

Airbnb & Short Term Rentals. Issues For Policy Makers.

Summary:

1. **Lay of the Land:** There are 572 short term rentals advertised online in the city.
2. **Making Sense of the Numbers:** There are two sets of numbers: registered and unregistered.
3. **Tourists Invade Neighborhoods:** Traditional residential neighborhoods are filling with tourists.
4. **Winners and Losers:** While a handful of property owners might win, the rest of us lose.
5. **Going Backwards on Housing:** New housing created in Santa Cruz is eclipsed by STR growth.
6. **Shifting Tourists From Hotels to Homes.** Lodging revenue is a zero sum game.
7. **Shrinking Tax Revenue:** STRs take guests from hotels and reduce city tax revenues.
8. **STRs, Answer to What Question?:** Hotel occupancy is 69%. 504 rooms under construction.
9. **Tourism, Planned or Unplanned:** City planning is now being done by individual property owners.
10. **Myth of the Sharing Economy:** Airbnb touts sharing yet 80% here are whole-house rentals.
11. **Fairness and Equal Treatment:** Today we have two groups of owners being treated differently.
12. **The Challenge of Enforcement:** The typical permissive STR ordinance is unenforceable.
13. **Property Rights:** Owners claim they have rights to operate a STR. Courts say they don't.
14. **The ADA & Airbnb:** Public accommodations require accessibility. Most Airbnbs are not accessible.
15. **What About Legacy Vacation Rentals:** The city can grandfather STRs pre-Airbnb.
16. **Venice Beach, a Look at Our Future?:** The worst case scenario.
17. **Neighborhoods in the Coastal Zone:** Not all city neighborhoods are the same.
18. **The City's Planning Documents:** City plans are clear. Prioritize housing.
19. **What to Do?:** How can the city regulate fairly?
20. **Subletting:** The old school answer for many property owners.

1. The Lay of the Land.

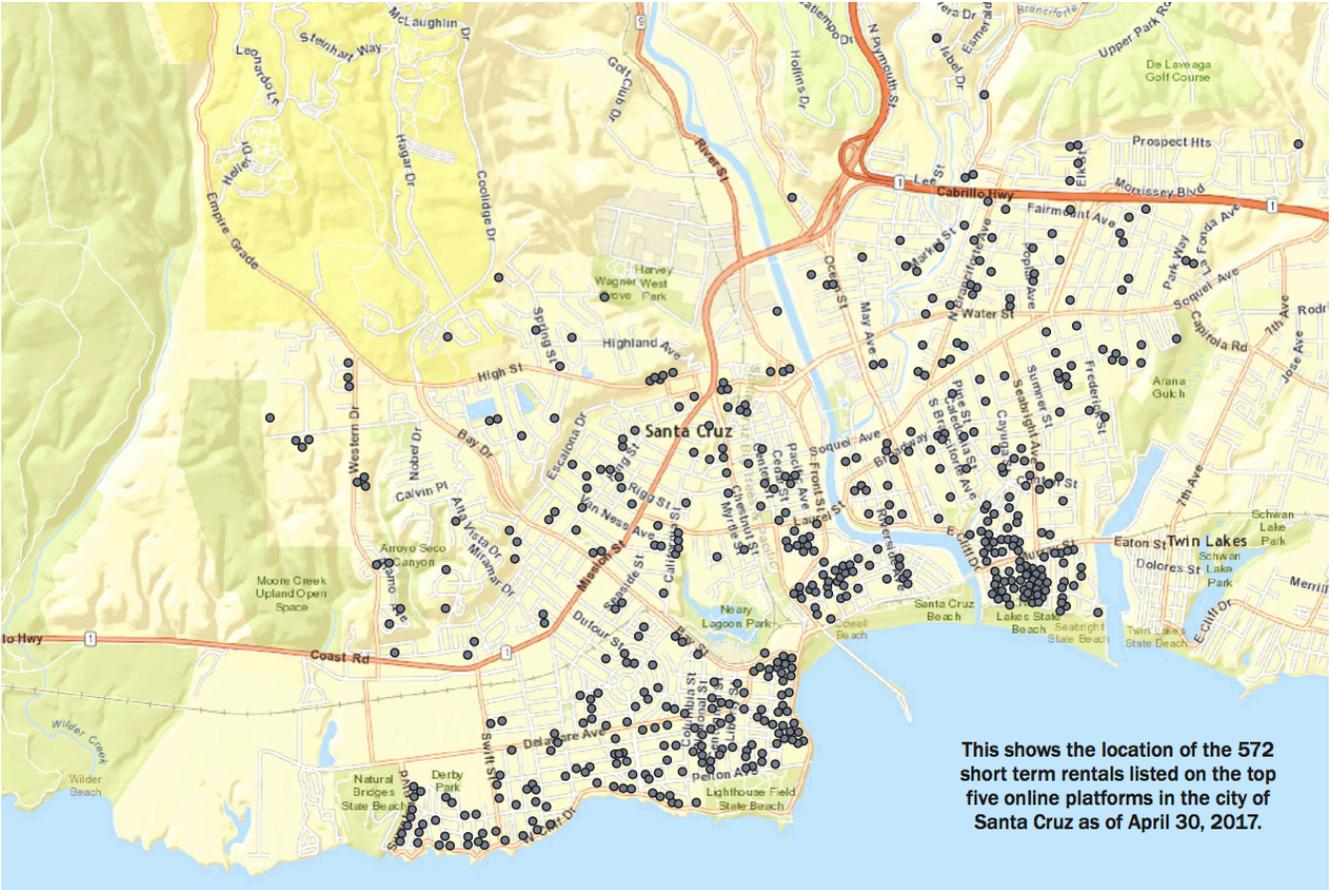
Santa Cruz has been a tourist town since the 1891 when James Fair built a railroad from Alameda to the Santa Cruz Waterfront. In that time we have welcomed tourists in local hotels and a handful of short term rentals (STR), predominantly in beach neighborhoods. Finance Department records show that in 2014 Santa Cruz had a total of 71 short term rentals. In the three years since, 232 more STR have been registered. However, this is only one part of the story. Many STR owners do not register with the city. I completed a hand-survey of the top 5 websites in April 2017. The total number of STR at that time was 572 with an average of 10 new listings being added each week. This growth was not the result of city planning or a change in the zoning or the permit process. It was due to the rise of online reservation portals like Airbnb, Flipkey, Homeaway, and VRBO. Today a property owner can register their property as a de-facto hotel on Airbnb in under an hour.

