

AGENDA ITEM REQUEST FORM

Department: Rent Program

Department Head: Nicolas Traylor

Phone: 620-6564

Meeting Date: March 21, 2018

Final Decision Date Deadline: March 21, 2018

STATEMENT OF THE ISSUE: Members of the community have sent letters to the Rent Board and Rent Program staff members. Staff members recommend letters that do not pertain to a specific item on the Rent Board agenda be included as consent items for consideration by the Rent Board.

INDICATE APPROPRIATE BODY

- | | | | | |
|---|---|--|--|---|
| <input type="checkbox"/> City Council | <input type="checkbox"/> Redevelopment Agency | <input type="checkbox"/> Housing Authority | <input type="checkbox"/> Surplus Property Authority | <input type="checkbox"/> Joint Powers Financing Authority |
| <input type="checkbox"/> Finance Standing Committee | <input type="checkbox"/> Public Safety Public Services Standing Committee | <input type="checkbox"/> Local Reuse Authority | <input checked="" type="checkbox"/> Other: <u>Rent Board</u> | |

ITEM

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|---|--|--|
| <input type="checkbox"/> Presentation/Proclamation/Commendation (3-Minute Time Limit) | | |
| <input type="checkbox"/> Public Hearing | <input type="checkbox"/> Regulation | <input checked="" type="checkbox"/> Other: <u>CONSENT CALENDAR</u> |
| <input type="checkbox"/> Contract/Agreement | <input type="checkbox"/> Rent Board As Whole | |
| <input type="checkbox"/> Grant Application/Acceptance | <input type="checkbox"/> Claims Filed Against City of Richmond | |
| <input type="checkbox"/> Resolution | <input type="checkbox"/> Video/PowerPoint Presentation (contact KCRT @ 620.6759) | |

RECOMMENDED ACTION: Receive letters from community members regarding the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance, RMC 11.100 – Rent Program (Cynthia Shaw 620-5552).

AGENDA ITEM NO:

F-2.

ITEM F-2 ATTACHMENT 1

From: linda n [<mailto:lmno77p@yahoo.com>]

Sent: Thursday, March 15, 2018 2:19 PM

To: Virginia Finlay; David Gray; Emma Gerould; Lauren Maddock; Nancy Coombs; Nicolas Traylor; Paige Roosa

Cc: Ilona Clark; Christina Borowski; mvasilis@yahoo.com

Subject: Responses to Rent Board Meeting of Feb. 28, 2018

Dear Rent Board Members and Staff,

At he Board meeting of February 28 I spoke about how difficult it is for us (you, landlords, renters and I) to understand the proposed regulations. Now I know that it is Ken Baar who wrote or culled the recent MNOI ones, for example. Therefore, I'm very concerned that the Staff recommended extending his contract and that the Board approved it on the consent calendar without much, if any, input from the public or discussion from the Board--just confused looks at the February 21 meeting.

Also at the Feb. 28 meeting it was clear that the Board and Staff, namely Nick Traylor who spoke, did not agree with Mr. Baar's suggestions that would create complicated administrative practices.

In my opinion based on his phone conversations from Australia and his writings, he is not the best nor the only "expert" in fair return regulations. At the Feb. 28 meeting we heard in person from Michael St. John who is local and also well-regarded. It would be prudent to hire Mr. St. John in order for the Board to get another view for balance and greater understanding.

If it is possible to hire St. John and Assoc. instead of Mr. Baar, that is what I would suggest. If not, then hire St. John and Assoc. in addition to Mr. Baar in order to craft the best regulations.

Thank you for your considerations.

Sincerely,
Linda Newton
Landlord and Member of AURHP

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From: Ilona Clark [mailto:in70clark@gmail.com]

Sent: Wednesday, March 14, 2018 12:10 PM

To: Cynthia Shaw; Paige Roosa; David Gray; Emma Gerould; Lauren Maddock; Nancy coombs; Nicolas Traylor; Rent Program; Virginia Finlay

Subject: chapter 905 conflates Capital Improvements with NOI

To the Richmond Rent Board and Staff,

Please consider our suggestions regarding separating capital improvement raises from NOI raises. Capital improvement raises should NOT be tied in with NOI or other types of raises. They are distinct and finite. They are associated with specific projects - like roofs.

NOI and HLR will be relevant for the next few years - they are mechanisms by which Richmond can readjust to rent controlled conditions. However, petitions for capital improvements will be ongoing as there are always roofs to replace, painting to be done, appliances to replace.

Oakland and San Francisco keep them separate. In Berkeley capital improvement raises are extremely rare - it is possible that this is the reason. Fortunately for Berkeley, they have a large population of students which gives them a higher turnover rate so vacancies keep housing providers going.

We are not Berkeley. Please separate capital improvements from other types of raises.

thank you

These suggestions have been compiled by the AURHP.

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Richmond can do better!

ITEM F-2 ATTACHMENT 1

From: Ilona Clark [mailto:in70clark@gmail.com]

Sent: Wednesday, March 14, 2018 5:55 AM

To: Mike Vasilas; Christine Borowski; Nicolas Traylor; Paige Roosa; Luke Blacklidge; Cynthia Shaw; David Gray; Emma Gerould; Lauren Maddock; Nancy coombs; Rent Program; Virginia Finlay

Subject: Meetings this week - AURHP and Richmond Rent Board Executive Staff

Nick and Paige,

thank you once again for meeting with us so willingly. We are thankful for the opportunity to weigh in on these regulations as they are being pondered - so much better than trying to clean up messes after they are set and damage is done. We also want to acknowledge the contributions that Micheal St John made pro-bono. Our discussion and input has been richer, more varied and much more productive as a result. We understand that the rent board has no plans to hire SJA for further input and that, for all practical purposes, it will not be discussed further. As stated, I plan to follow up with an email but know that the writing is on the wall, so to speak.

Here is a summary of what was discussed over the course of the two meetings - I hope it is accurate and I've attached our revised draft edits as well:

- Definitions of fair return for NOI and base year were discussed. Together, we brought up problems with the idea of using the actual return for a given year for each building as complex, potentially expensive and lacking standard to which we may all compare. The presumption that any given year all or most properties were making a fair return is invalid. This is especially true during the period being considered - 2015, 2014 - when the recession affected renters and housing providers alike and many housing providers kept rents low or lowered rents assuming they would be able to make up the difference later and that it was better to hold on and wait it out.
- We discussed using HUD rates for 2015 as a standard for fair return and the 50% NOI rule - both of these were brought forth by St John and while we prefer the former, he likes the latter just as well. Mike presented a proposal for using HUD rates that is clear and performs all the requirements relevant to the idea of fair return. The standard provided by HUD has been used in other jurisdictions, like Berkeley - it will be vetted by legal counsel. Different methods will be presented to the board for consideration.
- We also discussed briefly HLR which come last in the timeline for regulations. HLR and NOI are related and the order in which petitions are filed may affect the outcome for housing providers. Nick mentioned that it will be better for housing providers to wait for HLR regulations to be written before filing any petition for NOI fair return, though the HLR regulations will be written last as they are most complex.
- All acknowledged that NOI and HLR are closely related, quite complex and relevant only at the beginning stages of implementing RC. We are all still on a learning curve as far as what they need to do and how they might work in real time.
- Mike will send his proposal on Fair return which uses 2015 HUD rates as a standard **and** details how those raises might occur in real time.
- We discussed the use of vague terms such as extraordinary, exceptional and unreasonable which leave much open to interpretation and may necessitate hearings which are expensive, time consuming and may not be needed if regulations are written with more

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specific verbage. While it may be considered legally and politically expedient to rely on hearing officers and appeals processes, numerous petitions and appeals are not practical for many small housing providers and cumbersome proceedings may simply put them off from using the system. it also does not guide hearing officers toward a balanced approach as we have experienced in other jurisdictions. We have put these words in red to highlight how ubiquitous they are in these regulations. This results in problems including non-compliance with the ordinance, going out of business and instability for **all** stakeholders.

- We discussed capital improvements While not all our members agree with this method, using a permanent raise schedule (7.5% and 12.5%) has several advantages. It benefits renters with lower raises in the short term and benefits housing providers with more stability and higher rents in the long term. It also streamlines administrative processes. We are glad to hear the staff are working on implementing this language at the request of the board.
- We feel strongly that capital improvement raises are NOT tied in with NOI or other types of raises. Capital improvements are distinct and finite. They are associated with specific projects. Also while NOI and HLR will be relevant for the next few years. Petitions for capital improvements will never end as there are always roofs to replace (ervery20-30 years), Painting to do (every 10 years for exterior), appliances to replace (every 5-10 years). None of this is exceptional, raises for NOI and HLR are, by definition exceptional and unusual and this is confirmed by Baar's own language when defining NOI (section 905 A. 5. a. i, ii, iii, b., b ii, v). In our edits, we have taken the Capital improvement section out of the NOI section completely.
- Expenses passed through for master metered services may no longer be passed through per the ordinance - discussed. No changes per legal team, this would have to be addressed with NOI petition. Berkeley allows a separate agreement for these situations.
- 8c. limits the time housing providers must complete proposed improvement projects to 12 months. Given the length of time it takes to do projects properly and the fact that Richmond's permitting process is significantly longer than in other jurisdictions, we suggest at least 24 months from the time a project is proposed.
- Discussed #9 - the timeline in which capital improvement are made, petitions are filed, petitions are approved and rents are raised and how this affects vacancy de-control. As written, if a petition for a raise is approved, the raise will not apply to any renter whos tencany began within the last 24 months. This is only relevant to those paying below market rents. We expressed concern that this will incentive housing providers to put off projects until the 24 months have elapsed, possibly to the detriment of the renter and the building itself. we suggest 12 months as the limit.
- Note that even if any raises apply to all units, for practical purposes, they may not apply to units that are already at market, since renters may move to get a better deal if market rents go up further.

Please see changes below or in the attachment.

Chapter 9. Standards for Individual Maximum Allowable Rent Adjustments

Please note: Regulations 901-904 and 911-912 are not contained within this document. Such regulations are accessible at the following

link: <http://www.ci.richmond.ca.us/DocumentCenter/View/45610>. This link does not lead to the 900's

905. Maintenance of Net Operating Income (MNOI) Fair Return Standard

A. Fair Return Standard

1. Presumption of Fair Base-Year Net Operating Income. It shall be presumed HUD FMR data from year 2015 per size of unit represent the net operating income received by the Landlord in the base year provided a Fair Return. *The presumption that any given year all or most properties were making a fair return is invalid. Sometimes properties lose money when they are first purchased. Does this mean a negative return is a fair return because it didn't make money when purchased? Often there are problems with a bldg's condition or management that the owner can correct and generate a much higher return over time. An item purchased for \$100 in 2000 now costs \$500 in 2018. (<http://www.usinflationcalculator.com/>) So even if the rent went up by \$400 over this time, there is NO increase in return to the owner. The owner is getting nothing on her investment. Using the section 8 standard listed for the base year provides a clear, universally applicable way to ensure housing providers no be prevented from fair return by having in place unusually low rents from achieving a fair return Would this obviate the need for separate HLA?*

Fair Return. Should the owner/tenant believe that this base rent does not accurately reflect market rent, due to unique circumstances, the owner/tenant has the ability to petition the board for an increase/decrease of the base rent. A Landlord has the right to obtain a net operating income equal to **the base year NOI as defined above** ~~base year net operating income~~ adjusted by ~~___% of the percentage~~ increase in the Consumer Price Index (CPI), since the base year. It shall be presumed this standard provides a Fair Return. *Reasons for using an objective universal metric rather than individual cash flow for a given year. What if the base year NOI is negative? This adjustment percentage also needs to be bigger than 100%. At 100% of CPI, there is never an increase in return for the owner. As time goes on and the value of the dollar decreases, the owner needs more money from tenants just to keep up with the increases in expenses. There is no increase of income for the owner. AGA is already defined in original ordinance as 100% of CPI*

3. Base Year.

a. For the purposes of making Fair Return determinations pursuant to this section, ~~the~~ calendar year 2017 ~~is the base year~~. The base year CPI shall be , unless subsection (b) is applicable *or unless gross receipts do not exceed gross expenditures by % in the year 2017 excluding unusual costs.*
the owner only owns the property for 2-3 months in the first calendar year?

b. In the event that property changed ownership after fiscal year 2015-16 a determination of the allowable Rent is made pursuant to this section, if a subsequent petition is filed, the base year shall be the year that was considered as the "current year" in the prior petition. Fair NOI plus interim AGA's
Use HUD standards and et rid of this section

4. Current Year

The "current year" shall be the calendar year preceding the application. The "current year CPI" shall be the annual CPI for the current year.

