Attachment F

San José ARO Study

Final Report

April 2016

ECONOMIC ROUNDTABLE

Knowledge for the Greater Good

Study of the Apartment Rent Ordinance of the City of San José

Final Report

April 2016

Kenneth Baar

Patrick Burns

Daniel Flaming

Underwritten by the City of San José, California

This report has been prepared by the Economic Roundtable study team, which assumes all responsibility for its contents. Data, interpretations and conclusions contained in this report are not necessarily those of any other agency that sponsored or assisted this project.

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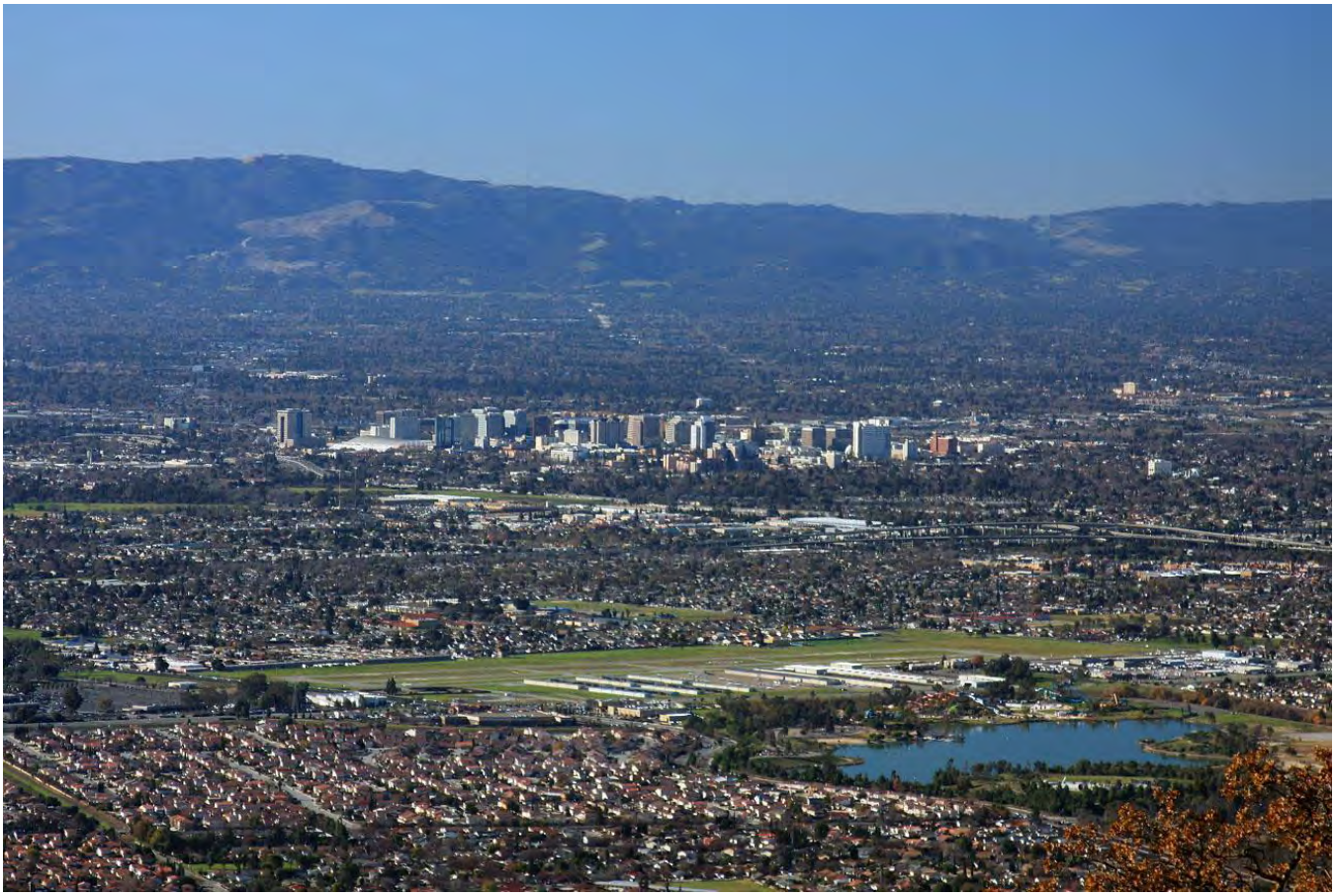

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Executive Summary

Study of the City of San José Apartment Rent Ordinance

In June 2015, the San José City Council identified the review and exploration of potential modification of the San José Rental Dispute Mediation and Arbitration Ordinance (Municipal Code Chapter 17.23, referred to in this report as the Apartment Rent Ordinance or ARO) as its second highest policy priority for FY 2015-16. The San José Housing Department was tasked with beginning this process and developed a workplan to carry out the Council's priority. This study includes analyses to help inform staff's recommendations when they are brought back for Council consideration. The scope of work for this study was accepted by the City Council and includes the following key items:

- Demographic characteristics of ARO tenants
- Comparison of ARO and non-ARO rents
- Characteristics of ARO Apartments
- Comparison of Allowable Rents Increases under ARO with CPI and Allowable Increases under other Rent Stabilization Ordinances
- Analysis of debt-service pass-through
- Financial outcomes of ARO rental properties

This Executive Summary for the Preliminary Draft report provides key findings related to the questions posed in the Council-approved scope.

Characteristics of ARO Apartments

The ARO was adopted in 1979 and applies to multifamily rental units in buildings with three or more units constructed before September 7, 1979. Among these apartments, those that are occupied by Section 8 tenants, owners-occupied, or that received public subsidies are exempt from coverage under the ordinance. Currently, approximately 44,300 apartments, or about one-third of the rental units in the City, are subject to the ARO.

Forty-one percent of ARO units are in smaller buildings between 3 to 9 units. Thirty-six percent of ARO units are in larger buildings of 20 or more units. The table below sets out the distribution of the units by building size:

ARO Units by Building Size	3 or 4 Unit Bldgs.	5 to 9 Unit Bldgs.	10 to 19 Unit Bldgs.	20 to 49 Unit Bldgs.	50 + Unit Bldgs.	City Total
Percent	21%	19%	23%	26%	9%	100%

Approximately three quarters of the units are concentrated in three council districts: Council Districts 1, 3, and 6. With respect to building age, 42 percent of all units subject to the ARO (ARO units) were built in the 1960s, with another third of ARO units built in the 1970s.

Since 1990, median rent increases for ARO units have exceeded those for non-ARO units on both an absolute and percentage basis. Median rents for ARO housing units rose from $618 to $1,306 from 1990 to 2014, an increase of 111 percent compared with an increase in the CPI-U All Items of 91 percent. In "real" inflation adjusted dollars the increase was from $1,181 to $1,308 during this period, an 11 percent increase.

For most years, increases in actual ARO rents mirrored the rate of inflation. The exceptions are the boom years of the dot.com era and the most recent strong housing market from 2012 to the present, during which ARO rents increased faster than the rate of inflation and led to excessive rent increases due to the high annual allowable rent increase.

Median rents for non-ARO housing units rose from $733 to $1,502 during this period. In real "inflation adjusted" dollars the increase was from $1,401 in 1990 to $1,504 in 2014, a 7 percent increase. The gap between ARO and non-ARO rent levels has narrowed: while the non-ARO median rent was 21 percent higher than the ARO median rent in 2009, that gap has narrowed to just 15 percent by 2014. Information about the ARO unit inventory and the socioeconomic and demographic characteristics of ARO renters is set forth in Chapters 1 and 2.

In recent years, San José has also had a rising number of tenant complaints in buildings with ARO units. Since 2012, tenants have filed about 70 complaints to the Housing Department per year about annual rent increases in excess of the ARO-allowed 8 percent. Other common complaints concern service reductions in violation of current leases, improper "no cause" eviction notices, and housing code violations, totaling 792 petitions filed between 2010 and 2015 (approximately 160 petitions per year).

Housing quality, gauged by San José Code Enforcement service level "tiers" assigned to each building, show that more recently built ARO units are in better condition than older ARO units. Just 12 percent of ARO units built in the 1970s are assigned Service Level Tier III status, requiring inspections on a 3-year cycle because of the number and severity of documented housing code violations found. Over half of those built in the 1940s and 1950s are in Service Level Tier III.

Profile of Renters Living in ARO Units

Renter living in ARO units have lower incomes than non-ARO renters. The median household incomes of non-ARO renter households was nearly $8,000 higher than the incomes of ARO renter households in 2014, the latest year of data available.

Renter households in ARO units are slightly more rent burdened than those in non-ARO apartments in San José. Fifty-six percent of ARO renters pay 30 percent or more of their income for housing compared to 52 percent of non-ARO renters.

Also, there are higher rates of overcrowding in units covered by the ARO than those that are not. Thirty-nine percent of ARO units have more than one person per room versus 31 percent of non-ARO units. Ten percent of ARO units are severely crowded (greater than 1.5 persons per room) versus 8 percent of non-ARO units.

ARO units have a significant amount of turnover, with 26 percent of renters residing in their current units less than 12 months, and 37 percent for less than two years. Another 32 percent have resided in ARO units 2-4 years, and only 31 percent have lived there 5 years or longer.

The demographic data on renters living in ARO units reveal that they are slightly younger than non-ARO renters, and significantly younger than San José's other residents. The plurality of ARO unit renters are Latino households (49 percent), with Asian American and Pacific Islander households constituting another 24 percent. Fifty-five percent of ARO renters are citizens either born in the United States, or else were born overseas to U.S. parents. Another 14 percent are U.S. citizens by naturalization.

Forty-nine percent of ARO renters do not have an education beyond high school, versus 42 percent for non-ARO renters.

ARO renters have the largest share of residents who speak English "Not Well" or "Not at All" (32 percent) versus 29 percent for non-ARO renters. Further contextual information about the ARO unit inventory and the socioeconomic and demographic characteristics of ARO renters appear in Chapters 2 and 3.

Standards for Allowable Rent Increases and Increases in Market Rent Levels

Under the ARO, annual rent increases of 8 percent are permitted. Additionally, "vacancy decontrol" applies to new tenancies when there is a voluntary vacancy. At the commencement of new tenancies that follow voluntary vacancies, apartment owners can set new rent levels without being restricted by the 8 percent ceiling. Typically, within a two-year period the rents of over one-third of all apartments may be set without any limit due to voluntary tenant turnover, and within a five-year period the rents of over two-thirds of all units may be reset without limits due to turnover.

The ARO's annual increase allowance of 8 percent has been significantly higher than most of the annual allowable rent increases under the other ten rent stabilization ordinances in California. The ordinances of Los Angeles, San Francisco, Oakland, Berkeley, Santa Monica, West Hollywood, and East Palo have generally limited annual increases to the rate of inflation or a portion of that rate, as measured by the rate of increases in the Consumer Price Index (CPI). From 1979, through 2000, the average increase in the San Francisco-Oakland-San José area CPI-U *All Items* was 3.3%. From 2000 through 2014, the average increase in the CPI-U *All Items* was 2.6%.

Also, in most years, the annual allowable increase under the ARO have been above the annual rate of increase in market rents in the San Francisco Bay Area, which has averaged 4.7 percent since 1980. As a result, the ARO has had little, if any impact, on overall rents. Overall, the annual increase allowed by the ARO has still been far above the average rate of inflation and the rate of increase in market rents over time. The ARO does provide some protection for in-place tenants from the possibility of increasing rents by more than 8% arising out of the significant increases in market rents of the past few years. Further information about standards for allowable rent increases and increases in market rent levels appears in Chapter 4.

Fair Return

In addition to the 8 percent per year annual increase, pursuant to the ARO's current standard for rent adjustments for individual buildings through a petition and hearing process, apartment owners may obtain rent increases to cover mortgage payments ("debt service") or increases in operating expenses since the prior year. Owners may also obtain rent increases to recover the amortized cost of capital improvements or rehabilitation. The allowance of a debt-service pass-through provides an opportunity for recent purchasers of ARO apartments to obtain substantial rent increases based on their new purchase mortgages. Under most rent stabilization ordinances in other jurisdictions, increases in debt-service are not considered as a factor in setting allowable rents.

The most common type of fair return standard under rent stabilization ordinances is a "maintenance of net operating income" (MNOI) standard. Net operating income is determined by subtracting operating expenses from gross income. Under this type of standard, "base" year net operating income adjusted by a CPI factor, since a base year net operating income is considered a fair return. (For example, if the net operating income in the base year was $100,000 and the CPI has increased by 75% since the base year, the fair net operating income in the current year would be $175,000.)

Net operating income is the portion of income available to cover debt service and to provide cash flow. By maintaining net operating income, this MNOI standard insures a right to rent increases adequate to cover increases in operating expenses and capital improvements. Unlike San José's individual rent adjustment methodology, an MNOI standard does not provide for separate pass-throughs of increases in debt service. The MNOI standard has been consistently upheld by the Courts as producing a fair return. Chapter 5 contains further discussion of fair return issues.

Financial Outcomes of Apartment Owners

Operating expenses of San José apartment buildings subject to the ARO are in the range of 25 percent to 45 percent of revenues. These operating cost ratios result in net operating income-to-rent ratios in the range of 55 to 75 percent. This average has remained stable over time. Some types of operating costs, typically utilities and government assessments have increased at a greater rate than the CPI. However, these costs are usually small relative to rental income. For example, there have been steep increases in water costs. But water costs are typically equal to about only two percent of rental income; therefore increases in these costs have a very small impact on overall profitability. Annual increases in the largest apartment operating expense, property taxes, are capped at 2% per year, except when a property is sold.

The values of San José apartments constructed before 1980 and, therefore, subject to the ARO, have increased substantially. Average values doubled from 1995 to 2000 (from $50,000 to $100,000 per unit) and have doubled again since 2000, to an average of about $190,000 per unit. Overall they have quadrupled in 20 years. The increases in value are attributable to the combination of increasing net operating incomes and declining mortgage interest rates. Overall owners of apartments subject to the City's ARO have obtained attractive returns from their investments as a result of increasing rents and net operating incomes and appreciation in the values of apartments. The financial outcomes of ARO apartment investments are discussed in Chapter 6.

About the Authors

Kenneth Baar has a Ph.D in urban planning and is an attorney. He has researched and published extensively on housing policy and real estate issues. Over the past 30 years, he has served as a consultant to thirty California jurisdictions on issues related to rent stabilization. His articles on the issue of fair return under rent stabilization have been cited in decisions of the California and New Jersey Supreme Courts and in numerous California Court of Appeal decisions. He has prepared fair return analyses in rent stabilization cases for seventeen California jurisdictions. In 2009, he authored analyses of rent control standards and the financial outcomes of apartment owners under rent stabilization that were included in a study by the Economic Roundtable that was commissioned by the City of Los Angeles. Also, he has served as a consultant to the World Bank and U.S. AID on policy issues in East European nations undergoing economic transition and on two occasions has been a visiting Fulbright professor in East Europe.

Patrick Burns, Economic Roundtable Senior Researcher, has specialized in labor market research, industrial sector analysis, GIS data mapping, survey development and research. He has co-authored numerous reports for public agencies analyzing labor market outcomes for targeted groups of workers. Patrick has a B.A. in Geography and International Development for Clark University, an M.A. in Economic Geography from Kent State University, and a C.Phil. in Economic Geography from UCLA. He has worked at the Economic Roundtable since 2002.

Daniel Flaming, Economic Roundtable President, is an expert in urban social policy and regional economic analysis. Dan worked for Los Angeles County for over 20 years, directing housing and community development, job training programs, and research programs for the county. Dan has led more than 40 major research projects at the Roundtable that have illuminated critical changes in the regional economy and labor market. These research projects have included analysis of the City's rental housing market, public sector economic development strategies, social and demographic profiles, business environment surveys, employment strategies for target sub-populations, technology commercialization strategies, and economic adjustments for dealing with 1990s defense cutbacks. He received his Ph.D. in Urban Studies from USC. Dan has been president of the Economic Roundtable since 1991.

Economic Roundtable is a nonprofit urban research organization with expertise in analyzing economic, social, and environmental conditions. It has provided policy research assistance to public sector agencies since 1991. Before that, the Economic Roundtable was a research unit within the Los Angeles County government. Its core strengths are creating, integrating, analyzing, and communicating highly detailed demographic, economic and housing data to provide operationally relevant information. The Roundtable has produced several reports on housing for public agencies, including "Economic Study of the Rent Stabilization Ordinance and the Los Angeles Housing Market" in 2009 and "Jobs, Wages and Housing: Affordable Housing Benefit Fee Study" in 2012 for the City of Los Angeles. These reports and others are available at the Roundtable web site, www.economicrt.org.

Photograph by Patrick Burns, Atlas Avenua, San José, CA, January 28, 2016.

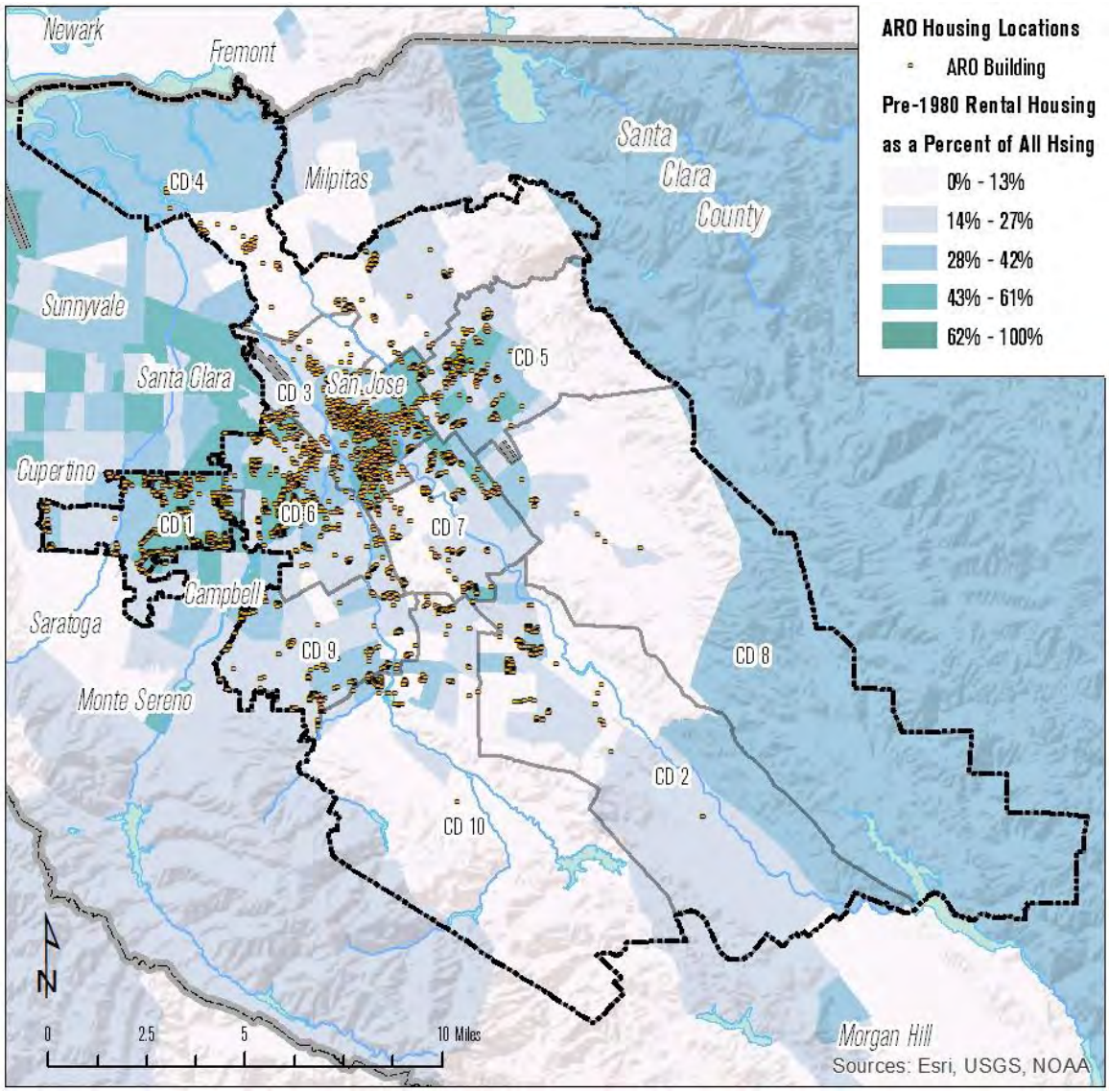
Chapter 1. City of San José ARO Housing Inventory and Characteristics

1. City of San José ARO Housing Inventory and Characteristics

1a. Building and Unit Characteristics

There are currently 44,283 rental housing units in the City of San José under the jurisdiction of its Apartment Rent Ordinance (ARO)[1], which constitutes 33 percent of the San José's supply of rental housing units, and 14 percent of its supply of all housing units.[2] Rental units covered by the ARO, according to the City's code, must have been built and first rented on or before September 7, 1979 and have three or more units in the structure. Among this older multi-family rental housing, units occupied by the building owner or by tenants receiving HUD Section 8 vouchers are exempt from the ordinance. Apartment owners of such units have the opportunity to submit an exemption request to the San José Housing Department through the Rental Rights and Referrals Program (RRRP) on an annual basis. Additionally, apartments that have public subsidies such as low-income housing tax credits or other public funding sources are also exempt.

Figure 1.1 – Rental Housing Covered by the Apartment Rent Ordinance (ARO), San José



Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Background shading: U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Table B25036: Tenure by Year Structure Built. Notes: Background shading data includes all pre-1980 rental housing, including ARO units, duplexes, condominiums and other rented housing, as a percentage of all housing in each tract. Geographic units displayed in the background are census tracts, with City Council District boundaries overlaid.

Over 5,000 multiple-family buildings in San José contain ARO units

There are currently 5,026 buildings in San José containing ARO units, which are mapped in Figure 1.1. ARO units and buildings are not evenly distributed across the City, but instead are clustered in a few Council Districts (CD): 73 percent of ARO units are located in CD 1, CD 3 and CD 6 (Table 1.1). Likewise, 70 percent of multi-family buildings with ARO units are found in those three Council Districts.

Table 1.1 – City Council Districts where ARO Units and Buildings are Located

City Council District	Number of ARO Units	Percent of Total ARO Units in District	Number of Buildings with ARO Units	Percent of Buildings with ARO Units in District
CD 1	12,658	29%	1,354	27%
CD 2	1,486	3%	195	4%
CD 3	10,067	23%	1,083	22%
CD 4	441	1%	59	1%
CD 5	2,450	6%	309	6%
CD 6	9,618	22%	1,067	21%
CD 7	3,055	7%	344	7%
CD 8	287	1%	18	0%
CD 9	3,526	8%	426	8%
CD 10	695	2%	171	3%
City Total	44,283	100%	5,026	100%

Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015.

92% of ARO units are in apartment buildings

The majority of ARO units – 92 percent – are apartments found in multi-family residential buildings (Table 1.2). However, there are other categories of rental housing that comprise the universe of ARO units, with long-term rented hotel/motel rooms being the next largest.

Table 1.2 – Types of Buildings in which ARO Units are Found

Building Types	Number of ARO Units	Percent of Total ARO Units	Number of Buildings with ARO Units	Building Type as a Percent of all ARO Types
Apartment	40,702	92%	4,901	98%
Long-Term Hotel/Motel	2,688	6%	34	0.7%
Guest House	607	1.4%	64	1.3%
Resid. Care/Service Facility	183	0.4%	19	0.4%
Fraternity/Sorority	79	0.2%	7	0.1%
Emergency Residential Shelter	24	0.1%	1	0.0%
City Total	44,283	100%	5,026	100%

Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Buildings in columns three and four are only those with one or more ARO units.

1b. Age and Building/Unit Size

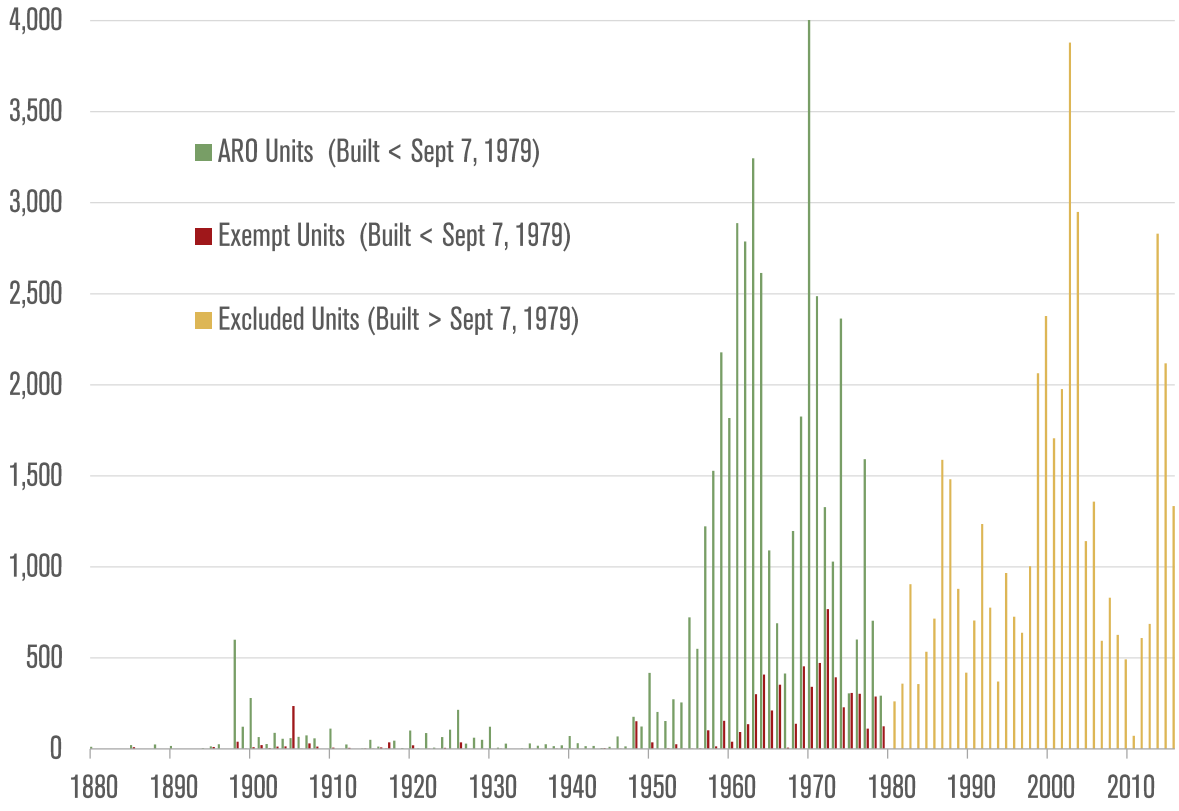
By definition, all rental housing units under the jurisdiction of the ARO are in buildings constructed before September 7, 1979.[3] The plurality of ARO units (42 percent) were built in the 1960s, with another third of ARO units built in the 1970s (Table 1.3).

Table 1.3 – Age of ARO Units, by Decade of Construction and Council District

Decade Built	CD 1	CD 2	CD 3	CD 4	CD 5	CD 6	CD 7	CD 8	CD 9	CD 10	Citywide Number	Citywide Percent
1939 or earlier	20	0	2,598	3	46	188	0	0	14	4	2,873	6%
1940 to 1949	0	7	344	6	31	114	29	5	0	0	536	1%
1950 to 1959	1,260	0	2,809	0	503	2,360	294	0	281	0	7,507	17%
1960 to 1969	5,997	315	3,403	82	1,229	4,688	830	0	1,399	626	18,569	42%
1970 to 1979	5,381	1,164	913	350	641	2,268	1,902	282	1,832	65	14,798	33%
All Years	12,658	1,486	10,067	441	2,450	9,618	3,055	287	3,526	695	44,283	100%

Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. "1970 to 1979" excludes units and buildings built and first rented after September 7, 1979.

Figure 1.2 – Age of Current ARO, Exempt and Excluded Rental Housing Units, by Year, San José



Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015.

Figure 1.2 illustrates when rental units in San José's current housing inventory were constructed, comparing the numbers of ARO units to those currently exempt (due to owner occupancy or tenants receiving HUD Section 8 vouchers) and excluded from the Apartment Rent Ordinance (built and first rented out after September 7, 1979). The City maintains a "Multiple Housing Roster," which is a list of all multi-family rental buildings with 3 or more units in San José.[4] Of the Multiple Housing Roster, ARO units make up 48 percent of the units in buildings with three or more units, "exempt" units[5] are a relatively small seven percent, and excepted units built and first rented after September 7, 1979 comprise 45 percent of the Roster.

Table 1.4 – ARO Units by Size of Building and City Council District, Number

City Council District	3 or 4 Unit Bldgs.	5 to 9 Unit Bldgs.	10 to 19 Unit Bldgs.	20 to 49 Unit Bldgs.	50 + Unit Bldgs.	District Total
CD 1	2,861	1,664	2,861	4,405	867	12,658
CD 2	427	220	393	358	88	1,486
CD 3	1,418	2,819	2,355	1,551	1,924	10,067
CD 4	78	175	112	0	76	441
CD 5	484	806	642	518	0	2,450
CD 6	1,746	2,062	2,554	2,530	726	9,618
CD 7	880	321	287	1,300	267	3,055
CD 8	.	53	42	192	0	287
CD 9	948	495	1,130	752	201	3,526
CD 10	652	11	12	20	0	695
City Total	9,492	8,626	10,388	11,626	4,149	44,283

Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Note: The size categories in this table are based upon the number of total Multiple Housing Roster (MHR) units per building. Each building registered in the MHR may contain ARO and exempt units, but this table tallies just the ARO units in each building.

The ARO covers 48% of 3+ unit buildings

Table 1.5 – ARO Units by Size of Building and City Council District, Percent

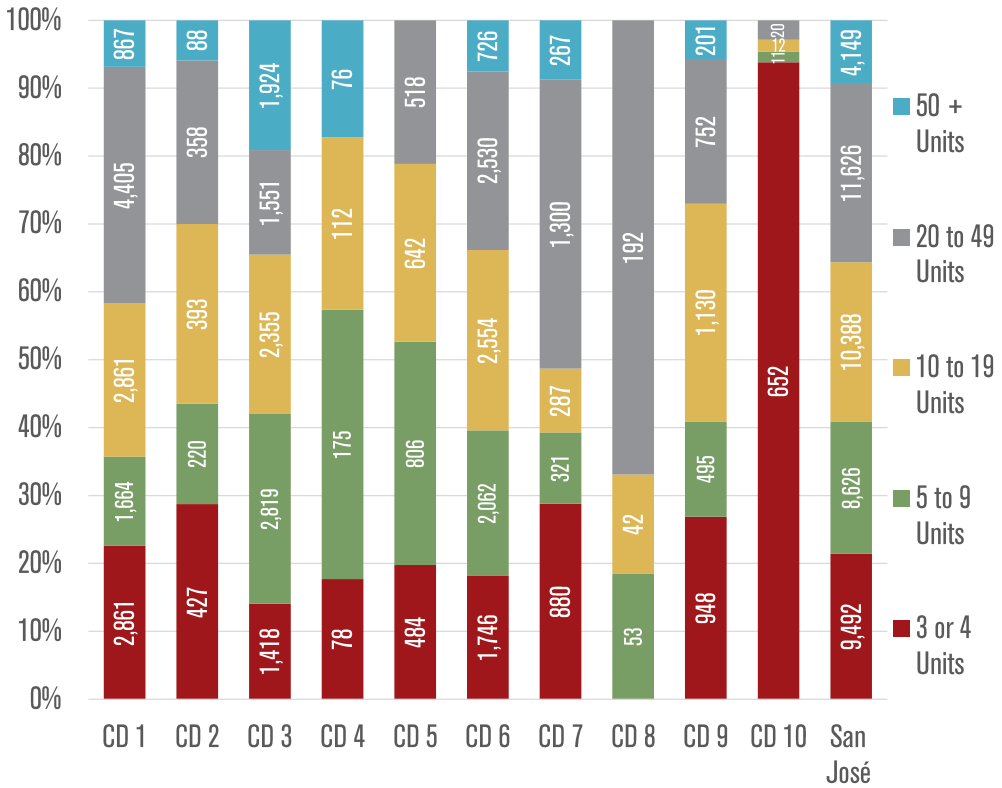
City Council District	3 or 4 Unit Bldgs.	5 to 9 Unit Bldgs.	10 to 19 Unit Bldgs.	20 to 49 Unit Bldgs.	50 + Unit Bldgs.	District Total
CD 1	23%	13%	23%	35%	7%	100%
CD 2	29%	15%	26%	24%	6%	100%
CD 3	14%	28%	23%	15%	19%	100%
CD 4	18%	40%	25%	0%	17%	100%
CD 5	20%	33%	26%	21%	0%	100%
CD 6	18%	21%	27%	26%	8%	100%
CD 7	29%	11%	9%	43%	9%	100%
CD 8	0%	18%	15%	67%	0%	100%
CD 9	27%	14%	32%	21%	6%	100%
CD 10	94%	2%	2%	3%	0%	100%
City Total	21%	19%	23%	26%	9%	100%

Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Note: The size categories in this table are based upon the number of total Multiple Housing Roster (MHR) units per building. Each building registered in the MHR may contain ARO and exempt units, but this table tallies just the ARO units in each building.

The most common ARO building size is 20-49 units

ARO units are found in buildings large and small, and can also include units that may be exempted from the Ordinance due to Section 8 tenancy or owner-occupancy. The plurality of ARO units Citywide – 26 percent – are found in buildings with 20-49 units (Table 1.4, Table 1.5). CD 8 stands out with 67 percent of its ARO units in building with 20 to 49 total units, but it has only 287 ARO units district-wide. CD 1 has over 4,400 ARO units in buildings of this size. Figure 1.3 illustrates trends in ARO units based upon building size, and shows a relatively low number of ARO units in buildings with 50 or more total rental units. Most of San José's larger apartment buildings with 50 or more units were built after 1979, and are not under the jurisdiction of the ARO.

Figure 1.3 – Percent of ARO Units by Building Size and Council District, San José



Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. The size categories in this table are based upon the number of total Multiple Housing Roster (MHR) units per building. Each building registered in the MHR may contain ARO and exempt units, but this table shows just ARO units in each building.

Construction of the smallest ARO apartment buildings in San José peaked in the 1960s, when over 6,000 units in buildings of three to four total units came online (Table 1.6). Construction and initial occupancy of larger apartment buildings (20 to 49 units and 50 units or more) surged in the 1960s and 1970s, up until the window of ARO jurisdiction closed in September 1979.

Construction of the largest ARO buildings – with 20+ units – surged from the 1960s up until September 1979

Table 1.6 – Number of ARO Units by Age and Size of Building

Decade Built	3 or 4 Unit Bldgs.	5 to 9 Unit Bldgs.	10 to 19 Unit Bldgs.	20 to 49 Unit Bldgs.	50 + Unit Bldgs.	Decade Total
1939 or earlier	767	1,045	624	266	171	2,873
1940 to 1949	133	162	85	156	0	536
1950 to 1959	1,096	2,209	2,620	1,184	398	7,507
1960 to 1969	6,198	2,793	3,301	4,432	1,845	18,569
1970 to 1979	1,300	2,417	3,758	5,588	1,735	14,798
Total	9,492	8,626	10,388	11,626	4,149	44,283

Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Note: The size categories in this table are based upon the number of total Multiple Housing Roster (MHR) units per building. Each building registered in the MHR may contain ARO and exempt units, but this table tallies just the ARO units in each building.

Looking at the age and size of buildings of *exempt* and *excluded* rental housing units in San José – those in buildings with three or more units and *not* covered by the ARO – the surge in constructing larger apartment buildings ("20 to 49 Units" and "50 Units or More") continued into the 1980s, 1990s and 2000s (Table 1.7). For this decade, the trend for units in buildings of 50 units or more is on pace to exceed 13,800 by 2020.[6] Interestingly, the peak of exempt and excluded rental unit construction in mid-sized buildings with 10 to 19 units was in the 1980s, with this particular use of land in the City becoming less feasible in subsequent decades. Also, the troubled 1990s – a decade of prolonged economic recession in California – still saw well over 10,000 total rental units added to the City's housing stock, a 45 percent increase over the 1980s total.

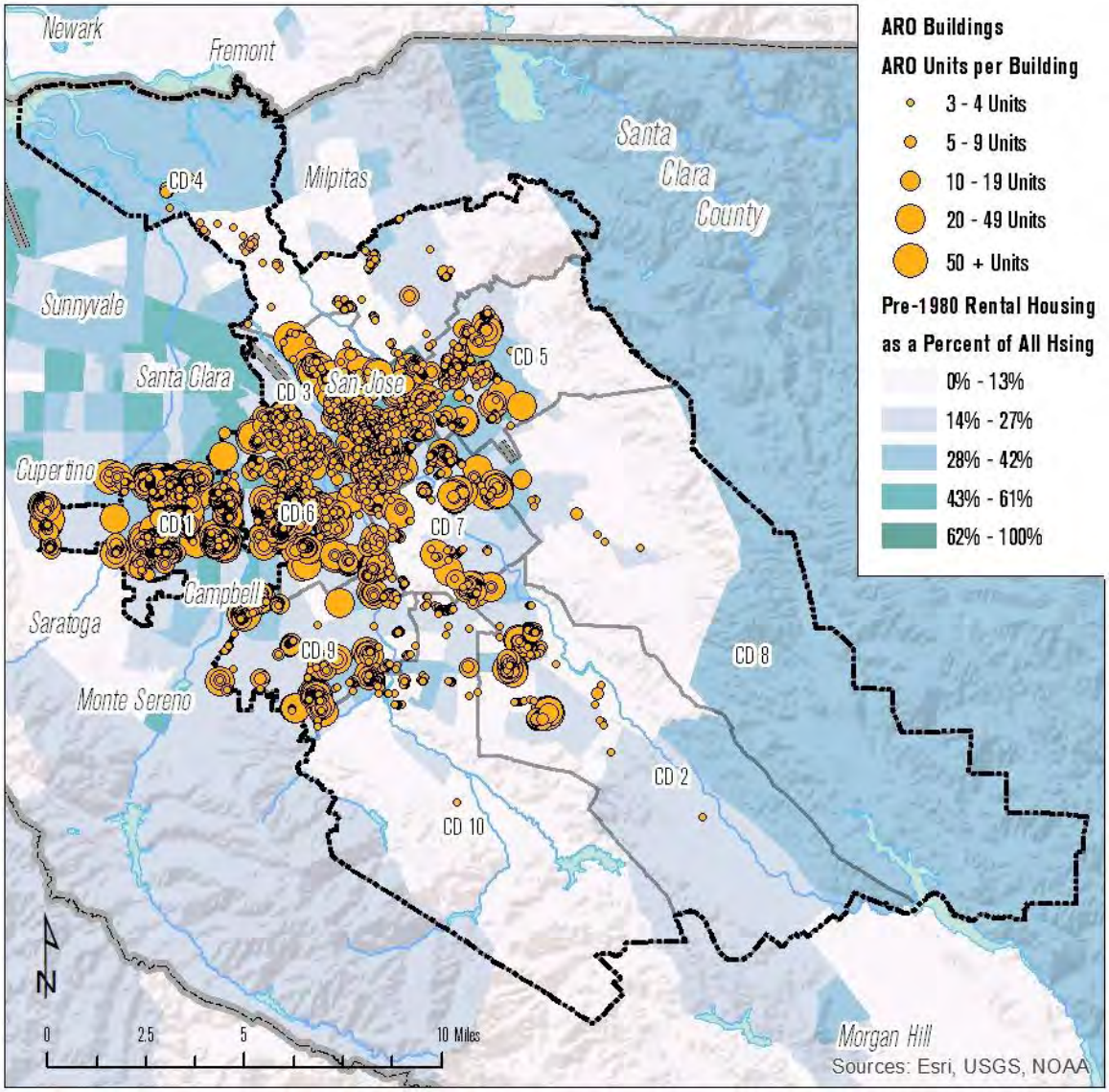
Table 1.7 – Number of Excluded and Exempt Units by Age and Size of Building

Decade Built	3 or 4 Unit Bldgs.	5 to 9 Unit Bldgs.	10 to 19 Unit Bldgs.	20 to 49 Unit Bldgs.	50 + Unit Bldgs.	Decade Total
1939 or earlier	43	115	73	92	214	537
1940 to 1949	2	10	0	149	0	161
1950 to 1959	45	51	46	204	0	346
1960 to 1969	321	422	624	509	267	2,143
1970 to 1979	168	374	630	908	1,262	3,342
1980 to 1989	217	1,392	2,704	996	2,191	7,500
1990 to 1999	189	848	1,234	3,252	5,342	10,865
2000 to 2009	29	246	926	3,143	11,211	15,555
2010 or later	12	117	232	549	6,740	7,650
City Total	1,026	3,575	6,469	9,802	27,227	48,099

Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Note: The size categories in this table are based upon the number of total Multiple Housing Roster (MHR) units per building. Each building registered in the MHR may contain ARO and exempt units, but this table tallies just the ARO units in each building. Excluded rental housing units in this table are in buildings with three or more units, but built and first rented after September 7, 1979. Exempt rental housing units are in buildings with three or more units, built and first rented on or before September 7, 1979, but are not covered by the ARO due to occupancy by the owner, or tenants with short-term government subsidies, such as HUD's Section 8 Housing Choice Voucher program. See Figure 1.2 for an illustration of these types relative to ARO units.

Figures 1.4, 1.5 and 1.6 detail the location and size of buildings with ARO units. Figures 1.4 shows *all* buildings with ARO units, broken out by size and age.

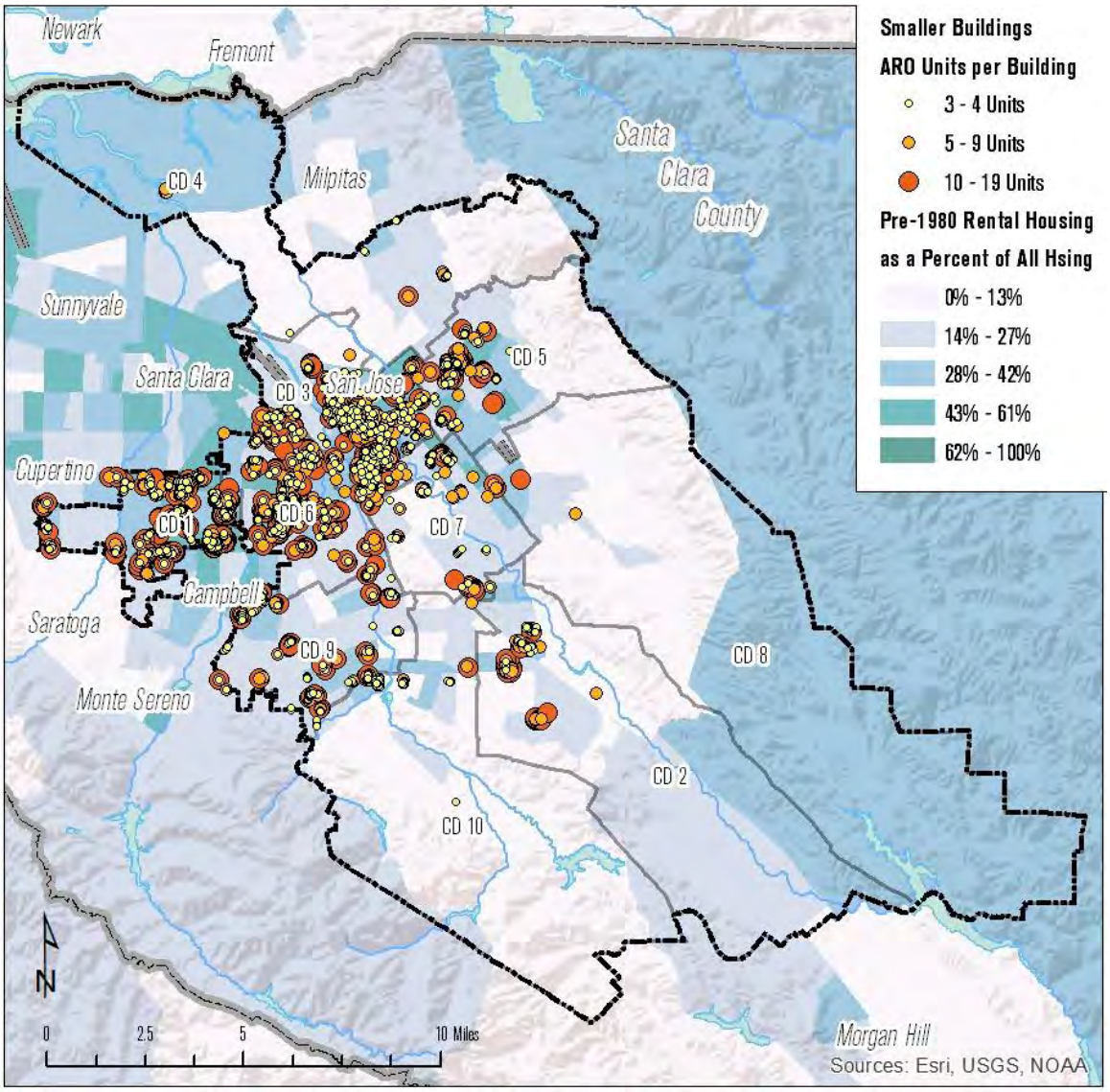
Figure 1.4 – Location of San José Rental Housing Covered by the ARO, by Number of Units per Building



Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015.
Background shading: U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Table B25036: Tenure by Year Structure Built.
Notes: Background shading data includes all pre-1980 rental housing, including ARO units, duplexes, rented condominiums and other rented housing units, as a percentage of all housing within each census tract. Geographic units displayed in the background are census tracts, with City Council District boundaries overlaid for reference.

Figures 1.5 shows *smaller* buildings with ARO units – those with 3-4 units, 5-9 units and 10-19 units per building.

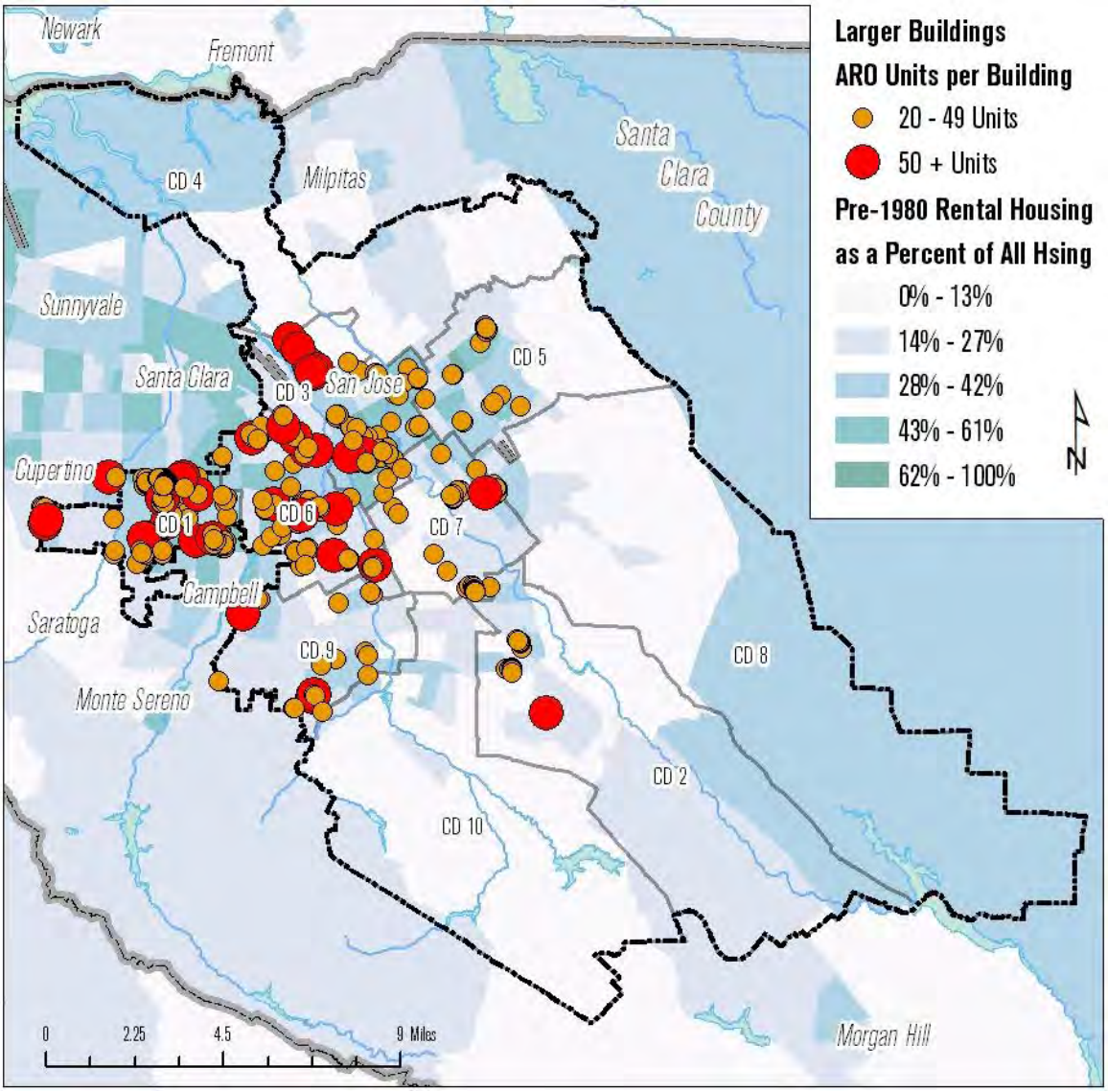
Figure 1.5 – Location of San José Rental Housing Covered by the ARO, Highlighting Smaller Buildings



Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Background shading: U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Table B25036: Tenure by Year Structure Built. Notes: Background shading data includes all pre-1980 rental housing, including ARO units, duplexes, rented condominiums and other rented housing units, as a percentage of all housing within each census tract. Geographic units displayed in the background are census tracts, with City Council District boundaries overlaid for reference.

Figures 1.6 shows *larger* buildings with ARO units – those with 20-49 and 50 or more units per building.

Figure 1.6 – Location of San José Rental Housing Covered by the ARO, Highlighting Larger Buildings



Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015.
Background shading: U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Table B25036: Tenure by Year Structure Built.
Notes: Background shading data includes all pre-1980 rental housing, including ARO units, duplexes, rented condominiums and other rented housing units, as a percentage of all housing within each census tract. Geographic units displayed in the background are census tracts, with City Council District boundaries overlaid for reference.

The number of buildings with ARO units in each Council District varies, with the majority located in CD 1, CD 3, and CD 6 (Table 1.8).

Table 1.8 – Number of Buildings with ARO Units, by Size and Council District

City Council District	3 or 4 Unit Bldgs.	5 to 9 Unit Bldgs.	10 to 19 Unit Bldgs.	20 to 49 Unit Bldgs.	50 + Unit Bldgs.	District Total	Percent of Total
CD 1	746	230	216	151	11	1,354	27%
CD 2	113	33	32	16	1	195	4%
CD 3	398	432	183	60	10	1,083	22%
CD 4	21	27	9	0	2	59	1%
CD 5	126	117	49	17	0	309	6%
CD 6	464	297	199	94	13	1,067	21%
CD 7	227	47	20	48	2	344	7%
CD 8	0	7	3	8	0	18	0%
CD 9	242	68	85	28	3	426	8%
CD 10	167	2	1	1	0	171	3%
City Total	2,504	1,260	797	423	42	5,026	100%
Percent of Total	50%	25%	16%	8%	1%	100%	

Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Note: The size categories in this table are based upon the number of total Multiple Housing Roster (MHR) units per building. Each building registered in the MHR may contain ARO and exempt units, but this table tallies just the ARO units in each building.

1c. Ownership Characteristics

The length of time that buildings with ARO units have been held by the same owner is relatively short (Table 1.9). Based upon the transfer date in Santa Clara County Assessor's sales records – which includes "arms-length," market-rate sales between independent, unrelated parties, but also transfers between family members deeding properties over to one another and converting them into family trusts – 94 percent occurred since 1980. This means that the vast majority of buildings under the ARO's jurisdiction changed ownership or had the opportunity to be sold since the ordinance went into effect. Additionally, Council Districts with the largest number of ARO units – CD 1, CD 3 and CD 6 – have large percentages of their sales taking place since 2000.

Table 1.9 – Age of ARO Units by Decade of Last Transfer and Council District of Last Transfer Date

Decade Last Transferred	CD 1	CD 2	CD 3	CD 4	CD 5	CD 6	CD 7	CD 8	CD 9	CD 10	Citywide Number	Citywide Percent
1959 or earlier	0	0	4	0	0	0	0	0	0	0	4	0.0%
1960 to 1969	0	0	0	0	0	98	0	0	0	0	98	0.2%
1970 to 1979	884	200	199	0	332	366	184	10	476	11	2,662	6%
1980 to 1989	489	182	511	0	105	577	181	0	364	32	2,441	6%
1990 to 1999	1,329	694	1,275	40	255	1,449	959	277	622	126	7,026	16%
2000 to 2009	4,187	304	2,873	57	1,055	3,533	837	0	788	316	13,950	32%
2010 or later	5,769	106	5,205	344	703	3,595	894	0	1,276	210	18,102	41%
Total	12,658	1,486	10,067	441	2,450	9,618	3,055	287	3,526	695	44,283	100%

Decade Last Transferred	CD 1	CD 2	CD 3	CD 4	CD 5	CD 6	CD 7	CD 8	CD 9	CD 10	Citywide Percent
1959 or earlier	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0.0%
1960 to 1969	0%	0%	0%	0%	0%	1%	0%	0%	0%	0%	0.2%
1970 to 1979	7%	13%	2%	0%	14%	4%	6%	3%	13%	2%	6%
1980 to 1989	4%	12%	5%	0%	4%	6%	6%	0%	10%	5%	6%
1990 to 1999	10%	47%	13%	9%	10%	15%	31%	97%	18%	18%	16%
2000 to 2009	33%	20%	29%	13%	43%	37%	27%	0%	22%	45%	32%
2010 or later	46%	7%	52%	78%	29%	37%	29%	0%	36%	30%	41%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Santa Clara County Assessor's Office, Condensed Sales database, fall 2015.

"Out of town" ownership of ARO units is uncommon

Another ownership characteristic is the location of ARO building owners, which we draw from the mailing address on file at the Sana Clara County Assessor's office. A plurality of owners – 47 percent – are located in the City of San José, including those who live in units alongside their ARO tenants (Figure 1.7). Another 29 percent of owners are located elsewhere in Santa Clara County. Only five percent are owned with out-of-state addresses. Across the City, CD 5 has the highest recorded local ownership rate, among its numerous ARO buildings. Only CD 8 stands out with a majority of units owned by entities outside the county, but has a relatively low number of units (Figure 1.8). "Out of town" ownership of ARO units is uncommon.

Figure 1.7 – ARO Units by Owner Location, San José

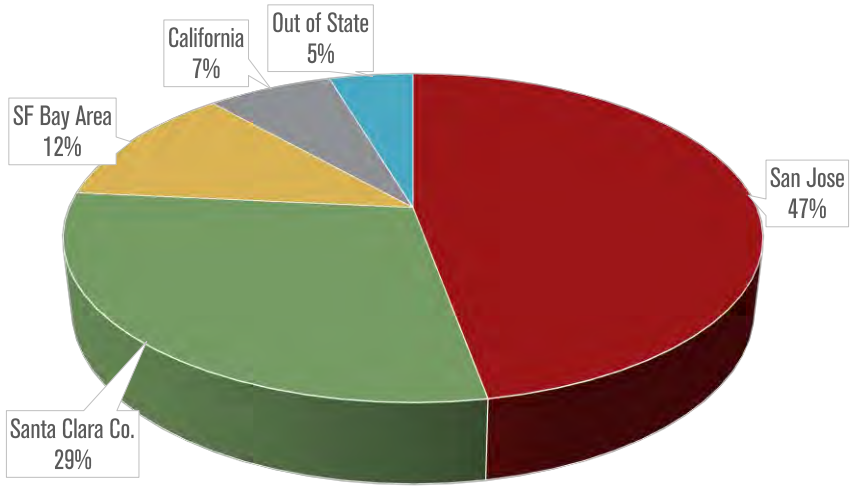
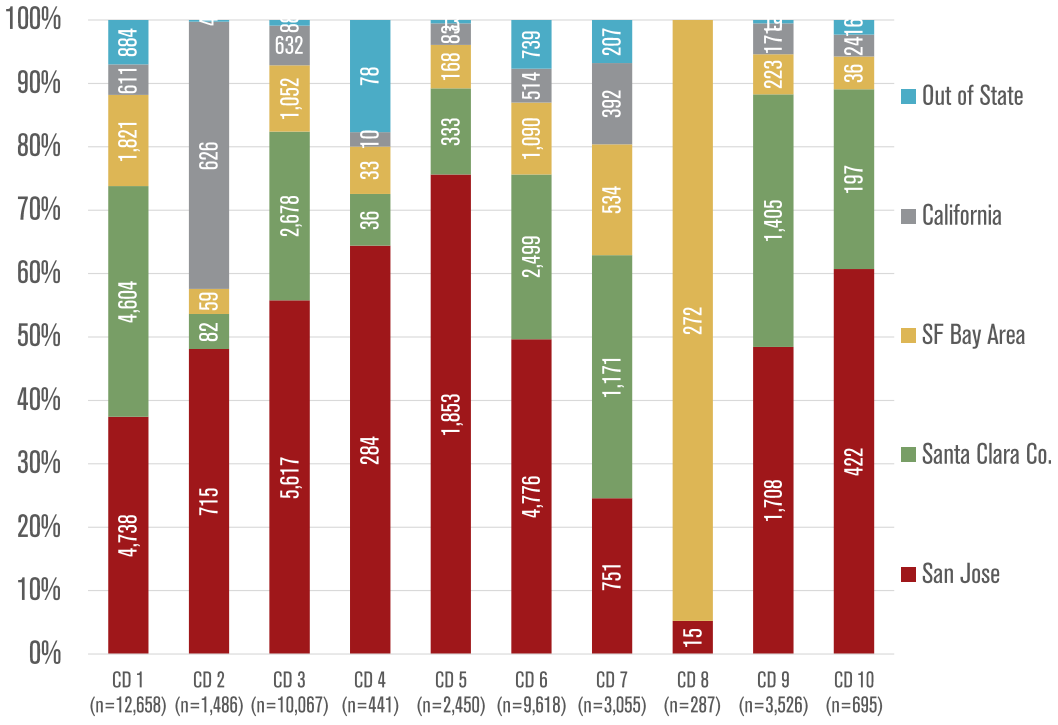


Figure 1.8 – ARO Units by Owner Location and Council District, San José



Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Santa Clara County Assessor's Office, Master File database, fall 2015. Note: Geographic areas are mutually exclusive. For example, "Santa Clara Co." is the balance of the county outside of the City of San Jose.

Breaking out the location of ARO building ownership by building size, over half of ARO units in smaller-sized buildings ("3 or 4 Units" and "5 to 9 Units") have owners located in the City of San José (Table 1.10, Figure 1.9). For ARO units in medium- to larger-sized buildings ("20 to 49 Units" and "50 Units or More"), the percentages of local ownership drop off while more distant owners rise. For the ARO buildings with 50 or more units, 27 percent have ownership outside of the San Francisco Bay Area, compared to just seven percent of the smallest category, triplexes and fourplexes.

