adjustment factors are averaged for 1-2 person and 2-3 person households.

## Affordability: long-term controlled vs. market-rate units, including surcharges

Unit Size	Monthly Housing Budget	Long-Term Controlled			Market Rate		
		Median MAR without Vacancy Increase	% of Monthly Housing Budget	% of Monthly Housing Budget with \$31.30 Median Surcharges	Median MAR with Vacancy Increase	% of Monthly Housing Budget	% of Monthly Housing Budget with \$31.30 Median Surcharges
0	\$1,120	\$766	68%	71%	\$1,172	105%	107%
1	\$1,200	\$841	70%	73%	\$1,556	130%	132%
2	\$1,360	\$1,058	78%	80%	\$2,055	151%	153%
3+	\$1,600	\$1,356	85%	87%	\$2,721	170%	172%
<b>Affordable?</b>		<b>Yes</b>	<b>Yes</b>		<b>No</b>	<b>No</b>	

Figure 15

Notes: Surcharges are based on median 2010 taxes of 4 – 10 unit properties plus registration fees.

To afford a suitably sized Santa Monica apartment today, new renters require a household income that exceeds the area median. They need roughly twice the income of tenants living in similar long-term controlled units. Paying market rate, the typical family of four with a housing budget of \$1,600 could afford nothing larger than a one-bedroom apartment in Santa Monica with a median rent of \$1,556.

**Household income required to afford controlled units**

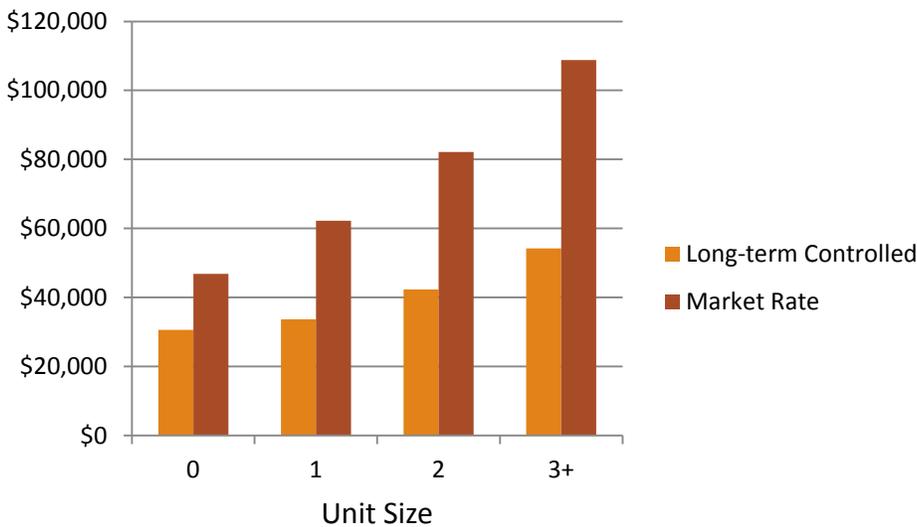


Figure 16

**Rent burden is high throughout the region**

The 2010 Census makes it clear that rents in Santa Monica and the region have become burdensome for a very large share of the renter population. As shown in Figure 16, even the Santa Monica median household income of \$66,269 is sufficient only for a 1-bedroom unit. About half the households in Santa Monica, Los Angeles, Long Beach, Culver City, West Hollywood and Malibu are rent burdened (Figure 17).

**Is overcrowding an issue?**

Another way Santa Monicans may be able to manage the rent burden is by increasing the number of occupants per unit who share the rent. According to the 2010 Census, there is no strong evidence of this, but the average household size of renter-occupied units (including non-controlled units) rose from 1.66 inhabitants in 2000 to 1.71 inhabitants in 2010, an increase of about 3.5%. By comparison, there were 2.81 inhabitants per rental unit in Los Angeles County in 2010. The difference can be attributed to the large number of singles and one-bedrooms in Santa Monica.