2. Making Sense of the Numbers.

Anyone looking into the STR situation in Santa Cruz quickly gets confused by the many numbers being thrown around. Keep in mind that about half of all STR operators do not register their units with the city. That is why the Finance Department will say there are 303 STRs and researchers like myself will say there are 572. The Finance Department only sees STRs that have voluntarily registered. My count of 572 includes all the advertised units, both registered and unregistered.

3. Tourists Invade the Neighborhoods.

Santa Cruz has historically welcomed tourists in hotels in the city's zoning districts for commerce and tourism. Hotel approvals require off street parking, safety infrastructure, and public hearings with neighborhood input. Most importantly, keeping our hotels in commercial districts and out of the neighborhood meant that welcoming tourists never displaced or competed with the 56% of local residents who are tenants. Tourists benefitted our city through occupancy tax revenue (TOT). The neighborhoods were reserved for tenants and owners. The beauty of this history is that expansion of tourism never competed with tenants for housing. Tourist accommodation and housing were kept distinct from one another. That balance is now gone as STRs convert housing residential zoning districts and reduce the number of long term rentals.



4. Winners and Losers.

New technologies change markets and they create a shifting environment of winners and losers. The winners are property owners who convert long term rentals into STRs and generate higher rents. Studies have shown that property owners with a unit in a desirable neighborhood can generate 2-3 times the gross rents compared to the same unit rented long term to a full time tenant. For out-of-area owners there are a handful of local service companies that have started up in Santa Cruz that do housecleaning, reservation services, and logistics for absentee property owners who operate a STR. This makes STRs an easy transition for property owners.

The list of losers is longer:

Tenants. Fifty six percent (56%) of Santa Cruz residents rent in a tight rental market. The low availability of rentals leads to high rents and long search times for tenants. Short term rentals exacerbate this situation as property owners convert housing into vacation rentals. Short term rentals pit tourists who are willing to pay upwards of \$100 per night against residents who typically pay \$25-\$40 per night. In this competition tenants will always lose. Accommodating tourists in hotels and B&Bs guarantees that they won't out-compete local residents for scarce housing.