Smaller ARO buildings more commonly have owners based in San José than larger ones

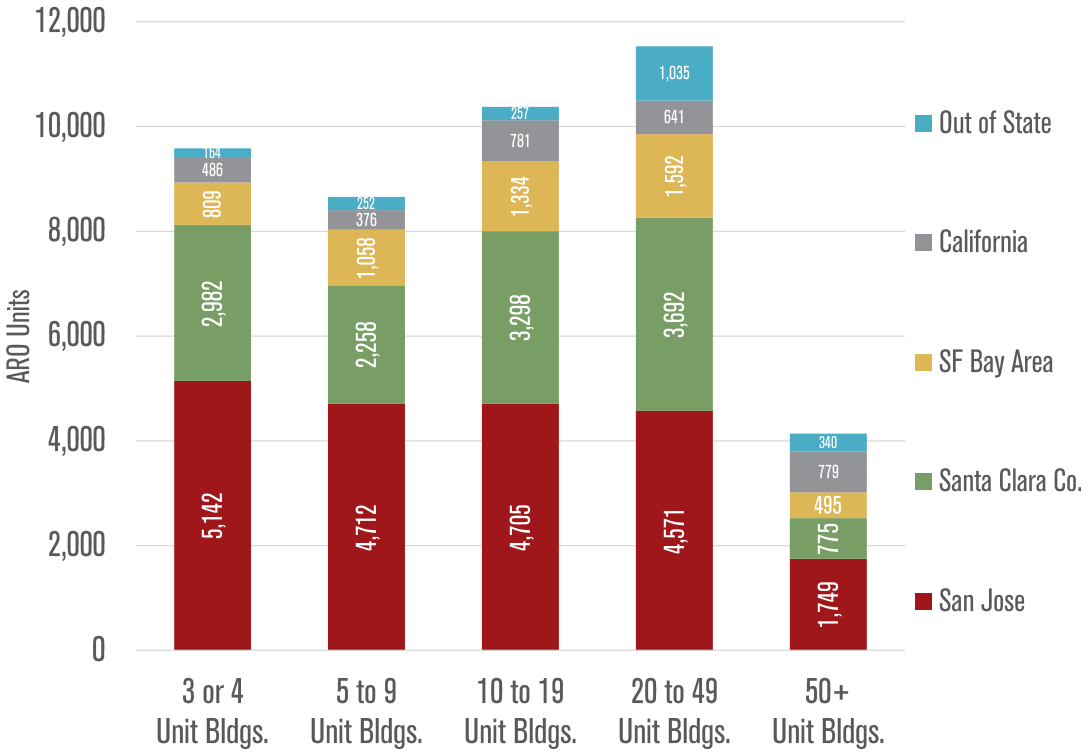
Table 1.10 – Number of Excluded and Exempt Units by Age and Size of Building

Owner Location	3 or 4 Unit Bldgs.	5 to 9 Unit Bldgs.	10 to 19 Unit Bldgs.	20 to 49 Unit Bldgs.	50 + Unit Bldgs.	All Sizes
San Jose, CA	5,142	4,712	4,705	4,571	1,749	20,879
Santa Clara Co.	2,982	2,258	3,298	3,692	775	13,005
SF Bay Area	809	1,058	1,334	1,592	495	5,288
California	486	376	781	641	779	3,063
Out of State	164	252	257	1,035	340	2,048
Total	9,583	8,656	10,375	11,531	4,138	44,283

Owner Location	3 or 4 Unit Bldgs.	5 to 9 Unit Bldgs.	10 to 19 Unit Bldgs.	20 to 49 Unit Bldgs.	50 + Unit Bldgs.	All Sizes
San Jose, CA	54%	54%	45%	40%	42%	47%
Santa Clara Co.	31%	26%	32%	32%	19%	29%
SF Bay Area	8%	12%	13%	14%	12%	12%
California	5%	4%	8%	6%	19%	7%
Out of State	2%	3%	2%	9%	8%	5%
Total	100%	100%	100%	100%	100%	100%

Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Santa Clara County Assessor's Office, Master File database, fall 2015. Note: Geographic areas are mutually exclusive. For example, "Santa Clara Co." is the balance of the county outside of the City of San Jose.

Figure 1.9 – ARO Units by Owner Location and Building Size, San José



Source: Economic Roundtable analysis; City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Santa Clara County Assessor's Office, Master File database, fall 2015. Note: Geographic areas are mutually exclusive. For example, "Santa Clara Co." is the balance of the county outside of the City of San Jose.

1d. Property Valuation Trends

Over 1,000 ARO units in 64 buildings were transacted in the 1st three quarters of 2015

Recent sales[7] of ARO properties, measured in the numbers of units and square feet transacted, following a brief slowdown during the last recession, demonstrating strong market demand. From January 2015 through September 2015, 1,073 ARO units in 64 buildings were transacted, about 2 ½ percent of the total 44,000 ARO inventory (Figures 1.10 and 1.11). This adds up to nearly 800,000 square feet of rental housing. For

Figure 1.10 – Multi-Family Housing Units Transacted Annually in San José by ARO Status

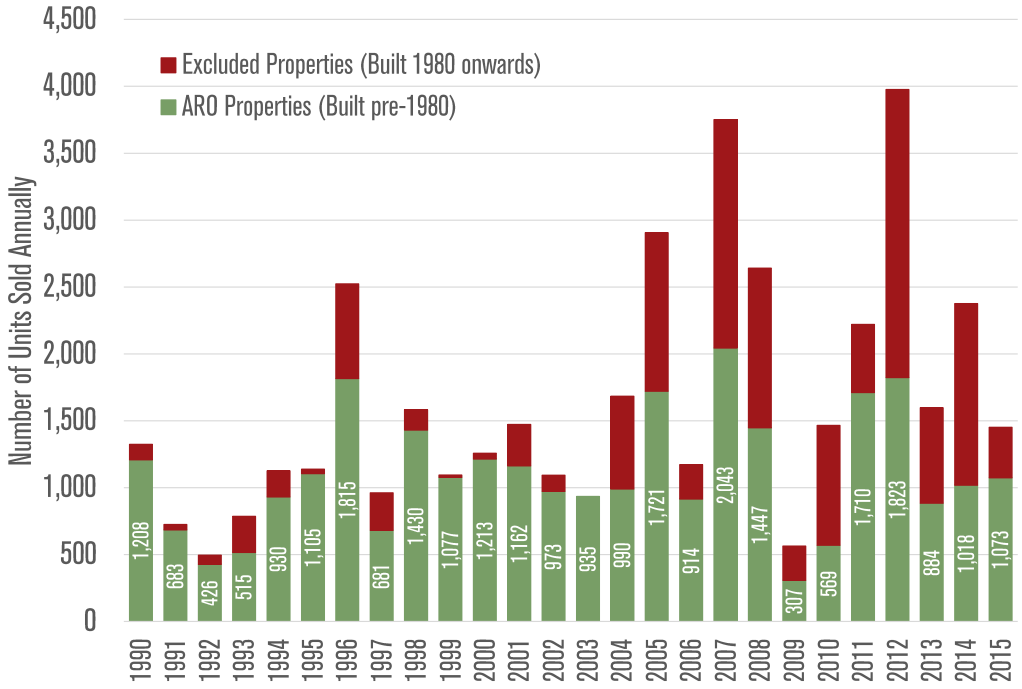
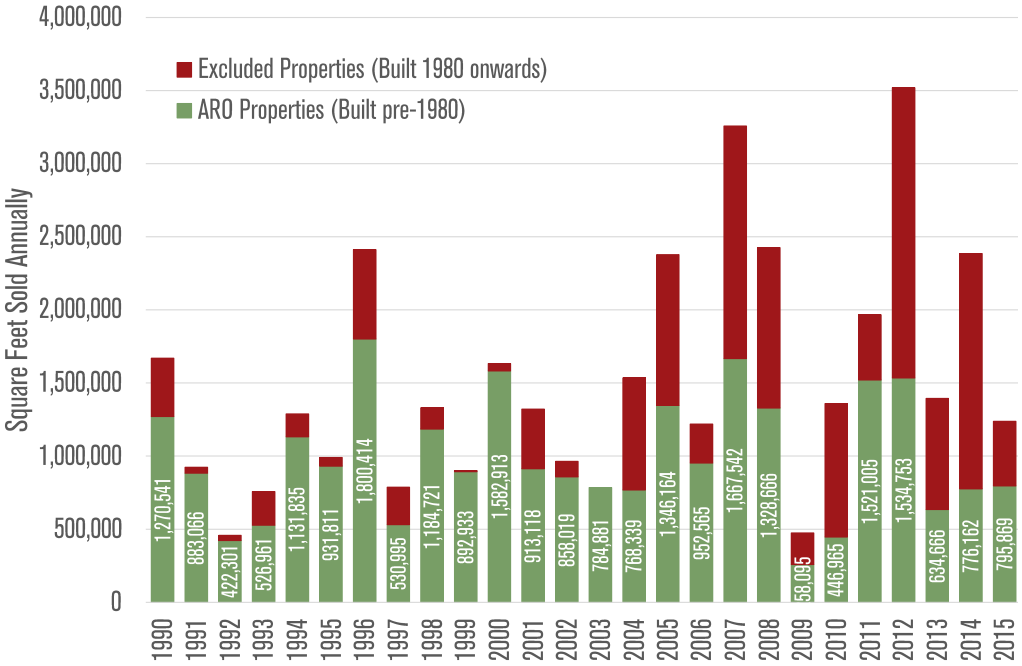


Figure 1.11 – Multi-Family Housing Sq. Ft. Transacted Annually in San José by ARO Status



Sources: Economic Roundtable analysis; CoStar Group, "City of San José Apartment Sales Transactions," www.costar.com Notes: Data for 2015 is partial year, coving through 9/30/2015. All data shows transactions of multi-family housing with five or more units; ARO properties are defined as are multi-family housing with five or more units and built before 1980.

reference, 378 units in five apartment buildings built 1980 or later were transacted in the same period, adding up to over 442,000 square feet.[8]

The trend in multi-family property *values* is upward, aside from the noticeable downturn during the Great Recession (Figures 1.12 and 1.13). The average price per ARO unit is just under $200,000, or $258 per square foot. These property values are 222 percent higher than 1990 per unit, and 258 percent higher than 1990 per square foot. Comparatively, multi-family properties built in 1980 or later have fetched higher prices per unit since the recent recession, averaging over $100,000 more in sale values compared to ARO units since 2010. This gap is equal to 55 percent of the 2015 average price of

Average prices of ARO units are just under $200,000, or $258 per SF, and 84% higher than in 1990

Figure 1.12 – Multi-Family Housing Average Sales Price per Unit in San José

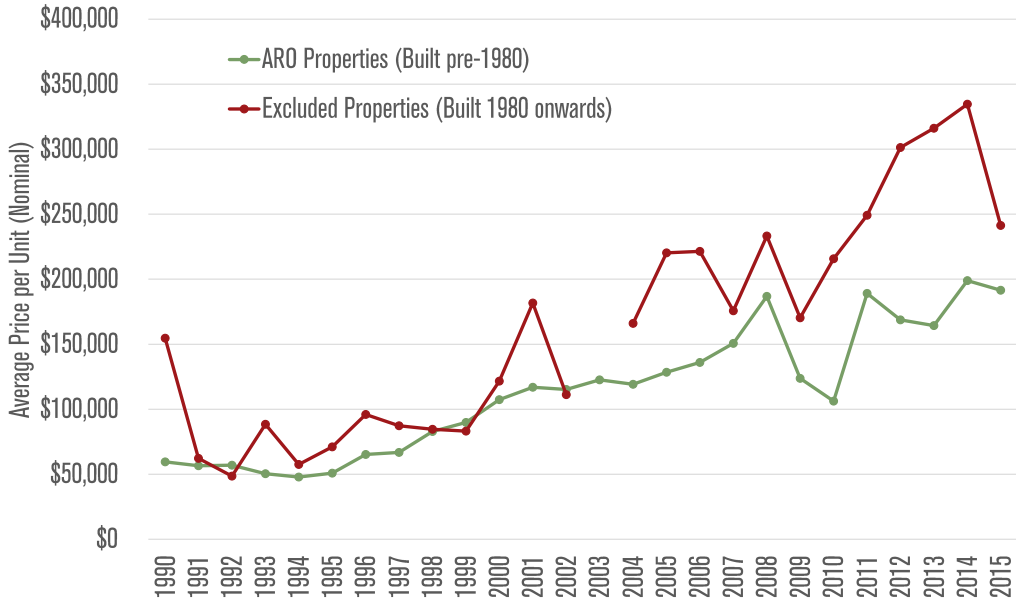
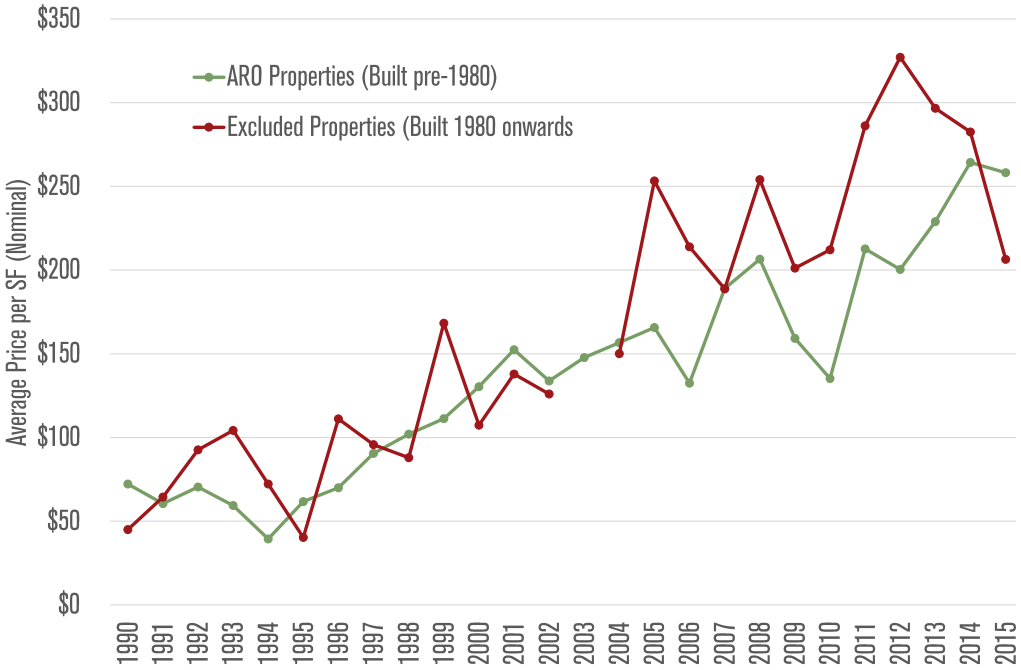


Figure 1.13 – Multi-Family Housing Average Sales Price per Square Footage in San José

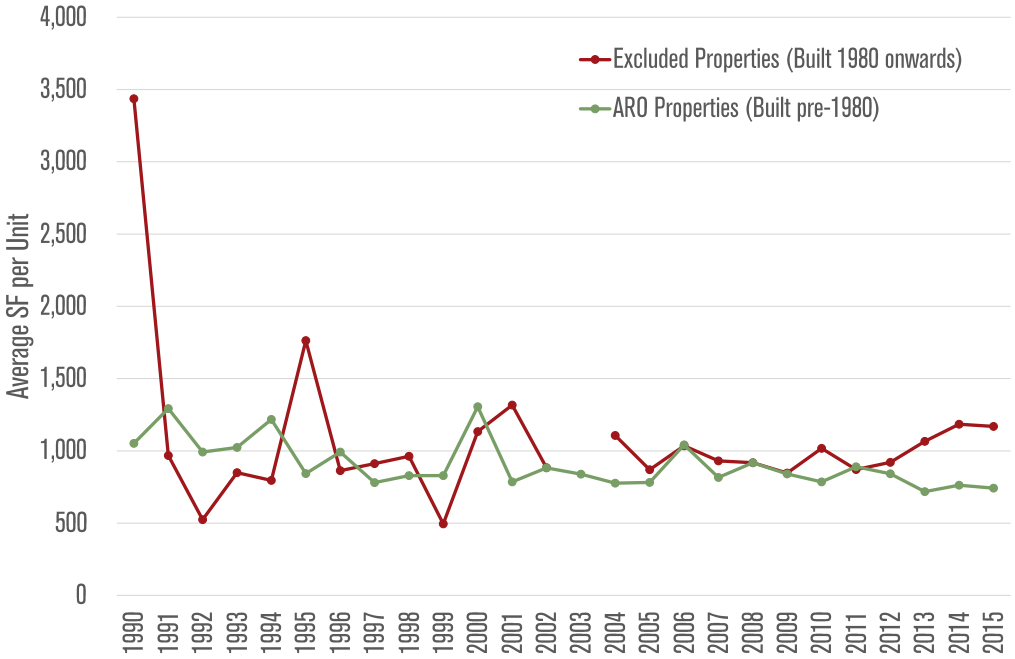


Sources: Economic Roundtable analysis; CoStar Group, "City of San José Apartment Sales Transactions," www.costar.com Notes: Data for 2015 is partial year, coving through 9/30/2015. All data shows transactions of multi-family housing with five or more units; ARO properties are defined as are multi-family housing with five or more units and built before 1980.

ARO units sold. The difference between ARO and other multi-family property sales values on a per square foot basis is less, an average of $52 since 2010, equal to 20 percent of the 2015 average per-square-foot price of ARO properties.

The difference between the per-unit and per-square-foot sales values of ARO versus excluded properties indicates that the latter are larger-sized units sold in the last few years (Figure 1.14). Since 1990, the average size per unit of ARO and excluded properties sold has been roughly identical, but diverging since 2013. This may be the result of larger-sized units in properties built since 1980 now coming up for sale on the market by their first owners. Other potential factors contributing to the sales price differences may include building age, quality, and/or location.

Figure 1.14 – Multi-Family Housing Average Square Footage per Unit Transacted in San Jose, by ARO Status



Sources: Economic Roundtable analysis; CoStar Group, "City of San José Apartment Sales Transactions," www.costar.com Notes: Data for 2015 is partial year, coving through 9/30/2015. All data shows transactions of multi-family housing with five or more units; ARO properties are defined as are multi-family housing with five or more units and built before 1980.

1e. Rental Housing Quality and Tenant-Landlord Relations

As described earlier, the City of San José's Multiple Housing Program requires a Residential Occupancy Permit for all rental properties with three or more units under one roof.[9] The Multiple Housing Program includes periodic inspections of rental properties to ensure compliance with municipal codes, and to identify substandard housing conditions. The *code enforcement status* of ARO units – shown in Service Level "Tiers" – is summarized in Table 1.11 and Figure 1.15, broken out by Council Districts. This rental housing quality indicator is based upon which rental housing properties generate the most complaints from tenants or neighbors, or otherwise need more inspection services to comply with municipal codes.[10]

The City inspects all multi-family housing, including all ARO units, for compliance with its building code.

Table 1.11 – ARO Units by Code Enforcement Service Level Tier and Council District

City Council District	Tier I. 6-Year Cycle	Tier II. 5-Year Cycle	Tier III. 3-Year Cycle	Total
CD 1	4,304	4,943	3,411	12,658
CD 2	536	631	319	1,486
CD 3	1,343	3,705	5,019	10,067
CD 4	306	55	80	441
CD 5	424	511	1,515	2,450
CD 6	2,466	4,143	3,009	9,618
CD 7	856	1,223	976	3,055
CD 8	72	205	10	287
CD 9	1,420	1,218	888	3,526
CD 10	41	207	447	695
City Total	11,768	16,841	15,674	44,283

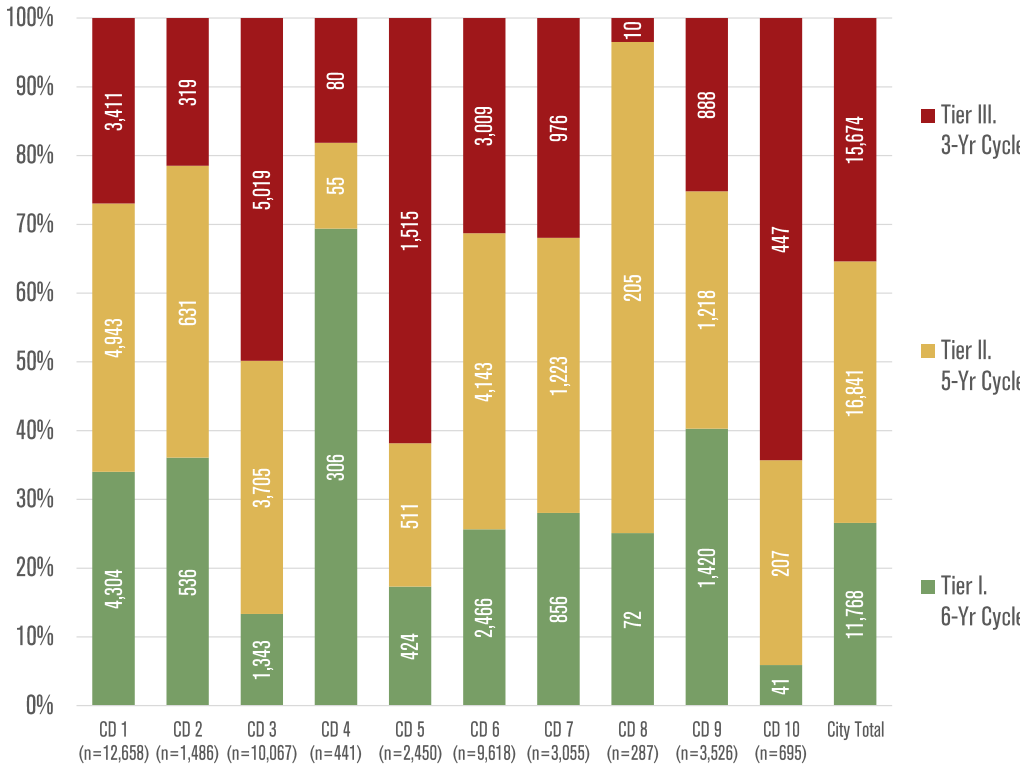
City Council District	Tier I. 6-Year Cycle	Tier II. 5-Year Cycle	Tier III. 3-Year Cycle	Total
CD 1	34%	39%	27%	100%
CD 2	36%	42%	21%	100%
CD 3	13%	37%	50%	100%
CD 4	69%	12%	18%	100%
CD 5	17%	21%	62%	100%
CD 6	26%	43%	31%	100%
CD 7	28%	40%	32%	100%
CD 8	25%	71%	3%	100%
CD 9	40%	35%	25%	100%
CD 10	6%	30%	64%	100%
City Total	27%	38%	35%	100%

Source: Economic Roundtable analysis; City of San José Department of Planning, Building and Code Enforcement, Code Enforcement Division Multiple Housing Roster (MHR) database, combined with the City of San José Housing Department, Apartment Rent Ordinance (ARO) database, fall 2015. Note: The Department of Planning, Building and Code Enforcement's multiple housing program inspects all rental properties registered in the MHR, and these buildings may contain both ARO and exempt units, but this table counts just the ARO units.

There is a relatively even split of ARO units among Service Level Tier I (6-year inspection cycle of exterior, common areas and 10 percent of units; audit of owner's annual checklist, less than one code violation per unit), Tier II (5-year inspection cycle of exterior, common areas and 25 percent of units, less than two code violations per unit), and Tier III (3-year inspection cycle of exterior, common areas and 50 percent of units, due to having more than one code violations per unit and missing repairs completion deadlines). CD 3, CD 5 and CD 10 stand out as having 50 percent or more of ARO units assigned to Service Level Tier III – averaging more than one violation per unit. CD 8 stands out with 71 percent of its ARO units in Service Level Tier II – better renter housing conditions, albeit for a relatively small number of ARO units.

Broken out by the decade during which the buildings containing ARO units where built and first occupied, Table 1.12 and Figure 1.16 clearly show that more recently built units are less likely to be in Service Level Tier III, and older buildings have more units in Service Level Tier III. For example, just 12 percent of ARO units built in the 1970s are

Figure 1.15 – ARO Units by Code Enforcement Service Level Tier and Council District



Source: Economic Roundtable analysis; City of San José Department of Planning, Building and Code Enforcement, Code Enforcement Division Multiple Housing Roster (MHR) database, combined with the City of San José Housing Department, Apartment Rent Ordinance (ARO) database, fall 2015. Note: See notes in prior table in this section.

assigned Service Level Tier III status, while over half of those built in the 1940s and 1950s are in this tier. This correlation between housing quality and year built is expected, given the wear and tear of normal housing occupancy. Also, some older multi-family properties bring in less rent and require more maintenance to offset aging structures compared to

Over ½ of ARO units built in the 1940s & 1950s are inspected every 3 years, to address housing quality issues

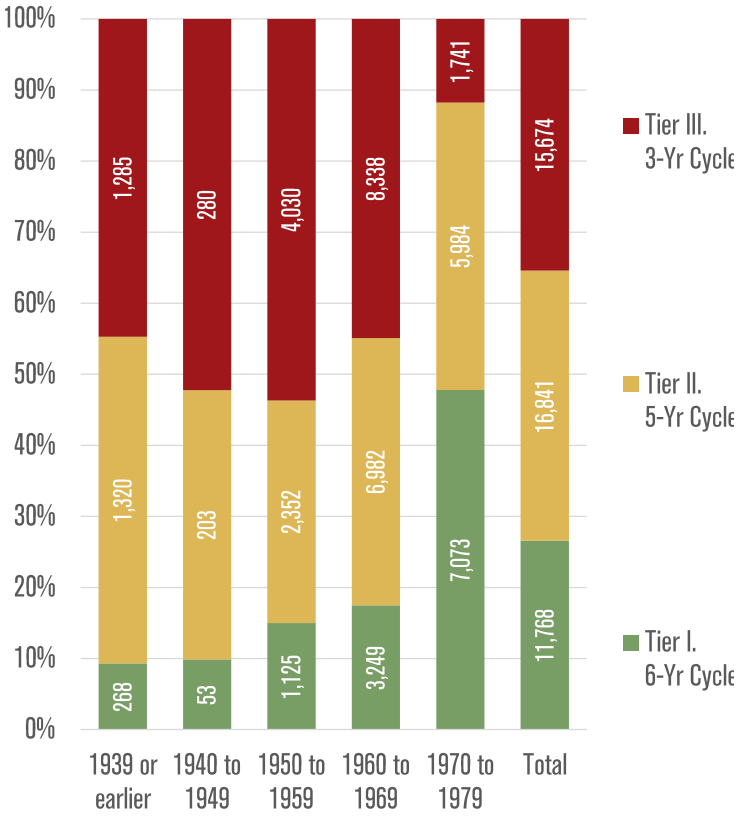
Table 1.12 – ARO Units by Code Enforcement Service Level Tier and Year Built

Decade Built	Tier I. 6-Year Cycle	Tier II. 5-Year Cycle	Tier III. 3-Year Cycle	Total
1939 or earlier	268	1,320	1,285	2,873
1940 to 1949	53	203	280	536
1950 to 1959	1,125	2,352	4,030	7,507
1960 to 1969	3,249	6,982	8,338	18,569
1970 to 1979	7,073	5,984	1,741	14,798
Total	11,768	16,841	15,674	44,283

Decade Built	Tier I. 6-Year Cycle	Tier II. 5-Year Cycle	Tier III. 3-Year Cycle	Total
1939 or earlier	9%	46%	45%	100%
1940 to 1949	10%	38%	52%	100%
1950 to 1959	15%	31%	54%	100%
1960 to 1969	17%	38%	45%	100%
1970 to 1979	48%	40%	12%	100%
Total	9%	46%	45%	100%

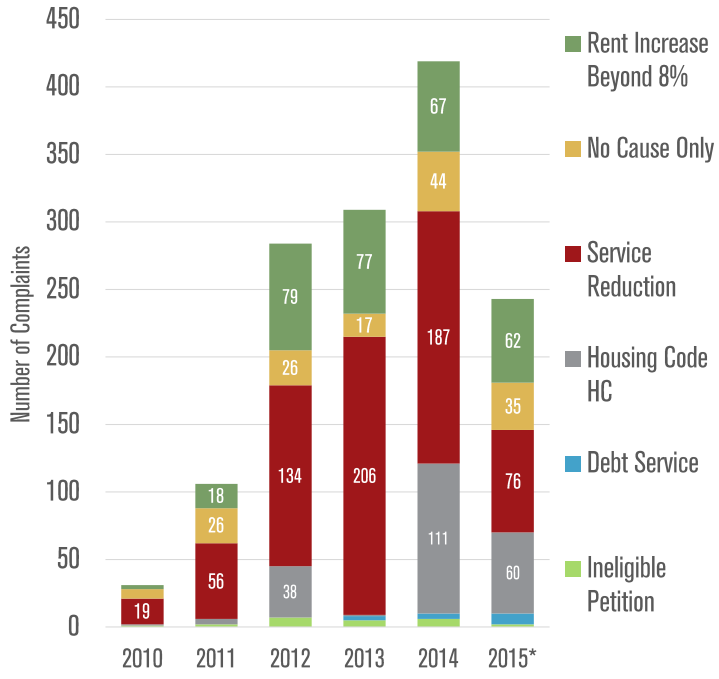
Source: Economic Roundtable analysis; City of San José Department of Planning, Building and Code Enforcement, Code Enforcement Division Multiple Housing Roster (MHR) database, combined with the City of San José Housing Department, Apartment Rent Ordinance (ARO) database, fall 2015. Note: The Department of Planning, Building and Code Enforcement's multiple housing program inspects all rental properties registered in the MHR, and these buildings may contain both ARO and exempt units, but this table counts just the ARO units.

Figure 1.16 – ARO Units by Code Enforcement Service Level Tier and Council District



Source: Economic Roundtable analysis; City of San José Department of Planning, Building and Code Enforcement, Code Enforcement Division Multiple Housing Roster (MHR) database, combined with the City of San José Housing Department, Apartment Rent Ordinance (ARO) database, fall 2015. Note: See notes in prior table in this section.

Figure 1.17 – Housing Complaints Filed by ARO Tenants via Petitions to the City, by Year of Filing



Source: Economic Roundtable analysis; City of San José Housing Department, Complaints database, fall 2015. Note: 2015 (*) is a partial data year.

newer properties, and this may lead to delayed or unmet maintenance issues and violations of the City's housing code.

Complaints in the form of tenant petitions filed with the City's Housing Department are another indicator of rental housing quality and tenant-landlord relations. For the recent years with available complaints data, the City of San José's has seen a rising number of overall complaints in buildings with ARO units (Figure 1.17). Since 2012, about 70 complaints per year of rent increases beyond the ARO-allowed 8 percent; 2015 was on pace to reach that number. Other common complaint types concern service reductions in violation of current leases, improper "no cause" eviction notices, and housing code violations.

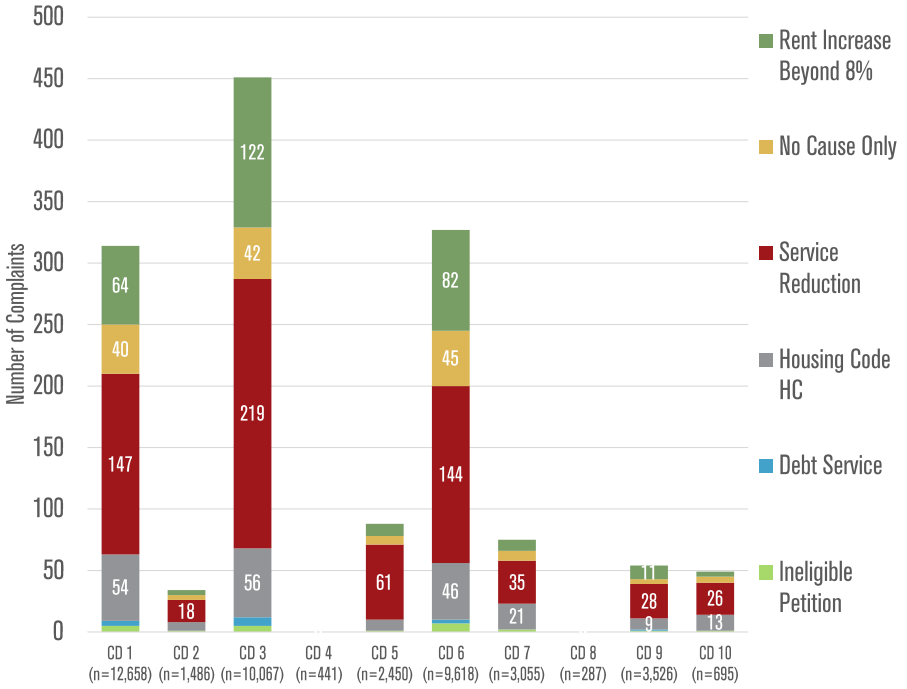
The City receives ~70 complaints annually from ARO tenants about rent increases beyond 8%

Broken out by Council District, housing complaints for buildings with ARO units roughly correspond with the number of ARO units in each (Figure 1.18). CD 3 has the most

ARO tenant housing complaints are most numerous in CDs 1, 3 & 6, and concern ARO units built in the 1950s & 1960s

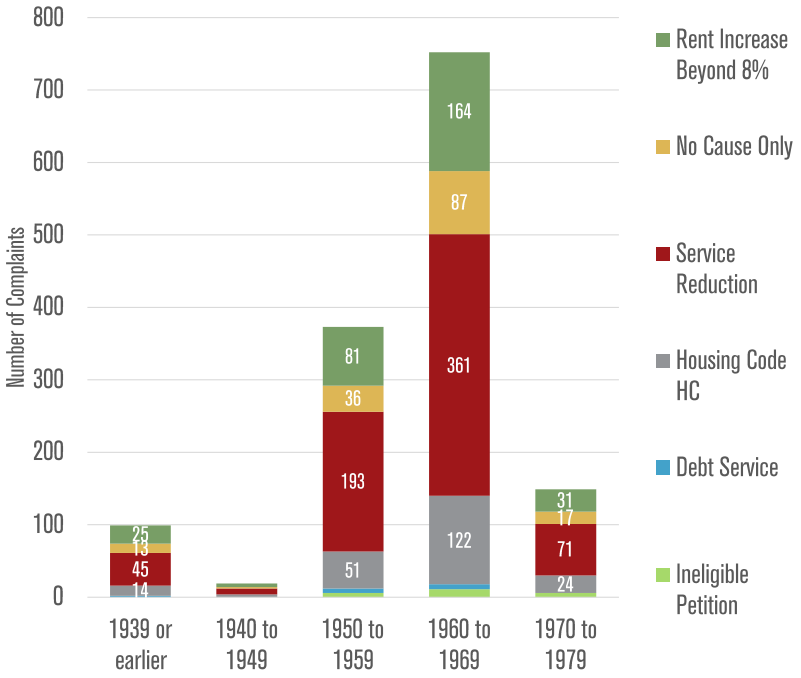
overall number of housing complaints in the period 2010 to 2015, as well as the most number of complaints of rent increase beyond the ARO-allowed 8 percent, followed by CD 6 and CD 1. Broken out by year built, housing complaints from buildings with ARO units, most emerge from those built in 1960s and 1950s (Figure 1.19).

Figure 1.18 – Housing Complaints Filed by ARO Tenants via Petitions to the City, by Council District



Source: Economic Roundtable analysis; City of San José Housing Department, Complaints database, fall 2015.

Figure 1.19 – Housing Complaints Filed by ARO Tenants via Petitions to the City, by Year Built



Source: Economic Roundtable analysis; City of San José Housing Department, Complaints database, fall 2015.

Summary of Findings

- There are over 44,000 ARO housing units in the City of San José, all in buildings of three or more units, and constructed and first rented on or before September 7, 1979. There are over 5,000 multiple-family buildings containing these ARO units.
- ARO housing units constitute 33 percent of the San Jose' supply of rental housing units, and 14 percent of its overall supply of housing units.
- Of all San José rental housing units in buildings with three or more units, ARO units make up 48 percent of the total, "excluded" units (built and first rented after September 7, 1979) make up 45 percent, and "exempt" units (built and first rented on or before September 7, 1979, but occupied by owners or tenants with short-term government subsidies) are seven percent.
- The majority of ARO units -- 73 percent -- are located in the Council Districts: CD 1, CD 3 and CD 6.
- By definition, ARO units were built and first rented on or before September 7, 1979. The plurality of ARO units (42 percent) were built in the 1960s, with another third of ARO units built in the 1970s.
- ARO units are found in buildings large and small, and can include units that are exempted from the ordinance. The plurality of ARO units Citywide - 26 percent - are found in buildings with 20-49 units. CD 1 has over 4,400 ARO units in buildings of this size.
- Most buildings under the ARO's jurisdiction -- 94 percent -- changed ownership, or had the opportunity to be sold, since the ordinance went into effect. This includes assessor's sales records in which "arms-length," market-rate sales took place, as well as transfers between family members and conversions into family trusts.
- The plurality of ARO building owners -- 47 percent -- live in the City of San Jose, including those who live in units alongside their ARO tenants. Another 29 percent of owners are located elsewhere in Santa Clara County. Only five percent are owned with out-of-state addresses.
- ARO property sales are strong, demonstrating strong market demand. From January to through September 2015, 1,073 ARO units in 64 buildings were transacted, about 2.4 percent of the total ARO unit inventory, or just under 800,000 square feet of rental housing. Aside from 2009, the last 10 years have seen at least this many units transacted.
- The trend in multi-family property values is upward. The average price per ARO unit is just under $200,000, or $258 per square foot. These property values are 222 percent higher than 1990 per unit, and 258 percent higher than 1990 per square foot, when adjusted for inflation.
- ARO housing quality, gauged by code enforcement service level "tiers" assigned to each building, show that more recently built units are in better condition. For example, just 12 percent of ARO units built in the 1970s are assigned to service level tier III, requiring inspections on a 3-year cycle. Over half of those built in the 1940s and 1950s are in this service level tier.
- In recent years, San Jose has had a rising number of overall complaints in buildings with ARO units. Since 2012, about 70 complaints per year of annual rent increases in excess of the allowed 8 percent. Other common complaints concern service reductions in violation of current leases, improper "no cause" eviction notices, and housing code violations.

Endnotes

[1] About the Apartment Rent Ordinance: "In 1979, the San José City Council appointed a task force to address rent issues in rental housing. In July 1979 the City Council adopted a Rent Stabilization Ordinance for mobile home parks and apartments and created the Rental Rights and Referrals Program to administer the ordinance. In 1985 the City Council voted to separate the Rent Stabilization Ordinance into two separate ordinances, one for mobile home parks and a second for apartments. The Apartment Rent Ordinance, which is Municipal Code Chapter 17.23, and its companion Regulations regulate rent increases on apartments." Source: City of San José Housing Department. http://www.sanjoseca.gov/index.aspx?NID=4743

For the purpose of this report, we define "ARO" units as those covered by the Apartment Rent Ordinance (built and first rented after September 7, 1979, with three or more total units in the structure) and not exempted due to being occupied by the building owner or a tenant receiving HUD "Section 8" housing choice voucher support. "Non-ARO" refers to those units that are not rent stabilized but that upon a petition by a tenant in connection with a notice to terminate tenancy are subject to part 7 of the Apartment Rent Ordinance.

[2] Economic Roundtable analysis of the City of San José Housing Department's *Apartment Rent Ordinance (ARO) database* (Fall 2015) and U.S. Census Bureau, *2014 1-Year American Community Survey Estimates*, Table DP04 Selected Housing Characteristics.

[3] "Properties that are covered by the City's Rent Control Ordinance were built and occupied prior to September 7, 1979." … "Rental housing developments exempted from the ordinance include single-family dwellings, duplexes, condominiums, hotels, boarding houses, which are rented to transient guests for periods of less than 30 days, nonprofit homes for the aged, school dormitories, rental units owned and operated by any government agency, and any new rental units first rented after September 7, 1979." Source: City of San José Housing Department. http://www.sanjoseca.gov/index.aspx?NID=4743

When US Census Bureau data appear in this report, we use the "Year Built" and "Housing Units in Multi-Unit Structures" variables to capture information ARO units and their occupants. The "Year Built" variable is aggregated by decade, so is includes all those built before 1980, and this is our close proxy for the September 7, 1979 cutoff date in the Apartment Rent Ordinance.

[4] All rental properties with three or more units are registered in the City of San José Housing Department's *Multiple Housing Program*, including buildings with ARO units. This city program issues required Residential Occupancy Permits (ROPs), and collaborates with the Code Enforcement Division of the City of San José Planning, Building and Code Enforcement Department to ensure compliance with minimum housing standards through inspections of rental units. The *Multiple Housing Roster* can be viewed and downloaded here: https://www.sanjoseca.gov/index.aspx?NID=445

San José rental units are excepted from the ARO if they are single-family dwellings, in duplexes or in condominiums. Also excepted are rooms in hotels and boarding houses rented for less than 30 days, as well as nonprofit homes for the aged, school dormitories, and rental units owned, operated or subsidized by a government agency. Units with long-term government subsidies such as tax credits and affordable housing covenants likewise are excepted from the ordinance.

[5] "Exempt" rental units are those in properties with three or more units that were built and first rented on or before September 7, 1979, but not covered by the ARO due to a short-term, year-to-year reason. Reasons for ARO exemptions include those occupied by the building's owner, or the tenant receives a subsidy from the U.S. Department of Housing and Urban Development's (HUD's) Housing Choice Voucher / Section 8

program. Exempt units that would otherwise be under ARO jurisdiction are tracked and updated each year by the San José Housing Department.

[6] The City of San José *Multiple Housing Roster* file used by the Economic Roundtable in this study was created November 11, 2015, which is 1,776 days into the current 3,653-day decade. Since 6,740 (exempt) rental housing units have been constructed and occupied in buildings with 50 or more units thus far this decade, we estimate that 13,861 units total may be built by 2020, assuming the current rate of construction continues.

[7] Sales data in this section are based upon CoStar Group "City of San José Apartment Sales Transactions" data, and are verified arm's length market transactions only.

[8] Sales of non-ARO multifamily properties located within the City of San José are presented as a reference point, but only a few of these newer (built 1980 or later) buildings are transacted each year. This is why non-ARO properties have greater fluctuations in value.

[9] "This includes apartments, hotels, motels, fraternities, sororities, emergency shelters, and residential care facilities. Permits must be renewed annually. Condominiums are not included on the Multiple Housing Roster and they do not require a Residential Occupancy Permit." Source: City of San José Planning, Building & Code Enforcement Department, Code Enforcement Division.
https://www.sanjoseca.gov/index.aspx?NID=445

[10] "The City Auditor issued recommendations for the development of a risk-based approach. The audit report recommended focusing limited Code Enforcement staff resources on the buildings that generate the most complaints or need for inspection services. Code Enforcement staff reviewed the frequency of services provided and violations observed during inspections conducted 2000 – 2013 for every building on the Multiple Housing Roster. Tier assignments were based upon the number and severity of documented violations per unit in each building and the frequency of inspection services provided during the thirteen years. The auditor found no correlation between the age of the building and the frequency of Code Enforcement services and therefore this factor was not considered." Source: City of San José Planning, Building & Code Enforcement Department, Code Enforcement Division. "Multiple Housing Program - Frequently Asked Questions" https://www.sanjoseca.gov/DocumentCenter/View/47095

Planning, Building & Code Enforcement Department handouts provides information, including the frequency of Code Enforcement inspection services on a 3-year, 5-year or 6-year inspection cycle. Property owners eligible for Service Level Tier 1 make an online commitment to annually inspect all multi-family units; provide tenants with completed checklist and timeline for making repairs; and maintain documents available for Code Enforcement staff audit and routine inspection conducted on a 6-year cycle.

The purpose of the 3-tier service delivery model is for Code Enforcement to provide more frequent inspections to the buildings needing it most. All new construction is assigned to Service Level Tier 1. There is a requirement to check the status of common maintenance issues and communicate the findings of their self-assessments by providing a completed checklist to tenants. Owners and managers are encouraged to utilize best management practices so that fewer violations are noted during inspections. Movement to a higher or lower service level tier depends upon meeting standards specified in the FAQs. Source: City of San José Planning, Building & Code Enforcement Department, correspondence with Mollie McLeod, Division Manager, February 2016.

Photograph by Patrick Burns, Eugene Avenue, San José, CA, January 28, 2016.

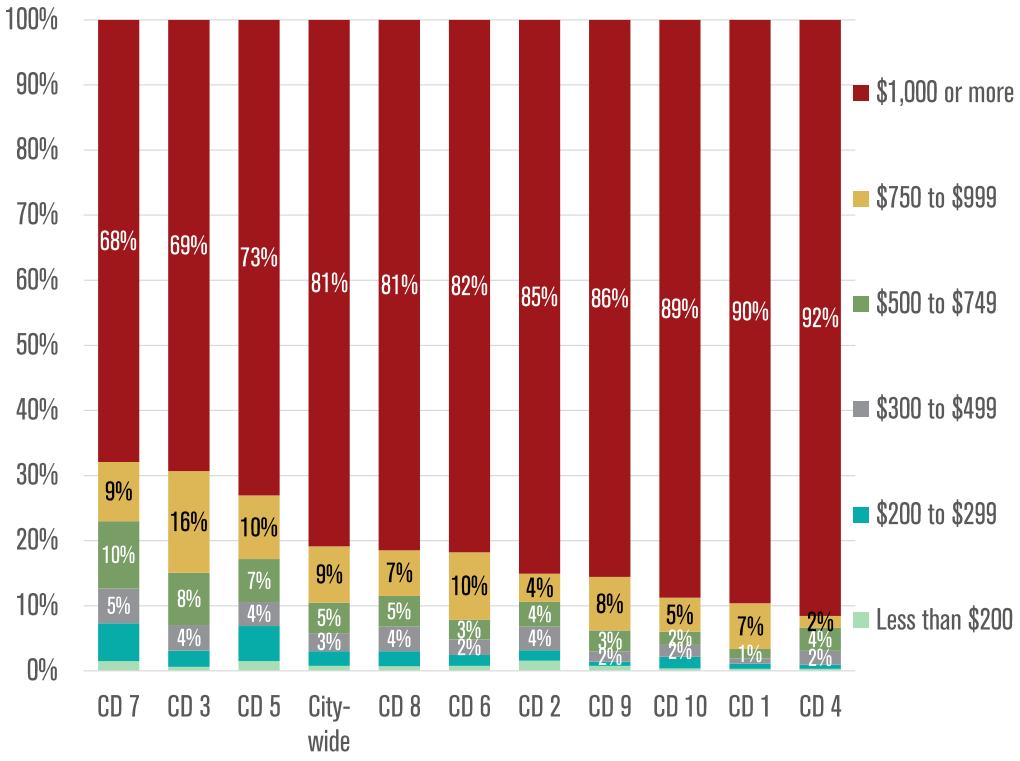
Chapter 2. City of San José Tenant Rent, Income and Socioeconomic Conditions

2. City of San José Tenant Rent, Income and Socioeconomic Conditions

2a. Differences in Tenant Rent Levels across the City

Rent levels vary by building age, square footage per unit, number of bedrooms per unit, neighborhood, and even by costs of building maintenance and type of ownership. In the City of San José, neighborhood differences in actual rents[1] can be seen at the level of Council Districts (CD) (Figure 2.1). For all renter occupied housing, tenant rent levels are predominantly over $1,000 per month, ranging from 92 percent of renters in CD 4, to 68 percent of residents in CD 7 paying that amount or more. CD 7, CD 3, and CD 5 had the most rental housing at lower rent amounts, all lower than the Citywide average.

Figure 2.1 – Rent Levels for All Apartments, by Council Districts, City of San José



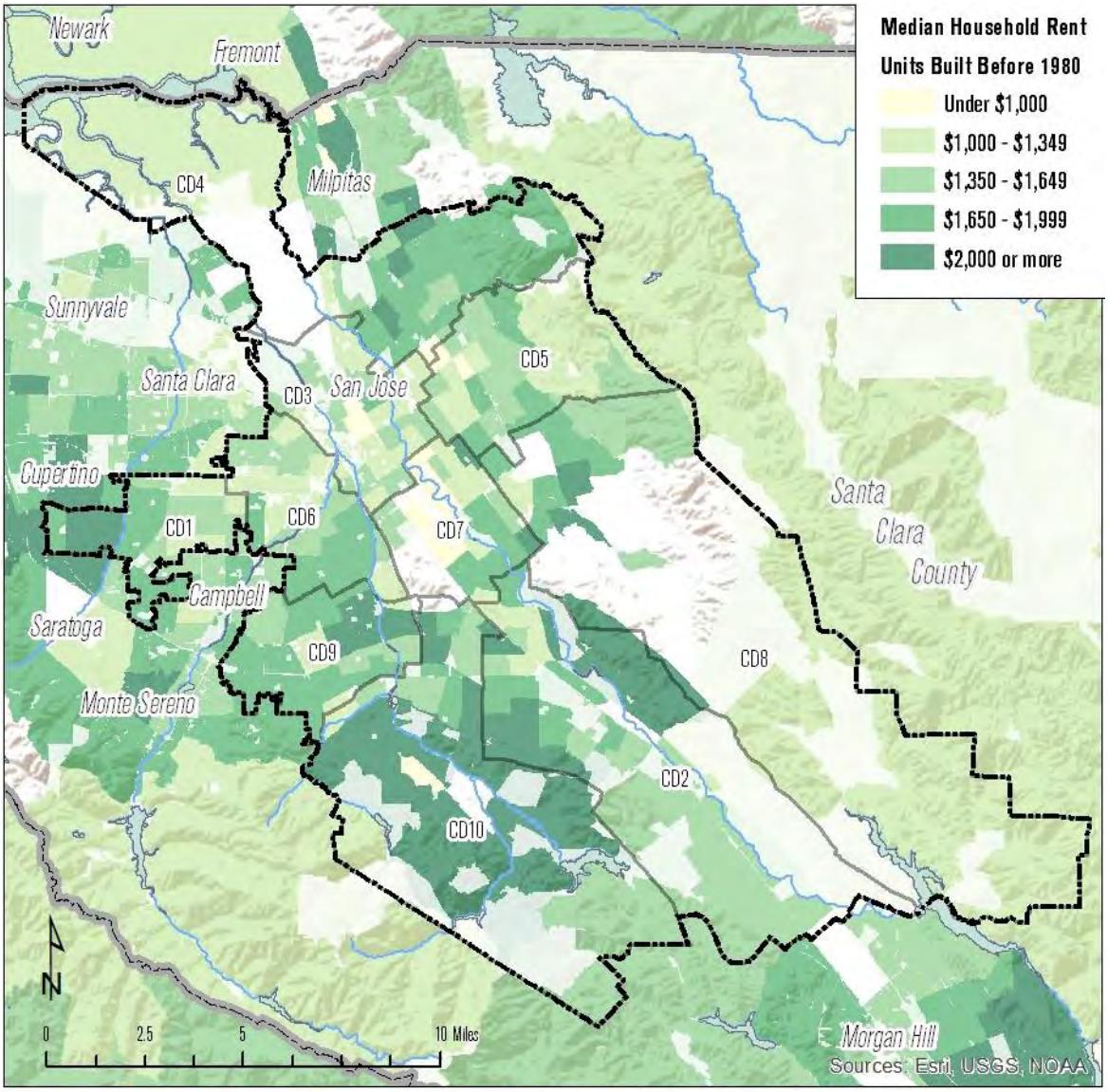
Sources: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Table B25068: Bedrooms by Gross Rent. Universe: Renter-occupied housing units. Notes: Data includes all rental housing, including ARO units, duplexes and rented condominiums, as well as units of all bedroom sizes.

81 percent of San José renters pay $1,000 per month

The following map reveals some isolated neighborhoods with median rent under $1,000 per month, and more numerous areas with median rents in excess of $2,000 per month (Figure 2.2). Median rents at $2,000 or above are found in the southern half of the City, as well as in communities that neighbor Cupertino and Milpitas. The San José metropolitan area (also known as the San José-Sunnyvale-Santa Clara, CA metropolitan statistical area, composed of Santa Clara and San Benito Counties) has had some of the lowest vacancy rate in the nation in recent years.[2] Median rents in the City of San José reflect this, with more residents competing for rental housing as the cost of owner-occupied housing has trended upwards despite the early 2000s dot-com recession (March 2001 to November 2001) and the "Great Recession" (December 2007 to June 2009).[3]

Adjusted for inflation, both ARO and non-ARO rents in the City of San José rose over the past two and half decades (Figure 2.3).[4] Median monthly rents for ARO housing units rose from $1,181 in 1990 to $1,308 in 2014, in adjusted dollars, an 11 percent increase.

Figure 2.2 – Median Household Rent, Pre-1980 Housing

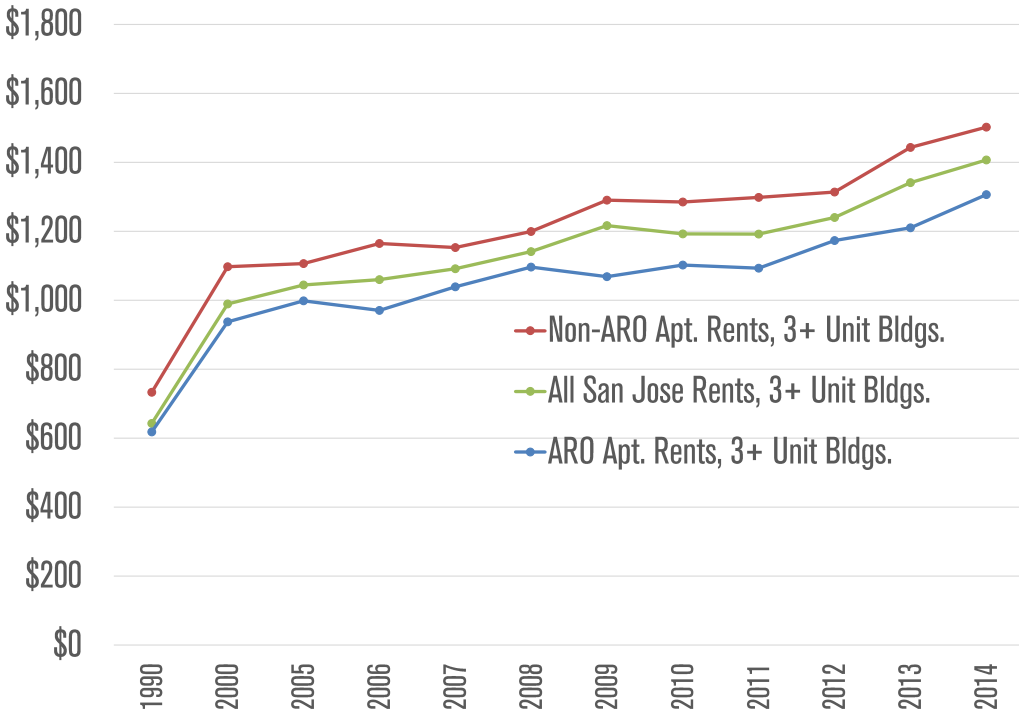


Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Table B25111 Median Gross Rent by Year Structure Built. Notes: Data includes all pre-1980 rental housing, including ARO units, duplexes, rented condominiums and other rented housing units, for all bedroom sizes. Geographic units displayed are census tracts, with City Council District boundaries overlaid for reference. Census tracts filled white (no color) indicate that either no or too few pre-1980 sample observations were available.

Median monthly rents for non-ARO housing units rose from $1,401 in 1990 to $1,504 in 2014, a 7 percent increase.[5] This data indicate that ARO rents grew at a faster rate than non-ARO rents, and that the differential of $196/month between ARO and non-ARO rents is relatively low in 2014. For both types of San José rental housing combined, rents rose from $1,228 in 1990 to $1,409 in 2014, in adjusted dollars, a 15 percent increase.[6]

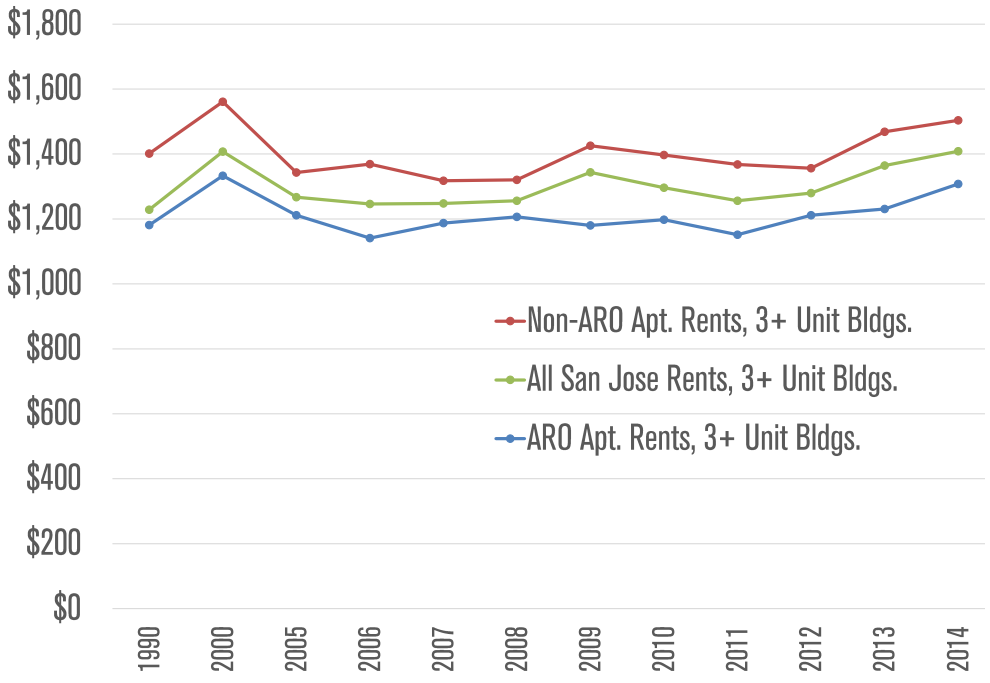
Historically, nominal median rent prices for ARO and non-ARO rental housing in San José have risen since 1990 (Figure 2. 3), although experiencing a brief slowdown in 2010 due to the Great Recession. Non-ARO median rents have recently been 15 percent higher than ARO median rents, although the gap was 21 percent in 2009. Adjusted for inflation to 2015 dollars, median rents in San José rose from 1990 to 2000, and but fell from 2000 to 2005, before rising in the lead up to the Great Recession and after (Figure 2.4). Nominal and adjusted rents have risen since 2011. Why? Although the California economy experienced a major, prolonged downturn in early- to mid-1990s[7], it was

Figure 2.3 – Median Gross Rent by ARO Status, City of San José, Unadjusted



San José median rents have risen since 1990, both for ARO and non-ARO units

Figure 2.4 – Median Gross Rent by ARO Status, City of San José, Adjusted for Inflation



Sources: U.S. Census Bureau, 1990 Census of Population and Housing, Public Use Microdata Set (PUMS); U.S. Census Bureau, 1990 Census of Population and Housing, PUMS; U.S. Census Bureau, 2005-2014 1-Year American Community Survey, PUMS: Median Gross Rent by Year Structure Built, Tenure and Units in Structure. All data adjusted to first-half 2015 dollars using the CPI-U for San Francisco-Oakland-San José, California. Data shown are for all bedroom sizes.

growing again in the late 1990s through the early-2000s "Dot-Com" boom. The early 2000s dot-com recession stifled the Northern California economy for several years, including housing rents, business sales, and worker earnings. Since 2012, however, median adjusted rents have risen somewhat or held steady.