### Gross Rent as a Percentage of Household Income (GRAPI)

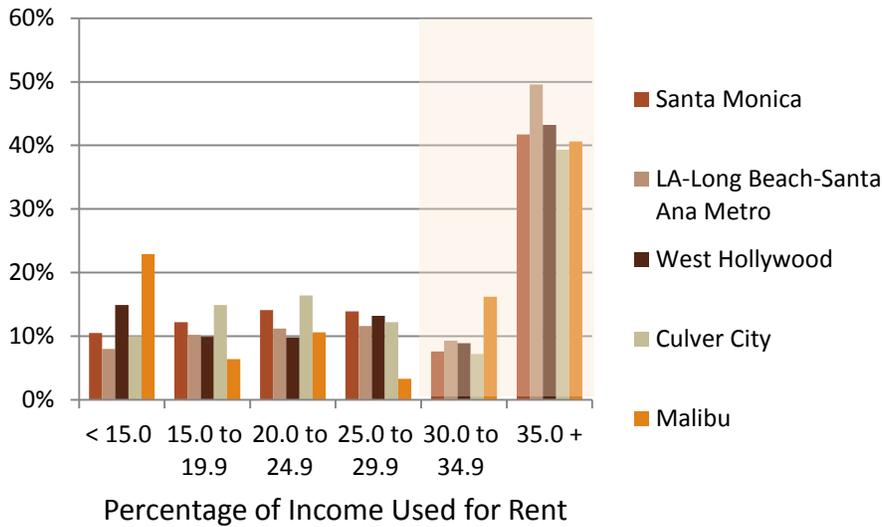


Figure 17  
Source: U.S. Census, 2010 American Community Survey

As shown in Figure 18, in Santa Monica the share of burdened households paying more than 35 percent of their income to rent has increased by more than a third since the 2000 Census. Presumably, without the limiting effects of long-term controlled units, the number of rent-burdened households shown in the shaded area would be even higher.

### Gross rent as a percentage of household income in Santa Monica

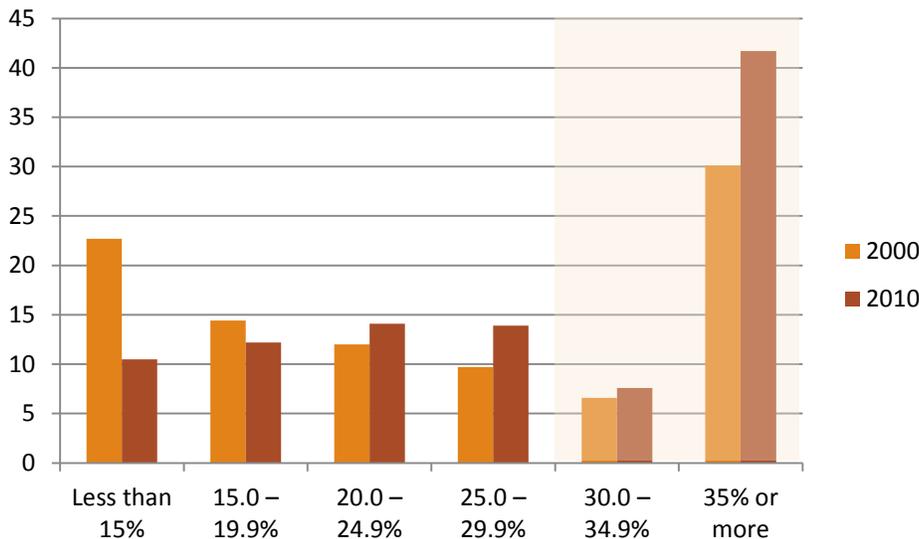


Figure 18  
Source: U.S. Census 2000 Summary File; U.S. Census, 2010 American Community Survey.  
Notes: Occupied units paying rent (excluding units where GRAPI cannot be computed)

## Turnover trends

High rents affect not only who can afford to move into Santa Monica, they affect how long tenants can afford to remain in their units. Whether residents set roots in a community or continually move around matters in two important ways: it defines a neighborhood’s character, affecting its desirability to prospective residents, and it defines how a city sees itself, as a stable, engaged community or a more transient society.

For long-term residents, the value of their controlled rental housing (especially vis-à-vis the high rents of their new neighbors) is an incentive to stay in their units. While mobility within the city was a ready option for tenants prior to vacancy decontrol, today, tenants remaining in long-term controlled units are vacating more slowly. For some long-term tenants, it would be too expensive to relocate within the city, and options for affordable housing are generally far from Santa Monica. New residents since 1999, on the other hand, begin paying the higher market rents revealed in this report and are more likely to be able to afford moving to another market-rate unit. This mobility is borne out by higher turnover rates of units with tenancies starting in 1999 or later.