5. Adjustment of Base Year Net Operating Income.

Landlords or Tenants may present evidence to rebut the presumption that the base year net operating income provided a Fair Return. Grounds for rebuttal of the presumption shall be based on at least one of the following findings:

a. **Exceptional Individual Expenses in the Base Year.** The Landlord's operating expenses in the base year were **unusually** high or low in comparison to other years. In such instances, adjustments may be made in calculating operating expenses in order that the base year operating expenses reflect **average** expenses for the property over a **reasonable** period of time. The following factors shall be considered in making such a finding:

i. **Extraordinary** *Need a definition here* amounts were expended for necessary maintenance and repairs.

ii. Maintenance and repair expenditures were **exceptionally** low so as to cause inadequate maintenance or significant deterioration in the quality of services provided.

iii. Other expenses were **unreasonably** high or low notwithstanding the application of prudent business practices.

b. **Exceptional Individual Circumstances in the Base Year.** The gross income during the base year was disproportionately low **compared with-----** ~~due to exceptional circumstances~~. In such instances, adjustments maybe made in calculating base year gross rental income consistent with the purposes of this chapter. The following factors shall be considered in making such a finding:

i. If the gross income during the base year was lower than it might have been because some residents were charged reduced rent.

ii. If the gross income during the base year was **significantly** lower than normal because of the destruction of the premises and/or temporary eviction for construction or repairs.

iii. The pattern of rent increases in the years prior to the base year and whether those increases reflected increases in the CPI.

iv. Base period rents were disproportionately low in comparison to the base period rents of comparable apartments in the City. *Historic Lows?*

v. Other ~~exceptional~~ individual circumstances.

6. Calculation of Net Operating Income. Net operating income shall be calculated by subtracting operating expenses from gross rental income.

a. **Gross Rental Income.**

i. Gross rental income shall include:

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Gross rents calculated as gross scheduled rental income at **one hundred percent occupancy** *trap? If units are withdrawn from the market, does this still count against HP?* and all other income or consideration received or receivable in connection with the use or occupancy of the Rental Unit, except as provided in **Subparagraph (B)** of this section . If there are vacant units at the time a petition is filed the rent shall be calculated on the basis of average rents for comparable units in the property which have had vacancy increases within the past two years. If there are no comparable units in the property rental income for the vacant units shall be calculated on the basis of rents for recently established initial rents for comparable units in the City.

ii. Gross rental income shall not include:

Utility Charges for sub-metered gas, electricity or water;
Charges for refuse disposal, sewer service, and, or other services which are either provided solely on a cost pass-through basis and/or are regulated by state or local law;
Charges for laundry services; and
Storage charges.

b. **Operating Expenses.** Operating expenses shall include the following:

i. **Reasonable costs of operation and maintenance of the Rental Unit.**

ii. **Management expenses.** It shall be presumed that management expenses have increased between the base year and the current year by the percentage increase in rents or the CPI, whichever is greater, unless the level of management services has either increased or decreased significantly between the base year and the current year. This presumption shall also be applied in the event that management expenses changed from owner managed to managed by a third party or vice versa

iii. **Utility costs** except a utility where the consideration of the income associated with the provision of the utility service is regulated by state law and consideration of the costs associated with the provision of the utility service is preempted by state law or the income associated with the provision of the utility is not considered because it is recouped from the Tenants on a cost pass-through basis..

iv. **Real property taxes**, subject to the limitation that property taxes attributable to an assessment in a year other than the base year or current year shall not been considered in calculating base year and/or current year operating expenses.

v. **License, registration and other public fees** required by law to the extent these expenses are not otherwise paid or reimbursed by Tenants.

vi. **Landlord-performed labor** compensated at **reasonable** *define* hourly rates. However, no Landlord-performed labor shall be included as an operating expense unless the Landlord submits documentation showing the date, time, and nature of the work performed. There shall be a maximum allowed under this provision of five percent (5%) of gross income unless the Landlord shows greater services were performed for the benefit of the residents. (HOURLY RATE PRESUMPTIONS TO BE INSERTED)

vii. **Legal expenses.** Reasonable attorneys' fees and costs incurred in connection with successful good faith attempts to recover rents owing, successful good faith unlawful detainer actions not in derogation of applicable law, legal expenses necessarily incurred in dealings with respect to the

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normal operation of the Property, and reasonable costs incurred in obtaining a rent increase pursuant to Sections ___ ___ of the Ordinance.

To the extent allowable legal expenses are not annually reoccurring and are substantial. they shall be amortized over a five-year period, unless the Rent Board concludes that a different period is more reasonable. At the end of the amortization period, the allowable monthly rent shall be decreased by any amount it was increased because of the application of this provision. *If legal expenses are annually reoccurring, they may be passed through at cost*

Capital Improvements section moved out of section defining NOI as these raises are distinct from other types of raises.

We moved this section out of NOI because we strongly recommend that capital improvement raises are NOT tied in with NOI or other types of raises. They are distinct and finite. They are associated with specific projects. Also while NOI and HLR will be relevant for the next few years. Petitions for capital improvements will never end as there are always roofs to replace

10. Relationship of Individual Rent Adjustment to Annual General Adjustment Any Individual Increase Adjustment established pursuant to this Section **shall take into account the extent of vague** - *Replace with include* any Annual General Adjustments the Landlord may be implementing, or otherwise be entitled to, at and during the time for which the Individual Adjustment is sought regarding the petitioning year, ~~and the Individual Adjustment may be limited or conditioned accordingly.~~ *While limited banking is allowed, it should never be mandated. AGA is only to maintain Fair return, once it is established, by compensating for inflation. Any decrease or delay of AGAs mandated by the regulations creates a decreasing fair return over time.*

If there is any Individual Rent Adjustment then Landlord should also get the AGA increase on top of the individual adjustment.

11. Limits to Annual Rent Adjustments Based on Maintenance of Net Operating Income Standard

A. Purpose

The purpose of this subsection (A) is to protect Tenants from substantial rent increases which are not affordable, and which may force such Tenants to vacate their homes and result in consequences contrary to the stated **purposes of the Ordinance, namely, to maintain the diversity of the Richmond community, to preserve the public peace, health and safety; Maintain housing stock and advance the housing policies of the City** with regard to low and fixed income persons, minorities, students, handicapped and the aged, *both renters and housing providers included.*

~~If it is determined that the Landlord is not entitled to an Individual Adjustment, the Landlord may implement the full upcoming General Adjustment.~~ *in addition to any banked AGA Not To Exceed 15% of MAR*

c. Exclusions from Operating Expenses. Operating expenses shall not include the following:

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- i. Mortgage principal or interest payments or other debt service costs and costs of obtaining financing. *Except debt incurred as a result of capital improvement in order to avoid ix below. – “ix. Expenses which are attributable to unreasonable delays in performing necessary maintenance or repair work or the failure to complete necessary replacements. (For example if a roof replacement is unreasonably delayed, the full cost of the roof replacement would be allowed; however, if interior water damage occurred as a result of the unreasonable delay.”*
- ii. Any penalties, fees or interest assessed or awarded for violation of any provision of this chapter or of any other provision of law.
- iii. Land lease expenses.
- iv. Political contributions and payments to organizations or individuals which are substantially devoted to legislative lobbying purposes.
- v. Depreciation.
- vi. Any expenses for which the Landlord has been reimbursed by any utility rebate or discount, Security Deposit, insurance settlement, judgment for damages, settlement or any other method or device.
- vii. **Unreasonable** increases in expenses since the base year.
- viii. Expenses associated with the provision of master-metered gas and electricity services. *cases where no submeter exists and practice has been to pass through these expenses at cost to renter. Discussed – Per Traylor, new leases should not include pass-throughs. Old leases are now contradicted by the Ordinance and owners have not legal option but to discontinue the passthrough and continue to provide the service. They may ask for a raise under NOI to offset the loss*

Legal expenses. Reasonable attorneys' fees and costs incurred in connection with successful good faith attempts to recover rents owing, successful good faith unlawful detainer actions not in derogation of applicable law, legal expenses necessarily incurred in dealings with respect to the normal operation of the Property, and reasonable costs incurred in obtaining a rent increase pursuant to Sections ____ ____ of the Ordinance.

ix. Expenses which are attributable to unreasonable delays in performing necessary maintenance or repair work or the failure to complete necessary replacements. (For example if a roof replacement is unreasonably delayed, the full cost of the roof replacement would be allowed; however, if interior water damage occurred as a result of the unreasonable delay...?)

d. Adjustments to Operating Expenses. Base year and/or current year operating expenses may be averaged with other expense levels for other years or amortized or adjusted by the CPI or to reflect levels that are **normal** for residential Rental Units or may otherwise be adjusted, in order to establish an expense amount for that item which **most reasonably** serves the objectives of obtaining a **reasonable** comparison of base year and current year expenses and providing a Fair Return. If the claimed operating expense levels are **exceptionally** high compared to prior expense levels and/or **industry standards** the Landlord shall have the burden of proof of demonstrating that they are reasonable and/or reflect recurring expense levels. Expenses which are **exceptional and reasonable** shall be amortized in order to achieve the objectives of this section. *If charging above market, this will take care of itself – what is the objective here and what are the actual consequences?*

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e. Projections of Base Year Operating Expenses in the Absence of Actual Data If the Landlord does not have base year operating expense data, it shall be presumed that operating expenses increased by the percentage increase in the CPI between the base year and the current year. This presumption is subject to the exception that specific operating expenses shall be adjusted by other amounts when alternate percentage adjustments are supported by a preponderance of evidence (such as data on changes in the rates of particular utilities or limitations on increases in property taxes.)

7. Allocation of Rent Increases Rent increases authorized pursuant to this section shall be allocated as follows:

a. Rent increases for unit-specific capital improvements shall be allocated to that unit;

b. Rent increases for building-wide or common area capital improvements shall be allocated equally among all units;

c. Rent increases resulting from the Net Operating Income analysis shall be allocated equally among all units; *Many buildings have wildly differing rent on simliar spaces - this difference will only increase as rent control becomes more entrenched under vacancy decontrol. Also, if units are already at market, rent may not be raised on them without risking a vacancy.*

d. Notwithstanding the subsections above, the hearing examiner or the Board, in the interests of justice, shall have the discretion to apportion the rent increases in a manner and to the degree necessary to ensure fairness. Such circumstances include, but are not limited to, units that are vacant or owner occupied.

