“BANKING” ANNUAL GENERAL ADJUSTMENT RENT INCREASES
Policy Considerations

AUGUST 19, 2017

ITEM H-2

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"Banking" defined:

- A Landlord is able to raise the Rent up to the Maximum Allowable Rent level after deferring previous Annual General Adjustment (AGA), or "cost-of-living," rent increases.
- Landlords maintain the ability to apply previously unused AGA increases, if banking policy is permitted.

How banking works: *(an example)*

- Mary moves into her unit in 2015, base rent is $1,000. Between 2015-2020 the landlord waives cost-of-living AGA rent increases, maintaining Mary's rent at $1,000.
- Cost-of-living increases from 2015-2020 equaled approximately 3% per year or 15% over 5 years (<u>without compounding</u>). In 2020, the landlord gives Mary a 15% rent increase (with 60 days' notice) and her monthly rent increases from $1,000 up to $1,150.

Compounding AGA's vs. Simple Interest AGA's

- Richmond's 2016-17 AGA's are compounded.
- Compounding AGA increases can confuse and complicate calculating increases.
- If a banking scheme is permitted, future AGA increases should use a simple interest formula, saving staff costs and preventing confusion.

Example of Compounding vs. Simple Interest Banking

- The 2016 AGA increase was 3%.
  The 2017 AGA increase was 3.4%.
  A 6.56% combined compounded increase results when banking. *This calculation is confusing and challenging for most people.*
- Banking with simple interest:
  3% + 3.4% AGA increases = 6.4%
- Simple interest compounding should be established for simplicity if banking is implemented.

PART 1: Policy Considerations Against Banking AGA Rent Increases

Richmond Landlords receive a higher cost-of-living increase than those in surrounding rent controlled cities.

- Since Richmond's AGA rent increases are based upon 100% of the change in the CPI, rents among Richmond's rent-controlled units are expected to increase at a faster rate than in surrounding jurisdictions.
- Hence, if a landlord loses an AGA increase one year, they should be able to keep rents commensurate with inflation as long as they don't defer too many years.

Banking: 100% CPI vs. 65% CPI

Banking with AGAs based on 100% of Consumer Price Index (Richmond)		
Year	**Rent Amount**	**AGA**
2013*	$1,000 (base rent)	NA
2014*	$1,023	2.3%
2015*	$1,051	2.7%
2016	$1,082	3%
2017	$1,119	3.4%
5 yrs	**+ $119**	**+11.4%**

Banking with AGAs based on 65% of Consumer Price Index (Berkeley)		
Year	**Rent Amount**	**AGA**
2013	$1,000 (base rent)	NA
2014	$1,017	1.7%
2015	$1,034	2.0%
2016	$1,050	1.5%
2017	$1,069	1.8%
5 yrs	**+$69**	**+7%**

Most landlords will benefit from vacancy decontrol and will receive a fair return even without taking AGA rent increases

- Landlords can raise rents without limit at tenancy onset. Every time a landlord has the opportunity to reset the rent, they can make up for lost AGA increases.

Some landlords don’t need to take AGA rent increases

A landlord may make a business decision to waive an AGA rent increase, knowing they already are getting a Fair Return.

Prohibiting banking makes rent increases much more predictable for tenants and landlords

- Without banking, a tenant could predict rent increases: never being raised above that year's AGA (currently roughly 3%). This type of predictability provides housing and economic stability for tenants.

Even if banking is prohibited, landlords have legal recourse to recover “lost” AGA increases.

- Landlords can recover “lost” AGA rent increases through the Rent Program’s petition process.
- Landlords must provide the Rent Board with documentation that banking kept the Maximum Allowable Rent Level below a Fair Return threshold.

Unrestricted banking potentially creates lump-sum rent hikes and long-term tenant housing instability *(an example)*

- A landlord doesn't raise rent for 10 years, meanwhile AGA increases 3% annually.
- Unrestricted banking, if implemented, allows a landlord to implement a 30% rent increase at once.
- A tenant paying $2,000 from 2015 to 2025, sustains a $600 per month, immediate rent increase.
- This unexpected and sizable rent increase could jump outside a fixed-income budget and lead to forced tenant moves.
- A tenant with fixed and/or low income is especially susceptible (i.e. A senior receiving social security benefits).

PART 2: Policy Arguments In Favor of Banking AGA Rent Increases

The Annual General Adjustment:
A primary measure of fairness in the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance

- The Annual General Adjustment is a primary mechanism for providing a Fair Rate of Return, per the Ordinance.
- California Supreme Court ruled, “landlords have a constitutional right to a “fair return” in rent control schemes” (*California Rent Control as Applied: Assessed Value as a Measure of Fair Return, 1987*).
- Restriction of a landlord’s ability to generate a Fair Return is contrary to the purpose of the ordinance.