2b. Household Incomes of ARO Renters

The median household income of ARO renters in San José has stagnated in the past decade, currently at 72 percent of its 2000 high water mark when adjusted for inflation (Figures 2.5 and 2.6). Non-ARO renters have fared somewhat better, currently at 78 percent of their level of highest earnings in 2000. The gap between ARO and non-ARO

Renter households' median incomes have stagnated since 1990

Figure 2.5 – Median Household Income by ARO Status, Unadjusted

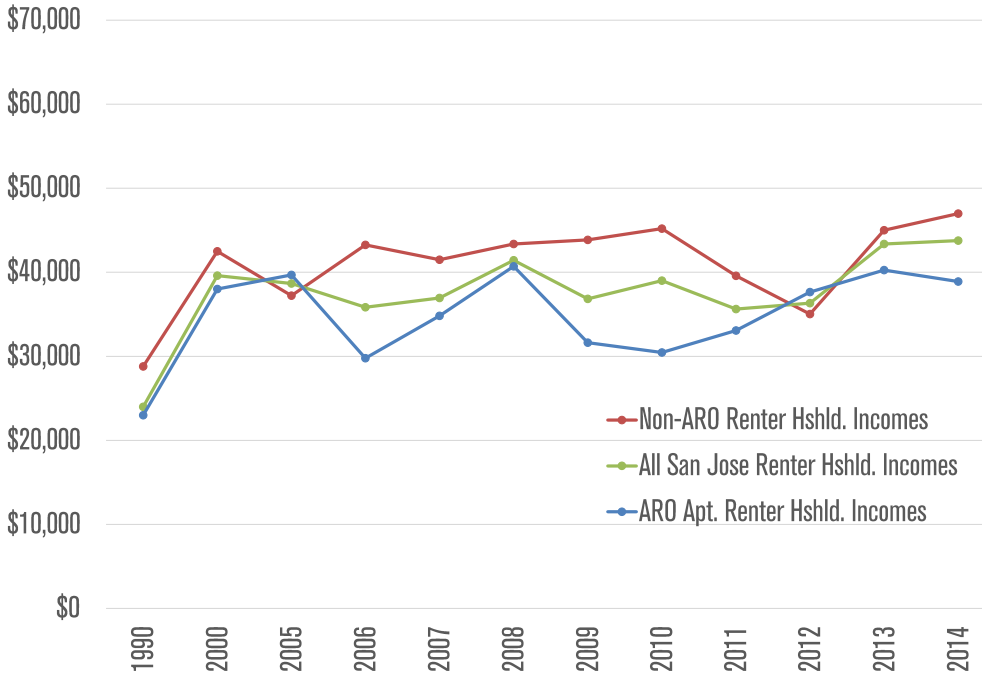
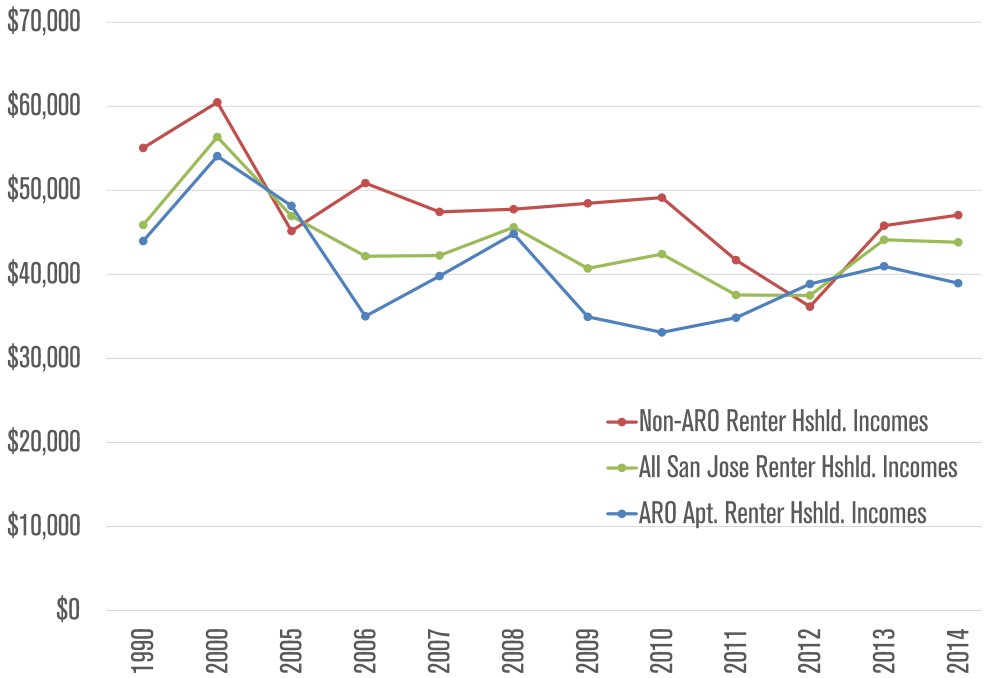


Figure 2.6 – Median Household Income by ARO Status, Adjusted for Inflation

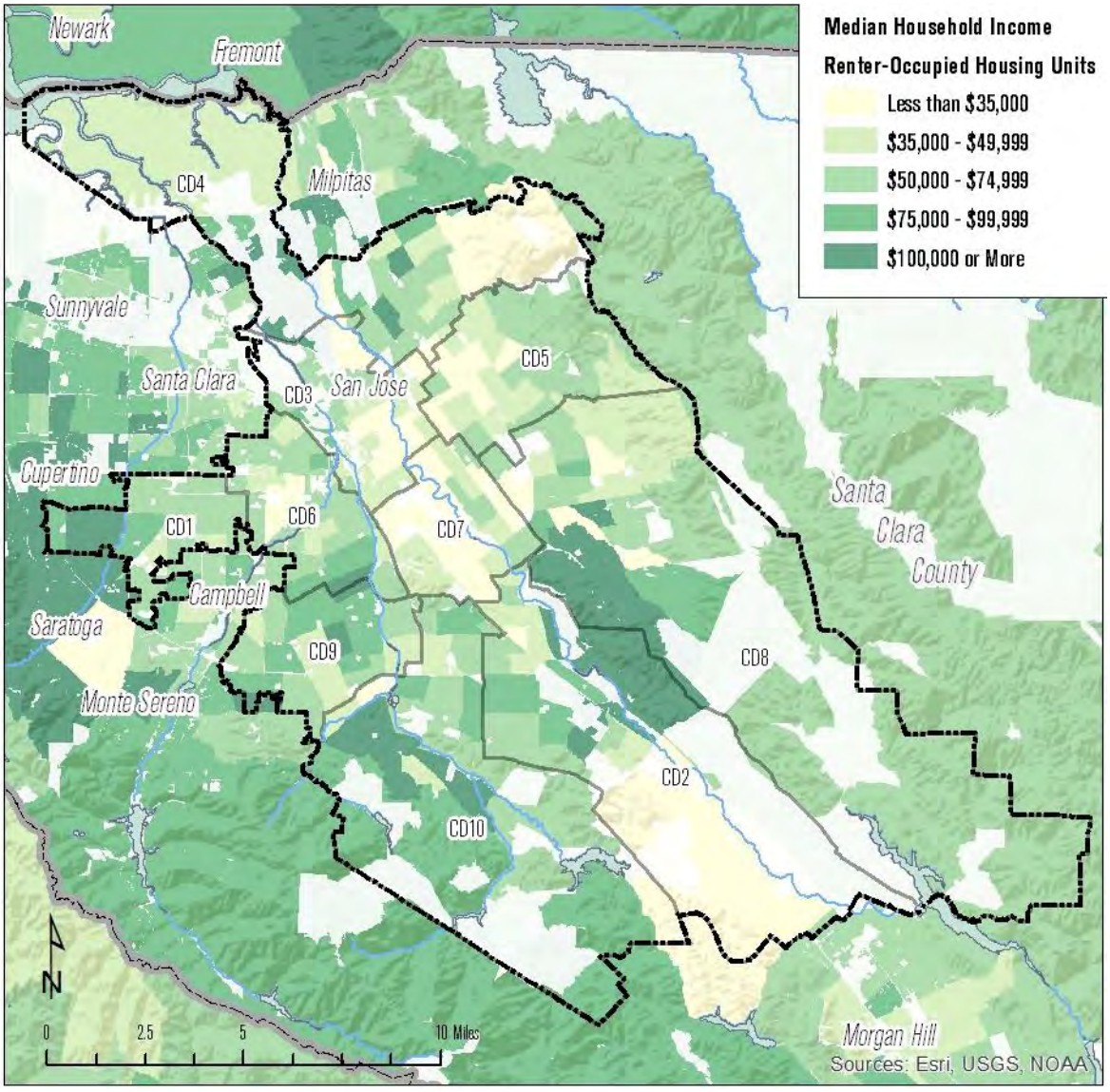


Sources: Economic Roundtable analysis; U.S. Census Bureau, 1990 Census of Population and Housing, Public Use Microdata Set (PUMS); U.S. Census Bureau, 1990 Census of Population and Housing, Public Use Microdata Set (PUMS); U.S. Census Bureau, 2005-2014 1-Year American Community Survey, Public Use Microdata Set (PUMS): Median Household Income by Year Structure Built, Tenure and Units in Structure. All data adjusted to first-half 2015 dollars using the CPI-U for San Francisco-Oakland-San José, California. Data shown is for all bedroom sizes.

renters' median annual household income now stands at just over $8,000, and non-ARO renter households have enjoyed an average of just under $7,300 more annual income than ARO households since 1990. The gap between ARO and non-ARO renters' median household incomes was at its widest in 2006 and 2010 – both times around $16,000 non-ARO renter households.

Across San José neighborhoods, the central part of the City has the lowest median renter household incomes, although pockets of low- and high-income areas exist across the City (Figure 2.7). By Council District, median renter household incomes range from just under $39,000 in CD 3 to over $77,000 in CD 10. By comparison, homeowners' median household incomes ranges from just over $77,000 in CD 7 to over $121,000 in CD 10. Citywide, the median household income for renters is $60,927, and $115,361 for homeowners.[8]

Figure 2.7 – Median Household Income of All Renters



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Table B25119 (Median Household Income the Past 12 Months by Tenure). White areas were unpopulated census blocks in 2010. Data shown are for all bedroom sizes. Universe: All renter-occupied housing units, including rented single-family homes, duplexes, condominiums and other rented housing; includes ARO and non-ARO units.

Comparing renter households' median monthly rent and median *monthly* income (converted from annual income) – for ARO, non-ARO and both renters combined – it is

clear that as rents have risen or held steady, incomes have stagnated or declined (Figures 2.8 and 2.9). This is situation for the median, or "middle," renter household in San José; the percentage of San José renter households paying an outsized share of their income for rent is discussed next.

Figure 2.8 – Median Monthly Gross Rent and Household Income by ARO Status, Unadjusted

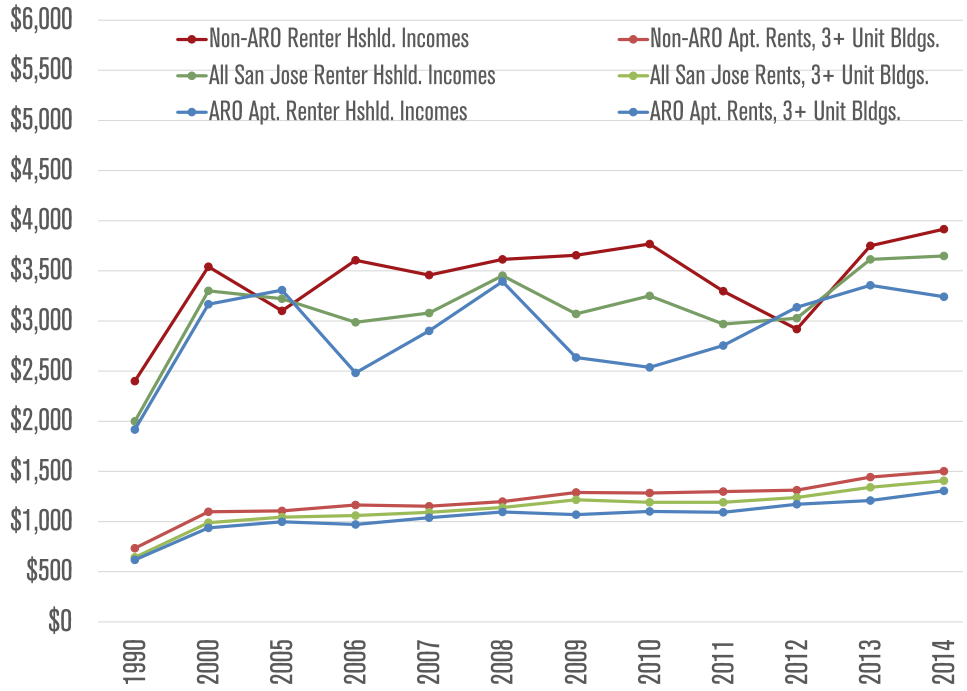
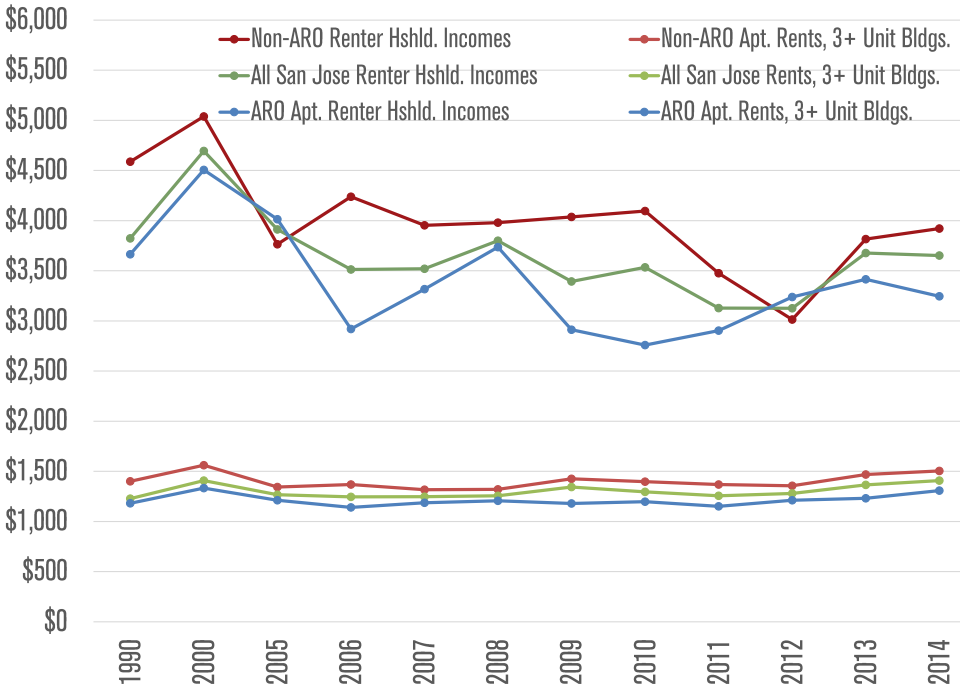


Figure 2.9 – Median Monthly Gross Rent and Household Income by ARO Status, Adjusted for Inflation

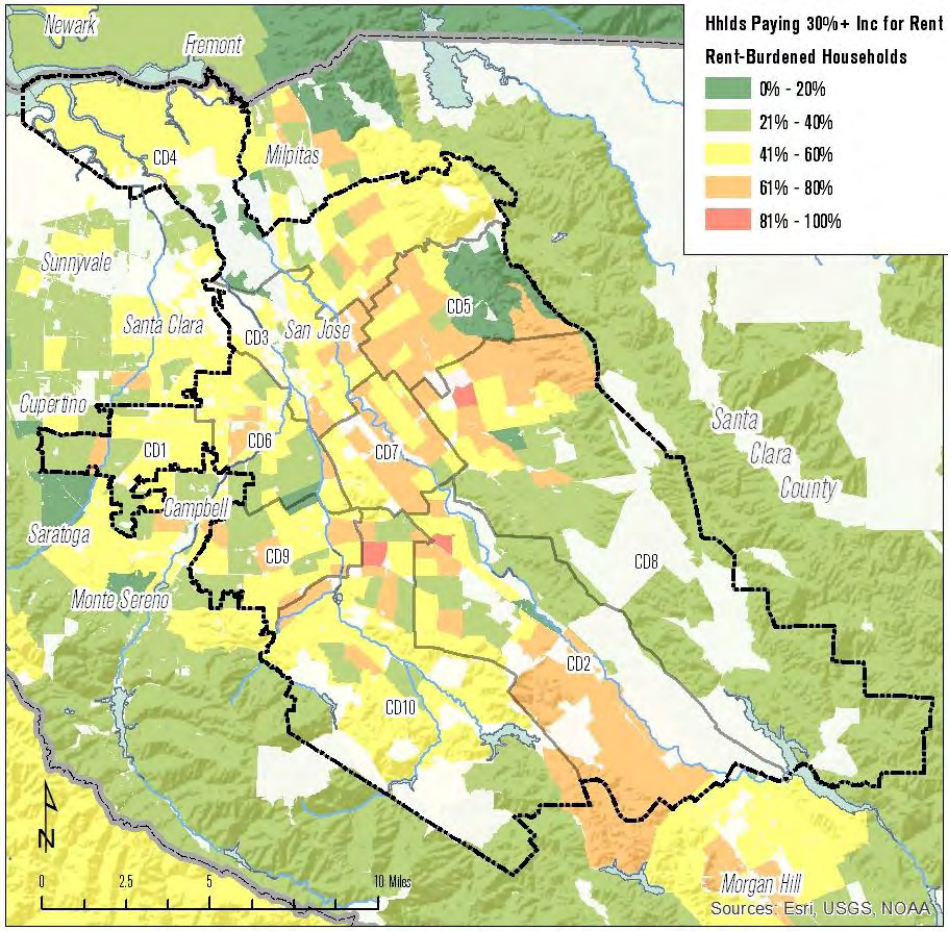


Sources: Economic Roundtable analysis; U.S. Census Bureau, 1990 Census of Population and Housing, Public Use Microdata Set (PUMS); U.S. Census Bureau, 1990 Census of Population and Housing, Public Use Microdata Set (PUMS); U.S. Census Bureau, 2005-2014 1-Year American Community Survey, Public Use Microdata Set (PUMS): Median Gross Rent and Median Household Income by Year Structure Built, Tenure and Units in Structure. All data adjusted to first-half 2015 dollars using the CPI-U for San Francisco-Oakland-San José, California. Data shown is for all bedroom sizes.

2c. Rent Burden

Rent burdened San José households, defined as those spending more than 30 percent of income on rent, stand out relative to other cities in the Santa Clara Valley (Figure 2.10).

Figure 2.10 – Percent of Households Paying 30 Percent or More of Income for Rent



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Table B25070, Gross Rent as a Percent of Household Income in the Past 12 Months. White areas were unpopulated in 2010.

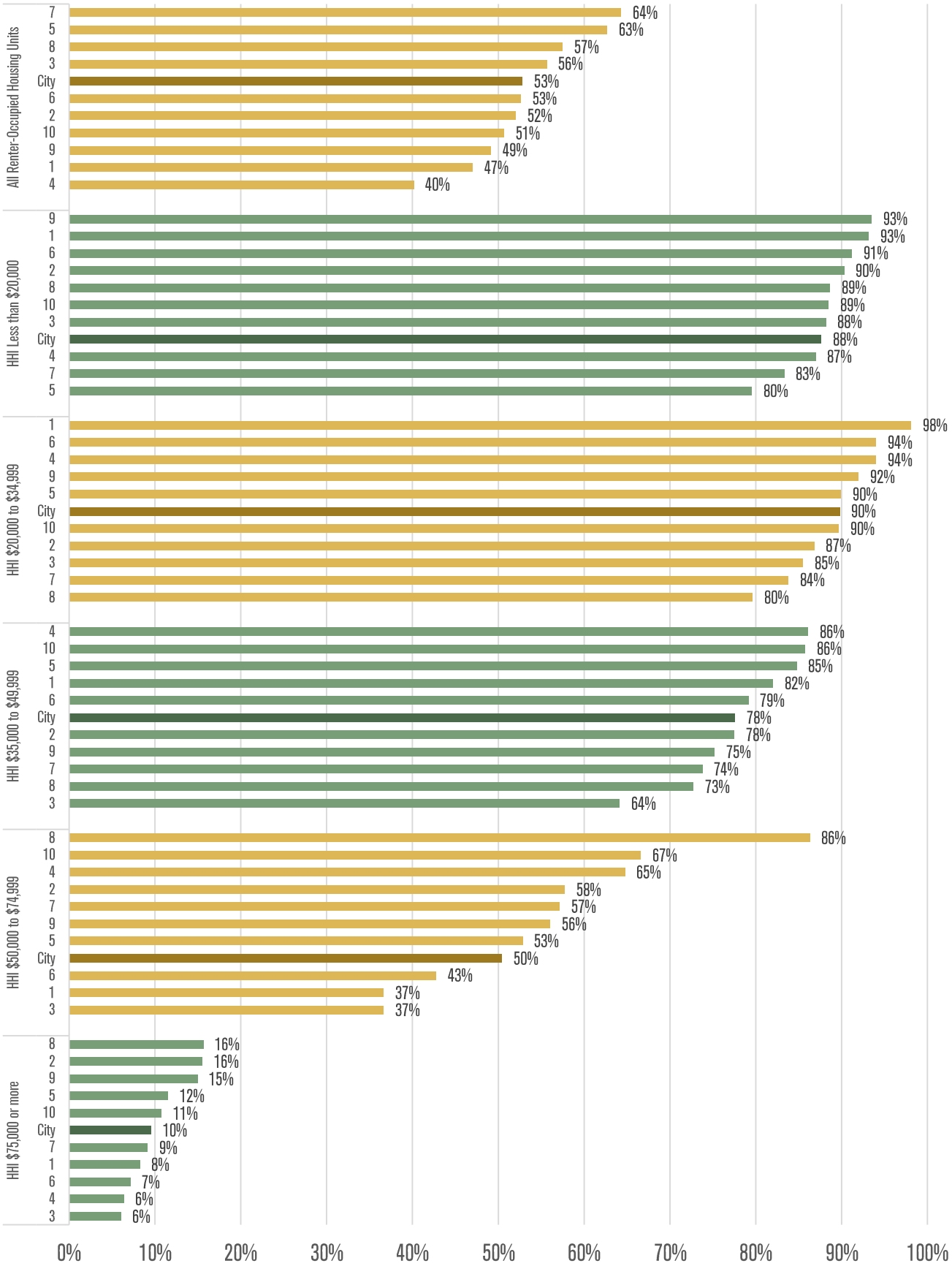
53 percent of San José renter households are rent burdened, paying 30 percent or more of their income on housing

Table 2.1 – Rent Burden: Percent of All Renter-Occupied Housing Units Paying 30 Percent or More of Household Income (HHI) for Rent

City Council District	All Renter-Occupied Housing Units	HHI Less than $20,000	HHI $20,000 to $34,999	HHI $35,000 to $49,999	HHI $50,000 to $74,999	HHI $75,000 or more
CD 1	47%	93%	98%	82%	37%	8%
CD 2	52%	90%	87%	78%	58%	16%
CD 3	56%	88%	85%	64%	37%	6%
CD 4	40%	87%	94%	86%	65%	6%
CD 5	63%	80%	90%	85%	53%	12%
CD 6	53%	91%	94%	79%	43%	7%
CD 7	64%	83%	84%	74%	57%	9%
CD 8	57%	89%	80%	73%	86%	16%
CD 9	49%	93%	92%	75%	56%	15%
CD 10	51%	89%	90%	86%	67%	11%
City Total	53%	88%	90%	78%	50%	10%

Sources: Economic Roundtable analysis; U.S. Census 2009-2013 American Community Survey 5-Year Estimates, B25106 Tenure by Housing Costs as a Percentage of Household Income in the Past 12 Months. Universe: All Renter-occupied housing units. Note: Renter-occupied housing units with "zero or negative income" and "no cash rent" are excluded from this table. Data shown is for all bedroom sizes.

Figure 2.11 – Rent Burden by Household Income and City Council District



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Table B25106 Tenure by Housing Costs as a Percentage of Household Income in the Past 12 Months. Universe: All Renter-occupied housing units. Note: Renter-occupied housing units with "zero or negative income" and "no cash rent" are excluded from this table. Data shown is for all bedroom sizes.

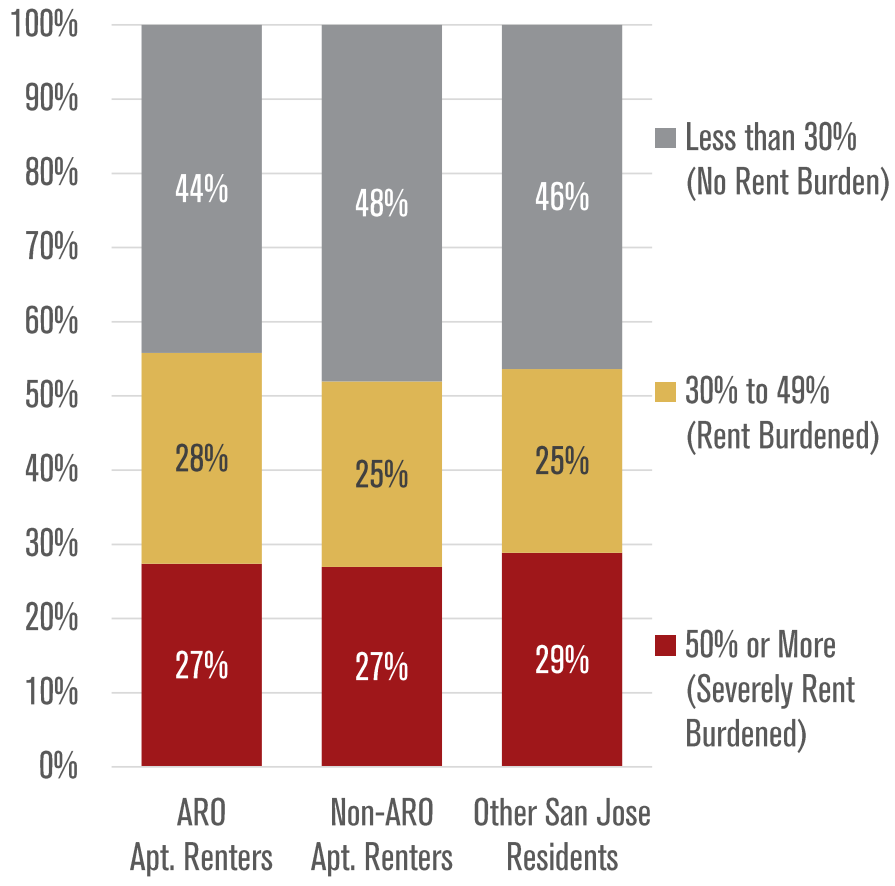
Fifty-three percent of all renter households in San José are rent burdened. Neighborhoods with higher shares of rent burdened households appear in CD 7 (64 percent), CD 5 (63 percent), CD 8 (57 percent) and CD 3 (56 percent). Table 2.1 and Figure 2.11 break out the percentages of rent burdened households in each Council District by household income. For households with less than $35,000 annual income, 80 to 96 percent of households are rent burdened, reflecting the difficulty in affording rental housing across the City. For households with higher incomes – $50,000 to $74,999 and $75,000 or more – the share of rent burdened households in each Council District declines significantly. One outlier is that 86 percent of renter households in CD 8 are rent burdened

53 percent of all renter households in San José are rent burdened

San José renter households living in ARO units are slightly more rent burdened than those in non-ARO apartments. Fifty-six percent of ARO renters pay 30 percent or more of their income for housing compared to 52 percent of non-ARO renters (Figure 2.12). Other San José residents (not renting in buildings with three or more units) experience rent burden similar to what ARO and non-ARO renters experience.

56 percent of ARO renters pay 30+ percent of their income for housing, compared to 52 percent of non-ARO renters

Figure 2.12 – Percent of Renter Households Experiencing Rent Burden and Severe Rent Burden, by ARO Status, City of San José



Sources: Economic Roundtable analysis; U.S. Census 2009-2013 American Community Survey 5-Year Public Use Microdata Sample (PUMS), Tenure by Year Built by Housing Costs as a Percentage of Household Income in the Past 12 Months. Universe: All Renter-occupied housing units. Notes: Renter-occupied housing units with "zero or negative income" and "no cash rent" are excluded from this table. Data shown is for all bedroom sizes. Owner-occupied households are excluded from the "Other San José Residents" group in this figure, since they do not rent their housing.

For comparison purposes, 53 percent of *all* San José renter households are rent burdened (27 percent severely rent burdened), 57 percent of all California renter households are rent burdened (30 percent severely rent burdened), and 52 percent of all renter households nationwide are rent burdened (27 percent severely rent burdened).[9]

2d. Overcrowding

San José has some of the worst rental overcrowding in the Santa Clara Valley

Overcrowded living conditions are detrimental to human wellbeing.[10] Overcrowding is measured using a ratio of occupants per room, including bedrooms, kitchens, living rooms, family rooms, and dining rooms, but excluding bathrooms, porches, balconies, foyers, halls, or half-rooms.[11] Overcrowding in rental housing may result from a shortage of units with more affordable rents, forcing renters to bring on more income earners to pool share the cost of housing, or from a general shortage of two- and three-bedroom units large enough to accommodate demand from families that rent. There are different standards for measuring overcrowding. To illustrate the definition of housing overcrowding using the federal standard as determined by the Department of Housing and Urban Development, three people occupying a one bedroom apartment with a kitchen and dining room are not overcrowded (3 people:3 rooms=1.0 ratio), but four people would be overcrowded (4:3=1.33), and five persons would be severely overcrowded (5:3=1.66).[12]

The percent of Santa Clara Valley households experiencing overcrowding varies from city to city, but the City of San José stands out with some of the highest rates of renter households in this condition (Figure 2.13). Sixteen percent of San José renter households are overcrowded, with six percent severely overcrowded. Only the City of Gilroy (20 percent overcrowded, with 6 percent severely overcrowded) and the Alum Rock neighborhood (30 percent overcrowded, with 4 percent severely overcrowded) rank higher. The Santa Clara County communities with the least amount of renter overcrowding are Monte Sereno, Loyola and Los Altos Hills.[13]

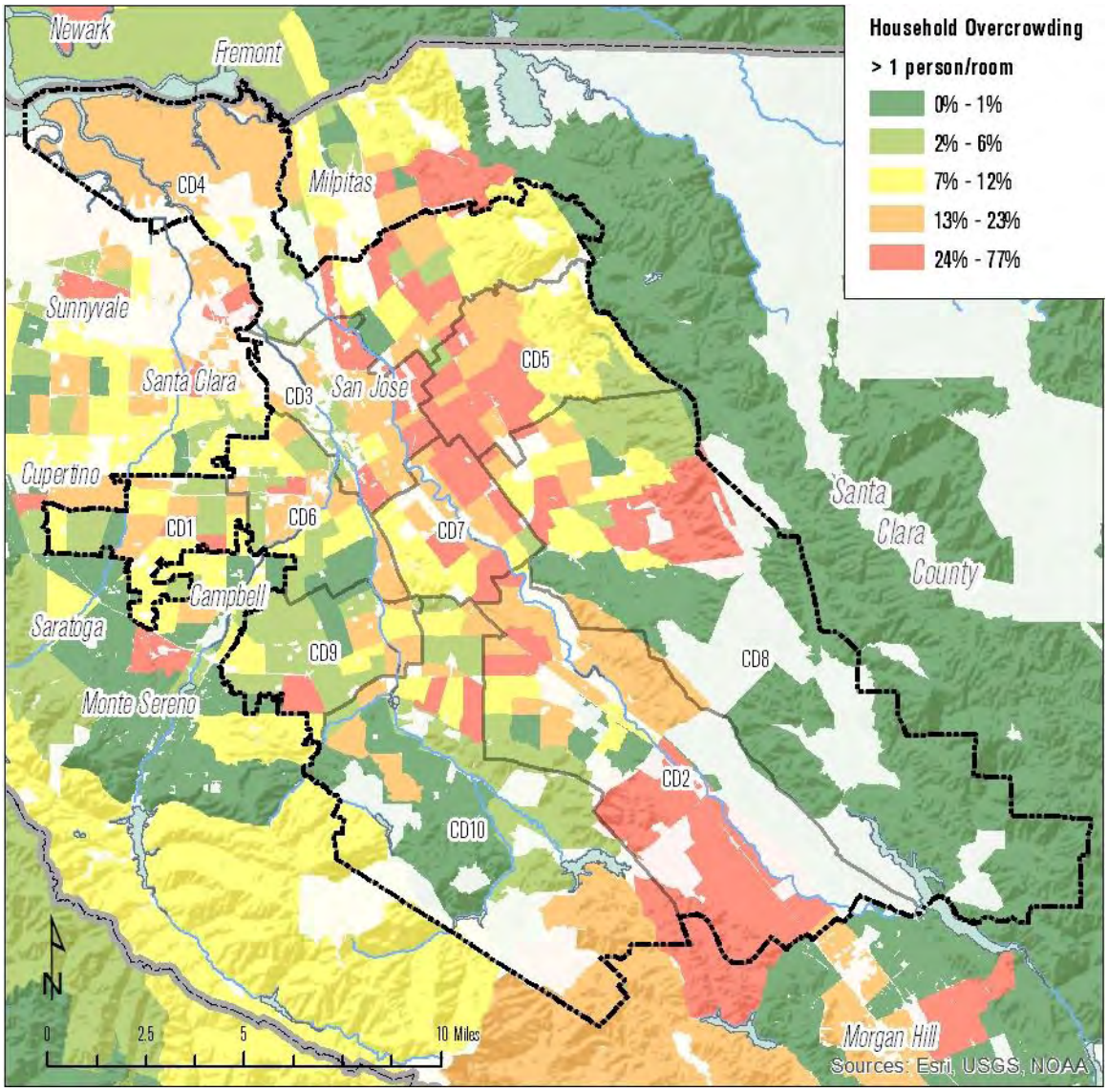
CD 5 had the highest rate of overcrowding (29 percent), followed by CD 7 (26 percent) (Table 2.2). These two districts also have the highest percentage of severely overcrowded renter households – 10 percent each. These rates are much higher than the aforementioned Citywide averages of 16 percent of renter housing units experiencing overcrowded living conditions, and six percent experiencing severe overcrowding. CD 9 is the only area with single-digit levels of renter housing unit overcrowding, seven percent overall with two percent experiencing severe overcrowding.

Table 2.2 – Overcrowding in All Renter-Occupied Housing Units, City of San José

City Council District	Not Overcrowded (< 1.01 occupants per room)	Overcrowded (1.01 to 1.50 occupants per room)	Severely Overcrowded (1.51 or more occupants per room)	All Overcrowded (1.01 or more occupants per room)
CD 1	87%	8%	4%	13%
CD 2	80%	13%	7%	20%
CD 3	81%	10%	9%	19%
CD 4	88%	7%	5%	12%
CD 5	71%	19%	10%	29%
CD 6	88%	9%	4%	12%
CD 7	74%	16%	10%	26%
CD 8	85%	12%	4%	15%
CD 9	93%	5%	2%	7%
CD 10	88%	6%	6%	12%
City Total	84%	10%	6%	16%

Sources: Economic Roundtable analysis; U.S. Census 2009-2013 American Community Survey 5-Year Estimates, B25014 Tenure by Occupants per Room. Universe: All renter-occupied housing units. Data in this figure are for all renters, regardless of year built, and in all types of rental housing, including single-family homes, duplexes, mobile homes, and condominiums.

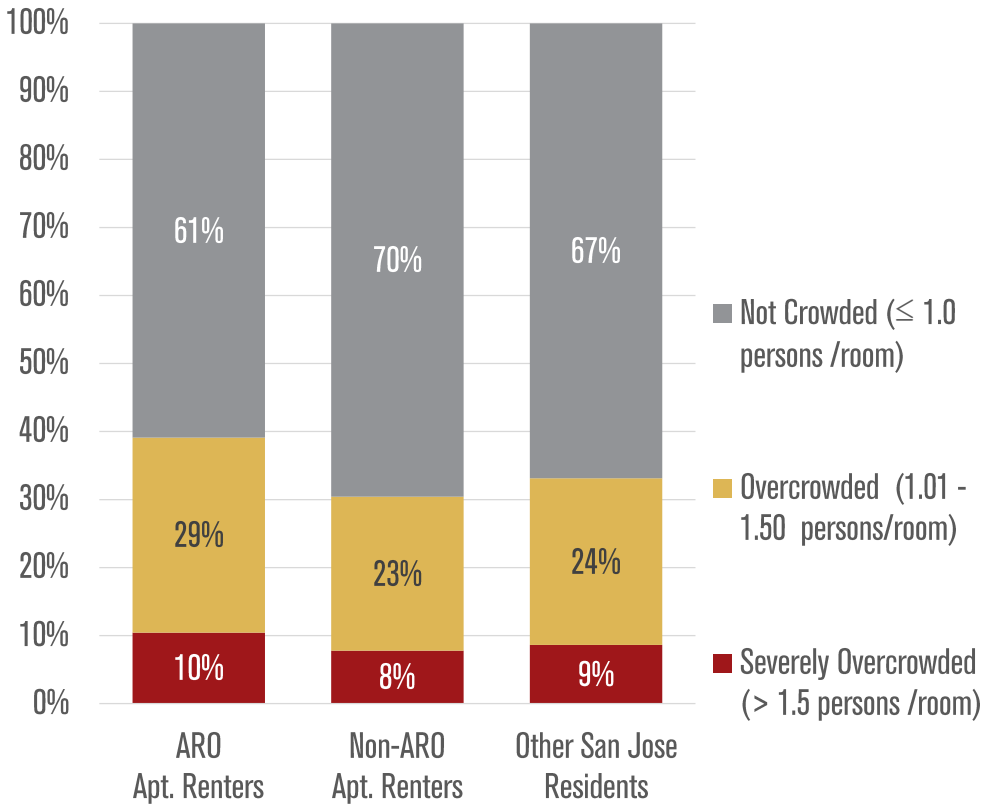
Figure 2.13 – Percent of Renter Households Experiencing Overcrowding



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, B25014 Tenure by Occupants per Room. Note: Data in this figure are for all renters, regardless of year built. Geographic units displayed are census tracts, with City Council District boundaries overlaid for reference. White areas were unpopulated census blocks in 2010.

San José ARO units have higher rates of overcrowding than those not covered by the Ordinance

Based upon the ARO status of renter households in the City of San José, there are higher rates of overcrowding in units covered by the Ordinance than those that are not (Figure 2.14). Thirty-nine percent of ARO units have more than one person per room, while 10 percent of those are severely crowded with greater than 1.5 persons per room. Other San José residents (including owner-occupied housing and those not renting in buildings with three or more units) more closely resemble the overcrowding conditions in non-ARO apartments.



Source: Economic Roundtable analysis; U.S. Census 2009-2013 American Community Survey 5-Year Public Use Microdata Sample (PUMS). Tenure by Year Built by Occupants per Room. Note: Overcrowded is 1.01 to 1.50 occupants per room, severely overcrowded is 1.51 or more occupants per room. Data in this figure distinguish between year built and type of rental housing, such as single-family homes, duplexes, mobile homes, and condominiums. See end notes for category definitions.

Summary of Findings

- Over the past 24 years, rent increases for ARO housing have exceeded those for non-ARO housing on both an absolute and percentage basis. Median rents for ARO housing units rose from $1,181 per month in 1990 to $1,308 in 2014, in adjusted dollars, an 11 percent increase. Median rents for non-ARO housing units rose from $1,401 in 1990 to $1,504 in 2014, a 7 percent increase.
- The gap between ARO and non-ARO rent levels has narrowed. Non-ARO median rents have recently been 19 percent higher than ARO median rents. While the non-ARO median rent was 21 percent higher than the ARO median rent in 2009, that gap has narrowed to just 15 percent by 2014.
- ARO renters have somewhat lower incomes than non-ARO renters. The gap between ARO and non-ARO renters' median household incomes was just above $8,000 in 2014, the latest year of data available. This gap was around $16,000 in 2006 and 2010, the largest it had been since 1990.
- In comparison, as rents have risen or held steady, renter households' incomes have stagnated or declined, for ARO, non-ARO and both renters combined.
- Renter households in ARO units are slightly more rent burdened than those in non-ARO apartments in San José. Fifty-six percent of ARO renters pay 30 percent or more of their income for housing compared to 52 percent of non-ARO renters.
- There are higher rates of overcrowding in units covered by the Apartment Rent Ordinance than those that are no. Thirty-nine percent of ARO units have more than one person per room versus 31 percent of non-ARO units, while 10 percent of ARO units are severely crowded with greater than 1.5 persons per room versus 8 percent of non-ARO units.

Endnotes

[1] Rent data in this report are actual gross rents reported by renters to the US Census Bureau, and not surveys of asking rents listed in newspaper or Craigslist ads. In the current American Community Survey program, respondents are asked "*What is the monthly rent for this house, apartment, or mobile home?*" The US Census Bureau defines Gross Rent as "*The amount of the contract rent plus the estimated average monthly cost of utilities (electricity, gas, and water and sewer) and fuels (oil, coal, kerosene, wood, etc.) if these are paid for by the renter (or paid for the renter by someone else). Gross rent is intended to eliminate differentials which result from varying practices with respect to the inclusion of utilities and fuels as part of the rental payment.*" Source: U.S. Census Bureau, *American Community Survey Design and Methodology Report* (January 2014), Version 2.0, January 30, 2014. See *Chapter 6. Survey Rules, Concepts and Definitions.* http://www.census.gov/programs-surveys/acs/methodology/design-and-methodology.html

[2] Kolko, Jed "All Those Vacant Homes" *Trulia Research Blog on Housing Policy*, November 6, 2013. Accessed at http://www.trulia.com/blog/trends/vacancy-rate/ on September 23, 2015. Table excerpted from the article, entitled "Metros with the Lowest Vacancy Rate" is as follows:

Rank	U.S. Metro	Vacancy rate, Oct 2013	Difference since Apr 2000
1	San José, CA	3.0%	0.3%
2	Ventura County, CA	3.4%	0.6%
3	Orange County, CA	3.9%	0.6%
4	Minneapolis–St. Paul, MN-WI	4.1%	1.5%
5	Denver, CO	4.4%	0.8%
6	San Francisco, CA	4.5%	0.6%
7	Middlesex County, MA	4.5%	1.7%
8	Bethesda-Rockville-Frederick, MD	4.7%	2.4%
9	Long Island, NY	4.7%	1.5%
10	Oakland, CA	5.1%	0.9%

[3] "*U.S. Business Cycle Expansions and Contractions*" National Bureau of Economic Research, http://www.nber.org/cycles.html

[4] In this chapter, the three comparison groups of San José residents are defined as follows:

ARO Apartment Renters:
- Live in San José, CA
- Live in buildings with 3+ units
- Pay cash rent for housing
- Live in buildings built 1979 or earlier

Non-ARO Apt. Renters:
- Live in San José, CA
- Live in buildings with 3+ units
- Pay cash rent for housing
- Live in buildings built 1980 or later

Note: Under City code, units that we categorize as "Non-ARO" are legally subject to Part 7 of the ARO, *Evictions from Certain Units Built after the Effective Date of this Chapter.*

Other San José Residents:
- Live in San José, CA
- Live in all other types of buildings, including single-family houses, duplexes, mobile homes or trailers, RVs or vans, etc. with 3+ units Mobile home or trailer
- Own their housing, occupy it without payment of rent, or are pay cash rent for housing (such as units in duplexes), but are not included in the prior two groups.
- Live in buildings built in any year, but are not included in the prior two groups.

[5] Other data sources, such as RealFacts, show significantly higher median rent levels in the City of San José than the US Census American Community Survey. Some of the reasons for this are that data sources differ due to different methodologies, sample sizes, and frequencies of data collection. In the case of median rents, the Census Bureau surveys renters while RealFacts surveys property owners. In this instance, the data from the US Census American Community Survey offers a more conservative estimate.

[6] These time series data are drawn from the U.S. Census Bureau, *1990 Census of Population and Housing*, Public Use Microdata Set (PUMS); U.S. Census Bureau, *2000 Census of Population and Housing*, Public Use Microdata Set (PUMS); U.S. Census Bureau, 2005-2014 1-Year *American Community Survey*, Public Use Microdata Set (PUMS): Median Gross Rent by Year Structure Built, Tenure and Units in Structure. All data adjusted to first-half 2015 dollars using the CPI-U for San Francisco-Oakland-San José, California. Custom tables using PUMS data are required for comparing ARO to non-ARO rental housing due to the specific types of units under the jurisdiction of the Apartment Rent Ordinance: Rental properties built and occupied prior to September 7, 1979, with three or more units.

[7] California's early- to mid-1990s recession was due to a combination of a national recession (July 1990 to March 1991) and cutbacks in national defense contracting that hit the local aerospace industry extremely hard. The subsequent mid-1990s period of stagnation strongly affected rental housing markets across the state, where vacancies rates soared and rent prices fell. See Flaming, Daniel et al. 1992. *Los Angeles County Economic Adjustment Strategy for Defense Reductions*, Economic Roundtable, April 1992. See also Myers, Dowell. 2007. "*Immigrants and Boomers: Forging a New Social Contract for the Future of America*" Russell Sage Foundation.

[8] U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Table B25119 (Median Household Income the Past 12 Months by Tenure) for San José City, California. Data are in 2014 Inflation-adjusted dollars:

	Estimate	Margin of Error
Total:	$87,210	+/-2,190
Owner occupied	$115,361	+/-3,138
Renter occupied	$60,927	+/-1,818

[9] Source: Economic Roundtable analysis; U.S. Census 2010-2014 American Community Survey 5-Year Estimates, Table B25070: Gross Rent as a Percentage of Household Income in the Past 12 Months. Universe: All Renter-occupied housing units.

[10] Econometrica, Inc. (2007), Measuring Overcrowding in Housing, prepared for the U.S. Department of Housing and Urban Development Office of Policy Development and Research.

[11] We utilize the HUD *Persons-Per-Room (PPR)* measure of overcrowding in this study. See the following review of overcrowding measures: Bethesda, Maryland (Econometrica, Inc.), Kevin S. Blake, Rebecca L. Kellerson, Aleksandra Simic (ICF International). 2007. "Measuring Overcrowding in Housing," Prepared for: U.S. Department of Housing and Urban Development, Office of Policy Development and Research.

[12] The three categories of occupants per room presented in section are:

- Not Crowded: A rental housing unit is considered adequate or not crowded when the number of rooms per unit corresponds with or exceeds the number of people in the household (≤ 1.0 persons /room).
- Overcrowded: A rental housing unit is considered crowded when the number of people in the household corresponds with or exceeds the number of rooms per unit (1.01 - 1.50 persons/room). A 5-person household that occupies a 1-bedroom apartment with a living room and kitchen (3 rooms) is considered to be living in overcrowded conditions.

- Severely Overcrowded: This is a further threshold of overcrowding, comparable to having 3 or more occupants living in a studio apartment with a kitchen (2 rooms) and 5 or more occupants in 1-bedroom apartment with a living room and kitchen (3 rooms) (> 1.5 persons /room). A 6-person household that occupies a 1-bedroom apartment with a living room and kitchen (3 rooms) is living in severely overcrowded conditions

[13] U.S. Census Bureau, 2009-2013 5-Year American Community Survey, American FactFinder Estimates by Place, Table B25014 Tenure by Occupants per Room.

Photograph by Patrick Burns, Race Street, San José, CA, January 28, 2016.

Chapter 3. San José Renter Demographics

3. San José Renter Demographics

3a. Data and Definitions

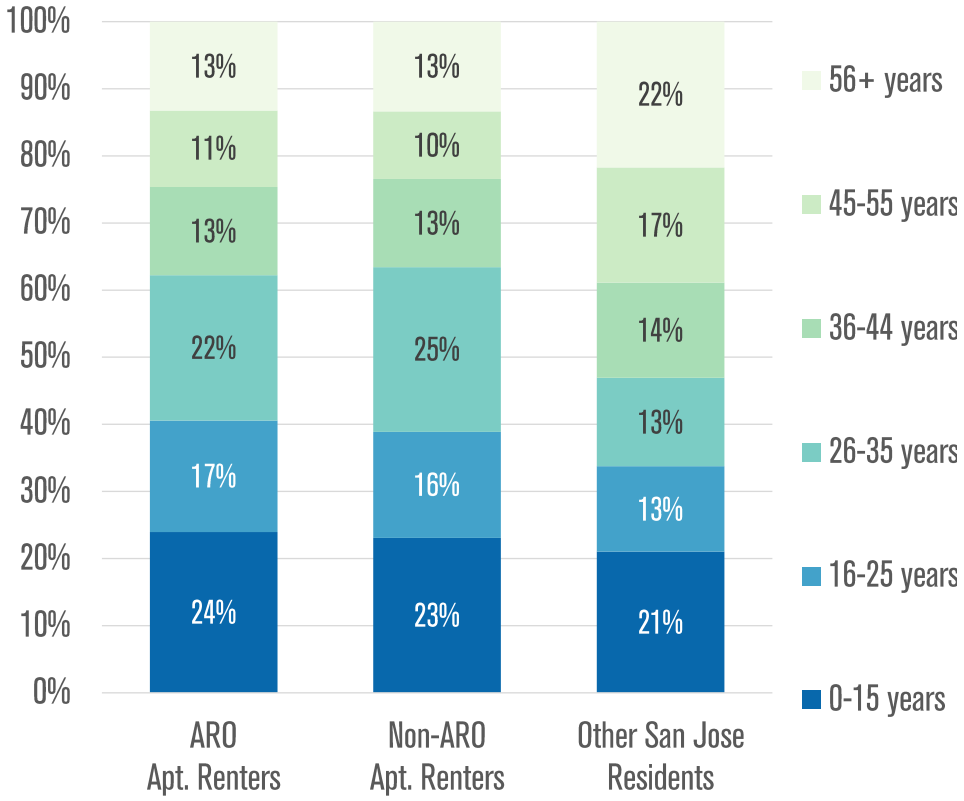
Most of the analysis in this and the prior chapter uses the U.S. Census Bureau's 5-Year and 1-Year American Community Survey (ACS) Estimates and Public Use Microdata Sample (PUMS) files. These ongoing federal surveys of population and housing conditions offer the largest sample sizes of San José households, the most recently released data, and the widest range of subject matter variables.[1] ACS data are used in public policy and academic research across the country.

Given the intricacies of San José's Apartment Rent Ordinance (ARO) and the irregular shape of its Council Districts (CD) and overall boundaries, we select Census variables, variable categories, and areas that best match "ARO Apartment Renters" in the City, as well as creating two comparison groups of our own: "Non-ARO Apartment Renters" and "Other San Jose Residents." Although not exact matches to San José's renters living in ARO units described inventoried in the previous chapter, they are extremely close and the best that these data allow. Please read the notes at the end of this chapter for detailed definitions of these three groups.[2]

3b. Age

Renters under the jurisdiction of San José's Apartment Rent Ordinance (ARO) are slightly younger than non-ARO renters, and significantly younger than San José's other residents (including those living in single-family houses, duplexes, condominiums and elsewhere) (Figure 3.1). ARO and non-ARO rental housing have greater shares of working-age residents and their children, while the City's other housing types are occupied by older residents 56 years of age or older (22 percent, compared to 13 percent for ARO and non-ARO renters).

Figure 3.1 – Age of ARO, non-ARO and other San José City Residents

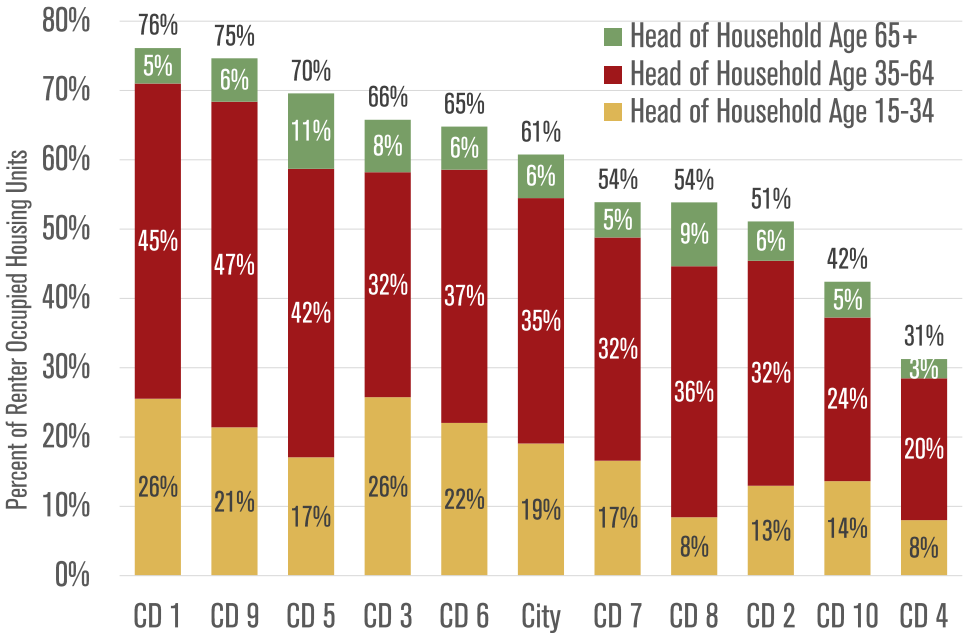


Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Public Use Microdata Sample (PUMS). All household residents included.

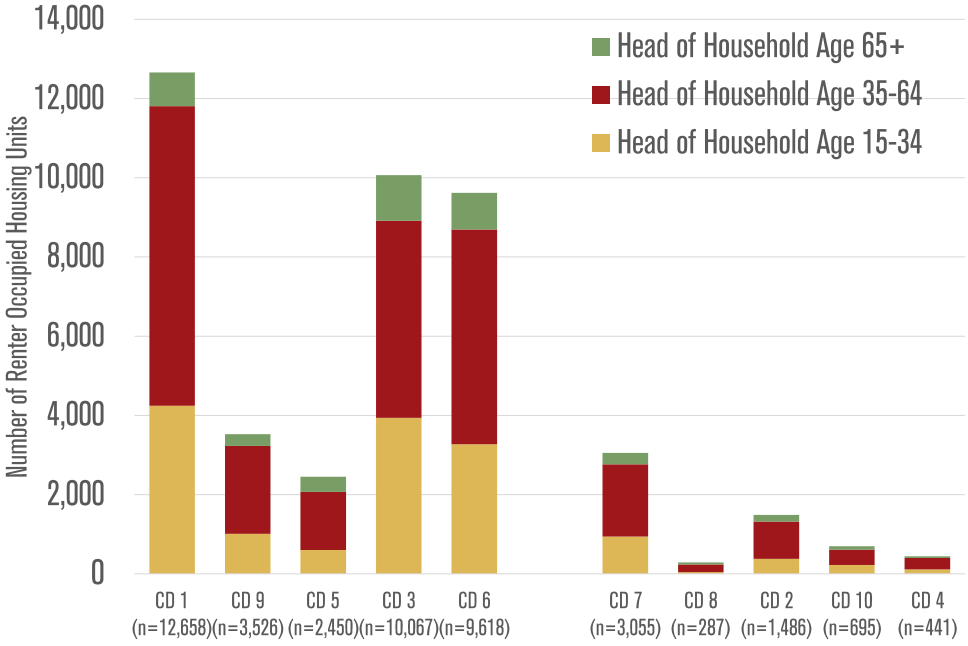
ARO housing units are occupied by greater shares of working-age residents and their children.

Across the City of San José, the age of the heads of households occupying rental housing units built before 1980 is similarly distributed (Figure 3.2). CD 1, CD 9, and CD 5 each have 70 percent or more of their rental housing inventories built before 1980, and only CD 5 has more than 10 percent of rental units inhabited by a householder age 65 or above. CD 1, CD 9, and CD 5 also have the largest shares of working-age renter householders occupying pre-1980 rental units – all over 40 percent. Citywide, 19 percent of pre-1980 rental housing units have a head of household age 34 or younger, 35 percent have a head of household age 35-64, and six percent have a head of household age 65 or

Figure 3.2 – Renters of Pre-1980 Housing, by Age of Householder and Council District, City of San José, Shown in Percent (above) and Number (below)



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Table B25126, Tenure by Age of Householder by Year Structure Built. Universe: Renter occupied housing units. Notes: Bars in top chart highlight all rental housing built before 1980, including duplexes not under the ARO; the balance of the bars not shown in the top chart are those in rental housing built 1980 or later.



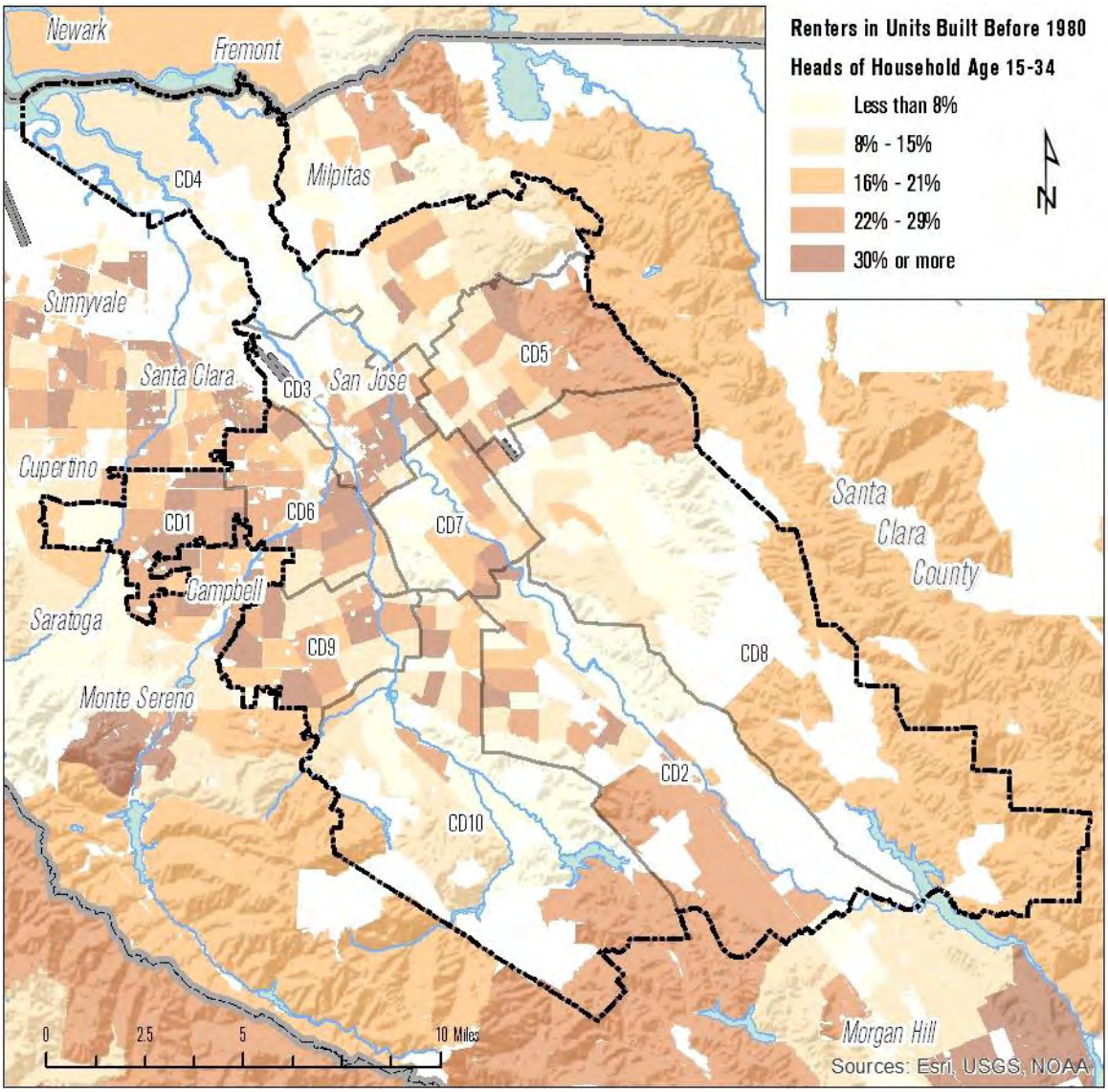
Source: City of San José Housing Department, Multiple Housing Roster (MHR) database, fall 2015. Notes: The bars and numbers in parenthesis below each bar show the numbers of ARO rental units per district, for reference with the top chart.

above. The approximate numbers of pre-1980 rental households by age of householder appears in the bottom half of Figure 3.2, using the *Multiple Housing Roster* as a basis.