Beginning section on capital improvements – much of which will be replaced with a permanent rent raise option as discussed by Rent board

viii. **The Amortized Costs of Capital Replacements.** ~~Improvements~~ Operating expenses include the amortized costs of capital replacements plus an interest allowance to cover the amortization of those costs. For purposes of this section a capital improvement shall be any improvement to a unit or property which materially adds to the value of the property, appreciably prolongs its useful life or adapts it to new use and has a useful life of more than one year and a direct cost of \$250.00 or more per unit affected. Allowances for capital improvements shall be subject to the following conditions: *Consider “permanent amortization”, which means that a lower rent increase will be allowed but will remain in place permanently. The on-again/off-again system is cumbersome. Rents increase for varying periods by varying amounts, then decrease again. The annual adjustment is imposed on the underlying base rent, not on the amortized amounts. The bookkeeping to handle this is complex and subject to error. permanent amortization system, in contrast, simply awards the interest as a rent increase. The interest is paid forever. The original amount is never re-paid. Tenants like permanent amortization because the rent increase is smaller. Property owners like permanent amortization because the calculations are simpler. Rent board staffs like the permanent amortization method because it is far easier to track lawful rent ceilings with permanent amortization of amortizable amounts.*

Much of the following sections would be irrelevant if permanent

The costs are amortized over the period set forth in Section ___ of this regulation and in no event over a period of less than thirty six months. *If costs are amortized over more than 10 years they will be added to the base rent for future calculations and there will be no rollback.*

The costs do not include costs incurred to bring the Rental Unit into compliance with a provision of the Richmond Municipal Code or state law where the original installation of the improvement was not in compliance with code requirements. *This paragraph excludes from consideration costs incurred where the initial installation was not to code. This limitation is not a good idea, in my view. What difference does it make if a prior owner many years in the past did work without permits or not to code or if code standard change as they have with windows and will with EQ retrofits? We should be encouraging responsible property owners to bring property conditions to code in all circumstances.*

~~At the end of the amortization period, the allowable monthly rent shall be decreased by any amount it has increased due to the application of this provision.~~

~~*Project completed within 10 years of petition submission—past or future*~~

~~The amortization period shall be in conformance with the following schedule adopted by the Rent Board unless it is determined that an alternate period is justified based on the evidence presented in the hearing.~~

~~(continued on following page) **AMORTIZED COST TABLE (EXAMPLE)**~~

~~Units in Bldg 40~~

~~-~~

~~-~~

~~TABLE here— not needed~~

ix. Interest Allowance for Expenses that Are Amortized. An interest allowance shall be allowed on the cost of amortized expenses. The allowance shall be the interest rate on the cost of the amortized expense equal to the "average rate" for thirty-year fixed rate on home mortgages plus two percent. The "average rate" shall be the rate Freddie Mac last published in its weekly Primary Mortgage Market Survey (PMMS) *currently 4.32%* as of the date of the initial submission of the petition. In the event that this rate is no longer published, the Rent Board shall designate by regulation an index which is most comparable to the PMMS index.

x. Impact of Vacancy Decontrol on Rent Increases Based on Capital Improvements

If a unit becomes vacant during the pendency of a schedule which provides for the expiration of increases for capital improvements and the unit qualifies for a vacancy increase pursuant to Civil Code section 1954.53, the capital improvements schedule shall terminate *for the given unit(s). Not for the entire increase if it involves other units*

8. Conditional Rent Adjustments for **Proposed** Capital Improvements

a. In order to encourage necessary capital improvements, the Board allows a Landlord to petition for an upward rent adjustment based upon anticipated future expenses for capital improvements. The purpose of this procedure is to permit Landlords to seek advanced authorization for future rent adjustments

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based upon anticipated capital improvements. A petition under this Section should only be made for anticipated expenses that the Landlord intends to incur during the twelve month period following the date of final Board decision. This procedure should not be used for anticipated expenses for ordinary repairs and maintenance.

b. If the petition is granted in whole or in part, the rent increase shall be postponed until such time as the capital improvements are made and an Addendum authorizing the increases is issued.

c. No addendum shall be issued for such proposed capital improvements unless they are completed within ~~twenty four~~ ~~twelve~~ months from the date of final decision granting the conditional rent adjustment, unless the Landlord obtains an additional addenda authorizing an extension of the time period to complete the capital improvement. *Given the time to get permits approved and other delays common in the completion of construction projects, 12 months is in my view unnecessarily tight. If supported by just cause such extensions shall be granted. This language will be made clearer to avoid mis-interpretation*

9. Any unit which received a vacancy rent increase pursuant to Civil Code section 1954.53 within the ~~12 months~~ ~~two years~~ prior to the Fair Return application shall be ineligible for a rent increase for the portion of any rent increased based on the cost of proposed capital improvements. *This makes no sense. Just because the tenant is paying the market rent of two years ago doesn't mean they shouldn't help to pay for a capital improvement that needs to be done now? If the proposed increase would push the rent above the market, the landlord can't give that increase anyway or the tenant will move. This may incentive housing providers to put off projects until the 24 months have elapsed, possibly to the detriment of the renter and the building itself.*

End section on capital improvements – much of which will be replaced with a permanent rent raise option as discussed by Rent board

B. Rent Increase Limit

Notwithstanding any other provision of this regulation, the implementation of a Maximum Allowable Rent increase shall be limited each year as follows:

_____ (e.g. 15%) of the Maximum Allowable Rent on the date the petition is filed, or _____ (e.g. \$150 per month), whichever is greater.

On January 1st of each year beginning in February 2018, the \$___and/or ___% limitation shall be adjusted upward by 100% of the percentage increase in the Consumer Price Index, All Urban Consumers, for the San Francisco-Oakland-San Jose metropolitan area, ~~less its shelter component~~, for the twelve month period ending on the preceding June 30th, rounded to the nearest dollar. *This has been taken care of per Traylor, thank you*

If the amount of any rent increase granted under these regulations exceeds this limit, any portion in excess of the annual limit shall be deferred.

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In subsequent years deferred amounts of the allowable rent increase may be implemented.

At the end of each year the deferred amount of the increase shall be calculated and an interest allowance shall be calculated based on the standard set forth in Section ___ of this regulation. One twelfth of the interest allowance shall be added on to full monthly increase authorized under the MNOI standard. *Dont understand If this is an attempt to create a mechanism by which property owners will be made whole, it needs to be clarified. If the fair return calculations result in a greater than 15% increase overall, the 15% limit will necessarily deny property owners a fair return.*

12. Constitutional Right to a Fair Return. No provision of this regulation shall be applied so as to prohibit the Board from granting an individual rent adjustment that is demonstrated by the Landlord to be necessary to meet the requirements of this ordinance and/or constitutional **Fair Return requirements.** *define*

-- Richmond can do better!

ITEM F-2 ATTACHMENT 1

From: Rosmarie Levy [<mailto:rosmarielevy@gmail.com>]
Sent: Monday, February 19, 2018 4:34 PM
To: Rent Control
Subject: Attention Rent Board Members

Dear Rent Board Members,

We want to draw your attention to the fact that the decision to roll back rents to July 2015 is without merit, and ultimately will result in punishing the people it was intended to protect. That decision was made without regard to market conditions, the amounts tenants were paying in a given unit or property, and the amenities the tenants were enjoying. If the primary goals of the program are to eliminate exorbitant rent increases, and eliminating unfair evictions, it is likely to fail on both counts.

We own a 12-unit building of 10,000 square feet on Nevin Avenue and 32 Street. All are large, 2-bedroom units, with a separate dining area, balconies, covered parking spaces, a dedicated locked storage, a shared laundry facility, as well as a central play area for the children. The building is located on a quiet street in proximity to shops, public transportation and schools.

The current rents (AFTER two raises from July 2015) range from \$772 to \$1,118. This is clearly not only way below market, but it is insufficient to maintain the building, let alone to provide a fair return on investment. The current rent levels are a sure way to put us owners in the red, with a very real possibility that we will have to default on our mortgage payments and face foreclosure.

We value our tenants and do not want to displace any of them, or to exploit them. We simply want to provide a safe place to live, a place our tenants can enjoy and feel at home. In the past year we spent over \$70,000 dollars in maintenance and improvements, and there is much more that needs to be done (for example, the roof is old and we have bids in the \$60,000 range for its replacement. And there are many other areas needing costly attention.)

We are asking you to look at the disparity of market rents vs. rents that are historically low and are now frozen. If, before implementing these rules, a survey of market rents in specific areas for specific apartments would have been conducted, perhaps none of this would have been necessary. We have recently received notice from Section 8 (we have one Section 8 tenant) that they are

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increasing the rent to \$1,800/month. That letter also states that a 2-bedroom unit in this area can rent for over \$2,200/month). The average rent in our building is currently only \$953.

If you want property owners to be able to properly maintain buildings and to make Richmond an attractive place to work and live, laws have to be fair to landlords as well as to tenants. Historically low rents must be adjusted upward, otherwise owners will not be able to maintain their properties.

Sincerely,

Ephraim and Rosmarie Levy

Members of AURHP

**ITEM F-2
ATTACHMENT 1**

From: Michael St. John [mailto:msjetal@pacbell.net]
Sent: Saturday, March 10, 2018 9:01 AM
To: Cynthia Shaw; Paige Roosa; David Gray; Emma Gerould; Lauren Maddock; Nancy coombs; Nicolas Traylor; Rent Program; Virginia Finlay
Subject: Re: Rent raises for capital Improvements - thinking outside the box

Director Traylor and Board Members: I have pasted below and also attach a memo explaining my thoughts about the fair return regulations now under consideration. I hope these comments are helpful as you pursue the difficult task of crafting fair return regulations. Best regards, MStJ.

ST. JOHN & ASSOCIATES
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707-937-3711 • msjetal@pacbell.net • Fax 510.845.1813
www.stjohnandassociates.net

Date: March 5, 2018

Memo To: RRP Board Members Gray, Finlay, Gerould, Coombs, and Maddock

Cc: Director Traylor, Deputy Director Roosa

From: Michael St. John, Ph.D.

Re: Fair Return Regulations

This memo expands on topics addressed in my memo to the Director dated 2/26/18. I attended your public workshop on 2/28/18, and listened carefully to the presentation by Paige Roosa and to Dr. Baar's comments by phone. I was impressed with Ms. Roosa's clear and balanced presentation of the options you face in creating regulations to carry out the mandate to limit rent increases that unreasonably burden tenants while at the same time to allow rent increases that provide property owners with a fair return. I was saddened to hear Dr. Baar say, as he said in both of his memoranda to you, that partial indexing is compatible with the fair return principle.

It seems to me that Richmond has an opportunity, right now, in real time, to advance the state of the art with regard to rent control. The Richmond rent control ordinance, by specifying that annual adjustments will be at the full consumer price index, already positions itself as balanced. Not pro-tenant, not pro-owner ... balanced. If rents are limited to something below inflation, that will produce pro-tenant results. If rents are allowed by right to increase by more than inflation, that will produce pro-owner results. If rents are allowed to increase at the inflation rate, that would produce balanced results. There is fundamental balance in the position that rents should increase in parallel with inflation. Now, in the regulation-making process, the Board has the opportunity to either reinforce this principle or undermine it.

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The rules you are charged with crafting appear complex. The fair return principle underlying these rules is simple, however. The Maintenance of Net Operating Income (MNOI) fair return method says that the net operating income (NOI) generated in the base year must be allowed to be maintained continuously in future years. Bottom line, base year net operating income must not be eroded by inflation. To be protected against the eroding impact of inflation, the base year net operating income must be allowed to increase at the inflation rate.

Dr. Baar, in contrast, would have you believe that you can adjust the consumer price index (CPI), decreasing it to 40, 60, or some other percentage of its true value, using that adjusted CPI figure in the fair return calculations. The inflation-adjustment of rents or of NOI is called “indexing”. The adjustment of rents or NOI by a portion of inflation is called “partial indexing”. We say that the CPI is “indexed” by inflation or “partially indexed” by 40%, 65%, or some other percentage of inflation. Dr. Baar argues in favor of partial indexing.

The partial indexing concept originated with Dr. Baar, actually. He alone among experts in this area has been advocating for this adjustment for the past 40 years. No other expert has suggested that the CPI be adjusted in this way in the rent control context or, to my knowledge, in any other context. The CPI, computed continuously by the Bureau of Labor Statistics since 1913, is used in many sectors of the economy – in employment and other contracts, to adjust social security payments, and so forth. In all of these contexts it is the full value of inflation that is used, not a portion of inflation.

Any economist would know instinctively that inflation adjustments should be full value. No economist has ever said - no economist would ever say – that partial indexing is compatible with a fair return. Dr. Baar has training in city planning and a law degree, but no training in economics. When challenged about his expert witness credentials in court cases, he has explained that he is “self-taught” in economics. So far as I know, Dr. Baar has never consulted an economist to get a second opinion about his partial indexing theory. His reports contain no references to the economic literature on rent control or on fair return. To the best of my knowledge, no writing of Dr. Baar’s has ever been reviewed by an economist before publication, nor have any of Dr. Baar’s articles been peer-reviewed. Meanwhile, Dr. Baar is often the only person advising California courts, cities, and counties about fair return. This has led to much confusion over the years.