Prohibiting banking increases Rent Program costs

- Rent ceilings must be calculated manually if banking is not permitted.
- Increased petitions to determine correct Maximum Allowable Rent can be expected due to this complicated calculation.
- Increased petitions filed detracts staff resources, results in higher staff costs, and reduces other vital services, such as compliance efforts, outreach, and education.

Recovery of lost AGA increases through petition process places undue burden on landlords

- Banking prohibition increases landlord petitions filed to recover deferred AGA increases.
- Unnecessary bureaucratic burdens are imposed upon landlords attempting to achieve a Fair Return.

Prohibiting banking *will force* landlords to apply the AGA rent increase each year, so they don't lose the ability to recover those AGA increases in future years

- Landlords will adopt a practice of raising rent each year as a matter of good business practice.
- Tenants struggling financially may be less likely to receive reprieve from Landlords if annual rent raising becomes the norm.

A rent registration system becomes infeasible if banking is prohibited

- Rent registration significantly enhances compliance.
- Prohibiting banking challenges the ability to track rents.
- Cost increases ensue due to increased staff reallocation to meticulous calculations, and their interpretation during counselling.

Long-term tenants benefit financially

- A tenant, whose base rent is $1,500 and doesn't receive an AGA increase for 5 years, will have saved around $2,700.
  Saving approx. $45 per month for 60 months.

Calculation: $1,500 x 3% = $45
$45 x 60 (months) = $2,700

- These saving disappear without banking due to landlords adopting a practice of increasing rents annually.

Case Study: Banking in East Palo Alto

Prohibited banking: East Palo Alto's Rent Program experience

- The Richmond Rent Board directed staff to conduct additional research on the banking policy and practical implications.
- The following case study is based on information provided by the City of East Palo Alto's Rent Stabilization Program.
- Until recently, East Palo Alto's Rent Stabilization Program prohibited banking.

East Palo Alto prohibited banking: Why?

- East Palo Alto's banking prohibition ensued after a major housing provider kept rents unraised for many years, eventually raising rents in lump sum.
- Rent increased 40% for thousands of tenants.
- Goal of banking prohibition:
  Tenant Protection from destabilizing massive lump sum increases.

Program administration difficulties from banking:

- Manual calculation of the Maximum Allowable Rent Level consumed staff time
- Development of an East Palo Alto rent registration system became infeasible due to banking prohibition.

Banking Prohibition: Calculating rent ceilings became more difficult. – How?

- East Palo Alto Housing Counselors manually calculated Maximum Allowable Rent, requiring them to research essential facts:

1) The base rent in question
2) The year the tenant moved in
3) Years AGA increases were taken and or deferred
4) Was landlord authorized to AGA increase(s)?
   Rent Program records were cross-checked for the landlord's rent increase notice(s).

Note: Similar to Richmond's Rent Ordinance, the East Palo Alto Rent Ordinance requires landlords to submit a copy of rent increase notices

East Palo Alto's Executive Director recommends banking

- Due to difficulties created by the prohibition on banking, East Palo Alto Rent Board amended rules to allow banking.
- New rule: landlords are required to take no more than 10% of accrued AGA increases per year.
- The Executive Director of the East Palo Alto Rent Program strongly recommends banking because it's prohibition made administration of the Program much more difficult.

Banking prohibition: A negative impact on EPA program administration

- More difficult for staff to determine a tenant's Maximum Allowable Rent Level (MAR)
- More disputes and petitions over the MAR
- Strained staff resources
- Diverted resources away from other Program services

Banking prohibition and documented Landlord trends:
- Incentive to use every AGA increase
- Discourages landlords from deferring rent increases

- Upon instituting a no banking policy, the EPA Rent Program saw a substantial increase in the number of rent increase forms that were submitted.
- According to the EPA Executive Director, the significant increase in rent increase notices filed with the Board was the result of landlord's not wanting to lose AGA increases.

Case Study: Banking in Los Angeles

2009 Los Angeles study addressed the banking issue:

- A 2009 economic report commissioned by the City of Los Angeles, recommended banking.
- Despite the recommendation, the Los Angeles Rent Board voted to prohibit banking.
- The Executive Director of the Los Angeles Rent Stabilization Program, Anna Ortega:

[although the Los Angeles Rent Board ended up voting to prohibit banking, the report laid out several key reasons for allowing banking]

LA study recommended banking: Why?