Maps of San José showing the geographic distribution of pre-1980 rental unit occupants start with Figure 3.3, which highlights heads of households less than 35 years of age. This captures young worker households as well as those occupied by college students (San José State University, plus the City's four community colleges: San José City College, Mission College, Evergreen Valley College and West Valley College). CD 1, CD 3, CD 6 and CD 9 all have a preponderance of neighborhoods where young renters account for far more than 20 percent of all renter households.

Young renter households are 20 percent or more of CD 1, 3, 6 & 9

Figure 3.3 – Renter Households Living in Units Built before 1980 and Whose Head of Household is Age 15 to 34 Years, as a Percent of All Renter Households

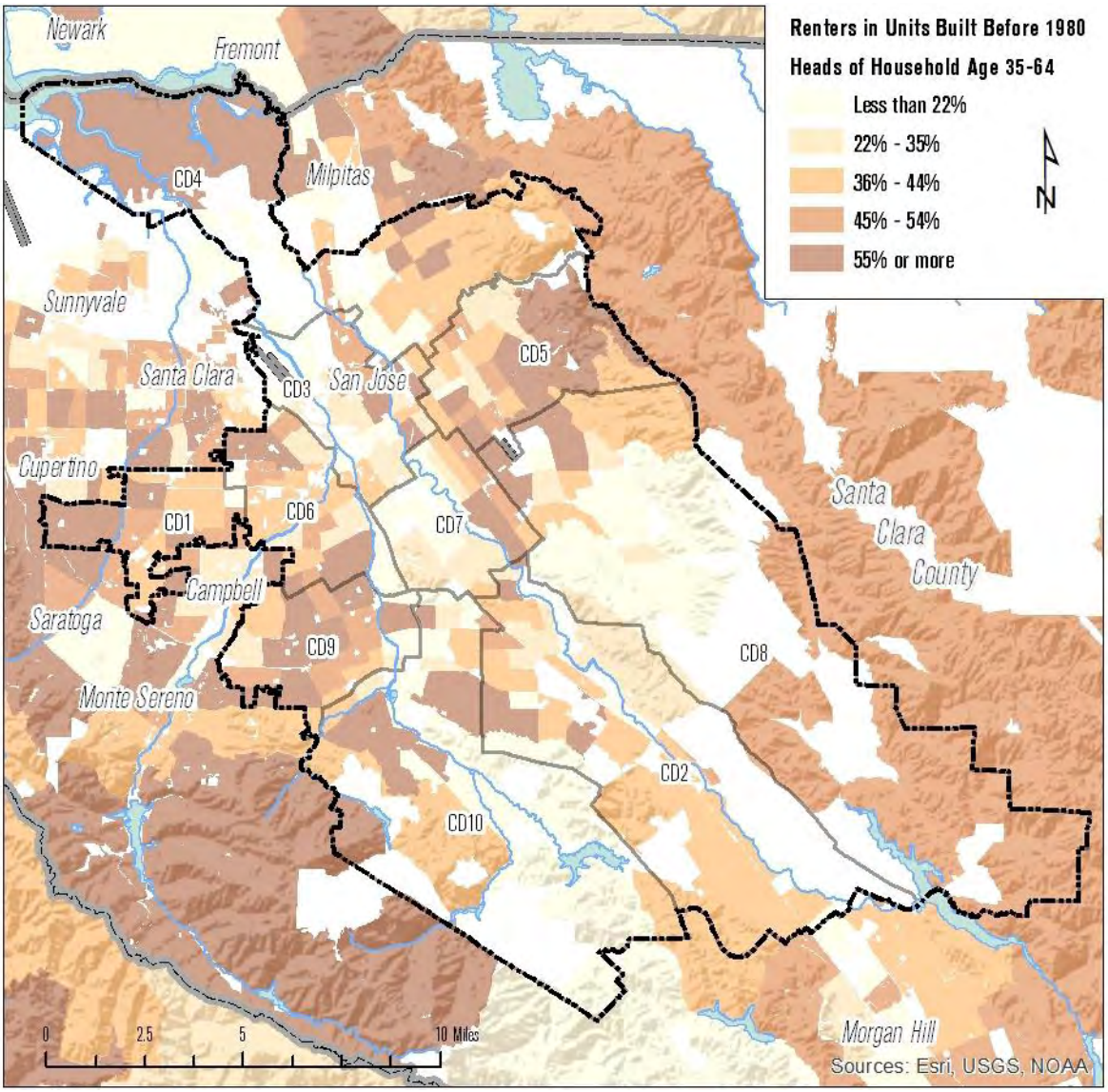


Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Table B25126, Tenure by Age of Householder by Year Structure Built. Universe: Renter occupied housing units. Notes: Geographic units displayed are Census tracts, with Council District boundaries overlaid for reference. Data includes all pre-1980 rental housing, including ARO units, duplexes, rented condominiums and other rented housing units. Census tracts filled white (no color) indicate that either no pre-1980 sample observations or too few pre-1980 sample observations were available, or were unpopulated portions of Census tracts in 2010.

The greatest share of age 35 to 64 renter households are in CD 1, 5 & 9

The map highlighting heads of households who are age 35 to 64 years of age appears in Figure 3.4. This captures middle- to older-worker households. Neighborhoods in CD 1, CD 5 and CD 9 have the greatest shares of renter households led by working-age residents of pre-1980 units, while other pockets of these households are visible across the City.

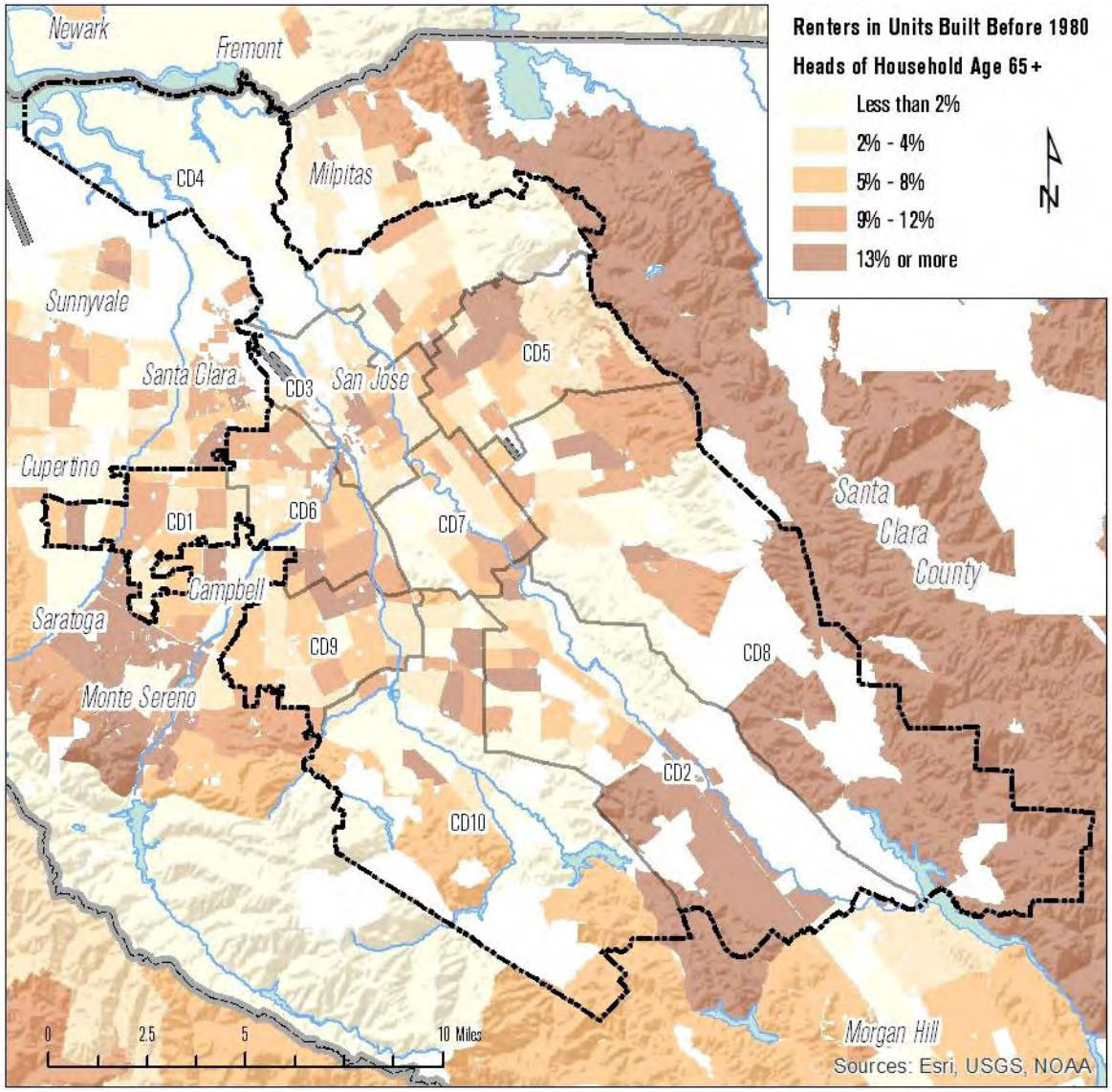
Figure 3.4 – Renter Households Living in Units Built before 1980 and Whose Head of Household is Age 35 to 64 Years, as a Percent of All Renter Households



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Table B25126, Tenure by Age of Householder by Year Structure Built. Universe: Renter occupied housing units. Notes: Geographic units displayed are Census tracts, with Council District boundaries overlaid for reference. Data includes all pre-1980 rental housing, including ARO units, duplexes, rented condominiums and other rented housing units. Census tracts filled white (no color) indicate that either no pre-1980 sample observations or too few pre-1980 sample observations were available, or were unpopulated portions of Census tracts in 2010.

The map highlighting heads of households who are age 65 or more years of age appears in Figure 3.5. This captures older-worker households, retiree households and those headed by the elderly. Neighborhoods in CD 2, CD 3, CD 5, CD 6 and CD 10 have the greatest shares of renter households led by these older residents of pre-1980 units, although other pockets of these households are visible across the City.

Figure 3.5 – Renter Households Living in Units Built before 1980 and Whose Head of Household is Age 65 or More Years, as a Percent of All Renter Households

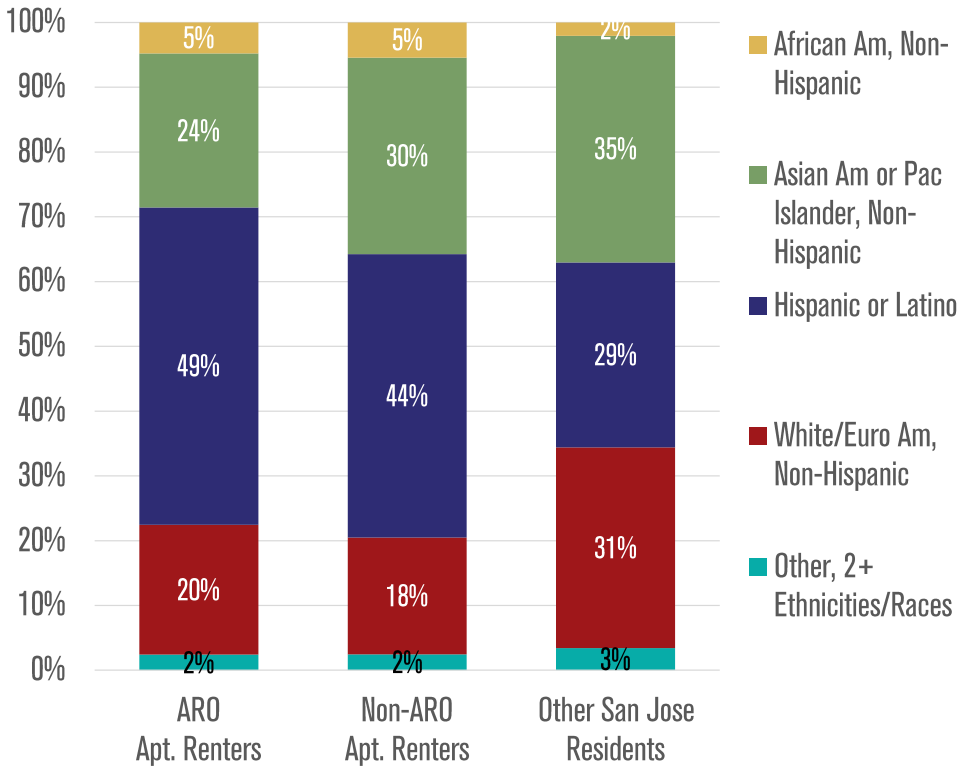


Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Table B25126, Tenure by Age of Householder by Year Structure Built. Universe: Renter occupied housing units. Notes: Geographic units displayed are Census tracts, with Council District boundaries overlaid for reference. Data includes all pre-1980 rental housing, including ARO units, duplexes, rented condominiums and other rented housing units. Census tracts filled white (no color) indicate that either no pre-1980 sample observations or too few pre-1980 sample observations were available, or were unpopulated portions of Census tracts in 2010.

3c. Race-Ethnicity

The racial-ethnic profile of renters living in the City of San José is very diverse. The plurality of ARO unit renters are Latino households (49 percent), with Asian American and Pacific Islander households constituting another 24 percent, White/European American households 20 percent, African American households five percent, and the balance made up of other households (Figure 3.6). Interestingly, Asian American and Pacific Islander households are a larger share of non-ARO than ARO rental households (30 versus 24 percent), and a still larger percent of non-renter households (35 percent) in the City. The share of White/European American households is also higher among non-renter households (31 percent), while Latino and African American households are smaller shares when non-renters are compared to renters, and when non-ARO occupants are compared to ARO occupants.

Figure 3.6 – Race-Ethnicity of San José Renter Residents, by ARO status

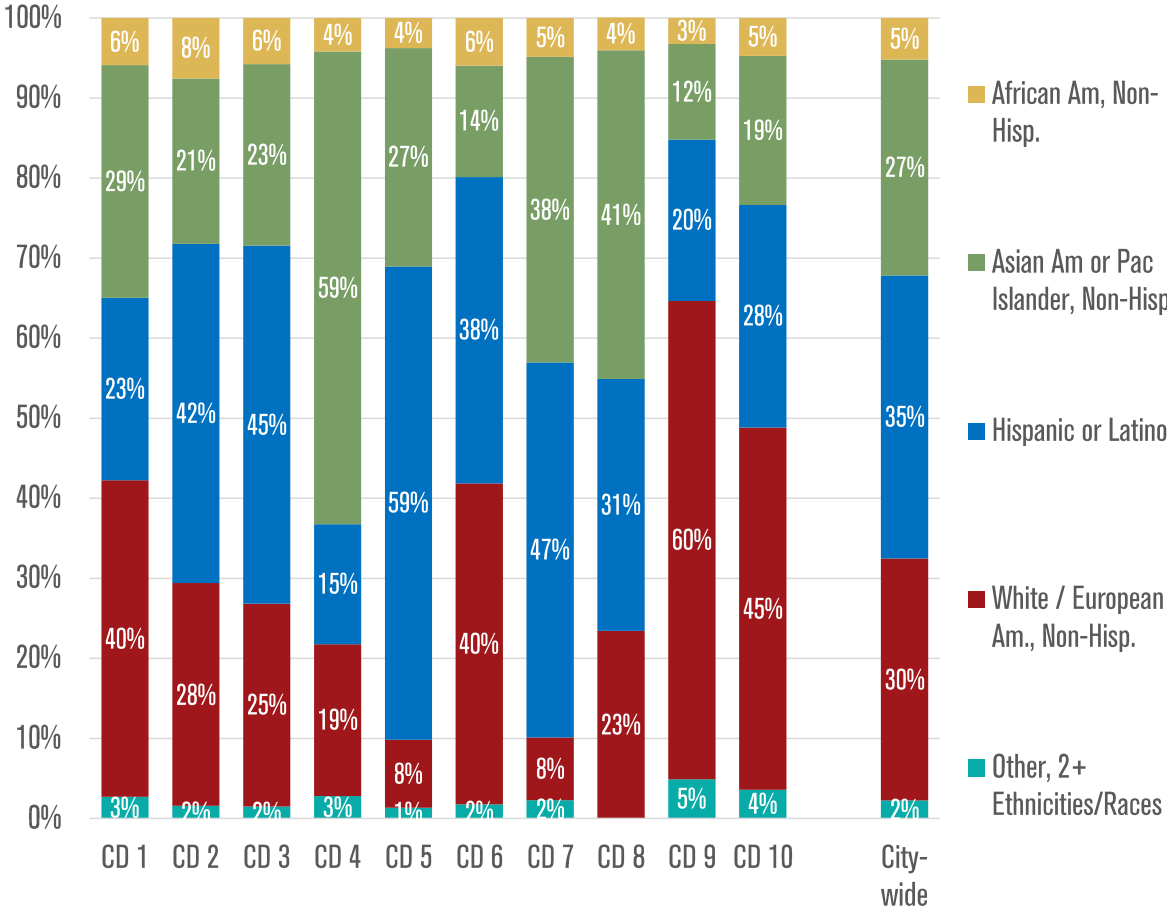


Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Public Use Microdata Sample (PUMS). Based upon recoding of RAC1P and HISP variables.

The distribution of San José renter households by Council Districts, broken out by race and ethnicity, is illustrated in Figure 3.7. Only three Council Districts have more than 50 percent – an absolute majority – of renter residents in one racial-ethnic group: CD 4 has an estimated 59 percent Asian American or Native Hawaiian or Pacific Islander renters, CD 5 has an estimated five 59 percent Hispanic or Latino renters, while an estimated 60 percent of CD 9 renters are White or European American. While these three Districts are home to three different racial-ethnic group majorities, the balance of San José is extremely diverse. Only its African American renter population, ranging from three to eight percent per district, and its renter population of American Indians, "Other Races," and "Two or More Races" are relatively small.

Only 3 city council districts have >50% of renters belonging to any one racial-ethnic group

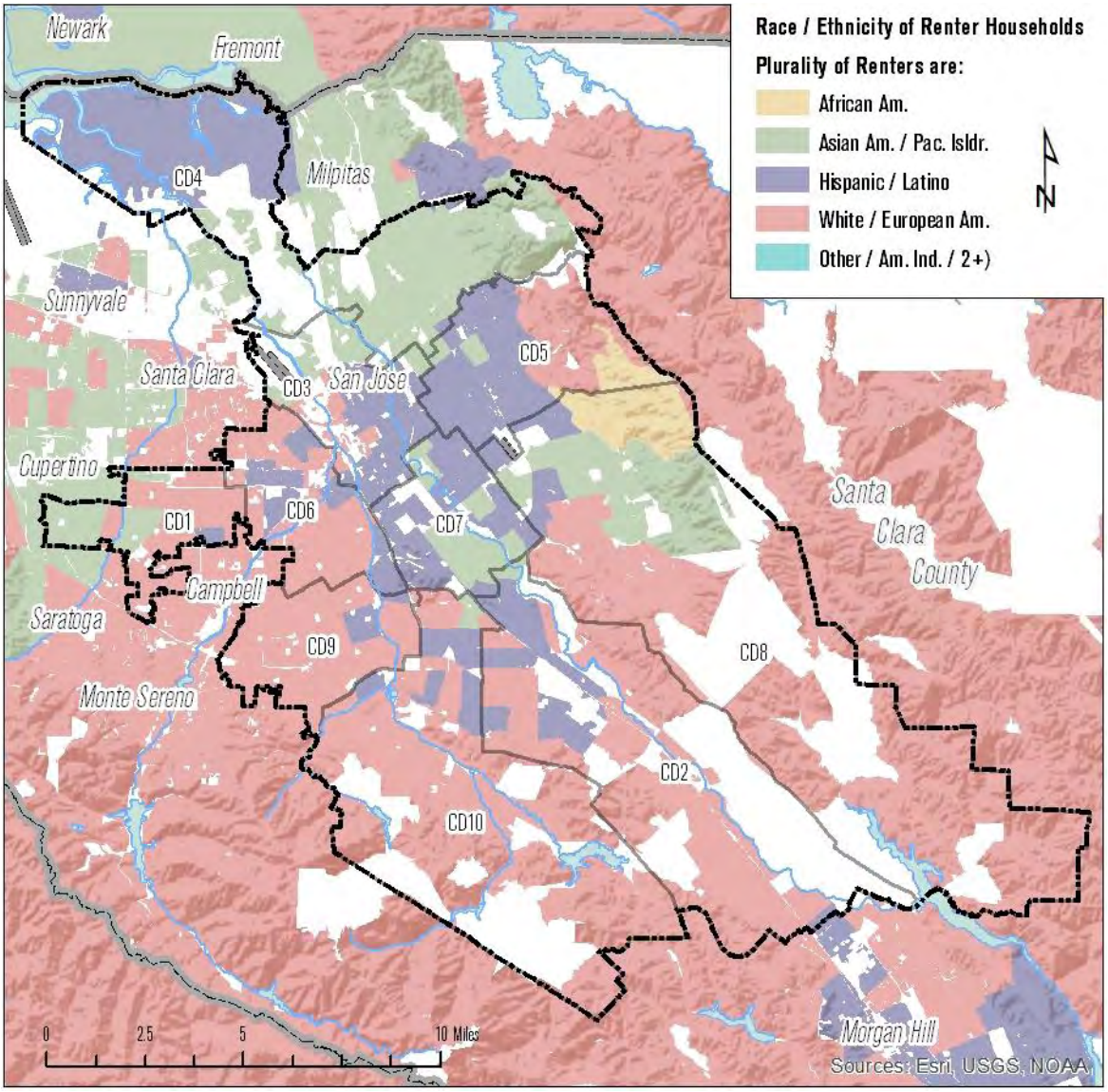
Figure 3.7 – Race-Ethnicity of the plurality of San José Renter Residents, by Census Tract



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Tables B25003a Tenure (White Alone Householder), B25003b Tenure (Black or African American Alone Householder), B25003c Tenure (Am Indian and Al Native Alone Householder), B25003d Tenure (Asian Alone Householder), B25003e Tenure (Native Haw and Other PI Alone Householder), B25003f Tenure (Some Other Race Alone Householder), B25003g Tenure (Two or More Races Householder), B25003h Tenure (White Alone, Not Hispanic or Latino Householder), B25003i Tenure (Hispanic or Latino Householder).

The geographic distribution of San José renter households, broken out by race and ethnicity, is further illustrated in a series of maps, starting with Figure 3.8 showing the race and ethnicity categories selected by a plurality of renter residents in each Census tract. Hispanic or Latino renters, followed by White/European American renters and Asian American households are the plurality of most Census tracts across the City of San José.

Figure 3.8 – Race-Ethnicity of the plurality of San José Renter Residents, by Census Tract

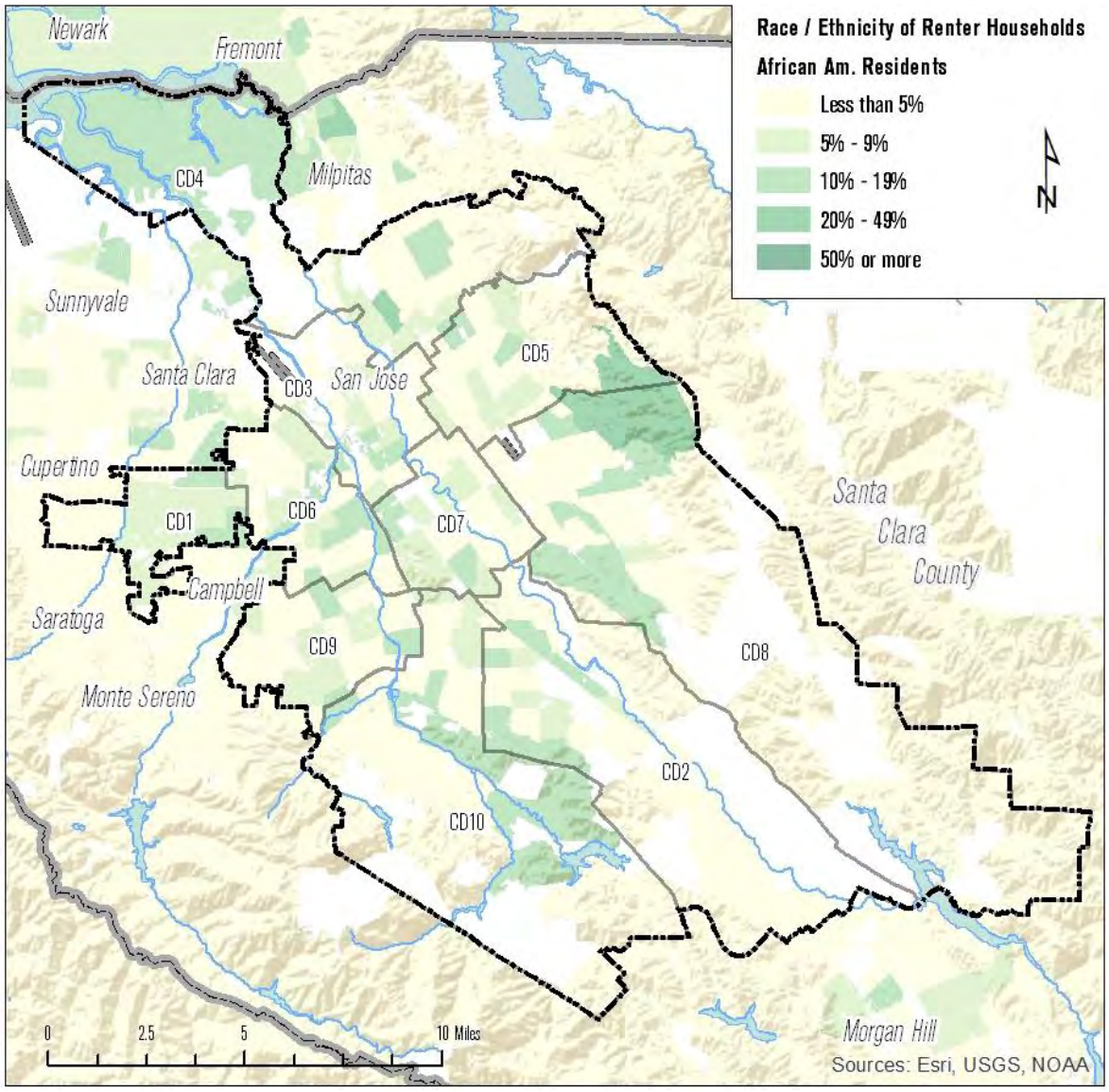


Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Tables B25003a Tenure (White Alone Householder), B25003b Tenure (Black or African American Alone Householder), B25003c Tenure (Am Indian and Al Native Alone Householder), B25003d Tenure (Asian Alone Householder), B25003e Tenure (Native Haw and Other PI Alone Householder), B25003f Tenure (Some Other Race Alone Householder), B25003g Tenure (Two or More Races Householder), B25003h Tenure (White Alone, Not Hispanic or Latino Householder), B25003i Tenure (Hispanic or Latino Householder). Map areas filled white (no color) were unpopulated Census blocks in 2010.

Individual maps follow this one showing the geographic sub-groups of San José renter households:

The geographic distribution of African American San José renter households appears in Figure 3.9, at the Census tract level. These are renter households that responded "No, not Spanish/Hispanic/Latino" and who reported "Black" or "African American" as their only entry in the American Community Survey's race question.

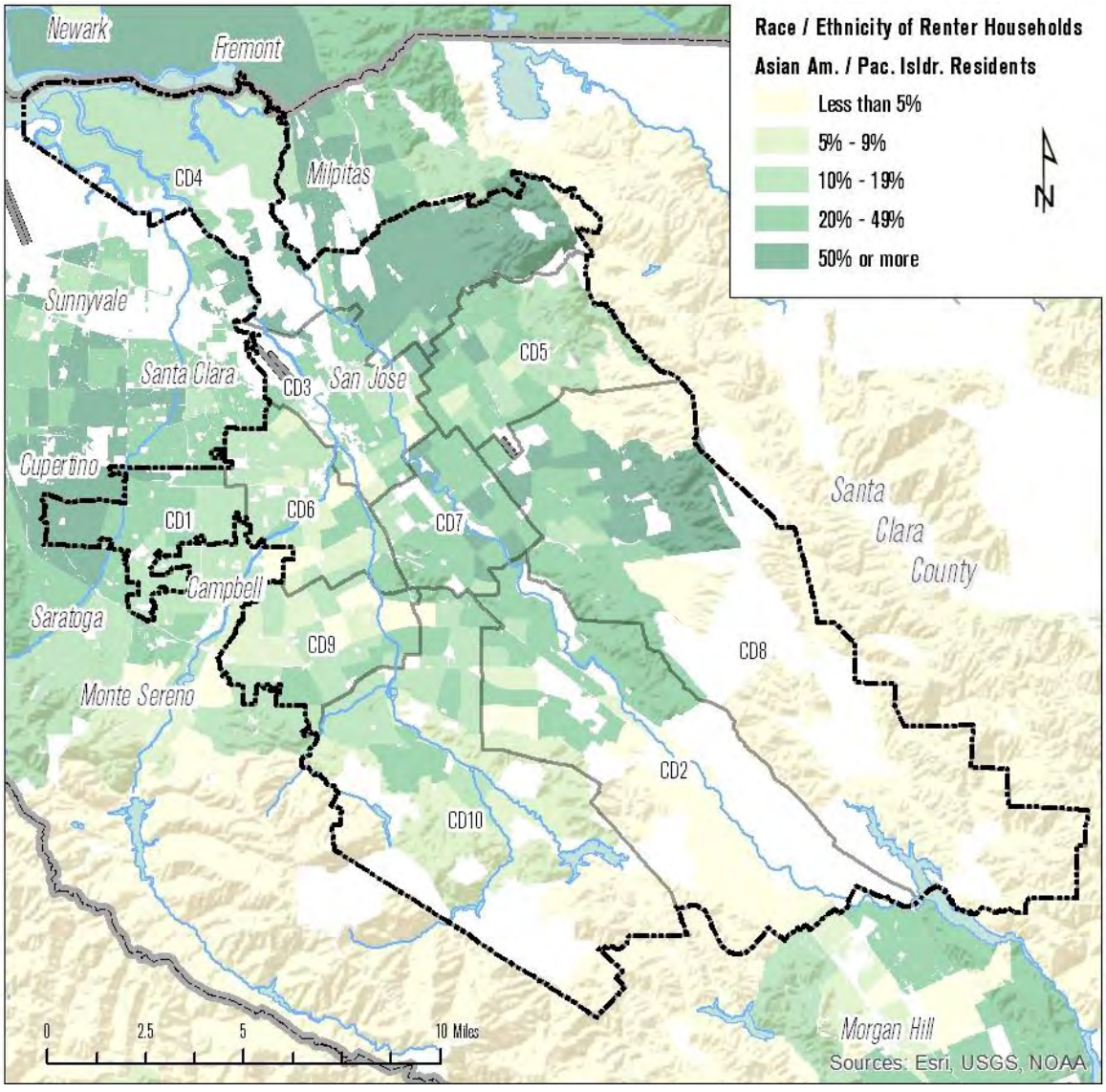
Figure 3.9 – African American Renter Households, as a Percent of All San José Renter Residents



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Tables B25036 Tenure by Year Built, B25003b Tenure (Black or African American Alone Householder). Notes: Data includes renters in all types of rental units, ARO and non-ARO, plus duplexes. Geographic units are Census tracts. Map areas filled white (no color) were unpopulated Census blocks in 2010.

The geographic distribution of Asian American and Pacific Islander San José renter households appears in Figure 3.10, at the Census tract level. These are renter households that responded "No, not Spanish/Hispanic/Latino" and who reported their race as "Asian American" or "Pacific Islander." Geographic origins of Asian American residents or their ancestors include South, Southeast and East Asia, while those of Pacific Islanders refers to those with ancestry in Polynesia, Melanesia, and Micronesia.

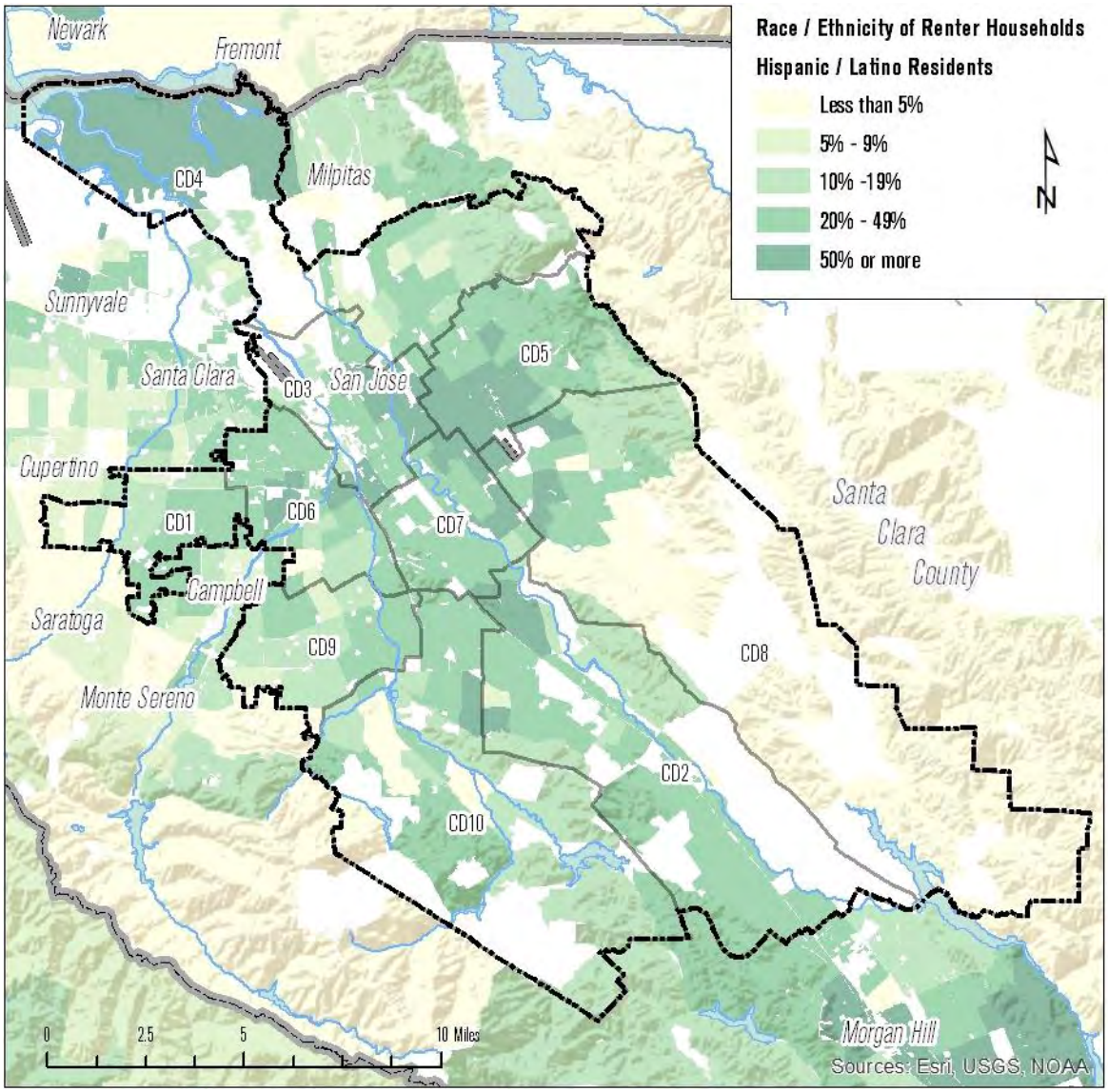
Figure 3.10 – Asian American and Pacific Islander Renter Households, as a Percent of All San José Renter Residents



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Tables B25036 Tenure by Year Built, B25003d Tenure (Asian Alone Householder). Notes: Data includes renters in all types of rental units, ARO and non-ARO, plus duplexes. Geographic units are Census tracts. Map areas filled white (no color) were unpopulated Census blocks in 2010.

The geographic distribution of Hispanic or Latino San José renter households appears in Figure 3.11, at the Census tract level. Hispanic or Latino origin can be the heritage, nationality, lineage, or country of birth of the person or the person's parents or ancestors before arriving in the United States. People who identify as Hispanic, Latino, or Spanish may be any race. Geographic origins can include Mexico, Puerto Rico, and Spanish-speaking countries of Central America, South America, or the Caribbean.

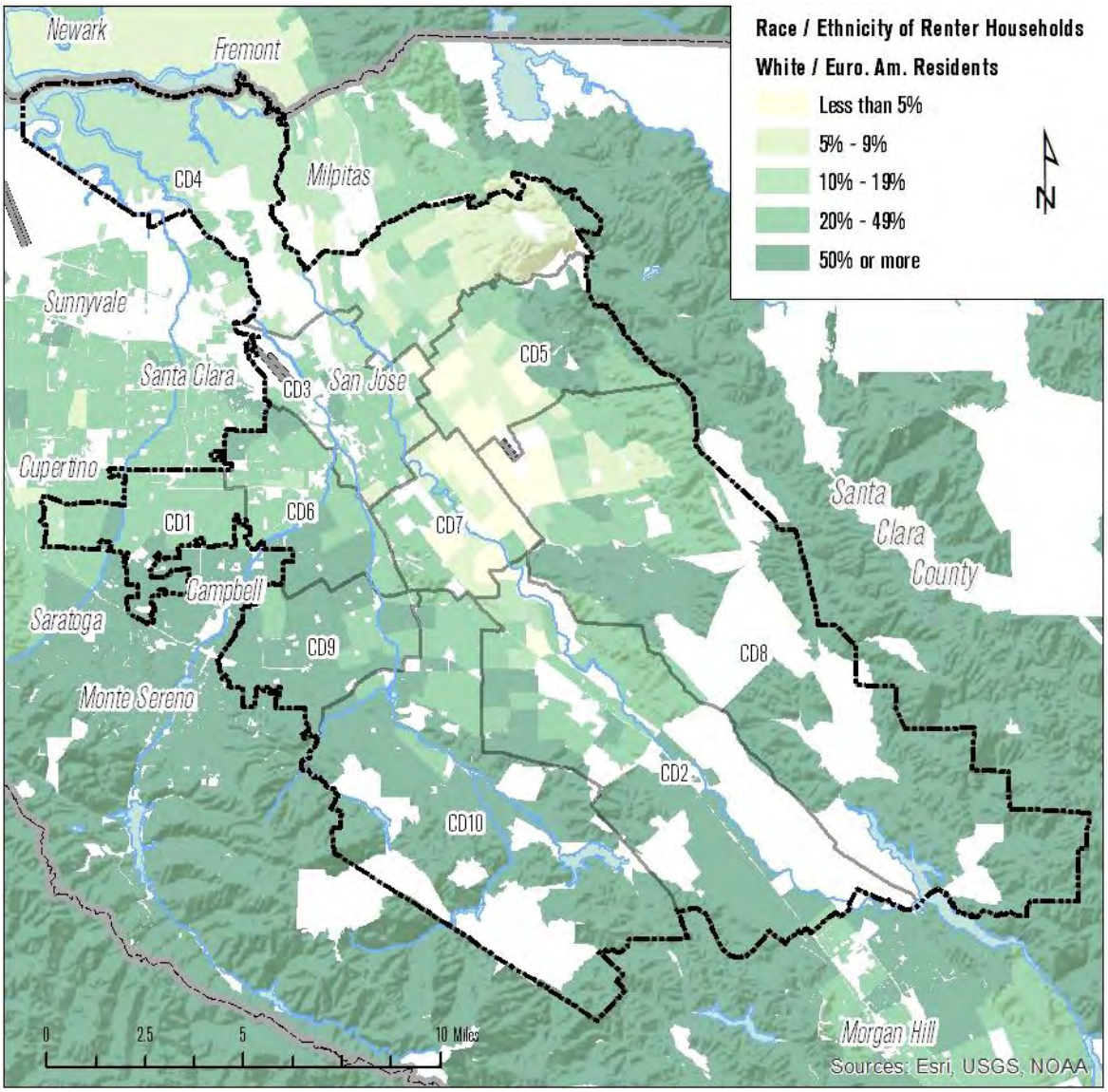
Figure 3.11 – Hispanic or Latino Renter Households, as a Percent of All San José Renter Residents



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Tables B25036 Tenure by Year Built, B25003i Tenure (Hispanic or Latino Householder). Notes: Data includes renters in all types of rental units, ARO and non-ARO, plus duplexes. Geographic units are Census tracts. Map areas filled white (no color) were unpopulated Census blocks in 2010.

The geographic distribution of White or European American renter households in San José is shown in Figure 3.12, at the Census tract level. These are renter households who responded "*No, not Spanish/Hispanic/Latino*" and who reported "*White*" as their only entry to the race question. This includes renters or their ancestors with origins in Europe, the Middle East, or North Africa, such as Irish, German, Italian, Lebanese, Arab, or Moroccan.

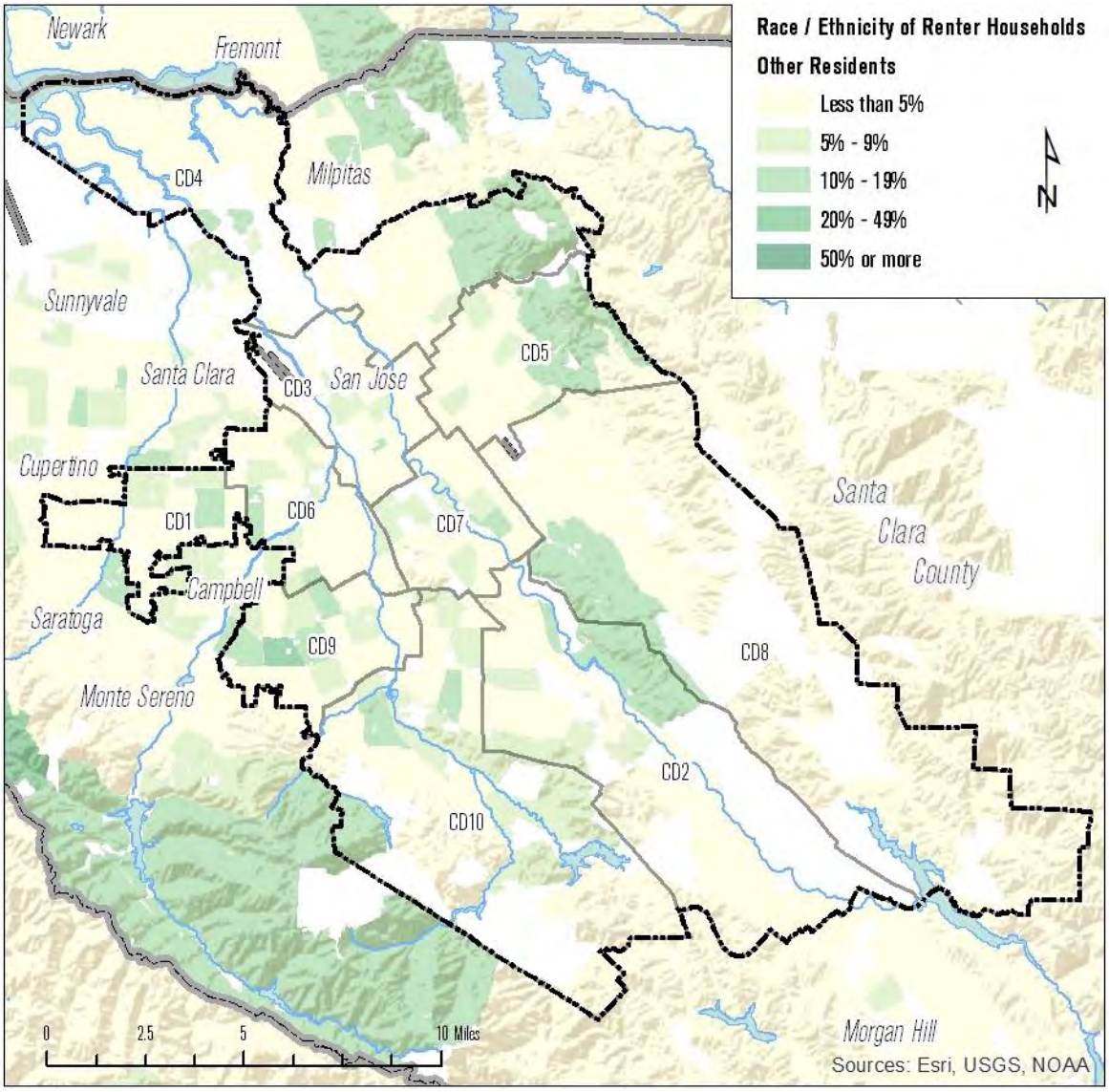
Figure 3.12 – White / European American Renter Households, as a Percent of All San José Renter Residents



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Tables B25003h Tenure (White Alone, Not Hispanic or Latino Householder). Notes: Data includes renters in all types of rental units, ARO and non-ARO, plus duplexes. Geographic units are Census tracts. Map areas filled white (no color) were unpopulated Census blocks in 2010.

The geographic distribution of American Indian San José renter households appears in Figure 3.13, at the Census tract level. Renter households that identified as "Other Races" (non-Hispanic) and "Two or More Races" (non-Hispanic) are also counted in this map.

Figure 3.13 – Other Renter Households, as a Percent of All San José Renter Residents



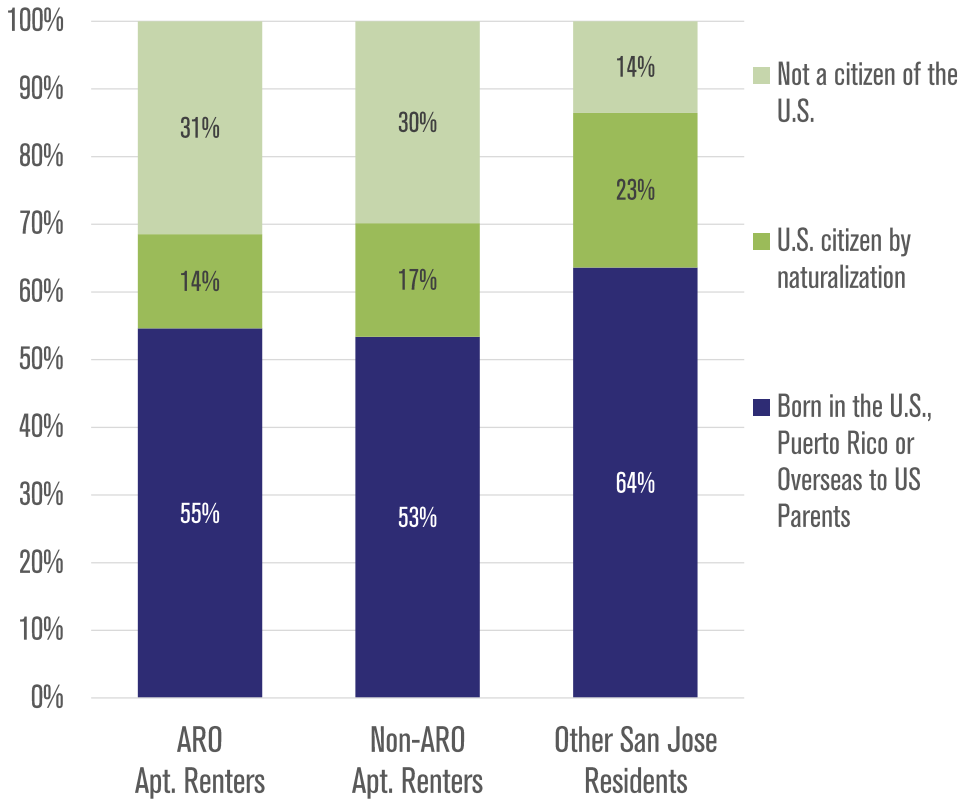
Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Tables B25003c Tenure (Am Indian and Al Native Alone Householder), B25003f Tenure (Some Other Race Alone Householder), B25003g Tenure (Two or More Races Householder). Notes: "Other Residents" in this figure are renter heads of households who identified as American Indian, Alaska Native, "some other race" or "two or more races." Data includes renters in all types of rental units, ARO and non-ARO, plus duplexes. Map areas filled white (no color) were unpopulated Census blocks in 2010.

Taken altogether, the maps in Figures 3.8 through 3.13 reveal patterns of ethnic minorities live in more urban, central locations of the City of San José, while whites and others live more on the City's edges.

3d. Citizenship Status

Over half of renters living in the City of San José – both in ARO and non-ARO units – are citizens either born in the United States or Puerto Rico, or else were born overseas to U.S. parents (Figure 3.14). Another 14 to 17 percent are U.S. citizens by naturalization. The remaining thirty percent of renter residents are not citizens of the U.S. In contrast, the citizenship status of San José's other residents is somewhat different. A larger majority (64 percent) are U.S. citizens by birth, and a larger share (23 percent) are U.S. citizens by naturalization; only 14 percent are not citizens of the U.S. Non-citizens includes green card holders, persons with temporary visas for work, travel and education, undocumented residents, and any others surveyed by the Census who were not U.S. citizens.

Figure 3.14 – Citizenship Status of San José Renter Residents, by ARO status

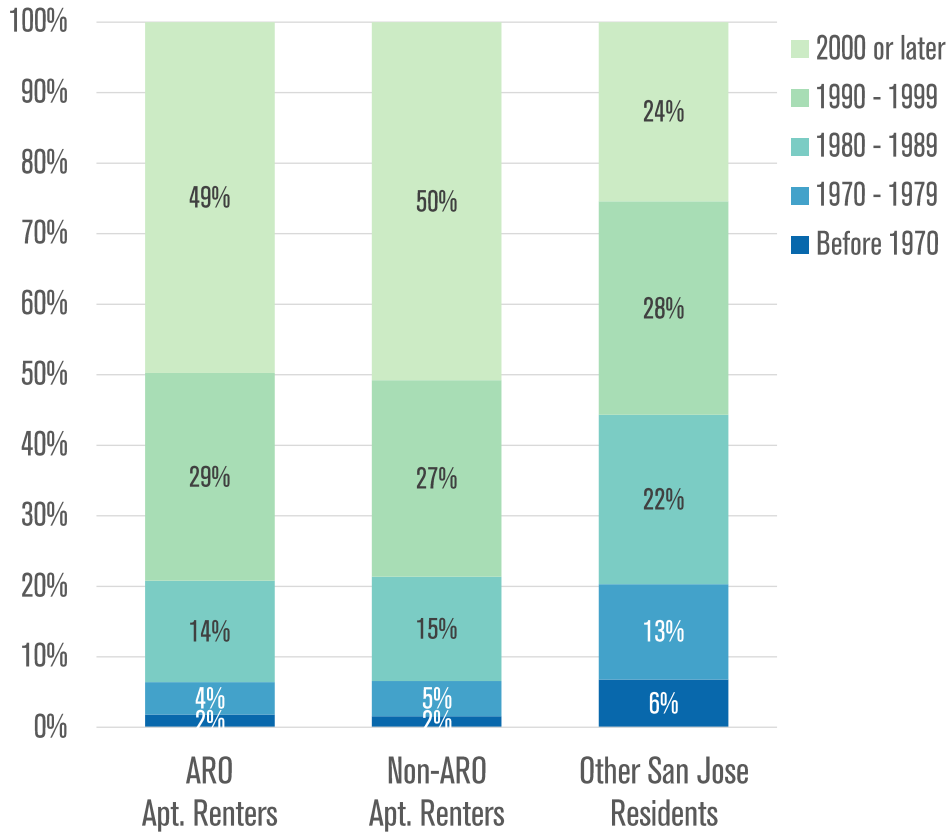


Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Public Use Microdata Sample (PUMS). Based upon recoding of the CIT (Citizenship Status) variable. Universe: Total population.

3e. Decade of Entry

For those not born in the U.S., their year of entry is summarized in Figure 3.15. As with citizenship status, ARO and non-ARO renter residents in San José are very similar, with roughly half of non-U.S. born residents arriving in the year 2000 or later, and almost another 30 percent arriving in the U.S. during 1990s. Immigrants who now live in San José's other, non-rental housing are more established, with just under 20 percent arriving before 1980 and another 22 percent arriving during the 1980s.

Figure 3.15 – Decade of Entry of Non-U.S. Born San José Renter Residents, by ARO status



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Public Use Microdata Sample (PUMS). Based upon recoding of the DECADE (Decade of entry) variable. Universe: Total population not born in the U.S.

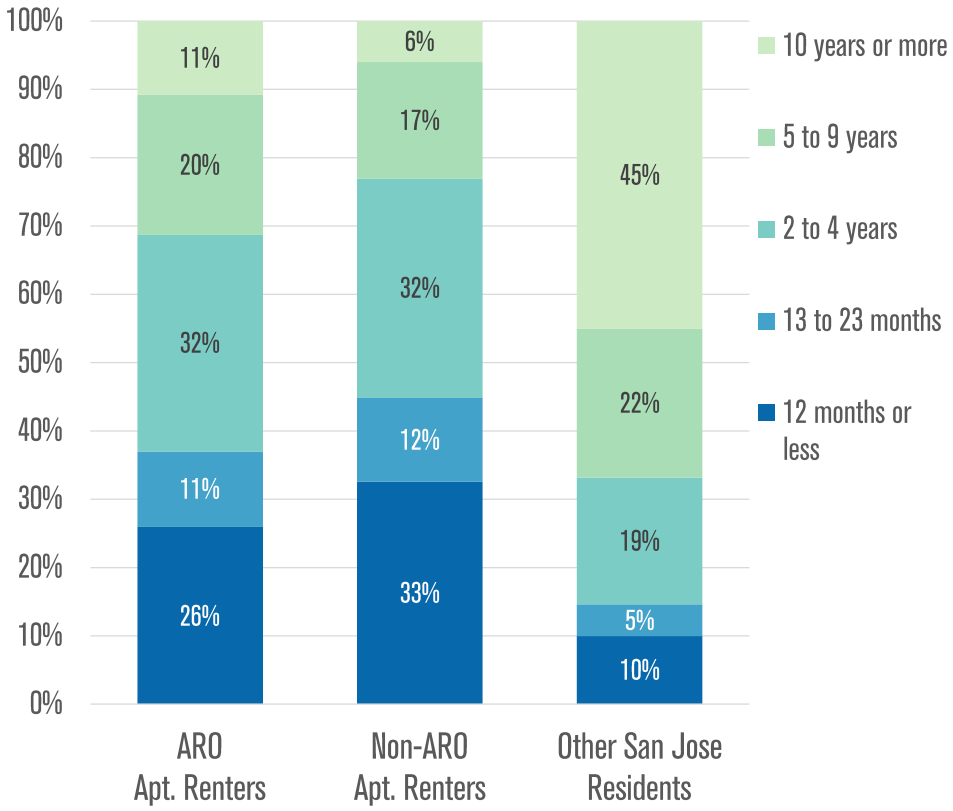
3f. When Moved Into Current Home

ARO renters stay longer in the same units than non-ARO renters

San José renters currently living in ARO units have stayed in the same place somewhat longer than those in non-ARO units (Figure 3.16). Almost two-thirds (63 percent) of those renting ARO units have stayed there two years or longer, while 55 percent of non-ARO occupants have stayed that long. Other San José residents are the most established, with two thirds (67 percent) staying 5 years or more.

Given this point-in-time estimate of when ARO tenants moved in, one can infer the turnover rate for ARO units. If 26 percent of ARO tenants move out of their units after 12 months or less, this turnover includes two types of ARO tenants: 1) renters who are starting longer stays in apartments, but moved in within the prior 12 months, and 2) renters who moved in within the prior 12 months and are hyper-mobile, meaning their pattern is to move to new apartment each year, such as college students, persons whose jobs change, or who cannot afford the last rent increase. The size of this second group is less than 26 percent in one year, but its cumulative size over several years may exceed 26 percent. How large this percentage may be is difficult to determine without longitudinal data that track the same renters over time, but Figure 3.16 may indicate higher turnover in ARO units than 26 percent.

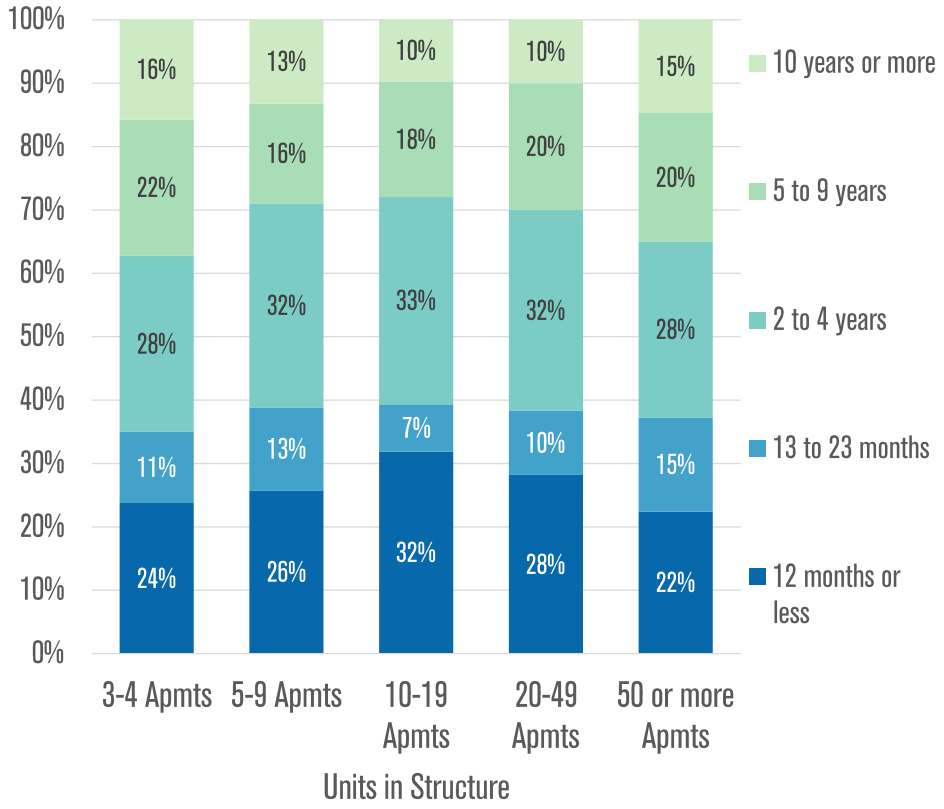
Figure 3.16 – When San José Renter Residents Moved into Their Current Homes, by ARO status



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Public Use Microdata Sample (PUMS). Based upon recoding of the MV (When moved into this house or apartment). Universe: Total population not living in group quarters. Note: Data in this section and chart include tenants in apartment buildings with 3-4 total units, and thus may differ slightly from findings in later chapters where only apartment buildings with 5+ units are studied.