Unfortunately, the partial indexing concept - a purely political adjustment with no basis in economics or real estate finance - has become embedded in many rent control ordinances throughout the state. Dr. Baar tells listeners that courts of appeal have condoned his partial indexing principle. This is true, unfortunately. Judges do not generally have training in economics. Even if they did, they would not be supposed to use their own expertise when making decisions. They are bound by law and tradition to heed the advice of experts. The expert whose advice they have heeded in several key cases at law has been ... Dr. Baar himself. These decisions are part of a recursive cycle in which Baar’s theories misled courts into writing decisions that Baar now uses to mislead you and other rent boards about fair return.

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Dr. Baar is urging you to believe that it is perfectly OK for you to apply the partial indexing adjustment to the fair return rule that you will soon enact. He says that 40% indexing, 60% indexing, or 100% indexing will all produce a fair return. Paige Roosa's example showed that 100% indexing would allow a rent increase of \$63, that 75% indexing would allow a rent increase of \$26, and that 50% indexing would allow no increase. A fair return rule that says that zero, \$26, and \$63 are all compatible with a fair return is fundamentally useless.

I heard Dr. Baar tell you last Wednesday that the impact on tenants of using 2/3 of the CPI in the fair return calculations would be "minimal". That is untrue, as the "Maria" example demonstrates. I heard Dr. Baar say that the rationale for partial indexing is that debt service is fixed. That may be true for some properties in the short run, but it isn't true for any property in the long run. It is therefore substantially not true.

By saying that you can choose any rate of indexing you wish, Dr. Baar is saying that this is a political question, not an economic question. His saying this over the years has led many jurisdictions to use their power to tip the scales in a pro-resident direction by choosing a rate of indexing less than 100%. This has created imbalances that have led to dozens of lawsuits, millions of dollars in litigation costs, fierce debates in the state and local legislatures, and massive confusion on all sides.

Also: A fair return rule including partial indexing combined with an annual adjustment rule with full inflation adjustments makes no sense whatsoever. Dr. Baar should know this. If rents increase at the full CPI every year, it is highly unlikely that any property owner will achieve further rent increases from a partial indexing fair return rule. Expenses would have to increase extraordinarily for that to happen. The fair return rule should match the annual adjustment rule. Both should be at 100% of the CPI.

There should be no need for this debate. The rules appear complex, but the principle is simple. The base year net operating income should be adjusted by full inflation. In no other way can a fair return be guaranteed under the MNOI fair return system.

Ms. Roosa's presentation set out four policy questions:

1. **How much of inflation should be applied to the NOI?** As above, anything less than 100% of inflation will automatically deny every property owner a fair return. It is critically important that Richmond adopt full indexing of Net Operating Income.
2. **What should the Base Year be?** The base year for the fair return analysis could be 2014 or 2015. I see no strong argument for one over the other.

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3. **Should rent increases calculated to provide a Fair Return be capped to avoid rent shock, and if so, how much?** I think such a provision makes good sense. It protects tenants against sudden, large rent increases. That said, it should be clear that the limit, if you decide to adopt a limit, is per year. That is, if the fair return result is that rents should increase, for example, by 35%, the rent would increase by 15% the first year, by another 15% the second year, and by up to 15% the third year. The third year's increase would include the remainder of the fair return result plus the annual adjustments in the first, second, and third years. Consideration should also be given to "making the property owner whole", which means that there should be something extra to account for the delay. Fair return delayed is fair return denied.

4. **Should amortization of capital improvements be permanent or temporary?** I favor the permanent amortization method because it is easier to administer and because the rent increase is lower. Tenants will like that, I think. Owners will also like it because permanent increases are included in the income that banks and buyers look at on refinancing or sale. Rent control staff persons like it because permanent increases are far easier to track. That said, it should be clear that the permanent-temporary question is not a fair return question. Either method of accounting for capital improvements can support a fair return.

There are some other topics that are important in this context. For one, it is important to the integrity of the MNOI fair return system that base year income be adjusted when appropriate. There is language in the draft regulation about this, but the language needs clarification. Most important, the concept "exceptional" should be removed. We don't know how "exceptional" the low base rent condition may be. It is my guess that quite a few units were caught at the beginning of rent control with below market rents. If the MNOI system doesn't begin with market rents, the fair return guarantee won't be fulfilled.

As I mentioned in my 2/26/18 memo, it is possible that HUD (Section 8) rents might be used as a floor in the MNOI process. Any base year rent below the HUD standard could be adjusted upwards to equal the HUD standard in the MNOI calculations. This would take care of the circumstances already mentioned in the draft regulation – below market rents for whatever reason – that would deny a property owner a fair return forever.

Another way to adjust base year income would be to apply the 50% NOI rule. This is explained in my fair return report identified in footnote 2. In brief, the 50% rule says that if base year NOI is less than 50% of gross income, the base year income can be adjusted upwards in the MNOI analysis so that the 50% standard is met. Like the HUD rent standard, the 50% NOI rule would provide a uniform method by which exceptionally low rents could be increased in the fair return process so that rents allowed by the application of the MNOI method would grant property owners a fair return.

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Recommendation: That I be hired by the Board to make revisions to the draft regulations such that they conform to the principles articulated above and in my memo to the director dated 2/26/18. Dr. Baar is sometimes seen as the only expert able to do this. This is incorrect. I am well qualified by training and experience to make revisions to the regulations. As a member of Berkeley's rent board from 1981 to 1983, I had a hand in enacting Berkeley's regulations, and as a rent control consultant in the years since I have had occasion to draft, review, and comment on rent control regulations in Berkeley and other jurisdictions around the state. I would welcome this assignment, and would work with staff and the Board to make sure that the regulations you adopt are understandable, balanced, and workable in practice.

Michael St. John, Ph.D.

See Baar's memo dated 12/20/17, pages 13-14.

As I describe in the report "Fair Return and the California Courts", available on my website, and in other reports that I can make available on request, Dr. Baar's theories are based on a statistical error made many years ago.

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Cc: Director Traylor, Deputy Director Roosa

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Michael St. John, Ph.D.

ITEM F-2 ATTACHMENT 1

From: Ilona Clark [mailto:in70clark@gmail.com]

Sent: Friday, March 09, 2018 8:22 PM

To: Cynthia Shaw; Paige Roosa; David Gray; Emma Gerould; Lauren Maddock; Nancy coombs; Nicolas Traylor; Rent Program; Virginia Finlay

Subject: Rent raises for capital Improvements - thinking outside the box

To the Richmond Rent Board and Staff,

Please consider our suggestions regarding Individual rent raises for Capital Improvements. . These suggestions have been compiled by the AURHP and include input from *the communications to the director and to the board by economist Michael St. John of SJA. We believe that his thoughts should be considered. Dr. St. John appears to have a balanced viewpoint and highly relevant expertise.*

At the most recent rent board meeting, we were glad to see the board members discussing the idea of permanent capital improvement raises which would streamline the process administratively, provide a mechanism to reimburse housing providers for expenses and benefit renters with smaller raises.

viii. *The Amortized Costs of Capital Replacements. Improvements Does this exclude painting?*

Operating expenses include the amortized costs of capital replacements plus an interest allowance to cover the amortization of those costs. For purposes of this section a capital improvement shall be any improvement to a unit or property which materially adds to the value of the property, appreciably prolongs its useful life or adapts it to new use and has a useful life of more than one year and a direct cost of \$250.00 or more per unit affected. Allowances for capital improvements shall be subject to the following conditions:

Consider “permanent amortization”, which means that a lower rent increase will be allowed but will remain in place permanently. The on-again/off-again system is cumbersome. Rents increase for varying periods by varying amounts, then decrease again. The annual adjustment is imposed on the underlying base rent, not on the amortized amounts. The bookkeeping to handle this is complex and subject to error. Permanent amortization system, in contrast, simply awards the interest as a rent increase. The interest is paid forever. The original amount is never re-paid. Tenants like permanent amortization because the rent increase is smaller. Property owners like permanent amortization because the calculations are simpler. Rent board staffs like the permanent amortization method because it is far easier to track lawful rent ceilings with permanent amortization of amortizable amounts.

The following sections would be irrelevant if permanent

The costs are amortized over the period set forth in Section ___ of this regulation and in no event over a period of less than thirty-six months. If costs are amortized over more than 10 years they will be added to the base rent for future calculations and there will be no rollback.

The costs do not include costs incurred to bring the Rental Unit into compliance with a provision of the Richmond Municipal Code or state law where the original installation of the improvement was not in compliance with code requirements. This paragraph excludes from consideration costs incurred where the initial installation was not to code. This limitation is not a good idea. What difference does it make if a prior owner many years in the past did work without permits or not to code, or if code standards change as they have with windows and will with EQ retrofits? We should be encouraging responsible property owners to bring property conditions to code in all circumstances.

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At the end of the amortization period, the allowable monthly rent shall be decreased by any amount it has increased due to the application of this provision.

Project completed within 3 years of petition submission - past or future

The amortization period shall be in conformance with the following schedule adopted by the Rent Board unless it is determined that an alternate period is justified based on the evidence presented in the hearing.

table here - unnecessary

ix. Interest Allowance for Expenses that Are Amortized. An interest allowance shall be allowed on the cost of amortized expenses. The allowance shall be the interest rate on the cost of the amortized expense equal to the "average rate" for thirty-year fixed rate on home mortgages plus two percent. The "average rate" shall be the rate Freddie Mac last published in its weekly Primary Mortgage Market Survey (PMMS)) currently 4.32%

as of the date of the initial submission of the petition. In the event that this rate is no longer published, the Rent Board shall designate by regulation an index which is most comparable to the PMMS index.

x. Impact of Vacancy Decontrol on Rent Increases Based on Capital Improvements

*If a unit becomes vacant during the pendency of a schedule which provides for the expiration of increases for capital improvements and the unit qualifies for a vacancy increase pursuant to Civil Code section 1954.53, the capital improvements schedule shall terminate for the given unit(s). **Not for the entire increase if it involves other units***

The following section has been moved to provide consistency:

8. Conditional Rent Adjustments for **Proposed Capital Improvements**

a. In order to encourage necessary capital improvements, the Board allows a Landlord to petition for an upward rent adjustment based upon anticipated future expenses for capital improvements. The purpose of this procedure is to permit Landlords to seek advanced authorization for future rent adjustments based upon anticipated capital improvements. A petition under this Section should only be made for anticipated expenses that the Landlord intends to incur during the twelve month period following the date of final Board decision. This procedure should not be used for anticipated expenses for ordinary repairs and maintenance.

*b. If the petition is granted in whole or in part, the rent increase shall be postponed until such time as the capital improvements are made and an Addendum authorizing the increases is issued. **The rent increase shall be in addition to CPI for the year in which it is authorized.***

Housing providers should never be compelled to bank CPI - they need to keep up with inflation

*c. No addendum shall be issued for such proposed capital improvements unless they are completed within ~~twenty four~~ **twelve** months from the date of final decision granting the conditional rent adjustment, unless the Landlord obtains an additional addenda authorizing an extension of the time period to complete the capital improvement. **Given the time to get permits approved and other delays common in the completion of construction projects, 12 months is in my view unnecessarily tight. If supported by just cause such extensions shall be granted. What does this mean?***

9. Any unit which received a vacancy rent increase pursuant to Civil Code section 1954.53 within the 12 months ~~two years~~ prior to the Fair Return application shall be ineligible for a rent increase for the

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portion of any rent increased based on the cost of proposed capital improvements. This makes no sense. Just because the tenant is paying the market rent of two years ago doesn't mean they shouldn't help to pay for a capital improvement that needs to be done now? If the proposed increase would push the rent above the market, the landlord can't give that increase anyway or the tenant will move. This discourages landlord from doing capital improvements that benefit the tenant such as new double paned windows or a new paint job.