Neighborhoods. Quality neighborhoods require neighbors. Locals in our residential districts get to know their neighbors and learn to accommodate and support each other. These relationships can last decades and make our neighborhoods safe and supportive places for families, children, and the elderly. Some homeowners and tenants now find that the house next door hosts a revolving door of strangers with luggage going in and out at all hours. In some cases the visitors have large parties or park their cars to disrupt the neighborhood balance.

Schools. Santa Cruz City Schools rely on student enrollment for their funding. As housing for families with children is converted to STRs families often leave the city in search of housing elsewhere. When an enrolled child leaves the city, our school system loses revenue. It would be valuable to know how many of the 572 short term rentals in the city today displaced a family with children. In addition, the greatest long term challenge for city schools is attracting quality teachers who often cannot afford local rents. For schools STR are doubly disruptive.

Hotel Workers. Local hotels employ reservation clerks, maintenance workers, housekeeping staff, restaurant workers, and night clerks. These are predominantly low and middle income jobs. As STRs take away hotel guests, hotel worker hours and wages are suppressed. Airbnb is diverting traditional service worker earnings into more privileged pockets - those of property owners.

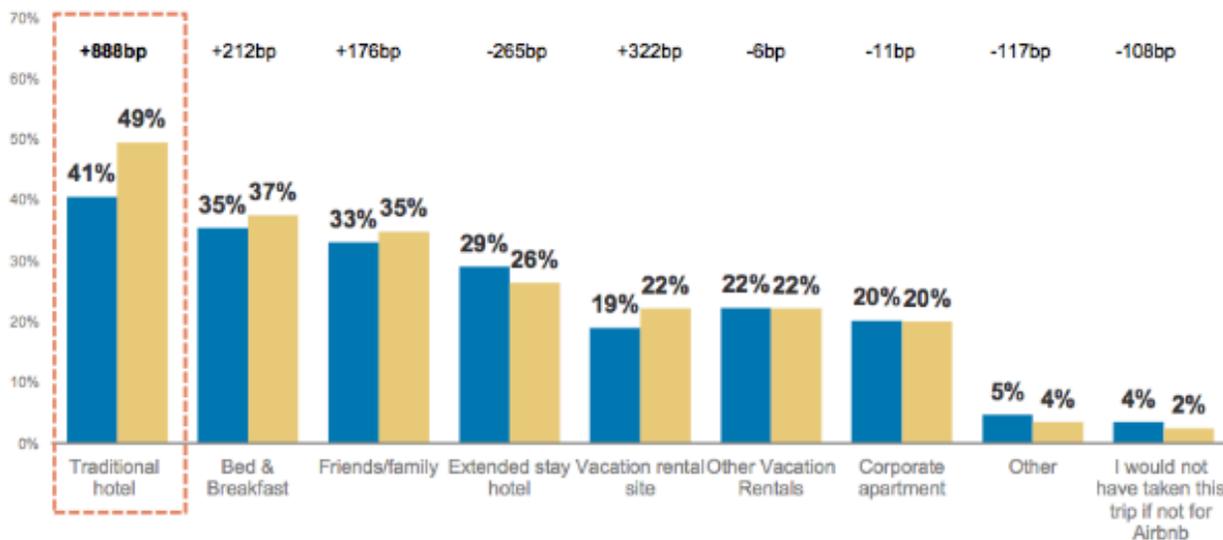
Home Buyers. Investors purchase income property based on the annual rents. Purchasing a property and converting it to a short term rental can double the rents. Higher income makes the property more valuable to an investor and causes properties in desirable neighborhoods to increase beyond the customary market price. This drives real estate prices up, harming first time home buyers and working people trying to buy a home for their family.

5. Going Backwards on Housing.

All of the city's planning documents call for preserving rental housing. Fifty six percent of Santa Cruz residents are tenants, and that number is growing every year. However, the rapid growth in STRs has reversed the city's efforts to gain on the housing front. In the last three years the city has gained 263 new residential units. That is the good news. The bad news is that in the same period the Finance Department signed up 246 new STRs. That's not good, but what's worse is that a majority of STR owners never register and stay underground. That means in reality new housing likely went backwards by several hundred units.

