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TIME FOR A PARADIGM SHIFT

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A year ago, the City Council instituted a new program allowing the conversion to condominiums of 100 units of rental housing each year. There are some 125 units in the pipeline, but not one condominium unit has yet been produced from this new program. An initiative will be on the ballot in November that would reform the condominium conversion program, allowing five times as many conversions, at far lower per unit cost, but with equivalent benefits to the Housing Trust Fund.

The council had for a quarter century prohibited most conversions, but has recently opened the door to allow the conversion of 100 units per year because a San Francisco lawsuit cut the legs from under the Council's prohibition of tenants-in-common sales. Believing that condominiums are preferable to tenants in common units, and hoping to cash in on conversions by charging a whopping affordable housing fee to fund low income housing projects, the Council, with impressive timidity, undertook a program that would allow the conversion of a third of one percent of Berkeley's rental units to condominiums each year. At this rate, it will take 43 years to bring owned units and rented units into balance at roughly 22,000 housing units in each category.

For several decades City of Berkeley housing policy has been based on the proposition that rental housing is in short supply and must be carefully preserved in order to protect the City's ethnic, cultural, and economic diversity. For a quarter century, therefore, we have had rent and eviction controls, prohibitions on tenants-in-common ownership and condominium conversion, funding for the construction of "permanently affordable rental housing", and inclusionary zoning requirements on new construction, all designed to achieve the underlying diversity objective.

But times have changed. First, the Costa-Hawkins Act changed Berkeley's rent control rules from the restrictive form that began in 1979 to the "vacancy decontrol" form that now prevails throughout the state. Beginning in 1999, rents go to market on turnover. As of 2006, roughly a quarter of Berkeley's rental units are still occupied by pre-1996 tenants paying below market rents, but the majority of Berkeley's rental units are at market now and can no longer be considered "affordable housing" in any meaningful sense.

Second, the appellate decision in the case known as "Tom v. City and County of San Francisco" spelled the end of Berkeley's prohibition on tenants-in-common (TIC) ownership. It is now recognized that Berkeley rental properties can be freely converted to tenants-in-common ownership, as they could be before the TIC prohibition was enacted in 1992.

Third, the dot com crash in 2001 led to the exodus of thousands of young professionals from the Bay Area, reducing the demand for rental housing. Meanwhile, the Council has allowed the construction of hundreds of units in highrise buildings in the downtown area and the University has built hundreds of units of student housing in the South Campus area. Rental housing is no longer in short supply. Indeed, the vacancy rate is higher than it has been since the 1960s or early 1970s. There are thousands of vacant rental units in Berkeley today. And rents have been falling, not rising, for the last three or four years. The rental market is soft, not tight, as it had been, prior to these developments, since the late 1970s.

Meanwhile, the Bay Area has experienced a sharp rise in prices of for-sale housing. Whereas middle-income individuals and families could afford to buy a home in Berkeley in the 1970's, 1980's, and early 1990's, middle-income individuals and families are hard-pressed to find a home in Berkeley that they can afford today. Condominiums, far less costly than single family homes, are a logical second choice for middle-income residents who want to live in Berkeley but can't afford Berkeley's home prices. Yet, because of the long-standing prohibition, condominiums are in short supply. The paltry 100 units now allowed by the Council falls far short of the demand for affordable for-sale housing.

It is time for a paradigm shift. We need a new vision to match new circumstances. What is needed today is workforce housing for university employees, policemen, teachers, city government employees, and other middle-income residents. These individuals and families typically want to own their own homes. Wisely, these families don't plan to remain in rental housing for more than a brief transition period. Understanding well the financial advantages of homeownership, they know that remaining in rental housing prevents the accumulation of equity that, for most Americans, is a crucial component of financial security in retirement.