A break-out of when ARO tenants moved into their current units by building size shows those in smaller buildings (3-4 and 5-9 units) are nearly at the overall 26 percent annual turnover rate shown in the prior figure, and the rate for triplexes and fourplexes here is slightly higher than that for buildings with 50 or more ARO units (Figure 3.17). At the top ends of the bars, tenant households in smaller ARO buildings (3-4 and 5-9 units) tend to stay a little longer, as do tenants in very large buildings. Possible explanations for this might be that smaller, "mom-n-pop" ARO buildings are run in such a way that tenants want to stay longer on average, despite likely being older ARO buildings. The largest ARO buildings (50+ unit) are often newer, so despite being run by property management companies that may raise rents more regularly, their tenant households may have other amenities providing reasons to stay longer than mid-sized ARO buildings.

Figure 3.17 – When San José ARO Renter Residents Moved into Their Current Homes, by Units in Structure

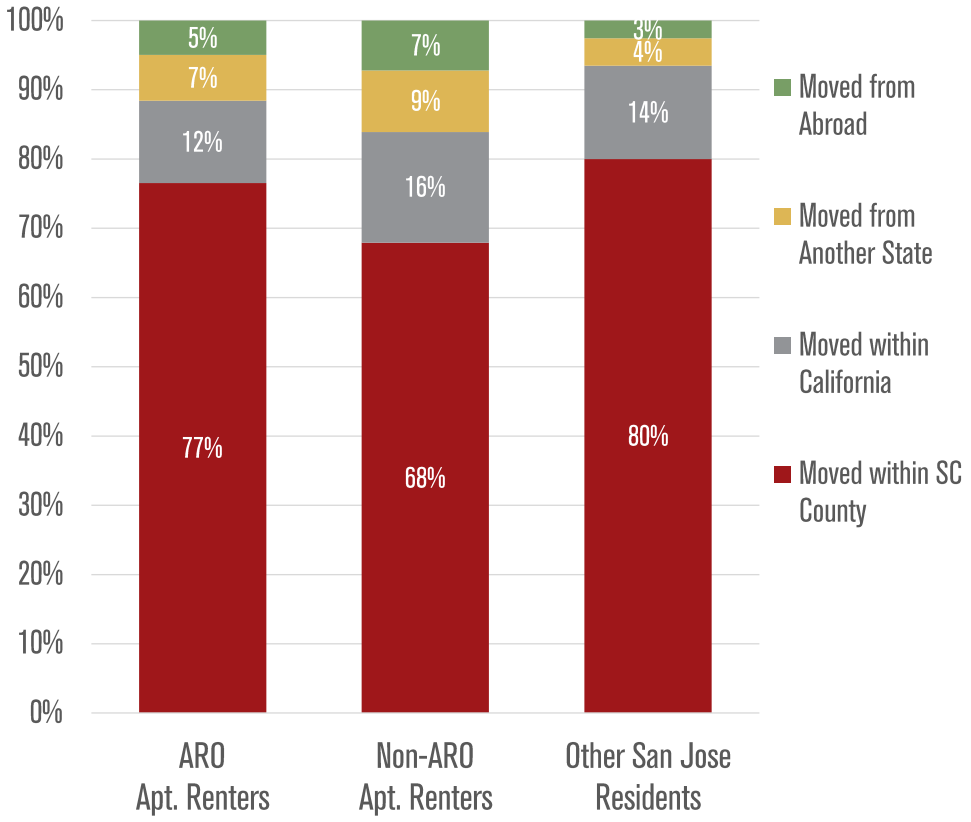


Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Public Use Microdata Sample (PUMS). Based upon recoding of the MV (When moved into this house or apartment). Universe: Total population in pre-1980 buildings with three or more units in structure, paying cash rent, not living in group quarters. Notes: This figure examines when tenant households currently in ARO units moved in, and excludes non-ARO renters and Other San José residents

3g. Residential Mobility: Where Moved From

For San José renter residents who have lived in their current housing for 12 months or less, most moved from prior housing elsewhere in Santa Clara County (Figure 3.18). Those who moved into ARO units were somewhat more likely to have moved from elsewhere in the county, compared to those who moved into non-ARO units (77 to 68 percent, respectively). Renters who moved from another state or from abroad were more

Figure 3.18 – Where Recently-Moved San José Renter Residents Lived One Year Ago, by ARO Status



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Public Use Microdata Sample (PUMS). Based upon recoding of the MIG (Mobility status; where one lived here 1 year ago), MigPUMA (Migration PUMA) and MIGSP (Migration state or foreign country code) variables. Universe: Total population.

Table 3.1 – Mobility of Renter Households in the Past 12 Months, City of San José

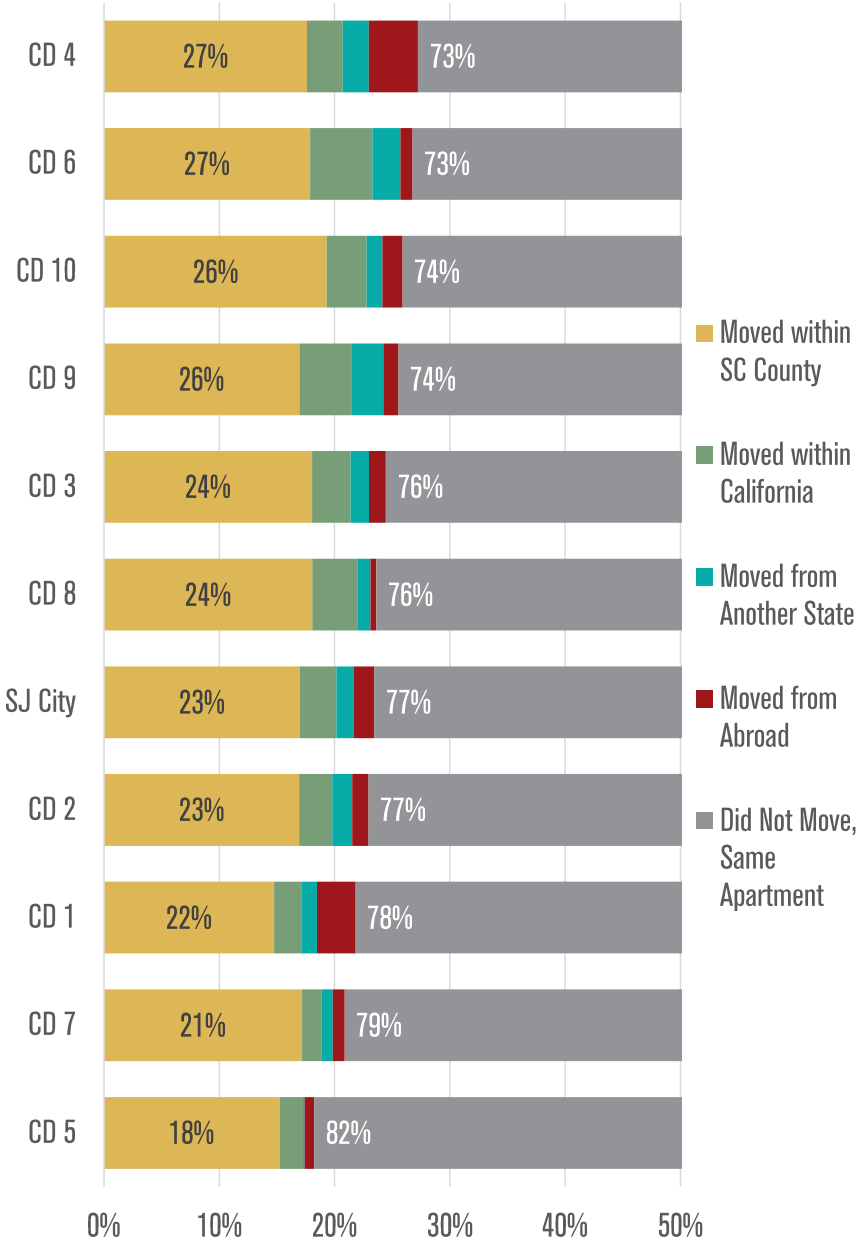
City Council District	Did Not Move, Same Apartment	Moved within Santa Clara County	Moved within Rest of California	Moved from Another State	Moved from Abroad
CD 1	78%	15%	2%	1%	3%
CD 2	77%	17%	3%	2%	1%
CD 3	76%	18%	3%	2%	1%
CD 4	73%	18%	3%	2%	4%
CD 5	82%	15%	2%	0%	1%
CD 6	73%	18%	5%	2%	1%
CD 7	79%	17%	2%	1%	1%
CD 8	76%	18%	4%	1%	0%
CD 9	74%	17%	4%	3%	1%
CD 10	74%	19%	3%	1%	2%
City Total	77%	17%	3%	2%	2%

Sources: Economic Roundtable analysis; U.S. Census 2009-2013 American Community Survey 5-Year Estimates, B07013 Geographical Mobility in the Past Year by Tenure for Current Residence in the US. Universe: All renter-occupied housing units.

likely to have moved into non-ARO housing. Other San José residents were the most likely to have moved from within the county, and least likely to have moved in from out of state or abroad.

Breaking out mobility for all rental households by San José Council Districts, there is variability, from 82 percent of renters who did not move in the prior 12 months in CD 5, to 73 percent in CD 4 (Table 3.1, Figure 3.19). CD 1 and CD 4 had the highest share of renters who recently moved from aboard (3 and 4 percent, respectively), while CD 10 had the greatest share of renter movers from elsewhere in the City or County (19 percent).

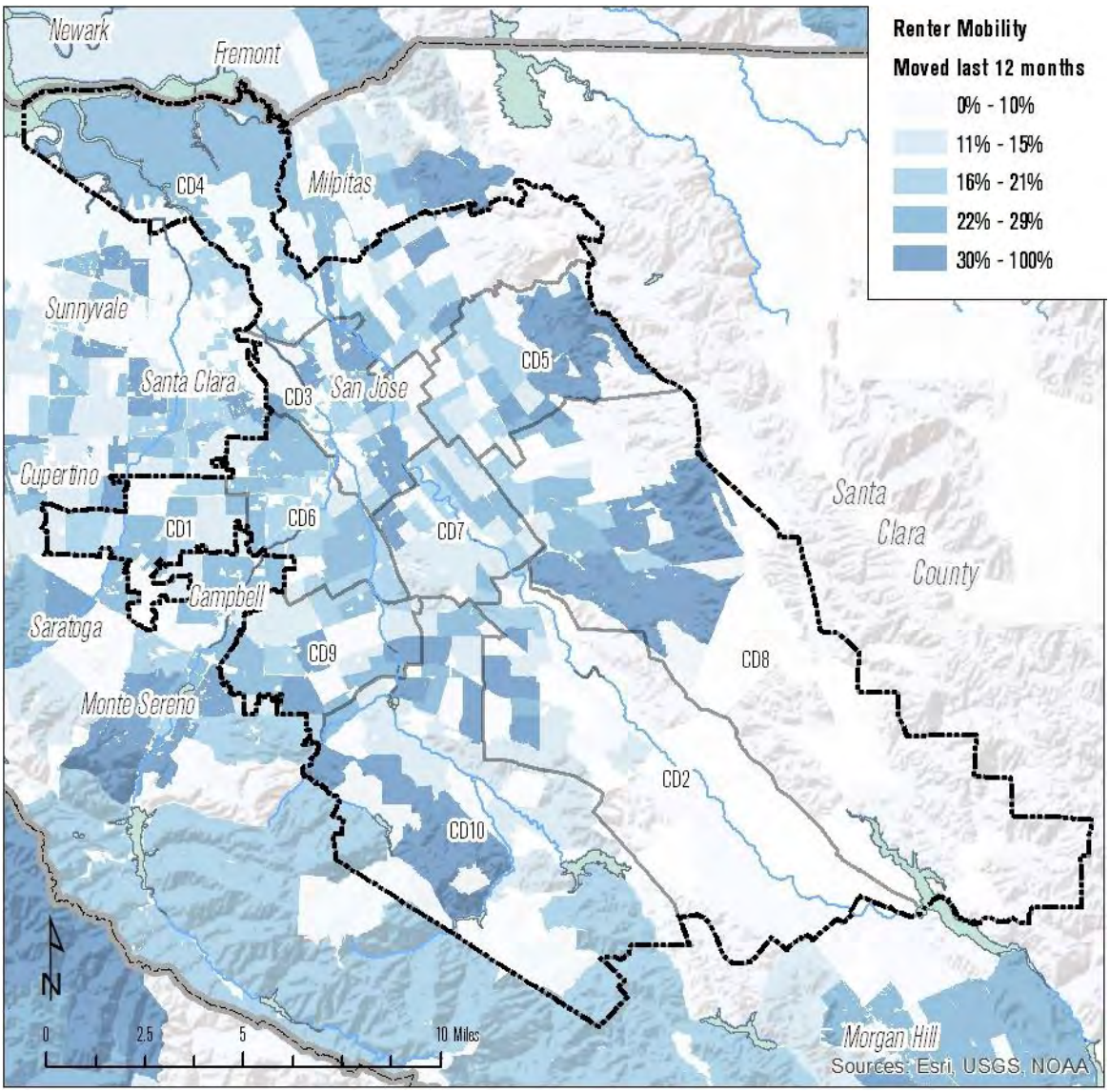
Figure 3.19 – Renter Household Mobility, by City Council District, City of San José



Source: Economic Roundtable analysis; U.S. Census 2009-2013 American Community Survey 5-Year Estimates, B07013 Geographical Mobility in the Past Year by Tenure for Current Residence in the US.

Looking at all renters across San José citywide, the neighborhoods where the most renters had moved in during the last 12 months are scattered and are found in every Council District (Figure 3.20). Higher turnover is associated with proximity to colleges, newly constructed, large apartment buildings, or other land uses, but this map captures just one snapshot of the ongoing churning of renter residents' mobility. A snapshot from another time period may see other neighborhoods standout, while current neighborhoods with 30 percent or more renter mobility may recede to the background.

Figure 3.20 – Renters Moving in During the Past Year, as a Percent of All Renters



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Table B07013 Geographical Mobility in the Past Year by Tenure for Current Residence in the United States. Data includes renters in all types of rental units, ARO and non-ARO, plus duplexes. Geographic units are Census tracts. Map areas filled white (no color) were unpopulated Census blocks in 2010.

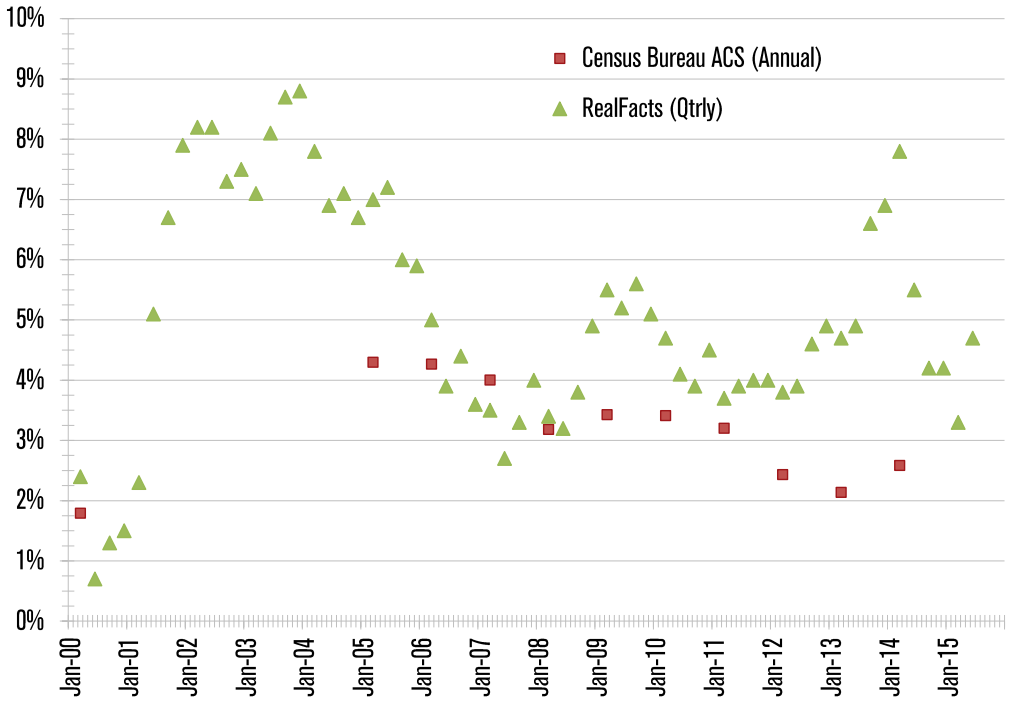
Overall, ARO renters are moving within Santa Clara County more than non-ARO renters, and this appears to happen in many San José neighborhoods, including Council Districts with the some of the largest numbers of ARO units (CD 6 and CD 3). This higher turnover within the rental housing market is by choice for some households, but indicates undesired housing instability for others.

3h. Vacancy Rates

Related to renter mobility is the vacancy rate in rental housing units. As discussed in Chapter 2, the San José metropolitan area (*San José-Sunnyvale-Santa Clara, CA*, composed of Santa Clara and San Benito Counties) has had some of the lowest vacancy rate in the nation in recent years. [3]

Vacancy rates for all rental housing in *City* of San José have fluctuated over the past 15 years, generally staying below five percent based upon U.S. Census Bureau data (Figure 3.21). RealFacts, which reports data on larger apartment buildings, shows spikes in vacancy following recessions in the early and late 2000s, but otherwise echoes that the San José has had a relatively tight rental market since 2000.

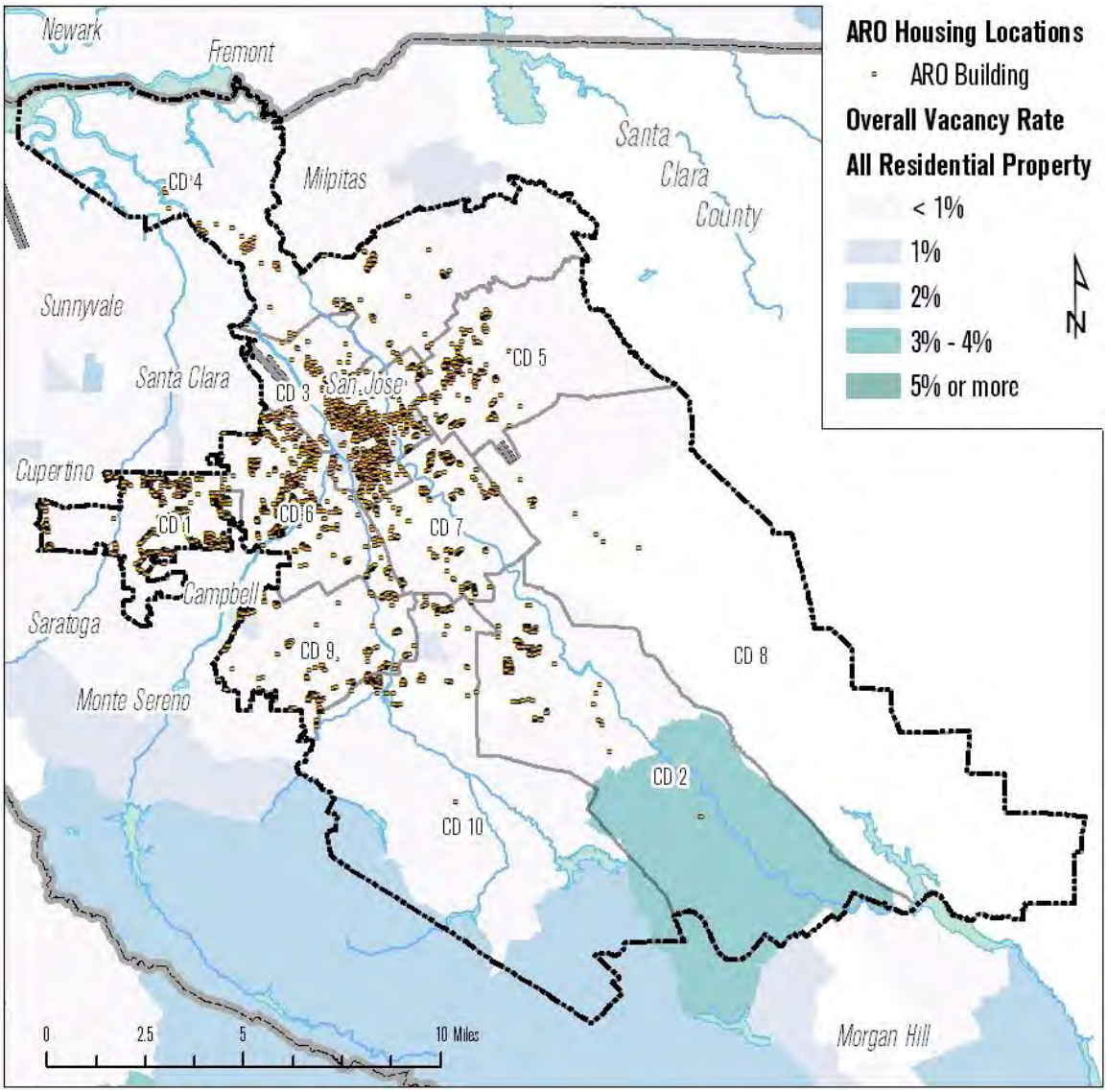
Figure 3.21 – Overall Rental Housing Vacancy Rate, City of San José



Sources: Economic Roundtable analysis; U.S. Census Bureau, 2000 Census of Population and Housing, Tables H004 Tenue and H005 Vacancy Status Tenure by Year Structure Built, (H005_2/(H005_2+H004_3)). U.S. Census Bureau, 2005-2014 1-Year American Community Survey, Tables B25003 Tenure and B25004 Vacancy Status (B25004_2_EST/(B25004_2_EST+B25003_3_EST)). RealFacts Quarterly Report: Rent, Occupancy, Vacancy Data courtesy of the City of San José.

The rate of vacancy in all housing – both renter- and owner-occupied housing units – that lasts three months or less reveals a tighter overall market in San José (Figure 3.22) than the point-in-time data in Figure 3.21. In this dataset, produced jointly by the U.S. Department of Housing and Urban Development and the U.S. Postal Service[4], only outlying neighborhoods in the southern end of the City have relatively high rates of vacancy lasting three months or less for all housing types, in excess of three percent. Figure 3.22 overlays buildings with ARO units for reference, highlighting that they are located where vacancy is relatively tight and nowhere near neighborhoods with sustained housing vacancies.

Figure 3.22 – Rates of Vacancy Lasting Three Months or Less for All Housing, San José



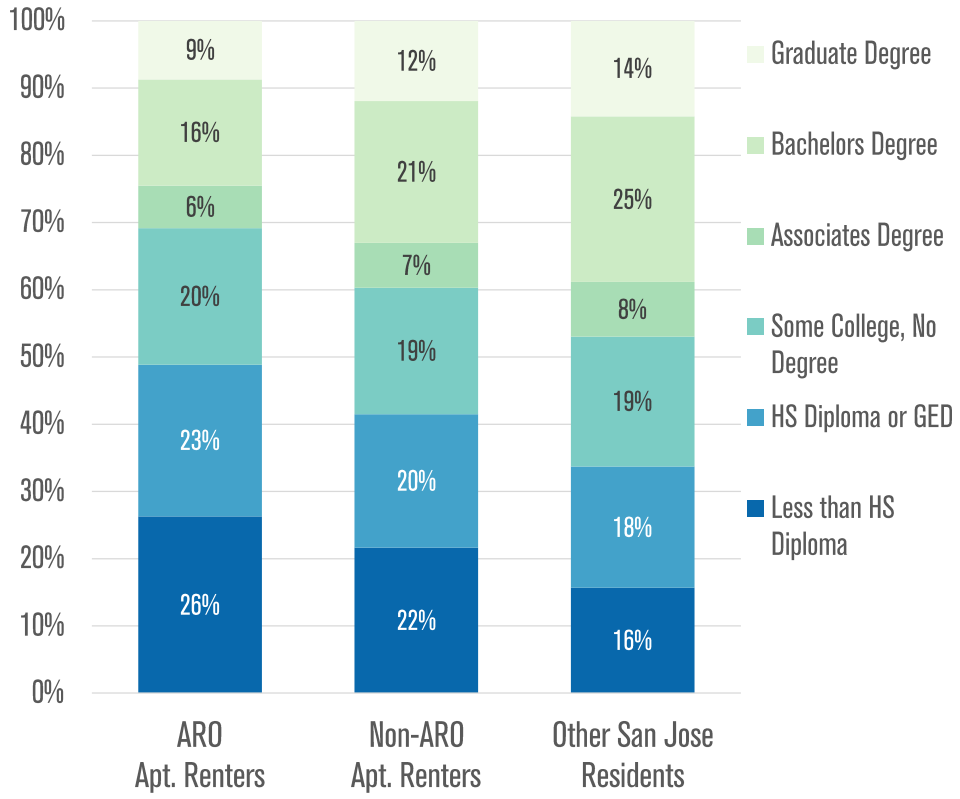
Source: Economic Roundtable analysis; U.S. Housing & Urban Development Department, Aggregated U.S. Postal Service Administrative Data on Address Vacancies in June 2015. Variable mapped is VAC_3_RES "Vacant 3 Mos. to Less Count – Residential." Notes: Data includes all residential addresses, both owner- and renter-occupied. Geographic units displayed in the background are Census tracts, with city council district boundaries overlaid for reference. Foreground location of buildings with ARO units is displayed for reference.

3i. Educational Attainment

The level of education completed by San José residents varies noticeably between ARO renters, non-ARO renters, and other residents of the City (Figure 3.23). ARO renters have the largest share of residents with a high school diploma or less (49 percent). Non-ARO renters have the next largest share with less than a high school education, 42 percent. Only 34 percent of other San José residents stopped their education short of college; conversely, 14 percent of these residents have a graduate degree, compared to nine and 12 percent of ARO and non-ARO renters, respectively.

ARO renters have the largest share of residents (49%) with a high school diploma or less

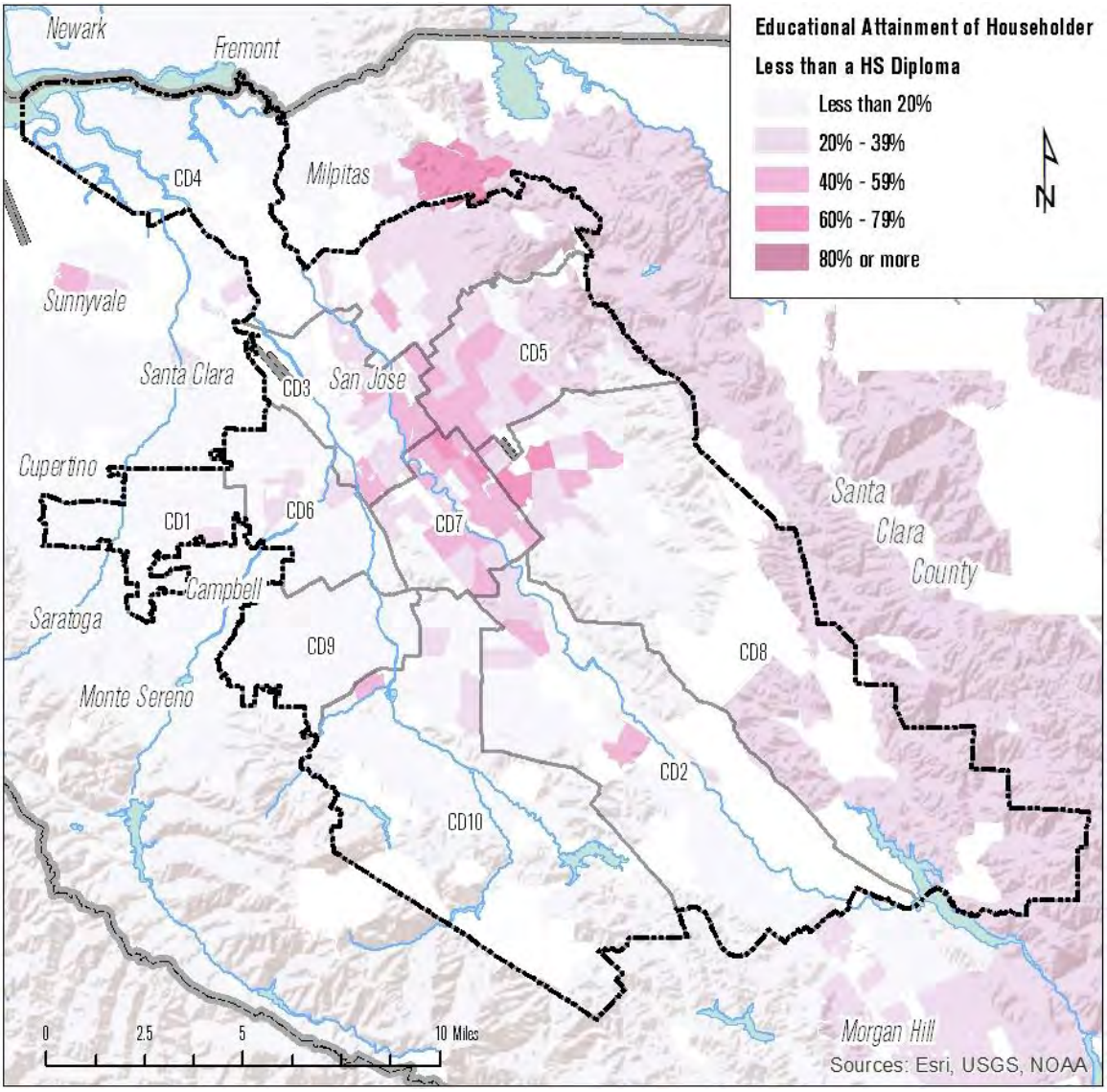
Figure 3.23 – Educational Attainment of San José Renters, by ARO Status



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Public Use Microdata Sample (PUMS). Based upon recoding of the SCHL (Educational attainment) variable. Universe: Total population 25 years old or greater.

The geography of educational attainment is depicted in the next series of maps, the first highlighting the neighborhoods with the highest share of renter heads of household without a high school diploma (Figure 3.24). While found in every part of the City, the central and northeastern parts of San José have the highest concentrations. Citywide, 20 percent of renter heads of household are not high school graduates.

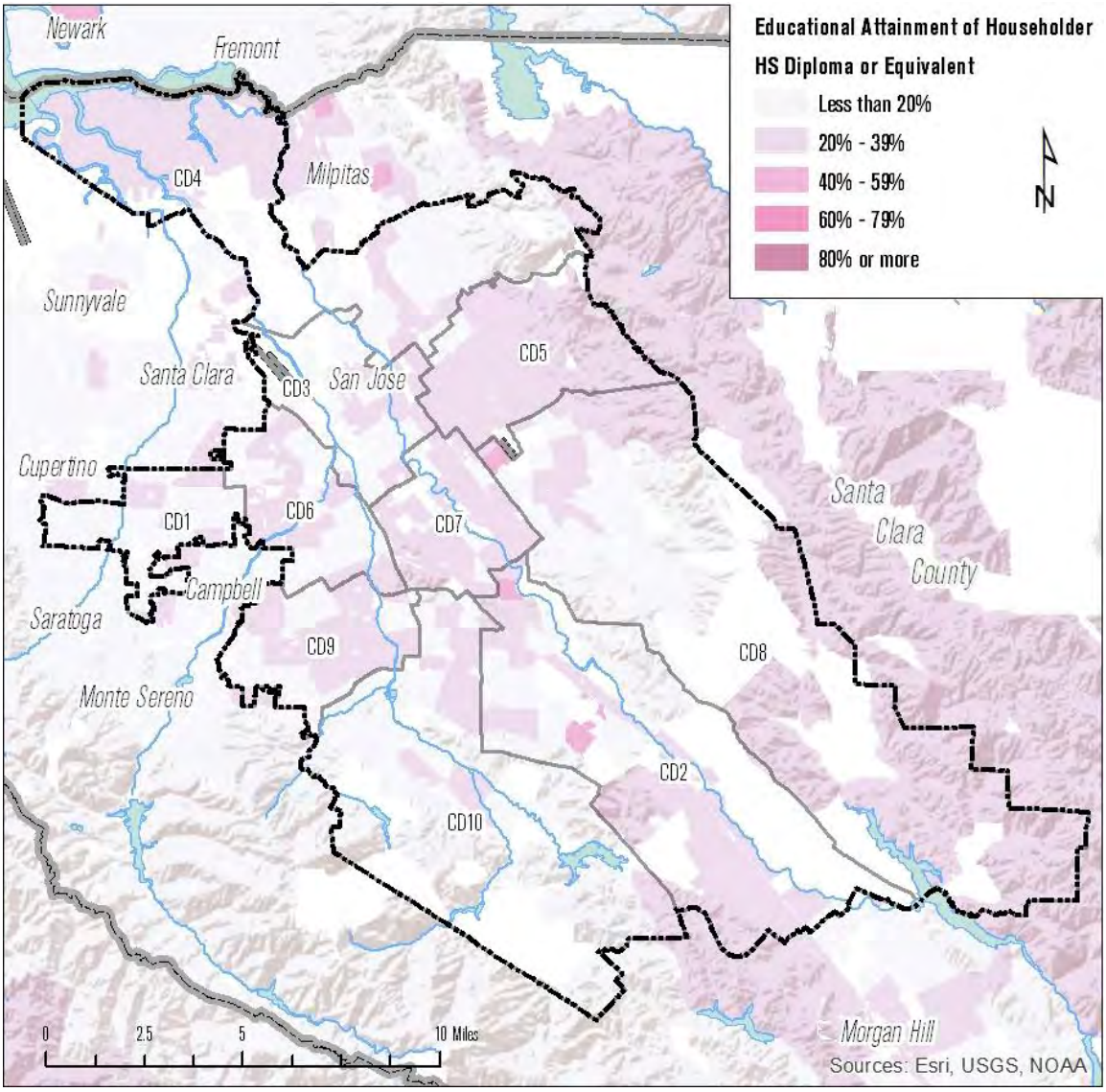
Figure 3.24 – San José Renters with Less than a High School Diploma, by Place of Residence



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Table B25013 Tenure by Educational Attainment of Householder. Notes: Data includes renters in all types of rental units, ARO and non-ARO, plus duplexes. Geographic units are Census tracts. Universe: Renter heads of household (householders). Map areas filled white (no color) were unpopulated Census blocks in 2010.

The neighborhoods with the highest share of renter heads of household with a high school diploma or equivalent – but no college education – are shown in Figure 3.25. These renter households are found in pockets across all neighborhoods and Council Districts. Citywide, 19 percent of renter heads of household have graduated from high school.

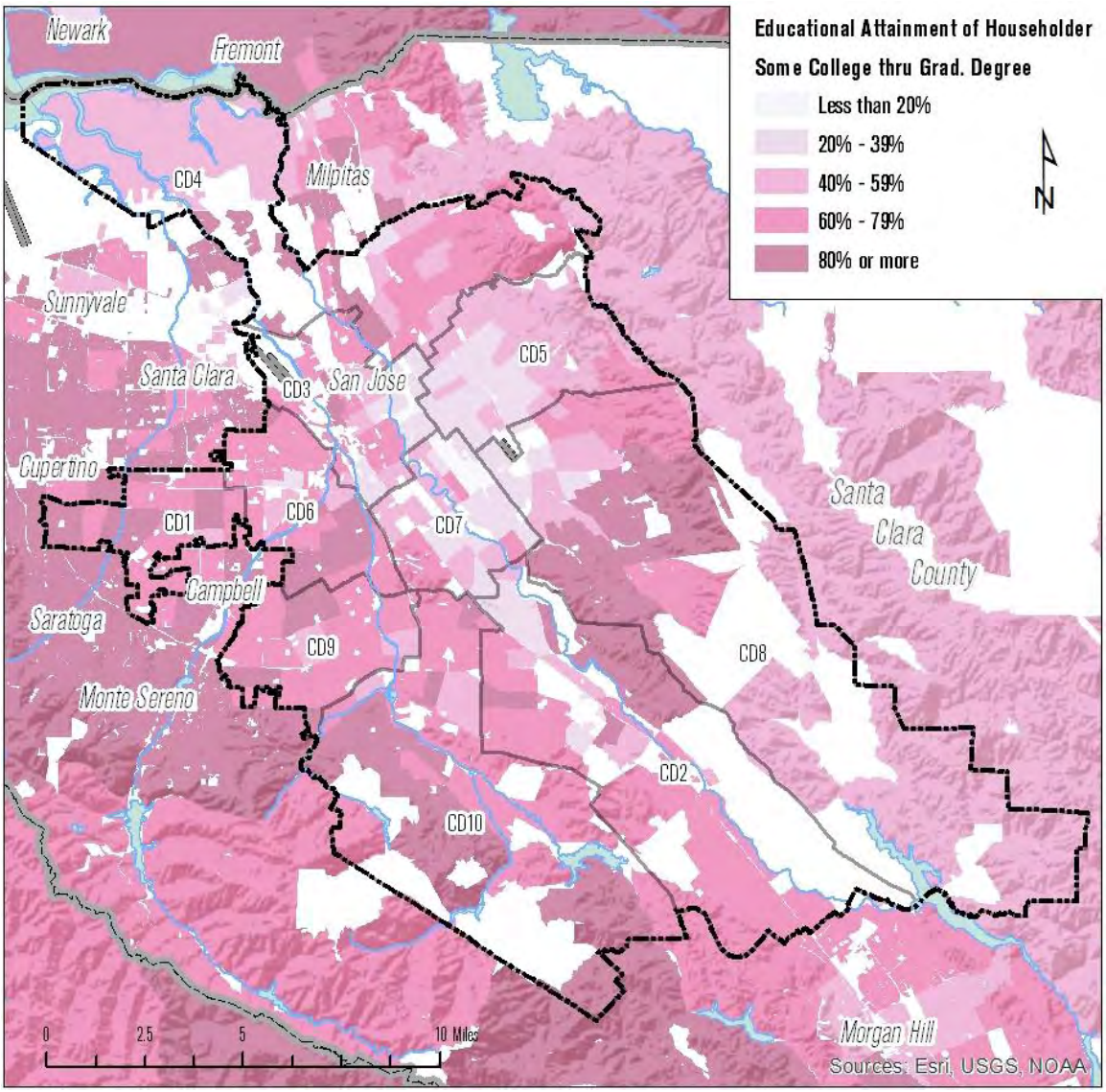
Figure 3.25 – San José Renters with a High School Diploma or Equivalent, but No College, by Place of Residence



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Table B25013 Tenure by Educational Attainment of Householder. Notes: Data includes renters in all types of rental units, ARO and non-ARO, plus duplexes. Geographic units are Census tracts. Universe: Renter heads of household (householders). Map areas filled white (no color) were unpopulated Census blocks in 2010.

The neighborhoods with the highest share of renter heads of household with some college attended, an undergraduate, professional or graduate degree completed are depicted in Figure 3.26. The highest concentrations of these renters appear in the Western portions of San José, bordering other cities with high shares of residents with advanced educational attainment: Santa Clara, Los Altos, Cupertino Saratoga, and Monte Sereno. Citywide, 61 percent of renter heads of household have some level of college education.

Figure 3.26 – San José Renters with Some College Education, Undergraduate or Graduate Degrees, by Place of Residence



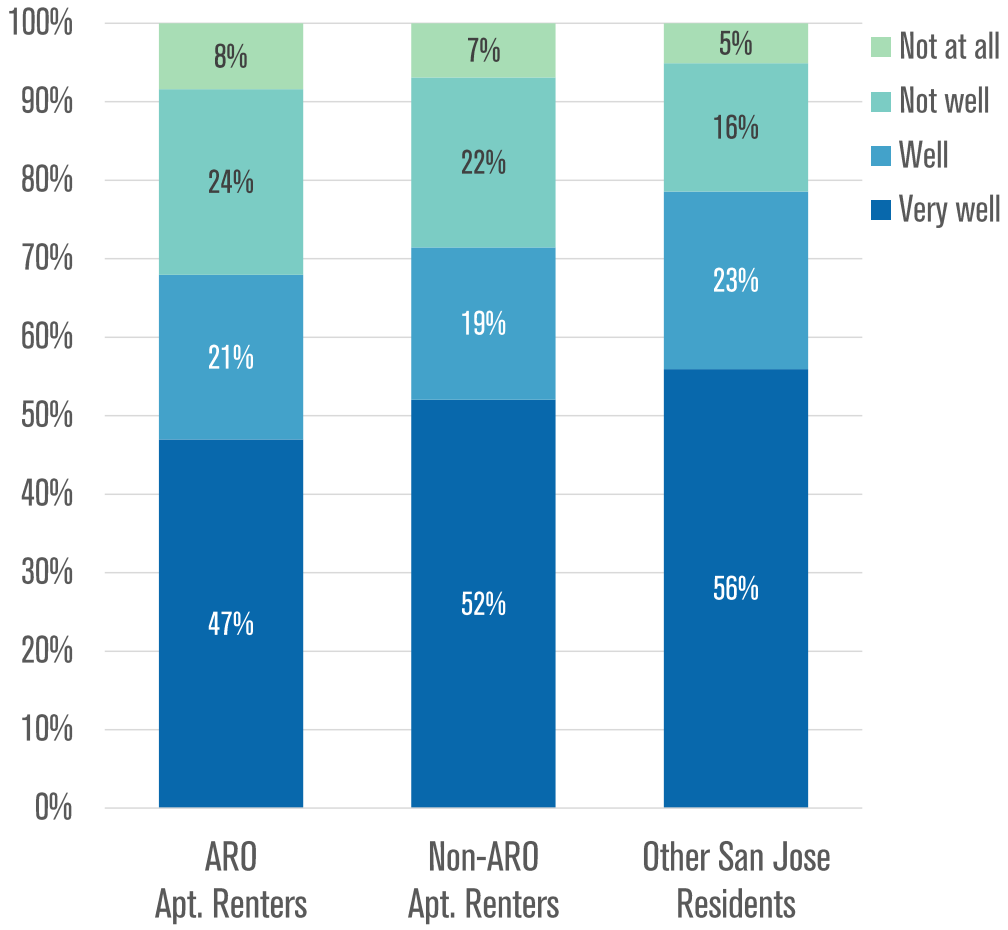
Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Estimates Table B25013 Tenure by Educational Attainment of Householder. Notes: Data includes renters in all types of rental units, ARO and non-ARO, plus duplexes. Geographic units are Census tracts. Universe: Renter heads of household (householders). Map areas filled white (no color) were unpopulated Census blocks in 2010.

3j. English Ability

Proficiency in spoken English varies somewhat between ARO and non-ARO renters, and between them and all other San José residents (Figure 3.27). ARO renters have the largest share of residents who speak English "Not Well" or "Not at All" (32 percent). Non-ARO renters have the next largest share, 29 percent, while 21 percent of other San José residents of are in these combined categories.

ARO renters have lower levels of English proficiency that non-ARO renters and other San José residents

Figure 3.27 – Spoken English Ability of San José Renters, by ARO Status



Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Public Use Microdata Sample (PUMS). Based upon recoding of the SCHL (Educational attainment) variable. Universe: Total population 25 years old or greater.

Summary of Findings

- Renters under the jurisdiction of San José's Apartment Rent Ordinance (ARO) are slightly younger than non-ARO renters, and significantly younger than San José's other residents.
- The racial-ethnic profile of renters living in the City of San José is very diverse. The plurality of ARO unit renters are Latino households (49 percent), with Asian American and Pacific Islander households constituting another 24 percent, White/European American households constituting 20 percent, African American households constituting five percent, and the balance made up of other households.
- Over half of renters living in the City of San José – both in ARO and non-ARO units – are citizens either born in the United States, or else were born overseas to U.S. parents. Another 14 to 17 percent are U.S. citizens by naturalization. The remaining thirty percent of renter residents are not currently citizens of the U.S., including green card holders, visa holders and undocumented residents.
- Roughly half of San José renters not born in the U.S arrived since the year 2000, and almost another 30 percent arrived in the U.S. during 1990s.
- ARO units have a significant amount of turnover, with 37 percent of renters residing in their current units for less than two years. Another 32 percent have resided in ARO units 2-4 years, and only 31 percent have lived there 5 years or longer.
- Vacancy rates for San José rental housing have fluctuated over the past 15 years, generally staying below five percent in U.S. Census Bureau data.
- The rate of vacancy in all housing – both renter- and owner-occupied housing units – that lasts three months or less is below three percent.
- ARO renters have the largest share of residents with a high school diploma or less (49 percent) versus 42 percent for non-ARO renters.
- ARO renters have the largest share of residents who speak English "Not Well" or "Not at All" (32 percent) versus 29 percent for non-ARO renters.

Endnotes

[1] "The American Community Survey is the premier source of statistics about the socioeconomic and housing characteristics of our nation. Together with population data from the once-a-decade census, ACS data help determine how more than $400 billion in federal funds are distributed to state and local areas each year." (U.S. Census Bureau. 2010. "American Community Survey – Key Facts"). The U.S. Census American Community Survey 5-year sample size for the City of San José is approximately 5 percent, and a 1 percent sample for the 1-year data. The data are released nine to 13 months after the end of each collection year. Topics include:

People:

- Basic Count/Estimate
- Age & Sex
- Age Group
- Disability
- Education
- Employment
- Income & Earnings
- Insurance Coverage
- Language
- Marital & Fertility Status
- Origins
- Population Change
- Poverty
- Relationship
- Veterans

Housing:

- Basic Count/Estimate
- Financial Characteristic
- Occupancy Characteristic
- Physical Characteristic
- Health and Safety Characteristic

"The American Community Survey is the premier source of statistics about the socioeconomic and housing characteristics of our nation. Together with population data from the once-a-decade census, ACS data help determine how more than $400 billion in federal funds are distributed to state and local areas each year." Source: U.S. Census. 2010. "American Community Survey: Key Facts" https://www.census.gov/content/dam/Census/programs-surveys/acs/news/10ACS_keyfacts.pdf

[2] In this chapter, the three comparison groups of San José residents are defined as follows:

ARO Apartment Renters:

- Live in San José, CA
- Live in buildings with 3+ units
- Pay cash rent for housing
- Live in buildings built 1979 or earlier

Non-ARO Apt. Renters:

- Live in San José, CA
- Live in buildings with 3+ units
- Pay cash rent for housing
- Live in buildings built 1980 or later

Note: Under City code, units that we categorize as "Non-ARO" are legally subject to Part 7 of the ARO, *Evictions from Certain Units Built after the Effective Date of this Chapter.*

Other San José Residents:

- Live in San José, CA
- Live in all other types of buildings, including single-family houses, duplexes, mobile homes or trailers, RVs or vans, etc. with 3+ units Mobile home or trailer
- Own their housing, occupy it without payment of rent, or are pay cash rent for housing (such as units in duplexes), but are not included in the prior two groups.
- Live in buildings built in any year, but are not included in the prior two groups.

[3] Kolko, Jed "All Those Vacant Homes" *Trulia Research Blog on Housing Policy*, November 6, 2013. Accessed at http://www.trulia.com/blog/trends/vacancy-rate/ on September 23, 2015. Table excerpted from the article, entitled "Metros with the Lowest Vacancy Rate" is as follows:

Rank	U.S. Metro	Vacancy rate, Oct 2013	Difference since Apr 2000
1	San José, CA	3.0%	0.3%
2	Ventura County, CA	3.4%	0.6%
3	Orange County, CA	3.9%	0.6%
4	Minneapolis–St. Paul, MN-WI	4.1%	1.5%
5	Denver, CO	4.4%	0.8%
6	San Francisco, CA	4.5%	0.6%
7	Middlesex County, MA	4.5%	1.7%
8	Bethesda-Rockville-Frederick, MD	4.7%	2.4%
9	Long Island, NY	4.7%	1.5%
10	Oakland, CA	5.1%	0.9%

[4] The U.S. Department of Housing and Urban Development (HUD) has established an agreement with the United States Postal Service (USPS) to receive quarterly aggregate data on addresses identified by the USPS as vacant. These addresses represent the universe of all addresses in the United States and are updated every three months. The data include all addresses (residential and commercial) that USPS has recorded in its database, with a status indicator for addresses that delivery staff on urban routes have identified as being vacant, as well as a business/residential/other indicator. Addresses are identified as vacant if mail has not been collected for 90 days or longer. Source: https://www.huduser.gov/portal/datasets/usps.html

Chapter 4

Standards for Allowable Rent Increases under the ARO and Increases in Market Rent Levels

I. Introduction

Apartment rent stabilization ordinances are in effect in eleven California cities: Los Angeles, San José, San Francisco, Oakland, Berkeley, Santa Monica, Beverly Hills, Hayward, East Palo Alto, Los Gatos, and West Hollywood. In addition to the apartment rent ordinances, approximately ninety jurisdictions in California regulate the rents of mobilehome park spaces.[1]

This chapter discusses:

1) The annual rent increase standard in San José's ARO compared with the standards in other California rent stabilization ordinances,
2) The *amount of the rent increases allowed under the ARO* compared with rent increases allowed under the other apartment rent stabilization ordinances in California and with rent increases in rents in unregulated markets,
3) Actual rent increases in rental units covered by the ARO and rental units that are not covered by the ARO.
4) Trends in initial rents for new tenants., Initial rents are unregulated in both units covered by the ARO and units exempted from the ARO.

II. The Scope of San José's ARO

Approximately 44,300 rental units (33% of the City's 133,000 rental units), are covered by San José's ARO. The ordinance is applicable to rental units in multi-family apartment buildings with three or more units that were constructed before September 7, 1979, with exemptions forunits occupied by Section 8 tenants, rental units in institutional facilities, units constructed with public subsidies.[2] State law exempts condominium units which have been sold to individual owners and single family dwellings.[3]

Under the ARO, apartment owners are permitted annual rent increases of 8% Allowable rent increases that are not implemented in a particular year may be "banked." for up to two years. If the rent has not been increased in more than 24 months, an increase of 21% is permitted.[4]

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[1] Mobilehome owners are considered to be in a particularly vulnerable position because their substantial investments in their mobilehomes are tied to their park space rentals. "Mobile"homes are actually immobile due to the high costs of moving mobilehomes and more critically, the fact that few mobilehome parks would accept mobilehomes that are more than a few years old.

[2] Section 17.23.150.

[3] Cal. Civil Code Sec. 1954.52.(a)(3). (The state exemption does not apply to single family dwellings that are on the same parcel with other dwelling units.)

[4] Section 17.23.210.

If a rent increase is in excess of these amounts, the tenant may "invoke the rental dispute mediation and arbitration hearing process by filing a petition with the City's Rental Rights and Referrals Program "for review of rent increases in excess of 8% per year."[5] If the tenant files a petition, then the rent increase in excess of the allowable annual rent increases cannot be imposed unless it is approved by a Rental Rights and Referrals Program hearing officer after a review for compliance with the standards in the ordinance and regulations.

In contrast, under the rent stabilization ordinances of seven jurisdictions – San Francisco, Los Angeles, Berkeley, Santa Monica, West Hollywood, East Palo Alto, and Beverly Hills – even if the tenant does not object, the apartment owner is not permitted to impose a rent increase in excess of the annual allowable increase without petitioning and obtaining approval for the increase. Under Oakland's ordinance, as under San José's ordinance, a rent increase in excess of the annual allowable increases goes into effect without any review, unless the tenant petitions for a review

Apart from the annual allowable rent increases, at the commencement of each tenancy, apartment owners have the right to set the initial rent without any restrictions (vacancy decontrol), unless the unit has become vacant as a result of a no-fault eviction.

A vacancy decontrol provision was included in the City's ordinance when it was adopted in 1979.[6] Since then, State law (the Costa-Hawkins Act adopted in 1996), has mandated vacancy decontrol, preempting the power of localities to determine whether or not rents may be increased upon voluntary apartment vacancies.[7]

Due to voluntary tenant turnover, vacancy decontrol permits apartment owners to reset the rents of a quarter of all units at market levels within a 12 month period and a majority of rental units within a five-year period.

Data from the American Community Survey (ACS) conducted by the US Census Bureau **covering a period of five years** indicates that in buildings constructed before 1980 approximately 28% of all tenant households moved into their units within the past twelve months, 11% percent moved in within the past thirteen to twenty four months, and 32% moved in between within the past two to five years. These rates of tenant turnover are typical of the past eight years.

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[5] Section 17.23.220.

[6] Ordinance No.19696 (July 10, 1979) (Currently San Jose Muni. Code Sec. 17.23.190)

[7] Cal. Code Sec. 1954.50 - .535. Before the adoption of the Costa-Hawkins Act in 1996, Berkeley, Santa Monica, West Hollywood, and East Palo Alto did not allow vacancy increases. (The Costa-Hawkins Act is not applicable to regulations of mobilehome park rents.)

Table 4.1
San José Tenants
Length of Occupancy
ACS Surveys 2009-2013

Length of Tenancy	Units Constructed Before 1980	Units Constructed 1980 or later
12 months or less	28%	33%
13 to 23 months	11%	12%
Total Less than 2 Years	39%	44%
2 yrs to 4 yrs 11 mos	32%	32%

Source: U.S.Census, 2014 American Community Survey, PUMS (Public Use Microdata Sample)

For more detailed discussion of tenants' length of occupancy, see Chapter 3)

III. Background – The Spread of Rent Stabilization in California and Standards for Annual Allowable Rent Increases under California's Rent Stabilization Ordinances

In California, rent regulations became widespread within a few years after the passage of Proposition 13 in 1978. Proposition 13 led to about a two-thirds reduction in property taxes and, therefore, a significant reduction in overall apartment operating costs. As a result, tenant expectations that rents should also be reduced were widespread. Instead, in the years following the passage of Proposition 13, rents increased at high rates as a result of tightening market conditions and exceptionally high rates of inflation. From 1978 to 1982, the annual rate of increase in the San Francisco-Oakland-San José CPI-All Urban Consumers (CPI-U) All-Items index ranged from 7.5% to 12.9%. (Appendix A of this Report includes the CPI tables that are referred to in this Chapter). Rents in the San Francisco Bay Area increased at similar rates.

By 1982, rent regulations were adopted by Los Angeles, San Francisco, San José, Oakland, Hayward, Berkeley, Santa Monica, Beverly Hills, and Los Gatos. All of the ordinances, except the ordinances of Berkeley and Santa Monica, contained vacancy decontrol provisions and allowed fixed percentage annual increases.

Allowable annual rent increases under the ordinances that were adopted in the years following the passage of Proposition 13 were comparable to or below the high rate of inflation at that time. The annual increase allowances were: San José – 8%, Oakland – 10%, Los Angeles – 7%, San Francisco – 7%, and Los Gatos -70% of CPI. Under the Berkeley and Santa Monica ordinances, allowable annual rent increases were determined by their Rent Board based on an annual study of increases in apartment operating costs.

Starting in 1983, the high rate of inflation abated. The annual increases in the S.F.-Oakland-San José CPI All Urban Consumer s All Items Index (the CPI-U) from 1983 through 1985 were 0.8%, 5.7%, and 4.2%. In 1984, San Francisco reduced the allowable annual increase to 4%. In 1985, the Los Angeles ordinance was amended to tie the allowable annual rent increase to the annual increase to the percentage increase in the CPI, with a minimum allowable annual increase of 3% and a maximum of 8%.

In the following years, the annual allowable increases under the San Francisco and Oakland rent ordinances were further reduced. In 1993, San Francisco tied the annual allowable rent increase to 60% of the percentage increase in the CPI. Oakland reduced the annual allowable increase from 10% to 8% in 1984, to 6% in 1987, to 3% in 1996. In 2001, the allowable annual increase was tied to the CPI increase.

After West Hollywood was incorporated in 1984, it adopted an ordinance that authorized annual increases equal to 75% of the percentage increase in the CPI and limited increases upon vacancies to 10%, with a limit of one vacancy increase within a five-year period.

Since 1983, San José has been one of the two rent controlled jurisdictions to retain an annual rent increase allowance of 8% or higher. Beverly Hills has continually permitted annual increases of 10%.

Current Standards under Rent Stabilization Ordinances for Allowable Rent Increases

Currently, most apartment rent control ordinances tie the allowable annual rent **increases to the percentage increase in the Consumer Price Index (CPI) All Items.** (See the Appendix of this chapter for a discussion of alternate CPI indexes). The Los Angeles and Oakland ordinances allow increases equal to 100% of the percentage increase in the CPI, San Francisco limits annual increases to 60% of the CPI increase. Berkeley limits the annual increase to 65% of the CPI increase; Santa Monica and West Hollywood allow annual increases equal to 75% of the percentage increase in the CPI; and East Palo Alto limits increases to 80% of the percentage increase in the CPI. Hayward and Los Gatos authorize annual increases of up to 5% and Beverly Hills allows annual increases of up to 10%.

Table 4.2.
Rent Stabilization Ordinances
Annual Rent Increase Standards

*Annual Rent Increase Based on CPI**	
Jurisdiction	***Annual Rent Increase Standard***
Los Angeles	**100% of CPI (Minimum 3%, Maximum 8%)**
San Francisco	**60% of CPI**
Oakland	**100% of CPI**
Berkeley	**65% of CPI**
Santa Monica	**75% of CPI**
West Hollywood	**75% of CPI**
East Palo Alto	**80% of CPI**
Fixed Percentage Annual Increase	
Jurisdiction	***Annual Rent Increase Standard***
San José	**8%**
Hayward	**5%**
Beverly Hills	**10%**
Los Gatos	**5%**

*All of the ordinances use the CPI-U All Items except the Oakland ordinance which uses the average of the CPI All Items and All Items Less Shelter Indexes.

In a 1994 study of the Los Angeles rent stabilization program that was commissioned by the city, the authors concluded that authorizing annual increases in rents tied to the percentage increase in the CPI would enable "apartment owners ... [to] maintain on an inflation adjusted basis, the net operating income (NOI) generated by their rental properties" and would provide apartment owners with adequate incentives to maintain their properties.

> ... indexing rent increases to the CPI-U also ensured, for typical rent stabilized properties, that apartment owners could maintain on an inflation adjusted basis, the NOI generated by their rental properties. This financial result is based on the historical tendency for apartment operating costs to track the general rate of inflation and the vacancy decontrol provision in the ARO that allows rent levels for vacated units to be set at market levels. Maintenance of real NOI for stabilized properties protects the City of Los Angeles from potential lawsuits based on government "takings" claims and should provide stabilized apartment owners with sufficient financial incentives to adequately maintain their apartment holdings.[8]

The CPI as a Determinant of Allowable Annual Rent Increases

In the course of discussion about possible amendments to the annual increase standard in the ARO and in other jurisdictions, it has been frequently claimed that the CPI All-items is not a

[8] Hamilton, Rabinovitz & Alschuler, The 1994 Los Angeles Rental Housing Study: Technical Report on Issues and Policy Options, p. 245 (December 1994, Prepared for the Rent Stabilization Division)

good standard for setting allowable increases. Commonly, it is noted that the particular costs of operating residential rental properties increase at different rates than the CPI All-items, which considers increases in the prices of an overall basket of typical household expenses. In particular it has been noted that some utility costs have increased by more than rate of increase in the CPI.

While this issue is often raised when annual rent increase standards are proposed, in the larger California jurisdictions with rent stabilization, Los Angeles, Oakland, and San Francisco, (as well as in Berkeley, East Palo Alto, Santa Monica, and West Hollywood), the outcome has been the adoption of a standard based on the CPI All-items, rather than the use of a weighted index which requires an annual study of apartment operating costs .