6. Shifting Tourists From Hotels to Homes.

STR advocates say they are bringing new business to the city and attracting travelers that would not otherwise come to Santa Cruz. The available data shows this to be a false claim. In November of 2016 Morgan Stanley conducted a study of Airbnb users to determine how and why they use the the rental platform. It was discovered that only 2% of Airbnb users would not make their planned vacation if they could not stay in an Airbnb. 98% of users said they would use a hotel, motel, bed and breakfast, hostel or other accommodations. STRs are not bringing new visitors to the city. They are simply shifting visitors from hotels into homes. (Blue bars below are 2015 results. Yellow are 2016 results)



Airbnb users are substituting away from hotels more than any other accommodation type – and more quickly. AlphaWise, Morgan Stanley Research

7. Shrinking Tax Revenue.

A detailed analysis of the shift to STRs in the city reveals that tax revenues are a casualty of the sharing economy.

TOT: The Transient Occupancy Tax (TOT) represents 16% of the city's general fund revenue. This revenue has been a stable source of income for years as the city's hotels have hovered around 69% occupancy.

In 2016 TOT revenue from all the city's hotels totaled \$8,220,000. These 56 hotels have a combined count of 2,074 rooms. This means the average TOT revenue per hotel room in 2016 was \$3,964.00.

The 2016 TOT revenue from the registered STRs in the city totaled \$910,000. These 303 registered STRs have a combined count of 511 rooms. This means the average revenue per STR room in 2016 was \$1,780.00. This is 66% lower than the TOT revenue per room from hotels.

If the city promotes the rise of STRs, the result will be a shifting of tourist stays from hotels to STRs and a corresponding reduction in TOT. To make matters worse, TOT revenue from hotels represent revenue coming into the city with nothing going out. The city knows where its 56 hotels are. There is no way a rouge operator can build a new hotel without the city knowing. Therefore the city spends nothing on hotel enforcement. In contrast, STRs come and go on the internet quietly and without detection. Any

ordinance regulating STRs will require an enforcement regime to shut down the unregistered and illegal units. This effort will likely be similar to the city's rental inspection ordinance and will require the hiring of additional city staff. TOT revenue from hotels is 100% retained by the city. TOT revenue from STRs is diminished as enforcement creates a corresponding expense on the city's budget.

Sales and Use Taxes: The \$18,887,500 in sales and use taxes the city received in 2016 represents 27% of the general fund. These taxes are generated when city residents purchase goods and services at local businesses. Local residents make these purchases every day. Unlike tourists, there is no vacancy rate for a resident. These taxes amount to \$900 per household. When a residential unit is converted to short term use does not have full time residents purchasing products and services across the local economy every day. Tourists tend to spend money only on food service and entertainment and cannot match the \$29,000 each resident spends per capita on goods and services like: *appliances, computers, electronics, art supplies, food service, entertainment, pharmacy, florists, furniture, home decor, home improvement, musical instruments, office supplies, optical and vision care, medical care, pet supplies, legal services, auto purchases, auto repair, building materials, garden supplies, apparel, gasoline, and grocery.*

A shift from housing to STRs will result in a corresponding drop in the city's sales and use taxes.

8. STRs: An Answer to a Question Never Asked.

In some cities STRs are a response to an unmet need for tourist accommodations. This is not the case in Santa Cruz. Our hotels have been operating at 69% occupancy for many years. There are currently 504 new hotel rooms under construction (as of April 2017) that will increase the city's hotels room count by 22%. It is true that some tourists prefer to stay in a home rather than a hotel. Tourists are customers who think only about their own desires. They do not think of the impact they are having on our city or the downstream effects STR growth has on housing availability or tax revenues. It is policy makers at the city hall who think long term and who can preserve our neighborhoods, preserve tax revenue and create a welcoming city for tourists in our licensed hotels.

9. Tourism in Santa Cruz, Planned or Unplanned?

Until the creation of Airbnb, overnight accommodations for tourists were confined to commercial and tourist-serving zoning districts within the city. The residential neighborhoods were set aside for local residents and the two distinct property uses did not compete with each other. Today, the historic model of property use based on zoning is in chaos. Planning is no longer in the hands of the city. Instead, individual property owners are re-shaping the neighborhoods based on maximizing rental income instead of general plan zoning. Our city is at a cross roads. Will we reclaim the neighborhoods for non commercial residential use, or witness a further deregulation of our neighborhoods? Will the future of tourism be planned or unplanned?