The impact of vacancy decontrol is influenced by a few factors. Among these are the rates at which long-term tenants are replaced by market-rate tenants, the overall economy, eviction protections for existing tenants and the housing market in general. The health of the economy, for example, determines whether tenants remain employed in the area and are able to afford their apartments here or if they have to move.

Eviction protections may slow the rate of turnover. Measure RR, which took effect December 17, 2010, strengthened the Rent Control Charter to provide greater protections from eviction. From 2005 to 2010, the Board received on average copies of 105 eviction notices per year for reasons other than non-payment of rent. By comparison, the Board received just 54 such notices in 2011 after Measure RR took effect.

### High turnover in market-rate units

The fact that a unit experiences at least one vacancy increase makes it likely that it will receive another such increase within a relatively short period of time. This is intuitively reasonable; tenants in long-term controlled units, whose rents are well below market levels, have a powerful economic incentive to remain in place. Those whose rents are in some cases more than double the amount being charged for a comparable unit in the same neighborhood, do not.

### Re-rental frequency in market-rate units

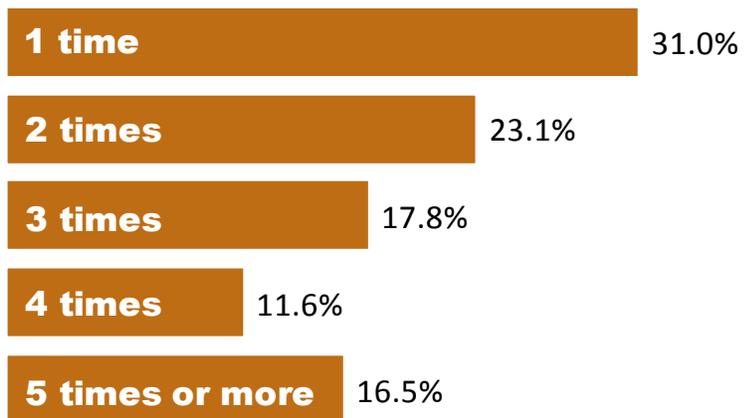


Figure 19

Of the 17,291 units that have experienced a market-rate vacancy increase, only 31 percent have experienced just one such increase. The remaining 69 percent have been re-rented two or more times since 1999.

While 19 percent of the tenants who moved into their units in 1999 still remain in their units, they represent just 4.3 percent of the units now rented at market rate since vacancy decontrol began. In fact, of the 17,291 units rented since vacancy decontrol began, 45 percent are tenancies that were established within the last three years.

**Market-rate tenancies by move-in year**

Year	Units Given First Time Market-rate Increase	Units Occupied By Tenants who Moved In By Year	Current Percent of Market-rate Units
1999	3,910	745	4.3%
2000	2,470	606	3.5%
2001	2,097	792	4.6%
2002	1,677	872	5.0%
2003	1,408	875	5.1%
2004	1,165	988	5.7%
2005	934	988	5.7%
2006	725	1,059	6.1%
2007	666	1,216	7.0%
2008	603	1,300	7.5%
2009	611	2,243	13.0%
2010	599	2,869	16.6%
2011	426	2,738	15.8%
	17,291	17,291	

Figure 20

**Turnover was lower in 2011**

The Rent Control Board has processed 48,718 Vacancy Unit Registration forms in the thirteen years since vacancy decontrol began in 1999. An analysis of re-rental activity as measured by these forms confirms that after a two-year increase in turnover in market-rate units in 2009 and 2010, re-rental activity dropped dramatically in 2011, as shown in Figure 21. With the exception of Area F, the Board received the fewest number of registration forms since the inception of vacancy decontrol. It is too soon to tell if this is a one-time anomaly or the beginning of a new trend.