In fact, when weighted operating cost studies have been used to determine annual allowable rent increases, the outcome has been mainly determined by the percentage increase in the CPI. Net operating income after operating expenses constitutes more than half of rental income. In the context of rent regulations and annual operating cost studies (as well as the application of fair return standards), it has been considered reasonable to adjust this portion of rental income by the percentage increase in the CPI. Furthermore, the CPI has been used as the best available index to project increases in maintenance, management, and insurance costs, which constitute a substantial portion of apartment operating costs. Publicly available information on these costs is very limited. Property tax increases have been limited to 2% per year, except when properties are reassessed upon sale. More specific cost indexes or rate schedules can be used project increases in utility costs (e.g. refuse collection, water, sewer, public assessments). However, these costs.typically constitute only about a quarter of apartment operating costs (equal to about 10% of rental income). Therefore, the CPI All-Items is the principal determinant of the outcome when weighted operating cost studies are used.

For decades, in order to set allowable annual rent increases, Berkeley and Santa Monica,relied on annual apartment operating cost studies which took into account the weighted cost of expenses that were specific to apartment buildings. When this approach was used annual hearings were required to consider the studies and determine what annual rent increase should be permitted. However, in the past decade these jurisdictions replaced this approach with a CPI standard. In Berkeley, this change was advocated by the apartment owners' association.

IV. Annual Rent Increases under the ARO Compared to Annual Increases Permitted under Other Rent Stabilization Ordinances

Apart from San José and Beverly Hills, since 1995 none of the other nine cities with rent regulations have authorized any annual rent increases in excess of 5%. This outcome is the results of the facts that increases in the CPI have been under 5% since 1995 and' that the ordinances which do not link the annual allowable rent increase to the percentage increase in the CPI have a fixed ceiling of 5% on annual allowable increases.

Since 2000, the annual allowable increases in San Francisco, Los Angeles, and Oakland have not exceeded 3.4%. During this period, in Los Angeles, the average allowable increase has been 3.3%, in San Francisco the average has been 1.4%, and in Oakland the average has been 2.2%.

Table 4.3 below provides the average of annual allowable rent increases under each ordinance by decade. Table 4.4 indicates the allowable rent increases under each rent ordinance in each year.

Table 4.3.
Averages of Allowable Annual Rent Increases under Rent Stabilization Ordinances

	Time Period			
City	***1980-1989***	***1990-1999***	***2000-2009***	***2010-2015***
San José	**8%**	**8%**	**8%**	**8%**
San Francisco	**4.8%**	**2.3%**	**1.9%**	**1.2%**
Los Angeles	**5.4%**	**3.6%**	**3.4%**	**3.0%**
Oakland	**7.8%**	**4.5%**	**2.3%**	**2.2%**
Berkeley	**4.2%**	**5.6%**	**1.7%**	**1.3%**
Santa Monica	**3.7%**	**2.5%**	**2.6%**	**1.5%**
Hayward	**5.0%**	**5.0%**	**5.0%**	**5.0%**
West Hollywood	**3.2%**	**1.9%**	**2.3%**	**1.2%**
Beverly Hills	**8.4%**	**10.0%**	**10.0%**	**10.0%**
East Palo Alto	**2.9%**	**3.4%**	**3.1%**	**1.6%**
Los Gatos	**5.0%**	**5.0%**	**5.0%**	**5.0%**

Table 4.4

Allowable Annual Rent Increases under Rent Stabilization Ordinances

	San José	San Francisco	Los Angeles	Oakland	Berkeley	Santa Monica	Hayward	West Hollywood	Beverly Hills	East Palo Alto	Los Gatos
Year	**(spaces for years preceding the adoption of an ordinance are noted with a dash mark)**										
1979	8.0%	-	-	-	-7.20%	-	-	-	-	-	
1980	8.0%	-	7.0%	10.0%	5.0%	6.5%	-	-	-	-	70% CPI
1981	8.0%	-	7.0%	10.0%	5.0%	5.5%	-	-	-	-	70% CPI
1982	8.0%	7.0%	7.0%	10.0%	9.0%	5.5%	-	-	-	-	70% CPI
1983	8.0%	7.0%	7.0%	10.0%	4.7%	4.5%	-	-	-	-	5.0%
1984	8.0%	4.0%	7.0%	8.0%	0.0%	4.0%	-	-	-	-	5.0%
1985	8.0%	4.0%	4.0%	8.0%	2.0%	3.0%	-	3.0%	7.0%	-	5.0%
1986	8.0%	4.0%	5.0%	8.0%	3%+ $2.50	2.5%	-	2.5%	10.0%	2.7%	5.0%
1987	8.0%	4.0%	4.0%	6.0%	3.5%	4.0%	5.0%	3.5%	5.0%	0.4%	5.0%
1988	8.0%	4.0%	4.0%	6.0%	$25.00	3.0%	5.0%	3.2%	10.0%	3.4%	5.0%
1989	8.0%	4.0%	5.0%	6.0%	3.0%	3.0%	5.0%	3.7%	10.0%	4.9%	5.0%
1990	8.0%	4.0%	5.0%	6.0%	4%/$1 7 min	6.0%	5.0%	3.7%	10.0%	4.9%	5.0%
1991	8.0%	4.0%	5.0%	6.0%	4% + 45% of 1980 rent	3.5%	5.0%	3.5%	10.0%	3.9%	5.0%
1992	8.0%	4.0%	5.0%	6.0%	$26.00	3.0%	5.0%	2.7%	10.0%	2.3%	5.0%
1993	8.0%	1.9%	3.0%	6.0%	$20.00	3.0%	5.0%	2.0%	10.0%	3.3%	5.0%
1994	8.0%	1.3%	3.0%	6.0%	$18.00	2.0%	5.0%	0.7%	10.0%	1.0%	5.0%
1995	8.0%	1.1%	3.0%	3.0%	1.5%	1.5%	5.0%	1.7%	10.0%	1.4%	5.0%
1996	8.0%	1.0%	3.0%	3.0%	1.0%	1.6%	5.0%	1.2%	10.0%	1.8%	5.0%

	San José	San Francisco	Los Angeles	Oakland	Berkeley	Santa Monica	Hayward	West Hollywood	Beverly Hills	East Palo Alto	Los Gatos
1997	8.0%	1.8%	3.0%	3.0%	1.1%	2.0%	5.0%	1.0%	10.0%	5.6%	5.0%
1998	8.0%	2.2%	3.0%	3.0%	0.8%	1.0%	5.0%	1.2%	10.0%	7.1%	5.0%
1999	8.0%	1.7%	3.0%	3.0%	1.0%	1.0%	5.0%	1.7%	10.0%	2.3%	5.0%
2000	8.0%	2.9%	3.0%	3.0%	$6.00	3.0%	5.0%	2.2%	10.0%	6.3%	5.0%
2001	8.0%	2.8%	3.0%	3.0%	$10.00	4.2%	5.0%	2.7%	10.0%	5.8%	5.0%
2002	8.0%	2.8%	3.0%	0.6%	3.5%	$11	5.0%	2.2%	10.0%	2.1%	5.0%
2003	8.0%	0.8%	3.0%	3.6%	0.0%	3.0%	5.0%	1.5%	10.0%	2.2%	5.0%
2004	8.0%	0.6%	3.0%	0.7%	1.5%	1.3%	5.0%	2.7%	10.0%	0.5%	5.0%
2005	8.0%	1.2%	3.0%	1.9%	0.9%	3.0%	5.0%	3.2%	10.0%	2.1%	5.0%
2006	8.0%	1.7%	4.0%	3.3%	0.7%	4.0%	5.0%	4.0%	10.0%	2.4%	5.0%
2007	8.0%	1.5%	5.0%	3.3%	2.6%	2.3%	5.0%	2.2%	10.0%	3.2%	5.0%
2008	8.0%	2.0%	3.0%	3.2%	2.2%	2.7%	5.0%	2.7%	10.0%	3.3%	5.0%
2009	8.0%	2.2%	4.0%	0.7%	2.7%	1.0%	5.0%	0.0%	10.0%		5.0%
2010	8.0%	0.1%	3.0%	2.7%	0.1%	2.0%	5.0%	1.2%	10.0%	0.0%	5.0%
2011	8.0%	0.5%	3.0%	2.0%	0.7%	3.2%	5.0%	2.2%	10.0%	1.4%	5.0%
2012	8.0%	1.9%	3.0%	3.0%	1.6%	1.5%	5.0%	1.2%	10.0%	2.4%	5.0%
2013	8.0%	1.9%	3.0%	2.1%	1.7%	1.0%	5.0%	0.7%	10.0%	2.0%	5.0%
2014	8.0%	1.0%	3.0%	1.9%	1.7%	0.8%	5.0%	1.2%	10.0%	2.0%	5.0%
2015	8.0%	1.9%	3.0%	1.7%	2.0%	0.4%	5.0%	0.7%	10.0%	2.0%	5.0%

Note: Additional allowable rent adjustments for master-metered buildings are not included. Cities using CPI standard may have differing allowable annual increases in the same year due to differing anniversary dates for measuring CPI increases.

V. Allowable Rent Increases under the ARO Compared with Inflation

The allowable annual rent increases under the ARO have been significantly above the rate of inflation. From 1979, through 2000, the average increase in the San Francisco-Oakland-San José area CPI-U *All Items* was 3.3%. From 2000 through 2014, the average increase in the CPI-U *All Items* was 2.6%.

As shown in Table 6 below, when the compounded amounts of the allowable annual increases under the ARO are compared with the compounded increases in the CPI, the differences are especially great. In the case of a tenant who remained in occupancy from January 2010 through December 2015, the compounded total of the allowable annual rent increases was 58.7%, compared with a 16.1% increase in the CPI-U *All Items*.

Table 4.5

Annual Rent Increases allowed under San José Ordinance Compared with Rates of Inflation (SF-Oak-SJ CPI-U All-items Index)

	San José annual allowable increase under ARO	*SF-Oak-SJ CPI All-items Index*
1980	**8%**	**15.2%**
1981	**8%**	**12.9%**
1982	**8%**	**7.5%**
1983	**8%**	**0.8%**
1984	**8%**	**5.7%**
1985	**8%**	**4.2%**
1986	**8%**	**3.0%**
1987	**8%**	**3.4%**
1988	**8%**	**4.4%**
1989	**8%**	**4.9%**
1990	**8%**	**4.5%**
1991	**8%**	**4.4%**
1992	**8%**	**3.3%**
1993	**8%**	**2.7%**
1994	**8%**	**1.6%**
1995	**8%**	**2.0%**
1996	**8%**	**2.3%**
1997	**8%**	**3.4%**
1998	**8%**	**3.2%**
1999	**8%**	**4.2%**
2000	**8%**	**4.5%**
2001	**8%**	**5.4%**
2002	**8%**	**1.6%**
2003	**8%**	**1.8%**
2004	**8%**	**1.2%**
2005	**8%**	**2.0%**
2006	**8%**	**3.2%**
2007	**8%**	**3.3%**
2008	**8%**	**3.1%**
2009	**8%**	**0.7%**
2010	**8%**	**1.4%**
2011	**8%**	**2.6%**
2012	**8%**	**2.7%**
2013	**8%**	**2.2%**
2014	**8%**	**2.8%**
2015	**8%**	**2.6%**
Average 1979-1999	**8%**	**3.2%**
Average 2000-2015	**8%**	**2.4%**
Cumulative Jan. 2010-Dec. 2015	**58.7%**	**15.2%**

VI. Allowable Increases under the ARO Compared with Increases in Market Rents

The prior sections of this Chapter compared annual allowable rent increases under the ARO with the increases allowed under other rent stabilization ordinances with the rate of inflation (the CPI-U *All Items* index. This section compares trends in average rents for the nation, the San Francisco Bay Area, and San José, and reports trends in San José in asking rents and initial rents for new tenants.

To the extent that increases in market rents have been far below the annual increases allowed under the ARO, the ARO has had a very limited overall impact and probably no impact on the rents of most units. Broadly, the data discussed below indicates the ARO was not a constraint on rent increases for most of the years since it was adopted. In most years, neither average nor median market rents for all tenants nor initial rents for new tenants increased by 8% per year.

Trends in Market Rents

In addition to the all-items index, the BLS provides the CPI "Rent of Primary Residence" index that measures trends in rents (hereinafter referred to as the "CPI Rent Index." The BLS provides this index for 24 metropolitan areas in the U.S., as well as for the U.S as a whole. The index does not include a breakdown of rent trends by age of building or length of tenancy, and cannot be broken down into subsets in the same manner as Census data through its Public Use Microdata Sample (PUMS) database.

The San Francisco-Oakland-San José CPI Rent: Index is based on a rent survey of the "Combined Statistical Area" (CSA) comprising the nine Bay Area counties, the Santa Cruz-Watsonville Metropolitan Statistical Area, and the Stockton-Lodi Metropolitan Statistical Area.

There are approximately 1.2 million rental units in the area covered by the CPI Rent Index for the San Francisco-Oakland-San José Area CSA. Approximately one-quarter of those apartments are subject to local rent regulations.[9] The Rent Index for the Bay Area CSA largely reflects trends in unregulated market rents because three-quarters of the apartments that are sampled by the BLS survey are not subject to a rent regulation. Furthermore, about 25% of the rentals of units that are subject to rent regulation in the CPI Rent Index survey involve rentals in which an apartment owner was able to set the initial rent within the past two years due to tenant turnover and vacancy decontrol.

To the extent that apartment owners implement larger rent increases for new tenants when units become vacant (through vacancy decontrol) than for rental increases for tenants remaining in place, the average of all rent increases reflected in the increases in the CPI rent index would be greater than the average rent increases for tenants who remain in place.

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[9] This estimate is based on a projection of approximately 300,000 rent controlled units in the San Francisco Bay Area, based on the following approximate projections for each City with rent controlled units: San Francisco – 180,000; Oakland – 60,000; San Jose – 44,000; Berkeley – 19,000; Hayward – 9,000; East Palo Alto – 2,000.

In most years, the allowable rent increases under the ARO have far exceeded the rates of increase in the CPI Rent Index for the San Francisco Bay Area. From 1979 thru 2015, the S.F. Bay Area CPI Rent Index increased by an average of 4.9% year. From 2000 through 2015, the average annual increase has been 3.3%. In about one-third of the years since 1979, the annual increase in the CPI Rent Index was less than 3%. From 2002 through 2011, the average increase in the SF Bay Area CPI rent was 1.9%.

In contrast, in the years immediately following the adoption of the ARO were marked by annual increases in the CPI Rent Index exceeding or nearly equaling the 8% ceiling under the ARO. From 1979 to 1986, the annual increases San Francisco-Oakland-San José Rent Index ranged from 7.2 to 12.9%. From 1998 through 2000, the annual increase ranged from 7 to 7.8%. In 2001, the annual increase in the rent index was 10.6%. In the past two years, the increases in the Rent Index have been under 5.5% and 6.1%; however, the studies of the real estate industry have documented increases of more than 8% per year among the larger properties that they survey.

On a cumulative basis, the differences between the allowable increases under the ARO and market trends have often been striking. For example, during five-year periods when market rents were increasing by 4% a year, the cumulative increase in market rents would have been 21.6%, while the cumulative increase in the allowable rents under the ARO for the same period would be 46.9%.[10] Under these circumstances, the ARO has had little effect on actual rent levels.

[10] 8% per year compounded.

Table 4.6

Annual Rent Increases Allowed under San José ordinance Compared with Increases in the San Francisco-Oakland-San José CSA CPI Rent Index

	San José Annual Allowable Increase under ARO	*SF-Oak-SJ CPI Rent Index*
1980	**8%**	**12.69%**
1981	**8%**	**10.20%**
1982	**8%**	**9.6%**
1983	**8%**	**9.9%**
1984	**8%**	**8.4%**
1985	**8%**	**8.1%**
1986	**8%**	**8.3%**
1987	**8%**	**4.6%**
1988	**8%**	**4.3%**
1989	**8%**	**3.9%**
1990	**8%**	**4.7%**
1991	**8%**	**3.6%**
1992	**8%**	**2.4%**
1993	**8%**	**2.7%**
1994	**8%**	**1.9%**
1995	**8%**	**1.5%**
1996	**8%**	**2.6%**
1997	**8%**	**6.1%**
1998	**8%**	**7.8%**
1999	**8%**	**7.0%**
2000	**8%**	**7.0%**
2001	**8%**	**10.6%**
2002	**8%**	**3.8%**
2003	**8%**	**0.1%**
2004	**8%**	**-0.2%**
2005	**8%**	**0.3%**
2006	**8%**	**1.5%**
2007	**8%**	**3.9%**
2008	**8%**	**4.1%**
2009	**8%**	**3.2%**
2010	**8%**	**-0.1%**
2011	**8%**	**2.3%**
2012	**8%**	**4.1%**
2013	**8%**	**4.5%**
2014	**8%**	**5.5%**
2015	**8%**	**6.1%**
Avg. 1980-2015	**8%**	**4.9%**
Avg. 2000-2015	**8%**	**3.3%**

Trends in SF Bay Area Market Rents Compared with National Trends

To place the increases in the SF-Oak-SJ Area CPI Rent Index in perspective, the cumulative increases in this area have been well above the national average. From 1979 through 2015, the S.F.-Oak-SJ Area CPI Rent Index increased by 454% compared to an increase of 285% in the U.S. CPI Rent Index. During this period, the average annual increase in the SF-Oak-SJ CPI rent index was 4.9%, compared with the national average of 3.8%.

In an exception to the foregoing patterns, from 2000 to 2010, the S.F.-Oak-SJ Area CPI Rent Index increased by less than the increase in the U.S. CPI Rent Index. During this decade, the SF-Oak-SJ CPI Rent Index increased by 32.7% compared to an increase in the national index of 35.6%. However, from January 2010 to December 2015, the S.F. Area CPI Rent Index increased by 29% compared to an increase in the national CPI Rent Index of 16.9 %

Table 4.7

Increases in SF-Oakland-San José CPI Rent Index Compared with Increases in U.S. CPI Rent Index

Year	*SF-Oak-SJ CPI-U Rent Index*	*U.S. CPI-U Rent Index*
1980	12.7%	8.9%
1981	10.2%	8.7%
1982	9.6%	7.6%
1983	9.9%	5.8%
1984	8.4%	5.2%
1985	8.1%	6.2%
1986	8.3%	5.8%
1987	4.6%	4.1%
1988	4.3%	3.8%
1989	3.9%	3.9%
1990	4.7%	4.2%
1991	3.6%	3.5%
1992	2.4%	2.5%
1993	2.7%	2.3%
1994	1.9%	2.5%
1995	1.5%	2.5%
1996	2.6%	2.7%
1997	6.1%	2.9%
1998	7.8%	3.2%
1999	7.0%	3.1%
2000	7.0%	3.6%
2001	10.6%	4.5%
2002	3.8%	4.0%
2003	0.1%	2.9%
2004	-0.2%	2.7%
2005	0.3%	3.0%
2006	1.5%	3.6%
2007	3.9%	4.3%
2008	4.1%	3.7%
2009	3.2%	2.3%
2010	-0.1%	0.2%
2011	2.3%	1.7%
2012	4.1%	2.7%
2013	4.5%	2.8%
2014	5.5%	3.2%
2015	6.1%	3.6%
Jan. 2010 - Dec.2015	29%	16.9%

As well as substantially exceeding the national average, the overall increases in the SF-Oak-SJCPI Rent Index from 1979 to 2015 exceeded the overall increases in each of the other twenty-three standard metropolitan areas (SMSA) in the U.S. for which the CPI Rent Index has been compiled since 1979. The table below compares the increases in the CPI Rent Index among metropolitan areas from 1979 through 2015.

Table 4.8

Increases in CPI Rent Indexes of Metropolitan Statistical Areas Compared

SMSA	*Cumulative Percent Increases in CPI Rent Index*				
	1979–1990	*1990–2000*	*2000-2010*	*2010-2015*	*1979-2015*
SF-Oak-SJ	**125%**	**51%**	**30%**	**25%**	**454%**
U.S.	86%	33%	36%	15%	285%
Los Angeles	119%	18%	58%	13%	364%
Anchorage	31%	39%	37%	17%	190%
Atlanta	93%	39%	11%	11%	230%
Boston	121%	32%	35%	13%	346%
Chicago	88%	42%	33%	12%	300%
Cincinnati	73%	30%	24%	12%	212%
Cleveland	63%	38%	20%	8%	192%
Dallas	62%	42%	16%	19%	218%
Denver	54%	67%	18%	28%	287%
Detroit	71%	27%	19%	13%	189%
Honolulu	107%	18%	47%	11%	301%
Houston	35%	46%	28%	21%	206%
Kansas City	70%	37%	23%	13%	225%
Miami	66%	33%	52%	15%	284%
Milwaukee	77%	29%	26%	9%	214%
Minneapolis	79%	34%	23%	14%	237%
New York City	97%	37%	53%	15%	370%
Philadelphia	103%	27%	36%	11%	289%
Pittsburgh	63%	26%	25%	16%	199%
Portland	58%	44%	23%	23%	246%
St. Louis	77%	20%	25%	12%	199%
San Diego	111%	26%	57%	12%	367%
Seattle	72%	43%	31%	23%	295%

Source: Author's tabulations based on Bureau of Labor Statistics, CPI data

Trends in Actual Rents in San José

Data on Actual Rent Trends in San José

Data on Rent Trends in San José is available from decennial census reports and the Census Bureau's American Community Survey (ACS), which is performed on an annual basis.

The ACS, has been performed since 2005. It is based on a sample of about one percent of all households, with standard margins of error of two percent. In the case of San José, the annual sample sizes have ranged from 944 to 1,309 units. The latest available ACS data contains averages for 2014, and therefore does not reflect the exceptional trends of the last year and a half.[11]

The Public Users Microdata Set (PUMS) can be used in order to obtain data for subsets of all rental units, making it possible to obtain averages based on age of the building, the move-in year of the tenant and/or the size of the building.

PUMS data sets are created for each ACS and were created for the 1990 and 2000 decennial censuses but not for the 2010 decennial census.

Industry data is very current (e.g. for the most recent quarter) but is limited to large buildings (for example, only buildings of all ages with 50 or more units) which may differ in character in terms of amenities and desirability from the balance of the rental market. Also, industry surveys inquire about asking rents rather than average rents.

While each data set has limitations, the combination of the data from these sources is instructive about trends in the overall market and apartments subject to the ARO.

Differences in Rent Increases between Pre and Post 1980 buildings

From 2000 to 2005, average monthly rents in buildings with 3 or more units in San José hardly changed. In buildings constructed before 1980, average rents increased by 6.5% over the five year period (from $937 to $998). In buildings constructed 1980 are later, average rents increased by 4.5% (from $989 to $1,044).

From 2005 to 2014, he average rents of multifamily units constructed before 1980 increased by 30.8% ($998 to $1,306) compared to a 35.8% increase among units constructed 1980 or later($1,106 to $ 1,502).

In 2008 there were substantial increases in average rents. In contrast, rents were relatively stable in 2009 through 2011. In 2012, rents again started to increase at a substantial rate.

[11] The 2014 ACS was released in September 2015.

The differences in average rent levels between pre- and post-1980 buildings have ranged from $104 to $233. These differences may be caused by factors other than age, such as differences in average size, quality, amenities, and/or location.

Table 4.9
Average Rents Multifamily Properties (3 or more units) in San José
1990, 2000, and 2005-2014
Pre and Post 1980 Buildings

	Average Rent			
Year	Units Built before 1980	Units Built 1980 or later	Difference in Average Rents Pre- & Post- 1980	All Units
1980				$325 All size bldgs.*
1990	618	733	115	643
2000	937	1,097	160	989
2005	998	1,106	108	1,044
2006	971	1,164	194	1,060
2007	1,037	1,153	114	1,091
2008	1,096	1,199	104	1,141
2009	1,068	1,290	222	1,216
2010	1,102	1,285	183	1,192
2011	1,093	1,298	205	1,192
2012	1,173	1,314	140	1,240
2013	1,210	1,443	233	1,341
2014	1,306	1,502	196	1,407

Sources: Data from 2005-2014 based on Annual Census Surveys. Data for 1980, 1990, and 2000 based on Decennial Census.
*In 1980, 41% of rental units were in single family, single family attached, and two unit bldgs..

Comparisons Based on Building Sizes

Among buildings constructed before 1980, average rents and the rates of increase in rents have in buildings with 3 or 4 units and in buildings with 20 or more units have not differed substantially from overall averages.[12]

Table 4.10
Average Rents – 1990, 2000, & 2005-2014
Buildings Built Before 1980
Comparison of Buildings with 3 or 4 units, Buildings with 20 or more units
All Buildings 3 or More Units

	Average Rents		
	3 & 4 unit bldgs.	20 or more unit bldgs.	All bldgs. 3 or more units
Year			
1990	683	610	618
2000	1,007	939	937
2005	1,052	1,017	998
2006	1,067	942	971
2007	1,051	1,105	1,037
2008	1,101	1,077	1,096
2009	1,188	1,066	1,068
2010	1,103	1,125	1,102
2011	1,155	1,113	1,093
2012	1,160	1,113	1,173
2013	1,194	1,184	1,210
2014	1,379	1,350	1,306

Sources: American Community Surveys (ACS) and Decennial Census, Public Use Microdata Sets

[12] The statistical differences which do appear are smaller than standard margin of error, except in the cases of the 1990 and 2000 decennial census.

Increases in "Real" (Inflation Adjusted) Rents

Projections of rent increases based on actual dollars are subject to the limitation that they do not reflect what may be considered the "real" increase in rents. If the wages of tenants are increasing at the same pace as rents, there may not be an increase in the "real" rental costs. In studies of trends in household income and standards of living, it is common to use household income amounts that are inflation adjusted in order to evaluate outcomes in terms of affordability

In San José, the average rent in inflation adjusted dollars of units in buildings with three or more units constructed before 1980s, increased by 8% from 2005 to 2014 and has certainly increased by an additional amount since the Census Bureau's 2014 American Community Survey. Overall, since 1990, inflation adjusted rents have increased by 10.8%. While overall rent increases since 1990 have exceeded the rate of increase in the CPI, this 25 year period includes a twelve year period from 2000 to 2013 in which inflation adjusted rents by 7.6%

Table 4.11

Average Rents Multifamily Properties (3 or more units) in San José Current and Inflation Adjusted Dollars Pre and Post 1980 Buildings 1990, 2000, and 2005-2014

Year	*Units built before 1980*		*Units built 1980 or later*	
	Average Rent	**Inflation Adjusted Average (2015 dollars)**	**Average Rent**	**Inflation Adjusted Average (2015 dollars)**
1990	**618**	**1181**	**733**	**1401**
2000	**937**	**1333**	**1,097**	**1561**
2005	**998**	**1211**	**1,106**	**1342**
2006	**971**	**1142**	**1,164**	**1369**
2007	**1,037**	**1185**	**1,153**	**1318**
2008	**1,096**	**1207**	**1,199**	**1320**
2009	**1,068**	**1180**	**1,290**	**1425**
2010	**1,102**	**1198**	**1,285**	**`1397**
2011	**1,093**	**1152**	**1,298**	**1368**
2012	**1,173**	**1211**	**1,314**	**1356**
2013	**1,210**	**1231**	**1,443**	**1468**
2014	**1,306**	**1308**	**1,502**	**1504**

Sources: American Community Surveys (ACS) and Decennial Census, Public Use Microdata Sets and CPI –U All Items, SF-Oak-SJ.

Trends in Initial Rents for Recent Movers

Typically, rents for new tenants are higher than the rents for existing tenants. The differences may be attributable to several factors. As previously discussed, landlords may refrain from raising the rents of existing tenants in order to avoid turnover costs and/or to promote good relations. Another factor may be that tenants with lower rents are less likely to move; as a result, units with higher rents are more likely to have recent movers.

Average rents for tenants who moved in within the past year have been above the average for all tenants in every year since 2005. The differences between the overall average and the average for new tenants have been greatest in times of substantial inflation in rents. In buildings constructed before 1980, in times when market rents were not increasing (e.g. 2006 and 2010),[13] the difference between the overall average and the average rent of the tenants who moved in within the past year was under $40, while in the past three years the differences have ranged from $121 to $199.

In buildings constructed before 1980, the average rent for tenants who moved in within the past year increased by 19% from 2011 to 2014. In buildings constructed in 1980 or later, the increase was 32.5%. These **increases** compare with an increase in the CPI-U *All-items* of 7.9% during this period.

From 2013 to 2014, the increase in average rents for new tenants in buildings constructed 1980 or later was exceptional. The average for tenants who had moved in within the last twelve months increased from $1,626 to $1,925, an increase of 18.4%. In contrast, the increase in the rents of new tenants in pre-1980 buildings was 1.3%.

[13] In 2006, the CPI-U Rent Index increased by 1.5% and in 2010 the Index actually decreased by 0.3%.

Table 4.12

Average Rents of Tenants Moving in Within Past 12 Months Compared with Average Rents for All Tenants Multifamily Properties (3 or more units) in San José 1990, 2000, and 2005-2014 Pre and Post 1980 Buildings

Year	*Units built before 1980*		*Units built 1980 –present*	
	Average Rent	Average Rent Moved in within last 12 months	Average Rent	Average Rent Moved in within last 12 months
1990	618	647*	733	784*
2000	937	1,004*	1,097	1,228*
2005	998	1,069	1,106	1,206
2006	971	1,003	1,164	1,248
2007	1,037	1,144	1,153	1,244
2008	1,096	1,199	1,199	1,291
2009	1,068	1,209	1,290	1,316
2010	1,102	1,133	1,285	1,412
2011	1,093	1,197	1,298	1,453
2012	1,173	1,314	1,314	1,533
2013	1,210	1,409	1,443	1,626
2014	1,306	1,427	1,502	1,925

Sources: American Community Surveys (ACS) and Decennial Census, Public Use Microdata Sets

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Data from Real Estate Industry Surveys

Private real estate industry services survey trends in asking rents and market rents. Typically those services obtain data for larger buildings which charge higher than average rents. The data from these sources seems to indicate that the initial rent levels of the large buildings are more

volatile and that they have increased by greater percentages than the initial rent levels in other portions of the rental stock. This may reflect greater efforts by owners of large buildings to maximize returns on upward cycles in the market. The data also indicates that the larger buildings have experienced greater rent reductions during downward cycles, with reductions ranging from 6% to 11% in some years.

RealFacts Data

Realfacts reports on rental market trends are widely publicized in the news. Realfacts obtain data from property resident managers and leasing agents on asking rents in properties with fifty or more units.

The average size of the properties it surveys in San José is about 250 units. For example, in the 3rd quarter of 2015, Realfacts surveyed 157 properties with 37,384 units (an average of 248 units per property).

Its reports covering San José indicate that asking rents increased by 62.1% from 2010 through 2015.

Table 4.13
Trends in Asking Rents – RealFacts Reports San José

Year	*Asking Rent Annual Average*	*Pct Change over Prior Year*
2000	**$1,594**	
2001	**$1,652**	**3.6%**
2002	**$1,346**	**-18.5%**
2003	**$1,259**	**-6.5%**
2004	**$1,234**	**-2.0%**
2005	**$1,253**	**1.5%**
2006	**$1,343**	**7.2%**
2007	**$1,489**	**10.9%**
2008	**$1,595**	**7.1%**
2009	**$1,486**	**-6.8%**
2010	**$1,485**	**-0.1%**
2011	**$1,643**	**10.6%**
2012	**$1,804**	**9.8%**
2013	**$1,974**	**9.4%**
2014	**$2,173**	**10.1%**
2nd Q 2015	**$2,407**	**10.8%**
Pct Increase 2010-2nd Q 2015		**62.1%**

Marcus & Millichap National Apartment Reports

Marcus & Millichap, a nationally prominent source of data on trends in multifamily housing publishes annual reports on multifamily housing throughout the nation, as well as quarterly reports on individual markets.

Its reports provide data on rent trends for the San José metropolitan area, rather than being limited to the City. The reports indicate that asking rents increased in this area by 57.6% from 2010 to 2014.

Table 4.14
Trends in Asking Rents San José Area
Reported in Marcus & Millichap Annual National Apartment Reports

Year	*Asking Rent*	*Pct Change over Prior Year**
2004	**$1,286**	
2005	**$1,332**	**3.6%**
2006	**$1,481**	**11.2%**
2007	**$1,641**	**10.8%**
2008	**$1,589**	**-3.2%**
2009	**$1,401**	**-11.8%**
2010	**$1,447**	**3.3%**
2011	**$1,777**	**22.8%**
2012	**$1,917**	**7.9%**
2013	**$2,058**	**7.4%**
2014	**$2,281**	**10.8%**
Percentage Increase 2010-2014		**57.6%**

Pct. Change over Prior Year calculated by authors of this report.

Berkeley and East Palo Alto Rent Board Data Based on Reporting for All Rental Units

Data from Berkeley and East Palo Alto are worth noting because their rent stabilization programs have a virtually a complete dataset on rent trends encompassing small buildings as well as large buildings that were constructed before 1980. Under their ordinances, information on the rents and the move-in dates of each tenant in all regulated buildings (most of the buildings constructed before 1980) must be reported to the rent administration on an annual basis. While the average rents in those cities may differ from the average rents in San José due to market differences, the data on the rent trends in those cities is instructive about trends in market rents in the Bay Area.

The data indicates that the average initial rent for new tenants of rent-stabilized apartments in East Palo Alto increased by 67.5% from 2011 to 2015, from $1,081 to $1,811.[14] In Berkeley, from the third quarter of 2010 to the third quarter of 2015, median rents for new tenants of one-bedroom apartments increased by 55.6% and the median rents of two-bedroom apartments increased by 62.5%.[15] The median rent increases within the last reported twelve-month period, from the third quarter in 2014 to the third quarter in 2015, were particularly striking, equaling 15%.[16]

VII. "Additional" Allowable Rent Increases under Rent Stabilization Ordinances

Apart from allowing annual across-the-board rent increases tied to a percentage of the percent increase in the CPI or set at a fixed percentage, rent stabilization ordinances have provided for the following types of increases: banking of rent increases that were allowed in prior years but were not implemented, additional increases for subgroups of properties and/or additional rent increases designed to cover cost increases attributable to specific types of government fees.

In some cases the increases have been set at a fixed percentage. In other cases, they have been individualized, based on the amount of the increase for each property in a designated type of expense.

"Banking" of Rent Increases

Under a majority of apartment rent stabilization ordinances in California, but not the Los Angeles Rent Stabilization Ordinance nor the West Hollywood rent ordinance, apartment owners may "bank" allowable annual rent increases if they are not implemented in the year in which they are permitted. Commonly, the jurisdictions that allow banking limit the amount of banked rent increases that can be implemented within a single year so that tenants are not suddenly faced with steep rent increases.

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[14] Source: Tabulations by Author based on the database of East Palo Alto Rent Stabilization Board.

[15] In the third quarter of 2010, 727 tenancies commenced in one bedroom units and 523 tenancies commenced in 2 bedroom units. In the third quarter of 2015, 520 tenancies commenced in one bedroom units and 383 tenancies commenced in 2 bedroom units.

[16] Executive Director, Memo to Rent Stabilization Board, "Market Medians Report Updated with data for the 2nd and 3rd Quarter of 2015.Berkeley Rent Board.

Table 4.15
Banking provisions in California Rent Stabilization Ordinances

Jurisdiction	*Type of Banking Provision*
San José	**21% rent increase authorized if rents have not been increased in over 24 months**
Los Angeles	**Banking Not Permitted**
Berkeley	**Unlimited right to bank annual increases**
Beverly Hills	***Banking not addressed in ordinance***
East Palo Alto	**Not more than three annual general adjustments may be banked and the overall rent increase cannot exceed 10% in a single year.**
Hayward	**The Banked adjustment plus the annual adjustment cannot exceed 10% in any year**
Los Gatos	***Banking not addressed in ordinance***
Oakland	**Banked adjustments plus annual adjustment implemented in any year cannot exceed three times annual adjustment**
San Francisco	**Unlimited right to bank annual increases**
Santa Monica	**Unlimited right to bank annual increases**
West Hollywood	**Banking Not Permitted** **Increases since 1996 may not be banked**

Source: Based on author's review of rent ordinances.

Rationales for allowing banking have included: 1) Allowing banking provides apartment owners with an incentive to defer allowable rent increases (or, alternately stated, removes a disincentive to deferring allowable rent increases) thereby benefitting tenants.. Otherwise apartment owners are faced with a "use it or lose it" choice; and 2) Owners should not be "penalized" for not implementing allowable rent increases as soon as they are permitted. The rationale for not permitting or for limiting banking is that, when apartment owners decide to use a substantial amount of banked increases the result can be a rent "shock" for tenants.

Apartment owners may forego annual allowable rent increases for different reasons. One purpose may be to retain current tenants and to improve relations with tenants. Some may forego allowable rent increases for tenants based on individual considerations such as the financial situation of the tenant or the desirability of the tenant. Alternatively, allowable annual rent increases might not be implemented because the average rents in the overall market have not increased. It may be more likely that banked increases would be imposed upon changes in

ownership by new owners who have made larger investments and have larger mortgages than the previous owner.

Pass-Throughs for Subclasses of Property and/or Specific Types of Costs

Under some of the rent stabilization ordinances, pass-throughs are authorized for a substantial number of properties either without any petition process or with a petition process that only requires documentation of a specific type of expense increase.

Under the ARO, the City Council may authorize pass-throughs of new charges (as opposed to increases in an existing charge) which are imposed by governmental entities or public utilities.[17] To date the Council has not authorized any pass-throughs pursuant to this section of the ARO.

In other rent stabilized jurisdictions, pass-throughs above the annual allowable rent increase have been authorized for buildings with master-metered gas and electricity, for newly imposed public fees and bonds, for increases in water costs, and/or for rent stabilization board registration fees.

The pass-throughs have taken two forms: "across-the-board" or "individualized." An "across-the-board" pass-through may be a uniform rent adjustment for all properties or for a designated class of properties. For example, a program might allow an additional rent increase of 0.5% for all buildings with master-metered electricity.

In order to place pass-throughs in perspective, in San Francisco, Berkeley, Santa Monica, and West Hollywood they have been adopted in the context of regulations which have limited annual across-the-board rent increases to less than 100% of the percentage increase in the CPI. Therefore, those cities could have felt a greater need to allow for additional rent increases to cover certain types of cost increases.

Additional Increases for Buildings with Master Metered Gas and/or Electricity Service

Some rent-controlled jurisdictions have provided apartment owners with varying types of additional increase allowances for buildings with master-metered gas and/or electricity. For example, under the Los Angeles Rent Stabilization Ordinance, apartment owners are permitted additional rent increases of 1% per year if their buildings are master metered for gas and/or for electricity.

, Under other rent stabilization ordinances the amounts of allowable pass-throughs for increases for master-metered gas and electricity have been linked to an estimate by the rent board of average cost increases for the provision of gas and/or electricity or to the provision of documentation by individual apartment owners of their particular cost increases.

[17] Section 17.23.205.A.

When Berkeley and Santa Monica based annual rent increase allowances on apartment operating cost studies, in some years across-the-board rent increases were authorized to cover the provision of master-metered electricity and/or gas.

In Santa Monica, since 1985 the adjustments have totaled only about 3% to 4% of the rent. Under the San Francisco ordinance, owners may petition for a pass-through that is based on the actual increases in gas and electricity costs for the individual property. In some years, the volume of petitions was substantial. In FY 2005-06, the San Francisco Board received 228 petitions covering 4,746 units. In FY 2006-07, the Board received 406 petitions covering 4,703 units. Since 2010, there have been less than fifty utility pass-through petitions per year. Board staff has indicated that the petitions were generally filed by more sophisticated owners of larger buildings.

Gas and electricity cost increases for master-metered buildings were a pressing issue in the past, but have not been in recent years. In the past few decades, gas and electricity rates have fluctuated upwards and downwards.

Under these circumstances, it may be more reasonable to determine how to allow for increases when they occur, rather than to provide for fixed annual allowances which are unlikely to parallel actual trends in costs on more than a temporary basis. In Los Angeles, where additional annual rent increases of 1% per year have been permitted for each master metered gas and master metered electricity, over a 30-year period an additional 30-60% in rent increases have been authorized for master-metered buildings for these services. While at one point the additional annual rent increases of 1-2% may have been reasonable, over a thirty year period the additional of 1-2% every year for the purpose of covering increases in the cost of these utilities have been much greater than the actual cumulative increases in these costs. As an alternative to additional utility increases that exist in perpetuity, the authorization of any rent increase to cover these costs could be based on a one-year across-the-board allowance based on an estimate of the average cost increase of providing these services. The extra allowance could be for one rent increase rather than automatically recurring. If the circumstances so warrant, petitions could be permitted for owners who incur cost increases are well above the average.

Rent Adjustment Mechanisms Designed to Achieve Conservation Objectives as Well as Cost Pass-through Objectives

In some instances, rent adjustment mechanisms have been used to achieve conservation objectives, apart from the standard objectives of rent regulations.

Pass-Throughs of Charges for Excess Water Usage

Under the regulations of the San Francisco Rent Board, apartment owners may pass-through to tenants half of "excess use charges (penalties)" levied by the City Water Department, provided that the owner has complied with low flow retrofit requirements for toilets and showers.[18]

VIII. Consideration of Tenant Income in Rent Control Standards

Exemptions from Rent Regulation Based On Tenant Income

In the course of the current discussions about the ARO, suggestions have been made about exemptions from rent regulation for units occupied by tenants with incomes above a designated level.

From a policy perspective, such proposals may raise the issue of whether the purpose of the rent regulations are to limit annual rent increases because rent increases above a certain amount would be excessive, or if, alternatively, the purpose is to protect economically needy households. If the purpose is to prevent excessive rent increases then the income of the tenant is not relevant to the purpose. If the purpose is to protect economically needy households, than the income of the tenant is a central factor.

Legislation is commonly the outcome of varying public purposes. In the case of rent stabilization laws, while they have set forth both of the foregoing purposes, they have always provided for across-the-board regulation without consideration of tenant incomes, with only one exception discussed below. Under New York City's rent stabilization law, in units where the rent has reached a certain level and that are occupied by households with an income of $200,000 or more can become exempt from rent regulation under certain conditions.

An exemption from rent regulation of units with high-income tenants may create an incentive for apartment owners to pick high-income households over moderate- or low-income households as renters.

Additional Protections for Low-Income Tenants

As far is this author is aware, outside of San José, the only additional protections of low-income tenants in regulation of private unsubsidized tenancies exist is in the context of requirements for displaced tenants. For example, under certain rent-controlled jurisdictions, such as Los Angeles and San Francisco, higher relocation benefits and longer notice periods are required for tenants

[18] San Francisco Residential Rent Stabilization and Arbitration Board Rules and Regulations, Sec.4.13 (adopted in 1991). Under the Beverly Hills ordinance 90% of excess water charges can be passed through to tenants.(Beverly Mun. Code. Sec. 4-6-7).

who are to be displaced by no-fault evictions, such as evictions for owner occupation and/or building closures.

The protection of low-income households has been a primary justification of rent controls. However, the tool for accomplishing this objective has been to limit rent increases for all tenants to a level that is deemed to be reasonable, rather than targeting rent increase protections towards particular classes and income groups.

In the course of debates over rent controls, some critics of rent control have taken the position that the controls should only protect low-income households that need protection, rather than all tenants. On the other hand, owners have taken the position they should not be required to subsidize tenants because their income is low and that subsidization is a state responsibility, rather than a responsibility that may be imposed on individual owners.

No apartment rent stabilization ordinance authorizes differentials in allowable rent increases based on tenant income.

The ARO contains a provision requiring that a hearing officer shall consider "economic and financial hardship" imposed on a tenant in determining what rent increase shall be allowed for that tenant pursuant to the increase allowances beyond the annual adjustment. It states that

> Hardship to tenants.
> In the case of a rent increase or any portion thereof which exceeds the standards set in Section 17.23.440A or B, then with respect to such excess and whether or not to allow same to be part of the increase allowed under this chapter, the hearing officer shall consider the economic and financial hardship imposed on the present tenant or tenants of the unit or units to which such increases apply. If, on balance, the hearing officer determines that the proposed increase constitutes an unreasonably severe financial or economic hardship on a particular tenant, he may order that the excess of the increase which is subject to consideration under paragraph C. of Section 17.23.440, or any portion thereof, be disallowed.[19]

The foregoing section was specifically reviewed and upheld by the U.S. Supreme Court.[20] However, the Court's review was very restricted in scope. The legal challenge was considered as a "facial challenge" in a circumstance in which the clause had never been applied in an individual rent adjustment case. Therefore, the Court ruled that it was "premature" to consider the plaintiff's claim under the "Takings Clause" of the Constitution and limited its consideration to whether the provision violated the "Due Process" or "Equal Protection" clauses of the Constitution.[21]

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[19] Section 17.23.450

[20] *Pennell v. City of San Jose*, 485 U.S. 1 (1988)

[21] *Id*. 485 U.S. at 15.

If a future rent increase based on a petition was deemed to be necessary in order to provide a fair return, a new constitutional issue would emerge if the allowable increase was then reduced below that amount for a particular tenant based on tenant hardship considerations. The New Jersey Supreme Court, which had consistently upheld tenant protections and had an exceptionally strong record of compelling municipalities to allow a fair share of affordable housing, struck down this local provision, holding that such an outcome would be unconstitutional,

The Court stated:

> A legislative category of economically needy senior citizens is sound, proper and sustainable as a rational classification. But compelled subsidization by landlords or by tenants who happen to live in an apartment building with senior citizens is an improper and unconstitutional method of solving the problem.[22]

Just as exemptions from rent regulation of units occupied by high income tenants would create incentives to choose high income tenants, additional protections for low income tenants would create incentives for apartment owners to discriminate the against low income applicants in the tenant selection process.

New York's Subsidy Offsetting Rent Increases of Low Income Senior and Disabled Tenants

New York's Senior Citizen Rent Increase Exemption (SCRIE) exempts from annual rent increases senior households and households of disabled persons in which household income is under $50,000 and rent exceeds one-third of household income.[23]

However, this program does not impact the amount of rent that apartment owners receive because it is financed through tax rebates offsetting the amounts of the exemptions.

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[22] *Property Owners Assn. v. North Bergen*, 74 N. J. 327, 339, 378 A. 2d 25, 31 (1977)

[23] Tenants must apply to the State Department of Finance for the exemptions authorized by the program.

Appendix to Chapter 4

Selection of a CPI Index in Rent Regulation

In some jurisdictions in which rent regulations have been adopted there have been discussions and debates over which CPI index should be used in setting allowable rent adjustments.

The Bureau of Labor Statistics (BLS) publishes price indices for individual types of costs as well as the overall market basket of expenditures of a household through periodic surveys. In particular, the BLS produces the Consumer Price Index (CPI) "All Items" and "All Items Less Shelter." Apart from publishing price indexes for different costs, the BLS publishes indexes for two different groups of consumers "All Urban Consumers" (CPI-U) and "Urban Wage Earners and Clerical Workers" (CPI-W). (Appendix A, at the end of this Report, includes CPI tables)

Under most of the rent control ordinances that use a CPI standard, the CPI-U *All Items* for the metropolitan area is used. Under Oakland's annual rent increase standard, the allowable increase is tied to the average of the percentage increases in the CPI-U *All Items* and the CPI-U *All Items Less Shelter* indices.[24]

CPI *All Items* indexes take into account a basket of household costs weighted in accordance with their shares of average household expenditures. "Shelter" constitutes 38.7% of the market basket in the CPI-U *All Items* index. In measuring Shelter costs, rent levels are used as a proxy to measure housing costs for homeowners. [25]

The weights of the household costs in the San Francisco-Oakland-San José CPI-U *All Urban* index are: Shelter – 38.7%, Food and beverages – 14.3%, Transportation – 14%, Medical Care – 7.3%, Education – 6.3%, Recreation -5.7%, Household furnishings and operations – 3.9%; Fuels and utilities – 3.5%, , Other Goods and Services – 3.3%., Apparel – 2.9%.[26]

At various times, tenant and/or landlord representatives have proposed the use of alternates to the CPI-U *All Items* on the basis that an alternate would be more reasonable. Proposals to use a particular index are usually most favorable to the particular group (landlords or tenants) proposing the use of that index in the particular years at the particular time when the proposal is made.

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[24] Oakland Municipal Code Sec. 8.22.070.B.3.

[25] "Rent of primary residence (rent) and Owners' equivalent rent of primary residence (rental equivalence) are the two main shelter components of the Consumer Price Index .... Rental equivalence measures the change in implicit rent, which is the amount of a homeowner would pay to rent, or would earn from renting, his or her home in a competitive market." (Bureau of Labor Statistics web page, www.bls.gov , Consumer Price Indexes for Rent and Rental Equivalence.

[26] See Bureau of Labor Statistics (BLS) "Table 3 (2011-2012 Weights). Relative Importance of components in the Consumer Price Indexes. Selected metropolitan areas, Dec.2014" posted at "www.bls.gov/cpi/cpiriar.htm"

The following discussion considers issues related to the selection of particular indexes.

The All Urban Consumers: All Items (CPI-U) Index versus the Urban Wage Earners and Clerical Workers: All Items Index (CPI-W)

A rationale for using of the *CPI for Urban Wage Earners and Clerical Workers (CPI-W)* index, rather than the CPI-U index, is that the former more accurately reflects changes in the cost of living for renters because renters are more likely to be wage earners and clerical workers. However, the differences between the overall increases in the two indexes have been very small. Over the last 36 years, since 1979, the *All Urban Consumers* (CPI-U) *All Items* index has increased by 261% compared to an increase of 256.1% in the *CPI-W* index. The CPI for All Urban Consumers (CPI-U) All Items is generally used in rent regulations. It is the most widely reported index in public discourse about inflation and prices and it is the most commonly used and accepted index in public regulations and contracts.

The All Items Index versus the All Items Less Shelter Index

The differences between the increases in the CPI-U *All Items* and the CPI-U *All Items Less Shelter* indices have been greater than the differences between the increases in the CPI-U and the CPI-W indexes.

The CPI-U *All Items* index is based on the costs of a market basket of household costs including housing costs represented by rent levels. The use of the CPI-U *All items* index in order to determine allowable rent increases is subject to the criticism that its use is "circular" to the extent that it includes exceptional increases in rents as a factor in determining what rent increases should be permitted.[27] When rents increase at a higher rate than the other items in the basket of goods, the use of the CPI-U *All Items* index as the standard for allowable rent increases results in a higher annual allowable increase. Conversely, if rents are increasing at a lower rate than other costs or are decreasing, the use of the CPI-U *All Items* index would lead to lower annual allowable rent increases.

Since the City's ARO was adopted, the average annual increase in the CPI-U *All Items* index for the area has exceeded the average increase in the CPI-W *All Items Less Shelter* index for the area by 0.2%. The average annual increase in the *All Items* index was 3.7 % compared to an average annual increase in the *All Items Less Shelter* index of 3.3%. On a cumulative basis from 1979 to 2014, the *All Items* index increased by 361% compared to a 312% increase in the *All Items Less Shelter* index. During periods of exceptional increases in rents relative to the increases in other costs, the increases in the CPI-U *All Items* index have exceeded the increases in the CPI-U *All Items Less Shelter* index by 1 to 3%. These significant differences occurred in 1985, 1986, 1998,

[27] The authors of a 1994 Report for the City of Los Angeles on its rent stabilization ordinance reached a similar conclusion. See Hamilton, Rabinovitz, and Alschuler, The 1994 Los Angeles Rental Housing Study: Technical Report on Issues and Policy Options, p. 247 (Dec. 1994).

and 2001, when the increases in the CPI-U *Residential Rent Index* exceeded the increases in the CPI-U *All Items* index by more than 4%. (See table below.)

The table below compares the increases in the CPI-U *All Items* and CPI-U *All Items Less Shelter* indices.

Table 4.16

Increases in CPI All-items and All-items Less Shelter Indexes Compared

Year	Percentage Increase over Prior Year Average		Differences in Percentage Increases	
	CPI-U All Items	CPI-U All Items Less Shelter	All Items Index Increase Higher	All Items Less Shelter Index Increase Higher
1980	15.1%	13.1%	2.0%	
1981	12.9%	8.4%	4.5%	
1982	7.5%	7.6%	-	0.1%
1983	0.8%	2.5%	-	1.7%
1984	5.7%	5.1%	0.5%	-
1985	4.2%	2.9%	1.4%	-
1986	3.0%	1.2%	1.7%	-
1987	3.4%	2.8%	0.6%	-
1988	4.4%	4.5%	-	0.1%
1989	4.9%	4.9%	0.0%	-
1990	4.5%	4.7%	-	0.2%
1991	4.4%	4.2%	0.2%	-
1992	3.3%	3.7%	-	0.3%
1993	2.7%	2.9%	-	0.2%
1994	1.6%	1.5%	0.2%	-
1995	2.0%	2.1%	-	0.1%
1996	2.3%	1.9%	0.4%	-
1997	3.4%	2.1%	1.3%	-
1998	3.2%	1.1%	2.1%	-
1999	4.2%	2.7%	1.5%	-
2000	4.5%	3.2%	1.3%	-
2001	5.4%	2.5%	2.9%	-
2002	1.6%	0.5%	1.1%	-
2003	1.8%	2.2%	-	0.5%
2004	1.2%	2.6%	-	-
2005	2.0%	2.8%	-	0.9%
2006	3.2%	3.8%	-	0.6%
2007	3.3%	3.3%	0.0%	-
2008	3.1%	3.9%	-	0.8%
2009	0.7%	0.3%	0.4%	-
2010	1.4%	2.7%	-	1.3%
2011	2.6%	3.2%	-	0.6%
2012	2.7%	2.4%	0.3%	-
2013	2.2%	1.3%	0.9%	-
2014	2.8%	1.7%	1.1%	-
2015	2.6%	0.8	1.8	
	Overall Increase		Average Annual Increase	
1980-201	261%	211%	3.7%	3.3%

There is no single correct answer as to which of the CPI indices should be used in an annual rent increase standard. The best direction may be that once a particular index is selected it should be retained. Otherwise, the process of selecting an index can become a process by which indexes are switched according to which index is most favorable to a particular interest at a particular time.

Chapter 5

Individual Rent Adjustment Standards under the ARO and Constitutional Standards For Fair Return

Introduction

The purposes of this chapter are to discuss the standards under the ARO for authorizing rent increases in excess of the annual allowable across-the-board increases and to discuss constitutional fair return requirements.

A central purpose of individual rent adjustment standards under rent stabilization ordinances is to insure that apartment owners may obtain a fair return in cases in which the annual allowable rent increases are not adequate to provide a fair return. Under the type of fair return standard that is mostly widely used under rent stabilization ordinances, apartment owners have a right to rent increases which are adequate to cover increases in operating costs and provide for growth in net operating income. Questions that emerge include: how the individual rent adjustment standards in the ARO compare with constitutional fair standards, and the current and potential future impacts of the current standards.

Under the ARO, if a tenant objects to a rent increase in excess of the allowable annual increase, the apartment owner must justify the additional rent increase through the administrative hearing process on the basis of the individual rent adjustment standards. Under the current individual rent adjustment standards in the ARO, which are a type of fair return standard, owners may pass through increases in operating costs and debt service payments since the prior year to the extent these increases are not covered by the allowable annual increases and vacancy decontrols.

In order to consider issues related to the individual rent adjustment standard, it is essential to provide an explanation of:

1) fair return concepts from a constitutional, economic, and regulatory perspective,
2) the types of fair return standards used among jurisdictions with rent stabilization ordinances,
3) the rationale related to the use of different types of fair return standards , and the advantages and drawbacks in the context of rent regulation, and
4) what options the City has in regard to fair return standards and other standards.

The explanation is detailed because fair return concepts are multifaceted and in some ways operate in a manner that may be counterintuitive.

A. Constitutional Standards for Fair Return – Judicial Doctrine

Owners of rent regulated properties have a constitutional right to a "fair return." Under all rent stabilization ordinances, including the ARO, regulated owners may petition for a rent increase above the amounts authorized by the annual adjustment standard in order to present a claim that an additional increase is necessary to obtain a fair return. Cities may select the fair return formulas that apply to fair return petitions. However, the courts are the ultimate arbiter's of whether a fair return has been permitted.

In fact, very few fair return petitions have been filed under California's apartment rent control ordinances as long as vacancy decontrols have been in effect. This outcome has occurred because the combination of annual rent increase allowances and vacancy decontrols have allowed overall rent levels to increase by more than the CPI and therefore have been adequate to cover operating cost increases and to permit growth in net operating income.

1. General Guidance in Judicial Precedent

When peacetime rent stabilization ordinances were first introduced in California, towards the end of the 1970's and early 1980's, there was conflicting authority and substantial uncertainty about which fair return standard would meet judicial approval. In the face of this uncertainty, cities adopted rent stabilization ordinances that usually contained very general guidelines or statements of principle without setting forth a specific definition of fair return or a methodology for determining what constitutes a fair return. (Typically, these general provisions were supplemented with more specific regulations.)[1]

In 1983, in response to a legal challenge based on a claim that the fair return provisions in a rent control ordinance were overly vague, the California Supreme Court held that an ordinance does not have to contain a specific fair return formula and that the selection of a formula is a legislative task. The Court stated:

> That the ordinance does not articulate a formula for determining just what constitutes a just and reasonable return does not make it unconstitutional. Rent control agencies are not obliged by either the state or federal Constitution to fix rents by application of any particular method or formula. As the United States Supreme Court has stated, "[t]he Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas." [cites omitted] … The method of regulating prices is immaterial so long as the result achieved is constitutionally acceptable. (cite omitted) ["it is the result reached not the method employed which is controlling"].)[2]

In 1997, the Court reiterated longstanding general principles for fair return that have been set forth in utility cases and rent control fair return cases, stating that fair return:

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[1] See e.g. Los Angeles Rent Adjustment Commission Guidelines, Sec 240.00 ("Guidelines to be Used by Hearing Officers for Determining A Just and Reasonable Return"); San Francisco Residential Rent and Arbitration Board, Rules and Regulations, Part VI ("Rent Increase Justifications")

[2] *Carson Mobilehome Park Owners' Assn. v. City of Carson,* 35 Cal.3d 184, 191 (1983)

> 1. "involves a balancing of the investor and consumer interests," 2.should be a "return ... commensurate with returns on investments in other enterprises having corresponding risks.", and 3. "should be sufficient ... to attract capital."[3]

In 2001, the Court held in *Galland v. Clovis* that the concept of "fair rate of return" is a legal term that refers to a "**constitutional minimum**", although the terminology is borrowed from finance and economics. The Court also stated that the return must "allow [the] Owner to continue to operate successfully."[4] (While *Galland* involved mobilehome park rent regulations, the Courts have applied the same fair return principles to apartment and mobilehome park rent stabilization.). In its opinion, the Court stated:

> Although the term "fair rate of return" borrows from the terminology of economics and finance, it is as used in this context a legal, constitutional term. It refers to a constitutional minimum within a broad zone of reasonableness. As explained above, within this broad zone, the rate regulator is balancing the interests of investors, i.e., landlords, with the interests of consumers, i.e. mobilehome owners, in order to achieve a rent level that will on the one hand maintain the affordability of the mobilehome park and on the other hand allow the landlord to continue to operate successfully. [cite omitted]. For those price-regulated investments that fall above the constitutional minimum, but are nonetheless disappointing to investor expectations, the solution is not constitutional litigation but, as with nonregulated investments, the liquidation of the investments and the transfer of capital to more lucrative enterprises.[5]

While these concepts give localities and reviewing courts' broad discretion in formulating fair return standards, they leave uncertainty as to what outcomes would be considered reasonable and constitutional by the courts when reviewing "as applied" challenges to administrative rulings on individual petitions by Rent Boards or hearing officers. ("As applied" challenges are challenges to individual decisions, as opposed to "facial" challenges which involve a challenge to the overall validity of the law or regulations.)

