Berkeley City Council

CONSENT CALENDAR
July 14, 2015

To: Honorable Mayor and Members of the City Council

From: Councilmember Laurie Capitelli and Councilmember Jesse Arreguin

Subject: Increase in Business License Tax for Owners of Residential Rental Property with Tax Reductions for Small, Low or Moderate-Income Owners

RECOMMENDATIONS

Consider placing on the 2016 general election ballot an increase in the business license tax for residential rental properties. To that end direct the City Manager to:

1. Prepare estimates of tax receipts that would be due under the ordinance given the alternatives outlined in Attachment A.
2. Prepare an estimate of rent increases over the past five years.
3. Schedule a Council Workshop regarding the proposal in the fall including reporting on above items and discussing the content and timing of a voter poll.

CURRENT SITUATION AND ITS EFFECTS

Rents are rising to unprecedented levels in Berkeley and throughout the San Francisco Bay Area. These increases create enormous hardship for tenants, especially those with low incomes, because they reduce the income available for other necessities of life. These hardships generate a need for additional and costly services from local government, such as subsidies to create affordable housing for low-wage working families, the elderly, and people with disabilities, emergency assistance to prevent homelessness, and other increased needs. In light of the increased costs to local government caused by rent increases, it is appropriate that a modest fraction of the increased rents be returned to the City.

A modest tax increase will not burden the rental housing sector because rents have increased far beyond what is actually necessary in order to profitably operate and maintain rental housing. The current rent increases are bringing in windfall profits that result from the combination of increasing demand for rental housing and the long-term inability of Berkeley and the Bay Area to sufficiently increase the supply of rental housing. The result has been a massive $100,000,000 a year transfer of income from tenants to real estate investors.

Nor will the tax burden renters. Most rental units subject to the tax are under rent stabilization, which would not allow the tax to be passed through to current tenants. Under vacancy decontrol landlords generally charge the maximum rent that the market will bear at the start of each new tenancy, so they will not be able to charge higher rent than they already do. The same principle applies to the smaller number of tenants in exempt apartments. Landlords in these properties already raise the rent as high as the market allows as tenant leases expire. They may claim that they will increase the rent to pass the cost of the tax on to the tenants, but in fact they would increase the rent by just as much even without the tax.

The City currently has a business license tax on gross receipts that applies to residential rental units in mixed-use properties and to residential rental units in residential properties with three units or more. The tax rate is set at $10.81 for every $1,000 in gross receipts, or 1.081%. The average 2014 rent in units that report to the Rent Board was $1,500 a month, up from $720 a month in 1998, just before vacancy decontrol. If rents had simply increased at the rate of inflation, they would average $1,060, a full $440 less each month. An increase of 1% in the business license tax on the gross residential rents would cost the average landlord $15 per unit per month and bring in from $2,000,000 to $3,000,000 annually depending on the extent of the exemptions.

Some people suggest that the appropriate response is simply to allow “the market” to construct additional rental housing to meet the increased demand. But this shortage of rental housing has developed over the past 40 years, and it would take a similar length of time to develop sufficient new rental housing to overcome that deficit. Indeed, in a city like Berkeley, which is located in the central Bay Area and is already built out, construction of new rental housing cannot return rents to their previous levels. Clearing sites that have already been built on at lower densities and constructing housing at higher densities can only be sustained by the extremely high rents now being charged in recently built housing. Any decline in those rents would bring a halt to new construction. New construction will likely moderate the rate of future increases, but excessive rents will last for the foreseeable future, as will their harmful impacts.

<u>FINANCIAL IMPLICATIONS</u>
If passed by the voters, each 1% increase in the business license tax on the gross residential rents may bring in from $2,000,000 to $3,000,000 annually depending on the extent of the exemptions as described in Attachment A.

<u>CONTACT INFORMATION</u>
Councilmember Laurie Capitelli 510-981-7150
Councilmember Jesse Arreguín 510-981-7140

ATTACHMENT A: TAX OUTLINE AND ALTERNATIVES

Increase in the existing business license tax on gross rents from residential rental units in mixed-use properties and residential properties with three units or more. Residential properties with one or two units and rental property owned by the University or by non-profit organizations are and would continue to be exempt from this tax. The measure would provide for the City Council to establish criteria and process for a hardship exemption. Certain properties would qualify for exemptions from the increase or a tax reduction.

ALTERNATIVES

1. Alternative tax increase amounts (% and approximate dollar amount)(Current tax is 1.081% of gross receipts)
    a. 1.799% to 2.88% total (avg. increase $30 per unit per month
    b. 2.799% to 3.88% total (avg. increase $45 per unit per month)
    c. 3.799% to 4.88% total (avg. increase $60 per unit per month)
2. General tax (majority vote) or special tax (2/3 vote required)
    a. Special tax with all funds dedicated to affordable housing and homelessness prevention.
    b. General tax with committee to advise Council on how best to spend the tax revenue. The committee would be composed of people with expertise in affordable housing and in homelessness prevention.
3. Alternative exemptions for small and low and moderate-income landlords (Exempts current owners only, tax would apply to all properties purchased after the tax passes; owner must be natural person or family, or sole owner of LLC or LLP)
    a. Tax reduction for owners of less than 10 units who are low income, fully exempt from the gross receipts tax on residential rental income. (Low income is 80% AMI, currently $52,000 for an individual, $60,000 for family of two, $74,000 for family of four.)
    b. Landlords with 5 units or less, regardless of income level, exempt from increase.
4. New Construction and Transitional Exemptions
    a. 10 years from date of Certificate of Occupancy (retroactively and future construction).
    b. 5 years from date of purchase of the property. (Applies only to properties purchased prior to the year of passage of the ordinance.)
    c. 5 years from passage of the ordinance for properties with “inclusionary” housing units.
5. Alternative exemptions from the increase for long-term and other tenancies (More than one could be included in the ordinance)
    a. Units occupied by “old rent control” tenants where there has not been a vacancy increase since 1998. (These units have not received major rent increases.)
    b. Units occupied by tenants in place for more than 10 years. (While units that have turned over since 1998 received major rent increases, they now lag the market significantly.)

c. Units with rents restricted by a regulatory agreement with the City of Berkeley. (These units have not received major rent increases.)
d. Units occupied by tenants receiving monthly rental assistance through the Section 8 Housing Choice Voucher and Shelter Plus Care Programs. (This will encourage landlords to participate in these programs.)