The following section is in the middle of the Capital Improvement section but seems to pertain more to NOI :

c. Exclusions from Operating Expenses. Operating expenses shall not include the following: This is confusing, section b is about operating expenses and now c is too

i. Mortgage principal or interest payments or other debt service costs and costs of obtaining financing. Except debt incurred as a result of capital improvement in order to avoid ix below

ii. Any penalties, fees or interest assessed or awarded for violation of any provision of this chapter or of any other provision of law.

iii. Land lease expenses.

iv. Political contributions and payments to organizations or individuals which are substantially devoted to legislative lobbying purposes.

v. Depreciation.

vi. Any expenses for which the Landlord has been reimbursed by any utility rebate or discount, Security Deposit, insurance settlement, judgment for damages, settlement or any other method or device.

vii. Unreasonable increases in expenses since the base year.

viii. Expenses associated with the provision of master-metered gas and electricity services. Lets discuss cases where no submeter exists and practice has been to pass through these expenses at cost to renter

Legal expenses. *Reasonable attorneys' fees and costs incurred in connection with successful good faith attempts to recover rents owing, successful good faith unlawful detainer actions not in derogation of applicable law, legal expenses necessarily incurred in dealings with respect to the normal operation of the Property, and reasonable costs incurred in obtaining a rent increase pursuant to Sections ___ of the Ordinance. This may seem to contradict b vii*

ix. Expenses which are attributable to unreasonable delays in performing necessary maintenance or repair work or the failure to complete necessary replacements. (For example if a roof replacement is unreasonably delayed, the full cost of the roof replacement would be allowed; however, if interior water damage occurred as a result of the unreasonable delay...?)

d. Adjustments to Operating Expenses. Base year and/or current year operating expenses may be averaged with other expense levels for other years or amortized or adjusted by the CPI or to reflect levels that are normal for residential Rental Units or may otherwise be adjusted, in order to establish an

ITEM F-2 ATTACHMENT 1

expense amount for that item which *most reasonably* serves the objectives of obtaining a reasonable comparison of base year and current year expenses and providing a Fair Return. If the claimed operating expense levels are *exceptionally high* compared to prior expense levels and/or **industry standards** the Landlord shall have the burden of proof of demonstrating that they are reasonable and/or reflect recurring expense levels. Expenses which are exceptional and reasonable shall be amortized in order to achieve the objectives of this section. *If charging above market, this will take care of itself – what is the objective here and what are the actual consequences?*

e. Projections of Base Year Operating Expenses in the Absence of Actual Data If the Landlord does not have base year operating expense data, it shall be presumed that operating expenses increased by the percentage increase in the CPI between the base year and the current year. This presumption is subject to the exception that specific operating expenses shall be adjusted by other amounts when alternate percentage adjustments are supported by a preponderance of evidence (such as data on changes in the rates of particular utilities or limitations on increases in property taxes.)

7. Allocation of Rent Increases Rent increases authorized pursuant to this section shall be allocated as follows:

a. Rent increases for unit-specific capital improvements shall be allocated to that unit;

b. Rent increases for building-wide or common area capital improvements shall be allocated equally among all units;

*c. Rent increases resulting from the Net Operating Income analysis shall be allocated equally among all units; *Need to rethink this, Many buildings have wildly differing rent on similar spaces - this difference will only increase as rent control becomes more entrenched under vacancy decontrol**

d. Notwithstanding the subsections above, the hearing examiner or the Board, in the interests of justice, shall have the discretion to apportion the rent increases in a manner and to the degree necessary to ensure fairness. Such circumstances include, but are not limited to, units that are vacant or owner occupied.

Sincerely,

Ilona Clark and the AURHP

--

Richmond can do better!

ITEM F-2 ATTACHMENT 1

From: Ilona Clark [mailto:in70clark@gmail.com]

Sent: Friday, March 09, 2018 9:37 AM

To: Cynthia Shaw; Paige Roosa; David Gray; Emma Gerould; Lauren Maddock; Nancy coombs; Nicolas Traylor; Rent Program; Virginia Finlay

Subject: Base Year and Fair Return should be based on an industry standard, not an arbitrary and individual amount

To the Richmond Rent Board and Staff,

Please consider our suggestions regarding the definition of Base Year in regards to Fair Return. These suggestions have been compiled by the AURHP and the communications to the director and to the board by economist Michael St. John. We believe that his thoughts should be considered. Dr. St. John appears to have a balanced viewpoint and highly relevant expertise..

Section 905, as written, defines base year for purposes of determining fair return as actual NOI of a given year. This vague definition will be different for each unit and each property. During the chosen year, properties may have lost or gained depending on circumstances. Many housing providers lowered rents during the recession to retain renters that were going through rough times. Some may have put off maintenance and then had to make up for this the next year. If the building was a recent purchase, it is likely that more work than usual will have been done to it the year or two after it changed hands, making that an atypical year, not one on which fair return should be defined. While the regulations, as written, give lip service to these circumstances, it is based on false presumptions and vague words like "extraordinary" and "unusual," leaving everything open to interpretation.

Using HUD standard for fair return gives a much-needed standard that can be used by everyone. I can look at this and compare it to my below-market rents and know whether or not my units qualify for a bump in rents. They would not, and I don't even need a hearing officer to know this. One of our members has a well defined, well thought-out procedure for calculating fair return based on HUD rates which we will present to staff at an upcoming meeting. It is clear, concise and prevents housing providers from claiming more fair return raises on some low rent units while other units may be at market (above HUD fair return standard)

905. Maintenance of Net Operating Income (MNOI) Fair Return Standard

A. Fair Return Standard

*1. **Presumption of Fair ~~Base Year~~ Net Operating Income.** It shall be presumed **HUD FMR data from year 2015 per size of unit represent** ~~the net operating income received by the Landlord in the base year provided a Fair Return.~~*

The presumption that any given year all or most properties were making a fair return is invalid. Sometimes properties lose money when they are first purchased. Does this mean a negative return is a fair return because it didn't make money when purchased? Often there are problems with a building's condition or management that the owner can correct and generate a much higher return over time. An item purchased for \$100 in 2000 now costs \$500 in 2018. (<http://www.usinflationcalculator.com/>) So even if the rent went up by \$400 over this time, there is NO increase in return to the owner. The owner is getting nothing on her investment.

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Using the HUD standard listed for the base year provides a clear, universally applicable way to ensure housing providers not be prevented from fair return by having in place unusually low rents from achieving a fair return

Would this obviate the need for separate HLA?

Fair Return. *Should the owner/tenant believe that this base rent does not accurately reflect market rent, due to unique circumstances, the owner/tenant has the ability to petition the board for an increase/decrease of the base rent. A Landlord has the right to obtain a net operating income equal to **the base year NOI as defined above** ~~base year net operating income~~ adjusted by ~~___%~~ ~~of the percentage~~ increase in the Consumer Price Index (CPI), since the base year. It shall be presumed this standard provides a Fair Return. Reasons for using an objective universal metric rather than individual cash flow for a given year. What if the base year NOI is negative? This adjustment percentage also needs to be bigger than 100%. At 100% of CPI, there is never an increase in return for the owner. As time goes on and the value of the dollar decreases, the owner needs more money from tenants just to keep up with the increases in expenses. There is no increase of income for the owner. AGA is already defined in original ordinance as 100% of CPI*

3. Base Year.

a. *For the purposes of making Fair Return determinations pursuant to this section, ~~the calendar year 2017 is the base year.~~ The base year CPI shall be _____, unless subsection (b) is applicable **or unless gross receipts do not exceed gross expenditures by _____% in the year 2017 excluding unusual costs.***

What if the owner only owns the property for 2-3 months in the first calendar year?

b. *In the event that property changed ownership after fiscal year 2015-16 ~~a determination of the allowable Rent is made pursuant to this section, if a subsequent petition is filed, the base year shall be the year that was considered as the "current year" in the prior petition.~~ Fair NOI plus interim AGA's*
Use HUD standards and get rid of this section

4. Current Year Use HUD standards and get rid of this section

The "current year" shall be the calendar year preceding the application. The "current year CPI" shall be the annual CPI for the current year.

5. Adjustment of Base Year Net Operating Income. Use HUD standards and replace this section

Landlords or Tenants may present evidence to rebut the presumption that the base year net operating income provided a Fair Return. Grounds for rebuttal of the presumption shall be based on at least one of the following findings:

a. **Exceptional Individual Expenses in the Base Year.** *The Landlord's operating expenses in the base year were unusually high or low in comparison to other years. In such instances, adjustments may be made in calculating operating expenses in order that the base year operating expenses reflect average expenses for the property over a reasonable period of time. The following factors shall be considered in making such a finding:*

ITEM F-2 ATTACHMENT 1

i. **Extraordinary** *Need a definition here* amounts were expended for necessary maintenance and repairs.

ii. Maintenance and repair expenditures were ~~exceptionally~~ low so as to cause inadequate maintenance or significant deterioration in the quality of services provided.

iii. Other expenses were ~~unreasonably~~ high or low notwithstanding the application of prudent business practices.

b. ~~Exceptional~~ **Individual Circumstances in the Base Year.** The gross income during the base year was disproportionately low *compared with----- due to exceptional circumstances.* In such instances, adjustments maybe made in calculating base year gross rental income consistent with the purposes of this chapter. The following factors shall be considered in making such a finding:

i. If the gross income during the base year was lower than it might have been because some residents were charged reduced rent.

ii. If the gross income during the base year was significantly lower than normal because of the destruction of the premises and/or temporary eviction for construction or repairs.

iii. The pattern of rent increases in the years prior to the base year and whether those increases reflected increases in the CPI.

iv. Base period rents were disproportionately low in comparison to the base period rents of comparable apartments in the City. *Historic Lows?*

v. Other ~~exceptional~~ *individual* circumstances.

Richmond can do better!

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Be kind, for everyone you meet carries a heavy burden.

ITEM F-2 ATTACHMENT 1

From: Ilona Clark [mailto:in70clark@gmail.com]

Sent: Friday, March 02, 2018 10:31 PM

To: Cynthia Shaw; Paige Roosa; David Gray; Emma Gerould; Lauren Maddock; Nancy coombs; Nicolas Traylor; Rent Program; Virginia Finlay; Bill Lindsay

Subject: Sole Source Contract is up to you

To the Richmond Rent Board,

This month's board meetings brought up a lot of questions and concerns. Since Nick has said the hiring (or not) of Ken Baar is up to you, I'm addressing this letter to the five of you.

The way in which Ken Baar was hired is by Sole Source contract. This is only allowed under very limited circumstances which do not apply to this case.

Sole source contracting without a legitimate reason violates trust in any public entity and sets a bad precedent. Creating and maintaining public trust is the only way the rent board will be effective. If renters and housing providers do not feel they will get a fair hearing, they will not utilize the valuable resources you offer.

The justifications for the awarding of this contract are inaccurate: He is not the only expert. And his ignorance about our ordinance puts the city at greater legal risk than further delay of the hearings.

Several things Baar said are simply untrue -

- Baar stated that mortgage costs are fixed - this may be true for SFH and buildings with 4 units or fewer, depending on the financing mechanism. However, commercial properties only get commercial loans, the interest rates for which are fixed for 3 to 7 years and then they rise or the housing provider has to refinance.
- Baar stated that partially indexed CPI is not significantly different from using 100% of CPI. (I'm not sure why this is coming up in the meetings at all since the ordinance already defines AGA's as 100% of CPI). Both Barton and St. John differ from Baar on this point - and so do I. After managing under Oakland's partially indexed CPI for 7 years, I can say 100% of CPI would have made a difference to me!
- Baar referred to the Capital Improvement amount as an estimate. They are actual costs with invoices to confirm the amounts. They are not estimates.
- Baar stated that any given apartment turns over in 10 years or less. While this may be true where the housing market is not distorted, Rent controlled apartments have a very low turnover, unless the housing provider is catering to a transient population, like students. Under rent control; area rents rise faster than CPI allows for controlled apartments. Vacancy de-control and the fact that the cost of housing rises faster than CPI make vacant apartments very expensive so housing providers can stay afloat. So people who are established in rent controlled housing often can't afford to move.
- His conclusion that using rent returns for the year 2015 rather than an objective measurement like HUDrate for a given year, creates uncertainty since housing providers will have different numbers, every unit will have different numbers and they do not necessarily reflect ANY return. It also creates the potential for many

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unnecessary petitions since there will be no objective metric to us to see if ones NOI is fair or not.