10. Myth of the Sharing Economy.

Airbnb likes to repeat the idea that their hosts are small-time folks looking to make a little income by renting out a room or the couch in their living room. There are certainly people who do that, however, 80% of STR listings in Santa Cruz are whole house rentals, many of them operated by out of town investors with multiple properties. The "sharing economy" creates an unregulated free market in previously regulated areas of our lives. It is reshaping cities without public input, city planning, and with no regard for the zoned uses that have made them livable. In our neighborhoods the sharing economy is a movement for deregulation. Airbnb is exploiting slow moving city governments to reshape our city in their own interest. The result is a decrease of rental housing, higher rents, and higher home prices.

11. Fairness and Equal Treatment.

The city has an ordinance to allow homes in residential neighborhoods for bed and breakfast use. This has been in place for over 30 years and because it is very restrictive it has served the city in limiting the number of B&Bs in the neighborhoods. Under the ordinance B&Bs have to be historic, have lots of onsite parking, have owners living on site, and be no closer than one quarter mile from another B&B.

By comparison, the city's Airbnb rentals have to meet none of these requirements. This situation creates a deeply unfair regulatory environment that does not treat city property owners equally. On the one hand are owners who play by the rules, invest in parking and public safety, and a second set of owners who fly under the radar and create lodging properties with complete freedom.

12. The Challenge of Enforcement.

So far the majority of cities have failed to enforce their new STR codes. They have failed for a number of different reasons, but there are some common failures that we can learn from.

Making Airbnb police its site. Many cities issue STRs a unique registration number that they require on all advertising. Their ordinances call for Airbnb to police their site and screen out any listing that doesn't have a number. This doesn't work. Twenty years ago Congress passed the Communications Decency Act. It was designed to make the new world of the internet possible. Section 230 of this act shields internet companies from the postings of those who use their site. Yelp is not liable for hateful things someone might say about a restaurant and Craigslist is not responsible for a bizarre post by an angry user. Airbnb is protected by this law and cannot be held accountable for what people decide to list on its platform, with or without a registration number. The lesson here is that any ordinance that requires Airbnb to screen or police their site will not achieve its goal.

Distinguishing between hosted and non-hosted units. The Los Angeles Staff report says that: "However well intentioned, San Francisco's Office of Short Term Rentals has said it is virtually impossible to identify a hosted stay from a non-hosted stay..." It goes on to say: "San Francisco's Planning Department has reported that it is virtually impossible to discern what is occurring on a night by night basis." The city of San Francisco has a special department with full time staff just to deal with short term rentals and to date they have failed to enforce their ordinance and successfully distinguish a hosted from a non-hosted rental. Any ordinance that treats hosted and a non-hosted rentals differently will not be enforceable without a massive budget and an army of investigative staff. In my four month review of all STRs in Santa Cruz I found numerous listing that are registered with the city as hosted (renting out a room) that are actually being rented as non-hosted (renting an entire house). A city the sets out different standards for hosted and non-hosted will fail to enforce their ordinance.

Setting limits on the number of nights. We know that without the help of the internet platforms the only way to determine the number of nights a property is rented is to have city staff stake out a property every night and spy on arrivals and departures. This is not a desired course of action and not possible based on the city budget. To determine the true number of rented nights one would have to have the cooperation of dozens of internet sites, all of whom are shielded from cooperation by the Communications Decency Act. In short, any ordinance that limits the number of nights is ultimately unenforceable.

13. Property Rights.

Claims are often made that property owners have a right to use their property as they see fit and any city restriction violates these rights. This was the position of several people on the city's STR subcommittee. They are wrong. Property owners have no explicit rights to use their property in violation of zoning. This issue was settled in 1991 in a case of Ewing vs. Carmel-by-the-Sea. On appeal the Sixth District court affirmed that the city of Carmel can prohibit transient use of a property in a residential zone. The court found short term rentals a commercial use and observed that:

"nonresidential uses may have a deleterious impact on a residential district until finally the residential character of the neighborhood and its desirability as a place of detached residences are utterly destroyed."