- More frequent rent increases for Los Angeles Rent controlled tenants
- Use-it-or-lose-it rent increase policy pressures Landlords to avoid loss to raise rents by raising rent annually.
- Banking is a common practice in rent control jurisdictions: Seven other rent control jurisdictions in California allow owners to bank AGA rent increases
- To improve compliance, Los Angeles had plans to institute rent registration.
- Without banking allowed a robust rent registration system (with new tenancy rent tracking) was not feasible.

Los Angeles Rent Board ultimately prohibits banking: Why?

- LA decides to prohibit banking.

(Despite recommendation to allow banking, 2009 Study)

- Based upon reasoning that:
  - *rent increases are likely to be banked during years with economic downturns, and if a number of years of deferred rent increases are applied when the housing market heats up, [this] undercuts the major benefit provided by rent control, which is to protect against rapid rent increases.*

Banking prohibition: Robust rent registration system derailed

- Robust rent registration system derailed (one that tracks each tenancy and each tenancy's rent level).
- Instead, LA Rent Program forced to create a "rent registry", only tracking unit rent levels.
  - not tracking new tenancies and their associated rent ceilings over time.

Part 3: Policy Recommendation

OPTIONS	Policy Pros	Policy Cons
Option 1: Do not allow banking for future AGA increases. Utilize a “use it or lose it” approach to AGA rent increases. *Examples: Los Angeles, West Hollywood*	**Preserves housing stability** by preventing significant increases imposed at once **Rent increases are predicable** Landlords may already be receiving a Fair Return without AGA increases due to vacancy rent increases	**- Difficult Program** administration leading to higher Program costs - Rent registration and tracking system made infeasible - Landlords burdened without regular vacancy rent increases **- to keep up with inflation landlord files rent adjustment petition** **- Landlords take each year’s AGA** rent increase, so not to lose them.
Option 2: Allow banking for all past and future AGA increases, with restrictions on the magnitude and frequency of rent increases. *Examples: East Palo Alto, Oakland*	**Supports both strong housing stability for tenants and an way for landlords to receive a Fair Return.** **Allows for adoption of rent registration**	**- Adds complexity to calculating rents**: - increased complexity **leads to increased Program costs.** - Restrictions on banking may have same effect as out right prohibition: **landlords <u>may</u> take each years increase, so not to lose them.**
Option 3: Allow banking of all AGA rent increases, without restriction. *Examples: Berkeley, Santa Monica* *NOTE: Berkeley and Santa Monica calculate AGA increases as a fraction of CPI*	**Provides for most cost savings** to Program due to simplicity of calculating the MAR **Allows for the establishment of a robust rent registration/rent tracking system** **Keeps ongoing Program costs down in the long-run** Saves tenants money	- Long-term **tenants could face a significant increase at once**, which is contrary to the primary benefit of rent control laws: housing stability

Policy Recommendation

- Banking with restrictions. Why?
  - The Board may want to establish a rent registration/rent tracking system to improve compliance as the Rent Program evolves. Banking prohibition makes rent registration/rent tracking infeasible.
  - Program administration becomes more difficult when banking is prohibited and Program costs increase.
  - Banking with restrictions: a system providing housing stability for tenants and a resource for landlords to receive Fair Return.
  - Prohibiting banking: *(based on our case studies)* would influence landlords to elect taking AGA rent increases, so they don't lose them.

FINAL POLICY RECOMMENDATION

Option 1 (Recommended)	Option 2 (Recommended)
Landlords may, but is not required to, raise the rent up to the Maximum Lawful Rent level.	Landlords may, but is not required to, raise the rent up to the Maximum Lawful Rent level.
- Landlords can take a current year's AGA increase in addition to 5% of previously deferred AGA amount in any one year (12 month period). - Landlords may take more than one annual increase (with proper notice) provided the total amount is at or below the year's AGA plus 5% previously deferred increases. **- Example: The AGA is 3% and a landlord has deferred AGA increases totaling 6%, the landlord would only be able to take 5% of the 6% of previously deferred AGA. - The owner can take that year's AGA (3%) plus an additional 5% (for a total of 8%).**	Landlords may, but is not required to, take the current year's AGA increase, but the total amount banked cannot be more then 5% in one preceding twelve month period. **Example: If the AGA is 3% and the landlord has deferred AGA increases totaling 6%, the maximum amount the landlord can bank for that twelve month period is 2% out of the 6% of deferred increases. Therefore the owner would be able to take that year's AGA of 3% plus an additional 2% for a total of 5%.**
	If the current year's Annual General Adjustment exceeds 5%, a Landlord may not apply deferred Annual General Adjustment increases until the next Annual General Adjustment increase (less than 5%).