The presumption that in any given year all or most properties were making a fair return is invalid. Sometimes properties lose money when they are first purchased. Does this mean a negative return is a fair return because it didn't make money when purchased? Often there are problems with a bldg's condition or management that the owner can correct and generate a much higher return over time. An item purchased for \$100 in 2000 now costs \$500 in 2018. (<http://www.usinflationcalculator.com/>) So even if the rent went up by \$400 over this time, there is NO increase in return to the owner. The owner is getting nothing on her investment.

Using the section 8 standard listed for the base year provides a clear, universally applicable way to ensure housing providers not be prevented by having in place unusually low rents from achieving a fair return.

Furthermore, Baar called in to the meeting unprepared, he did not have the presentation in front of him, he did not have specific examples to illustrate his ideas, his proposals demonstrate his ignorance of our ordinance, on which he is supposed to be working. The cost of this contract doubled in the last week for a ceiling of \$15,000 to \$30,000 - would this happen with a bid?

In conclusion, Ken Baar should not be the sole voice advising the rent board and it's staff on these regulations, His sole source contract is suspect and his guidance is often more confusing than helpful.

You have all been thoughtful and receptive to many different ideas and have already embraced two that Baar did not promote - 100% CPI and smaller, permanent capital improvement raises. Please open the door to St. John and associates, the other expert in this field is available to you. His voice can clarify the economics of the proposals, identify and mitigate unintended consequences and think outside the box for the benefit of us all, renters and housing providers alike.

Ask him to provide us with a presentation like the one Barton did.

Contract with him for input on the regulations. He has already provided the rent board with high quality commentary pro bono.

Retain him in an advisory capacity to provide a balanced perspective going forward, as you have with Baar.

Allow him to bid for this contract as is legal and fair

Thank you for your consideration.

ilona clark and the AURHP

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ATTACHMENT 1**

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Richmond can do better!

Notice of Rent Increase

November 1, 2017

*What I will give my renters
with AGA increase each
year to help us keep track
of amortization schedule*

Dear ~~Ilona~~:

Effective January 1, 2018, the rent for the unit you now occupy will be increased by \$70 per month. This increase is CPI for 2016, 2017 and 2018, 1.7%, 2% and 2.3%, respectively. 6% of \$1175 is \$70.

For future rent increase calculations, the portion which makes up your utilities (\$125) will be combined with your base rent as discussed previously.

\$1300 rent + \$86 capital improvement (year 3 of 5) + \$105 Capital improvement (year 2 of 7) + \$70 (CPI x 3) = \$1561

Your new monthly payment will be \$1561 per month, due on the first day of each month.

Please let Ilona or Chris know if you have any questions.

All other terms of our rental agreement continue to remain in effect.

Thank you for choosing to live at
continue to live here for a long time.

I appreciate your tenancy and hope that you will

Sincerely,

Website forms Oakland Capital
 Improvements petition submitted once
 before rent raise (after project completion)

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ENHANCED NOTICE TO TENANTS FOR CAPITAL IMPROVEMENTS*

This enhanced notice must be served with a notice of rent increase and RAP Notice and filed with the Rent Adjustment Program within 10 days of service of these notices on the tenant.

Date: November

To Tenant(s): _____

Property Address: _____ Unit Number 0 Top Rear

Current Rent: \$ 1175 # of Units 1

Date of Rent Increase: January 1, 2017

Step 1: Enter the building-wide capital improvements (See instructions for examples)

Building-wide Capital Improvements CATEGORY (Attach separate sheet if needed)	TOTAL COSTS	DATE COMPLETED	DATE PAID FOR
SUBTOTAL:			

Step 2: Multiply Subtotal in Step 1 by 70% (Increase Limited to 70%)

$$\frac{\$ \text{Subtotal}}{\text{Subtotal}} \times 70\% = \text{Step 2}$$

Step 3: Divide results of Step 2 by the number of units affected

$$\frac{\$ \text{Step 2}}{\text{Step 2}} + \frac{\text{# of units}}{\text{# of units}} = \$ \text{Step 3}$$

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Step 4: Enter capital improvements for specific unit

Unit-Specific Capital Improvement CATEGORY (Attach separate sheet if needed)	TOTAL COSTS	DATE COMPLETED	DATE PAID FOR
Window replacement and covering	12634.85	June 3, 2016	June 13, 2016
SUBTOTAL:	12634.85		

Step 5: Multiply Subtotal in Step 4 by 70% (Increase Limited to 70%)

$$\frac{\$ 12634.85}{\text{Subtotal}} \times 70\% = \frac{8844.40}{\text{Step 5}}$$

Step 6: Add:

6a: TOTAL for building wide capital improvement for this unit (Step 3)

$$\underline{\$ 0}$$

6b: TOTAL for unit specific capital improvement (Step 5)

$$\underline{\$ 12634.85}$$

6c: Total allowable cost for unit (pre-amortization)

$$\underline{\$ 8844.40}$$

(6c)

Step 7: INSTRUCTIONS TO CALCULATE THE AMORTIZATION PERIOD

To calculate the amortization period (length of time for the pass-through), first calculate 10% of the current monthly rent.

Step 7a: (10% limit) Current Rent \$ 1175 x 10% = \$ 117.5

(7a)

Step 7b: (# of months) Divide the total allowable pass-through (6c) by 7a \$ $\frac{8844.40}{(6c)} + \frac{117.5}{(7a)} = \frac{75.27}{(7b)}$

Step 7c: (60 months?) If the number determined in 7b is less than or equal to 60, the amortization period is 60 months or 5 years.

Step 7d: (Length of time?) If the number determined in 7b is greater than 60, divide 7b by 12.

$$\frac{75.27}{(7b)} \div 12 = \frac{6.27}{(7d)}$$

Step 7e: (# of years) If 7d is not a whole number, round up to the next highest number. 7

(7e)

7e= the # of years you are allowed to pass through the rent increase.

Step 7f: (Allowable # of months) The allowable # of months is 7e x 12 84. The rent increase ends on the last month.

*required
submission to Rent
Board - website
owner*

Step 8: INSTRUCTIONS TO CALCULATE THE RENT INCREASE

Step 8a: If the number determined in 7b is less than or equal to 60, divide the total pass-through per unit (6c) by 60.

$$\frac{\$ \text{6c}}{60} = \$ \text{ALLOWABLE RENT INCREASE}$$

Step 8b: If the number determined in 7b is greater than 60, divide the total pass-through per unit (6c) by the number of allowable months (7f)

$$\frac{\$ 8844.40}{6c} \div \frac{84}{7f} = \$ 105.29 \text{ ALLOWABLE RENT INCREASE}$$

Step 9: PROVIDE NOTICE OF THE NEW RENT AND AMORTIZATION PERIOD

Rent Increase Amount: \$ 105

Rent Increase % 8.9 (cannot exceed 10%) (To determine the % divide the rent increase amount by the current rent, then multiply the remaining number by 100)

$$\frac{\$ 105}{\text{Rent increase}} \div \frac{\$ 1175}{\text{Current Rent}} \times 100 = \frac{8.9}{\% \text{ increase}}$$

New Rent: \$ 1491 (old rent plus rent increase)

Amortization Period 7 (In years, minimum of 5)

Date Rent Increase Begins: 1/1/2017 Date Rent Increase Ends: 12/31/2023

*An Owner may still file an *Owner Petition* for capital improvement increase instead of the enhanced notice requirements.

Use of this form is optional; an owner may provide his or her own form that meets the requirements of the RAP Ordinance and Regulations.

There is an excel spreadsheet available on the RAP website which will calculate the amortization period for you.

<http://www2.oaklandnet.com/Government/o/hcd/s/LandlordResources/index.htm>

By: _____
Owner's Signature

Print Name

Public Comment

When my Dad had a stroke in 2012, I took over management of his 5 units in Oakland. The house needed a paint job estimated at \$20,000 . and there was no money. He had been trying to refinance for 3 years but the recession had made credit tight. The next winter the building leaked in 3 different places. I finally did manage a refi and got the paint job done. But rent control in Oakland has made making ends met difficult. I **thought** my dad managed the place poorly – and that I could do a better job. I never imagined the laws could be designed to make us fail. Sine then I've learned that Dad had good reasons for doing things the way he did. And Oakland rent control laws have only become more strict and more punitive. The forces behind carelessly executed regulations really do not care if we persevere and the city now has a fund earmarked to buy up small properties that just happen to be “financially distressed” to create **unnaturally** occurring affordable housing.

But that is Oakland. This is Richmond. And we are living in truly interesting times. I believe rent control can be done in a way that balances the needs of both renters and housing providers. Even within the confines of Costa Hawkins and the ordinance, we have an opportunity to build the foundation of common-sense rent control. We get to learn from the mistakes of others and use those lessons to keep small housing providers and their renters in Richmond. There is a real possibility that Richmond could get rent control right.

However, in order to do this, you will need all the information you can get from many perspectives. Not just one with a few uninspired examples.

Ilona Clark, AURHP 2/28/18

~~E-3~~ G-1

As a member of the AURHP, I strongly question the rent boards contract with Ken Baar.

The grounds for this sole source contract are baseless.

1st, he is not the only expert. In fact, we have another right here in this room.

2nd, while petitions for increases may be piling up, as one housing provider who has submitted a petition, I'd rather you take some time to get more than one take on this immensely complex subject; than do a rush job and provide poor service as a result. As far as legal risk goes, the risk is greater if you pass regulations that carelessly contradict the ordinance. Or one that invites all of Richmond's Housing providers to file petitions with poorly thought out definitions and gives few, if any, formulas. Using vague words such as extraordinary and exceptional ensures that every petition goes before a hearing officer. This is incredibly expensive, inefficient and unnecessary.

~~We are going to see~~ you reviewed the memo from Michael ST John as the Ken Baar will not provide a balance for Richmond. He will happily cut and paste for \$290/hr and you will be unable to make any informed decisions because you will be ill-informed.

idea of permanent cap imp't is straight from him and he has never good idea for these regulations

Just because he's charging an arm and a leg does not mean he's doing a good job. For example Chapter 9, #11 B defines AGA as CPI Less its shelter component. The ordinance has already defined AGA as 100% of CPI. Is reading the ordinance on which Baar is working below his pay grade?

Baar recommends vague standards to be interpreted by a hearing officer. Where is the rent board? Where is the internet? Oh, never mind he took this from ordinances that were written back when we didn't have any of that.

Get some balance and do this right. Renters are not better off when their housing providers go out of business. Once we sell, we will not be buying back into this market, For small timers, there won't be a chance to come back with corrections to regulations that put us out of business.

Richmond can do much better

**ITEM F-2
ATTACHMENT 1**

-----Original Message-----

From: Stefan Brunnschweiler [mailto:stefanbrunnschweiler1@gmail.com]

Sent: Tuesday, February 27, 2018 4:40 PM

To: Nicolas Traylor

Cc: Paige Roosa

Subject: Request to hire Michael St. John

Hi Nicolas,

As a Richmond housing provider, I would like to strongly request that you and the Richmond Rent Board consider authorizing the rent department to hire Michael St. John in addition to Ken Baar. Michael St. John is a well-regarded and very experienced expert on fair return regulations who can augment Ken Baar's legal considerations with an economist's understanding of the very critical financial consequences.

Thank you.

Stefan Brunnschweiler

Sent from my iPhone

ITEM F-2 ATTACHMENT 1

-----Original Message-----

From: Sherry Zalabak [mailto:sherZ@comcast.net]

Sent: Tuesday, February 27, 2018 4:00 PM

To: Nicolas Traylor; ncombs@richmondrent.org; dgray@richmondrent.org; egerould@richmondrent.org; Imaddock@richmondrent.org; vfinlay@richmondrent.org; Cynthia Shaw

Cc: Paige Roosa

Subject: ATTN: BOARD MEMBERS

Dear Members of the Rent Board,

My name is Sherry Zalabak and I am a member of the Association of United Richmond Housing Providers (AURHP).

I was raised in Richmond and my grandmother and mother were early Richmond Housing Providers.