14. Airbnb and the ADA.

The Americans With Disabilities Act (ADA) requires public accommodations (lodging establishments, restaurants, etc) to be ADA compliant. Hotels are required to have these accommodations for the

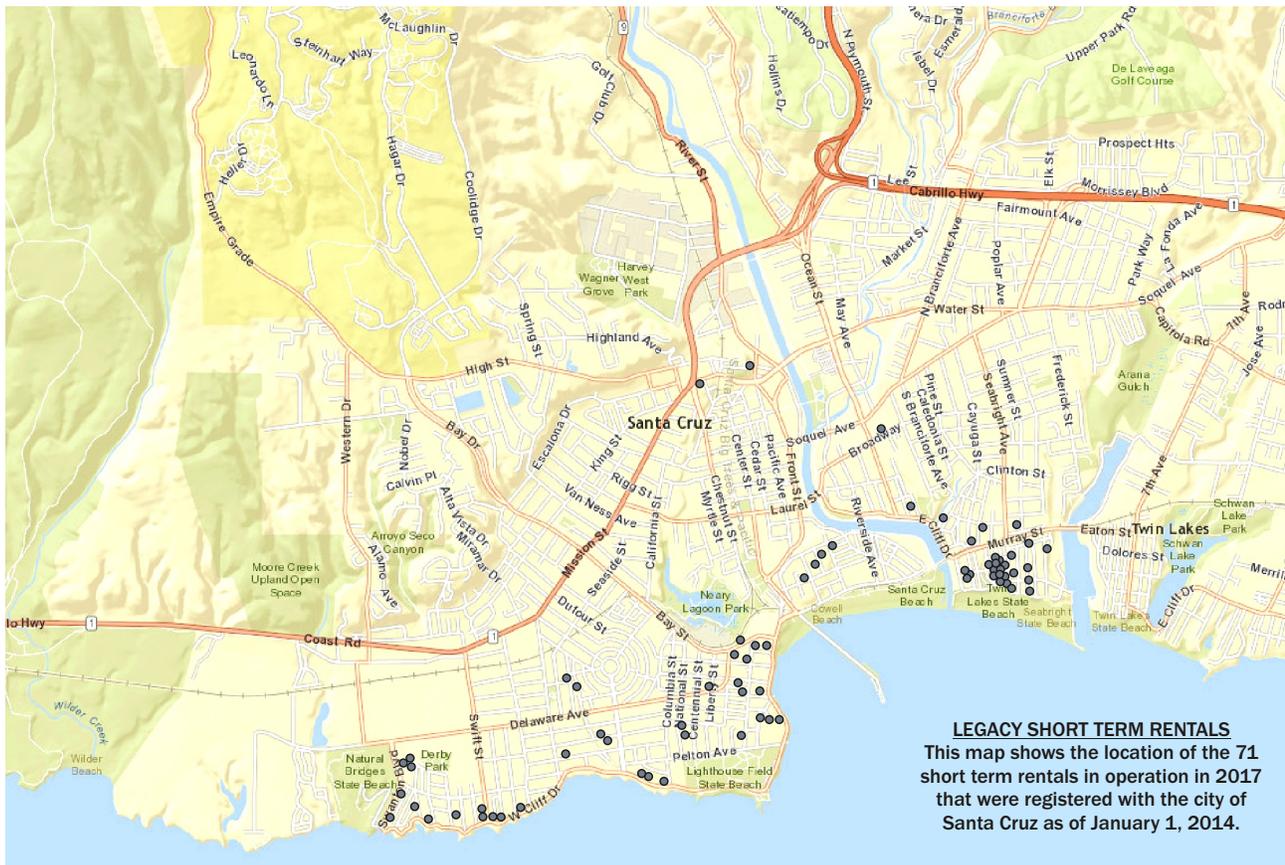
disabled. This raises the question: Are STRs required to have fully handicap accessible facilities? The act states that ADA facilities are required in any place of lodging except:

"for an establishment located within a building that contains not more than five rooms for rent or hire and that is actually occupied by the proprietor of the establishment as the residence of the proprietor."

So, renting short term in a building with less than five rooms where the host resides is exempt from the ADA. The most recent review of Santa Cruz city STRs finds that 80% of listings are whole house rentals where the owner does not live on site. These listings are not exempt from the ADA and could attract litigation from a disabled customer. Lawsuits on these grounds have already been filed in Southern California.