Uncertainty as to what constitutes a fair return has been augmented by the fact that over a forty-year span appellate courts have reached diametrically opposite conclusions in regard to particular fair return issues. Furthermore, debate over the issue has been complicated by the fact that individual passages in court opinions, when taken out of context, can lend support to propositions at variance with the overall conclusions in those opinions.

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[3] *Kavanau v. Santa Monica Rent Control Board*, 16 Cal.4th 761, 772 (1997).

[4] As explained in the following portions of this chapter, the right to "operate successfully" has not included the right to cover mortgage indebtedness.

[5] 24 Cal.4th 1004, 1026 (2001)

2. Specific Guidance on Fair Return in Judicial Precedent

In 1984, in *Fisher v. City of Berkeley*, the State Supreme Court set forth some specific principles in in a lengthy discussion of fair return issues.[6]

a. Rejection of Claims to a Right to a Fair Return on "Value"

The Court held that a standard which defines a fair return as a fair rate of return on the ***value*** of a regulated property is "circular" in the context of regulation. Such a standard is circular because value depends on the allowable rent and, therefore, cannot be used to determine what rent should be allowed to permit a fair return.

The Court explained:

> The fatal flaw in the return on value standard is that income property most commonly is valued through capitalization of its income. Thus, the process of making individual rent adjustments on the basis of a return on value standard is meaningless because it is inevitably circular: value is determined by rental income, the amount of which is in turn set according to value. Use of a return on value standard would thoroughly undermine rent control, since the use of uncontrolled income potential to determine value would result in the same rents as those which would be charged in the absence of regulation. Value (and hence rents) would increase in a never-ending spiral. [7]

It also held that a rent regulation is not invalid just because it reduces the value of properties and that: "Any price-setting regulation, like most other police power regulations of property rights, has the inevitable effect of reducing the value of regulated properties."[8]

3. The Right to an Increasing Net Operating Income

In *Fisher*, the Court also gave other guidance that has come to play a central role in fair return doctrine. The Court held that a regulatory scheme "may not indefinitely freeze the dollar amount …profits without eventually causing confiscatory results. …If the net operating profit of a landlord continues to be the identical number of dollars, there is in time a real diminution to the landlord which eventually becomes confiscatory." [9] In other words, growth in net operating income must be permitted. This concept is critical because it sets forth a standard for fair return – whether or not allowable rent increases have been adequate to cover increases in operating costs and permit growth in net operating income.

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[6] *Fisher v City of Berkeley*, 37 Cal.3d. 644, 679-686 (1984).

[7]. *Id*. 37 Cal.3d.at 680, fn 33.

[8] *Id*., 37 Cal.3d. at 686.

[9] *Id*. 37.Cal.3d. at 683.

B. The Maintenance of Net Operating Income (MNOI) Standard

The type of fair return standard which is used to determine whether allowable rent increases have been adequate to cover operating cost increases and permit growth in net operating income, by comparing current current net operating income with a base year net operating income is known as a "maintenance of net operating income" (MNOI) standard.

Under this standard – known as a "*maintenance of net operating income" (MNOI)* standard – apartment owners are entitled to rent increases which are adequate to cover operating cost increases and to permit growth in net operating income. (In the context of fair return, "maintenance" of net operating income includes the concept of maintaining the value of the net operating income by providing for an inflation adjustment factor in calculating fair net operating income. Net operating income is income net of operating expenses; debt service is not considered as an operating expense.)[10]

Under MNOI standards, "fair return" (fair net operating income) is calculated by adjusting base year net operating income by a portion of or by one hundred percent of the percentage increase in the Consumer Price Index (CPI) since the base year. For example, under a standard which provides for indexing the net operating income at 100% of the rate of increase in the CPI, if the net operating income was $100,000 in the base year and the CPI has increased by 70% since the base year, the current fair net operating income would be $170,000.

Under most MNOI standards, the year specified as the base year precedes the adoption of rent regulation. However, a more recent year may be used as the base year. Jurisdictions with MNOI standards provide for indexing a base period of net operating income by varying percentages of the percentage increase in the Consumer Price Index, ranging from 40% to 100%. Berkeley and Santa Monica provide for 40% indexing and most mobilehome ordinances index by less than 100%. All of these indexing standards have been upheld by the Courts.[11]

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[10] "Net operating income" may be contrasted with "net income" which is income net of debt service payments.

[11] See *Berger v. City of Escondido*, 127 Cal.App.4th 1, 13-15 (2007); *Stardust v.City of Ventura*, 147 Cal.App. 4th 1170, 1181-1182 (2007); *Colony Cove Properties v. City of Carson*, 220 Cal. App.4th 840, 876 (2013)

The rationale for less than 100% indexing has been that the rate of increase in equity may exceed 100% of the rate of increase in the CPI even if the rate of increase in the overall value of a property is lower. For example, the value of an apartment building may increase by 20% from $1,000,000 to $1,200,000, but the increase in the equity of an owner who purchased with a 70% loan may increase from $300,000 to $500,000.

In the Colony Cove opinion, the Court stated:

> In *H.N. & Frances C. Berger Foundation v. City of Escondido*, the court explained why 100 percent indexing was not required for a rent controlled mobilehome park to achieve a fair return: "A mobilehome park's operating expenses do not necessarily increase from year to year at the rate of inflation, and . . . a 'general increase at 100% of CPI . . . would be too much if expenses have increased at a lower rate.'" (*H.N. & Frances C. Berger Foundation v. City of Escondido [cite omitted]*.) Moreover, "the use of indexing ratios may satisfy the fair return

(cont.)

The example below illustrates how MNOI standards work. In the hypothetical, rents have increased by $50,000 between the base year and the current year. During this period operating costs have increased by $30,000 and the net operating income has increased by $20,000, from $60,000 in the base year to $80,000 in the current year. Through an individual rent adjustment petition (with adequate documentation of income and operating expenses) the owner would be able to obtain an additional rent increase The allowable increase would be $10,000 because the fair net operating income (the base year net operating income adjusted by the CPI increase) is $90,000.

Table 5.1
Illustration of MNOI Standard

	CPI	Gross Income	Operating Expenses	Net Operating Income	Fair Return Allowable Rent Increase
Base Year *	**100**	**$100,000**	**$40,000**	**$60,000**	
Current Year	**150**	**$150,000**	**$70,000**	**$80,000**	
Current Year Fair Net Operating Income (Base Year NOI Adjusted by 50% increase in CPI)				**$90,000**	
Fair NOI – Current NOI *($90,000 – $80,000)*					**$10,000**

The MNOI has been adopted by Los Angeles, Santa Monica, Berkeley, West Hollywood, East Palo Alto and is in effect under San Jose's mobilehome park rent stabilization ordinance.[12] In addition, this type of standard is set forth in a substantial portion of the mobilehome park rent stabilization ordinances in the State and is often applied under other mobilehome rent stabilization ordinances, which list factors to be considered in determining what is a fair return, without setting forth a formula. (Approximately ninety jurisdictions regulate mobilehome park rents.)

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criterion because park owners typically derive a return on their investment not only from income the park produces, but also from an increase in the property's value or equity over time." (*Ibid*.; accord *[cite omitted]* [explaining that "one reason for indexing NOI at less than 100 percent of the change in the CPI" is that "real estate is often a leveraged investment" in which "[t]he investor invests a small amount of cash, but gets appreciation on 100 percent of the value"]. *Id*.876-877.

[12] San Jose Muni Code Sec. 17.22.470-580.

Rationale for the MNOI Standard

The MNOI standard works differently than rate of return standards because it compares the net operating income with a prior (base year) net operating income rather than comparing the net operating income with the investment (purchase price). It is not an "intuitive" measure because it is not a real estate return measure that is commonly used by investors or laypersons, but rather is a measure of fair return under rent regulation. The rationale for the use of this type of standard is set forth in the following discussion.

By providing for growth in net operating income, the MNOI standard provides for growth in the portion of rental income (the net operating income) that is available to pay for increases in debt service, to fund capital improvements, and/or to provide additional cash flow (net income). Therefore, the growth in net operating income also provides for appreciation in the value of a property. The standard provides all owners with the right to an equal rate of growth in NOI regardless of their particular purchase and financing arrangements. By measuring reasonable growth in net operating income by the rate of increase in the CPI, this approach meets the twin objectives of "protecting" tenants from rent increases that are not justified by operating cost increases and increases in the CPI, and of providing regulated owners with a "fair return on investment."

Under the MNOI standard, it becomes the investor's task to determine what investment and financing arrangements make sense in light of the growth in net operating income permitted under the fair return standard.

In fair return challenges, appellate courts have repeatedly upheld the use of an MNOI standard.[13] In 1984, a Court of Appeal found that the MNOI standard was reasonable because it allowed an owner to maintain prior levels of profit. [14] In 1998, a Court of Appeal concluded that the MNOI formula is a "fairly constructed formula" which provides a ""just and reasonable" return on ... investment," even if an alternative fair return standard – such as the rate of return on investment standard (discussed further below) – would provide for a higher rent.

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[13] Most of the published appellate court opinions regarding fair return under rent regulation have involved mobilehome park rent regulations. This is a consequence of the facts that: 1) the mobilehome rent regulations are stricter – not allowing for increases upon vacancies, 2) some of the mobilehome rent ordinances have not allowed for annual across-the-board rent increases, thereby compelling owners to submit fair return petitions each time they desire to obtain a rent increase, 3) the stakes in mobilehome park cases are substantial due to the size of mobilehome parks, typically involving from one to several hundred spaces. However, in regards to fair return issues the fair return concepts are interchangeable with the courts relying on fair return opinions from apartment cases in mobilehome park cases and vice versa.

[14] *Oceanside Mobilehome Park Owners' Ass'n v. City Oceanside,* 157 Cal.App.3d.887 (1984); Also see *Baker v. City of Santa Monica,* 181 Cal.App.3d. 972 (1986)

> [the] MNOI approach adopted by the Board is a "fairly constructed formula" which provided Rainbow a sufficiently "just and reasonable" return on its investment. ... The Board was not obliged to reject [an] MNOI analysis just because an historical cost/book value formula using Rainbow's actual cost of acquisition and a 10 percent rate of return would have yielded a higher rent increase.[15]

Typically, the base year under an MNOI standard precedes the adoption of rent control based on the concept that rent levels which were set in the unregulated market provided a fair return. In the case of San Jose, the allowable annual increases, which have substantially exceeded the rate of increase in the CPI, clearly have been sufficient to allow owners to preserve pre-regulation levels (inflation adjusted) of net operating income.(See discussion in Chapter 6) In instances in which an MNOI standard is adopted years after the initial adoption of rent control, owners will not have not have records from earlier decades and will not have been on notice that such records would ever be relevant in a fair rent determination. Therefore, a recent year could be used as the base year. Owners should have income and expense records for the last three years, since under federal tax law, businesses are required to retain their business records for three years.

C. Rate of Return on Investment Standards

In *Fisher*, Court indicated that a return on investment standard could provide a fair return. However, its qualifications about such standards illustrated the difficulties with such an approach.

Rent ordinances commonly include a provision stating that their purpose is to provide a fair "return on investment." However, **none of the California jurisdictions with apartment rent regulations have used a "'*rate*' of return on investment" standard**. This type of standard has been implemented under some mobilehome park space rent ordinances.

When rate of return on investment formulas have been used in the context of rent regulations, the most common formula has been:

[15] *Rainbow Disposal v. Mobilehome Park Rental Review Board*, 64 Cal. App.4th 1159, 1172 (1998)

FAIR RENT = OPERATING EXPENSES + X% of INVESTMENT

The allowable rent depends on what rate of return is considered fair. The following examples illustrate the outcomes under a 6% and a 9% rate of return standard.

FAIR RENT = OPERATING EXPENSES + X% of INVESTMENT

		(fair net operating income)
$70,000	+	**6%** of $1,200,000
$70,000	+	$72,000
		= $142,000
	or	
$70,000	+	**9%** of $1,200,000
$70,000	+	$108,000
		= $178,000

Investment is defined as the total investment (purchase price + improvements) rather than only as the cash investment (total investment minus mortgage borrowing). The return is the net operating income (income before mortgage payments), rather than only the cash flow (net operating income left after mortgage payments).[16] In other words, the total return is compared with the total investment.

Circularity of the *Rate* of Return on Investment Standard

Rate of return on investment is commonly used as a measure of return by real estate analysts in evaluating real estate investments. Intuitively, the concept that investors should always be permitted a fair rate of return on their investments is commonly accepted . However, in the context of a fair return determination under a rent regulation, the use of a fair rate of return on investment standard works in a **circular** manner.

In the market place, investment is determined by the expected returns. If the allowable returns under a price regulation are set at designated percentage of the investment, the process of determining what is a fair return becomes circular. Under such an approach, h the investment (and, therefore, the investor) determines what return and, therefore, what rents will be fair.

[16] In some jurisdictions a fair return on cash investment standard has been used. However, such standards discriminate among owners based on their financing arrangements. In three cases, a California Court of Appeal has ruled that consideration of debt service in a rent setting standard has no rational basis. *Palomar Mobilehome Park Ass'n v. Mobile Home Rent Review Commission* [San Marcos], 16 Cal.App.4th 481, 488 (1993) and *Westwinds Mobilehome Park v. Mobilehome Park Rental Review Board* [Escondido], 30 Cal.App.4th 84, 94 (1994), *Colony Cove v. City of Carson*, 220 Cal.App.4th 840, 871 (2013).

A leading utility text notes the fallacies and circularity of using the purchase price (the "transfer cost") as the measure of investment in order to calculate fair return, in the context of a price regulation.

> Transfer cost does not represent a contribution of capital to public service. Instead, it represents a mere purchase by the present company of whatever legal interests in the properties were possessed by the vendor. Even under an original-cost standard of rate control, investors are not compensated for buying utility enterprises from their previous owners any more than they are compensated for the prices at which they may have bought public utility securities on the stock market. Instead, they are compensated for devoting capital to public service. ... The unfairness, not to say the absurdity, of a uniform rule permitting a transferee of a utility plant to claim his purchase price was noted by Judge Learned Hand … The builder who does not sell is confined for his base to his original cost; he who sells can assure the buyer that he may use as a base whatever he pays in good faith. If the builder can persuade the buyer to pay more than the original cost the difference becomes part of the base and the public must pay rates computed upon the excess. Surely this is a most undesirable distinction. (Niagara Falls Power Company v. Federal Power Commission, 1943 ...)[17]

This fallacy has been generally overlooked in rent control cases. However, federal courts in New York have concluded that the return on investment approach does not make sense in the context of land use controls and rent regulation. They have noted that under the rate of return on investment approach, the "regulated" investor is able to regulate the allowable return by determining the size of the investment. In a zoning case, the Court held:

> In addition to being inconsistent with the case law, appellants' [return on investment] approach could lead to unfair results. For example, a focus on reasonable return would distinguish between property owners on the amount of their investments in similar properties (assuming an equal restriction upon the properties under the regulations) favoring those who paid more over those who paid less for their investments. Moreover in certain circumstances, appellants theory "would merely encourage property owners to transfer their property each time its value rose, in order to secure ... that appreciation which could otherwise be taken by the government without compensation..." [cites omitted][18]

While the California courts have upheld the use of a rate of return on investment standard, they have noted the limitations of such an approach. In the *Fisher* case, the California Supreme Court noted that the "mechanical" application of a return on investment standard could produce

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[17] Bonbright, Danielson, and Kamerschen, Principles of Public Utility Rates, 240-241 (1988, Arlington, Virginia, Public Utilities Reports, Inc.)

[18] *Park Avenue Tower Associates v. City of New York*, 746 F.2d. 135, 140 (1984).

"confiscatory results in some ....cases" and alternatively could provide for "windfall" returns of recent investors, who paid high prices:

> At the same time that mechanical application of the fair return on investment standard may have the potential to produce confiscatory results in some individual cases [cites omitted] it is also recognized that the standard has the potential for awarding windfall returns to recent investors whose purchase prices and interest rates are high. If the latter aspect were unregulated, use of the investment standard might defeat the purpose of rent price regulation.[19]

On the other hand, if a "prudent" investor standard is used to try to curb abuses of a rate of return on investment standard by limiting what size investments will be considered in measuring what net operating income would be fair, the results also become circular. Under this type of approach the investment may be considered "prudent" only if the current rents are already adequate to generate a net operating income which is adequate to generate the rate of return which is considered reasonable. If this approach is followed no rental increase can ever be justified by the standard.

Subsequent to the *Fisher* opinion, one Court of Appeal concluded that the argument that a purchase cost may be viewed as high (imprudent) is a "Catch-22.". The Court explained:

> ... it is a "Catch-22" argument. It posits that a prudent investor will purchase only rent-controlled property for a price which provides a fair rate of return at the then-current (i.e. frozen) rental rates. Having done so, however, the fair market value is frozen ad infinitum because no one should pay more than the frozen rental rate permits; and existing rental rates are likewise frozen, since the investor is already realizing a "fair rate of return".[20]

This duality in concepts in regards to rate of return on investment standards is not an accident. It reflects the inevitable appearance of the two sides of a circular concept. On the one hand, there is the view that rate of return on investment standards should not provide windfall returns to recent investors and should not provide an incentive to invest as much as possible for a property by providing a right to charge rents that will provide a fair return on any investment. On the other hand, there is the view that an owner should be able to obtain a fair return on a prudent investment. However, if such an approach is adopted, an investment may be considered imprudent if the current rents do not yield a fair return on that investment.

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[19] 37 Cal.3d. 644, 691 (1984)

[20] *Westwinds Mobile Home Park v. City of Escondido*, (1994), 30 Cal.App.4th. 84, 93-94.

Subjectivity and Differences in How to Measure Fair Rate of Return under a Rate of Return on Investment Standard

Apart from the circularity issues associated with the use of a rate of return on investment standard, there are substantial issues associated with the calculation of the investment (the rate base) and with the determination of an appropriate rate.

In fact, rates of return vary substantially among properties, especially in times of substantial inflation in property values. Therefore, the net operating income (and, consequently the rent) that will yield a fair return on an investment made decades ago might be a fraction of the rent required to provide the same rate of return on the investment of a recent purchaser.

When rate of return on investment standards are used, a host of options appear for measuring the investment and for the determination of a reasonable rate of return. In an adjudicatory process the fair return determination can turn into a mix and match process (among the alternate measures of investment and of a fair rate) aimed at obtaining a desired result.

Selecting a Rate

The selection of an appropriate rate presents one set of problems. Varying theories and/or statistical constructions" about how to compute what is a "fair rate" can lead to widely differing outcomes. One commentary, in a textbook on utility rate regulation, characterizes expert presentations on which particular rate is as "witches brews of statistical elaboration and manipulation".

> "... as we begin sheer disgust to move away from the debacle of valuation, we will probably substitute a new form of Roman holiday— long-drawn-out, costly, confusing, expert contrived presentations, in which the simple directions of the *Hope* and *Bluefield* cases are turned into veritable witches' brews of statistical elaboration and manipulation.[21]

In mobilehome park rent stabilization fair return cases, expert witness' projections of a fair rate of return have ranged from 4% to 12% (and even higher). Typically, in recent years, experts on behalf of mobilehome park owners have testified that a rate of return of about 9% is fair, while experts on behalf of cities and/or residents have contended that a fair rate is equal to the prevailing capitalization rate, now about 5 to 6%.[22] Adjudicators' (retired judges acting as

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[21] Shepard and Gies, *Utility Regulation, New Directions in Theory and Policy*, 242-243 (1966, New York, Random House)

[22] The prevailing capitalization rate is the net operating income/purchase price rate that new purchasers are obtaining at the outset of their investments. When the purchase price is inflation adjusted in the fair return analysis the fair return also becomes inflation adjusted.

arbitrators, rent commissions, trial courts, and appellate courts) conclusions about what rate is fair have ranged from 5% to 9%.

Measuring the Investment (The Rate Base)

The selection of a rate base raises another set of issues. Large variations in the outcome of a fair return calculation can also be generated by alternate choices in regard to the measure of the investment (rate base). One principal issue within the return on investment debate has been over whether the original investment should be used as a rate base or whether that investment costs should be adjusted for inflation. Typically, long-term owners have investments that are low by current standards, while recent purchase prices have low rates of return relative to their investment. The problem with the return on investment approach is that in periods of inflation in the prices of real property, the fair return becomes a function of the length of ownership. As a result, the rate of return on investments in apartment buildings with comparable rents and operating costs will vary substantially based on the purchase date of the building.

Some courts have held that the investment should be inflation adjusted to reflect the real amount of the investment in current dollars. In *Cotati Alliance for Better Housing v. City of Cotati*, a California Court of Appeal concluded that Cotati's return on investment standard was not confiscatory because "[t]he landlord who purchased property years ago with pre-inflation dollars is not limited to a return on the actual dollars invested; the Board may equate the original investment with current dollar values and assure a fair return accordingly."[23] Commonly, if not usually, when rate of return on investment standards are used, the rent setting body has adjusted the original investment by inflation.

However, in other instances California appellate courts have upheld the use of a formula under which investment was calculated in a manner virtually opposite to adjusting the original investment by inflation. Instead they have upheld "…taking the price paid for the property and deducting accumulated depreciation to arrive at a net historic value" See e.g. *Palomar Mobilehome Park Assn. v. Mobile Home Rent Review Com*. (1993), 16 Cal.App.4th 481, 487, in which the Court reasoned:

> [The park owner] argues that "historic cost" approach effectively transfers to tenants the use of $11 million in assets (the difference between the historic cost of the property and its current value) free of charge. It is true that in calculating a "fair" return, the City's proffered formula does not give park owners credit for any appreciation in the value of their property. Yet this is true any time a "fair return on investment" approach is used in lieu of a "fair return on value" formula. As we have explained .... both the United States and California Supreme Courts have approved the "investment" approach as constitutionally permissible. We are in no

[23] 148 Cal.App.3d. 280, 289 (1983)

> position to hold to the contrary by accepting Palomar's value-based test as a constitutional minimum. (Id. 16 Cal.App. 4th at 488)

The table on the following page illustrates how the wide range of possible rate bases and fair rates possible can lead to vastly diverging results under a rate of return on investment formula.

Table 5.2

Alternate Outcomes under Rate of Return on Investment Standard (Investment x Fair Rate = Fair Net Operating Income)

Investment (Rate Base)	Fair Rate	Fair Net Operating Income* (fair rate x investment)
$2,000,000 original investment (e.g. 40 apartments x $50,000 / apartment unit)	**5%** capitalization rate (prevailing noi/purchase price ratio purchases in 2015)	**$100,000**
	7%	**$140,000**
	9%	**$180,000**
$1,200,000 original investment minus depreciation of improvements	**5%**	**$60,000**
	7%	**$84,000**
	9%	**$108,000**
$4,000,000 original investment adjusted by CPI	**5%**	**$200,000**
	7%	**$280,000**
	9%	**$360,000**

* Allowable rent = fair net operating income + operating expenses

Even if the original investment is inflation adjusted, the outcome under a rate of return on investment standard is heavily dependent on whether an apartment owner purchased a property in a low or high cycle in real estate values. The hypothetical below illustrates how the standard may work. An owner who paid the same price for a property in 2010 (at the end of flat cycle in apartment values) as an owner paid in 2000 (at the end of a surge in values) is permitted a much lower rent under this type of standard, because the period of inflation used to adjust the purchase price is much shorter.

Outcomes Under Rate of Return on Investment Formula
Using Inflation Adjusted Investment

Purchase Year	1990	2000	2010	2015
Average Purchase Price/Unit	59,000	107,000	106,000	191,000
Base Year CPI	132.1	180.2	227.469	258.572
Current CPI	258.572	258.572	258.572	258.572
Inflation (CPI) Adjustment of Original Purchase Price	96%	43%	14%	0%
Purchase Price /Unit CPI Adjusted	115,486	153,536	120,494	191,000
7% of Purchase Price	8,084	10,748	8,435	13,370
Annual Operating Expenses/ Unit	5,400	5,400	5,400	5,400
Allowable Annual Rent (7% of purchase price + operating expenses)	13,484	16,148	13,835	18,770
Allowable Monthly Rent	1,124	1,346	1,153	1,564

Furthermore, under a rate of return on investment standard, the amount of rent that is required to provide a fair return can actually decrease as a result of a downward cycle in values (and, therefore, investments.).

D. San José's Fair Return Standard

San Jose, Oakland and San Francisco have used a different standard than either the MNOI standard or the rate of return on investment standard in the formulation of their fair return standards. Under the standards of these jurisdictions, apartment owners are allowed to pass through increases in operating costs over the prior year to tenants. In San Jose, when a pass-through is being considered in an individual rent adjustment hearing, the allowable rent increase over the prior year's rent is set at an amount adequate to cover the allowable cost increases (for operations and maintenance, rehabilitation, and/or capital improvements) over the prior year plus 5%. As a result, this formula allows the for the possibility of obtaining a rent increase in excess of the annual allowable increase of 8%. These pass-through standards, including San Jose's

standard, do not provide for any consideration of what rent increases have occurred before the prior year and how those rent increases have compared with increases in operating expenses before the prior year.

The ARO provides for pass-throughs of increases in operating expenses, rehabilitation, capital improvements, and debt service.[24] The standard includes requirements that rehabilitation costs must be amortized over at least three years and capital improvements must be amortized over at least five years.[25] Increases in debt service interest are subject to a limitation to the interest associated with mortgage amounts that do not exceed 70% of the value of the property. The regulations contain detailed rules regarding consideration of increased debt service costs.[26] The pass-through amounts for each of the four provisions become part of next year's base rent.

While the ordinance and regulations provide for specific rules regarding rent increase allowances for cost pass-throughs, the ordinance also includes subjective directions that increases must be:

> reasonable under the circumstances, taking into consideration that the purpose of this chapter is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious, or unreasonable rent increases, and under certain circumstances, unjustified economic hardship…

and that consideration shall be given to the:

> reasonable relationship to the purposes for which such costs were incurred and the value of the real property to which they are applied.

As indicated, the City's standard provides for the possibility that petitions for large rent increases may be filed by recent purchasers of apartments, in order to pass-through increases in debt service over the debt service level of the prior owner.

San Francisco and Oakland's Pass-through Provisions

San Francisco's pass-through provision is similar to the San Jose standard, but San Francisco's standard contains two prominent limitations on pass-through increases, which are not contained in the ARO. Under San Francisco's pass-through allowance, increases are limited to seven percent and may not be imposed more than once every five years.[27]

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[24] Sec. 17.23.440

[25] Sec. 17.23.440.A.3.

[26] Sec. 17.23.440.B.and Apartment Regulations Sec. 2.030.03.

[27] San Francisco Rent Stabilization & Arbitration Board, Rules and Regulations, Sec. 6.10(d).

Oakland's pass-through provisions are also similar to those of San Jose, except that Oakland eliminated the debt service pass-through for newly acquired units on April 1, 2014. (This restriction is not applicable to units on which a bona-fide offer to purchase was made before that date.[28])

E. Treatment of Debt Service Expenses under San Jose's Ordinance and Other Ordinances and Issues Associated with Allowances for Debt Service Expenses

Treatment of Purchase Related Increases in Debt Service under the San Jose ARO

Under the San Jose ARO, apartment owners may pass through purchase related increases in interest payments of debt service (mortgages) over the interest payments of the prior owner. Under the ordinance and regulations pursuant to the ordinance, an investor can pass-through to tenants up to 80% of the increases over the prior owner's debt-service costs.[29]

The absence, prior to 2014, of petitions based on increases in debt service, may be attributable to a variety of reasons, including: the high turnover in apartment tenants which enabled owners to set a substantial portion of rents at market levels; the limited portion of units which could absorb additional rent increases beyond the annual increases of 8% authorized by the ordinance; landlord decisions to forego such increases; and/or an absence of general knowledge that such increases could be imposed. The debt service petitions that were filed in 2014 resulted in substantial increases in monthly rents ranging from $64 to $481, with an average increase of $199/month. In half of the cases, the increase was greater than $250/month.

The table below sets forth the size of the buildings, the number of petitioning residents, and the rent increase granted in each case.

[28] City of Oakland, Rent Adjustment Board Regulations, Appendix A, Sec. 10.4.

[29] See Regulations Sec. 2.03.03 setting forth detailed rules regarding the treatment of mortgage interest payments. If the loan exceeds 70% of the appraised value of the property, the portion of the interest increase that can be passed through is limited to interest attributable to a 70% loan to value ratio

Table 5.3.
Debt Service Increase Petitions under ARO

Sale Date	Units	Units Served Notice of Rent Increase	Tenants Petitions Filed	Beginning Average Rent	Rent Increase Permitted (Debt-Service Pass-Through Amount)	New Average Monthly Rent	Percentage Increase
2008	8	2	2	$614	$481	$1,095	78%
2014	24	17	3	$1,120	$89	$1,209	8%
2015	8	7	6	$946	$193	$1,139	21%
2014	6	6	6	$598	$378	$976	65%
2013	12	12	11	$902	$300	$1,202	33%
2014	25	1	1	$675	$114	$789	17%
2015	7	4	1	$881	$335	$1,216	30%
2014	6	4	2	$1,298	$209	$1,507	16%
2015	6	5	1	$1,198	$327	$1,525	27%
2014	4	4	4	$1,191	$408	$1,599	34%
2015	4	4	4	$1,700	$255	$1,955	15%
2015	4	1	1	$1,920	$230	$2,150	12%
2014	6	4	1	$871	$64	$935	7%
2015	4	1	1	$2,295	$305	$2,600	17%
	124	**72**	**44**	**$1,158**	**$199**	**$1,357**	**27%**

Source: City of San Jose Housing Department, Rental Rights and Referrals Program

Assuming current volumes of apartment sales in San Jose continue, the number of instances in which there is a potential for the justification for debt service pass-through under the current standard is substantial. The records from one real estate data service includes data on the sales of 59 buildings with a total of 646 units that were sold in 2015 and 54 buildings with 1685 units that were sold in 2014. In most of those sales, the increase in price over the prior sale was $50,000/apartment unit or more and in a substantial portion cases the increase was over $100,000/apartment unit. Conservatively, assuming the increase in annual debt service is equal to 3% of the increase in the current purchase price over the prior purchase price, the additional debt service associated with a $100,000 increase in purchase would be equal to about

$300/month.[30] In cases in which the previous owner held a property for a significant length of time and paid off a portion or all of the mortgage, the difference between the new and old mortgages would be even greater.

Treatment of Purchase Related Debt Service Costs Under Other Rent Stabilization Ordinances

In contrast to San Jose's standard, six of the eleven apartment rent control ordinances specifically **exclude** consideration of debt service in setting allowable rent levels, except when the debt service is associated with capital improvements. Such exclusions exist in the ordinances of Los Angeles, Oakland, Berkeley, Santa Monica, West Hollywood, and East Palo Alto.[31] Beverly Hills ordinance does not authorize any rent adjustments for increases in debt service, but does not specifically state that debt service expenses are excluded.[32] Also, San José's Mobilehome Rent Stabilization ordinance excludes consideration of debt service costs, except when associated with the cost of capital improvements.[33]

Under the San Francisco, Los Gatos, and Hayward ordinances, increases in debt service may be passed through. However, under the San Francisco ordinance, increases based on debt service increases are limited to 7% and in buildings with six or more units are allowed only once every five years.

[30] This projection is based on the assumption that 70% of the price, and, therefore 70% over the increase over the prior price, is financed by a mortgage and that the mortgage interest rate is 5%. Therefore, the increase in mortgage interest would be 5% of $70,000 =$3,500/year.

[31] Under Oakland regulation debt service pass-through were authorized until 2014.

[32] Beverly Hills Muni Code Sections 4-5-101 thru 4-5-707.

[33] San José Muni. Code Sec. 17.22.540.B.1. There are exceptions for refinancing required as a result of the terms of a mortgage in effect when the ordinance was adopted and for interest costs associated with the amortized costs of capital improvements.

Table 5.4
Treatment of Purchase Mortgage Interest Expenses Under Apartment Rent Stabilization Ordinances

Jurisdiction	*Consideration of Purchase Mortgage Interest Expenses*	*Limitations on Allowance of Debt Service Expenses*
Los Angeles	**Excluded**	
Oakland		Debt service pass-through repealed on April 1, 2014. Pre-repeal purchasers exempted from repeal.
Berkeley		
Santa Monica		
West Hollywood		
East Palo Alto		
Beverly Hills		
San José	**Included**	Loan to Value Ratio Limited. Standards contain a list of factors to be considered, but not a formula for how they would applied.
Hayward		
Los Gatos		
San Francisco		Increase Limited to 7% of Rent. Buildings of 6 units or more permitted only once every five years

Source: Based on author's review of rent ordinances.

Most of the MNOI standards in mobilehome park rent stabilization ordinances preclude consideration of debt service. Under the other common type of fair return standard in mobilehome park rent stabilization ordinances, rate of return on investment, consideration of debt service is also excluded because fair return is measured by the return on the total investment, rather than just the cash portion of the investment. (Consistent with using this measure of return, the rate base for measuring the return is the total investment, and the calculation of the return is based on consideration of the whole return, rather than return net of mortgage interest payments.)

Judicial Doctrine Regarding Consideration of Debt Service Interest in Setting Allowable Rent Increases

As, noted, the general judicial doctrine regarding fair return, which has been frequently reiterated in California appellate decisions, has been that: "[r]ent control agencies are not obliged by either the state or federal Constitution to fix rents by application of any particular method or

formula."[34] However, in three cases the California Court of Appeal has held that consideration of debt service in a rent setting process has no rational basis.[35]

> Assume two identical parks both purchased at the same time for $1 million each. Park A is purchased for cash; Park B is heavily financed. Under Palomar's approach, calculating return based on total historic cost and treating interest payments as typical business expenses would mean that Park A would show a considerably higher operating income than Park B. Assuming a constant rate of return, the owners of Park B would be entitled to charge higher rents than the owners of Park A. We see no reason why this should be the case.[36]

In a subsequent opinion, the same Court of Appeal reaffirmed its conclusion in regard to the treatment of debt service expenses. "We have previously rejected the notion that permissible rental rates based on a fair rate of return can vary depending solely on the fortuity of how the acquisition was financed."[37]

In a recent (2013) opinion, a California Court of Appeal again affirmed the view that tying rents to individual owners' financing arrangements has no rational basis.

> Apart from the inequities that would result from permitting a party who financed its purchase of rent-controlled property to obtain higher rents than a party who paid all cash, there are additional reasons for disregarding debt service. …debt service arrangements could easily be manipulated for the purpose of obtaining larger rent increases, by applying for an increase based on servicing a high interest loan and then refinancing at a lower interest rate or paying off the loan after the increase was granted. Alternatively, an owner might periodically tap the equity in a valuable piece of rental property, thus increasing the debt load. In any event, we discern no rational basis for tying rents to the vagaries of individual owners' financing arrangements.[38]

While the foregoing precedent holds that debt service should not be considered, in two cases around 1990, a California Court of Appeal carved out an exception to this rule. The Court held

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[34] See text at notes 3-4.

[35] *Palomar Mobilehome Park Ass'n v. Mobile Home Rent Review Commission* [of San Marcos], 16 Cal.App. 4th 481, 488 (1993);

[36] Id, at 489.

[37] *Westwinds Mobile Home Park v. Mobilehome Park Rental Review Bd*., 30 Cal.App.4th 84, 94 (1994)

[38] *Colony Cove Properties v. City of Carson*, 220 Cal.App. 840,871 (2013). Courts in other states have reached similar conclusions. In 1978, when considering the constitutionality of an apartment rent control ordinance, the New Jersey Supreme concluded that: "Similarly circumstanced landlords ... must be treated alike. Discrimination based upon the age of mortgages serves no legitimate purpose." *Helmsley v. Borough of Fort Lee*, 394 A.2d. 65, 80-81 (1978).

that mobilehome park owners have a vested right to have their debt service considered if the debt service was an allowable expense under the fair return standard in effect at the time the property was purchased.[39] In *Palacio de Anza v. Palm Springs Rent Review Commission*, the Court concluded that the guidelines in effect when the mobilehome park was purchased created vested rights.

> [the guidelines]... created land-use property rights which became vested ... when the financing of the ... purchase was undertaken in reliance on the existing rent-control laws. In this sense, [the park owner] enjoys a situation or status analogous to that of one who had established the right to pursue a nonconforming use on land following a zoning change.[40]

In a subsequent case, in 1991, the same court reaffirmed this conclusion.[41] (Prior to these cases, the City Attorney's office of San Jose reached the same conclusion.[42]) A repeal of a debt service pass-through that made an exception for units purchased prior to the repeal would conform with the holdings in these two cases.[43]

Comment

If debt service is considered, owners who make equal investments in terms of purchase price and have equal operating expenses, may be entitled to differing rents depending on differences in the size of their mortgages and/or the terms of their financing arrangements. As indicated, in three cases the California Court of Appeal has ruled that such a standard has no rational basis.

When increases in debt service can be passed through apart from other allowable rent increases, then the allowable rent is set at a level that provides "reimbursement" for the financed cost of purchasing a building. This "reimbursement" is in addition to the otherwise allowable rent increases that would provide a fair return by providing for increases in net operating income, which can be used to finance increasing debt service.

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[39] *Palacio de Anza v. Palm Springs Rent Review Com.*, 209 Cal.App.3d. 116 (1989)

[40] *Palacio*, *Id*,, 209 Cal. App.3d at 120.

[41] *El Dorado Palm Springs, Ltd.v. Rent Review Com*., 230 Cal.App.3d. 335 (1991).

[42] Memo from the Deputy City Attorney to the San José City Council, May 13, 1985 ("Limitations on Debt Service Pass Through – Retroactivity")

[43] On the other hand, it should be noted that under judicial doctrine applicable to land use law in general there has been no vested right to develop based on the fact that a land use was allowed under the zoning in effect when the purchase was made. Instead, vested rights have been limited to situations in which construction has been permitted and has commenced. Also, in a recent rent control case, a federal circuit court of appeal rejected the view that pre-rent control purchase arrangements could create a right to be free of subsequent regulations that may diminish the value of the property. *Rancho de Calistoga v. City of Calistoga*, 800 F.3rd 1083 (2015)

Chapter 6

Financial Outcomes for Owners of Apartment Buildings covered by the ARO

INTRODUCTION

This chapter discusses trends in operating expenses, net operating income, and values of apartments subject to the City's Apartment Rent Ordinance (ARO). (Trends in rents and characteristics of apartment buildings are discussed in Chapter 4.)

The objectives of the chapter are: to provide policy makers and the public with a perspective on the typical ratios of operating expenses to rental income in residential rental properties; the amounts of operating cost increases relative rental income; and trends in appreciation in apartment values

Operating costs average about 35% of rental income, typically ranging between 25% and 45%. An allowance of 7% of rental income (about $1,000/unit/year or $85/month) for necessary capital expenses would raise this ratio to about 42%. Debt service costs are not considered as an operating cost.

The balance of rental income – "net operating income"– about 55% to 70% of gross rental income, is income that can be used to cover debt service or can provide cash flow.

Average ratios to rental income for specific costs are in the following ranges: real estate taxes and property assessments–15%, insurance–2.4%, maintenance–5%, management–5%, trash collection–1.7%, utilities–3%, landscape -0.5%.

In San Jose increases in rents have been adequate to cover operating cost increases and provide continual growth in net operating income.

Apartment values of buildings subject to the ARO have increased from an average of about $50,000 per unit from 1985 to 1995 to about $115,000 from 2000 to 2005 to about $190,000 in the past few years.

The balance of this chapter provides detail about apartment operating costs and appreciation.

The specific amounts of the projections in this analysis may be debated (e.g. whether the most accurate projection of the average operating cost to rental income ratio would be 30%, 35%, 40%, or 45%and whether or not the projections in this chapter are 5% or 10% too low or too high.) The essential information is that that apartment operating costs are equal to less than half of rental income and that the balance of rental income is net operating income which provides a return on apartment investments. Net operating income may or may not be devoted primarily to debt service depending on the owners purchase cost and financing arrangements.

Also, it is essential to understand the impact of increases in specific types of operating expenses relative to rental income, especially increases in utility costs and other government fees and taxes which are beyond the control of apartment owners. While the percentage

increases in some of these costs, especially water, may be substantial, their ratio to rental income is low. (E.g. Even if water costs go up 50%, the cost increase may be equal to only one or two percent of rental income, because the average ratio of water costs to rental income is about 2%.) On the other hand, increases in the largest cost, property taxes, are limited to 2% per year, except when a property is sold.

Of course substantial deviations and exceptions from these averages will be found among the thousands of apartment buildings in the City. A method of addressing instances of exceptional cost increases is through a special rent adjustment standard that provides for the right to rent increases which cover operating expense increases in cases in which the annual allowable rent increases and the vacancy decontrol mechanisms do not provide this result.

I. Operating Costs

Operating costs include the various types of expenses associated with operating apartment buildings, including property taxes, management, maintenance (including amortized costs of capital improvements), insurance, refuse collection, and utilities, but do not include debt service (mortgage payments). Debt service is considered an investment expense rather than an operating expense. In the U.S., apartment operating expense to gross income ratios typically range from 30% to 50%. In California, ratios are typically in the 25% to 45% range.

A. Data Sources

Because there is no comprehensive source of data on the operating costs of small and medium size apartment buildings, various data sources had to be used in order to develop the projections in this chapter. Each of the data sources on apartment operating expenses have different strengths and weaknesses. However, collectively the sources provide substantial information and are consistent in the overall operating expense/rental income ratios that they project.

Apartment operating costs data that has been collected and published by national real estate services is from operators of large professionally managed buildings. In such reports the average building size is in the range of hundreds of units. Also, while sizes of the national samples covered by these reports are substantial (thousands of units), sample sizes for particular localities are usually small.

The "Rental Housing Finance Survey," (RHFS,2012) conducted by the U.S. Department of Housing and Urban Development (HUD) based on 2010 and 2011 data, reported nationwide average expense ratios of property taxes, maintenance, insurance, and capital expenses based on a

survey that included approximately two thousand apartment buildings of all sizes.[1] However, the HUD study did not include any regional or localized data.

Multiple sources of real estate industry data on the operating costs of individual apartment buildings in San José and the San Francisco Bay Area were used in this analysis to estimate average apartment operating costs. Some of the sources contained information on individual properties covered by the ARO. Such information was used to project average ratios for specific types of expenses to rental income and/or overall operating cost/rental income ratios.

The data sources with operating expense information included:

1) Apartments for sale listings of buildings subject to the ARO which included income and operating expense data.
2) Appraisal reports included in rent increase petitions based on increased debt service submitted to the City's Rental Rights and Referrals Program (RRRP)
3) Data from operators of affordable housing in San Jose
4) Institute of Real Estate Management (IREM) - *Income/Expense Analysis Apartments*: An annual publication on operating expenses of primarily larger professionally managed buildings throughout the nation
5) REIS Services LLC. Reis prepares analyses of rent trends for a large sample of large apartment buildings in metropolitan areas. The data includes an overall operating expense ratio, but does not include a breakdown by expense categories.

In addition to the above data sources, publicly available databases, public reports, and rate schedules are used to estimate the amounts and rates of increase of specific types of expenses. (mainly expenses that are either public record (e.g. property taxes) or that are provided by third party providers (e.g. refuse collection).

The data from affordable housing operators are from apartment buildings in San José that are not subject to the ARO.

As indicated, the data from IREM reports on operating costs is based on operating costs statements for larger apartment buildings, which are not typical in size of the buildings covered by the ARO and include buildings that are not subject to the ARO because they were constructed after 1980. However, these reports contain more detailed expense categorizations than the other sources.

[1] The following study which was performed in 2015, with a planned release by HUD in the fall of 2016.

B. Overall Operating Cost Ratios

1. Current Levels

In San José, apartment operating costs are typically in the range of 25% to 45% of rental income, with an average of about 35%. This ratio is consistent with the ranges found in other California cities and metropolitan areas.

Data on operating expenses of apartment owners was obtained from 96 for sale listings from 2013 through 2015 for buildings with five or more units, which were constructed before 1980 in order project average operating expense levels Tabulations of operating expense averages that are presented in this report include calculations of the authors of this report using the amounts reported in individual real estate for sale listings. Operating cost data for individual properties was set forth in the real estate listings. The tabulations that are presented in this report are not attributable to, nor are they endorsed by any data source, including the Multiple Listing Service.

The average size of the buildings was 8.6 units. The average of the reported operating expenses was $411/apartment unit/month, which was 33.5% of an average rental income of $1,266. 42% of these buildings had an operating cost/rental income ratio in the range of 30% to 39.9%; 33% had ratios ranging from 20 to 29%, and 12% had ratios ranging from 40 to 49%. The projection of an average ratio of 33.5% includes an imputed allowance for management expenses of 5% of rental income, in cases in which there was no allowance for management expenses in the for sale listing. The imputed 5% allowance reflects an imputed value of the apartment owners' services in managing a building when no management expense was reported.

The exceptional rent increases of the past two years, which were far above the rate of inflation, would bring the average rent well above the average of $1,266 in the for-sale listings which were reviewed. From June 2014 to December 2015, the S.F.-Oak-San Jose CPI Rent Index increased by 10.2% compared to a 2.8% increase in the CPI all items index.[2] In 2014, the average rent reported in the American Census Survey (ACS) for buildings with five or more units was $1,388. Therefore, it is likely that current operating expense ratios are lower.

Income and expense data from apartments for sales listings and appraisals submitted in conjunction with individual rent adjustment petitions submitted to the Rental Rights and Referrals Program for debt service pass-throughs indicated similar levels of operating expenses.

The average operating costs for 20 deed-restricted affordable housing buildings in San José with an average of 53 units was $457/month (excluding any expenses for resident social services). The operating expense/rental income ratio for these buildings was higher than for ARO units due to deed restrictions on the rent levels.

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[2] The CPI All Urban Consumers-All Items Index –SF-Oak-SJ increased from 253.219 to 260.99; the CPI The CPI All Urban Consumers-Rent of Primary Residence Index –SF-Oak-SJ increased from 348.153 to 383.630.

IREM's annual income/expense analysis for San Jose, which is limited to 16 buildings, reports an average operating cost of $591/apartment unit/month among buildings with an average rent of $1,844. The IREM data on median monthly operating expenses /apartment unit for other metropolitan areas in California (Los Angeles, Orange County, Sacramento, and San Diego), which are based on reports from 16 to 58 buildings, reports median monthly operating expense ranges from $408 to $608. In seven of the eight building groups the median operating expense/apartment unit/month is $522 or less. (IREM data based on reports from less than 10 buildings are not considered in this discussion.)

The first table below sets forth a combination of data tabulated by the authors using data from individual sale listings and from data on individual properties supplied by a provider of non-profit housing, and operating expense/income data published by two national sources of real estate data (IREM and REIS). The second table contains data from most recent IREM Income/Expense Analysis on operating expense/rental income ratios in California metropolitan areas.

Table 6.11
Overall Operating Costs San José Apartment Buildings
With 5 or More Units
Not Including Capital Improvements

	Sample Characteristics						
Source	**Type of Bldgs**	**Bldgs**	**Units**	**Avg No. of Units**	**Average or Median Rent**	**Monthly Operating Cost/Unit**	**Ratio Oper. Exp/ Rent**
Units Covered by ARO							
For Sale Listings 2013-2015	**Constructed before 1980 covered by ARO**	**98**	**848**	**8.6**	**$1,226**	**$411***	**33.5%**
Non-Profit Housing and Large Professionally Managed Properties							
2014	**Non-Profit Housing in San José**	**20**	**1071**	**53**	**Rents are Deed Restricted**	**$457**	
Reis Inc.	**San José Area Large Buildings All Ages-(half pre-1973)**	**575**		**152**	**Not Included in data**	**Not Included in data**	**33.2%**
Institute of Real Estate Management (IREM) 2014	**San José Area Large Buildings All Ages**	**16**	**4132**	**258**	**$1,844**	**$591**	**31.9%**

* Management expense of 5% of income imputed if no management expense projected.

Table 6.2

Operating Expense Levels Reported by Institute of Real Estate Management (IREM)

Metropolitan Area	Bldg Type	Bldgs	Average No. of Units	Median Rent	Median Oper. Exp/Unit/Mo.	Op.Exp/ Rent Ratio
Los Angeles	Low Rise	16	168	1827	608	33.7%
Los Angeles	Garden	41	243	1412	463	31.1%
Oakland	Garden	13	148	1457	502	30.5%
Orange County	Low Rise	28	167	1300	515	35.3%
Orange County	Garden	58	171	1368	522	36.4%
Sacramento	Garden	27	190	902	408	41.0%
San Diego	Low Rise	36	91	1354	441	28.9%
San Diego	Garden	35	211	1303	418	29.7%

Source: Institute of Real Estate Management (IREM), Income/Expense Analysis, Conventional Apartments 2015 (National Association of Realtors, Chicago). The IREM reports contain annual amounts. In the table monthly amounts are computed by the authors.)

Operating Expenses of Smaller Buildings

Three and four units buildings comprise about 20% of the rental stock subject to the ARO. An oft-repeated claim has been that 3 and 4 unit buildings (which contain about 20% of the units subject to the ARO) have higher operating expense ratios than larger buildings.

Data was compiled from the limited sources that could be located with operating expense data for three and four unit properties. Data from nineteen for sale listings in 2016 for 3 and 4 unit buildings indicated that the average of the operating expense ratios for these buildings were not higher on the average than the averages reported by IREM for larger buildings.[3]

[3] Six out of the buildings had operating expenses under 30%, ten had ratios between 30 and 39%, and three had ratios over 40%.

CoStar reports included data on overall operating expenses in 26 comparable sales reports of buildings with 3 or 4 units from 2000 to 2015. The average of the operating expense ratios was 32.7%. The data did not include a breakdown by expense categories. If an additional amount of 5% is imputed for management services, based on the assumption that most of the properties were owner managed, the ratio would 37.7%.

Data on property tax assessments could be obtained from the County Assessor's data base. The authors' compilations based on this data revealed that average of property taxes per unit per month were about $50 higher for buildings with 3 or 4 units than the overall average among apartment buildings.

HUD's Rental Housing Finance Study (RHFS,2012), which was nationwide, reported median and average maintenance, insurance, and capital improvement expense levels with a breakdowns into 2 to 4 unit property and a 5 to 24 unit property categories. The differences in the cost levels between these two building size categories were not substantial. Average monthly insurance and average monthly maintenance costs for 2 to 4 unit buildings were each about $10 higher than for 5 to 24 unit buildings.[4]

Issues About The Use of Data from For Sale Listings

Some owners commented that the operating cost projections in the for sale listings were downwardly biased for marketing purposes.,

One bias towards understatement of overall operating expenses in the data in the for-sale listings may be in the omissions or understatements of capital improvement expenditures and of expenses that do not recur monthly or annually. It appears that costs that are fixed and easily recalled by sellers are more likely to be accurately reported in the for sale listings. Review of the expense listings reveals that the projections for recurring expenses (e.g. insurance and refuse collection) were typically precise amounts while projections of types of expenses which vary from month to month appeared to be rounded estimates.[5]

Capital Improvements

As indicated, if the data sources on operating expenses understate overall apartment ownership expenses it is most likely to be in the area of capital expenses which are not recurring on an annual basis. No systematic data was found on average capital improvement expenses for apartments in the San Francisco Bay Area.

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[4] See HUD, Rental Housing Finance Study, 2012, Table 1, Selected Characteristics By Mortgage Status, All Properties and Table2a, Selected Characteristics By Mortgage Status, 2 to 4 units.

[5] Listings with missing data were not considered in developing the tabulations used in this analysis.

In the U.S. Department of Housing and Urban Development Rental Housing Finance Survey of 2012 (RHFS, 2012), a national survey, approximately one-third of the respondents reported that they did not make any capital improvements in 2010 and 2011. Among the buildings that had capital improvements the annual median was $675 (a monthly median of $56) and the annual mean (average) was $1,250 (a monthly average of $104).[6] In fact, the actual annual medians and means are lower because the foregoing projections do not take into account the substantial proportion of buildings (one-third of all buildings, which contained 30% of all the units covered by the survey) for which it was reported that no capital improvements were made during the two year period. Taking into account the buildings that reported that no capital improvement expenses were incurred, the actual medians and averages were approximately one-third lower than the medians and means based on data that was limited to the buildings that incurred capital improvement expenditures., The actual monthly median would be $37 and the monthly mean (average) would be $66.

The National Apartment Association's 2015 annual survey of 3,557 buildings nationwide with an average size of 252 units reported that capital expenditures per unit averaged $1,090/year or $90/month.[7] The IREM Income/Expense Analysis covering apartment costs in 2014, reported that median annual capital expenditures for 307 buildings in the Western Region of the U.S. were $0.79/sq. ft.[8] In the case of apartments with 1,000 square feet, the annual amount would $790 and the monthly amount would be $61.

A study based on 2011 data from 882 buildings in the State of Washington, with an average of 108 units reported an average capital expenditure of $718/year or $60/month (equaling 6.5% of estimated gross rent.)[9] The data from this study indicates that the capital expenditure patterns are cyclical in conformance with trends in rental markets. Assuming that the same cycles would have occurred on a national basis, in conformance with the upward cycle in rents of the past few years,.current averages would be higher than the averages reported in the RHFS, 2012

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[6] Median capital expense and mean expense levels were reported for a two year period – 2010&2011. The per unit median amount for the two year period was $1,350 and the mean (average) for the two year period was $2,499.

[7] National Apartment Association, *2015 NAA Survey of Operating Income & Expenses in Rental Apartment Communities*, p. 28.

[8] IREM, Income/Expense Analysis, Conventional Apartments, 2015, p.207. Table "2014 Capital Expenditures for Conventional Apartments, $/Sq. Ft of Rentable Area" (Institute of Real Estate Management of the National Association of Realtors., Chicago)

[9] Dupre & Scott Apartment Advisors, Inc, (Seattle) "Capital Expenses and Replacement Reserves",

2. Trends on Overall Operating Costs

Operating expense data in for sale listings and IREM reports from past years project overall operating cost ratios that are similar to current ratios.. Increases in operating expenses have equaled about one-third the increases in rents, consistent with the fact that operating cost ratios have been stable,

Increases in the rates for some utilities and public services are tied to the CPI. However, some utility costs (especially water costs) and public assessments have recently increased at exceptional rates. However, the total of these types of expenses, which are largely beyond the control of apartment owners, is small relative to overall rental income.

The annual increase in the largest operating expense, property taxes, is limited to 2% per year except when a property is sold, when it is reassessed at full value. As a result, there are wide divergences among properties in the amount of the property tax per apartment unit, the frequency of increases (beyond 2%/ year), and in the ratio of their property taxes to rental income.

Two of the major operating expenses - management and maintenance - are subject to substantial discretion and control by owners. Trends in maintenance costs reflect trends in wages and the costs of materials in the overall economy.

However, trends in apartment operating costs cannot be determined simply by changes in the costs of providing the same levels of maintenance and services.[10] They also may be influenced by the sensitivity of rent and vacancy levels to changes in the level of maintenance and services. In some markets, additional maintenance and upgrades may have a substantial impact on rent and vacancy levels, while in others they may not have a substantial impact.

The dynamics of the market at a particular time may provide incentives to either reduce, maintain at current levels, or increase maintenance and/or service expenditures. Owners have incentives to reduce maintenance and services expenditures if these strategies either will not result in reductions in rental income or will reduce rental income by less than the corresponding cost reductions. Alternatively, market dynamics may induce increases in maintenance and services that will garner rent increases exceeding increases in expenditures.

The table below sets forth past years reports of operating expense levels.

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[10] For a discussion of these issues see Goodman, "Determinants of operating costs of multifamily housing", Journal of Housing Economics, Vol. 13, 226-244 (2004).

Table 6.3

Trends in Operating Costs San José Apartment Buildings

	Sample Characteristics						
Source	**Year**	**Bldgs**	**Units**	**Avg No. of Units**	**Average or Median Rent**	**Monthly Operating Cost/Unit**	**Ratio Oper. Exp/ Rent**
Units Covered by ARO							
For Sale Listings San José Buildings with 5 or more units	**2010** (market slump / low sales volume)	**16**	**201**	**12.5**	**$909**	**$344***	**37.9%**
	2005	**85**	**893**	**10.5**	**$1,002**	**$322***	**32.1%**
	2000	**57**	**577**	**10.1**	**$880**	**$216***	**24.5%**
Units in Large Buildings IREM Sample							
IREM Reports San José Area Large Bldgs All Ages	**2005**	**35**	**7,849**	**224**	**$1,208**	**$451**	**32.8%**
	2000	**22**	**3,656**	**166**	**$1,480**	**$405**	**29.6%**
	1990	**59**	**8,633**	**146**	**$758**	**$269**	**34.8%**

*NOTE: Management expense of 5% of income imputed if no management expense projected in the for sale listing..

3. Variations in Operating Costs and Operating Cost Trends Among Classes of Apartment Buildings

The available data samples were generally not adequate to provide a breakdown according to building characteristics.

The data from the IREM reports indicates that larger buildings have operating expenses that are about $100/apartment/month higher than smaller buildings. However, their operating cost ratios are not higher because the average rent levels of the larger buildings, which include buildings constructed before and after 1980, are a few hundred dollars higher.

There are a number of possible explanations for the differences in average operating expenses between larger buildings and smaller buildings. The larger buildings may offer more services. The differences may also reflect differences in operating strategies among owners of smaller and larger buildings, with owners of larger properties preferring to maximize rents, while owners of smaller properties may prefer to minimize the risks and the costs associated with turnover.

C. Operating Expenses by Type of Expense

Management, maintenance, and property taxes make up the bulk of operating expenses**.** Insurance and utilities (common area gas, common area electricity, water and sewer, refuse collection) each average about 2% of rental income or less. Therefore, even substantial increases among the latter group of costs would have a relatively small impact on overall operating expenses and net operating income.

The following table contains operating expense ratio data by category of expense based on 96 for sale listings from 2013 through 2015.

Table 6.4

Average Apartment Operating Expenses 2013-2015
Buildings with 5 Units or More Built before 1980

Expense Category	Average / Apt / Month	Expense / Income Ratio
R.E. Taxes and Assessments*	$183	14.9%
Insurance	$30	2.4%
Landscape	$7	0.6%
Maintenance	$52.86	4.3%
Management	$66	5.4%
Other	$19	1.6%
Trash	$21	1.7%
Utilities	$32	2.6%
Total Operating. Expenses	$411	33.5%
Rental Income	$1,226	

Source: Based on author's tabulations using data in for sale listings in 2013 through 2015 of 96 buildings with 848 units.
* This projection includes assessments and other costs billed along with property taxes. These costs include sanitary sewer charges- $22.62/monthand Storm Water assessments- $4.30/month

1. Property Taxes

Property taxes are set at 1.2192% of assessed value. Annual increases in assessed value are limited to 2% per year in the absence of a sale.

When a building is sold, it is reassessed at market value. As a result, in a market where real estate values have been increasing, the level of property tax expense is largely a function of the length of ownership of a property, with much higher tax levels for recent purchasers than for long term owners.

For example, if a property was purchased in 1990 for the average price of $59,532 per unit, the current assessed value per unit would $99,418 (based on a 2% increase in assessed value each year

since 1990) and the property tax per unit would be $1,212/year or $101/month/apartment unit.[11] If the property was purchased in 2015 for the average price of $191,463 per unit, the property tax would be $2,334/year or $194/month/apartment unit.