I am a small property owner of a triplex on Richmond. I have been attending the meetings held by the Rent Control Program and the Rent Board. During these meetings I have struggled with many of the various proposals designed to deliver a fair return to housing providers yet ensuring affordable housing to tenants. I have come to realize that small Richmond landlords already provide AFFORDABLE HOUSING for tenants. We are the victims of others who have raised rents to abusive and exorbitant levels.

It appears to me that the Rent Ordinance and with its multifaceted regulations that has ambushed small-time housing providers... really has little to do with us. The topic for me and other small-timers can be summed up in two words "BASE RENT".

This became crystal clear after reading today's memo submitted to the Rent Program by Dr. St. John. His suggestion that "Base Rent" be related to some verifiable economic standard is brilliant. His recommendation that the standard used in Section 8 of Federal Housing Regulations, in my view, speaks to the primary concern of the AURHP. This reasonable and fair starting point and the consequent buy-in by all parties is essential to the worthy goal of Affordable Housing. I cannot think of a more appropriate adage than; DO NO HARM. Dr. St. John's recommendations embody this adage. Why do harm if it is not necessary. Also, why cost the City of Richmond time and money adjudicating petition after petition?

I urge the Rent Program to retain Dr. St. John to assist us in our mutual goals for Affordable Housing and Fair Return.

Sherry Zalabak

ITEM F-2 ATTACHMENT 1

From: Ilona Clark [mailto:in70clark@gmail.com]

Sent: Monday, February 26, 2018 6:39 PM

To: Cynthia Shaw; Paige Roosa; David Gray; Emma Gerould; Lauren Maddock; Nancy coombs; Nicolas Traylor; Rent Program; Virginia Finlay; Ben Choi; Bill Lindsay; Eduardo Martinez; Gayle McLaughlin; Jael Myrick; Jovanka Beckles; Melvin Willis; Tom Butt - external

Subject: Ken Baar's contract is illegal and illadvised

To the Richmond Rent Board and Staff,

We are extremely concerned about the appointment of Ken Baar as consultant on regulation regarding rent raises above AGA for MNOI, Capital Improvements, Historic Low Rents all of which should be designed to ensure a Fair Return to housing providers in Richmond.

We say Fair Return but really what is at stake is keeping small housing providers in Richmond. Keeping us in business and, in some cases, keeping us housed. The regulations you are considering will affect this community profoundly for many decades to come and should not be taken lightly.

The first concern we have is the manner in which Mr Baar was appointed. As you know this is a sole source contract. there was no bidding process which, according to law, is required for any contract worth \$3000 or more.

There are two stated reasons for bypassing this process -

1) "Ken Baar is the only contractor who will be able to prepare such regulations in a legally defensible manner."

This is not true, there are other experts in this field who are at least as competent to prepare these regulations. We know of some of them and so does Mr Traylor.

2) "there is currently a backlog of over 40 landlord Fair Return petitions and there are no Fair Return regulation yet in place. Those petitions cannot yet be adjudicated placing the city a substantial legal risk"

While this may be true, as one of the housing providers that have submitted a petition, I do not want a rushed, careless job done in order to get quick service. I want a fair equitable, streamlined process that I will be willing to do again because there will be future petitions as I do more projects on my property. Legal risk will actually be increased by hiring a person in this rushed manner.

This leads us to our second concern.

"Dr. Baar prepared and presented memoranda and proposed regulations to the Rent Board concerning fair return regulations," many of which are in tonight's packet. It is obvious that Baar cuts and pastes from ordinances that pre-date websites and he sites cases from regulations for trailer parks in cities without rent boards.

Ken Baar's legal approach is to set up a "standard" and then throw the entire thing to a hearing officer is inefficient. It will lead to an endless number of hearings, most of which will not be necessary, all of which will be expensive. It also bypasses the resources we have in our rent board staff and our technology. We strongly suggest a streamlined approach that allows information to be entered and downloaded to the website and software that will red-flag as necessary and send out notices as appropriate.

The work that Baar has already done on behalf of the board is shoddy. For example, in ch 9 11 B (p 126 of the packet) he has added "less shelter component" to the definition of CPI to define AGA rent increases. This language is not in the ordinance and is illegal. If chapter 9 is passed as written, the legal risk will be significantly greater than that of the risk of a little delay.

Since this agenda item was pulled last week, Baar's price has gone from a maximum of \$15,000 to \$30,000. The rules for sole source contracts state that "Such a request should not be made unless you

ITEM F-2 ATTACHMENT 1

are confident that your request is reasonable and appropriately justified to meet the City's requirements and withstand any possible audit."

At \$290/hr I can cut and paste too. The only thing that makes and fiscal sense is that he will not be paid for travel time. We are thankful for this since he lives in Australia.

Baar's approach is a legal one (no wonder he leans on hearing officers). An economic perspective would make much more sense. A perspective that will balance his out-dated policies and regulations that reflect the wisdom this community can gain from the errors others have made will save a lot of expense and disruption. Berkeley and other jurisdictions which passed strict rent control laws with Baar's help, drove small, minority and elderly housing providers out, at least they were the first to go. What do you imagine happened to their renters, for whom the regulation were written in the first place?

We strongly urge you to reject the extension of this sole source contract with Dr Baar. as proposed, because of the legal risk it creates on many levels. Mitigate this risk by bringing in a broader, more balanced perspective that will allow housing providers to stay in business in the long term.

Please oppose increased funding for Baar's sole-source contract tonight. There are better, more balanced ways to regulate housing in Richmond.

Ilona and the AURHP

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Be kind, for everyone you meet carries a heavy burden.

ST. JOHN & ASSOCIATES

P.O. Box 338, Mendocino, CA 95460
707-937-3711 • msjetal@pacbell.net • Fax 510.845.1813
www.stjohnandassociates.net

Date: February 26, 2018

Memo To: Richmond Rent Program Director Nicolas Traylor

From: Michael St. John, Ph.D.

Re: Fair Return Regulations

Introduction: Following our phone conversation on February 23, understanding the tight timeline for passage of the fair return regulations so that the petition backlog can be addressed, I have prepared the following notes that I hope will be helpful to staff and the Board. I also stand prepared to assist the Board as deliberations continue on the fair return and other regulations.

My qualifications for this assignment include the following: I am trained (MA, Ph.D.) as a regulatory economist. I have focused my attention for most of my career on rent regulation, and in particular on the theory and practice of fair return. I was a member of Berkeley's Rent Stabilization Board from 1981 to 1983, serving at that time as chair of the individual rent adjustment committee. I am familiar with regulations of rent control programs throughout California, having advised property owners and cities and counties on fair return issues many times over the years. My paper titled "Fair Return and the California Courts", available on the St. John & Associates website, is the most comprehensive statement of the theory and practice of fair return in the rent control context that I know of.¹ I have testified on fair return issues in many rent control hearings and in several cases at law involving fair return on investment. My bio-data is attached hereto.

In preparation for this memorandum, I have reviewed the Ordinance, the staff report and other materials available on the RRP website, Kenneth Baar's memo to the Richmond Rent Board dated 12/20/17, and the draft regulations.

Fair Return Regulation: I agree with Ken Baar that the Richmond Rent Board should adopt the Maintenance of Net Operating Income (MNOI) system as its fair return method. The MNOI system is not the only workable fair return system, but it is the easiest to implement, best understood, most balanced system in use today. That said, I also believe that it is wise for the Board to allow property owners to use a different fair return system if they wish to do so. The burden would be on the property owner show why the MNOI system doesn't in a particular case allow a fair return – a high bar – but this opportunity should not be denied. Without stating explicitly that a property owner may use an alternative fair return system if necessary, Subsection A.12 implies this and is probably adequate to the purpose as drafted.

¹ St. John & Associates, 1993, "Fair Return and the California Courts"

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Partial Indexing: Subsection A.2. says that property owners have the right to maintain the base year net operating income adjusted by “___% of” the percentage increase in the CPI. This is a mistake – a throw-back to the 1980s and 1990s when rent boards – often on Ken Baar’s advice – permitted a percentage of the actual CPI, not the whole CPI. To this day, Ken Baar routinely claims that “partial indexing” is legally and intellectually permissible. At page 12 of his report to the Richmond Rent Board, Dr. Baar appears to say that partial indexing is valid, although he (wisely) doesn’t actually recommend a percentage lower than 100%. It is true that some court decisions have appeared to condone partial indexing, but this does not make it intellectually sustainable. Partial indexing is a politically-motivated “fudge factor” for which there is no meaningful explanation in economics or real estate finance. There is more on this topic in the Fair Return report referenced above. The key sentence in A.2 should say that *“A Property Owner has the right to obtain a net operating income equal to the base year net operating income adjusted by the percentage increase in the Consumer Price Index (CPI) since the base year.”*

Base Year Adjustments: Subsection A.5. is key to the workability of the MNOI system. If base year adjustments are not allowed, inequities will be frozen into the fair return protocol. It is critical that meaningful base year adjustments be allowed. Subsection A.5.a. seems OK as drafted. That section provides for base year expense adjustments when appropriate.

I recommend that the word “exceptional” in Subsection A.5.b. be replaced with the word “individual”, or that the section be otherwise revised to remove the implication that base year adjustments will be required in only a handful of cases citywide. Subsection A.5.b.iii, for example may well be true for many property owners. It is common, absent rent control, for property owners to leave the rents unchanged for sitting tenants, often for many years, intending to increase rents in the future, on vacancy. If rent control intervenes, freezing rents for sitting tenants, a property owner may well not be receiving a fair return in the base year.

Or, to take another example, Subsection A.5.b.iv says that base rents may be increased in the fair return context when the rents are disproportionately low in comparison with base year rents for comparable properties. This may be true for many property owners for a variety of reasons. The reasons don’t matter. The fact that rents are far below market does matter. There may be nothing unusual about this. Subsection A.5.b. should therefore not limit itself to “exceptional circumstances”.

This issue might be addressed by establishing that any rents below the Section 8 standard can be listed, for fair return purposes, at the Section 8 standard for the base year in the fair return computations. This would provide a clear, universally applicable way to ensure that particular property owners not be prevented by having in place unusually low rents from achieving a fair return.

Amortizations: The draft regulations provide at A.6.b.vii, viii, ix, x, and A.6.d for amortization of large (“substantial”) expenses that are not expected to recur annually. This makes good sense. Large expenses can otherwise distort the fair return analysis. How exactly to implement this principle should be considered carefully. The draft regulation articulates a complex system by which capital improvements and other non-recurring expenses are amortized over a variety of

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time periods using a variety of interest rates, with rents increasing for the amortization period, then reverting to the pre-increase rent level. This is one way to do it, but it is not the best way, in my view.

I favor what I call “permanent amortization”, which means that a lower rent increase will be allowed but will remain in place permanently. The on-again/off-again system is cumbersome. Rents increase for varying periods by varying amounts, then decrease again. The annual adjustment is imposed on the underlying base rent, not on the amortized amounts. The bookkeeping to handle this is complex and subject to error. The amortization calculations typically involve computer-assisted calculations of the figure that will fully amortize the capital amount over a relevant time period, interest included.

The permanent amortization system, in contrast, simply awards the interest as a rent increase. The interest is paid forever. The original amount is never re-paid. Tenants like permanent amortization because the rent increase is smaller. Property owners like permanent amortization because the calculations are simpler. Rent board staffs like the permanent amortization method because it is far easier to track lawful rent ceilings with permanent amortization of amortizable amounts.

The Berkeley Rent Stabilization Board used the on-again/off-again system for many years, then converted in the late 1990s to the permanent amortization system. This has worked smoothly in Berkeley ever since.

If the permanent amortization system is adopted, the table on page 6 is unnecessary. An interest rate would be chosen and applied universally. Berkeley’s Regulation 1267 has three categories: Capital Improvements leading to a rent ceiling increase of 1.042%, Painting and Siding Repairs leading to a rent ceiling increase of 1.187%, and Other Long-Term Repairs leading to a rent ceiling increase of 0.927%. In Richmond, because interest rates are lower now than they were in the 1990s when the Berkeley rates were set, I suggest lower rates. I also suggest that the categories chosen should include the legal expenses covered in Section A.6.b.vii. As implied by the chart on page 6, an interest rate similar to 7% (0.583% per month) seems right in this time period. The board might want to tie the rate to an index of interest rates such as the index mentioned in Section A.6.b.ix.