What makes sense in this market is to allow condominium conversions so that the underutilized stock of rental housing can be turned into for-sale housing needed by middle-income residents. There would be no loss to renters – they are already housed, and already protected by rent and eviction controls. There would be significant benefits to middle-income residents, on the other hand, because a greater supply of condominiums will tend to reduce the over-high prices for condominiums and other for-sale housing, allowing these residents to stay in Berkeley. Otherwise, Berkeley's middle-income working folks will be forced by the high price of homes to seek housing elsewhere and to commute to their jobs in Berkeley, further increasing traffic congestion and parking difficulties.

The 100-unit limit to conversions is a drop in the bucket. A higher limit will not lead to net loss of rental housing because hundreds of rental units – many of them "affordable" because of inclusionary zoning - have been constructed in high-rise buildings in the downtown area in recent years. It would be wise to allow 200 to 500 units to convert to condominiums per year, so that the current imbalance (oversupply of rental units / undersupply of for-sale housing) can be corrected. The best policy would be to remove all restrictions and let citizens determine the number of rental and for-sale units in Berkeley. An alternative would be to set a vacancy rate floor. If the vacancy rate is above 5%, conversions might be unrestricted. If the vacancy rate is below 5% they might be limited.

As to diversity, there is no evidence that the City's housing policies have achieved their goals. A study using census data from 1970, 1980, and 1990 (St. John & Associates, 1993), showed that, even with restrictive rent control and condominium conversion prohibitions, Berkeley was gentrifying faster than any surrounding community. The study showed that lower income residents, single-parent families, working-class persons, households receiving public assistance, and even university students were systematically barred from living in Berkeley during the time of restrictive rent controls, whereas these categories of households were welcomed into all surrounding communities.

A more recent study by San Jose State University economists Benjamin Powell and Edward Stringham showed that “inclusionary zoning” programs don’t work either ("The Economics of Inclusionary Zoning: How effective Are Price Controls?", 2004). Communities with inclusionary housing programs added fewer affordable housing units than communities without such programs. The study also showed that these programs make market-rate housing more expensive, and that the decrease in market rate housing construction caused by the programs exceeds by many times the construction of affordable units under the programs.

Taken as a whole, the programs are counterproductive. Space prevents an explanation here of the reasons for the failure of these programs. Suffice it to say that like King Canute, who failed to stop the incoming tide, the City cannot stop steps people take to further their personal financial security.

Meanwhile, the benefits that flow from allowing conversions are significant:

- 1.5% transfer tax on the sales price of condominium units sold
- a substantial increase in the assessed value of the property, of which a part goes to the City through increased property taxes
- the affordable housing fee that would help fund truly affordable housing for low income residents.

These new revenues – which could sum to several million dollars a year - could be used to fund the many important services in the City which are currently under funded.

The initiative allows 500 units to convert per year instead of the City Council's 100 units. 500 units is less than 2% of Berkeley's rental housing. It will take nearly 10 years, at this rate, to bring Berkeley's housing stock into balance as between owners and renters.

The initiative provides for an $8 per square foot affordable housing fee on conversion. The initiative provides that this fee is paid upon conversion, whereas the City Council version provides for the fee to be paid upon sale. The initiative fee is roughly one fifth of the fee charged by the City Council version, but will provide just as much income for the Housing Trust Fund.

The initiative provides that tenants have all the protections they have under the rent law, but doesn't extend these protections unreasonably, as the Council version does, to include a lifetime lease. Tenant protections are important, but a lifetime lease is over the top and probably illegal. The lifetime lease provision does not craft a reasonable balance between the interests of sitting tenants and would-be homeowners.

In addition, the initiative gives tenants who purchase their units a 5% discount off the purchase price if they buy their unit following conversion. If they choose to move, they get a mandatory 2% golden handshake. It's a win-win for tenants. Say the value of the unit is $400,000. Tenants who choose to buy get it for $380,000. Tenants who choose to leave get $8,000 in moving costs. This arrangement will make it possible for many Berkeley tenants to make the transition from rental to homeownership. And it will make it possible for many with Berkeley employment to live in Berkeley who, otherwise, would have to seek for sale housing in other cities. In addition, the program provides almost $4,000,000 per year in funds for the Housing Trust Fund. It is truly a win-win-win.

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