15. What About Legacy Vacation Rentals?

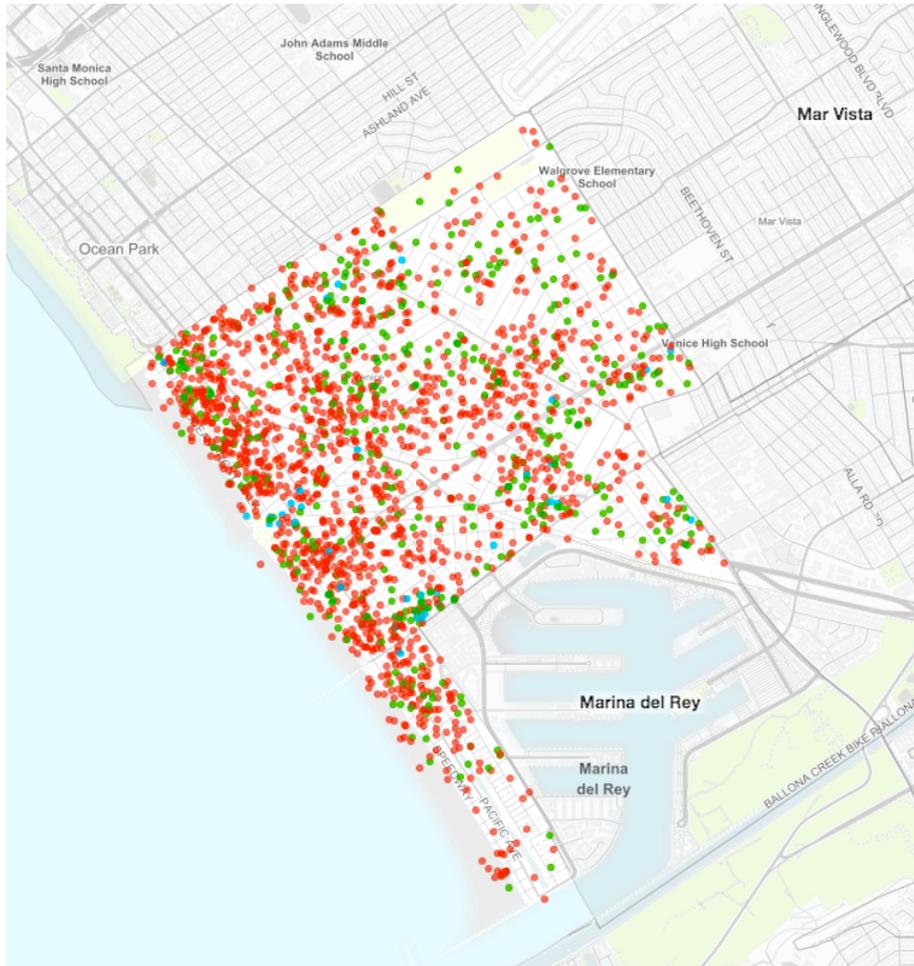
Santa Cruz has several dozen vacation rentals that have been in use for generations, predominantly on the lower west side and in lower Seabright. These legacy STRs are not part of the sharp spike in listings that have resulted from internet platforms like Airbnb. These rentals also are not displacing tenants as they have not provided long term housing for decades. The city could allow these STR to continue by grandfathering any STR that has been part of the city's TOT program before the rise of Airbnb. Proof that the rental was remitting TOT before 2014 could be a requirement for continued approval. The number of STR that would meet this requirement would be roughly 70 properties.



16. Venice Beach, a Look at our Future?

Venice Beach, California is one of the most impacted communities in the world as a result of Airbnb rentals. The city's charming neighborhoods and coastal location made it an early hot spot for STRs. The city was late to the game of regulating STRs and today there are over 1,918 Airbnbs in the 1.5 square mile city. One out of every 12 structures in Venice Beach today is an Airbnb rental. The map

below shows the Airbnb rentals in Venice Beach. Venice Beach is a cautionary tale for coastal cities in California.