Data on all assessed values in the County was obtained from County Assessor. Property taxes for properties covered by the ARO were tabulated by applying the property tax rate to the County;s database setting forth the assessed values of each parcel.

The average property tax per month (not including other charges on property tax bills) for units covered by the ARO was $111.38. The average for 3 and 4 unit buildings was $154.08, compared to an average of $100.79 for units in buildings with 5 or more units.

There were wide variations from the average consistent with the combination of the valuation methodology under Proposition 13 which ties assessed values to original purchase costs, adjusted upward by only 2% per year and substantial differences in value among rental units.

While the average was $111.38/unit/month, the property tax of 12½% of all units was over $200 per month and the property tax for 26.7% of all units was less than $50 per month.

[11] ($99,418 x .012) / 12 months.

Table 6.5
Property Taxes Per Unit Per Month
Properties Subject to the ARO

	ARO units	Units on Parcels with 5 or more units	Units on Parcels with 3 or 4 units
No. of Units*	41,707	33,846	8,350
Average Property Tax / Unit /Month	$111.38	$100.79	$154.08
Property Tax Range /Unit/Month	Percentage of Units		
$0-49	26.7%	30.1%	12.7%
$50-99	26.9%	29.8%	16.5%
$100-149	19.9%	18.8%	24.2%
$150-199	14.0%	13.6%	15.7%
$200-249	5.3%	2.4%	16.7%
$250-299	4.6%	3.1%	10.3%
$300-399	2.4%	2.2%	3.1%
$400-499	0.1%	0.1%	0.6%
$500+	<.1%		0.2%

* Buildings in which only a portion of the units are subject to the ARO are not included
Calculations of property tax amounts were made by multiplying the assessed value by the tax rate.

2. Assessments (Included in Property Tax Bill)

Apart from property taxes, apartment owners pay for other assessments that are included on the property tax bill. Apart from sanitary sewer costs, the total of these assessments is generally less than $10.00/apartment unit/month.

a. Sanitary Sewer Costs

Sanitary Sewer Fees

Sanitary sewer fees are set by City Resolution at $22.62/apartment unit/month for multifamily dwellings.[12] All dwellings of two units or more are included in this category under the standards for setting sewer rates.

Increases in Sanitary Sewer Fees

Sanitary sewer fees have increased by $10.26/apartment unit/month since 2006. The annual rate of increase since 2006 has been 6.9%. Although this rate of increase has exceeded the rate of inflation, in dollar terms the increase has been equal to less than one percent of monthly rents.

Table 6.6
Sanitary Sewer Rates

Fiscal Year	Rate/Apt./Month
2006-2007	$12.36
2007-2008	$13.42
2008-2009	$15.42
2009-2010	$17.72
2010-2011	$18.79
2011-2015	$19.35
2015-2016	$22.62

b. Storm Sewer Costs

Current Storm Sewer Fees

Storm Sewer Fees are set by City Council Resolution. The current rate for buildings with five or more units is $4.30/apartment unit/month.[13] A flat rate of $14.95 is applicable to three and four unit parcels, resulting in a monthly rate of $3.73 for four unit buildings and a monthly rate of $4.98 for three unit buildings.

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[12] City Council Resolution No. 77462 (2015).

[13] City Council Resolution No. 77463 (2015)

Increases in Storm Sewer Fees

Overall storm sewer fees have increased by $2.20/apartment unit/month since 2004. In 2004, the rate was $2.10 apartment unit/month, in 2008 the rate was $3.22, and in 2009 a rate of $4.18 was adopted.

Library Tax

The City assesses a library parcel tax with a monthly rate per apartment unit of $1.31.[14]

Overall Assessments

Apart from sanitary sewer costs, most apartment properties are subject to seven different assessments which total an average of $3 to $5/apartment unit/month.

3. Utility Costs

Utility costs typically include water, sewer, storm drainage, and common area electricity. On the average, costs for individual utilities are less than 2% of rental income and aggregate utility costs average about 10% of rental income.

Projections of average utility costs are based on a combination of cost projections in the real estate for sale listings, real estate industry publications on apartment operating costs, data on bills from publicly operated utilities, and public fee schedules that set fix rates on a per apartment unit basis.

Utility costs vary substantially among buildings.

c. Water Costs

Average Water Cost

The San José Water Company, a private company, supplies most of the apartment buildings in the City. (A very small proportion of apartment buildings are served by the San José Municipal Water District.) The discussion in this section is limited to the rates charged by the San Jose Water Company.

Water charges include a usage charge and a fixed monthly fee based on the size of the meter. Most of the water costs are attributable to the usage charge,

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[14] The annual rates are:.: first 20 units - $11.46/apartment, 21 to 50 units - $7.64/apartment, 51 to 100 units - $3.82/apartment, over 100 units/$1.54/apartment. San Jose Muni Code Sec. 4.79.010 (San Jose Library and Reading Protection Ordinance).

The rate for all levels of water usage in buildings with five or more units is uniform, rather than tiered for different levels of usage. Also, apartment buildings with five or more units are not subject to the drought surcharge that came into effect in the summer of 2015.

The usage charges for buildings with five or more units. are $3.567 per 100 cubic feet.[15]

For buildings with less than five units the water charges are tiered depending on the level of usage, with rates ranging from $3.21 to $3.92 per cubic foot.

Monthly meter charges are $21.07 for a half or three-quarters inch meter; $35.15 for a one and a half inch meter and $70.28 for a two inch meter.

The only sources of publicly available data on water expenses for apartment buildings that this author could locate was from expense reports for buildings in affordable housing projects that are not covered by the ARO. [16] Data from those reports indicate that the average water expense per apartment per month was $30.42 in 2013 and 2014. The data samples included fifteen buildings with an average size of approximately 50 units.

In 2014 it was reported that the average cost for single family dwellings was $70 and was expected to increase to $90.[17] A news release issued by the City indicated that about half of the residential water costs were attributable to outdoor irrigation.[18]

.Assuming that there are no outdoor or very limited irrigation costs for most apartments and assuming that apartments have a lower rate of indoor consumption on the average than single family dwellings, the average water cost per apartment would be less than half of the average cost for single family dwellings. Based on these very limited data sources it appears that an average monthly water cost per apartment would be in the range of $30 to $35.

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[15] San Jose Water Co., Rate Schedule 1 (July 29, 2015)

[16] In an effort to obtain even more precise projections of average costs per apartment for the cost of utilities provided by privately owned (publicly regulated) utilities, requests were made of those providers for data on average expense levels for apartments. The City offered to provide a list of a sample of apartment buildings which included data on the number of units in those buildings and requested an aggregate total of the utility cost for those buildings, so that an average cost per apartment unit could be computed. In the requests, it was agreed that no individual bill amounts would be disclosed in order not to breach any confidentiality. These requests were declined.

[17] "San Jose Water customers to face big rate increase," San Jose Mercury News, Aug. 15, 2014.

[18] Environment Services Department, City of San Jose News Release, "San Jose City Council Declares Citywide Emergency Drought, Restricts Hours of Outdoor Water Use", , Aug. 27, 2014.

Increases in Water Costs

Water rates are regulated by the California Public Utilities Commission (CPUC) which makes individual rate decisions for each company. Every three years the San Jose Water Company applies to the CPUC for rate adjustments setting the rates for the next three years.

San José Water Company rates increased by 139% from 2001 to 2015, compared to a 36% increase in the CPI. Currently, an application by the Company for rate increases in the three following years of 11.88%, 3.06%, and 4.78% is under consideration by the CPUC. The cumulative (compounded) total of the requested increases is 20.8% and the cumulative increase since 2001 would be 167% if these rate increases are approved.

The following table sets forth San José Water Company rates from 2001 to the present.

Table 6.7

San José Water Company Rates
Residential – 5 units or more

Year	Quantity Rate/ 100 cu. Ft.	1" meter	2" meter
2001	1.4886	$15.00	$59.00
2002			
2003			
2004	1.8849	18.89	60.44
2005	1.9201	19.84	63.48
2006	1.9883	19.84	63.48
2007	2.1616	21.59	69.07
2008			
2009			
2010	2.5223	27.18	86.99
2011			
2012			
2013	3.2807	32.07	102.63
2014	3.4554	33.94	108.62
2014 July	3.4570	33.96	108.68
2015	3.5670	35.15	112.45

Source: Rate Decisions of the California Public Utilities Commission (CPUC)

While the increases in water rates have been steep relative to inflation, the increases are equal to only about one or two percent of rental income (e.g., an increase in average monthly water costs/apartment unit of $15 to $20 over a 15 year period from $15 to $30.)

d. Gas and Electricity Costs

No data could be located on the proportion of apartment that are master-metered and average electricity and gas costs for apartment buildings with and without separate meters for tenants. However, review of for sale listings reveals that very few buildings have separate meters for electricity and that most have separate meters for gas. In a substantial portion of buildings water heating is master metered.

The limited data available from IREM reports indicates that in most years, in the buildings that were not master-metered, gas and electricity costs for common areas were each under one percent of rental income.

e. Charges for Refuse Collection

Average Refuse Collection Costs

San Jose's rate schedule for garbage collection from bins is based on bin size and the frequency of collections. Smaller buildings generally use push carts, with rates based on the size of the cart and its distance from the street. Calculations of average costs were based on tabulations using the City's data base of garbage bills with tabulations limited to the bills the buildings which are subject to the ARO and which use refuse bins (as opposed to push carts. (Individual bills are not public record.)

In buildings of five or more units that use bins garbage collection costs average approximately $11.40/apartment unit/month or less than one percent of rental income. The average is higher for buildings with five to nine units - $16.00/apartment unit/month and lower for buildings with twenty or more units - $10.08/apartment unit/month. In buildings with four units the average cost was higher -$21.90/apartment unit/month. While there was divergence in the garbage collection costs/apartment unit among the buildings that use bins, only a small fraction of the buildings had costs in excess of $20/apartment/month.

Table 6.8

Trash Collection Costs
Buildings with Trash Bins

Bldg Size Units	No. of Bldgs	No. of Units	Avg. Bill/ Month
4	1235	4940	$21.90
5-9	603	4087	$16.00
10-19	349	4495	$12.46
20 or more	281	17712	$10.08
all bldgs. 5 units or more	1233	26294	$11.40

In buildings with three or four units usually push cart rather than bin service was used. About half of the buildings in this category provided one 32 gallon push cart with weekly collection service, incurring bills of $384.84 per year, or $32.07 per month. For these buildings, the monthly cost per unit would be $8.02 for a four unit building and $10.69 for a three unit building.

Increases in Refuse Collection Costs

Refuse collection rates have increased by 20.2% since 2010.

5. Insurance

Average Insurance Costs

Insurance costs average $30/apartment unit/month or 2.4% of rental income. These averages are based on insurance costs projections in for sale listings for apartment sales from 2013 to 2015. The median monthly insurance cost reported in the IREM sample for 2014 of 16 large buildings in the San Jose area was also $30.

Increases in Insurance Costs

It does not appear that insurance costs have increased significantly during the past decade. The annual average of insurance costs reported in the for sale listings in 2000 was $16/apartment unit/month. Since then the monthly averages of the amounts reported in the for sale listings have fluctuated upwards and downwards between $24 and $34.

The IREM study, which contains 2014 data on median insurance expense levels for larger buildings in other California metropolitan areas, reports median insurance costs of $14 to

$36/apartment unit. In six of the eight building groups covered by the report[19] the median was between $17 and $24.

6. Maintenance

Maintenance expenses reported in the for sale listings in 2013 through 2015 averaged $53/apartment unit/month or 4.3% of rental income. This ratio is similar to the ratios reported for larger buildings in the IREM reports, but in dollar terms are much lower.

The appraisal reports accompanying the debt service pass-through petitions made projections of average annual maintenance expenses ranging from $500 to $1,000 ($42 to $84/month.) Compared to a rent of $1,400/month these amounts would range from 3% to 6% of annual rental income.

7. Management

Current Costs

Typically management fees are set at a percentage of rental income. Under California law on-site managers are required for buildings with 16 or more units.[20] 45% of the rental units covered by the ARO fall into this category.

A substantial portion of the smaller apartment properties are managed by their owners. About half of the for-sale listings did not include a projection for management costs.

In several of the appraisal reports submitted by apartment owners in conjunction with debt service increase pass-through petitions, appraisers stated that a projection for management costs of 5% of rental income would be reasonable.

[19] See table 6.2. listing the cities and number of units providing the bases for the data.

[20] California Code of Regulations, Title 25, Sec. 42.

II. Trends in Net Operating Income

A comparison of the rate of increase in net operating income of rent-stabilized apartments with the rate of increase in the CPI has been a standard yardstick for measuring the reasonableness of rent restrictions. This type of analysis was a centerpiece of the 1988, 1994, and 2007 studies for the City of Los Angeles that were commissioned by that City in order to evaluate the impact of its rent stabilization ordinance.[21]

Also, a comparison between increases in net operating income and increases in CPI has been the most widely used yardstick in measuring fair return (just and reasonable return) under rent regulations in California. (See Chapter 5)

As discussed in Chapter 5, mobilehome park owners have generally taken the position that restricting growth in net operating income ("indexing" of net operating income) to less than 100 percent of the percentage increase in the CPI is unreasonable. However, the courts have repeatedly held that ordinances that limit growth in net operating income to less than 100 percent of the percentage increase in the CPI are constitutional.[22]

In the case of apartment rent regulations in California, it is unlikely that many apartment owners would need to petition for an individual rent adjustment in order to obtain a fair return, under standards that provide for indexing net operating income by 100% of the rate of increase in the CPI. The vacancy decontrol mechanisms and the rental market trends in coastal regions have permitted increases upon vacancies in excess of the increase in the percentage increase in the CPI. (Exceptions to the ability to realize growth in net operating income equal to the percentage increase in the CPI could occur in cases in which both allowable annual rent increases have been below the increase in the CPI and an owner has not obtained significant vacancy increases due to little or no turnover of tenants. Also declines in net operating income may occur during times when market conditions (rather than rent regulations) are preventing rents from increasing at the same pace as operating costs.) However, the overall increases in the CPI-Rent Index since the adoption of the ARO have substantially exceeded the increases the CPI All-Items.

Los Angeles, for example, has received only a tiny number of petitions for fair return adjustments under its apartment rent stabilization ordinance, which allows annual increases equal to the percentage increase in the CPI and defines fair return as pre-rent control net operating income adjusted by 100% of the percentage increase in the CPI since its base year (1979). In the case of San José, since the ARO has allowed increases of 8%, which in most years has been far above the

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[21] Hamilton, Rabinovitz & Alschuler, The 1994 Los Angeles Rental Housing Study: Technical Report on Issues and Policy Options, pp. 183-218. (December 1994, Prepared for the Rent Stabilization Division); 1988 Rental Housing Review, pp. 202-224.; Economic Study of the Rent Stabilization Ordinance and the Los Angeles Housing Market, pp.252-258, (2009)

[22] See text accompanying Chapter 5, fn. 11

rate of increase in the CPI, it is even less likely than in Los Angeles that an apartment owner could not obtain a fair return.

Available data that can be used to compare current and past net operating income levels is too limited to provide precise comparisons. However, the data does give a projection of magnitude of the growth in net operating income of San Jose apartments over the decades.

The data from the apartments for sales listings for 2013 through 2015 indicate that the current average monthly net operating income per apartment is in the range of $815. These projections are based on a monthly rent projection of $1,226, which is conservative compared to current average rent levels, and on a projection of average monthly operating expenses of $411.[23]

In contrast, in the first half of 1990's monthly net operating income levels averaged approximately $400/unit. This estimate is based on calculations of median net operating income from 1990 through 1992 using the sales price and capitalization rate data from CoStar sales reports.[24]

The increase in net operating income levels of about 100% from the first three years of 1990's to the past three years compares with an increase in the CPI of 83% since 1992 and a 93% increase since 1990. In 2000, the average monthly net operating income, based on data from 57 apartment building sales, was approximately $584. The increase in average net operating income of 39% from the 2000 level of $584 to the average for 2013 through 2015 of $815 compares with an increase in the CPI of 42% during this period.

The foregoing projections of growth in net operating income and increases in the CPI are subject to the qualification that they do not fully reflect the surge in rents of the past year, which is not reflected in the most currently available data, and, therefore, may be conservative.

III. Length of Ownership

Data on length of ownership of apartment buildings would provide additional perspective on typical purchase prices of current owners and the relative role of capital gains in apartment investments. No reliable source for such information appeared in the course of preparing this study.

The County Assessor's Annual reports give some perspective on turnover in ownership. Since 2009 the annual reports of the Assessor have included data on the number of parcels (within each

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[23] See Table 6.1.

[24] In order to estimate net operating income the average price/apartment unit is multiplied by the capitalization rate. (E.g. 1990, $59,532 (average price x .0781 (capitalization rate) = $4,649 (annual net operating income) /12 months = $387 (monthly net operating income). Using the same equation the monthly net operating amounts for 2001 and 2002 are $387 and $415. (See table 6.7 setting forth average prices and capitalization rates.

property class) that are reassessed each year as a result of a change in ownership.[25] (The data does not indicate what portions of the changes are tied to market sales.) . In five of the seven years between 4% and 6% of all the multifamily (five or more units) parcels in the City were reassessed as a consequence of a change in ownership. In the 2013-14 fiscal year, 9% of the parcels were reassessed as a result of a change in ownership.

IV. Appreciation and Depreciation in Apartment Values

Appreciation and depreciation in value are a central determinant of the returns from apartment investments.

Apartment values have been heavily impacted by factors other than actual rent trends. Purchase prices reflect projections about future as well as current rent, net operating income, and value.

Apart from trends in rents and projections of future rents, changes in the cost of investment capital (i.e. mortgage interest rates)[26] and changes in prevailing capitalization rates[27] play a critical role in determining market values. As the cost of acquiring purchase money capital (the mortgage interest rate) declines, investors will expend more capital for the same income stream from an income producing property.

Also, the declines of recent decades in rates of return from alternate investments, such as bonds or bank deposits (CD's), have pushed up the value of returns from income producing real estate.

Since the 1990's a nationwide decline in capitalization rates has increased the value of income producing real estate. In strong real estate markets such as in coastal areas of California, capitalization rates have been particularly low.

In the first half of the 1990's, when the capitalization rate was about 8.5%, an annual net operating income stream of $5,000 per apartment was worth about $58,000 ($5,000/.085). Since 2005, when

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[25] The data is included in each annual report in a table "Assessor Parcels and "Added" Assessed Value Resulting from All Changes in Ownership (CIO) and New Construction (NC) by City and Major Property Type". The annual reports are posted on the Assessor's website.

[26] For example, the same annual mortgage payments which support a 30-year mortgage of $700,000 with a 9% interest rate will support payments on a mortgage $1,050,000 with a 5% interest rate.

[27] The "capitalization rate" is the ratio of net operating income/purchase price. It is a measure of how much is paid for each dollar of net operating income. For example, if the prevailing capitalization rate is 10% in order to obtain a net operating income stream of $10,000 investors, will pay $100,000. If the prevailing capitalization rate is 5%, in order to obtain a net operating oncome of $10,000 investors will pay $200,000.

the capitalization rate has averaged about 5.5%, the same net operating income stream of $5,000 has been worth $91,000 ($5,000/.055).

A. Trends in Apartment Values

While the Assessor's database includes data on assessed values and amounts tied to property transfers, it does not separate arms-length sales from other types of transactions in its data base. However, private firms provide real estate sales data to the real estate industry.

CoStar, a prominent real estate data source, provided a custom trend report on 1,492 sales from 1990 through 2015 of San José buildings with 5 units or more constructed before 1980. On average, 57 sales were reported per year. The annual totals of reported sales ranged 23 to 117. The data set does not include subsidized buildings and, therefore, would consist of buildings subject to the ARO.

Averaged sales price data for sales from 1970 through 1989 based on data in the reports from Realquest, another prominent source of real estate sales data. Due to the smaller sample sizes, averages for five year periods, rather than single years, were projected.

The trends in average sales prices per unit have been marked by periods in which values remained stable and by periods of cycles with steep increases and declines in value.

As in the case of virtually all types of real property in the SF Bay Area and most, if not all, California urban areas the overall increases in apartment values have far exceeded the rate of inflation; therefore, providing very attractive returns. However, the overall growth has also been interspersed with periods in which apartment values did not appreciate and experienced severe downturns.

From the *first half of the 1970's to the first half of the 1980's* average apartment prices tripled, from $11,518 to $33,410. To place the increases of the 1970's and 1980's in perspective, it is noted that from 1974 to 1982, the CPI increased by 107%. Overall, from 1970 to 1989 the CPI All Items increased by 235%.

From the *first half of the 1980's to the second half of the 1980's* average apartment values increased by about 60%, from $33,410 to $52,767. From *1990 through 1997*, the annual averages of prices per apartment ranged from $47,020 to $66,860. The average price declined from $59,532 in 1990 to $47,920 in 1994 and then increased to $66,860 in 1997.

- From *1997 through 2001*, apartment sales prices nearly doubled, reaching an average of $120,000.

- From *2001 through 2005* apartment values remained unchanged.

- From *2005 through 2008* apartment values surged by about 50% to an average of $186,873. In the following two years, 2009 and 2010, prices plunged to their levels from 2001 to

2005. Starting in 2011 prices moved back to their boom level of 2008 and have averaged $198,000 per unit in 2014 and 2015.

Annual rates of appreciation of in average apartment values have varied depending on the purchase period. Apartments held byowners who purchased between 1991 and 1998 have appreciated at an annual rate in the range of 5% to 6.9%, The average annual appreciation rate for owners who purchased between 1999 and 2007 has been in the range of 3.1% to 4.8%.

Annual appreciation rates for apartment investors who purchased after 2007 have varied enormously depending on whether the purchase was made in peak years – 2008 or 2011 thru 2015 or slump years - 2009 and 2010.

The following table sets forth the average sales prices per apartment since 2000 of buildings constructed before 1980 and the average capitalization rates associated with the apartment purchases in each year.

Table 6.9

Trends in San José Apartment Values
Buildings with 5 or More Units Built Before 1980

Year	No. of Sales Reported	No. of Units	Avg. Price / Unit	Capitalization Rate
1970-74	39	341	$11,518	
1975-79	83	683	$22,722	
1980-84	79	426	$33,410	
1985-89	139	515	$52,767	
1990	77	1,208	$59,532	7.81%
1991	54	683	$56,531	8.21%
1992	32	426	$56,986	8.75%
1993	32	515	$50,401	8.63%
1994	32	930	$47,920	9.14%
1995	36	1,105	$50,927	9.38%
1996	46	1,815	$65,268	11.02%
1997	51	681	$66,860	7.64%
1998	90	1,430	$82,912	7.37%
1999	79	1,077	$89,906	7.49%
2000	80	1,213	$107,365	6.66%
2001	52	1,162	$116,906	6.93%
2002	53	973	$115,277	7.18%
2003	61	935	$122,569	6.25%
2004	87	990	$119,259	6.10%
2005	117	1,721	$128,430	5.28%
2006	46	914	$135,934	4.94%
2007	69	2,043	$150,668	5.10%
2008	32	1,447	$186,873	5.29%
2009	30	307	$123,820	6.21%
2010	23	569	$106,235	6.58%
2011	43	1,710	$189,170	4.54%
2012	75	1,823	$168,729	6.06%
2013	68	884	$164,356	5.16%
2014	63	1,018	$198,940	5.61%
2015	64	1,073	$191,463	4.73%

Sources: 2000-2015 data provided in CoStar Group Inc. custom trend report. 1970-1989 data based on author's tabulations of average prices using data on individual sales prices from Realquest,Inc. reports.

B. Comparison of Values and Appreciation of San José Apartments Compared with National Values and Trends

From 2001 to 2014, there were vast differences in apartment values and the rate of appreciation in apartment values among metropolitan areas. One widely circulated real estate industry report (Marcus & Millichap, "National Apartment Report"), has prepared annual reports on average apartment building sales prices per unit in buildings selling for $1 million or more in 40 metropolitan statistical areas.[28]

In 2014, average prices per apartment unit varied among metropolitan areas from $45,000 to $288,000. Generally values are higher on the East and West coasts. In 2014, in eleven of the metropolitan areas covered by the survey the average price was under $75,000 per apartment unit. Five areas had average prices of over $200,000 per apartment unit.

The average values of San José area apartments, like house values, are among the highest in the nation. In 2001, among buildings selling for one million dollars or more, the average values per apartment unit of San José apartments of $140,588, were triple the averages in most other metropolitan areas. In 2014, the average value per apartment unit was $217,500.. Only three areas (New York, San Francisco, and Boston) had higher average values per apartment unit in 2014.

The increase in San José apartment values since 2001 of $76,912 has been above the national average in dollar terms. In percentage terms the appreciation of 54.7% has been below the national average.

The CoStar data which covers buildings of five units or more, indicate that the average value of apartments constructed before 1980 increased by 70.2% from 2001 to 2014.

[28] Annual "National Apartment Report" (2004-2015 annual issues) published by Marcus & Millichap, Real Estate Investment Brokerage Company. Each report provides data on average apartment sales price per unit for a three year period. Recent issues are available on the web.

Table 6.10

Nationwide Trends in Apartment Values (2001-2014)

Metro Statistical Area	2001	2008	2010	2014	*Increase in Average Price 2001-14*	*Percent Increase in Average Price 2001-14*
		market peak	*market slump*	*new market peak*		
San José	140,588	169,811	136,900	217,500	*$76,912*	*54.7%*
San Francisco	156,167	210,948	205,000	274,944	*$118,777*	*76.1%*
Atlanta	50,280	62,600	36,900	73,400	*$23,120*	*46.0%*
Austin	42,802	53,068	64,000	89,300	*$46,498*	*108.6%*
Boston	87,500	117,000	110,500	248,900	*$161,400*	*184.5%*
Charlotte	37,602	49,419	78,200	69,500	*$31,898*	*84.8%*
Chicago	57,850	75,594	75,600	147,600	*$89,750*	*155.1%*
Cincinnati	30,000	35,556	23,502	45,100	*$15,100*	*50.3%*
Cleveland	31,950	34,028	28,700	46,800	*$14,850*	*46.5%*
Columbus	38,620	41,896	18,293	48,100	*$9,480*	*24.5%*
Dallas/ Fort Worth	35,760	40,205	32,292	80,400	*$44,640*	*124.8%*
Denver	59,170	61,235	69,000	105,500	*$46,330*	*78.3%*
Detroit	40,000	36,219	22,930	46,400	*$6,400*	*16.0%*
Fort Lauderdale	54,495	85,500	52,800	132,200	*$77,705*	*142.6%*
Houston	30,937	45,448	27,200	83,000	*$52,063*	*168.3%*
Indianapolis	30,940	39,946	18,265	45,200	*$14,260*	*46.1%*
Jacksonville	41,871	48,400	36,300	60,900	*$19,029*	*45.4%*
Las Vegas	42,812	66,333	2,700	68,300	*$25,488*	*59.5%*
Los Angeles	71,875	135,897	125,727	178,600	*$106,725*	*148.5%*
Miami	48,529	87,800	71,900	133,000	*$84,471*	*174.1%*
Milwaukee	40,320	54,564	48,500	66,400	*$26,080*	*64.7%*
Minneapolis- St. Paul	45,000	64,529	55,000	85,000	*$40,000*	*88.9%*
New Haven	37,772	75,732	89,500	172,600	*$134,828*	*357.0%*
New York City	98,333	126,611	118,750	268,300	*$169,967*	*172.8%*
Northern New Jersey	40,555	83,000	69,167	131,300	*$90,745*	*223.8%*
Oakland	95,969	126,000	117,000	166,600	*$70,631*	*73.6%*
Orange County	81,458	145,948	139,509	179,400	*$97,942*	*120.2%*
Orlando	38,461	55,000	36,900	69,800	*$31,339*	*81.5%*
Philadelphia	36,960	72,600	80,400	120,400	*$83,440*	*225.8%*
Phoenix	40,000	574,446	29,931	71,900	*$31,900*	*79.8%*
Portland	48,281	73,438	69,100	102,100	*$53,819*	*111.5%*
Riverside- San Bernardino	46,000	90,769	71,286	106,500	*$60,500*	*131.5%*
Sacramento	50,000	94,660	57,418	84,600	*$34,600*	*69.2%*
Salt Lake City	46,000	72,377	62,000	91,100	*$45,100*	*98.0%*
San Diego	69,736	122,411	115,813	165,300	*$95,564*	*137.0%*
Seattle	72,916	114,321	102,174	200,100	*$127,184*	*174.4%*
Tampa	40,000	61,800	40,800	71,000	*$31,000*	*77.5%*
Washington, D.C.	47,956	93,800	117,300	178,800	*$130,844*	*272.8%*
West Palm Beach	53,167	77,300	72,400	148,400	*$95,233*	*179.1%*

Source of price data: Marcus & Millichap, National Apartment Report (annual issues 2004-2015).

V. Returns from Apartment Investments

Evaluations of the reasonableness of rent regulations generally consider whether allowable rent increases are adequate to cover operating cost increases (including the amortized costs of capital improvements) and provide growth in net operating income that is comparable to the rate of increase in the CPI. As discussed in Chapter 5, this measure is also used in also the standard that has been widely accepted by the Courts in fair return cases.

However, from an investment perspective, as opposed to a regulatory perspective, rate of return on cash investment is a more common standard, which takes into account annual income, appreciation, and leveraging. The prospect of appreciation is a central attraction of real estate investments, which is not as likely for investments with fixed returns, such as bonds.

A. Returns on Total Investment San José Apartments Constructed Prior to 1980

Apartment Investments from 1990 to 1997

From 1990 to 1997, annual average prices per apartment unit ranged $47,920 to $66,860/apartment unit. Assuming that the annual net operating income per unit now averages about $9,780/apartment unit/year ($815/apartment/month) ratios of net operating income to purchase price ratios are in the range of 14.6% to 20.4%.[29] The current values of apartment units of about $190,000 are about three to four times the average from 1990 to 1997.

Apartment Investments from 1998 to 2005

Owners who purchased from 1998 to 2005, with prices in the range of $82,912 to $128,430/apartment unit, with the same net operating income levels of $9,780 per year per apartment would now have net operating income/purchase price ratios in the range of 7.6 to 11.8%. Current average apartment values of their units now range from 48% to 131% above average purchase prices from 1998 to 2005.

Apartment Investments from 2006 to 2014

From 2005 to 2011 increases in net operating income would have been moderate as average rents increased by about 2%/year, a rate of increase comparable to the rate of inflation (CPI). From 2011 to 2015, there have been large fluctuations in apartment values with averages increasing from $135,934 in 2006 to $186,873 in 2008, then declining to $106,235 in 2010, and then increasing to $190,000 in the past two years.

[29] These rates differ from capitalization rates which reflect net operating income/price ratios at the time of the purchase.

The rates of return of recent purchasers vary drastically depending on where in the cycle of ups and downs in apartment prices their purchase was undertaken.

B. Returns on Cash Investments

In contrast to using a rate of return on *total* investment approach as discussed above, investors generally measure their returns by considering their return on cash investment, comparing net income (cash flow after mortgage payments) and appreciation with their cash investment.

Typically, apartment owners obtain a mortgage for about 70% of the purchase price. As a result of such leveraging, in California's real estate market, in which property values are increasing at a substantial rate, the rates of return on cash investment may be particularly high.

Cash flow and expectations about appreciation are central determinants of whether apartment owners will invest more or less in operating and maintaining their apartments. Depending on when an apartment building was purchased and on what financing terms, all, part, or none of net operating income may: (a) provide net income (cash flow) or (b) be consumed by mortgage payments.

As a result of the exceptional trends in interest rates and apartment values since 2000, some striking scenarios have been created. A portion of apartment owners, who purchased prior to about 2006 or in 2009 and 2010, paid prices for their apartments that are 30% below the current market value of their units.

Debt service levels of owners who purchased in 1997 or earlier to are likely to be low relative to current net operating income levels. Furthermore, a portion of these owners has had the opportunity to refinance their mortgage debt at more favorable interest rates. These owners are likely to have substantial cash flows, unless they have decided to obtain larger mortgages and, thereby, reduce their cash investment. These results were generated by the combination of substantial increases in rents since 2000 and the opportunity to reduce their debt service costs by refinancing at lower interest rates, as interest rates plummeted. The extent of refinancing has not been documented; however, industry sources have indicated that a substantial portion of owners refinanced their mortgages when interest rates dropped.

In addition, the owners who purchased more than ten years ago now would typically have equity in their property that is a large multiple of their original cash investment. For example, an owner who started with an $ equity (cash investment) of $30,000/ apartment unit (and borrowed $70,000/apartment unit) in order to purchase an apartment building that cost $100,000/ apartment unit would probably now have equity of $120,000/ apartment unit ($190,000 value minus an original loan of $70,000). The $120,000 in equity would be quadruple the original cash investment

VI. The Impacts of Rent Regulation on the Housing Supply

A commonly repeated claim about rent controls is that they exacerbate the housing shortage because they deter new construction. However, under state law, new construction is exempt from local regulations.

In fact, in the San Francisco Bay Area rates of apartment construction per square mile, have been higher in rent controlled jurisdictions than in neighboring cities.

Table 6.11
Distribution of Multifamily Construction in Santa Clara County (2006-2014)*
(Buildings 5 or More Units)

City	Land Area Square Miles	Multifamily Construction Units Permitted 1996-2014	Multifamily Construction Units Permitted *Annual Average* 2006-2014	Multifamily Units Permitted per Square Mile 1996-2014	Pct .of Santa Clara County ***Incorporated*** Land Area	Pct. of Santa Clara County Multifamily Const.
San Jose	176.53	41,603	4,623	236	50.0%	64.3%
Campbell	5.8	150	17	26	1.6%	0.2%
Cupertino	11.26	1,396	155	124	3.2%	2.2%
Gilroy	16.15	688	76	43	4.6%	1.1%
Los Altos	6.49	366	41	56	1.8%	0.6%
Los Altos Hills	8.8	0	0	0	2.5%	0.0%
Los Gatos	11.08	367	41	33	3.1%	0.6%
Milpitas	13.59	4,290	477	316	3.8%	6.6%
Monte Sereno	1.62	0	0	0	0.5%	0.0%
Mountain View	12	2,322	258	194	3.4%	3.6%
Morgan Hill	12.88	756	84	59	3.6%	1.2%
Palo Alto	23.88	1,760	196	74	2.7%	2.7%
Santa Clara	18.41	6,444	716	350	1.4%	10.0%
Saratoga	12.38	129	14	10	3.5%	0.2%
Sunnyvale	21.99	3,818	424	174	6.2%	5.9%
Unincorp. Areas	951	610	68	1	72.9%	0.9%
(Total Incorporated Areas)	353					
Total	1,304	64,699		50		

*2006 is used as the starting date because it is the first year in the Census Bureau electronic data base on annual permit amounts by place. Annual data for 2015 will be released on May 2, 2016.

Among the 14 cities in Alameda County, in two of the three cities with rent regulations - Berkeley and Oakland –apartment construction per square mile from 2016 through 2014 has been triple the rate in eight cities in the County that do not have rent regulation.[30] Some cities in the County without rent regulation have had virtually no apartment construction for decades.

In reality, levels of apartment construction are determined by a complex set of factors which cannot be quantified in a uniform manner; therefore making it virtually impossible to quantify the impact the relative of single factors, unless the factor excludes all apartment construction. Central determinants of the amount of apartment construction include the amount and types of apartment construction permitted under a city's zoning regulations, trends in market rents, the amount of vacant or "underutilized" land, and mortgage interest rates.

The great disparities among apartment construction in neighboring cities in the Bay Area, which are nearly comparable in terms of amenities and distance from employment centers, might support a conclusion that the distribution of apartment construction within the area is principally determined by the differences among the cities in the amounts of land that are zoned to accommodate apartment buildings and a city's policies associated with applying the zoning requirements.[31]

[30] In Alameda County, in cities **with** rent control multi-family permit totals/square mile from 2006-2014 were: Berkeley – 226; Oakland – 182, Hayward – 22.4. In cities **without** rent controls, multi-family permit totals/square mile from 2006-2014 were: Alameda – 8.3;Albany – 38;Dublin- 427, Emeryville – 2171; Fremont – 46.4; Livermore – 48.2; Newark – 22.4; Piedmont – ; Pleasanton – 77.2; San Leandro – 13.3; Union City – 48.8.

[31] Comparisons of municipal zoning allowances for multifamily housing would require consideration of factors that defy quantification, such as how the municipality weighs impact criteria (e.g. impacts on traffic and the neighborhood) in the permit review process) and the usability, ease of development, and current use of the land which is zoned for multifamily use.

Appendix A

Bureau of Labor Statistics, Consumer Price Index Tables

San Francisco-Oakland-San Jose CPI-U All-Items Index

Consumer Price Index - All Urban Consumers														
Original Data Value														
Series Id:	CUURA422SA0													
Not Seasonally Adjusted														
Area:	San Francisco-Oakland-San Jose, CA													
Item:	All items													
Base Period:	1982-84=100													
Years:	1975 to 2015													

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual		Increase in Annual Avg.*
1970			37.2			37.6			38.0			38.5	37.7		
1971			38.7			39.0			39.3			39.6	39.1		3.7%
1972			39.9			40.4			40.9			41.1	40.4		3.3%
1973			41.9			42.5			43.8			44.0	42.8		5.9%
1974			45.3			46.8			48.2			49.5	47.0		9.8%
1975			50.7			51.6			52.5			53.4	51.8		10.2%
1976			53.8			54.3			55.3			56.0	54.6		5.4%
1977			57.2			58.8			59.9			60.9	58.8		7.7%
1978		61.5		62.7		64.8		66.6		66.1		65.3	64.3		9.4%
1979		66.3		67.9		69.1		71.0		72.0		74.9	69.8		8.6%
1980		78.3		79.2		80.7		81.6		81.9		82.9	80.4		15.2%
1981		84.7		87.9		89.1		93.6		96.6		95.6	90.8		12.9%
1982		96.2		97.2		99.1		99.0		98.4		95.6	97.6		7.5%
1983		96.7		97.4		98.6		99.5		99.4		100.0	98.4		0.8%
1984		101.4		102.9		103.7		105.2		106.5		106.0	104.0		5.7%
1985		106.9		107.5		108.4		109.2		109.5		109.4	108.4		4.2%
1986		111.0		110.4		111.9		112.4		113.1		111.8	111.6		3.0%
1987	112.5	113.4	113.7	114.8	115.0	115.0	115.8	116.1	116.6	117.1	117.3	117.4	115.4		3.4%
1988	118.4	117.9	119.1	118.7	119.7	120.1	120.9	122.0	122.1	122.3	122.2	122.6	120.5		4.4%
1989	124.0	124.0	125.9	125.4	126.3	126.2	127.4	128.1	126.8	127.5	127.2	127.4	126.4		4.9%
1990	128.5	129.2	130.0	130.7	130.8	131.6	132.3	133.1	134.0	134.6	134.7	135.1	132.1		4.5%
1991	136.7	136.1	136.3	135.8	136.2	137.6	138.2	139.1	139.7	139.6	139.8	139.8	137.9		4.4%
1992	140.3	141.0	141.9	141.6	141.9	141.9	142.2	142.7	143.7	144.3	144.2	144.3	142.5		3.3%
1993	145.1	145.5	145.7	146.8	146.9	146.1	146.1	146.2	146.5	147.0	147.2	147.0	146.3		2.7%
1994	147.5	147.4	148.2	148.0	148.3	148.1	148.9	149.4	149.4	149.4	149.8	149.4	148.7		1.6%
1995	150.3	150.5	151.1	151.5	151.3	151.7	151.5	151.5	152.3	152.6	152.4	152.1	151.6		2.0%
1996	152.9	153.2	152.9	153.9	155.1	155.2	155.9	155.6	156.3	156.9	156.9	156.0	155.1		2.3%
1997	157.0	157.9	159.2	159.6	159.8	160.0	160.6	161.2	161.6	162.5	162.6	162.6	160.4		3.4%
1998		163.2		164.6		165.5		166.6		167.2		167.4	165.5		3.2%
1999		169.4		172.2		171.8		173.5		175.2		174.5	172.5		4.2%
2000		176.5		178.7		179.1		181.7		183.4		184.1	180.2		4.5%
2001		187.9		189.1		190.9		191.0		191.7		190.6	189.9		5.4%
2002		191.3		193.0		193.2		193.5		194.3		193.2	193.0		1.6%
2003		197.7		197.3		196.3		196.3		196.3		195.3	196.4		1.8%
2004		198.1		198.3		199.0		198.7		200.3		199.5	198.8		1.2%
2005		201.2		202.5		201.2		203.0		205.9		203.4	202.7		2.0%
2006		207.1		208.9		209.1		210.7		211.0		210.4	209.2		3.2%
2007		213.7		215.8		216.1		216.2		217.9		218.5	216.0		3.3%
2008		219.6		222.1		225.2		225.4		225.8		218.5	222.8		3.1%
2009		222.2		223.9		225.7		225.8		226.1		224.2	224.4		0.7%
2010		226.1		227.7		228.1		228.0		228.1		227.7	227.5		1.4%
2011		230.0		234.1		233.6		234.6		235.3		234.3	233.4		2.6%
2012		236.9		239.0		239.8		241.2		242.8		239.5	239.7		2.7%
2013		242.7		244.7		245.9		246.1		246.6		245.7	245.0		2.2%
2014		248.6		251.5		253.3		253.4		254.5		252.3	252.0		2.8%
2015		254.9		257.6		259.1		259.9		261.0		260.3	258.6		2.6%

* 2007-2015 Amounts in CPI table rounded to the first decimal place. Percentage Increase in Annual Average data not included in Bureau of Labor Statistics CPI Table

Source: Bureau of Labor Statistics

San Francisco-Oakland-San Jose CPI-U RENT OF PRIMARY RESIDENCE Index

Consumer Price Index - All Urban Consumers
Original Data Value

Series Id: CUURA422SEHA
Not Seasonally Adjusted
Area: San Francisco-Oakland-San Jose, CA
Item: Rent of primary residence
Base Period: 1982-84=100
Years: 1970 to 2015

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual		Increase in Annual Avg.*
1970			41.3			42.0			42.6			43.2	42.0		
1971			43.8			44.2			44.5			44.8	44.2		5.2%
1972			45.1			45.5			45.8			46.0	45.5		2.9%
1973			46.4			46.8			47.3			47.8	46.9		3.1%
1974			48.4			48.8			49.2			49.8	48.9		4.3%
1975			50.4			50.7			51.5			52.4	51.0		4.3%
1976			53.0			53.8			54.8			55.6	54.0		5.9%
1977			56.9			57.7			58.8			60.3	58.0		7.4%
1978		60.9		61.3		62.7		63.9		63.2		63.7	62.5		7.8%
1979		64.2		64.6		64.7		68.6		69.8		72.4	67.0		7.2%
1980		72.1		73.1		75.0		76.0		78.7		80.0	75.5		12.7%
1981		81.3		82.7		82.2		84.0		84.2		86.2	83.2		10.2%
1982		89.6		89.4		90.5		92.6		93.3		93.6	91.2		9.6%
1983		97.9		98.0		99.1		101.4		103.2		104.3	100.2		9.9%
1984		104.6		106.8		107.8		110.0		111.8		112.9	108.6		8.4%
1985		113.5		115.3		116.4		118.9		119.8		123.2	117.4		8.1%
1986		125.1		125.3		126.8		129.1		128.8		129.9	127.2		8.3%
1987	130.9	131.9	131.5	131.9	132.2	132.7	133.4	133.4	134.1	134.7	134.7	135.4	133.1		4.6%
1988	137.5	137.3	137.2	136.8	136.8	137.7	138.3	139.1	141.3	141.6	140.8	141.0	138.8		4.3%
1989	141.3	141.2	143.0	143.5	143.9	143.6	143.6	144.1	144.4	146.6	147.1	148.4	144.2		3.9%
1990	148.2	148.7	148.8	150.3	149.7	151.3	151.1	151.8	151.4	152.8	153.8	154.2	151.0		4.7%
1991	154.3	154.0	155.1	154.8	155.7	156.9	156.9	156.9	158.1	157.2	158.5	158.4	156.4		3.6%
1992	158.7	158.8	159.3	158.4	159.0	159.2	158.7	159.8	161.2	162.4	162.8	162.3	160.1		2.4%
1993	162.2	162.1	162.6	165.1	164.8	164.2	164.0	164.4	164.6	165.4	166.9	166.1	164.4		2.7%
1994	165.8	165.6	166.8	166.9	166.9	167.6	168.4	168.7	168.4	168.3	168.0	168.3	167.5		1.9%
1995	168.1	168.5	169.0	169.2	169.4	170.0	170.1	170.6	170.7	170.8	171.4	171.6	170.0		1.5%
1996	171.6	171.7	172.0	172.2	172.7	173.7	174.7	175.6	176.1	177.2	177.6	178.4	174.5		2.6%
1997	179.4	179.5	180.7	181.8	182.8	183.6	184.7	186.6	188.8	190.0	190.9	192.6	185.1		6.1%
1998	193.1	193.7	194.7	196.5	198.4	198.9	200.6	201.7	202.8	204.0	205.0	206.0	199.6		7.8%
1999	207.5	208.5	209.7	210.5	211.3	212.7	213.6	215.7	216.4	217.5	219.2	220.3	213.6		7.0%
2000	221.5	222.0	223.1	224.2	225.6	226.3	228.5	229.8	231.2	234.3	237.1	239.4	228.6		7.0%
2001	240.6	243.3	246.1	248.2	250.7	252.5	255.3	256.8	258.0	260.5	260.6	261.9	252.9		10.6%
2002	262.1	262.4	262.4	261.8	260.8	262.0	263.5	263.3	263.0	262.5	262.9	263.8	262.5		3.8%
2003	264.0	263.7	263.5	263.3	262.7	262.3	262.5	262.7	262.3	261.9	262.2	263.0	262.8		0.1%
2004	262.5	262.1	262.2	261.9	261.7	261.7	261.7	261.8	262.1	262.6	262.8	262.9	262.2		-0.2%
2005	262.9	263.1	263.0	262.6	263.1	263.1	262.8	262.8	262.7	263.0	263.2	263.3	263.0		0.3%
2006	263.7	264.6	265.7	266.3	266.9	266.4	267.3	267.4	267.8	267.8	269.3	270.7	267.0		1.5%
2007	272.7	274.2	274.6	274.8	275.2	276.1	276.9	278.1	279.4	280.8	282.2	282.9	277.3		3.9%
2008	283.4	283.7	284.7	286.2	286.6	288.1	289.0	290.6	291.6	292.8	294.5	294.6	288.8		4.1%
2009	295.6	297.2	298.0	298.3	298.3	299.7	299.6	298.8	298.8	297.9	297.8	297.9	298.2		3.2%
2010	297.5	297.3	296.6	296.9	297.1	296.6	297.6	297.4	298.6	298.7	299.7	299.7	297.8		-0.1%
2011	300.3	300.6	300.4	301.9	302.6	304.1	304.6	305.6	307.8	308.6	309.6	310.5	304.7		2.3%
2012	311.8	312.5	313.0	313.9	314.8	315.5	316.9	318.5	320.4	321.8	323.5	324.2	317.2		4.1%
2013	325.4	326.6	327.9	327.7	329.0	330.2	330.6	333.2	334.0	336.4	337.6	338.9	331.5		4.5%
2014	340.4	341.9	344.0	345.1	346.6	348.2	350.1	352.4	354.1	355.8	358.6	359.4	349.7		5.5%
2015	360.8	362.1	363.7	365.3	367.8	369.5	371.9	372.7	376.0	378.4	381.0	383.6	371.1		6.1%

* 2007-2015 Amounts in CPI table rounded to the first decimal place. Percentage Increase in Annual Average data not included in Bureau of Labor Statistics CPI Table

Source: Bureau of Labor Statistics

U.S. City CPI-U Average Rent of Primary Residence

Consumer Price Index - All Urban Consumers
Original Data Value

Series Id: CUUR0000SEHA
Not Seasonally Adjusted
Area: U.S. city average
Item: Rent of primary residence
Base Period: 1982-84=100
Years: 1970 to 2015

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual		Increase in Annual Avg.*
1970	45.6	45.8	46.0	46.1	46.2	46.4	46.5	46.7	46.8	47.1	47.2	47.6	46.5		
1971	47.7	48.0	48.1	48.3	48.5	48.7	48.7	48.9	49.0	49.2	49.3	49.4	48.7		4.7%
1972	49.6	49.8	49.8	50.0	50.1	50.3	50.4	50.5	50.6	50.8	50.9	51.1	50.4		3.5%
1973	51.5	51.7	51.9	52.0	52.3	52.4	52.5	52.8	53.0	53.2	53.4	53.6	52.5		4.2%
1974	53.9	54.2	54.4	54.6	54.7	55.0	55.2	55.4	55.7	56.0	56.2	56.5	55.2		5.1%
1975	56.8	57.1	57.2	57.4	57.6	57.8	58.0	58.3	58.5	58.8	59.1	59.4	58.0		5.1%
1976	59.6	60.0	60.3	60.5	60.7	61.0	61.3	61.5	61.8	62.1	62.3	62.6	61.1		5.3%
1977	63.2	63.4	63.7	64.0	64.3	64.6	64.9	65.2	65.6	65.9	66.3	66.7	64.8		6.1%
1978	67.1	67.5	67.8	68.2	68.7	69.1	69.4	69.7	70.3	70.7	71.2	71.6	69.3		6.9%
1979	71.9	72.2	72.4	72.7	73.4	73.8	74.3	75.0	75.6	76.6	76.9	77.3	74.3		7.2%
1980	77.8	78.4	78.8	79.0	79.8	80.7	81.1	81.6	82.4	83.3	83.8	84.3	80.9		8.9%
1981	84.9	85.3	85.8	86.3	87.0	87.4	87.8	88.8	89.5	90.2	90.8	91.5	87.9		8.7%
1982	92.0	92.3	92.8	93.0	93.7	94.0	95.0	95.5	95.8	96.7	97.2	97.5	94.6		7.6%
1983	98.1	98.5	98.7	99.1	99.3	99.7	100.2	100.6	101.2	101.6	101.9	102.2	100.1		5.8%
1984	102.6	102.9	103.4	104.1	104.4	104.9	105.5	106.1	106.6	107.2	107.6	108.2	105.3		5.2%
1985	108.6	109.2	109.5	110.0	110.9	111.4	111.9	112.6	113.1	114.0	114.8	115.1	111.8		6.2%
1986	115.5	115.6	116.2	117.4	117.6	118.0	118.8	119.0	119.6	120.2	120.6	120.8	118.3		5.8%
1987	121.3	121.7	121.8	122.0	122.3	122.3	123.0	123.8	124.4	124.8	124.8	125.6	123.1		4.1%
1988	126.0	126.3	126.4	126.6	126.9	127.3	127.8	128.4	129.1	129.4	129.8	130.1	127.8		3.8%
1989	130.5	130.9	131.1	131.4	131.7	132.3	133.0	133.5	133.9	134.7	135.2	135.5	132.8		3.9%
1990	135.8	136.0	136.5	137.0	137.3	137.9	138.7	139.4	140.0	140.5	140.7	141.1	138.4		4.2%
1991	141.2	141.5	142.0	142.5	142.8	143.0	143.7	143.7	144.6	144.6	145.0	145.2	143.3		3.5%
1992	145.4	145.6	146.4	146.2	146.3	146.6	147.0	147.0	147.2	148.0	148.6	148.6	146.9		2.5%
1993	148.9	149.1	149.1	149.7	149.9	150.3	150.4	150.8	151.0	151.4	151.6	151.9	150.3		2.3%
1994	152.2	152.8	153.2	153.3	153.3	153.4	153.9	154.5	155.0	155.2	155.6	155.7	154.0		2.5%
1995	156.1	156.4	156.7	157.0	157.2	157.5	157.9	158.2	158.5	158.9	159.3	159.6	157.8		2.5%
1996	160.0	160.4	160.6	160.9	161.2	161.7	162.2	162.5	162.9	163.3	163.7	164.0	162.0		2.7%
1997	164.4	164.8	165.1	165.5	165.9	166.4	166.8	167.3	167.8	168.2	168.7	169.1	166.7		2.9%
1998	169.5	169.9	170.3	170.7	171.1	171.7	172.2	172.8	173.4	173.9	174.5	174.9	172.1		3.2%
1999	175.3	175.6	176.0	176.4	176.7	177.1	177.5	177.9	178.4	178.8	179.8	180.3	177.5		3.1%
2000	181.1	181.5	182.0	182.3	182.7	183.2	183.9	184.6	185.3	186.1	186.8	187.6	183.9		3.6%
2001	188.2	188.9	189.6	190.2	191.0	191.6	192.3	193.1	193.9	194.7	195.5	196.4	192.1		4.5%
2002	197.0	197.7	198.2	198.5	198.8	199.3	199.8	200.2	200.7	201.3	202.0	202.5	199.7		4.0%
2003	203.3	203.7	204.1	204.5	204.9	205.1	205.6	206.1	206.6	206.9	207.5	207.9	205.5		2.9%
2004	208.3	208.8	209.2	209.7	210.2	210.7	211.2	211.9	212.4	212.8	213.2	213.9	211.0		2.7%
2005	214.5	215.0	215.5	216.0	216.4	216.8	217.5	218.0	218.6	219.3	220.0	220.5	217.3		3.0%
2006	220.9	221.6	222.3	222.9	223.6	224.4	225.2	226.2	227.1	228.0	228.9	230.0	225.1		3.6%
2007	230.8	231.7	232.5	233.0	233.5	234.1	234.7	235.3	236.1	237.1	238.2	239.1	234.7		4.3%
2008	239.9	240.3	240.9	241.5	241.8	242.6	243.4	244.2	244.9	245.9	246.7	247.3	243.3		3.7%
2009	248.0	248.3	248.6	248.9	249.1	249.1	249.0	249.0	249.0	248.9	248.9	249.0	248.8		2.3%
2010	249.1	249.0	249.1	249.0	248.9	249.0	249.1	249.0	249.4	249.6	250.3	251.0	249.4		0.2%
2011	251.6	251.8	252.1	252.2	252.4	252.6	253.1	254.0	254.6	255.7	256.4	257.2	253.6		1.7%
2012	257.7	258.2	258.6	258.9	259.2	259.4	260.1	260.7	261.4	262.7	263.4	264.1	260.4		2.7%
2013	264.7	265.3	265.8	266.0	266.6	266.9	267.5	268.5	269.1	270.0	270.7	271.7	267.7		2.8%
2014	272.3	272.7	273.5	274.1	274.7	275.3	276.2	277.0	278.0	279.0	280.1	280.9	276.2		3.2%
2015	281.6	282.4	283.1	283.6	284.2	285.0	286.1	287.1	288.3	289.4	290.3	291.2	286.0		3.6%

* 2007-2015 Amounts in CPI table rounded to the first decimal place. Percentage Increase in Annual Average data not included in Bureau of Labor Statistics CPI Table

Source: Bureau of Labor Statistics

San Francisco-Oakland-San Jose CPI-U All-Items Less Shelter Index

Consumer Price Index - All Urban Consumers
Original Data Value

Series Id: CUURA422SA0L2
Not Seasonally Adjusted
Area: San Francisco-Oakland-San Jose, CA
Item: All items less shelter
Base Period: 1982-84=100
Years: 1975 to 2015

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual	Increase in Annual Avg.*
1975												56.2		
1976			56.6			57.1			58.1			58.7	57.4	
1977			60.0			61.8			62.8			63.2	61.6	7.3%
1978		63.8		65.1		66.4		67.4		68.7		68.7	66.5	8.0%
1979		69.9		71.5		73.2		74.5		75.7		76.8	73.3	10.2%
1980		79.1		81.5		83.3		84.6		85.4		85.5	82.9	13.1%
1981		86.9		88.3		89.7		91.0		92.1		93.1	89.9	8.4%
1982		94.7		95.2		97.3		97.8		98.6		97.5	96.7	7.6%
1983		97.5		98.3		99.7		100.0		99.8		100.3	99.1	2.5%
1984		101.9		103.3		104.1		105.1		106.5		105.7	104.2	5.1%
1985		106.6		106.8		107.6		107.5		107.6		107.3	107.2	2.9%
1986		108.3		107.6		109.2		108.8		109.3		108.1	108.5	1.2%
1987	108.9	109.7	110.4	111.2	111.1	111.1	111.7	111.8	112.5	113.0	113.5	113.6	111.5	2.8%
1988	114.6	113.9	114.6	115.1	116.3	116.6	116.8	117.0	118.3	118.4	118.0	118.3	116.5	4.5%
1989	119.6	119.7	120.5	121.9	123.0	122.8	122.7	123.4	122.9	123.4	123.1	122.9	122.2	4.9%
1990	124.2	124.9	125.7	126.5	127.0	127.5	128.2	129.0	130.2	131.1	130.4	130.7	128.0	4.7%
1991	132.3	131.6	131.4	131.2	132.0	133.3	133.3	134.4	134.9	135.1	135.4	135.5	133.4	4.2%
1992	135.9	136.5	137.2	137.5	137.8	138.2	138.4	138.9	139.6	140.0	139.9	139.9	138.3	3.7%
1993	141.2	141.8	142.2	142.7	142.7	142.1	142.2	142.0	142.3	143.2	142.8	142.5	142.3	2.9%
1994	143.4	143.2	143.9	144.0	144.2	143.7	144.2	144.7	145.0	145.2	146.0	145.5	144.4	1.5%
1995	146.5	146.5	147.1	147.5	147.2	147.6	147.4	147.0	148.1	148.4	147.8	147.6	147.4	2.1%
1996	148.4	148.6	148.0	149.5	150.9	150.7	151.1	150.4	151.3	151.8	151.5	150.3	150.2	1.9%
1997	150.6	152.0	153.2	153.4	153.4	153.5	153.8	153.8	154.0	154.6	154.6	154.3	153.4	2.1%
1998		154.3		154.8		155.2		155.8		155.6		155.3	155.1	1.1%
1999		156.5		159.9		158.8		160.4		161.1		160.1	159.3	2.7%
2000		161.4		163.5		163.7		166.1		166.5		166.8	164.4	3.2%
2001		169.0		168.7		169.7		168.3		168.3		167.1	168.5	2.5%
2002		167.8		169.7		169.1		169.4		171.2		169.9	169.4	0.5%
2003		174.3		174.5		172.9		172.6		173.0		172.5	173.2	2.2%
2004		176.4		177.2		178.4		177.8		179.5		178.5	177.7	2.6%
2005		180.3		182.9		180.6		183.4		187.2		183.1	182.7	2.8%
2006		186.9		189.5		190.0		192.0		191.3		190.1	189.7	3.8%
2007		193.4		195.5		196.3		195.9		197.7		199.2	196.0	3.3%
2008		200.2		203.4		207.5		207.0		206.1		196.7	203.6	3.9%
2009		200.8		202.7		205.9		206.1		206.9		205.3	204.2	0.3%
2010		208.2		210.2		211.1		210.3		210.1		209.9	209.8	2.7%
2011		213.1		218.2		217.3		217.9		218.0		216.1	216.5	3.2%
2012		219.2		221.8		221.9		223.0		225.0		220.0	221.6	2.4%
2013		223.2		225.0		225.9		225.2		225.5		223.7	224.6	1.3%
2014		226.3		229.1		231.0		229.4		229.7		226.0	228.5	1.7%
2015		228.3		231.0		231.9		231.7		231.3		229.1	230.4	0.8%

* 2007-2015 Amounts in CPI table rounded to the first decimal place. Percentage Increase in Annual Average data not included in Bureau of Labor Statistics CPI Table

Source: Bureau of Labor Statistics