

## Could We Kill the Golden Goose?

By Mack Langston and Cathryn Low, Langston & Low

Local economists and housing experts generally project a strong apartment market next year and beyond. According to HUD, roughly 45% of all San Diego County households are renters. A recent countywide apartment and vacancy survey indicate that average rents for the county have increased approximately 7.5% in the past year. This is consistent with recent statistics from the National Low Income Housing Coalition (NLIHC) showing that the average Fair Market Rent (FMR as defined by HUD) in San Diego County increased 7.3% in 2003 compared to the prior year. However, this same report also indicated that the median family income actually went down 0.3% during the same period.

The NLIHC annual publication, *Out of Reach*, is an economic and demographic analysis of multifamily housing in every county and MSA in the U.S. The most recent report stated the 2003 median renter family income in San Diego County is \$35,654, about 60% of the median income for all families in the county.

This means that a family at the median renter income level has to spend 40% of income for a two-bedroom apartment at the average fair market rent of \$1,175, according to *Out of Reach*, or one-third more than the generally accepted affordability standard of 30% of household income applied to housing costs.

According to *Out of Reach*, since 2000 the median income in the county has increased a cumulative 9%, while the average fair market rent on a two-bedroom apartment has increased a total of 40%. With rent increases outpacing income growth 4 to 1, it's no wonder the clamour over affordable housing is growing.

So far, rental owners have been able to charge what the market will bear and still maintain a high occupancy level. The San Diego survey reflects a countywide vacancy rate of 3.1% based on the responses covering 39,752 units. This strong demand and the limited apartment supply explain the institutional consensus that San Diego is one of the most desirable areas in the country for multifamily investment.

Can rental owners still raise rents and maintain low vacancy? Demand will always be strong, even with the high cost of housing, because of the desirability of our climate, culture, recreation and other features that make San Diego an attractive place to live. These features will probably always make San Diego more desirable and less affordable than other parts of the country. However, there is a limit to the percentage of income that families can afford for housing.

Prosperous tenants create prosperous landlords. Local prosperity could be impacted if economic recovery and job growth are not as robust as earlier thought. The current outlook on the local economy and job growth is uncertain. Dr. Alan Gin, USD associate professor of economics said at a recent conference that expected job growth for 2003 is about 2,500 jobs, compared to 45,000 jobs in 2000. While job growth fuels the demand side, it doesn't necessarily improve average family income. Currently there are tens of thousands of military jobs and about 7,000 high wage civilian jobs that could be affected by the military's 2005 Base Realignment Commission (BRAC) closures.

It's not just rents putting pressure on tenants. The state budget deficit will take its toll on everyone. Over 100 proposals to address the deficit would if enacted raise state taxes and fees by an estimated \$57.6 billion annually, according to *CalTax*, a watchdog group. The list includes higher sales and incomes taxes, along with new taxes on alcohol and tobacco, gasoline, credit unions, bottled water, guns and ammo, 911 phone calls and diapers, all of which translates into fewer available dollars for rent.

When rents rise faster than income, as in the past several years, there comes a point where the pressure can only be met by sharing units between more wage earners; many landlords are now experiencing a higher resident count per unit compared to the past. Obviously this puts more wear and tear on units and increases operating expenses due to higher occupancy per unit. For tenants the only alternative to sharing apartments is relocation to more affordable markets, reducing labor resources in the county.

The increasing financial pressures felt by tenants are being amplified and transmitted by tenants' rights advocacy groups to state and local legislators, who, in an effort to assuage the public outcry are considering various measures to codify landlord-tenant relationships. The California legislature has passed 25 new laws governing landlord-tenant issues that will take effect in January 2004. In Los Angeles, San Francisco and eight other California cities, the result

of the pressures felt by tenants was rent control ordinances for the owners. As the affordability gap widens in San Diego, the greater the likelihood that rent control could be voted in here.

How will rental owners fare in 2004? Resistance to higher rents coupled with rising expenses may limit profitability margins until the economy expands enough for incomes to catch up with current housing costs. Owners should fare well, provided they use caution in controlling expenses and consider the longer-term ramifications of continued rental increases that exceed growth in tenant incomes. Undoubtedly there will be more regulation that owners must contend with, and it is important that they seek appropriate education and/or professional advice on managing within legal guidelines and financial prudence. The rental owner community has a vital interest in keeping the golden goose alive and well.

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