Using 7% and 15 years, one can see from the bottom portion of the chart on page 6 that the on-again/off-again system would lead for an expense of \$50,000 to a rent increase of \$44.94 per month that would be in place for 15 years, then expire. The permanent amortization system would lead to a permanent rent increase of \$29.17 that would never expire. As above, I believe that the lower figure produced by the permanent amortization process will be favored by tenants, owners, and rent board staffs.

Conditional Rent Adjustments for Proposed Capital Improvements: Section A.8 says that property owners can apply ahead to time for proposed improvements. This makes good sense. I suggest, however that A.8.c be amended to say that the work must be completed within 24 months, not 12 months. Given the time to get permits approved and other delays common in the completion of construction projects, 12 months is in my view unnecessarily tight.

Relationship of Individual Rent Adjustments to Annual General Adjustments: Section A.10 raises a question as to the meaning of the first paragraph. If this paragraph is interpreted to mean that annual adjustments, if not yet fully implemented at the time that the petition is filed, will be included in the calculations such that there is no double- or under-counting, good. This section should not, however, be interpreted to mean that future annual adjustments are to be added to the comparison year income in making the fair return determination - a mistake (later corrected after a lawsuit challenged the Board's interpretation) made in the early years of Berkeley's rent control program.

Capital Improvement Limitation: The second paragraph on page 5 excludes from consideration costs incurred where the initial installation was not to code. This limitation is not a good idea, in my view. What difference does it make if a prior owner many years in the past did work without permits or not to code? We should be encouraging responsible property owners to bring property conditions to code in all circumstances and a key to such encouragement is to allow reimbursement of capital improvement expenses.

Rent Increase Limit: Section A.6.b.11 intends to limit the impact on tenants by limiting the amount of the increase in any one year. This makes good sense. It supports the affordability purpose of the Ordinance. But it threatens the fair return purpose. If the fair return calculations result in a greater than 15% increase overall, the 15% limit will necessarily deny property owners a fair return. The final paragraph in B on page 10 appears to be an attempt to solve this problem, but is unclear. The mechanism by which property owners will be made whole when the 15% limitation is applied needs to be clarified.

Drafting Comments Not Mentioned Above:

- The reference to Subparagraph (B) in the first paragraph on page 3 is unclear. I think that note refers to the paragraph immediately following.
- Section A.6.c.iii is useless, it seems to me. This is probably a hold-over from a mobile home park regulation. Land for mobile home parks is often leased. Land for apartment buildings is almost never leased.
- The paragraph numbering on page 10 should be a. and b., not A. and B.
- The sentence in B. on page 10 reading "On January 1st of each year beginning in 2018, the \$___ and/or ___% limitation shall be adjusted ..." should be changed. The "and/or ___%" part makes no sense. A percentage can't be increased by the CPI.
- That same sentence goes on to say "... *adjusted upward by 100% of the percentage increase in the Consumer Price Index, All Urban Consumers, for the San Francisco-Oakland-San Jose metropolitan area, less its shelter component, for the twelve month period ...*" I believe that the shelter component restriction is a mistake, probably a hold-over from an ordinance or regulations applying to some other jurisdiction. To my knowledge the shelter component restriction isn't included elsewhere in the ordinance or draft regulations and shouldn't be included here.

Overview: Having worked with rent regulations in many jurisdictions over the past 30-something years, I have seen a tendency for rent laws and rent regulations to be written overly restrictively, leading to expensive implementation, legal challenges, and financial hardship on

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property owners. On the other hand, some jurisdictions have adopted rent increase limits so flexible that the basic tenant protection objective is not well served, leading to financial hardship for tenants. Some observers think this is inevitable – that owners and tenants will never be able to agree on regulations that make sense and are balanced. I disagree. I believe that balance can be achieved. It is my sense that the Richmond Rent Program is on a path to balance.

Balance would mean that the Ordinance would be implemented such that its dual objectives – controlling excessive rent increases and ensuring a fair return - would be met simultaneously. How to achieve this is not on its face obvious, but I believe that it can be achieved. The fair return regulations are, of course, key to this effort. It is in the service of balance that I have made the above recommendations. Among the recommendations I have made, those having to do with partial indexing and base rent adjustments are critical to achieving balance in the fair return process. If these recommendations are followed, I believe that excessive rent increases will be prevented and that property owners will be able to achieve a fair return, just as the Ordinance intends.



2/26/18

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EDUCATION:

- Ph.D. University of California at Berkeley, 1989, Department of Economics. Dissertation: "The Effect of Rent Control on Property Value: A Test of the Capitalization Hypothesis".
- MA University of California at Berkeley, 1984, Department of Economics. (Economics of Development, Regulatory Economics, and Industrial Organization)
- BA, Harvard College, 1962, cum laude in Government and Sociology.

OTHER TRAINING:

- Mediation Training, Redwood Empire Conflict Resolution Services, 2014
- Mediate Your Life mediation certificate program, 2011-2013
- Nonviolent Communication training, various teachers, 2008-2014

PROFESSIONAL EXPERIENCE:

- Principal Consultant, St. John & Associates, Property Management Consultants, 1985-present
- Nonviolent Communication trainer / mediator, 2010 to present
- Lecturer in Political Economy, Mendocino College, 2014 to present
- Lecturer in Economics, California State University at Hayward, 1995-96.
- Lecturer in Economics, San Francisco State University, 1983-84.
- Developer, Sierra West Construction, 1979-81.
- General Contractor, St. John & Sons Builders, 1971-1979.
- Chief, East Africa Loan Division, Office of Capital Development, US Agency for International Development, 1966-68.
- Financial Analyst, Agency for International Development, Washington, D.C., 1963-65.
- Fulbright Award, Teacher of English at Lucknow University, Lucknow, India, 1962-63.

PUBLIC SERVICE:

- Volunteer mediator, RECOURSE mediation services, 2014 - present
- Member, Facilities Committee, Mendocino Art Center, 2010 - 2014
- Commissioner, Housing Advisory Commission, Berkeley, 2005 – 2006.
- Boardmember and Chair, Mendocino Historical Review Board, 2004 – 2010.
- Boardmember, Strawberry Creek Lodge Elder Housing, 1994 - 1997.
- Boardmember, Berkeley Property Owners Association, 1990-96.
- Commissioner, Rent Stabilization Board, City of Berkeley, 1981-83.
- Member, Code Review Task Force, City of Berkeley, 1978-81.

SELECTED WRITINGS:

"Fair Return and the California Courts". Review and analysis of California case law relating to fair return in a rent control context. St. John & Associates, 1999.

"Inflation and Rent Control". Paper describing the effects of inflation on rents and property income in rent controlled jurisdictions, with particular reference to mobilehome parks, 1994.

"The Distributional Impact of Restrictive Rent Control Programs in Berkeley and Santa Monica, California." Paper presented at the Western Economic Association Conference, June, 1993.

"Rent Control in Perspective: Impacts on Citizens and Housing in Berkeley and Santa Monica after Twelve Years", (with Albert Sukoff). St. John & Associates, 1993.

"A Test of the Capitalization Hypothesis". Paper presented at the Western Economic Association conference, July, 1991.

"The Effects of Rent Controls on Property Value: A Test of the Capitalization Hypothesis". Doctoral dissertation, UC Berkeley Department of Economics, 1989.

"Indexing of Net Operating Income". St. John & Associates, 1989. (Paper submitted with amicus brief in Searle vs. City of Berkeley).

SELECTED EXPERT WITNESS DECLARATIONS, REPORTS, AND APPEARANCES:

El Camino 76 MHP, Oceanside (2013-14)
Summerset MHP, San Jose (2013)
Oakcrest MHP, San Jose (2012, 2014)
El Crystal MHP, Sonoma County (2011)
City of Marina (2008, 2009)
Indian Springs MHP, Palm Desert (2007, 2008)
Meadows MHP, Watsonville (2007)
City of Lancaster (2006, 2008, 2011, 2014)
Tower Management v. City of Oceanside (2001)
Casa de Amigos, City of Escondido (2001)
Hillsboro Properties v. City of Novato Rent Review Board (2000)
Hacienda Valley Mobile Estates v. City of Morgan Hill (2000)
Cashman v. Cotati (1995)
Scotts Valley Rent Review Board (1997)
Oceanside Rent Review Board (1997)
Carson City Council (1997)
Salinas City Council (1997)
Valparaiso v. City of Cotati (1997)
Santa Monica Beach v. City of Santa Monica (1996)
Craig v. Santa Monica Rent Control Board (1996)
Berger Foundation v. City of Escondido (1995)
Save Affordable Housing v. Rent Stabilization Board (1992, 1993)
Searle v. City of Berkeley (1989, 1990)

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From: Michael Vasilas [<mailto:mvasilas@yahoo.com>]
Sent: Friday, March 16, 2018 3:32 PM
To: David Gray; Virginia Finlay; Emma Gerould; Lauren Maddock; Nancy Coombs
Cc: Nicolas Traylor; Paige Roosa
Subject: A "constitutional minimum"

To the City of Richmond Rent Board,

The author of Richmond's rent control regulations, Ken Baar, has cited that “the concept of 'fair return' is a legal term that refers to a 'constitutional minimum’”. Ken Baar is a lawyer, an expert in the field of “fair return” case law, with a career arguably guided by the idea that “fair return” is and should be defined as the absolute minimum return an owner is allowed to receive, that can be defensible by law.

As our members sit in attendance at the recent rent board meetings, it's hard not to feel as if Ken Baar views the board chambers as his courtroom, the board members as the judge/jury, and his case being to prove to the Board that they need to adopt regulations that hold housing providers to this absolute minimum. However, unlike an actual court room, there is no defense attorney, there is no expert witness to be called upon, or breadth of data to be presented. The board is essentially limited to the regulations put before them, the presentation by their author, and 2 minutes of public comment by community members.

Our group knows that the city is very lucky to currently have such a thoughtful, conscientious, and qualified rent board, along with an extremely hard working, qualified, and responsive rent program staff. The rent board continuously shows desire to hear the community members' input, and the rent program has spent countless hours meeting with both tenants and landlords to obtain input and perspective from both sides. However, if this balanced input does not exist in the realm of the writing of the regulations, we are forced to be reactive rather than proactive in achieving a much needed level of balance in these regulations. This is the reasoning behind our group's suggestion that the city hire economist Michael St John as another expert. Having as much expert analysis from both legal and economic perspectives can only help in the creation of a balanced system. We understand that the rent board carries an enormous burden, as these regulations will dictate the future of small local rental ownership in this city, and quite possibly the direction of the city as a whole. We hope the board considers using it's authority to be provided with as much expert analysis to aid in their decision making.

While the board may feel confined by the wording of the ordinance, we hope the board understands that Baar's guidance towards a "legally defensible" minimum rate of return is not an obligation.

“The Board's obligation in setting reasonable rents and ensuring a

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fair return on investment is to balance the interests of the entire community”

There is no explicit definition of fair return, and it is under the authority of the rent board to choose any “fairly constructed formula”. MNOI has been chosen as the mechanism to provide owners with a fair return, and we hope the board chooses to follow the economic guidance of MNOI, as it is the following of the economic conditions of the model that will dictate it's effectiveness.

We are glad the rent program has suggested to follow the economic guidance of 100% indexing. As we further discuss “fair return” and MNOI, we hope the board addresses the fact that Base year rent adjustments are of pinnacle importance to the effectiveness of the MNOI model of fair return. We hope the board understands that the timing of the rollback has frozen many housing providers at Great Recession base rent levels, a recession that arguably affected Richmond a great deal more than other Bay Area cities. We hope this topic is deeply discussed at upcoming meetings, as creating a fair base year adjustment mechanism will be the “make or break” aspect of this ordinance for so many of our community members.

Thank all of you for all your hard work,

Mike Vasilas
AURHP