## Re-rental activity from 1999–2011

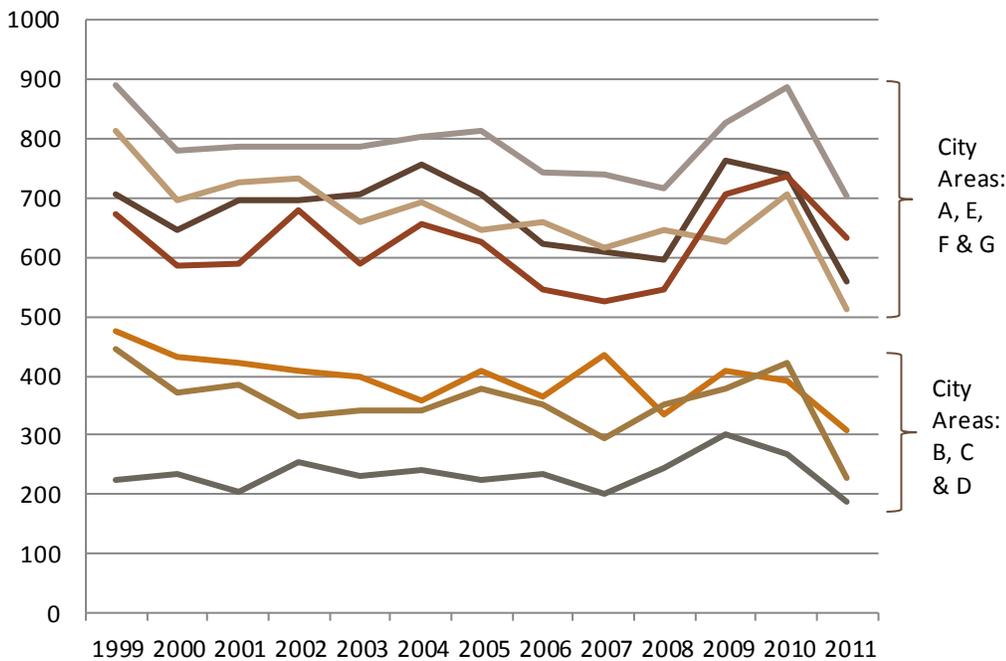


Figure 21

— A — B — C — D — E — F — G

## The role of unemployment in recent turnover trends

While unemployment wreaks havoc in any size household, in smaller households of one to two people, a loss of income can easily translate into a loss of housing. The recent economic downturn was particularly felt in Los Angeles County where unemployment rates increased 53 percent between 2008 and 2009 from 7.5 to 11.5 percent.

While some people may receive unemployment benefits for as long as 99 weeks, the amount received is insufficient to allow a tenant to continue their residency in a market-rate unit. According to the Employment Benefit Department of the State of California, the average weekly unemployment benefit is \$293. Averaged over twelve months, that figure equals \$1,270 per month. That level of income would barely allow a tenant to pay the \$1,172 median market-rate rent on a 0-bedroom unit and leave just \$98 for food and other expenses. The median market-rate rents on larger units (ranging from \$1,556 to \$2,721) would be completely out of reach, forcing the tenant to seek less expensive housing outside of Santa Monica.

### Unemployment Rates Los Angeles–Long Beach Glendale area

State of California Employment  
Development Department

2007: 5.1%

2008: 7.5%

2009: 11.5%

2010: 12.6%

December 2011: 11.6%

## The smaller the unit, the greater the turnover

As shown in Figure 22, of the 28,135 units subject to rent control, more than half (58 percent) are either 0- or 1-bedroom apartments. This coincides with the 2010 Census that found the share of single-person households in Santa Monica was 48 percent, compared to a statewide average of 23 percent.

Simply put: the bulk of the housing units in Santa Monica under rent control are designed for singles and couples, not families.

As shown in Figure 23, this unit mix correlates very closely to the types of units which experienced market-rate vacancies in 2011.

It is not surprising that the greatest volatility in apartment turnover has occurred in the smallest units. Nor is it surprising that these smaller units have experienced the highest incidences of re-rental in the three-year period between 2009 and 2011. These units tend to offer the most affordable entry point for prospective residents. Given the recent recession, it also stands to reason that single-person households would be particularly vulnerable to changes in housing due to job loss or reduced wages.