17. Neighborhoods in the Coastal Zone.

These neighborhoods have been the focus of vacation rental activity for many years. One could make the argument that home buyers in these heavily impacted neighborhoods knew there were vacation rentals and second homes next door when they purchased their property. The fact that the property next door is a tourist accommodation is more shocking in neighborhoods outside the coastal zone that have traditionally been for long term residents only. Of the 303 STRs currently registered with the city, 202 are in the coastal zone. An argument could be made for capping STR permits to the 202 currently in the Coastal Zone and set a sunset period of a year or two for the remaining 100 registered STRs to convert back to long term housing.

The streets with the greatest number of STRs are in the coastal zone.

In Seabright:

Alhambra Avenue has 8 STRs.

Mott Avenue has 10.

Mountain View has 8.

On the west side:

Alta Avenue has 10 STRs.

Centennial Street has 7.

Oxford Way has 7.
West Cliff Drive has 24.

18. The City's Planning Documents.

A review of the city's General Plan, Housing Element and Local Coastal Plan reveals a commitment to preserve housing and strengthen neighborhoods. The city's planning documents make no mention of shifting tourists away from the commercial zones and into the neighborhoods. Likewise, there are no planning goals to encourage tourists to avoid our local hotels. The need to work toward more long term housing is clearly the city's stated priority in the neighborhoods. The fact that a few entrepreneurs and venture capitalists build a website should not derail the city's goals and change the fundamental nature of our residential neighborhoods.

19. What to Do?

Today there are 758 STR rooms offered for rent in the city. **This is the same room count as the seven largest hotels in the city.** Most of these rooms came online in the last three years. If we could go back to 2014 and the city council was presented with an application from a corporation to build a 758 room hotel chain in converting residential housing the council would dismiss the application out of hand. Yet, that is exactly what has happened here, one property at a time.

The city has made it clear it wants to protect housing. The 2018 city budget is clear that preserving tax revenue will be challenge and a priority in the coming years. The STR subcommittee is recommending an inventory of 378 STRs (303 existing registered listings and 75 new listings) and no future limits on rooms being rented as STRs. This does not satisfy the city's goals of preserving housing and protecting neighborhoods.

Some coastal cities have banned short term rentals outright. These cities are now in the process of enforcing their new ordinances and shutting down the Airbnb and VRBOs in their neighborhoods. If Santa Cruz were to enact a ban it would shut down a small number of vacation rentals that have been in some families for generations. This option raises issues of fairness.

There are two "middle ground" propositions that meet the city's goals and do not ban legacy vacation rentals.

1. Approve the STRs that are currently registered in the coastal zone. Today there are 202 STRs in the city's coastal zone. These neighborhoods have historically been the focus of the lion's share of vacation rentals dating back decades. This option would freeze registrations at the current number in the coastal zone (both whole houses and rooms) and set up a sunset period for all unregistered STRs and those outside the coastal zone to revert back to residential use. One extra benefit of restricting the city's STRs to the coastal zone is the expressed interest the California Coastal Commission has on seeing alternative lodging in our coastal zone.

2. Approve of the STRs in the coastal zone that were registered as of January 2014. Two thirds of the 206 registered STRs in the coastal sprung up in the last three years. It is likely that the 71 STRs in the coastal zone that were registered before January 2014 have been used as vacation rentals for years and have not recently been part of the city's housing stock (see map on page 7). One way to allow continued vacation rental use for those legacy properties and reverse the conversion of housing to STR use in the last three years is to allow those vacation rentals registered on or before January 2014 to continue operation. A sunset period could then be put in place for all other STRs in the city to give them ample time to wind down their STR activity and convert their properties to residential use.

20. Subletting, a forgotten tradition.

Advocates of STRs often say that they did not convert their property to tourist use for money. They say they did so for flexibility. Some property owners prefer to keep their properties vacant part of the year so it can be used by family. Some owners want to go away for the summer and have their homes

occupied in their absence. Some owners simply don't want to be landlords and take on the long term responsibility for a full time tenant. These desires are not new. They have been with us as long as people have owned property here. However, before the arrival of online platforms like Airbnb, these owners met all of these needs by subletting. A sublet of 30 days or more is not considered a transient stay and therefore does not require registration by the city or the collection of occupancy tax. The added benefit of owners subletting their spaces is that in today's tight rental market prospective tenants often need a place to live for a month or two while they navigate the rental market and find a place to live. Subletting allows property owners flexibility, a reasonable income stream from their investment, and it provides a needed service to prospective tenants who spend up to 3 months searching for a place to live.