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MARKET DOWNTURN – THE END IS IN SIGHT

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Rents in Berkeley have been falling since 2001 or 2002. Rents rose steeply from the beginning of vacancy decontrol in January 1999, but the steep rise ended fairly quickly, and rents have been falling ever since. Rents in 2004/2005 are lower than in the previous year, but not much lower. It seems that the end of the downturn is in sight.

Rents rose dramatically with the advent of vacancy decontrol, of course. Average rents for studios rose 67% from 1998 to a high in 2002. One bedroom rents rose 90% in the same period. The increases for two and three bedroom units were 108% and 91%, respectively. The peak was in 2000/1 for one- and three-bedroom units and in 2001/2 for studios and two-bedroom units.

From those peaks, rents have fallen by 7% for studios, 12% for one-bedroom units, 15% for two-bedroom units, and 13% for three-bedroom units. Nevertheless, rents are still significantly higher than they were in 1998. The net gain from 1998 to the present is a 57% increase for studios, a 68% increase for one-bedrooms, a 77% increase for two-bedrooms, and a 66% increase for three-bedrooms.

The decrease in the past year is relatively small in all size categories – roughly $6 for Studios, $14 for one-bedrooms, $37 for two-bedrooms, and $125 for three-bedroom units. These dollar amounts translate to decreases of 0.7%, 1.3%, 2.6%, and 6.5%, respectively. These decreases are smaller than decreases in the previous three years. It seems that the downturn may be coming to an end.

I know of no reliable data on vacancies, but I expect that slowing of the downturn in rents is paralleled by a decrease in the vacancy rate, which may have been as high as 8 or 9 percent a few years ago. Gradually, the vacancies that developed at the time of the dot com crash are being absorbed again, and the vacancy rate seems to be dropping, despite additions to the stock through construction in the downtown area and by the University.

I predict that the vacancy rate will drop to normal levels within this year or next, that turnover will normalize, and that rents will flatten, then rise by a few percent per year over the next several years.

It has taken the market several years to stabilize after the advent of vacancy decontrol in 1999. January 1999 was the first time in 21 years that Berkeley property owners had the opportunity to set market rents. Owners and tenants alike had no idea what true market rents would be. Rents set in 1999 exceeded old-style rent controlled rents roughly fifty percent. By 2001, rents exceeded old-style rent controlled rents by close to 100%. It was an exciting time for property owners, who saw their rent income rise dramatically for the first time in two decades.

It seemed for a while that the sky was the limit. We all knew that Berkeley rent controlled rents were far below rents in San Francisco, which had vacancy decontrol all along. There was considerable excitement as owners tested the market, asking higher and higher rents in 1999 and 2000. Tenants became concerned – rents were rising and there weren't that many vacant apartments. So tenants seemed willing to pay higher and higher rents at that time. It was a sellers market.

But things soon turned around. The dot com crash caused a lot of people to leave the Bay Area. High rents fueled the rush to buy houses, which in turn fueled the hot market in single family homes. High rents caused students and others to join together in congregate housing whereas, under old-style rent control, when rental housing was cheap, many people chose to live alone. By 2001 or 2002, the sellers market turned into a buyers market, and rents have been falling ever since.

It was a bubble. Like all bubbles, rents shot up, then bumped down, as the steam came out of the market. Now we are almost back to normal. Assuming no other shock to the market, rents should stabilize within 2005/6 and then rise gradually with inflation thereafter.

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