**Units under rent control by unit size**

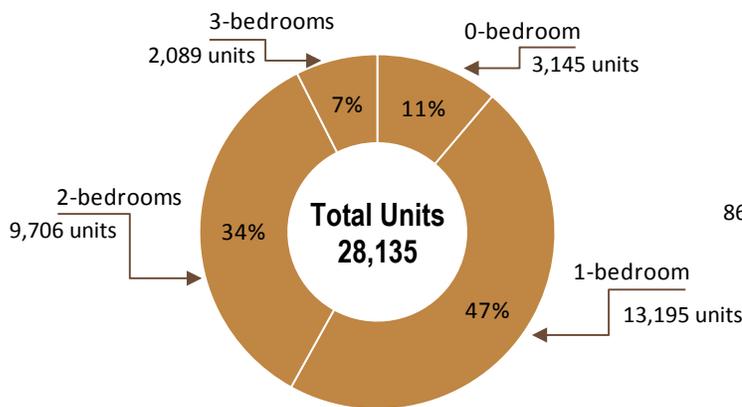


Figure 22

**2011 turnover by unit size**

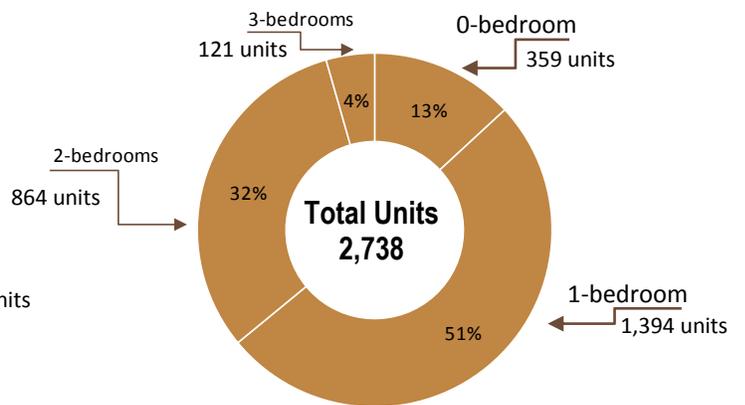


Figure 23

### **A growing trend of long-term tenancies**

Tenancies end for many reasons, many having nothing to do with cost: people move to new areas for work or other opportunities, or to be closer to family; they die or become too ill to remain in their homes; single people fall in love and move in together, leading one to give up his or her previous residence.

While the Census does not measure volatility, it does report on the length of tenancy. In the 2010 American Community Survey report for Santa Monica, 20.4 percent of renters indicated they moved into their units between 10 and 20 years ago (between 1990 and 1999). This figure correlates closely to rent control records, which show that of the 3,910 tenancies that began in 1999, 19 percent continue to reside in their units. In the 2000 Census, only 14.5 percent of renters reported moving into their units between 10 and 20 years before (i.e., between 1980 and 1989).

### **The Pico neighborhood: where neighbors remain neighbors longer**

The citywide transition of long-term rent-controlled units to market-rate units, now at 61 percent, is more or less consistent throughout Santa Monica except in Area D, commonly known as the Pico neighborhood. The geographic boundaries of Area D are Lincoln Boulevard to the west, Centinela Avenue to the east, Colorado Avenue to the north and Pico Boulevard to the south.

There, just 53 percent of the rent-controlled units have received a market-rate increase. One contributing factor may be that Area D has the fewest number of 0-bedroom units and the second fewest 1-bedroom apartments, both of which have relatively higher turnover rates.

**Percentage of units at market by city area**

	Market Rate Units	Total Units	% at Market Rate	% of Controlled Units
A	2,993	4,824	62%	17%
B	2,029	3,390	60%	12%
C	735	1,162	63%	4%
<b>D</b>	<b>1,536</b>	<b>2,900</b>	<b>53%</b>	<b>10%</b>
E	3,308	5,207	64%	19%
F	2,785	4,531	61%	16%
G	3,905	6,121	64%	22%
<b>Total</b>	<b>17,291</b>	<b>28,135</b>	<b>61%</b>	<b>100%</b>

Figure 24

**Demographic statistics from the 2010 Census**

In the wake of vacancy decontrol, Santa Monica has experienced a loss of class diversity. In other aspects, however, the demographic character of the city has remained resilient to market-based pressures. The Santa Monica of 1980 (the first census year after the City’s rent control law took effect) and the Santa Monica of today may look different on the outside (thanks to new construction), but in many respects, it remains the same.

**A growing population**

In the last decade, Santa Monica’s population increased by seven percent to 89,736, the largest gains occurring among white, non-Hispanics (2,435) and Asians (1,917). This increase represents a historical high. An additional 5,652 residents over a ten-year period represents a significant expansion in our city’s population. At 10,812 residents per square mile, Santa Monica remains one of California’s most densely populated cities.

The 2010 Census suggests a correlation between median household income by race and ethnicity and the increase in white and Asian residents. The median household incomes of these two groups are respectively almost 12 percent and 20 percent higher than those of the median household in Los Angeles County. While even these elevated incomes would leave a family of four rent-burdened if they rented a 2-bedroom apartment in Santa Monica, the burden is relatively lower compared to other racial and ethnic groups earning less income.

**Population by census year**

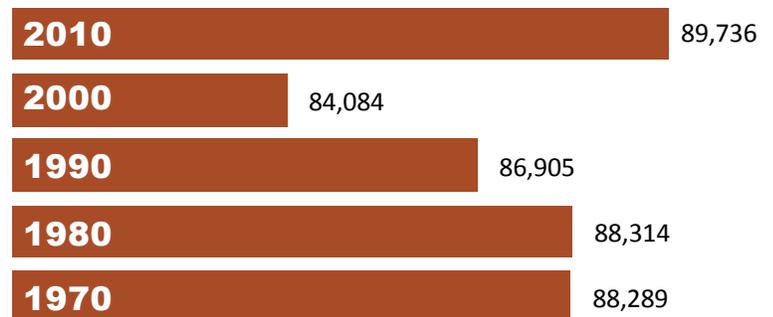


Figure 25  
Source: U.S. Census

## **In race and ethnicity, a lack of diversity continues**

Comparing race and ethnicity statistics from one census year to another is difficult as the questions relating to race and ethnicity in the 2000 Census were measurably different from earlier censuses. Direct comparisons cannot be easily gleaned.

That said, a review of the 1980 Census suggests that the racial and ethnic makeup of Santa Monica residents appears to have remained fairly consistent, the exception being Asian residents who have witnessed a 121 percent increase since 1980 (from 3,954 to 7,960). At just under four percent of the population, the African-American population, historically comparatively small, remains unchanged from 1980 to 2010. In 1980, 11,485 people identified themselves as being of Hispanic descent. In the 2010 Census, that figure rose only to 11,716, an increase of just one percent to 13.1 percent of the overall population.

Santa Monica's demographics have long differed from neighboring Los Angeles as well as California as a whole. Whereas Los Angeles County maintains a large Latino and Asian community (47.7 percent and 13.5 percent, respectively), Santa Monica does not: just 13.1 percent of the population is Hispanic and 8.9 percent is Asian. At 70 percent, Santa Monica's white, non-Hispanic population is strikingly higher than neighboring Los Angeles (which is just shy of 48 percent) and California (at 40 percent).

## **An older population**

Santa Monica is different from its neighbors in other ways too: it's older. In 1980, the median age in Santa Monica was 34.1. Now it is 40.4, well above the statewide median of 35.

What hasn't changed to any significant degree is that the majority of residents (71 percent) are in their prime working years, defined as age 18 to 64. This figure is exactly the same as it was in 2000 and is only slightly higher than in earlier census reports. The remaining population is evenly split between young people under the age of 18 (14 percent) and seniors age 65 and older (15 percent).

# Conclusion and Recommendations

Limited supply and high demand for rental units in Santa Monica will continue to push rent levels upward. In the past several years, supply has not increased much largely due to a soft real estate market and limited financing. Following the development of the city's Land Use and Circulation Element (LUCE), construction of several new apartment buildings has begun in Santa Monica, but these are not subject to the Rent Control Law. The requirement to fund affordable housing as part of these developments will provide a number of affordable units, yet the dissolution of redevelopment programs at the state level will continue to make such housing options rare.

In an article titled "Outta Sight" in *Multifamily Executive*, a trade publication of the rental housing industry, Hessam Nadjii, managing director of research and advisory services for Encino-based real estate consulting company Marcus & Millichap made the following comment about aggressive rent growth projections for 2012.<sup>5</sup>

*"Do I think there are extremely aggressive rent growth assumptions in the multifamily industry right now? Yes, absolutely. But for 2011 and 2012, I think those assumptions are justified. Because of the supply-demand dynamics, we are going to have record rent growth over that two-year period. Definitely the strongest performance since 1999 to 2000, and we might even beat that record."*

Given the evidence of significantly high rent growth reflected in this report, the Board may wish to consider actions within its authority to ameliorate the ever increasing lack of affordability. Vacancy decontrol-recontrol continues to grant owners the right to reset rents with qualifying new tenancies, and in only rare cases where tenants were evicted for no cause does the Board have the authority to restrict such increases. The Board continues to have power, however, over when and by how much established rents may be increased through its authority to decide general adjustments and allowable surcharges.

## Recommendations

### ▪ Consider basing general adjustments on a limited percentage of the change in CPI

The Board's general adjustment calculation has traditionally been a formula of general application that evaluates how owners' costs have increased from year to year. The general adjustment typically is granted as a percentage increase to the MAR. As explained above, in some years, the general adjustment has included caps in consideration of the effect of applying even low percentage increases to the already high rents that some tenants pay.

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<sup>5</sup> Chris Wood, "Outta Sight," *Multifamily Executive*, February 2011

The Board's "component ratio to gross rent" methodology for calculating general adjustments has been described as confusing by members of the public appearing at public hearings. Changing the law to allow the Board to determine general adjustments based on a percentage of the change in the CPI would make the process easier for everyone to understand.

The current formula does not account for increases in gross rent dollars provided by vacancy decontrol. By revising how general adjustments are determined, the Board would be able to consider increases that are a limited percentage of the change in the CPI.

- **Consider limiting how soon general adjustments can be made to market-rate tenancies**

Current Rent Control regulations allow owners to take general adjustments on tenancies that are at least 12 months old at the time of the September adjustment. As market-rate rents exceed median household affordability standards and as they typically provide immediate and significant increases in return to owners, the Board may consider lengthening the time between when a rent level is established and when the first general adjustment is allowed.

Section 1805(a) of the Rent Control Charter refers in part to the setting of the general adjustment as follows, "Such an adjustment, however, need not take effect immediately, and the Board may decide that new rent ceilings shall not take effect until some reasonable date after the above stated time periods."

- **Consider eliminating surcharges on market-rate tenancies**

Affordability is affected by the addition of surcharges to the MAR. Of the five taxes that may be passed through as surcharges, three were originally approved by the Board prior to the enactment of the Costa-Hawkins law: Community College Bond (1992); Unified Schools Bond (1990); and Stormwater Management User Fee (1995). Since these were approved with the intention to reimburse owners for costs that, at the time they were approved, could not be covered by increasing rents, it may be time to consider whether owners still need to be reimbursed. It is clear from the information in this report that owners are now collecting sufficient rental income to cover the cost of these and all other surcharges.

As shown in Figure 15, the addition of surcharges to long-term controlled rents does not make these rent levels unaffordable. The addition of these surcharges to market-rate rents, however, exacerbates the problem of unaffordability. Since vacancy decontrol, owners have had the freedom to negotiate market-rate rents that cover all of their costs and provide a fair return. It is not necessary to supplement such income with additional charges to the tenant to maintain this balance.

Another reason for eliminating these surcharges is that owners, except those who live on a property and pay their unit's share, bear none of the burden yet benefit from how the tax money is spent. Quality schools, Santa Monica Community College and a community that seeks to be environmentally responsible not only attract tenants but also add value to properties throughout the City of Santa Monica.



## SANTA MONICA RENT CONTROL BOARD

The Santa Monica Rent Control Board is composed of five elected members and usually meets the second Thursday of every month at 7:00 p.m. in the Council Chambers in City Hall. The Rent Control Board and Agency staff carry out the Rent Control Law's five basic goals: controlling residential rents; limiting the grounds for eviction; preserving rental housing; encouraging maintenance; and ensuring rental-property owners a fair return.

In addition to the Impact of Market-Rate Vacancies Report, the Rent Control Board publishes four other reports on an annual basis all of which are available on our website, [www.smgov.net/rentcontrol](http://www.smgov.net/rentcontrol).

- ▶ Impact of the Ellis Act
- ▶ Operating Budget
- ▶ Annual Report
- ▶ General Adjustment Report